## Exhibit 3-a

Audited Financial Statements for the five (5) years immediately preceding the current fiscal year

Audited financial statements are located in the Applicant's annual 10K filings. The 2011 10K filing is attached.

This document along with all other Penn National SEC filings, including all 10K filings which contain annual financial statements, can also be found at the Applicant's website, pngaming.com (click on " Investors", then "Financial Info", then "SEC Filings").

# Exhibit 3-a

## Penn National Gaming, Inc.

2011 Form 10-K

# PENN NATIONAL GAMING INC (PENN)

## 10-K

Annual report pursuant to section 13 and 15(d)
Filed on 02/24/2012
Filed Period 12/31/2011

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TABLE OF CONTENTS

Table of Contents

# UNITED STATES
# SECURITIES AND EXCHANGE COMMISSION
**Washington, D.C. 20549**

# FORM 10-K

**(Mark One)**

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

**For the fiscal year ended December 31, 2011**

**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 0-24206**

## Penn National Gaming, Inc.
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| **Pennsylvania**<br>(State or other jurisdiction of<br>Incorporation or Organization) | **23-2234473**<br>(I.R.S. Employer<br>Identification No.) |
| **825 Berkshire Blvd., Suite 200**<br>**Wyomissing, Pennsylvania**<br>(Address of principal executive offices) | **19610**<br>(Zip Code) |

Registrant's telephone number, including area code: (610) 373-2400
Securities registered pursuant to Section 12(b) of the Act:

| **Title of each class** | **Name of each exchange on which registered** |
|---|---|
| None | None |

Securities registered pursuant to Section 12(g) of the Act:
Common Stock, par value $.01 per share

Series B Preferred Stock, par value $.01 per share
(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☒ No ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

Indicate by check mark whether the registrant (1) has filed all reports 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 has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☒

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act:

| Large accelerated filer ☒ | Accelerated filer ☐ | Non-accelerated filer ☐ (Do not check if a smaller reporting company) | Smaller reporting company ☐ |
|---|---|---|---|

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

As of June 30, 2011 (the last business day of the registrant's most recently completed second fiscal quarter), the aggregate market value of the voting Common Stock held by non-affiliates of the registrant was approximately $2.7 billion. Such aggregate market value was computed by reference to the closing price of the Common Stock as reported on the NASDAQ Global Select Market on June 30, 2011. For purposes of making this calculation only, the registrant has defined affiliates as including all directors, executive officers and beneficial owners of more than ten percent of the Common Stock of the Company.

The number of shares of the registrant's Common Stock outstanding as of February 15, 2012 was 76,291,210.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the registrant's definitive proxy statement for its 2012 annual meeting of shareholders are incorporated by reference into Part III.

**TABLE OF CONTENTS**


| | | Page |
|---|---|---|
| | **PART I** | |
| ITEM 1. | BUSINESS | 1 |
| ITEM 1A. | RISK FACTORS | 14 |
| ITEM 1B. | UNRESOLVED STAFF COMMENTS | 24 |
| ITEM 2. | PROPERTIES | 24 |
| ITEM 3. | LEGAL PROCEEDINGS | 27 |
| ITEM 4. | MINE SAFETY DISCLOSURES | 29 |
| | **PART II** | |
| ITEM 5. | MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED SHAREHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES | 3( |
| ITEM 6. | SELECTED FINANCIAL DATA | 32 |
| ITEM 7. | MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS | 34 |
| ITEM 7A. | QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK | 60 |
| ITEM 8. | FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA | 61 |
| ITEM 9. | CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE | 109 |
| ITEM 9A. | CONTROLS AND PROCEDURES | 109 |
| ITEM 9B. | OTHER INFORMATION | 111 |
| | **PART III** | |
| ITEM 10. | DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE | 111 |
| ITEM 11. | EXECUTIVE COMPENSATION | 111 |
| ITEM 12. | SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDERS MATTERS | 111 |
| ITEM 13. | CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE | 111 |
| ITEM 14. | PRINCIPAL ACCOUNTING FEES AND SERVICES | 111 |
| | **PART IV** | |
| ITEM 15. | EXHIBITS, FINANCIAL STATEMENT SCHEDULES | 112 |

Table of Contents

## IMPORTANT FACTORS REGARDING FORWARD-LOOKING STATEMENTS

This document includes "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These statements are included throughout the document, including the section entitled "Risk Factors," and relate to our business strategy, our prospects and our financial position. These statements can be identified by the use of forward-looking terminology such as "believes," "estimates," "expects," "intends," "may," "will," "should" or "anticipates" or the negative or other variation of these or similar words, or by discussions of future events, strategies or risks and uncertainties. Specifically, forward-looking statements may include, among others, statements concerning:

- our expectations of future results of operations or financial condition;
- our expectations for our properties;
- the timing, cost and expected impact of planned capital expenditures on our results of operations;
- the impact of our geographic diversification;
- our expectations with regard to further acquisitions and development opportunities, as well as the integration of any companies we have acquired or may acquire;
- the outcome and financial impact of the litigation in which we are or will be periodically involved;
- the actions of regulatory, legislative, executive or judicial decisions at the federal, state or local level with regard to our business and the impact of any such actions;
- our ability to maintain regulatory approvals for our existing businesses and to receive regulatory approvals for our new businesses; and
- our expectations for the continued availability and cost of capital.

Although we believe that the expectations reflected in such forward-looking statements are reasonable, they are inherently subject to risks, uncertainties and assumptions about our subsidiaries and us, and accordingly, our forward-looking statements are qualified in their entirety by reference to the factors described below and in the information incorporated by reference herein. Important factors that could cause actual results to differ materially from the forward-looking statements include, without limitation, risks related to the following:

- the passage of state, federal or local legislation (including referenda) that would expand, restrict, further tax, prevent or negatively impact operations in or adjacent to the jurisdictions in which we do or seek to do business (such as a smoking ban at any of our facilities);
- the effects of local and national economic, credit, capital market, housing, and energy conditions on the economy in general and on the gaming and lodging

industries in particular;

- the activities of our competitors and the emergence of new competitors (traditional and internet based);

- increases in the effective rate of taxation at any of our properties or at the corporate level;

- our ability to identify attractive acquisition and development opportunities and to agree to terms with partners for such transactions;

- the costs and risks involved in the pursuit of such opportunities and our ability to complete the acquisition or development of, and achieve the expected returns from, such opportunities;

- our ability to secure state and local permits and approvals necessary for construction;

- construction factors, including delays, unexpected remediation costs, local opposition and increased cost of labor and materials;
- our ability to receive, or delays in obtaining, the regulatory approvals required to own, develop and/or operate our facilities, or other delays or impediments to completing our planned acquisitions or projects, including favorable resolution of any related litigation;
- our dependence on key personnel;
- our expectations for the continued availability and cost of capital;
- the impact of weather;
- the maintenance of agreements with our horsemen, pari-mutuel clerks and other organized labor groups;
- the outcome of pending legal proceedings;
- changes in accounting standards;
- the impact of terrorism and other international hostilities; and
- other factors as discussed in our filings with the United States Securities and Exchange Commission.

All subsequent written and oral forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by the cautionary statements included in this document. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law. In light of these risks, uncertainties and assumptions, the forward-looking events discussed in this document may not occur.

Table of Contents

# PART I

## ITEM 1. BUSINESS

### Overview

We are a leading, diversified, multi-jurisdictional owner and manager of gaming and pari-mutuel properties. The Company 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, we began our 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, we have continued to expand our gaming operations through strategic acquisitions (including the acquisitions of Hollywood Casino Bay St. Louis and Boomtown Biloxi, CRC Holdings, Inc., the Bullwhackers properties, Hollywood Casino Corporation, Argosy Gaming Company, Zia Park Casino, Sanford-Orlando Kennel Club and The M Resorts LLC (the "M Resort") in June 2011), greenfield projects (such as at Hollywood Casino at Penn National Race Course, Hollywood Slots Hotel and Raceway and Hollywood Casino Perryville), and property expansions (such as Hollywood Casino at Charles Town Races and Hollywood Casino Lawrenceburg). Most recently, we, along with our joint venture partner, opened Hollywood Casino at Kansas Speedway on February 3, 2012, and we anticipate opening our facilities in Columbus and Toledo, Ohio in 2012.

As of December 31, 2011, we owned, managed, or had ownership interests in twenty-five facilities in the following eighteen jurisdictions: Colorado, Florida, Illinois, Indiana, Iowa, Louisiana, Maine, Maryland, Mississippi, Missouri, Nevada, New Jersey, New Mexico, Ohio, Pennsylvania, Texas, West Virginia, and Ontario.

We believe that our portfolio of assets provides us with a diversified cash flow from operations. We continue to expand our gaming operations through the implementation and execution of a disciplined capital expenditure program at our existing properties, the pursuit of strategic acquisitions and the development of new gaming properties, particularly in attractive regional markets. Current capital projects are ongoing at several of our new and existing properties, including our facilities under construction in Ohio.

In this Annual Report on Form 10-K, the terms "we," "us," "our," the "Company" and "Penn National" refer to Penn National Gaming, Inc. and subsidiaries, unless the context indicates otherwise.

Table of Contents

**Properties**

The following table summarizes, by our reportable segments, certain features of our owned properties and our managed property that are currently in operations as of December 31, 2011:

| | Location | Type of Facility | Approx. Gaming Square Footage | Gaming Machines | Table Games(1) | Hotel Rooms |
|---|---|---|---|---|---|---|
| *Midwest* | | | | | | |
| **Owned Properties:** | | | | | | |
| Hollywood Casino Lawrenceburg | Lawrenceburg, IN | Dockside gaming | 150,000 | 3,219 | 87 | 295 |
| Hollywood Casino Aurora | Aurora, IL | Dockside gaming | 53,000 | 1,172 | 21 | — |
| Hollywood Casino Joliet | Joliet, IL | Dockside gaming | 50,000 | 1,177 | 23 | 100 |
| Argosy Casino Alton | Alton, IL | Dockside gaming | 23,000 | 1,052 | 15 | — |
| **Managed Property:** | | | | | | |
| Casino Rama | Orillia, Ontario | Land-based gaming | 93,000 | 2,498 | 108 | 289 |
| *Subtotal* | | | 369,000 | 9,118 | 254 | 684 |
| *East/West* | | | | | | |
| **Owned Properties:** | | | | | | |
| Hollywood Casino at Charles Town Races | Charles Town, WV | Land-based gaming/ Thoroughbred racing | 209,508 | 4,180 | 107 | 153 |
| Hollywood Casino at Penn National Race Course | Grantville, PA | Land-based gaming/ Thoroughbred racing | 99,194 | 2,451 | 53 | — |
| M Resort | Henderson, NV | Land-based gaming | 92,000 | 1,561 | 52 | 390 |
| Hollywood Casino Perryville | Perryville, MD | Land-based gaming | 34,329 | 1,500 | — | — |
| Hollywood Slots Hotel and Raceway | Bangor, ME | Land-based gaming/Harness racing | 31,750 | 1,000 | — | 152 |
| Zia Park Casino | Hobbs, NM | Land-based gaming/ Thoroughbred racing | 18,460 | 750 | — | — |
| *Subtotal* | | | 485,241 | 11,442 | 212 | 695 |
| *Southern Plains* | | | | | | |
| **Owned Properties:** | | | | | | |
| Hollywood Casino Bay St. Louis | Bay St. Louis, MS | Land-based gaming | 57,000 | 1,167 | 22 | 291 |
| Argosy Casino Riverside | Riverside, MO | Dockside gaming | 56,400 | 1,724 | 33 | 258 |
| Hollywood Casino Tunica(2) | Tunica, MS | Dockside gaming | 44,000 | 1,076 | 25 | 494 |
| Boomtown Biloxi | Biloxi, MS | Dockside gaming | 51,665 | 1,093 | 18 | — |
| Hollywood Casino Baton Rouge | Baton Rouge, LA | Dockside gaming | 28,000 | 1,120 | 23 | — |
| Argosy Casino Sioux City | Sioux City, IA | Dockside gaming | 20,500 | 719 | 16 | — |
| *Subtotal* | | | 257,565 | 6,899 | 137 | 1,043 |
| *Other* | | | | | | |
| **Owned Properties:** | | | | | | |
| Bullwhackers | Black Hawk, CO | Land-based gaming | 10,425 | 290 | — | — |
| Raceway Park | Toledo, OH | Standardbred racing | — | — | — | — |
| Beulah Park | Grove City, OH | Thoroughbred racing | — | — | — | — |
| Rosecroft | Oxon Hill, MD | Standardbred racing | — | — | — | — |
| Sanford-Orlando Kennel Club | Longwood, FL | Greyhound racing | — | — | — | — |
| Freehold Raceway(3) | Freehold, NJ | Standardbred racing | — | — | — | — |
| Sam Houston Race Park(4) | Houston, TX | Thoroughbred racing | — | — | — | — |
| Valley Race Park(4) | Harlingen, TX | Greyhound racing | — | — | — | — |
| *Subtotal* | | | 10,425 | 290 | — | — |
| *Total* | | | 1,122,231 | 27,749 | 603 | 2,422 |

(1) Excludes poker tables.

(2) Due to flooding in 2011 at Hollywood Casino Tunica, the gaming square footage has been temporarily reduced by 10,000 square feet compared to the prior year.

(3) Pursuant to a joint venture with Greenwood Limited Jersey, Inc., a subsidiary of Greenwood Racing, Inc.

(4) Pursuant to a joint venture with MAXXAM, Inc. ("MAXXAM").

**Midwest Owned Properties**

*Hollywood Casino Lawrenceburg*

Hollywood Casino Lawrenceburg is located on the Ohio River in Lawrenceburg, Indiana, approximately 15 miles west of Cincinnati. In late June 2009, we opened a new casino riverboat at Hollywood Casino Lawrenceburg, replacing the vessel at Argosy Casino Lawrenceburg. The Hollywood-themed casino riverboat has 150,000 square feet of gaming space on two levels with 3,219 slot machines, 87 table games and 41 poker tables, a restaurant, a buffet, a bar, a nightclub, a casual dining room, two cafes and meeting space. Hollywood Casino Lawrenceburg also includes a 295-room hotel.

The City of Lawrenceburg is currently designing a hotel to be built by the City of Lawrenceburg near our Hollywood Casino Lawrenceburg property. By contractual agreement reached with the City of Lawrenceburg, the project will ultimately be owned and operated by a subsidiary of the Company upon completion of construction. Currently slated to include 180 rooms and approximately 18,000 square feet of multipurpose space, the City of Lawrenceburg anticipates an opening date in the third quarter of 2013.

*Hollywood Casino Aurora*

Hollywood Casino Aurora, part of the Chicagoland market, is located in Aurora, Illinois, the second largest city in Illinois, approximately 35 miles west of Chicago. This single-level dockside casino provides 53,000 square feet of gaming space with 1,172 slot machines, 21 gaming tables and 7 poker tables. The facility features an upscale lounge, a steakhouse with a private dining room, a VIP lounge for premium players, a casino bar with video poker, a buffet, and a deli. Hollywood Casino Aurora also has a surface parking lot, two parking garages with approximately 1,500 parking spaces, and a gift shop.

*Hollywood Casino Joliet*

Hollywood Casino Joliet, part of the Chicagoland market, is located on the Des Plaines River in Joliet, Illinois, approximately 40 miles southwest of Chicago. This barge-based casino provides 50,000 square feet of gaming space on two levels with 1,177 slot machines, 23 table games and 3 poker tables. The land-based pavilion includes a steakhouse, a buffet, a deli, and a sports bar and entertainment lounge.

The complex also includes a 100-room hotel, a 1,100 space parking garage, surface parking areas with approximately 1,500 spaces and an 80-space recreational vehicle park.

*Argosy Casino Alton*

Argosy Casino Alton is located on the Mississippi River in Alton, Illinois, approximately 20 miles northeast of downtown St. Louis. Argosy Casino Alton is a three-deck gaming facility featuring 23,000 square feet of gaming space with 1,052 slot machines and 15 table games. Argosy Casino Alton includes an entertainment pavilion and features a 124-seat buffet, a restaurant, a deli and a 400-seat main showroom. The facility also includes surface parking areas with 1,341 spaces.

**Midwest Managed Property**

*Casino Rama*

Through CHC Casinos Canada Limited ("CHC Casinos"), our indirectly wholly-owned subsidiary, we manage Casino Rama, a full service gaming and entertainment facility, on behalf of the Ontario Lottery and Gaming Corporation ("OLGC"), an agency of the Province of Ontario. Casino Rama is located on the lands of the Rama First Nation, approximately 90 miles north of Toronto. The property has approximately 93,000 square feet of gaming space with 2,498 gaming machines, 108 table games and 15 poker tables. In addition, the property includes a 5,000-seat entertainment facility, a 289-room hotel and 3,170 surface parking spaces.

The Development and Operating Agreement (the "Agreement"), which we refer to as the management service contract for Casino Rama, sets out the duties, rights and obligations of CHC Casinos and our indirectly wholly-owned subsidiary, CRC Holdings, Inc. The compensation under the Agreement is a base fee equal to 2.0% of gross revenues of the casino and an incentive fee equal to 5.0% of the casino's net operating profit.

The Agreement terminated on August 1, 2011. In July 2011, we entered into a new interim agreement with the OLGC for the operation of the Casino Rama facility through March 31, 2012, which was subsequently extended in January 2012 for an additional six months through September 30, 2012. The OLGC is currently in the process of evaluating bids on a new five year term for the management of the Casino Rama facility, which includes a cap on management fees of $5 million per year. While we intend to participate in the bid process, there can be no assurance that the OLGC will select us to manage the property beyond September 30, 2012.

**East/West Owned Properties**

*Hollywood Casino at Charles Town Races*

Hollywood Casino at Charles Town Races is located within approximately a one-hour drive of the Baltimore, Maryland and Washington, D.C. markets. Hollywood Casino at Charles Town Races features 209,508 square feet of gaming space with 4,180 gaming machines and a 153-room hotel, as well as various dining options. In July 2010, we added table games and poker tables following voter approval of table games in the December 5, 2009 special election. As of December 31, 2011, the property had 107 table games and 30 poker tables. The complex also features live thoroughbred racing at a ¾-mile all-weather lighted thoroughbred racetrack with a 3,000-seat grandstand, parking for 6,048 vehicles and simulcast wagering and dining. In addition, a high-end steakhouse was completed in the fourth quarter of 2010 and a sports bar and entertainment lounge was opened in July 2011.

*Hollywood Casino at Penn National Race Course*

Hollywood Casino at Penn National Race Course is located in Grantville, Pennsylvania, which is 15 miles northeast of Harrisburg. Hollywood Casino at Penn National Race Course, which opened on February 12, 2008, is a 365,000 square foot facility with 2,451 slot machines. In July 2010, we added table games and poker tables following legislation passed in January 2010 permitting the operation of table games by existing licensees. As of December 31, 2011, the property had 53 table games and 16 poker tables. The facility also includes an entertainment bar and lounge, a sports bar, a buffet, a high-end steakhouse and various casual dining options, as well as a simulcast facility and viewing area for live racing. The facility has ample parking, including a five-story self-parking garage, with capacity for approximately 2,200 cars and approximately 1,500 surface parking spaces for self and valet parking. The property includes a one-mile all-weather lighted thoroughbred racetrack and a ⅞-mile turf track. The property also includes approximately 400 acres that are available for future expansion or development.

*M Resort*

On June 1, 2011, following the purchase of all of the outstanding debt of the M Resort and the receipt of requisite regulatory approvals, the Company acquired the business in exchange for the debt. Opened in March 2009, the M Resort, located approximately ten miles from the Las Vegas strip in Henderson, Nevada, is situated on over 90 acres on the southeast corner of Las Vegas Boulevard and St. Rose Parkway. The resort features over 92,000 square feet of gaming space with 1,561 slot machines, 52 table games, and 10 poker tables. M Resort also offers 390 guest rooms and suites, six restaurants and six destination bars, more than 60,000 square feet of meeting and conference space, a 4,700 space parking facility, a spa and fitness center and a 100,000 square foot events piazza. In January 2012, the M Resort expanded its convention space by about 25,000 square feet which will be used for both conventions and meetings, as well as concerts and other larger scale events.

*Hollywood Casino Perryville*

Hollywood Casino Perryville was opened to the public on September 27, 2010 and is located directly off Interstate 95 in Cecil County, Maryland just 35 miles northeast of Baltimore and 70 miles from Washington, D.C. Hollywood Casino Perryville is a Hollywood-themed facility which offers 34,329 square feet of gaming space with 1,500 slot machines. The facility also offers various food and beverage options, including a buffet and a grill, a gift shop and 1,600 parking spaces with valet and self-parking.

*Hollywood Slots Hotel and Raceway*

Hollywood Slots Hotel and Raceway, which is located in Bangor, Maine, includes 31,750 square feet of gaming space with 1,000 slot machines. On November 8, 2011, voters in Penobscot County approved the addition of table games. The addition of 10 table games and 4 poker tables is anticipated to be in place by March 31, 2012. Hollywood Slots Hotel and Raceway's amenities include a 152-room hotel, with 5,119 square feet of meeting and pre-function space, two eateries, a buffet and a snack bar, a small entertainment stage, and a four-story parking garage with 1,500 spaces. Bangor Raceway, which is adjacent to the property, is located at historic Bass Park and includes a one-half mile standardbred racetrack and grandstand to seat 3,500 patrons.

*Zia Park Casino*

Zia Park Casino is located in Hobbs, New Mexico and includes a casino as well as an adjoining racetrack. Zia Park Casino includes 18,460 square feet of gaming space with 750 slot machines and operates two restaurants. Year-round banquet services are available at the property and in the Turf Club, which also offers food and beverage services during the live racing season. The property has a one-mile quarter/thoroughbred racetrack, with live racing from September to December, and a year-round simulcast parlor.

**Southern Plains Owned Properties**

*Hollywood Casino Bay St. Louis*

Hollywood Casino Bay St. Louis is located in Bay St. Louis, Mississippi. The casino features 57,000 square feet of gaming space with 1,167 slot machines, 22 table games, and 6 poker tables. The waterfront Hollywood Hotel features 291 rooms and a 10,000 square foot ballroom, including nine separate meeting rooms offering mo than 14,000 square feet of meeting space. Hollywood Casino Bay St. Louis offers live concerts and various entertainment on weekends in the ballroom. The property als. features The Bridges golf course, an 18-hole championship golf course. Hollywood Casino Bay St. Louis has various dining facilities including a steakhouse, a buffet, a casual dining room and a clubhouse lounge as well as an entertainment bar. Other amenities include a recreational vehicle park with 100 spaces and a gift shop.

*Argosy Casino Riverside*

Argosy Casino Riverside is located on the Missouri River approximately five miles from downtown Kansas City in Riverside, Missouri. The casino primarily attracts customers who reside in the northern and western regions of the Kansas City metropolitan area. The casino features 56,400 square feet of gaming space with 1,724 slot machines and 33 table games.

This Mediterranean-themed casino and hotel features a nine-story, 258-room hotel and spa, an entertainment facility featuring various food and beverage areas, including a buffet, a steakhouse, a deli, a coffee bar, a VIP lounge and a sports/entertainment lounge and 19,000 square feet of banquet/conference facilities. Argosy Casino Riverside also has parking for approximately 3,000 vehicles, including a 1,250 space parking garage.

*Hollywood Casino Tunica*

Hollywood Casino Tunica is located in Tunica, Mississippi. Tunica County is the closest resort gaming jurisdiction to, and is easily accessible from, the Memphis, Tennessee metropolitan area. The Tunica market has become a regional destination resort, attracting customers from surrounding markets such as Nashville, Tennessee, Atlanta, Georgia, St. Louis, Missouri, Little Rock, Arkansas, and Tulsa, Oklahoma. This single-level casino features 54,000 square feet of gaming space with 1,076 slot machines, 25 table games and 6 poker tables. On May 1, 2011, Hollywood Casino Tunica was forced to close as a result of flooding by the Mississippi River. The property reopened on May 25, 2011. Due to the flooding, 10,000 square feet of gaming space remains closed. A section of this area is expected to reopen in the first quarter of 2012 as a high limit area, with the remainder reopening by the end of 2012.

Hollywood Casino Tunica's 494-room hotel and 123-space recreational vehicle park provide overnight accommodations for its patrons. Entertainment amenities include a steakhouse, a buffet, a grill, an entertainment lounge, a premium players' club, a themed bar facility, an indoor pool and showroom as well as banquet and meeting facilities. In addition, Hollywood Casino Tunica offers surface parking with 1,635 spaces.

*Boomtown Biloxi*

Boomtown Biloxi is located in Biloxi, Mississippi. Boomtown Biloxi offers 51,665 square feet of gaming space with 1,093 slot machines, 18 table games and 5 poker tables. It features a buffet, a steakhouse and a 24-hour grill and bakery. Boomtown Biloxi also has 1,450 surface parking spaces.

*Hollywood Casino Baton Rouge*

Hollywood Casino Baton Rouge is a dockside riverboat gaming facility operating in Baton Rouge, Louisiana. Hollywood Casino Baton Rouge features a riverboat casino reminiscent of a nineteenth century Mississippi River paddlewheel steamboat. The riverboat features approximately 28,000 square feet of gaming space with 1,120 gaming machines and 23 table games.

The facility also includes a two-story, 58,000 square foot dockside building featuring a variety of amenities, including a steakhouse, a 268-seat buffet, a deli, a premium players' lounge, a nightclub, a lobby bar, a public atrium, two meeting rooms, 1,490 parking spaces, and a gift shop.

In December 2007, we agreed to acquire 3.8 acres of adjacent land and to pay for half of the construction costs for a railroad underpass with the seller of the land. Construction on the underpass started in June 2009 and was completed in March 2011. The underpass provides unimpeded access to the casino property and to property owned by the seller for future development.

*Argosy Casino Sioux City*

Argosy Casino Sioux City is located on the Missouri River in downtown Sioux City, Iowa. The riverboat features 20,500 square feet of gaming space with 719 slot machines, 16 table games and 4 poker tables. The casino is complemented by adjacent barge facilities featuring dining facilities, meeting space, and 524 parking spaces.

Each gaming license in Iowa is issued jointly to a gaming operator and a local charitable sponsor. The agreement between our gaming operator subsidiary in Iowa, Belle of Sioux City, L.P. (the "Belle") and its charitable sponsor, Missouri River Historical Development, Inc. ("MRHD"), may expire as early as July 2012. The Belle is in the process of negotiating with MRHD to transition its current barge-based facility to a new land-based facility and to enter into a new long-term agreement with MRHD. If a new agreement cannot be reached, MRHD has indicated that it may issue a request for proposals for alternative operators for a new land-based facility and has preemptively filed a lawsuit seeking to establish its right to do so. If MRHD were to issue such a request, the Belle may contest MRHD's right to do so, may participate in the process and/or may seek an alternative charitable

sponsor. Accordingly, at this time, there can be no assurance that the Belle will be able to reach an agreement with MRHD or, absent such agreement, that it will be able to partner with an alternative charitable sponsor. In the event that both MRHD and the Belle find alternative partners, it is unclear whether the Iowa Gaming and Racing Commission would issue a gaming license to one or both such groups. Further, the Belle's ability to continue its operations may also be impacted by its ability to renew or extend its existing docking lease, which expires in January 2013, or to locate a suitable site to construct a land-based facility.

**Other Owned Properties**

*Bullwhackers*

The Bullwhackers casino, which is located in Black Hawk, Colorado, includes 10,425 square feet of gaming space with 290 slot machines. The property also includes a 344-car surface parking area. We also own and operate a gas station/convenience store located approximately 7 miles east of the Bullwhackers casino on Highway 119.

*Raceway Park*

Raceway Park is a 58,250 square foot facility with a ⅝-mile standardbred race track located in Toledo, Ohio. The facility also features simulcast wagering and has theatre-style seating capacity for 1,977 and surface parking for 3,000 vehicles.

*Beulah Park*

Acquired on July 1, 2010, Beulah Park in Grove City, Ohio is located on approximately 210 acres just outside of Columbus, Ohio. Beulah Park is a thoroughbred racing facility that features live thoroughbred racing from October to May as well as simulcast wagering from a number of nationwide tracks. Beulah Park includes a grandstand, outdoor paddock, a clubhouse facility and numerous food and dining options.

*Rosecroft*

On February 28, 2011, we completed our acquisition of Rosecroft Raceway in Oxon Hill, Maryland following the completion of a bankruptcy auction and approval of the purchase by a United States ("U.S.") Bankruptcy Court judge. Rosecroft Raceway, located approximately 13 miles south of Washington, D.C., is situated on approximately 125 acres just outside the Washington I-495 Beltway in Prince George's county. The Rosecroft facility features a ⅝-mile standardbred race track with a seven race paddock, a 53,000 square foot grandstand building, and a 96,000 square foot three story clubhouse building with dining facilities. In August 2011, Rosecroft Raceway re-opened for simulcasting and live standardbred racing resumed in late October 2011.

*Sanford-Orlando Kennel Club*

Sanford-Orlando Kennel Club is a ¼-mile greyhound facility located in Longwood, Florida. The facility has capacity for 6,500 patrons, with seating for 4,000 and surface parking for 2,500 vehicles. The facility conducts year-round greyhound racing and greyhound, thoroughbred, and harness racing simulcasts.

*Freehold Raceway*

Through our joint venture in Pennwood Racing, Inc. ("Pennwood"), we own 50% of Freehold Raceway, located in Freehold, New Jersey. The property features a half-mile standardbred race track and a 150,000 square foot grandstand.

*Sam Houston Race Park and Valley Race Park*

On April 8, 2011, following final approval by the Texas Racing Commission, we completed our investment in a joint venture with MAXXAM that owns and operates the Sam Houston Race Park in Houston, Texas and the Valley Race Park in Harlingen, Texas, and holds a license for a planned racetrack in Laredo, Texas. Sam Houston Race Park, opened in April 1994, is located 15 miles northwest from downtown Houston along Beltway 8. Sam Houston Race Park hosts thoroughbred and quarter horse racing and offers daily simulcast operations, as well as hosts various special events, private parties and meetings, concerts and national touring festivals throughout the year. Valley Race Park, which was opened in 1990, is a 91,000 square foot dog racing and simulcasting facility located in Harlingen, Texas.

*Off-track Wagering Facilities*

Our off-track wagering facilities ("OTWs") and racetracks provide areas for viewing import simulcast races of thoroughbred and standardbred horse racing, televised sporting events, placing pari-mutuel wagers and dining. We operate four OTWs in Pennsylvania, and through our joint venture in Pennwood, we own 50% of a leased OTW in Toms River, New Jersey.

**Trademarks**

We own a number of trademarks registered with the U.S. Patent and Trademark Office ("U.S. PTO"), including but not limited to, "Telebet," "The World Series of Handicapping," and "Players' Choice." We also have a number of trademark applications pending with the U.S. PTO.

BTN, Inc., our wholly-owned subsidiary, entered into a License Agreement with Boomtown, Inc., dated August 8, 2000 pursuant to which it uses "Boomtown" and other trademarks.

As a result of our acquisitions of Hollywood Casino Corporation and Argosy, we own the service marks "Hollywood Casino" and "Argosy" which are registered with the U.S. PTO. We believe that our rights to the "Hollywood Casino" and "Argosy" service marks are well established and have competitive value to the Hollywood Casino and Argosy properties. We also acquired other trademarks used by the Hollywood Casino and Argosy facilities and their related services. These marks are either registered or are the subject of pending applications with the U.S. PTO.

**Competition**

The gaming industry is characterized by a high degree of competition among a large number of participants, including riverboat casinos, dockside casinos, land-based casinos, video lottery and poker machines not located in casinos, Native American gaming, emerging varieties of Internet gaming and other forms of gaming in the U.S. In a broader sense, our gaming operations face competition from all manner of leisure and entertainment activities, including: shopping; high school, collegiate and professional athletic events; television and movies; concerts and travel. Legalized gaming is currently permitted in various forms throughout the U.S., in several Canadian provinces and on various lands taken into trust for the benefit of certain Native Americans in the U.S. and Canada. Other jurisdictions, including states adjacent to states in which we currently have facilities (such as in Ohio and Maryland), have legalized, and are likely to implement gaming in the near future. In addition, established gaming jurisdictions could award additional gaming licenses or permit the expansion or relocation of existing gaming operations. New, relocated or expanded operations by other persons will increase competition for our gaming operations and could have a material adverse impact on us. Finally, the imposition of smoking bans and/or higher gaming tax rates have a significant impact on our properties' ability to compete with facilities in nearby jurisdictions.

Our racing operations face significant competition for wagering dollars from other racetracks and OTWs, some of which also offer other forms of gaming, as well as other gaming venues such as casinos. Additionally, for a number of years, there has been a general decline in the number of people attending and wagering on live horse races at North American racetracks due to a number of factors, including increased competition from other wagering and entertainment alternatives and unwillingness of customers to travel a significant distance to racetracks. Our account wagering operations compete with other providers of such services throughout the country. We also may face competition in the future from new OTWs, new racetracks or new providers of account wagering. From time to time, states consider legislation to permit other forms of gaming. If additional gaming opportunities become available near our racing operations, such gaming opportunities could have an adverse effect on our business, financial condition and results of operations.

*Midwest.* In Ohio, voters passed a referendum in 2009 to allow four land-based casinos in four cities, one of which will be in downtown Cincinnati, which is the primary feeder market for our Hollywood Casino Lawrenceburg property. The proposed $400 million casino in nearby Cincinnati, Ohio will be operated by Caesars Entertainment as part of a joint venture with Rock Gaming LLC and is anticipated to open in 2013. This new facility will have an adverse impact on Hollywood Casino Lawrenceburg. However, the impact from this casino on our Midwest segment will be mitigated by the opening of our Ohio casinos, Hollywood Casino Toledo and Hollywood Casino Columbus, both of which are expected to open in 2012. On January 25, 2012, MTR Gaming Group, Inc. ("MTR") announced it had received its license to install and operate up to 2,500 video lottery terminals at its Scioto Downs racetrack in Columbus, Ohio. The facility will offer a 300 seat buffet, a casual dining restaurant and a bar/lounge. MTR anticipates opening the new facility in the second quarter of 2012. In Illinois, a new approximately $445 million casino opened on July 18, 2011 in Des Plaines, Illinois. As a result, Hollywood Casino Aurora and Hollywood Casino Joliet face additional competition as the facilities are located in the suburban area northwest of Chicago, however the 3% surcharge that Hollywood Casino Aurora and Hollywood Casino Joliet paid to subsidize local racing horse interests is no longer incurred as the new facility is now open. In addition, in July 2009, the Governor of Illinois signed a bill providing for the legalization of up to five video lottery terminals to be installed in licensed bars, restaurants and truck stops, among other venues that permit on-site alcohol consumption. In July 2011, the Illinois Supreme Court, in a unanimous ruling, cleared the way for the 2009 Illinois Video Gaming Act to go forward. The Illinois Gaming Board is currently in the process of finalizing the regulatory framework and awarding licenses, however numerous cities and counties have opted out of participation. Additionally in Illinois, the legislature in May 2011 passed a gaming expansion bill to allow five new casinos in the state while bringing slot machines to the Illinois racetracks. However, this legislation was not sent formally to the Governor of Illinois for approval. Currently, legislators are working on new expansion gambling proposals. Finally, casino gaming is not currently permitted in Kentucky, although legislation has been introduced to allow gaming at racetracks and casinos subject to a referendum which will take place in 2012. The commencement of gaming in Kentucky and the expansion of gaming in Illinois would negatively impact certain of our existing Midwest properties.

*East/West.* In November 2008, the citizens of Maryland approved a referendum to allow up to 15,000 slot machines at five locations throughout the state. These locations included a facility in each of Cecil, Allegany, Anne Arundel, Baltimore City and Worchester Counties. Applications for each of the gaming zones were submitted in February 2009. Hollywood Casino Perryville in Cecil County, which is our facility, opened to the public on September 27, 2010 and was the only Maryland facility operational in 2010. In January 2011, the Worchester County location opened at Ocean Downs Racetrack. In November 2010, zoning was approved by voters fr a proposed casino complex offering 4,750 slot machines at the Arundel Mills mall in Anne Arundel, Maryland. The developer of the project is targeting an opening in t summer of 2012 of approximately 2,500 to 3,000 slot machines, with the full facility expected to be open by the end of 2012. Particularly as the Anne Arundel facility opens, Hollywood Casino at Charles Town Races and Hollywood Casino Perryville will face increased

competition and their results will be negatively impacted. Additionally, the opening of a casino in Baltimore City, which now has a viable applicant, would negatively impact our operations at Charles Town and Perryville. In Pennsylvania, in April 2011, the Pennsylvania Gaming Control Board awarded a category 3 license to permit the operation of slot machines at an existing resort to Woodlands Fayette, LLC, operators of the Nemacolin Woodlands Resort in Wharton Township, Fayette County. However, Mason-Dixon Resort LP, which applied for a category 3 license in Gettysburg, filed an appeal with the state Supreme Court seeking to reverse the Board's decision. This appeal is still pending. If the appeal is successful and a category 3 license was awarded to Mason-Dixon Resort LP, our operations at Hollywood Casino at Penn National Race Course could be negatively impacted. In addition, in 2009, a category 3 license application was granted for a site in Valley Forge, Pennsylvania. The casino is currently under construction and could open as early as spring of 2012. We expect the opening of this casino to have a minor adverse effect on the financial results of Hollywood Casino at Penn National Race Course. Our East/West segment also contains our M Resort property which caters to the Las Vegas locals market. The strength of the Las Vegas locals market is partially linked to the health of the Las Vegas strip. Continued weakness in this market may continue to negatively impact the Las Vegas locals market, including our M Resort property.

*Southern Plains.* In Kansas, the legislature approved the expansion of casino gaming in its state, and in February 2010, Kansas Entertainment, LLC ("Kansas Entertainment"), a joint venture of affiliates of International Speedway Corporation ("International Speedway") and us, received the final approval under the Kansas Expanded Lottery Act, along with its gaming license from the Kansas Racing and Gaming Commission, to proceed with the development of an approximately $411 million Hollywood-themed destination facility overlooking Turn 2 at Kansas Speedway, which is located approximately 17 miles from Argosy Casino Riverside. Kansas Entertainment began construction of the facility in the second quarter of 2010 and the facility opened on February 3, 2012. The opening of this casino will have an adverse effect on the financial results of Argosy Casino Riverside. In Louisiana, construction on an approximately $357 million riverboat casino and hotel has begun with a planned opening in the summer of 2012. The opening of this riverboat casino will have an adverse effect on the financial results of Hollywood Casino Baton Rouge. In the Mississippi Gulf Coast market, there are various proposals for casinos in development, as well as expansions at existing properties, that may take place in the next few years. Construction on an approximately $60 million casino project in Biloxi has begun with a planned opening in the spring of 2012. The opening of this casino will have an adverse effect on the financial results of Boomtown Biloxi.

**U.S. and Foreign Revenues**

Our net revenues in the U.S. for 2011, 2010, and 2009 were approximately $2,727.1 million, $2,443.9 million, and $2,354.5 million, respectively. Our revenues from operations in Canada for 2011, 2010, and 2009 were approximately $15.2 million, $15.2 million, and $14.8 million, respectively.

**Segments**

In 2011, we realigned our reporting structure in connection with the hiring of a senior vice president of regional operations. We now have three senior vice presidents of regional operations who oversee various properties based primarily on their geographic locations and whom report directly to our President and Chief Operating Officer. This event impacted how our Chief Executive Officer, who is the Company's Chief Operating Decision Maker ("CODM") as that term is defined in Accounting Standards Codification ("ASC") 280, "Segment Reporting" ("ASC 280"), measures and assesses our business performance and has caused us to conclude that we now have reportable segments. Therefore, we have aggregated our properties into three reportable segments: (i) Midwest, (ii) East/West, and (iii) Southern Plains, consistent with how our CODM reviews and assesses our financial performance.

The Midwest reportable segment consists of the following properties: Hollywood Casino Lawrenceburg, Hollywood Casino Aurora, Hollywood Casino Joliet, and Argosy Casino Alton. It also includes our Casino Rama management service contract as well as the two Ohio properties that are currently under construction, Hollywood Casino Toledo and Hollywood Casino Columbus, which are scheduled to open by the end of May 2012 and November 1, 2012, respectively.

The East/West reportable segment consists of the following properties: Hollywood Casino at Charles Town Races, Hollywood Casino Perryville, Hollywood Slots Hotel and Raceway, Hollywood Casino at Penn National Race Course, Zia Park Casino, and M Resort.

The Southern Plains reportable segment consists of the following properties: Argosy Casino Riverside, Argosy Casino Sioux City, Hollywood Casino Baton Rouge, Hollywood Casino Tunica, Hollywood Casino Bay St. Louis, and Boomtown Biloxi. It also includes our 50% investment in Kansas Entertainment, which owns the Hollywood Casino at Kansas Speedway which opened in February 2012.

The Other category consists of our standalone racing operations, namely Beulah Park, Raceway Park, Rosecroft Raceway, Sanford-Orlando Kennel Club, and our joint venture interests in Sam Houston Race Park and Valley Race Park, Freehold Raceway, and Maryland Jockey Club (which was sold in July 2011). If we are successful in obtaining gaming operations at these locations, they would be assigned to one of our regional executives and reported in their respective reportable segment. The Other category also includes our corporate overhead operations which does not meet the definition of an operating segment under ASC 280 and our Bullwhackers property.

**Management**

| Name | Age | Position |
|---|---|---|
| Peter M. Carlino | 65 | Chief Executive Officer |
| Timothy J. Wilmott | 53 | President and Chief Operating Officer |
| William J. Clifford | 54 | Senior Vice President-Finance and Chief Financial Officer |
| Thomas P. Burke | 55 | Senior Vice President-Regional Operations |
| John V. Finamore | 53 | Senior Vice President-Regional Operations |
| Robert S. Ippolito | 60 | Vice President, Secretary and Treasurer |
| Jordan B. Savitch | 46 | Senior Vice President and General Counsel |
| Jay A. Snowden | 35 | Senior Vice President-Regional Operations |
| Steven T. Snyder | 51 | Senior Vice President-Corporate Development |

**Peter M. Carlino.** Mr. Carlino has served as our Chairman of the Board of Directors and Chief Executive Officer since April 1994. Since 1976, Mr. Carlino has been President of Carlino Capital Management Corp. (formerly known as Carlino Financial Corporation), a holding company that owns and operates various Carlino family businesses, in which capacity he has been continuously active in strategic planning and monitoring the operations.

**Timothy J. Wilmott.** Mr. Wilmott joined us in February 2008 as President and Chief Operating Officer. Mr. Wilmott most recently served as Chief Operating Officer of Harrah's Entertainment, a position he held for approximately four years. In this position, he oversaw the operations of all of Harrah's revenue-generating businesses, including 48 casinos, 38,000 hotel rooms and 300 restaurants. All Harrah's Division Presidents, Senior Vice Presidents of Brand Operations, Marketing and Information Technology personnel reported to Mr. Wilmott in his capacity as Chief Operating Officer. Prior to his appointment to the position of Chief Operating Officer, Mr. Wilmott served from 1997 to 2002 as Division President of Harrah's Eastern Division with responsibility for the operations of eight Harrah's properties.

**William J. Clifford.** Mr. Clifford joined us in August 2001 and was appointed to his current position as Senior Vice President-Finance and Chief Financial Officer in October 2001. From March 1997 to July 2001, Mr. Clifford served as the Chief Financial Officer and Senior Vice President of Finance with Sun International Resorts, Inc., Paradise Island, Bahamas. From November 1993 to February 1997, Mr. Clifford was Financial, Hotel and Operations Controller for Treasure Island Hotel and Casino in Las Vegas. From May 1989 to November 1993, Mr. Clifford was Controller for Golden Nugget Hotel and Casino, Las Vegas. Prior to May 1989, Mr. Clifford held the positions of Controller for the Dunes Hotel and Casino, Las Vegas, Property Operations Analyst with Aladdin Hotel and Casino, Las Vegas, Casino Administrator with Las Vegas Hilton, Las Vegas, Senior Internal Auditor with Del Webb, Las Vegas, and Agent, Audit Division, of the Nevada Gaming Control Board, Las Vegas and Reno.

**Thomas P. Burke.** Mr. Burke joined us in November 2002 and was appointed to his current position of Senior Vice President-Regional Operations effective October 2008. In this position, Mr. Burke is responsible for overseeing all facets of our facilities located in our Southern Plains segment. Previously, Mr. Burke served as Vice President and General Manager of our Argosy Casino Riverside from June 2006 until October 2008 and as President and General Manager of our Bullwhackers properties from November 2002 until June 2006. Prior to joining us, Mr. Burke held senior management positions at Ameristar Casinos, Station Casinos, Trump Taj Mahal Casino Resort and Trump Castle Hotel/Casino, American Gaming and Entertainment and the Majestic Star Casino.

**John V. Finamore.** Mr. Finamore joined us in November 2002 as Senior Vice President-Regional Operations. In this position, Mr. Finamore is responsible for overseeing all facets of our facilities located in our Midwest segment. Prior to joining us, Mr. Finamore served as President of Missouri Operations for Ameristar Casinos, Inc. from December of 2000 until February of 2002 and President of Midwest Operations for Station Casinos, Inc. from July 1998 until November 2000. Mr. Finamore has over 28 years of gaming industry and hotel management experience.

**Robert S. Ippolito.** In July 2001, we appointed Mr. Ippolito to the position of Vice President, Secretary and Treasurer. Mr. Ippolito has served as our Secretary and Treasurer since April 1994 and as our Chief Financial Officer from April 1994 until July 2001. Mr. Ippolito brings more than 24 years of gaming and racing experience to the management team both as a manager at a major accounting firm and as an officer of companies in the racing business.

**Jordan B. Savitch.** Mr. Savitch joined us in September 2002 as Senior Vice President and General Counsel. From June 1999 to April 2002, Mr. Savitch served as a director and senior executive at iMedium, Inc., a venture-backed software company offering innovative software solutions for increasing sales effectiveness. From 1995 to 1999, Mr. Savitch served as senior corporate counsel at Safeguard Scientifics, Inc., a NYSE-listed company specializing in identifying, developing and operating emerging technology companies. Mr. Savitch also spent four years in private practice as an associate at Willkie Farr & Gallagher, LLP in New York, New York.

**Jay A. Snowden.** Mr. Snowden joined us in October 2011 as Senior Vice President-Regional Operations. In this position, Mr. Snowden is responsible for overseeing all facets of our facilities located in our East/West segment. Prior to joining us, Mr. Snowden was the Senior Vice President and GM of Caesar's and Harrah's in Atlantic City, and prior to that, he held various senior leadership positions in St. Louis, San Diego and Las Vegas.

**Steven T. Snyder.** Mr. Snyder joined us in May 1998, and from 1998 through 2001 served as Vice President of Corporate Development. In June 2003, he accepted the position of Senior Vice President of Corporate Development and is responsible for identifying and conducting internal and industry analysis of potential acquisitions, partnerships and other opportunities. Prior to joining us, Mr. Snyder was a partner with Hamilton Partners, Ltd., as well as Managing Director of Municipal and Corporate Investment Banking for Meridian Capital Markets. Mr. Snyder began his career in finance at Butcher & Singer, where he served as First Vice President of Public Finance.

**Governmental Regulations**

The gaming and racing industries are highly regulated and we must maintain our licenses and pay gaming taxes to continue our operations. Each of our facilities is subject to extensive regulation under the laws, rules and regulations of the jurisdiction where it is located. These laws, rules and regulations generally concern the responsibility, financial stability and character of the owners, managers, and persons with financial interests in the gaming operations. Violations of laws or regulations in one jurisdiction could result in disciplinary action in other jurisdictions. A more detailed description of the regulations to which we are subject is contained in Exhibit 99.1 to this Annual Report on Form 10-K, which is incorporated herein by reference.

Our businesses are subject to various federal, state and local laws and regulations in addition to gaming regulations. These laws and regulations include, but are not limited to, restrictions and conditions concerning alcoholic beverages, environmental matters, employees, currency transactions, taxation, zoning and building codes, and marketing and advertising. Such laws and regulations could change or could be interpreted differently in the future, or new laws and regulations could be enacted. Material changes, new laws or regulations, or material differences in interpretations by courts or governmental authorities could adversely affect our operating results.

**Employees and Labor Relations**

As of December 31, 2011, we had 16,740 full- and part-time employees.

We are required to have agreements with the horsemen at each of our racetracks to conduct its live racing and simulcasting activities, with the exception of our tracks in Ohio and New Mexico. In addition, in order to operate gaming machines and table games in West Virginia, we must maintain agreements with each of the Charles Town Horsemen, pari-mutuel clerks and breeders.

At Hollywood Casino at Charles Town Races, we have an agreement with the Charles Town Horsemen expiring on December 31, 2012, and an agreement with the breeders that expires on June 30, 2012. The pari-mutuel clerks at Charles Town are represented under a collective bargaining agreement with the West Virginia Union of Mutuel Clerks, which expired on December 31, 2010 and has been informally extended on a month-to-month basis while negotiations are in process.

Our agreement with the Pennsylvania Thoroughbred Horsemen at Penn National Race Course expired on September 30, 2011 has been extended through February 29, 2012 pending continuing negotiations. We have a collective bargaining agreement with Local 137 of the Sports Arena Employees at Penn National Race Course with respect to pari-mutuel clerks, admissions and Telebet personnel which expired on December 31, 2011 and will likely be extended pending negotiations. We also have an agreement in place with Local 137 of the Sports Arena Employees with respect to pari-mutuel clerks and admission personnel at our OTWs, which expires on August 31, 2013.

Our agreement with the Maine Harness Horsemen Association at Bangor Raceway expired on December 31, 2011. We anticipate having a new agreement in place prior to the commencement of live racing which will occur in May 2012.

Our agreement with the Ohio Harness Horsemen Association at Raceway Park expires on November 30, 2012. In connection with the acquisition of Beulah Park, we have assumed the agreement with the Ohio Horsemen's Protective and Benevolent Association, which expires on November 30, 2012. Rosecroft Raceway entered into agreements with the Cloverleaf Standardbred Owners Association and Maryland Standardbred Breeder's Association as of July 5, 2011. Both of these agreements expire on December 31, 2022.

Across certain of our properties, the Seafarers Entertainment and Allied Trade Union represents approximately 1,860 of our employees under agreements that expire at various times between June

2012 and November 2020. At Hollywood Casino Joliet, the Hotel Employees and Restaurant Employees Union ("UNITE/HERE") Local 1 represents approximately 280 employees under a collective bargaining agreement which expires on March 31, 2015. In addition, at some of our properties, the Seafarer International Union of North America, Atlantic, Gulf, Lakes and Inland Waters District/NMU, AFL-CIO, the Security Police and Fire Professionals of America, the International Brotherhood of Electronic Workers, the UNITE/HERE Local 10, the Local No. 27 United Food and Commercial Workers, and the United Industrial, Service, Transportation, Professional and Government Workers of North America represent certain of our employees under collective bargaining agreements that expire at various times between May 2012 and February 2020. None of these particular unions represent more than 50 of our employees.

**Available Information**

For more information about us, visit our website at www.pngaming.com. The contents of our website are not part of this Annual Report on Form 10-K. Our electronic filings with the U.S. Securities and Exchange Commission (including all annual reports on Form 10-K, quarterly reports on Form 10-Q, and current reports on Form 8-K, and any amendments to these reports), including the exhibits, are available free of charge through our website as soon as reasonably practicable after we electronically file them with or furnish them to the U.S. Securities and Exchange Commission.

## ITEM 1A. RISK FACTORS

**Risks Related to Our Business**

**A substantial portion of our revenues is derived from our Charles Town, West Virginia and Lawrenceburg, Indiana facilities, which will face increased competitive pressures in the near term.**

For the year ended December 31, 2011, approximately 37.4% of our net revenues were collectively derived from our Charles Town and Lawrenceburg operations. Our ability to meet our operating and debt service requirements is substantially dependent upon the continued success of these facilities. The operations at these facilities and any of our other facilities could be adversely affected by numerous factors, including:

- risks related to local and regional economic and competitive conditions, such as a decline in the number of visitors to a facility, a downturn in the overall economy in the market, a decrease in consumer spending on gaming activities in the market or an increase in competition within and outside the state in which each property is located (for example, the potential effect on Charles Town due to the development of a casino complex at the Arundel Mills mall in Anne Arundel, Maryland, the potential opening of a casino in Baltimore, Maryland, as well as ongoing and potentially new competition in Pennsylvania and Maryland, and the potential impact on Lawrenceburg of a proposed $400 million casino in nearby Cincinnati, Ohio that will be operated by Caesars Entertainment as part of a joint venture with Rock Gaming LLC with an announced opening in 2013);

- changes in local and state governmental laws and regulations (including changes in laws and regulations affecting gaming operations and taxes) applicable to a facility;

- impeded access to a facility due to weather, road construction or closures of primary access routes; and

- the occurrence of floods and other natural disasters.

If any of these events occur, our operating revenues and cash flow could decline significantly.

**We may face disruption in integrating and managing facilities we may develop or acquire in the future.**

We expect to continue pursuing expansion opportunities, and we regularly evaluate opportunities for acquisition and development of new properties, which evaluations may include discussions and the review of confidential information after the execution of nondisclosure agreements with potential acquisition candidates, some of which may be potentially significant in relation to our size.

We could face significant challenges in managing and integrating our expanded or combined operations and any other properties we may develop or acquire, particularly in new competitive markets. The integration of properties we may develop or acquire will require the dedication of management resources that may temporarily divert attention from our day-to-day business. The process of integrating properties that we may acquire also could interrupt the activities of those businesses, which could have a material adverse effect on our business, financial condition and results of operations. In addition, the development of new properties may involve construction, local opposition, regulatory, legal and competitive risks as well as the risks attendant to partnership deals on these development opportunities. In particular, in projects where we team up with a joint venture partner, if we cannot reach agreement with such partners, or our relationships otherwise deteriorate, we could face significant increased costs and delays. Local opposition can delay or increase the anticipated cost of a project. Finally, given the competitive nature of these types of limited license opportunities, litigation is possible.

Management of new properties, especially in new geographic areas, may require that we increase our management resources. We cannot assure you that we will be able to manage the combined operations effectively or realize any of the anticipated benefits of our acquisitions. We also cannot assure you that if acquisitions are completed, that the acquired businesses will generate returns consistent with our expectations.

Our ability to achieve our objectives in connection with any acquisition we may consummate may be highly dependent on, among other things, our ability to retain the senior level property management teams of such acquisition candidates. If, for any reason, we are unable to retain these management teams following such acquisitions or if we fail to attract new capable executives, our operations after consummation of such acquisitions could be materially adversely affected.

The occurrence of some or all of the above described events could have a material adverse effect on our business, financial condition and results of operations.

**We may face risks related to our ability to receive regulatory approvals required to complete, or other delays or impediments to completing certain of our acquisitions.**

Our growth is fueled, in part, by the acquisition of existing gaming, racing, and development properties. In addition to standard closing conditions, our acquisitio are often conditioned on the receipt of regulatory approvals and other hurdles that create uncertainty and could increase costs, which could have a material adverse effect on our business, financial condition and results of operations.

**We face risks related to the development and expansion of our properties.**

We expect to use a portion of our cash on hand, cash flow from operations and available borrowings under our revolving credit facility for significant capital expenditures at certain of our properties. Any proposed enhancement may require us to significantly increase the size of our existing work force at those properties. We cannot be certain that management will be able to hire and retain a sufficient number of qualified employees to operate and manage these facilities at their optimal levels. The failure to employ the necessary work force could adversely affect our operations and ultimately

harm profitability. In addition, these enhancements could involve construction risks including cost over-runs and delays, market deterioration and timely receipt of required licenses, permits or authorizations. Our failure to complete any new development or expansion project as planned, on schedule, within budget or in a manner that generates anticipated profits, could have a material adverse effect on our business, financial condition and results of operations.

**We face a number of challenges prior to opening new or upgraded gaming facilities.**

No assurance can be given that, when we endeavor to open new or upgraded gaming facilities, the expected timetables for opening such facilities will be met in light of the uncertainties inherent in the development of the regulatory framework, construction, the licensing process, legislative action and litigation.

**We face significant competition from other gaming operations.**

The gaming industry is characterized by a high degree of competition among a large number of participants, including riverboat casinos, dockside casinos, land-based casinos, video lottery and poker machines not located in casinos, Native American gaming, and other forms of gaming in the U.S. Furthermore, competition from internet lotteries and other internet wagering gaming services, which allow their customers to wager on a wide variety of sporting events and play Las Vegas-style casino games from home, could divert customers from our properties and thus adversely affect our business. Such internet wagering services are often illegal under federal law but operate from overseas locations, and are nevertheless sometimes accessible to domestic gamblers. Currently, there are proposals that would legalize internet poker and other varieties of internet gaming in a number of states and at the federal level.

In a broader sense, our gaming operations face competition from all manner of leisure and entertainment activities, including: shopping; high school, collegiate and professional athletic events; television and movies; concerts and travel. Legalized gaming is currently permitted in various forms throughout the U.S., in several Canadian provinces and on various lands taken into trust for the benefit of certain Native Americans in the U.S. and Canada. Other jurisdictions, including states adjacent to states in which we currently have facilities (such as in Ohio and Maryland), have legalized, and are likely to fully implement, gaming in the near future. In addition, established gaming jurisdictions could award additional gaming licenses or permit the expansion or relocation of existing gaming operations. New, relocated or expanded operations by other persons could increase competition for our gaming operations and could have a material adverse impact on us.

Gaming competition is intense in most of the markets where we operate. There could be further competition in our markets as a result of the upgrading or expansion of facilities by existing market participants, the entrance of new gaming participants into a market or legislative changes. As competing properties and new markets are opened our operating results may be negatively impacted. For example, a proposed $400 million casino scheduled to open in 2013 in Cincinnati, Ohio will compete in the same market as our Lawrenceburg property, increased competition to our Charles Town property is anticipated from the opening of a significant casino complex at the Arundel Mills mall in Anne Arundel, Maryland , the potential opening of a casino in Baltimore, Maryland, as well as ongoing and potentially new competition in Pennsylvania and Maryland, an approximately $357 million riverboat casino and hotel in Baton Rouge, Louisiana is scheduled to open in the summer of 2012 that may have a potential impact on our Baton Rouge property, and an approximately $445 million casino that opened in July 2011 in Des Plaines, Illinois has negatively impacted our Hollywood Casino Aurora and Hollywood Casino Joliet properties. In addition, some of our direct competitors in certain markets may have superior facilities and/or operating conditions.

We expect each existing or future market in which we participate to be highly competitive. The competitive position of each of our casino properties is discussed in detail in the subsection entitled "Competition" of this Annual Report on Form 10-K.

**We may face reductions in discretionary consumer spending as a result of an economic downturn.**

Our net revenues are highly dependent upon the volume and spending levels of customers at our properties and as such our business has been adversely impacted by economic downturns. Decreases in discretionary consumer spending brought about by weakened general economic conditions such as, but not limited to, high unemployment levels, low levels of consumer confidence, weakness in the housing market and increased stock market volatility may negatively impact our revenues and operating cash flow.

**We are or may become involved in legal proceedings that, if adversely adjudicated or settled, could impact our financial condition.**

From time to time, we are defendants in various lawsuits relating to matters incidental to our business. The nature of our business subjects us to the risk of lawsuits filed by customers, past and present employees, competitors, business partners and others in the ordinary course of business. As with all litigation, no assurance can be provided as to the outcome of these matters and, in general, litigation can be expensive and time consuming. We may not be successful in these lawsuits, which could result in settlements or damages that could significantly impact our business, financial condition and results of operations (see, for example, the lawsuits described in Item 3 below).

**We face extensive regulation from gaming and other regulatory authorities.**

*Licensing requirements.* As owners and managers of gaming and pari-mutuel wagering facilities, we are subject to extensive state, local and, in Canada, provincial regulation. State, local and provincial authorities require us and our subsidiaries to demonstrate suitability to obtain and retain various licenses and require that we have registrations, permits and approvals to conduct gaming operations. These regulatory authorities have broad discretion, and may, for any reason set forth in the applicable legislation, rules and regulations, limit, condition, suspend, fail to renew or revoke a license or registration to conduct gaming operations or prevent us from owning the securities of any of our gaming subsidiaries or prevent another person from owning an equity interest in us. Like all gaming operators in the jurisdictions in which we operate, we must periodically apply to renew our gaming licenses or registrations and have the suitability of certain of our directors, officers and employees approved. We cannot assure you that we will be able to obtain such renewals or approvals. Regulatory authorities have input into our operations, for instance, hours of operation, location or relocation of a facility, and numbers and types of machines. Regulators may also levy substantial fines against or seize our assets or the assets of our subsidiaries or the people involved in violating gaming laws or regulations. Any of these events could have a material adverse effect on our business, financial conditic and results of operations.

We have demonstrated suitability to obtain and have obtained all governmental licenses, registrations, permits and approvals necessary for us to operate our existing gaming and pari-mutuel facilities. We cannot assure you that we will be able to retain them or demonstrate suitability to obtain any new licenses, registrations, permits or approvals. In addition, the loss of a license in one jurisdiction could trigger the loss of a license or affect our eligibility for a license in another jurisdiction. As we expand our gaming operations in our existing jurisdictions or to new areas, we may have to meet additional suitability requirements and obtain additional licenses, registrations, permits and approvals from gaming authorities in these jurisdictions. The approval process can be time-consuming and costly and we cannot be sure that we will be successful.

Gaming authorities in the U.S. generally can require that any beneficial owner of our securities file an application for a finding of suitability. If a gaming authority requires a record or beneficial owner of our securities to file a suitability application, the owner must generally apply for a finding of suitability within 30 days or at an earlier time prescribed by the gaming authority. The gaming authority has the power to investigate such an owner's suitability and the owner must pay all costs of the investigation. If the owner is found unsuitable, then the owner may be required by law to dispose of our securities.

*Potential changes in legislation and regulation of our operations.* Regulations governing the conduct of gaming activities and the obligations of gaming companies in any jurisdiction in which we have or in the future may have gaming operations are subject to change and could impose additional operating, financial or other burdens on the way we conduct our business.

Moreover, legislation to prohibit, limit, or add burdens to our business may be introduced in the future in states where gaming has been legalized. In addition, from time to time, legislators and special interest groups have proposed legislation that would expand, restrict or prevent gaming operations or which may otherwise adversely impact our operations in the jurisdictions in which we operate. Any expansion of gaming or restriction on or prohibition of our gaming operations or enactment of other adverse regulatory changes could have a material adverse effect on our operating results. For example, in October 2005, the Illinois House of Representatives voted to approve proposed legislation that would eliminate riverboat gambling. If the Illinois Senate had passed that bill, our business would have been materially impacted. In addition, legislation banning smoking appears to be gaining momentum in a number of jurisdictions where we operate or seek to do business (including passage in Illinois, Colorado and Pennsylvania in 2008). If these bans continue to be enacted, our business could be adversely affected.

*Taxation and fees.* We believe that the prospect of significant revenue is one of the primary reasons that jurisdictions permit legalized gaming. As a result, gaming companies are typically subject to significant revenue based taxes and fees in addition to normal federal, state, local and provincial income taxes, and such taxes and fees are subject to increase at any time. We pay substantial taxes and fees with respect to our operations. From time to time, federal, state, local and provincial legislators and officials have proposed changes in tax laws, or in the administration of such laws, affecting the gaming industry. In addition, worsening economic conditions could intensify the efforts of state and local governments to raise revenues through increases in gaming taxes. It is not possible to determine with certainty the likelihood of changes in tax laws or in the administration of such laws. Such changes, if adopted, could have a material adverse effect on our business, financial condition and results of operations. The large number of state and local governments with significant current or projected budget deficits makes it more likely that those governments that currently permit gaming will seek to fund such deficits with new or increased gaming taxes, and worsening economic conditions could intensify those efforts. Any material increase, or the adoption of additional taxes or fees, could have a material adverse effect on our future financial results.

*Compliance with other laws.* We are also subject to a variety of other rules and regulations, including zoning, environmental, construction and land-use laws and regulations governing the serving of alcoholic beverages. If we are not in compliance with these laws, it could have a material adverse effect on our business, financial condition and results of operations.

**We depend on our key personnel.**

We are highly dependent on the services of Peter M. Carlino, our Chairman and Chief Executive Officer, Timothy J. Wilmott, our President and Chief Operating Officer, William J. Clifford, our Senior Vice President-Finance and Chief Financial Officer, and other members of our senior management team. Our ability to retain key personnel is affected by the competitiveness of our compensation packages and the other terms and conditions of employment, our continued ability to compete

effectively against other gaming companies and our growth prospects. The loss of the services of any of these individuals could have a material adverse effect on our business, financial condition and results of operations.

**Compliance with changing regulation of corporate governance and public disclosure may result in additional expenses and compliance risks.**

Changing laws and regulations relating to corporate governance and public disclosure, including U.S. Securities and Exchange Commission regulations, generally accepted accounting principles, and NASDAQ Global Select Market rules, are creating uncertainty for companies. These changing laws and regulations are subject to varying interpretations in many cases due to their lack of specificity, recent issuance and/or lack of guidance. As a result, their application in practice may evolve over time as new guidance is provided by regulatory and governing bodies. In addition, further regulation of financial institutions and public companies is possible. This could result in continuing uncertainty and higher costs regarding compliance matters. Due to our commitment to maintain high standards of compliance with laws and public disclosure, our efforts to comply with evolving laws, regulations and standards have resulted in and are likely to continue to result in increased general and administrative expense. In addition, we are subject to different parties' interpretation of our compliance with these new and changing laws and regulations. A failure to comply with any of these laws or regulations could have a materially adverse effect on us. For instance, if our gaming authorities, the U.S. Securities and Exchange Commission, our independent auditors or our shareholders and potential shareholders conclude that our compliance with the regulations is unsatisfactory, this may result in a negative public perception of us, subject us to increased regulatory scrutiny, monetary penalties or otherwise adversely affect us.

**Inclement weather and other casualty events could seriously disrupt our business and have a material adverse effect on our financial condition and results of operations.**

The operations of our facilities are subject to disruptions or reduced patronage as a result of severe weather conditions, natural disasters and other casualty events. Because many of our gaming operations are located on or adjacent to bodies of water, these facilities are subject to risks in addition to those associated with land-based casinos, including loss of service due to casualty, forces of nature, mechanical failure, extended or extraordinary maintenance, flood, hurricane or other severe weather conditions. For example, in late August 2005, we closed Hollywood Casino Bay St. Louis in Bay St. Louis, Mississippi, Boomtown Biloxi in Biloxi, Mississippi and Hollywood Casino Baton Rouge in Baton Rouge, Louisiana in anticipation of Hurricane Katrina. Hollywood Casino Baton Rouge subsequently reopened on August 30, 2005. However, due to the extensive damage sustained, operations at Boomtown Biloxi and Hollywood Casino Bay St. Louis did not resume until June 29, 2006 and August 31, 2006, respectively. Many of our casinos operate in areas which are subject to periodic flooding that has caused us to experience decreased attendance and increased operating expenses. Any flood or other severe weather condition could lead to the loss of use of a casino facility for an extended period. For instance, Hollywood Casino Tunica was closed from May 1, 2011 to May 25, 2011 due to flooding. In terms of casualty events, on March 20, 2009, our Hollywood Casino Joliet was closed following a fire that started in the land-based pavilion at the facility. On June 25, 2009, the casino barge reopened with temporary land-based facilities, and w began construction of a new land-based pavilion, which opened in late December 2010.

**The extent to which we can recover under our insurance policies for damages sustained at our properties in the event of future hurricanes and casualty events could adversely affect our business.**

We maintain significant property insurance, including business interruption coverage, for these and other properties. However, there can be no assurances that we will be fully or promptly compensated for losses at any of our facilities in the event of future hurricanes or casualty events.

**Our operations in certain jurisdictions depend on management agreements and/or leases with third parties and local governments.**

Our operations in several jurisdictions depend on land leases and/or management and development agreements with third parties and local governments. If we are unable to renew these leases and agreements on satisfactory terms as they expire, our business may be disrupted and, in the event of disruptions in multiple jurisdictions, could have a material adverse effect on our financial condition and results of operations. For example, in Iowa, each gaming license is issued jointly to a gaming operator and a local charitable sponsor. Our gaming operator subsidiary in Iowa, Belle of Sioux City, L.P. (the "Belle"), is party to an agreement with its local sponsor, Missouri River Historical Development, Inc. ("MRHD") that may expire as soon as July 2012. The Belle is currently negotiating with MRHD to enter into a new long-term agreement in connection with which it has offered to construct a new land-based facility to replace its current barge-based facility. If the Belle does not reach a new agreement with MRHD, it will need to partner with another sponsor. At this time, no assurance can be given that the Belle will be able to reach a new agreement with MRHD or, if such agreement is not reached, that it will be able to partner with another sponsor. In addition, the Belle also has a docking lease with the City of Sioux City, scheduled to expire in January 2013, which permits it to dock its gaming vessel at its current location. Its failure to renew this lease on acceptable terms could disrupt its operations and adversely affect our operating results. Similarly, in the Province of Ontario, through CHC Casinos, our indirectly wholly-owned subsidiary, we manage Casino Rama, a full service gaming and entertainment facility, on behalf of the OLGC, an agency of the Province of Ontario. On October 5, 2010, the OLGC issued a request for proposals inviting gaming operators to bid on a new five year term for the management of the Casino Rama facility subject to a cap on management fees of $5 million per year. Our current management agreement for Casino Rama, which initially expired in July 2011, has been twice extended to provide additional time for the bid process. Our current extension expires on September 30, 2012. No assurance can be given that we will be given additional extensions or that we may ultimately be selected as the new operator.

**We are subject to environmental laws and potential exposure to environmental liabilities.**

We are subject to various federal, state and local environmental laws and regulations that govern our operations, including emissions and discharges into the environment, and the handling and disposal of hazardous and nonhazardous substances and wastes. Failure to comply with such laws and regulations could result in costs for corrective action, penalties or the imposition of other liabilities or restrictions. From time to time, we have incurred and are incurring costs and obligations for correcting environmental noncompliance matters. To date, none of these matters have had a material adverse effect on our business, financial condition or results of operations; however, there can be no assurance that such matters will not have such an effect in the future. In addition, as we acquire properties, we may not know the full level of exposure that we may have undertaken despite appropriate due diligence.

We also are subject to laws and regulations that impose liability and clean-up responsibility for releases of hazardous substances into the environment. Under certain of these laws and regulations, a current or previous owner or operator of property may be liable for the costs of remediating contaminated soil or groundwater on or from its property, without regard to whether the owner or operator knew of, or caused, the contamination, as well as incur liability to third parties impacted by such contamination. The presence of contamination, or failure to remediate it properly, may adversely

affect our ability to use, sell or rent property. The Bullwhackers property is located within the geographic footprint of the Clear Creek/Central City Superfund Site, a large area of historic mining activity which is the subject of state and federal clean-up actions. Although we have not been named a potentially responsible party for this Superfund Site, it is possible that as a result of our ownership and operation of this property (on which mining may have occurred in the past), we may incur costs related to this matter in the future. Furthermore, we are aware that there is or may have been soil or groundwater contamination at certain of our properties (such as Colorado and Ohio) resulting from current or former operations. These matters are in various stages of investigation, and we are not able at this time to estimate the costs that will be required to resolve them. Additionally, certain of the gaming chips used at many gaming properties, including some of ours, have been found to contain some level of lead. Analysis by third parties has indicated the normal handling of the chips does not create a health hazard. We are in the process of evaluating our disposal alternatives. To date, none of these matters or other matters arising under environmental laws has had a material adverse effect on our business, financial condition, or results of operations; however, there can be no assurance that such matters will not have such an effect in the future.

**The concentration and evolution of the slot machine manufacturing industry could impose additional costs on us.**

A majority of our revenues are attributable to slot machines operated by us at our gaming facilities. It is important, for competitive reasons, that we offer the most popular and up to date slot machine games with the latest technology to our customers.

A substantial majority of the slot machines sold in the U.S. in recent years were manufactured by a few select companies. In recent years, the prices of new slot machines have escalated faster than the rate of inflation. Furthermore, in recent years, slot machine manufacturers have frequently refused to sell slot machines featuring the most popular games, instead requiring participation lease arrangements in order to acquire the machines. Participation slot machine leasing arrangements typically require the payment of a fixed daily rental. Such agreements may also include a percentage payment of coin-in or net win. Generally, a participation lease is substantially more expensive over the long term than the cost to purchase a new machine.

For competitive reasons, we may be forced to purchase new slot machines or enter into participation lease arrangements that are more expensive than our current costs associated with the continued operation of our existing slot machines. If the newer slot machines do not result in sufficient incremental revenues to offset the increased investment and participation lease costs, it could hurt our profitability.

**We depend on agreements with our horsemen and pari-mutuel clerks.**

The Federal Interstate Horseracing Act of 1978, as amended, the West Virginia Racing Act and the Pennsylvania Racing Act require that, in order to simulcast race we have written agreements with the horse owners and trainers at our West Virginia and Pennsylvania race tracks. In addition, in order to operate gaming machines a table games in West Virginia, we are required to enter into written agreements regarding the proceeds of the gaming machines with a representative of a majority of the horse owners and trainers, a representative of a majority of the pari-mutuel clerks and a representative of a majority of the horse breeders.

Effective October 1, 2004, we signed an agreement with the Pennsylvania Thoroughbred Horsemen at Penn National Race Course that expired on September 30, 2011, but has been extended through February 29, 2012 pending continuing negotiations. We have a collective bargaining agreement with Local 137 of the Sports Arena Employees at Penn National Race Course with respect to pari-mutuel clerks, admissions and Telebet personnel which expired on December 31, 2011 and will likely be extended pending negotiations. We also have an agreement in place with Local 137 of the Sports Arena Employees with respect to pari-mutuel clerks and admission personnel at our OTWs, which expires on

August 31, 2013. At Hollywood Casino at Charles Town Races, we have an agreement with the Charles Town Horsemen expiring on December 31, 2012, and an agreement with the breeders that expires on June 30, 2012. The pari-mutuel clerks at Charles Town are represented under a collective bargaining agreement with the West Virginia Union of Mutuel Clerks, which expired on December 31, 2010 and has been informally extended on a month-to-month basis while negotiations are in process. Our agreement with the Maine Harness Horsemen Association at Bangor Raceway expired on December 31, 2011. We anticipate having a new agreement in place prior to the commencement of live racing which will occur in May 2012. Our agreement with the Ohio Harness Horsemen Association at Raceway Park expires on November 30, 2012. In connection with the acquisition of Beulah Park, we have assumed the agreement with the Ohio Horsemen's Protective and Benevolent Association which expires on November 30, 2012. Rosecroft Raceway entered into agreements with the Cloverleaf Standardbred Owners Association and Maryland Standardbred Breeder's Association as of July 5, 2011. Both of these agreements expire on December 31, 2022.

If we fail to maintain operative agreements with the horsemen at a track, we will not be permitted to conduct live racing and export and import simulcasting at that track and OTWs and, in West Virginia, we will not be permitted to operate our gaming machines and table games unless the state intervenes or changes the statute. In addition, our simulcasting agreements are subject to the horsemen's approval. If we fail to renew or modify existing agreements on satisfactory terms, this failure could have a material adverse effect on our business, financial condition and results of operations.

**Work stoppages, organizing drives and other labor problems could negatively impact our future profits.**

Some of our employees are currently represented by labor unions. A lengthy strike or other work stoppages at any of our casino properties or construction projects could have an adverse effect on our business and results of operations. Given the large number of employees, labor unions are making a concerted effort to recruit more employees in the gaming industry. In addition, organized labor may benefit from new legislation or legal interpretations by the current presidential administration. Particularly, in light of current support for changes to federal and state labor laws, we cannot provide any assurance that we will not experience additional and more successful union organization activity in the future.

**Risks Related to Our Capital Structure**

**Our substantial indebtedness could adversely affect our financial health and prevent us from fulfilling our obligations under our debt.**

Although we have lower debt leverage ratios than our domestic gaming competitors, we continue to have a significant amount of indebtedness. Our substantial indebtedness could have important consequences to our financial health. For example, it could:

- increase our vulnerability to general adverse economic and industry conditions;
- require us to dedicate a substantial portion of our cash flow from operations to debt service, thereby reducing the availability of our cash flow to fund working capital, capital expenditures, acquisitions and other general corporate purposes;
- limit our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate;
- limit, along with the financial and other restrictive covenants in our indebtedness, among other things, our ability to borrow additional funds; and
- result in an event of default if we fail to satisfy our obligations under our debt or fail to comply with the financial and other restrictive covenants contained in our debt instruments, which event of default could result in all of our debt becoming immediately due and payable and could permit certain of our lenders to foreclose on our assets securing such debt.

Any of the above listed factors could have a material adverse effect on our business, financial condition and results of operations. In addition, we may incur substantial additional indebtedness in the future, including to fund acquisitions. The terms of our existing indebtedness do not, and any future debt may not, fully prohibit us from doing so. If new debt is added to our current debt levels, the related risks that we now face could intensify.

**Volatility and disruption of the capital and credit markets and adverse changes in the global economy may negatively impact our revenues and our ability to access favorable financing terms.**

While we intend to finance expansion and renovation projects with existing cash, cash flow from operations and borrowing under our senior secured credit facility, we may require additional financing to support our continued growth. However, depending on then current economic conditions, our access to capital may not be available on terms acceptable to us or at all. Further, if adverse regional and national economic conditions persist or worsen, we could experience decreased revenues from our operations attributable to decreases in consumer spending levels and could fail to satisfy the financial and other restrictive covenants to which we are subject under our existing indebtedness. Finally, our borrowing costs under our senior secured credit facility are tied to LIBOR. We currently have no hedges in place to mitigate the impact of higher LIBOR rates and as such significant increases in LIBOR could have a negative impact on our results of operations.

**The availability and cost of financing could have an adverse effect on business.**

We intend to finance some of our current and future expansion and renovation projects primarily with cash flow from operations, borrowings under our current senior secured credit facility and equity or debt financings. Depending on the state of the credit markets, if we are unable to finance our current or future expansion projects, we could have to adopt one or more alternatives, such as reducing or delaying planned expansion, development and renovation projects as well as capital expenditures, selling assets, restructuring debt, obtaining additional equity financing or joint venture partners, or modifying our senior secured credit facility. Depending on credit market conditions, these sources of funds may not be sufficient to finance our expansion, and other financing may not be available on acceptable terms, in a timely manner or at all. In addition, our existing indebtedness contains certain restrictions on our ability to incur additional indebtedness. If we are unable to secure additional financing, we could be forced to limit or suspend expansion, acquisitions, development and renovation projects, which may adversely affect our business, financial condition and results of operations.

We have a revolving credit facility with a borrowing capacity of $700.0 million that expires in July 2016 via a bank group that is comprised of various large financial institutions with the top four institutions providing over 53% of the facility. If a large percentage of our lenders were to file for bankruptcy or otherwise default on their obligations to us, we could experience decreased levels of liquidity which could have a detrimental impact on our operations, including being able to fund our current project pipeline. There is no certainty that our lenders will continue to remain solvent or fund their respective obligations under our senior secured credit facility.

**Our indebtedness imposes restrictive covenants on us.**

Our senior secured credit facility requires us, among other obligations, to maintain specified financial ratios and to satisfy certain financial tests, including fixed charge coverage, interest coverage, senior leverage and total leverage ratios. In addition, our senior secured credit facility and $325 million 8¾% senior subordinated notes restrict, among other things, our ability to incur additional indebtedness, incur guarantee obligations, amend debt instruments, pay dividends, create liens on assets, make investments, engage in mergers or consolidations, and otherwise restrict corporate activities. A failure to comply with these restrictions could lead to an event of default thereunder which could result in an acceleration of such indebtedness.

**To service our indebtedness, we will require a significant amount of cash, which depends on many factors beyond our control.**

Based on our current level of operations, we believe our cash flow from operations, available cash and available borrowings under our senior secured credit facility will be adequate to meet our future liquidity needs for the next year. We cannot assure you, however, that our business will generate sufficient cash flow from operations, or that future borrowings will be available to us under our senior secured credit facility in amounts sufficient to enable us to fund our liquidity needs, including with respect to our indebtedness. In addition, if we consummate significant acquisitions and/or other expansion opportunities in the future, our cash requirements may increase significantly. As we are required to satisfy amortization requirements under our senior secured credit facility or as other debt matures, we may also need to raise funds to refinance all or a portion of our debt. We cannot assure you that we will be able to refinance any of our debt, including our senior secured credit facility, on attractive terms, commercially reasonable terms or at all. Our future operating performance and our ability to service or refinance the notes, extend or refinance our debt, including our senior secured credit facility, will be subject to future economic conditions and to financial, business and other factors, many of which are beyond our control.

**The price of our Common Stock may fluctuate significantly.**

Our stock price may fluctuate in response to a number of events and factors, such as variations in operating results, actions by various regulatory agencies and legislatures, litigation, operating competition, market perceptions, progress with respect to potential acquisitions, changes in financial estimates and recommendations by securities analysts, the actions of rating agencies, the operating and stock price performance of other companies that investors may deem comparable to us, and news reports relating to trends in our markets or general economic conditions.

## ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

## ITEM 2. PROPERTIES

The following describes our principal real estate properties by segment:

**Midwest**

*Hollywood Casino Lawrenceburg.* We own the Hollywood casino riverboat. We own and lease 52 acres in Lawrenceburg, Indiana, a portion of which serves as the dockside embarkation for the gaming vessel, and includes an entertainment pavilion, a 295-room hotel, two parking garages and an adjacent surface lot. In addition, we own a 52-acre parcel on Route 50 which we use for remote parking.

The City of Lawrenceburg is currently designing a hotel to be built by the City of Lawrenceburg near our Hollywood Casino Lawrenceburg property. By contractual agreement reached with the City of Lawrenceburg, the project will ultimately be owned and operated by a subsidiary of the Company upon completion of construction. Currently slated to include 180 rooms and approximately 18,000 square feet of multipurpose space, the City of Lawrenceburg anticipates an opening date in the third quarter of 2013.

*Hollywood Casino Aurora.* We own a dockside barge structure and land-based pavilion in Aurora, Illinois. We own the land, which is approximately 17,000 square feet, on which the pavilion is located and a pedestrian walkway bridge. The property also includes a parking lot under an operating lease agreement and two parking garages under capital lease agreements.

*Hollywood Casino Joliet.* We own approximately 276 acres in Joliet, Illinois, which includes a barge-based casino, a 100-room hotel, and a 1,100 space parking garage.

*Argosy Casino Alton.* The Alton Belle II is a riverboat casino, which we own. We lease a 2.5-acre parcel in Alton, Illinois, a portion of which serves as the dockside boarding for the Alton Belle II. The dockside facility includes an entertainment pavilion and office space. In addition, we lease a warehouse facility and own an office building.

*Casino Rama.* We do not own any of the land located at or near the casino or Casino Rama's facilities and equipment. The Ontario Lottery and Gaming Corporation has a long-term ground lease with an affiliate of the Rama First Nation, for the land on which Casino Rama is situated. Under the Agreement, CHC Casinos Canada Limited and CRC Holdings, Inc. have been granted full access to Casino Rama during the term of the Agreement to perform the management services under the Agreement. The Casino Rama facilities are located on approximately 57 acres.

*Hollywood Casino Columbus.* We currently own approximately 123 acres of land in Columbus, Ohio, where we have begun construction of Hollywood Casino Columbus.

*Hollywood Casino Toledo.* We own a 44-acre site in Toledo, Ohio, where we have begun construction of Hollywood Casino Toledo.

**East/West**

*Hollywood Casino at Charles Town Races.* We own 315 acres on various parcels in Charles Town and Ranson, West Virginia of which 155 acres comprise Hollywood Casino at Charles Town Races. The facility includes a 153-room hotel and a ¾-mile all-weather lighted thoroughbred racetrack, a training track, two parking garages, an employee parking lot, an enclosed grandstand/clubhouse and housing facilities for over 1,300 horses.

*Hollywood Casino at Penn National Race Course.* We own approximately 625 acres in Grantville, Pennsylvania, where Penn National Race Course is located on 225 acres. Currently, the property includes a 365,000 square foot facility, complimented by a one-mile all-weather lighted thoroughbred racetrack and a ⅞-mile turf track, and a parking garage. The property also includes approximately 400 acres surrounding the Penn National Race Course that are available for future expansion or development.

*M Resort.* We own the M Resort, which is situated on over 90 acres on the southeast corner of Las Vegas Boulevard and St. Rose Parkway, in Henderson, Nevada. The M Resort property includes a 390-room hotel, 4,700 space parking, and other land-based facilities.

*Hollywood Casino Perryville.* We own approximately 36 acres of land in Perryville, Maryland, where we opened Hollywood Casino Perryville to the public on September 27, 2010.

*Hollywood Slots Hotel and Raceway.* We lease the land on which the Hollywood Slots Hotel and Raceway facility is located in Bangor, Maine, which consists of just over 9 acres, and includes a 152-room hotel and four-story parking. In addition, we lease approximately 26 acres located at historic Bass Park, which is adjacent to the facility, which includes a one-half mile track and a grandstand with over 12,000 square feet and seating for 3,500 patrons.

*Zia Park Casino.* Our casino adjoins the racetrack and is located on an approximately 320-acre site that we own in Hobbs, New Mexico. The property includes a one-mile quarter/thoroughbred racetrack.

**Southern Plains**

*Hollywood Casino Bay St. Louis.* We own approximately 614 acres in the city of Bay St. Louis, Mississippi, including a 17-acre marina. The property includes a land-based casino, an 18-hole golf course, a 291-room hotel, and other land-based facilities, all of which we own.

*Argosy Casino Riverside.* We own approximately 41 acres in Riverside, Missouri, which includes a barge-based casino, a 258-room luxury hotel, an entertainment/banquet facility and a parking garage.

*Hollywood Casino Tunica.* We lease approximately 70 acres of land in Tunica, Mississippi. The property includes a single-level casino, a 494-room hotel, and other land-based facilities, which we own.

*Boomtown Biloxi.* We lease approximately 13 acres, most of which is utilized for the gaming location, under a lease that expires in 2093. We also lease approximately 5 acres of submerged tidelands at the casino site from the State of Mississippi. We own the barge on which the casino is located and all of the land-based facilities.

*Hollywood Casino Baton Rouge.* Hollywood Casino Baton Rouge is a four-story riverboat casino, which we own. We own a 17.4-acre site on the east bank of the Mississippi River in the East Baton Rouge Downtown Development District. The property site serves as the dockside embarkation for Hollywood Casino Baton Rouge and features a two-story building. We also own 5.5 acres of land that are used primarily for offices, warehousing, and parking. In December 2007, we agreed to acquire 3.8 acres of adjacent land and to pay for half of the construction costs for a railroad underpass with the seller of the land. Construction on the underpass started in June 2009 and was completed in March 2011. The underpass provides unimpeded access to the casino property and to property owned by the seller for future development.

*Argosy Casino Sioux City.* We have a lease in Sioux City, Iowa, for the landing rights, which includes the dockside embarkation for the Argosy IV, a riverboat casino. We own the Argosy IV as well as adjacent barge facilities.

**Other**

*Bullwhackers.* Our Bullwhackers casino is located on a 3.5-acre site, which we own. On August 30, 2006, we purchased a gas station/convenience store located approximately 7 miles east of the Bullwhackers casino on Highway 119 on a 7.6-acre site.

*Raceway Park.* We own approximately 92 acres in Toledo, Ohio, where Raceway Park is located. The property includes a ⅝-mile standardbred race track, including a clubhouse and a grandstand.

*Beulah Park.* We own approximately 210 acres in Grove City, Ohio, just outside of Columbus, Ohio. The property includes a thoroughbred racing facility, a grandstand, outdoor paddock and a clubhouse building.

*Rosecroft.* Rosecroft Raceway is situated on approximately 125 acres, which we own. The Rosecroft facility features a ⅝-mile standardbred race track with a seven race paddock, a 53,000 square foot grandstand building, and a 96,000 square foot three story clubhouse building with dining facilities.

*Sanford-Orlando Kennel Club.* We own approximately 26 acres in Longwood, Florida where Sanford-Orlando Kennel Club is located. The property includes a ¼-mile racing surface, a clubhouse dining facility and a main grandstand building. Kennel facilities for up to 1,300 greyhounds are located at a leased location approximately ½ mile from the racetrack enclosure.

*Freehold Raceway.* Through our joint venture in Pennwood, we own a 51-acre site in Freehold, New Jersey, where Freehold Raceway is located. The property features a half-mile standardbred race

track and a grandstand. In addition, through our joint venture in Pennwood, we own a 10-acre site in Cherry Hill, New Jersey, which is currently undeveloped.

*Sam Houston Race Park and Valley Race Park.* Through our joint venture with MAXXAM, we own 323 acres at Sam Houston Race Park and 80 acres at Valley Race Park. Sam Houston Race Park includes a one-mile dirt track and a 7/8-mile turf track as well as a 226,000 square foot grandstand and pavilion centre. Valley Race Park includes a 91,000 square foot dog racing and simulcasting facility.

*Off-track Wagering Facilities.* The following is a list of our four OTWs, which are leased, and their locations:

| Location | Approx. Size (Square Ft.) | Owned/Leased | Date Opened |
|---|---|---|---|
| Reading, PA | 22,500 | Leased | May 1992 |
| Chambersburg, PA | 12,500 | Leased | April 1994 |
| York, PA | 25,000 | Leased | March 1995 |
| Lancaster, PA | 24,000 | Leased | July 1996 |

In addition, through our joint venture in Pennwood, we own 50% of a leased OTW in Toms River, New Jersey, that has 28,160 square feet.

*Corporate.* We lease 45,917 square feet of executive office and warehouse space for buildings in Wyomissing, Pennsylvania from affiliates of Peter M. Carlino, our Chairman and Chief Executive Officer. We believe the lease terms for the executive office and warehouse to be no less favorable than such lease terms that could have been obtained from unaffiliated third parties.

## ITEM 3. LEGAL PROCEEDINGS

We are subject to various legal and administrative proceedings relating to personal injuries, employment matters, commercial transactions and other matters arisi in the normal course of business. We do not believe that the final outcome of these matters will have a material adverse effect on our consolidated financial position or results of operations. In addition, we maintain what we believe is adequate insurance coverage to further mitigate the risks of such proceedings. However, such proceedings can be costly, time consuming and unpredictable and, therefore, no assurance can be given that the final outcome of such proceedings may not materially impact our consolidated financial condition or results of operations. Further, no assurance can be given that the amount or scope of existing insurance coverage will be sufficient to cover losses arising from such matters.

The following proceedings could result in costs, settlements, damages, or rulings that materially impact our consolidated financial condition or operating results. In each instance, we believe that we have meritorious defenses, claims and/or counter-claims, and intends to vigorously defend ourselves or pursue our claim.

The Illinois Legislature passed into law House Bill 1918, effective May 26, 2006, which singled out four of the nine Illinois casinos, including the Company's Hollywood Casino Joliet and Hollywood Casino Aurora, for a 3% surcharge to subsidize local horse racing interests. On May 30, 2006, Hollywood Casino Joliet and Hollywood Casino Aurora joined with the two other riverboats affected by the law, Harrah's Joliet and the Grand Victoria Casino in Elgin (collectively, the "Four Casinos"), and filed suit in the Circuit Court of the Twelfth Judicial District in Will County, Illinois (the "Court"), asking the Court to declare the law unconstitutional. Hollywood Casino Joliet and Hollywood Casino Aurora began paying the 3% surcharge into a protest fund which accrued interest during the pendency of the lawsuit. In two orders dated March 29, 2007 and April 20, 2007, the Court declared the law unconstitutional under the Uniformity Clause of the Illinois Constitution and enjoined the collection of this surcharge. The State of Illinois requested, and was granted, a stay of this ruling. As a result,

Hollywood Casino Joliet and Hollywood Casino Aurora continued paying the 3% surcharge into the protest fund until May 25, 2008, when the 3% surcharge expired. The State of Illinois appealed the ruling to the Illinois Supreme Court. On June 5, 2008, the Illinois Supreme Court reversed the trial court's ruling and issued a decision upholding the constitutionality of the 3% surcharge. On January 21, 2009, the Four Casinos filed a petition for certiorari, requesting the U.S. Supreme Court to hear the case. Seven amicus curiae briefs supporting the plaintiffs' request were also filed. On June 8, 2009, the U.S. Supreme Court decided not to hear the case. On June 10, 2009, the Four Casinos filed a petition with the Court to open the judgment based on new evidence that came to light during the investigation of former Illinois Governor Rod Blagojevich that the 2006 law was procured by corruption. On August 17, 2009, the Court dismissed the Four Casinos' petition to reopen the case, and the Four Casinos decided not to pursue an appeal of the dismissal.

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

On June 12, 2009, the Four Casinos filed a lawsuit in Illinois Federal Court naming former Illinois Governor Rod Blagojevich, his campaign fund, racetrack owner John Johnston, and his two racetracks as defendants alleging a civil conspiracy in violation of the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. §1962(c),(d) ("RICO"), based on an illegal scheme to secure the enactment of the 3% surcharge legislation in exchange for the payment of money by Johnston and entities controlled by him. The Four Casinos sought to impose a constructive trust over all funds paid under the surcharge, and therefore all of the Illinois racetracks were named as parties to the lawsuit. The defendants in the RICO case filed motions to dismiss. On December 7, 2009, the district court denied the motions to dismiss the RICO count, but it granted the motion to dismiss the constructive trust count, stating that it did not have jurisdiction in this case to impose the constructive trust. The Four Casinos appealed this dismissal to the Seventh Circuit Court of Appeals, which affirmed the dismissal in an en banc opinion. The Illinois racetracks are now free to use the monies that they received from the 3% surcharge. Since the passing of House Bill 1918 into law, Hollywood Casino Joliet and Hollywood Casino Aurora have recognized approximately $55.2 million in expense as a result of the 3% surcharge, including $5.5 million during the year ended December 31, 2011. The 3% surcharge is included in gaming expense within the consolidated statements of operations.

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

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

On September 11, 2008, the Board of County Commissioners of Cherokee County, Kansas (the "County") filed suit against Kansas Penn Gaming, LLC ("KPG," a wholly-owned subsidiary of Penn created to pursue a development project in Cherokee County, Kansas) and the Company in the District Court of Shawnee County, Kansas. The petition alleges that KPG breached its pre-development agreement with the County when KPG withdrew its application to manage a lottery gaming facility in Cherokee County and currently seeks in excess of $50 million in damages. In connection with their petition, the County obtained an ex-parte order attaching the $25 million privilege fee paid to the Kansas Lottery Commission in conjunction with the gaming application for the Cherokee County zone. The defendants have filed motions to dissolve and reduce the attachment. Those motions were denied. Following discovery, both parties have filed dispositive motions.

On September 23, 2008, KPG filed an action against HV Properties of Kansas, LLC ("HV") in the U.S. District Court for the District of Kansas seeking a declaratory judgment from the U.S. District Court finding that KPG has no further obligations to HV under a Real Estate Sale Contract (the "Contract") that KPG and HV entered into on September 6, 2007, and that KPG properly terminated this Contract under the terms of the Repurchase Agreement entered into between the parties effective September 28, 2007. HV filed a counterclaim claiming KPG breached the Contract, and seeks $37.5 million in damages. On October 7, 2008, HV filed suit against the Company claiming the Company is liable to HV for KPG's alleged breach based on a Guaranty Agreement signed by the Company. Both cases were consolidated. Following extensive discovery and briefings, on July 23, 2010, the court granted KPG's motion for summary judgment and dismissed HV's claim. KPG filed a motion requesting reimbursement of the attorneys' fees and costs incurred in litigating this case pursuant to the terms of the Contract and was awarded approximately $0.9 million. HV has appealed both rulings of the district court. In December 2011, the Tenth Circuit Court of Appeals affirmed the district courts' rulings.

On March 11, 2011, CD Gaming Ventures, LLC ("CD Gaming"), a wholly-owned subsidiary of the Company and developer of the Columbus casino, filed suit in U.S. District Court against the City of Columbus (the "City"), Columbus officials, Franklin County and County officials. The lawsuit alleged that the City, Franklin County and various city and county officials violated the Company's rights under the U.S. and Ohio Constitutions, principally by removing preexisting sewer and water service in an effort to force annexation of the constitutionally-authorized casino site into the City. CD Gaming asked the court for an injunction preventing the City and the county from denying water and sewer service to the casino site and also sought monetary damages. On May 24, 2011, the City and CD Gaming announced they had reached a contingent agreement, subject to final documentation, that would result in the annexation of the casino site into the City in exchange for water and sewer service and other considerations. The agreement was conditioned, among other things, on the sale of real estate previously purchased by the Company in downtown Columbus for $11 million and an acceptable settlement agreement with certain affiliates of the Columbus Dispatch. A sale agreement for the real estate in downtown Columbus closed on August 23, 2011 and a release and settlement agreement has been finalized with certain affiliates of the Columbus Dispatch.

**ITEM 4. MINE SAFETY DISCLOSURES**

None.

## PART II

### ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED SHAREHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

**Range of Market Price**

Our Common Stock is quoted on the NASDAQ Global Select Market under the symbol "PENN." The following table sets forth for the periods indicated the high and low sales prices per share of our Common Stock as reported on the NASDAQ Global Select Market.

| | High | Low |
|---|---|---|
| **2011** | | |
| First Quarter | $ 38.17 | $ 33.42 |
| Second Quarter | 40.75 | 36.36 |
| Third Quarter | 44.29 | 33.05 |
| Fourth Quarter | 41.49 | 31.68 |
| **2010** | | |
| First Quarter | $ 30.22 | $ 22.45 |
| Second Quarter | 31.95 | 23.05 |
| Third Quarter | 30.86 | 22.35 |
| Fourth Quarter | 37.32 | 29.44 |

The closing sale price per share of our Common Stock on the NASDAQ Global Select Market on February 15, 2012, was $41.85. As of February 15, 2012, there were approximately 583 holders of record of our Common Stock.

**Dividend Policy**

Since our initial public offering of Common Stock in May 1994, we have not paid any cash dividends on our Common Stock. We intend to retain all of our earnings to finance the development of our business, and thus, do not anticipate paying cash dividends on our Common Stock for the foreseeable future. Payment of any cash dividends in the future will be at the discretion of our Board of Directors and will depend upon, among other things, our future earnings, operations and capital requirements, our general financial condition and general business conditions. In addition, our senior secured credit facility and $325 million 8¾% senior subordinated notes restrict, among other things, our ability to pay dividends. In addition, future financing arrangements may prohibit the payment of dividends under certain conditions.

**Stock Repurchase**

On June 9, 2011, the Board of Directors authorized the extension of the repurchase program previously authorized by the Board of Directors on June 9, 2010 which provided for the purchase of up to $300 million of our Common Stock. The current authorization extends the repurchase program until the Annual Meeting of Shareholders in 2012, unless otherwise extended or shortened by the Board of Directors. During the year ended December 31, 2011, we repurchased 2,981,406 shares of our Common Stock in open market transactions for approximately $105.2 million at an average price of $35.29 per share. During the year ended December 31, 2010, we repurchased 1,526,400 shares of our Common Stock in open market transactions for approximately $35.9 million at an average price of $23.49 per share. We did not repurchase any shares of our Common Stock in 2009.

The table below summarizes the Company's repurchases of Common Stock during the quarter ended December 31, 2011:

| | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Program(1) | Maximum Dollar Value of Shares that May Yet Be Purchased Under the Program |
|---|---|---|---|---|
| October 1, 2011 - October 31, 2011 | — | $ — | — | $ 238,329,608 |
| November 1, 2011 - November 30, 2011 | 1,190,935 | 34.69 | 1,190,935 | 197,013,437 |
| December 1, 2011 - December 31, 2011 | 1,034,954 | 35.61 | 1,034,954 | 160,159,344 |

## ITEM 6. SELECTED FINANCIAL DATA

The following selected consolidated financial and operating data for the five-year period ended December 31, 2011 is derived from our consolidated financial statements that have been audited by Ernst & Young LLP, an independent registered public accounting firm. The selected consolidated financial and operating data should be read in conjunction with our consolidated financial statements and notes thereto, "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the other financial information included herein.

| | Year Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2011 | 2010(1) | 2009(2) | 2008(3) | 2007 |
| | (in thousands, except per share data) | | | | |
| **Income statement data:(4)** | | | | | |
| Net revenues | $2,742,257 | $2,459,111 | $2,369,275 | $2,423,053 | $2,436,793 |
| Total operating expenses | 2,242,676 | 2,305,885 | 2,563,873 | 2,509,494 | 1,938,984 |
| Income (loss) from operations | 499,581 | 153,226 | (194,598) | (86,441) | 497,809 |
| Total other (expenses) income | (110,349) | (148,708) | (133,283) | 38,856 | (205,569) |
| Income (loss) from operations before income taxes | 389,232 | 4,518 | (327,881) | (47,585) | 292,240 |
| Taxes on income | 146,881 | 66,178 | (60,468) | 105,738 | 132,187 |
| Net income (loss) including noncontrolling interests | 242,351 | (61,660) | (267,413) | (153,323) | 160,053 |
| Less: Net loss attributable to noncontrolling interests | — | (2,193) | (2,465) | — | — |
| Net income (loss) attributable to the shareholders of Penn National Gaming, Inc. and subsidiaries | $ 242,351 | $ (59,467) | $ (264,948) | $ (153,323) | $ 160,053 |
| **Per share data:** | | | | | |
| Basic earnings (loss) per common share | $ 2.52 | $ (0.76) | $ (3.39) | $ (1.81) | $ 1.87 |
| Diluted earnings (loss) per common share | $ 2.26 | $ (0.76) | $ (3.39) | $ (1.81) | $ 1.81 |
| Weighted shares outstanding—Basic(5) | 77,991 | 78,079 | 78,122 | 84,536 | 85,578 |
| Weighted shares outstanding—Diluted(5) | 107,051 | 78,079 | 78,122 | 84,536 | 88,384 |
| **Other data:** | | | | | |
| Net cash provided by operating activities | $ 567,365 | $ 493,178 | $ 338,246 | $ 420,463 | $ 431,219 |
| Net cash used in investing activities | (338,802) | (736,758) | (262,659) | (391,498) | (611,617) |
| Net cash (used in) provided by financing activities | (236,508) | (223,153) | (108,747) | 542,941 | 186,255 |
| Depreciation and amortization | 211,476 | 212,387 | 194,436 | 173,545 | 147,915 |
| Interest expense | 99,564 | 130,215 | 134,984 | 169,827 | 198,059 |
| Capital expenditures | 293,081 | 362,955 | 289,551 | 344,894 | 361,155 |
| Balance sheet data: | | | | | |
| Cash and cash equivalents | $ 238,440 | $ 246,385 | $ 713,118 | $ 746,278 | $ 174,372 |
| Total assets | 4,606,346 | 4,462,879 | 4,712,616 | 5,189,676 | 4,967,032 |
| Total debt | 2,043,165 | 2,171,123 | 2,334,777 | 2,430,180 | 2,974,922 |
| Shareholders' equity | 1,971,631 | 1,777,766 | 1,852,076 | 2,057,273 | 1,120,962 |

(1) As a result of decreased earning projections resulting from an anticipated increase in competition from the scheduled opening of a $445 million casino in the second half of 2011 in Des Plaines, Illinois, as well as continued challenging market conditions in the Chicagoland regional market, we recorded a pre-tax goodwill impairment charge of $188.8 million ($173.0 million, net of taxes) related to our Aurora and Joliet properties during the year ended December 31, 2010. As a result of the May 2010 statewide election, whereby the voters determined that our casino in Columbus will be located at the site of the former Delphi Automotive plant along Columbus's West Side, we reclassified the land that

we had previously purchased in the Arena District site that had been originally approved for our casino as held for sale and recorded a pre-tax impairment charge of $31.3 million ($20.1 million, net of taxes). Additionally, during the year ended December 31, 2010, we wrote-off the trademark intangible asset associated with the Argosy acquisition for $4.4 million ($2.8 million, net of taxes) due to management's strategy to transition Argosy properties to the Hollywood Casino brand. We also recorded a pre-tax charge of $0.2 million during the year-ended December 31, 2010 related to the replaced Lawrenceburg vessel. See Note 3 below.

(2)

As a result of the anticipated impact of gaming expansion in Ohio, we recorded a pre-tax impairment charge of $520.5 million ($368.8 million, net of taxes) during the year ended December 31, 2009, as we determined that a portion of the value of our goodwill and indefinite-life intangible assets associated with the original purchase of Hollywood Casino Lawrenceburg was impaired. In addition, in conjunction with the opening of the new casino riverboat at Hollywood Casino Lawrenceburg, we recorded a pre-tax impairment charge for the replaced Lawrenceburg vessel of $11.9 million ($7.1 million, net of taxes) during the year ended December 31, 2009.

(3)

As a result of a decline in our share price, an overall reduction in industry valuations, and property operating performance in the then-current economic environment, we recorded a pre-tax impairment charge of $481.3 million ($392.6 million, net of taxes) during the year ended December 31, 2008, as we determined that a portion of the value of our goodwill, indefinite-life intangible assets and long-lived assets was impaired. The December 31, 2008 impairment charge by property was as follows: Hollywood Casino Lawrenceburg, $214.1 million pre-tax ($189.3 million, net of taxes); Hollywood Casino Aurora, $43.7 million pre-tax and net of taxes; Hollywood Casino Joliet, $94.4 million pre-tax ($60.4 million, net of taxes); Argosy Casino Alton, $14.1 million pre-tax and net of taxes; Bullwhackers, $14.2 million pre-tax ($9.1 million, net of taxes); Hollywood Slots Hotel and Raceway, $82.7 million pre-tax ($64.0 million, net of taxes); and Corporate overhead, $18.1 million pre-tax ($12.0 million, net of taxes).

(4)

For purposes of comparability, certain prior year amounts have been reclassified to conform to the current year presentation.

(5)

Since we reported a loss from operations for the years ended December 31, 2010, 2009 and 2008, we were required to use basic weighted-average common shares outstanding, rather than diluted weighted-average common shares outstanding, when calculating diluted loss per share for the years ended December 31, 2010, 2009 and 2008.

## ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### Our Operations

We are a leading, diversified, multi-jurisdictional owner and manager of gaming and pari-mutuel properties. As of December 31, 2011, we owned, managed, or had ownership interests in twenty-five facilities in the following eighteen jurisdictions: Colorado, Florida, Illinois, Indiana, Iowa, Louisiana, Maine, Maryland, Mississippi, Missouri, Nevada, New Jersey, New Mexico, Ohio, Pennsylvania, Texas, West Virginia, and Ontario. We believe that our portfolio of assets provides us with diversified cash flow from operations.

We have made significant acquisitions in the past, and expect to continue to pursue additional acquisition and development opportunities in the future. In 1997, we began our 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, we have continued to expand our gaming operations through strategic acquisitions (including the acquisitions of Hollywood Casino Bay St. Louis and Boomtown Biloxi, CRC Holdings, Inc., the Bullwhackers properties, Hollywood Casino Corporation, Argosy Gaming Company, Zia Park Casino, Sanford-Orlando Kennel Club and the M Resort in June 2011), greenfield projects (such as at Hollywood Casino at Penn National Race Course, Hollywood Slots Hotel and Raceway and Hollywood Casino Perryville), and property expansions (such as Hollywood Casino at Charles Town Races and Hollywood Casino Lawrenceburg). Most recently, we, along with our joint venture partner, opened Hollywood Casino at Kansas Speedway on February 3, 2012, and we anticipate opening our facilities in Columbus and Toledo, Ohio in 2012.

The vast majority of our revenue is gaming revenue, derived primarily from gaming on slot machines and, to a lesser extent, table games, which is highly dependent upon the volume and spending levels of customers at our properties. Other revenues are derived from our management service fee from Casino Rama, our hotel, dining, retail, admissions, program sales, concessions and certain other ancillary activities, and our racing operations. Our racing revenue includes our share of pari-mutuel wagering on live races after payment of amounts returned as winning wagers, our share of wagering from import and export simulcasting, and our share of wagering from our OTWs.

Key performance indicators related to gaming revenue are slot handle and table game drop (volume indicators) and "win" or "hold" percentage. Our typical property slot win percentage is in the range of 6% to 10% of slot handle, and our typical table game win percentage is in the range of 12% to 25% of table game drop.

Our properties generate significant operating cash flow, since most of our revenue is cash-based from slot machines and pari-mutuel wagering. Our business is capital intensive, and we rely on cash flow from our properties to generate operating cash to repay debt, fund capital maintenance expenditures, fund new capital projects at existing properties and provide excess cash for future development and acquisitions.

We continue to expand our gaming operations through the implementation and execution of a disciplined capital expenditure program at our existing properties, the pursuit of strategic acquisitions and the development of new gaming properties, particularly in attractive regional markets. Current capital projects are ongoing at several of our new and existing properties, including our facilities under construction in Ohio. Additional information regarding our capital projects is discussed in detail in the section entitled "Liquidity and Capital Resources—Capital Expenditures" below.

**Segment Information**

During 2011, we realigned our reporting structure in connection with the hiring of a senior vice president of regional operations. We now have three senior vice presidents of regional operations who oversee various properties based primarily on their geographic locations and whom report directly to our President and Chief Operating Officer. This event impacted how our Chief Executive Officer, who is the Company's CODM as that term is defined in ASC 280, measures and assesses our business performance and has caused us to conclude that we now have reportable segments. Therefore, we have aggregated our properties into three reportable segments: (i) Midwest, (ii) East/West, and (iii) Southern Plains, consistent with how our CODM reviews and assesses our financial performance.

The Midwest reportable segment consists of the following properties: Hollywood Casino Lawrenceburg, Hollywood Casino Aurora, Hollywood Casino Joliet, and Argosy Casino Alton. It also includes our Casino Rama management service contract as well as the two Ohio properties that are currently under construction, Hollywood Casino Toledo and Hollywood Casino Columbus, which are scheduled to open by the end of May 2012 and November 1, 2012, respectively.

The East/West reportable segment consists of the following properties: Hollywood Casino at Charles Town Races, Hollywood Casino Perryville, Hollywood Slots Hotel and Raceway, Hollywood Casino at Penn National Race Course, Zia Park Casino, and M Resort.

The Southern Plains reportable segment consists of the following properties: Argosy Casino Riverside, Argosy Casino Sioux City, Hollywood Casino Baton Rouge, Hollywood Casino Tunica, Hollywood Casino Bay St. Louis, and Boomtown Biloxi. It also includes our 50% investment in Kansas Entertainment, which owns the Hollywood Casino at Kansas Speedway which opened in February 2012.

The Other category consists of our standalone racing operations, namely Beulah Park, Raceway Park, Rosecroft Raceway, Sanford-Orlando Kennel Club, and our joint venture interests in Sam Houston Race Park and Valley Race Park, Freehold Raceway, and Maryland Jockey Club (which was sold in July 2011). If we are successful in obtaining gaming operations at these locations, they would be assigned to one of our regional executives and reported in their respective reportable segment. The Other category also includes our corporate overhead operations which does not meet the definition of an operating segment under ASC 280 and our Bullwhackers property.

**Executive Summary**

Economic conditions continue to impact the overall domestic gaming industry as well as operating results. We believe that the current economic conditions, including, but not limited to, high unemployment levels, low levels of consumer confidence, weakness in the housing and consumer credit markets and increased stock market volatility, have resulted in reduced levels of discretionary consumer spending compared to historical levels. In order to mitigate the impact of these conditions, we have increasingly focused on cost management, such as monitoring staff levels and establishing effective marketing programs, to continue to generate strong cash flow.

Even though the current economic environment has been challenging, we believe our strengths include our relatively low leverage ratios compared to the regional casino companies that we directly compete with and the ability of our operations to generate positive cash flow. These two factors have allowed us to develop what we believe to be attractive future growth opportunities in new regional gaming markets. We have also made investments in joint ventures and certain racetrack operations that we believe may allow us to capitalize on additional gaming opportunities in certain states if legislation or referenda are passed that permit and/or expand gaming in these jurisdictions.

*Financial Highlights:*

The major factors affecting our results for the year ended December 31, 2011, as compared to the year ended December 31, 2010, were:

- Net revenues and income from operations increased by $293.5 million and $82.2 million, respectively, for the year ended December 31, 2011, as compared to the corresponding period in the prior year, for our East/West segment, primarily due to the acquisition of the M Resort on June 1, 2011, the opening of Hollywood Casino Perryville on September 27, 2010, and the introduction of table games in July 2010 at Hollywood Casino at Charles Town Races and at Hollywood Casino at Penn National Race Course.

- Income from operations at our Midwest segment was impacted by a pre-tax insurance gain of $18.5 million at Hollywood Casino Joliet during the year ended December 31, 2011, compared to a pre-tax insurance gain of $7.5 million during the corresponding period in the prior year, and included goodwill and other impairment losses of $220.2 million during the year ended December 31, 2010.

- Excluding the recently opened Hollywood Casino Perryville and the recently acquired M Resort, management's continued focus on cost management contributed to improved operating margins at 14 of our 15 gaming facilities.

- Our Other category included a gain of $20.2 million on the sale of our interest in the Maryland Jockey Club in July 2011 for the year ended December 31, 2011 compared to a loss from our interest in the Maryland Jockey Club for the year ended December 31, 2010, which included our share of a goodwill impairment write-down recorded by the Maryland Jockey Club during the fourth quarter of 2010 for $14.4 million. Our Other category for the year ended December 31, 2011 also included a loss on the early extinguishment of debt for $17.8 million related to debt issuance costs write-offs and the call premium on the $250 million senior subordinated notes, as well as a $5.9 million charge for our share of a goodwill impairment write-down at our New Jersey joint venture.

- Net income attributable to the shareholders of Penn National Gaming, Inc. and its subsidiaries increased by $301.8 million for the year ended December 31, 2011, as compared to the year ended December 31, 2010, primarily due to the variances explained above and a decrease in interest expense as well as an increase in income taxes.

*Recent Developments:*

The following are recent developments that have had or are likely to have an impact on us:

- In July 2011, we entered into a new $2.15 billion senior secured credit facility which is comprised of a $700 million revolving credit facility that will mature in July 2016, a $700 million variable rate Term Loan A due in July 2016 and a $750 million variable rate Term Loan B due in July 2018. We utilized the proceeds of the two term loan borrowings and cash on hand to retire our previous senior secured credit facility obligation of $1,518.1 million (which had significant principal repayments due at the end of 2011 and 2012) and pay transaction costs and accrued interest and fees on the retired debt. As a result of this refinancing, we incurred a $10.2 million loss on the early extinguishment of debt during the year ended December 31, 2011. Additionally, in July 2011, we announced our intention to redeem all of our $250 million senior subordinated notes. The redemption price was $1,022.50 per $1,000 principal amount, plus accrued and unpaid interest, which was paid in August 2011. We funded the redemption of our $250 million senior subordinated notes from our new revolving credit facility and available cash. We recorded a $7.6 million loss on early extinguishment of debt during the year ended

December 31, 2011 related to debt issuance costs write-offs and the call premium on the $250 million senior subordinated notes.

- Following the purchase of all of the outstanding debt of the M Resort for $230.5 million and the receipt of requisite regulatory approvals, we acquired the business in exchange for the debt on June 1, 2011. We purchased all of the outstanding bank and subordinated debt of the M Resort in October 2010 at which time we also secured the right to acquire the business of the M Resort in exchange for the property's outstanding debt obligations.

- The Hollywood Casino Columbus project, a $400 million Hollywood-themed casino in Columbus, Ohio, inclusive of $50 million in licensing fees, is under construction, with a planned casino opening of up to 3,000 slot machines, 70 table games and 30 poker tables, structured and surface parking, as well as food and beverage outlets and an entertainment lounge. We expect that Hollywood Casino Columbus will open on November 1, 2012. Construction is also underway for Hollywood Casino Toledo, a $320 million Hollywood-themed casino in Toledo, Ohio, inclusive of $50 million in licensing fees, with a planned casino opening of 2,000 slot machines, 60 table games and 20 poker tables, structured and surface parking, as well as food and beverage outlets and an entertainment lounge. Hollywood Casino Toledo is anticipated to open by the end of May 2012.

- In June 2011, we reached an agreement in principle with the State of Ohio that will provide greater clarity regarding our total state tax burden and future competition, and establishes the framework, including licensing fees, tax structure and minimal capital expenditures, for the placement of video lottery terminals at the state's seven racetracks. The State of Ohio has approved the placement of video lottery terminals at the state's seven racetracks and while we await the regulatory structure to be put in place, we are actively seeking the potential relocation of our existing racetracks at Raceway Park and Beulah Park to Youngstown and Dayton, respectively. On October 21, 2011, The Ohio Roundtable filed a complaint in the Court of Common Pleas in Franklin County, Ohio against a number of defendants, including the Governor, the Ohio Lottery Commission and the Ohio Casino Control Commission. The complaint alleges a variety of substantive and procedural defects relative to the approval and implementation of video lottery terminals as well as several counts dealing with the taxation of standalone casinos.

- On July 18, 2011, the tenth licensed casino in Illinois opened in the city of Des Plaines. This facility is a new source of competition for Hollywood Casino Aurora and Hollywood Casino Joliet and has had a negative impact on these properties' financial results. However, the 3% surcharge Hollywood Casino Aurora and Hollywood Casino Joliet paid to subsidize local horse racing interests is no longer required with the opening of the Des Plaines facility.

- In February 2010, Kansas Entertainment received the final approval under the Kansas Expanded Lottery Act, along with its gaming license from the Kansas Racing and Gaming Commission, to proceed with the development of an approximately $411 million Hollywood-themed destination facility overlooking Turn 2 at Kansas Speedway. Kansas Entertainment began construction of the facility in the second quarter of 2010 and the facility opened on February 3, 2012. The approximately $411 million facility, inclusive of licensing fees, features a 95,000 square foot casino with approximately 2,000 slot machines, 52 table games and 12 poker tables, a 1,253 space parking structure, as well as a variety of dining and entertainment amenities. We, along with our partner in Kansas Entertainment, International Speedway, shared equally in the cost of developing and constructing the facility. We estimate that our share of the project will be approximately $155 million.

- Each gaming license in Iowa is issued jointly to a gaming operator and a local charitable sponsor. The agreement between our gaming operator subsidiary in Iowa, Belle of Sioux City, L.P. (the "Belle") and its charitable sponsor, Missouri River Historical Development, Inc. ("MRHD"), may expire as early as July 2012. The Belle is in the process of negotiating with MRHD to transition its current barge-based facility to a new land-based facility and to enter into a new long-term agreement with MRHD. If a new agreement cannot be reached, MRHD has indicated that it may issue a request for proposals for alternative operators for a new land-based facility and has preemptively filed a lawsuit seeking to establish its right to do so. If MRHD were to issue such a request, the Belle may contest MRHD's right to do so, may participate in the process and/or may seek an alternative charitable sponsor. Accordingly, at this time, there can be no assurance that the Belle will be able to reach an agreement with MRHD or, absent such agreement, that it will be able to partner with an alternative charitable sponsor. In the event that both MRHD and the Belle find alternative partners, it is unclear whether the Iowa Gaming and Racing Commission would issue a gaming license to one or both such groups. Further, the Belle's ability to continue its operations may also be impacted by its ability to renew or extend its existing docking lease, which expires in January 2013, or to locate a suitable site to construct a land-based facility.

- We closed the transaction to enter into a joint venture that owns and operates the Sam Houston Race Park in Houston, Texas and the Valley Race Park in Harlingen, Texas, and holds a license for a planned racetrack in Laredo, Texas on April 8, 2011, following final approval by the Texas Racing Commission and the satisfaction of certain closing conditions. We intend to work collaboratively with MAXXAM, our joint venture partner, to strengthen and enhance the existing racetrack operations as well as pursue other opportunities, including the potential for gaming operations at the pari-mutuel facilities, to maximize the overall value of the business.

- Hollywood Casino Joliet, which was undergoing a $55 million renovation, was closed following a fire that started in the land-based pavilion at the facility on March 20, 2009. All customers and employees were successfully evacuated, and the fire was contained on the land-side of the property before it could spread to the adjacent casino barge. On June 25, 2009, the casino barge was reopened with temporary land-based facilities, and we began construction of a new land-based pavilion. In December 2010, the first phase of the new permanent land-based pavilion was opened to the public and in January 2011 the final phase, including a sports bar, was completed. At the time of the fire, we carried a builders' risk insurance policy for the on-going renovations with a policy limit of $57 million, inclusive of $14 million for delay in completion and $43 million for property damage. The builders' risk insurance policy included a $50,000 property damage deductible and a 30-day delay in completion deductible for the peril of fire. In addition, we carried comprehensive business interruption and property damage insurance for the operational components of Hollywood Casino Joliet with an overall limit of $228 million. The operational insurance policy included a $2.5 million property damage deductible and a 48-hour business interruption deductible for the peril of fire. We received $81.2 million in insurance proceeds related to the fire at Hollywood Casino Joliet, with $18.6 million received during the year ended December 31, 2011. As the insurance recovery amount exceeded the net book value of assets believed to be damaged, destroyed or abandoned and other costs incurred as a result of the fire at Hollywood Casino Joliet in 2010, we recorded a pre-tax gain of $18.5 million during the year ended December 31, 2011. During the second quarter of 2011, the insurance claim for the fire at Hollywood Casino Joliet was settled and no further proceeds will be received.

- On May 1, 2011, Hollywood Casino Tunica was forced to close as a result of flooding by the Mississippi River. Due to the flooding, access to the property was temporarily cut-off and the property sustained minor damage. The property reopened on May 25, 2011. At the time of the flood, we carried property insurance coverage with a flood limit of $300 million for both

property damage and business interruption applicable to this event. This coverage included a $5 million property damage and two day business interruption deductible for the peril of flood. During the year ended December 31, 2011, we recorded a $5.2 million pre-tax loss for the insurance deductibles for property damage and business interruption. The $1.1 million insurance receivable within the consolidated balance sheet at December 31, 2011 was limited to the net book value of assets believed to be damaged and other costs incurred as a result of the flood at Hollywood Casino Tunica that are expected to be recovered via an insurance claim that we expect to finalize in 2012. During the year ended December 31, 2011, we received $7.0 million in insurance proceeds related to the flood at Hollywood Casino Tunica.

- In July 2011, we entered into a new interim agreement with the OLGC for the operation of the Casino Rama facility through March 31, 2012, which was subsequently extended in January 2012 for an additional six months through September 30, 2012. The OLGC is currently in the process of evaluating bids on a new five year operating contract for the facility (with bids required to include operating fees that do not exceed $5 million per year).

**Critical Accounting Estimates**

We make certain judgments and use certain estimates and assumptions when applying accounting principles in the preparation of our consolidated financial statements. The nature of the estimates and assumptions are material due to the levels of subjectivity and judgment necessary to account for highly uncertain factors or the susceptibility of such factors to change. We have identified the accounting for long-lived assets, goodwill and other intangible assets, income taxes and litigation, claims and assessments as critical accounting estimates, as they are the most important to our financial statement presentation and require difficult, subjective and complex judgments.

We believe the current assumptions and other considerations used to estimate amounts reflected in our consolidated financial statements are appropriate. However, if actual experience differs from the assumptions and other considerations used in estimating amounts reflected in our consolidated financial statements, the resulting changes could have a material adverse effect on our consolidated results of operations and, in certain situations, could have a material adverse effect on our financial condition.

The development and selection of the critical accounting estimates, and the related disclosures, have been reviewed with the Audit Committee of our Board of Directors.

*Long-lived assets*

At December 31, 2011, we had a net property and equipment balance of $2,277.2 million within our consolidated balance sheet, representing 49.4% of total assets. We depreciate property and equipment on a straight-line basis over their estimated useful lives. The estimated useful lives are determined based on the nature of the assets as well as our current operating strategy. We review the carrying value of our property and equipment for possible impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable based on undiscounted estimated future cash flows expected to result from its use and eventual disposition. The factors considered by us in performing this assessment include current operating results, trends and prospects, as well as the effect of obsolescence, demand, competition and other economic factors. In estimating expected future cash flows for determining whether an asset is impaired, assets are grouped at the individual property level. In assessing the recoverability of the carrying value of property and equipment, we must make assumptions regarding future cash flows and other factors. If these estimates or the related assumptions change in the future, 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.

*Goodwill and other intangible assets*

At December 31, 2011, we had $1,180.4 million in goodwill and $421.6 million in other intangible assets within our consolidated balance sheet, representing 25.6% and 9.2% of total assets, respectively, resulting from our acquisition of other businesses and payment for gaming licenses and racing permits. Two issues arise with respect to these assets that require significant management estimates and judgment: (i) the valuation in connection with the initial purchase price allocation; and (ii) the ongoing evaluation for impairment.

In connection with our acquisitions, valuations are completed to determine the allocation of the purchase prices. The factors considered in the valuations include data gathered as a result of our due diligence in connection with the acquisitions, projections for future operations, and data obtained from third- party valuation specialists as deemed appropriate. Goodwill is tested annually, or more frequently if indicators of impairment exist, for impairment by comparing the fair value of the reporting units to their carrying amount. If the carrying amount of a reporting unit exceeds its fair value in step 1 of the impairment test, then step 2 of the impairment test is performed to determine the implied value of goodwill for that reporting unit. If the implied value of goodwill is less than the goodwill allocated for that reporting unit, an impairment loss is recognized.

In accordance with Financial Accounting Standards Board ("FASB") ASC 350, "Intangibles-Goodwill and Other," the Company considers its gaming licenses, racing permits and the majority of its trademark intangible assets as indefinite-life intangible assets that do not require amortization based on our future expectations to operate our gaming facilities indefinitely as well as our historical experience in renewing these intangible assets at minimal cost with various state gaming and racing commissions. Rather, these intangible assets are tested annually, or more frequently if indicators of impairment exist, for impairment by comparing the fair value of the recorded assets to their carrying amount. If the carrying amounts of the indefinite-life intangible assets exceed their fair value, an impairment loss is recognized.

The evaluation of goodwill and indefinite-life intangible assets requires the use of estimates about future operating results of each reporting unit to determine their estimated fair value. We use a market approach model, which includes the use of forecasted adjusted EBITDA (earnings before interest, taxes, charges for stock compensation, depreciation and amortization, gain or loss on disposal of assets, and certain other income and expenses, and inclusive of loss from unconsolidated affiliates) and adjusted EBITDA multiples, as we believe that adjusted EBITDA is a widely-used measure of performance in the gaming industry and as we use adjusted EBITDA as the primary measurement of the operating performance of our properties (including the evaluation of operating personnel). In addition, we believe that an adjusted EBITDA multiple is the principal basis for the valuation of gaming companies. Changes in the estimated adjusted EBITDA multiples or forecasted operations can materially affect these estimates.

Forecasted adjusted EBITDA levels (based on our annual operating plan as determined in the fourth quarter) can be significantly impacted by the local economy in which our reporting units operate. For example, increases in unemployment rates can result in decreased customer visitations and/or lower customer spend per visit. In addition, the impact of new legislation which approves gaming in nearby jurisdictions or further expands gaming in jurisdictions where our reporting units currently operate can result in opportunities for us to expand its operations. However, it also has the impact of increasing competition for our established properties which generally will have a negative effect on those locations' profitability once competitors become established as a certain level of cannibalization occurs absent an overall increase in customer visitations. Lastly, increases in gaming taxes approved by state regulatory bodies can negatively impact forecasted adjusted EBITDA.

The adjusted EBITDA multiple utilized by us in our goodwill impairment valuation methodology is determined based on our current enterprise value, increased for a control premium. The control

premium assumption is based on acquisitions of precedent transactions of comparable businesses. In evaluating the estimates derived by the market based approach, management assesses the relevance and reliability of the multiples by considering factors unique to its reporting units, including recent operating results, business plans, economic projections, anticipated future cash flows, and other market data. These considerations can lead the Company to modify its individual reporting units adjusted EBITDA multiple. EBITDA multiples can be significantly impacted by various factors, such as a company's present and future cost of capital, the future growth opportunities for the industry as well as for the company itself, general market sentiment, investors' perceptions of senior management's effectiveness at deploying capital and managing overall operations, as well as pending or recently completed merger transactions.

Assumptions and estimates about future adjusted EBITDA levels and multiples by individual reporting units are complex and subjective. They are sensitive to changes in underlying assumptions and can be affected by a variety of factors, including external factors, such as industry and economic trends, and internal factors, such as changes in our business strategy, which may reallocate capital and resources to different or new opportunities which management believes will enhance our overall value but may be to the detriment of an individual reporting unit.

As of the Company's most recent impairment analysis test performed on October 1, 2011, we applied an estimated adjusted EBITDA multiple ranging between 5.4 and 8.9 to the individual reporting unit's forecasted adjusted EBITDA.

For 2011, one reporting unit had a fair value in excess of its carrying value by 2%. All of our other reporting units with significant amounts of goodwill and other indefinite-life intangible assets had fair values that were significantly in excess of their carrying value. However, we do not believe that the margin by which our reporting units' fair value exceeds their carrying value is the only predictor of the likelihood of future impairment charges or the potential magnitude of such charges. This is because the revenue and earning streams in our industry can vary significantly based on various circumstances, which in many cases are outside of the Company's control, and as such are extremely difficult to predict and quantify. We have disclosed several of these circumstances in the "Risk Factors" section of this Annual Report on Form 10-K. For instance, changes in legislation that approves gaming in nearby jurisdictions (which was the primarily reason for our impairment charges recorded in 2010 and 2009), further expands gaming in jurisdictions where we currently operate, new state legislation that requires the implementation of smoking bans at our casinos or any other events outside of our control that make the customer experience less desirable can result in sudden, dramatic and in some cases permanent declines in customer visitations. As such, we believe at this time all of our reporting units are at risk of goodwill impairment charges in future periods regardless of the margin by which the current fair value of our reporting unit exceeds its carrying value and that such margin cannot and should not be relied upon to predict which properties are most at risk for future impairment charges.

During the year ended December 31, 2010, we recorded a pre-tax goodwill impairment charge of $144.6 million and $44.2 million for Hollywood Casino Aurora and Hollywood Casino Joliet, respectively, due to decreased earning projections at our properties in the Chicagoland regional market resulting from an anticipated increase in competition from the scheduled opening of a $445 million casino in the second half of 2011 in Des Plaines, Illinois, as well as continued challenging market conditions in the Chicagoland regional market. During the year ended December 31, 2009, we recorded pre-tax impairment charges of $520.5 million at Hollywood Casino Lawrenceburg due to the anticipated impact of gaming expansion in Ohio.

Once an impairment of goodwill or other indefinite-life intangible assets has been recorded, it cannot be reversed. Because our goodwill and indefinite-life intangible assets are not amortized, there may be volatility in reported income because impairment losses, if any, are likely to occur irregularly and in varying amounts. Intangible assets that have a definite-life are amortized on a straight-line basis over their estimated useful lives or related service contract. We review the carrying value of our

intangible assets that have a definite-life for possible impairment whenever events or changes in circumstances indicate that their carrying value may not be recoverable. If the carrying amount of the intangible assets that have a definite-life exceed their fair value, an impairment loss is recognized.

The Company's remaining goodwill and other intangible assets by reporting unit at December 31, 2011 is shown below (in thousands):

| Reporting Unit | Remaining Goodwill and other intangible assets at December 31, 2011 |
|---|---|
| Hollywood Casino Lawrenceburg | $ 362,491 |
| Hollywood Casino Joliet | 210,158 |
| Hollywood Casino Aurora | 207,207 |
| Argosy Casino Riverside | 159,296 |
| Zia Park Casino | 145,777 |
| Argosy Casino Alton | 135,511 |
| Argosy Casino Sioux City | 92,795 |
| Hollywood Casino Baton Rouge | 75,521 |
| Others | 213,196 |
| Total | $ 1,601,952 |

*Income taxes*

At December 31, 2011, we had a net deferred tax liability balance of $135.3 million within our consolidated balance sheet. We account for income taxes in accordance with ASC 740, "Income Taxes" ("ASC 740"). Under ASC 740, deferred tax assets and liabilities are determined based on the differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities and are measured at the prevailing enacted tax rates that will be in effect when these differences are settled or realized. ASC 740 also requires that deferred tax assets be reduced by a valuation allowance if it is more likely than not that some portion or all of the deferred tax assets will not be realized.

The realizability of the deferred tax assets is evaluated quarterly by assessing the valuation allowance and by adjusting the amount of the allowance, if necessary. The factors used to assess the likelihood of realization are the forecast of future taxable income and available tax planning strategies that could be implemented to realize the net deferred tax assets. We have used tax-planning strategies to realize or renew net deferred tax assets in order to avoid the potential loss of future tax benefits.

ASC 740 also creates a single model to address uncertainty in tax positions, and clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in an enterprise's financial statements. It also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. At December 31, 2011, we had a liability for unrecognized tax benefits of $33.9 million, which is included in noncurrent tax liabilities within our consolidated balance sheet. We operate within multiple taxing jurisdictions and are subject to audit in each jurisdiction. These audits can involve complex issues that may require an extended period of time to resolve. In our opinion, adequate provisions for income taxes have been made for all periods.

*Litigation, claims and assessments*

We utilize estimates for litigation, claims and assessments. These estimates are based on our knowledge and experience regarding current and past events, as well as assumptions about future events. If our assessment of such a matter should change, we may have to change the estimate, which may have an adverse effect on our results of operations. Actual results could differ from these estimates.

**Results of Operations**

The following are the most important factors and trends that contribute to our operating performance:

- The fact that most of our properties operate in mature competitive markets. As a result, we expect a majority of our future growth to come from prudent acquisitions of gaming properties, jurisdictional expansions (such as the September 2010 opening of Hollywood Casino Perryville in Maryland, the February 2012 opening of a casino through a joint venture in Kansas, and the anticipated 2012 openings in Ohio), expansions of gaming in existing jurisdictions (such as the introduction of table games in July 2010 at Hollywood Casino at Charles Town Races and Hollywood Casino at Penn National Race Course) and expansions/improvements of existing properties.

- The actions of government bodies can affect our operations in a variety of ways. For instance, the continued pressure on governments to balance their budgets could intensify the efforts of state and local governments to raise revenues through increases in gaming taxes. In addition, government bodies may restrict, prevent or negatively impact operations in the jurisdictions in which we do business (such as the implementation of smoking bans).

- The fact that a number of states are currently considering or implementing legislation to legalize or expand gaming. Such legislation presents both potential opportunities to establish new properties (for instance, in Kansas where we opened a casino through a joint venture in February 2012, in Ohio where we have plans to open two casinos, one in Toledo by the end of May 2012 and the other in Columbus on November 1, 2012, and in Maryland where we opened Hollywood Casino Perryville on September 27, 2010, the first casino in the state) and increased competitive threats to business at our existing properties (such as the introduction of commercial casinos in Kansas, Maryland, Ohio, and potentially Kentucky, an additional casino in Illinois which opened on July 18, 2011, gaming expansion in Baton Rouge, Louisiana, and the introduction of tavern licenses in several states).

- The continued demand for, and our emphasis on, slot wagering entertainment at our properties.

- The successful execution of the development and construction activities currently underway at a number of our facilities, as well as the risks associated with the costs, regulatory approval and the timing for these activities.

- The risks related to economic conditions and the effect of such conditions on consumer spending for leisure and gaming activities, which may negatively impact our operating results and our ability to access financing.

The results of operations for the years ended December 31, 2011, 2010 and 2009 are summarized below:

| Year Ended December 31, | 2011 | 2010 | 2009 |
|---|---|---|---|
| | | (in thousands) | |
| Revenues: | | | |
| Gaming | $ 2,468,630 | $ 2,242,515 | $ 2,158,028 |
| Food, beverage and other | 400,258 | 334,808 | 339,235 |
| Management service fee | 15,185 | 15,190 | 14,787 |
| Revenues | 2,884,073 | 2,592,513 | 2,512,050 |
| Less promotional allowances | (141,816) | (133,402) | (142,775) |
| Net revenues | 2,742,257 | 2,459,111 | 2,369,275 |
| Operating expenses: | | | |
| Gaming | 1,298,938 | 1,198,097 | 1,161,510 |
| Food, beverage and other | 321,801 | 266,800 | 266,351 |
| General and administrative | 423,718 | 411,415 | 403,136 |
| Depreciation and amortization | 211,476 | 212,387 | 194,436 |
| Impairment losses | — | 224,709 | 532,377 |
| Insurance recoveries, net of deductible charges | (13,257) | (7,523) | 6,063 |
| Total operating expenses | 2,242,676 | 2,305,885 | 2,563,873 |
| Income (loss) from operations | $ 499,581 | $ 153,226 | $ (194,598) |

Certain information regarding our results of operations by segment for the years ended December 31, 2011, 2010 and 2009 is summarized below:

| Year Ended December 31, | Net Revenues | | | Income (loss) from Operations | | |
|---|---|---|---|---|---|---|
| | 2011 | 2010 | 2009 | 2011 | 2010 | 2009 |
| | | | (in thousands) | | | |
| East/West | $ 1,290,732 | $ 997,262 | $ 896,941 | $ 263,423 | $ 181,175 | $ 137,418 |
| Midwest | 826,436 | 825,847 | 806,866 | 211,356 | (39,514) | (346,260) |
| Southern Plains | 590,709 | 602,257 | 632,543 | 137,580 | 125,318 | 136,164 |
| Other | 34,380 | 33,745 | 32,925 | (112,778) | (113,753) | (121,920) |
| **Total** | $ 2,742,257 | $ 2,459,111 | $ 2,369,275 | $ 499,581 | $ 153,226 | $ (194,598) |

**Revenues**

Revenues for the years ended December 31, 2011, 2010 and 2009 are as follows (in thousands):

| Year ended December 31, | 2011 | 2010 | Variance | Percentage Variance |
|---|---|---|---|---|
| Gaming | $ 2,468,630 | $ 2,242,515 | $ 226,115 | 10.1% |
| Food, beverage and other | 400,258 | 334,808 | 65,450 | 19.5% |
| Management service fee | 15,185 | 15,190 | (5) | (0.0)% |
| Revenues | 2,884,073 | 2,592,513 | 291,560 | 11.2% |
| Less promotional allowances | (141,816) | (133,402) | (8,414) | (6.3)% |
| Net revenues | $ 2,742,257 | $ 2,459,111 | $ 283,146 | 11.5% |

| Year ended December 31, | 2010 | 2009 | Variance | Percentage Variance |
|---|---|---|---|---|
| Gaming | $ 2,242,515 | $ 2,158,028 | $ 84,487 | 3.9% |
| Food, beverage and other | 334,808 | 339,235 | (4,427) | (1.3)% |
| Management service fee | 15,190 | 14,787 | 403 | 2.7% |
| Revenues | 2,592,513 | 2,512,050 | 80,463 | 3.2% |
| Less promotional allowances | (133,402) | (142,775) | 9,373 | 6.6% |
| Net revenues | $ 2,459,111 | $ 2,369,275 | $ 89,836 | 3.8% |

In our business, revenue is driven by discretionary consumer spending, which has been impacted by weakened general economic conditions such as, but not limited to, high unemployment levels, low levels of consumer confidence, weakness in the housing market and increased stock market volatility.

We have no certain mechanism for determining why consumers choose to spend more or less money at our properties from period to period and as such cannot quantify a dollar amount for each factor that impacts our customers' spending behaviors. However, based on our experience, we can generally offer some insight into the factors that we believe were likely to account for such changes. In instances where we believe one factor may have had a significantly greater impact than the other factors, we have noted that as well. However, in all instances, such insights are based only on our reasonable judgment and professional experience, and no assurance can be given as to the accuracy of our judgments.

**Gaming revenue**

*2011 Compared with 2010*

Gaming revenue increased by $226.1 million, or 10.1%, to $2,468.6 million in 2011, primarily due to the variances explained below.

Gaming revenue for our East/West segment increased by $247.0 million in 2011, primarily due to the opening of Hollywood Casino Perryville on September 27, 2010 and the acquisition of the M Resort on June 1, 2011. In addition, gaming revenue also increased for our East/West segment due to the introduction of table games in July 2010 at Hollywood Casino at Charles Town and Hollywood Casino at Penn National Race Course partially offset by a reduction in slot machine revenue due to lower levels of electronic table game revenues and general economic conditions.

Gaming revenue for our Southern Plains segment decreased by $10.7 million in 2011, primarily due to closure of Hollywood Casino Tunica from May 1, 2011 to May 25, 2011 due to flooding.

Gaming revenue for Other decreased by $6.4 million in 2011, primarily due to decreased gaming revenue at Bullwhackers due to the continued impact of recent competition.

Gaming revenue for our Midwest segment decreased by $3.8 million in 2011, primarily due to lower gaming revenue at Hollywood Casino Aurora primarily due to increased competition with the opening of the tenth licensed casino in Illinois on July 18, 2011.

*2010 Compared with 2009*

Gaming revenue increased by $84.5 million, or 3.9%, to $2,242.5 million in 2010, primarily due to the variances explained below.

Gaming revenue for our East/West segment increased by $100.8 million in 2010, primarily due to increased gaming revenue at Hollywood Casino at Charles Town Races primarily due to the introduction of table games in July 2010 partially offset by lower attendance and spending levels in the first half of 2010 compared to the corresponding period in the prior year due to then-current economic

conditions and inclement weather in early 2010, increased gaming revenue at Hollywood Casino at Penn National Race Course primarily due to introduction of table games in July 2010 and the continued growth from a new gaming market, and the opening of Hollywood Casino Perryville on September 27, 2010.

Gaming revenue for our Midwest segment increased by $15.3 million in 2010, primarily due to increased gaming revenue at Hollywood Casino Joliet as this property was closed from March 20, 2009 until June 25, 2009 due to a fire. Our Midwest segment also experienced increased gaming revenue at Hollywood Casino Lawrenceburg primarily due to the continued impact of the opening of its new casino riverboat in late June 2009, which enabled this property to gain an increased share of its local gaming market. These were partially offset by decreased gaming revenue at Hollywood Casino Aurora primarily due to then-current economic conditions. In addition, the decline at Hollywood Casino Aurora was also impacted by increased patronage in the second quarter of 2009 as a result of the fire at Hollywood Casino Joliet.

Gaming revenue for our Southern Plains segment decreased by $29.4 million in 2010, primarily due to then-current economic conditions at the majority of our properties within this segment.

**Food, beverage and other revenue**

*2011 Compared with 2010*

Food, beverage and other revenue increased by $65.5 million, or 19.5%, to $400.3 million in 2011, primarily due to the variances explained below.

Food, beverage and other revenue for our East/West segment increased by $66.2 million in 2011, primarily due to the acquisition of the M Resort on June 1, 2011, and increased food, beverage and other revenue at Hollywood Casino at Charles Town Races primarily due to additional attendance levels as a result of the introduction of table games in July 2010.

Food, beverage and other revenue for Other increased by $6.2 million in 2011, primarily due to the acquisition of Beulah Park in July 2010.

Food, beverage and other revenue for our Southern Plains segment decreased by $10.7 million in 2011, primarily due to closure of Hollywood Casino Tunica from May 1, 2011 to May 25, 2011 due to flooding and, to a lesser extent, management's efforts to decrease promotional spending levels to improve margins and profitability.

*2010 Compared with 2009*

Food, beverage and other revenue decreased by $4.4 million, or 1.3%, to $334.8 million in 2010, primarily due to the variances explained below.

Food, beverage and other revenue for our Southern Plains segment decreased by $9.4 million in 2010, primarily due to decreased food, beverage and other revenue at Hollywood Casino Tunica primarily due to then-current economic conditions and to a lesser extent a decrease in promotional offers.

Food, beverage and other revenue for Other increased by $2.9 million in 2010, primarily due to the acquisition of Beulah Park in July 2010.

**Promotional allowances**

*2011 Compared with 2010*

Promotional allowances increased by $8.4 million, or 6.3%, to $141.8 million in 2011, primarily due to the variances explained below.

Promotional allowances for our East/West segment increased by $19.8 million in 2011, primarily due to the acquisition of the M Resort on June 1, 2011, and an increase in promotional allowances at Hollywood Casino at Charles Town Races primarily due to the introduction of table games in July 2010.

Promotional allowances for our Southern Plains segment decreased by $9.8 million in 2011, primarily due to closure of Hollywood Casino Tunica from May 1, 2011 to May 25, 2011 due to flooding and, to a lesser extent, efforts by management to rationalize our promotional spending levels to improve operating margins.

*2010 Compared with 2009*

Promotional allowances decreased by $9.4 million, or 6.6%, to $133.4 million in 2010, primarily due to efforts by management to rationalize our promotional spending levels.

**Operating Expenses**

Operating expenses for the years ended December 31, 2011, 2010 and 2009 are as follows (in thousands):

| Year ended December 31, | 2011 | 2010 | Variance | Percentage Variance |
|---|---|---|---|---|
| Gaming | $ 1,298,938 | $ 1,198,097 | $ 100,841 | 8.4% |
| Food, beverage and other | 321,801 | 266,800 | 55,001 | 20.6% |
| General and administrative | 423,718 | 411,415 | 12,303 | 3.0% |
| Depreciation and amortization | 211,476 | 212,387 | (911) | (0.4)% |
| Impairment losses | — | 224,709 | (224,709) | (100.0)% |
| Insurance recoveries, net of deductible charges | (13,257) | (7,523) | (5,734) | (76.2)% |
| Total operating expenses | $ 2,242,676 | $ 2,305,885 | $ (63,209) | (2.7)% |

| Year ended December 31, | 2010 | 2009 | Variance | Percentage Variance |
|---|---|---|---|---|
| Gaming | $ 1,198,097 | $ 1,161,510 | $ 36,587 | 3.1% |
| Food, beverage and other | 266,800 | 266,351 | 449 | 0.2% |
| General and administrative | 411,415 | 403,136 | 8,279 | 2.1% |
| Depreciation and amortization | 212,387 | 194,436 | 17,951 | 9.2% |
| Impairment losses | 224,709 | 532,377 | (307,668) | (57.8)% |
| Insurance recoveries, net of deductible charges | (7,523) | 6,063 | (13,586) | (224.1)% |
| Total operating expenses | $ 2,305,885 | $ 2,563,873 | $ (257,988) | (10.1)% |

**Gaming expense**

*2011 Compared with 2010*

Gaming expense increased by $100.8 million, or 8.4%, to $1,298.9 million in 2011, primarily due to the variances explained below.

Gaming expense for our East/West segment increased by $126.5 million in 2011, primarily due to the opening of Hollywood Casino Perryville on September 27, 2010, the acquisition of the M Resort on June 1, 2011, and an increase in gaming expense at Hollywood Casino at Charles Town Races which was primarily due to increased payroll expense and gaming taxes resulting from higher table game revenue due to the introduction of table games in July 2010.

Gaming expense for our Midwest segment decreased by $13.1 million in 2011, primarily due to a decline in gaming taxes at Hollywood Casino Aurora resulting from lower taxable gaming revenue mentioned above and the expiration of the 3% surcharge in July 2011 for both our Hollywood Casino Aurora and Hollywood Casino Joliet properties. Gaming expense for our Midwest segment also decreased due to lower marketing costs and payroll expense primarily due to increased cost management efforts.

Gaming expense for our Southern Plains segment decreased by $7.9 million in 2011, primarily due to closure of Hollywood Casino Tunica from May 1, 2011 to May 25, 2011 due to flooding.

Gaming expense for Other decreased by $4.7 million in 2011, primarily due to our fourth quarter 2010 restructuring efforts at Bullwhackers to reduce costs to improve the property's profitability.

*2010 Compared with 2009*

Gaming expense increased by $36.6 million, or 3.1%, to $1,198.1 million in 2010, primarily due to the variances explained below.

Gaming expense for our East/West segment increased by $46.8 million in 2010, primarily due to the opening of Hollywood Casino Perryville on September 27, 2010, higher gaming expense at Hollywood Casino at Charles Town Races primarily due to an increase in gaming taxes and payroll and benefit costs from the introduction of table games in July 2010, which were partially offset by a decrease in gaming taxes resulting from lower slot revenue. Our East/West segment also experienced higher gaming taxes and payroll and benefit costs at Hollywood Casino at Penn National Race Course from the introduction of table games in July 2010, which was partially offset by a decrease in regulatory fees and marketing costs.

Gaming expense for our Midwest segment increased by $6.3 million in 2010, primarily due to Hollywood Casino Joliet being closed from March 20, 2009 until June 25, 2009 due to a fire, and increased gaming expense at Hollywood Casino Lawrenceburg primarily due to higher gaming taxes from increased gaming revenues as well as higher marketing expenses during the first half of the year compared to the corresponding period in the prior year, which were partially offset by decreased payroll costs. The increases at these two properties were partially offset by decreased gaming expense at Hollywood Casino Aurora primarily due to a reduction in gaming taxes resulting from lower gaming revenue as well as lower payroll and benefit costs, which were partially offset by increased marketing expenses.

Gaming expense for our Southern Plains segment decreased by $16.2 million in 2010, primarily due to a reduction in gaming taxes resulting from lower gaming revenue, as well as decreased marketing expenses, participation fees, and payroll and benefit costs at the majority of our properties within this segment.

**Food, beverage and other expense**

*2011 Compared to 2010*

Food, beverage and other expense increased by $55.0 million, or 20.6%, to $321.8 million in 2011, primarily due to the acquisition of the M Resort on June 1, 2011.

*2010 Compared to 2009*

No significant variances were noted during this time period.

**General and administrative expense**

General and administrative expenses include expenses such as compliance, facility maintenance, utilities, property and liability insurance, surveillance and security, and certain housekeeping services, as well as all expenses for administrative departments such as accounting, purchasing, human resources, legal and internal audit. General and administrative expenses also include lobbying expenses.

*2011 Compared with 2010*

General and administrative expenses increased by $12.3 million, or 3.0%, to $423.7 million in 2011, primarily due to the variances explained below.

General and administrative expenses for our East/West segment increased by $26.9 million in 2011, primarily due to the acquisition of the M Resort on June 1, 2011, increased general and administrative expenses at Hollywood Casino at Charles Town Races primarily due to increased staffing needs to meet higher customer demand, and the opening of Hollywood Casino Perryville on September 27, 2010.

General and administrative expenses for our Southern Plains segment decreased by $11.8 million in 2011, primarily due to increased cost management efforts to mitigate lower levels of gaming revenue.

General and administrative expenses for our Midwest segment decreased by $8.5 million in 2011, primarily due to a decrease in general and administrative expenses at Hollywood Casino Aurora primarily due to a police services contract termination charge of $6.6 million in the second quarter of 2010.

General and administrative expenses for Other increased by $5.7 million in 2011, primarily due to increased corporate payroll and benefit costs to support the Company's growing operations.

*2010 Compared with 2009*

General and administrative expense increased by $8.3 million, or 2.1%, to $411.4 million in 2010, primarily due to the variances explained below.

General and administrative expenses for our Midwest segment increased by $12.7 million in 2010, primarily due to the police services contract termination at Hollywood Casino Aurora in the second quarter of 2010 for $6.6 million, and Hollywood Casino Joliet being closed from March 20, 2009 until June 25, 2009 due to fire.

General and administrative expenses for our East/West segment increased by $10.9 million in 2010, primarily due to higher general and administrative expense at Hollywood Casino at Charles Town Races primarily due to higher bonus expense in 2010 due to improved financial performance at this property compared to the prior year as well as increased utilities and relocation expense primarily due to the introduction of table games in July 2010, and the opening of Hollywood Casino Perryville on September 27, 2010.

General and administrative expenses for Other decreased by $14.3 million in 2010, primarily due to decreased corporate overhead expense primarily due to decreased lobbying expenses and decreased equity-based compensation, which were partially offset by higher payroll costs. Additionally, Other included lease termination charges and severance costs of $3.0 million at Bullwhackers for the year ended December 31, 2010.

**Depreciation and amortization expense**

*2011 Compared to 2010*

Depreciation and amortization expense decreased by $0.9 million, or 0.4%, to $211.5 million in 2011, primarily due to the variances explained below.

Depreciation and amortization expense for our Southern Plains segment decreased by $6.0 million in 2011, primarily due to decreased depreciation and amortization expense at Boomtown Biloxi and Hollywood Casino Bay St. Louis primarily related to replacement assets that were purchased after Hurricane Katrina now being fully depreciated in the third quarter of 2011, as well as decreased depreciation and amortization expense at Hollywood Casino Baton Rouge.

Depreciation and amortization expense for our Midwest segment decreased by $1.6 million in 2011, primarily due to customer relationship intangible assets being fully amortized at the end of the third quarter in 2010 at Hollywood Casino Lawrenceburg.

Depreciation and amortization expense for our East/West segment increased by $6.5 million in 2011, primarily due to the opening of Hollywood Casino Perryville on September 27, 2010 and the acquisition of the M Resort on June 1, 2011.

*2010 Compared to 2009*

Depreciation and amortization expense increased by $18.0 million, or 9.2%, to $212.4 million in 2010, primarily due to the opening of the new casino riverboat in late June 2009 at Hollywood Casino Lawrenceburg, and an increase in expense at Hollywood Casino Joliet as the property was closed from March 20, 2009 until June 25, 2009 due to a fire.

**Impairment losses**

*2011*

There were no impairment losses during the year ended December 31, 2011.

*2010*

As a result of decreased earning projections resulting from an anticipated increase in competition from the scheduled opening of a casino in the second half of 2011 in Des Plaines, Illinois, as well as continued challenging market conditions in the Chicagoland regional market, we recorded a pre-tax goodwill impairment charge in our Midwest segment of $144.6 million ($144.6 million, net of taxes) at Hollywood Casino Aurora and $44.2 million ($28.4 million, net of taxes) at Hollywood Casino Joliet during the year ended December 31, 2010. Additionally, during the year ended December 31, 2010, we wrote-off the trademark intangible asset associated with the Argosy acquisition for $4.4 million ($2.8 million, net of taxes) due to management's strategy to transition Argosy properties to the Hollywood Casino brand.

We also recorded a pre-tax impairment charge in our Midwest segment of $31.3 million ($20.1 million, net of taxes) associated with land that we had purchased in the Arena District for our Columbus, Ohio casino. Due to a May 2010 statewide election, the voters determined that our casino in Columbus will be located at the site of the former Delphi Automotive plant along Columbus's West Side and as such we reclassified our land in the Arena District as held for sale.

*2009*

As a result of the anticipated impact of gaming expansion in Ohio, we recorded a pre-tax impairment charge in our Midwest segment of $520.5 million ($368.8 million, net of taxes) during the year ended December 31, 2009, as we determined that a portion of the value of our goodwill and indefinite-life intangible assets associated with the original purchase of Hollywood Casino Lawrenceburg was impaired. In addition, in conjunction with the opening of the new casino riverboat at Hollywood Casino Lawrenceburg, we recorded a pre-tax impairment charge in our Midwest segment for the replaced Lawrenceburg vessel of $11.9 million ($7.1 million, net of taxes) during the year ended December 31, 2009.

**Insurance recoveries, net of deductible charges**

Insurance recoveries, net of deductible charges were $13.3 million during the year ended December 31, 2011 primarily related to a pre-tax insurance gain of $18.5 million in our Midwest segment for the fire at Hollywood Casino Joliet for the year ended December 31, 2011, which was partially offset by a pre-tax insurance loss in our Southern Plains segment of $5.2 million for the flood at Hollywood Casino Tunica for the year ended December 31, 2011.

In 2010, the insurance recovery amount exceeded the net book value of assets believed to be damaged, destroyed or abandoned and other costs incurred as a result of the fire at Hollywood Casino Joliet, and as such, we recorded a pre-tax gain of $7.5 million during the year ended December 31, 2010.

During the year ended December 31, 2009, we recorded a $6.1 million pre-tax loss in our Midwest segment as a result of the Hollywood Casino Joliet fire for the insurance deductibles for property damage, business interruption and employee lost wages, as well as a write-off of construction fees related to the renovation that are not recoverable under our insurance policies and certain consulting fees.

**Other income (expenses)**

Other income (expenses) for the years ended December 31, 2011, 2010 and 2009 are as follows (in thousands):

| Year ended December 31, | 2011 | 2010 | Variance | Percentage Variance |
|---|---|---|---|---|
| Interest expense | $ (99,564) | $ (130,215) | $ 30,651 | 23.5% |
| Interest income | 423 | 1,579 | (1,156) | (73.2)% |
| Gain (loss) from unconsolidated affiliates | 7,364 | (25,974) | 33,338 | 128.4% |
| Loss on early extinguishment of debt | (17,838) | (519) | (17,319) | (3337.0)% |
| Other | (734) | 6,421 | (7,155) | (111.4)% |
| Total other expenses | $ (110,349) | $ (148,708) | $ 38,359 | 25.8% |

| Year ended December 31, | 2010 | 2009 | Variance | Percentage Variance |
|---|---|---|---|---|
| Interest expense | $ (130,215) | $ (134,984) | $ 4,769 | 3.5% |
| Interest income | 1,579 | 6,522 | (4,943) | (75.8)% |
| Loss from unconsolidated affiliates | (25,974) | (1,121) | (24,853) | (2217.0)% |
| Loss on early extinguishment of debt | (519) | (4,793) | 4,274 | 89.2% |
| Other | 6,421 | 1,093 | 5,328 | 487.5% |
| Total other expenses | $ (148,708) | $ (133,283) | $ (15,425) | (11.6)% |

**Interest expense**

Interest expense decreased by $30.7 million, or 23.5%, to $99.6 million in 2011, primarily due to a $24.5 million decline in swap interest expense due to the expiration of certain receive-variable pay-fixed interest rate hedges which increased interest expense in the prior year due to the effective interest rate of the swaps being in excess of market rates due to the low interest rate environment. Additionally, in July 2011, we entered into a new senior secured credit facility and retired our $250 million 6¾% senior subordinated notes which lowered our overall funding costs compared to the prior year.

Interest expense decreased by $4.8 million, or 3.5%, to $130.2 million in 2010, primarily due to lower outstanding balances and lower interest rates on our senior secured credit facility, the

redemption of our $200 million 6⅞% senior subordinated notes in late 2009, and decreased interest expense resulting from our interest rate swaps, all of which were partially offset by the issuance of the $325 million 8¾% senior subordinated notes in August 2009 and lower capitalized interest during the year ended December 31, 2010.

**Interest income**

Interest income decreased by $1.2 million, or 73.2%, to $0.4 million in 2011, primarily due to the issuer of our remaining corporate debt security going into default and ceasing to make interest payments in mid 2010. See Note 10 to the consolidated financial statements for further details.

Interest income decreased by $4.9 million, or 75.8%, to $1.6 million in 2010, primarily due to lower interest on our corporate debt securities due to the sale of a security in the second quarter of 2009 and the issuer of the remaining security ceasing to make interest payments in mid 2010, and lower interest earned on cash on hand during the year ended December 31, 2010.

**Gain (loss) from unconsolidated affiliates**

We recorded a gain from unconsolidated affiliates of $7.4 million for the year ended December 31, 2011, primarily due to a gain of $20.2 million on the sale of our interest in the Maryland Jockey Club in July 2011, which was partially offset by a charge of $5.9 million for our share of a goodwill impairment write-down recorded at our New Jersey joint venture during the fourth quarter of 2011, and our share of Kansas Entertainment net losses for the year ended December 31, 2011 prior to the opening of the casino in February 2012.

Loss from unconsolidated affiliates increased by $24.9 million, or 2217.0%, to $26.0 million in 2010, primarily due to our share of losses in the Maryland Jockey Club, which included a $14.4 million charge for our share of a goodwill impairment write-down recorded by the Maryland Jockey Club during the fourth quarter of 2010 as a result of a negative outcome related to a zoning referendum.

**Loss on early extinguishment of debt**

During the year ended December 31, 2011, we recorded a $17.8 million loss on the early extinguishment of debt related to debt issuance costs write-offs for the 2011 refinancing of our senior secured credit facility and the call premium on the $250 million 6¾% senior subordinated notes.

During the year ended December 31, 2009, we wrote-off $4.8 million of debt issuance costs, as a result of the repayment of all outstanding borrowings under the Term Loan A Facility of the previous senior secured credit facility and the redemption of our $200 million 6⅞% senior subordinated notes due 2011.

**Other**

Other decreased by $7.2 million, or 111.4%, to ($0.7) million in 2011, primarily due to the reversal of previously accrued reserves associated with the Capitol House litigation that ended in the third quarter of 2010 for $9.6 million.

Other increased by $5.3 million, or 487.5%, to $6.4 million in 2010, primarily due to the reversal of previously accrued reserves associated with the Capitol House litigation for $9.6 million and foreign currency translation gains that were recorded during the year ended December 31, 2010, both of which were partially offset by a gain of $6.6 million related to the partial sale of corporate debt securities in the second quarter of 2009.

**Taxes**

Our effective tax rate (income taxes as a percentage of income from operations before income taxes) decreased to 37.7% for the year ended December 31, 2011, as compared to 1,464.8% for the year ended December 31, 2010. Our 2010 effective rate was impacted by the non-deductible portion of our goodwill impairment charges recorded for the year ended December 31, 2010. Our 2011 rate was impacted by the reversal of previously recorded unrecognized tax benefit reserves for years that either the statue of limitations has lapsed in 2011 or that have been favorably settled, coupled with favorable state income tax benefits received from the impact of certain subsidiary restructurings completed in 2011.

Our effective tax rate increased to 1,464.8% for the year ended December 31, 2010, as compared to a tax benefit of 18.4% for the year ended December 31, 2009, primarily as a result of the non-deductible portion of our goodwill impairment charges.

Our effective income tax rate can vary from period to period depending on, among other factors, the geographic and business mix of our earnings and the level of our tax credits. Certain of these and other factors, including our history and projections of pre-tax earnings, are taken into account in assessing our ability to realize our net deferred tax assets.

**Liquidity and Capital Resources**

Historically, our primary sources of liquidity and capital resources have been cash flow from operations, borrowings from banks and proceeds from the issuance of debt and equity securities.

Net cash provided by operating activities was $567.4 million, $493.2 million and $338.2 million for the years ended December 31, 2011, 2010 and 2009, respectively. The increase in net cash provided by operating activities of $74.2 million for the year ended December 31, 2011 compared to the corresponding period in the prior year is comprised primarily of an increase in cash receipts from customers of $281.3 million and a decrease in interest payments of $23.1 million, which were partially offset by an increase in cash paid to suppliers and vendors of $189.9 million, in income tax payments of $18.6 million and cash paid to employees of $51.6 million. The increase in cash receipts collected from our customers for the year ended December 31, 2011 compared to the prior year was primarily due to the previously discussed property openings, expansions and acquisitions in our East/West segment. Additionally, the increase in higher cash payments for operating expenses for the year ended December 31, 2011 compared to the prior year was primarily due to increased expenses from the recent events at our East/West segment as well as less insurance proceeds received in 2011 for the fire at Hollywood Casino Joliet, which were partially offset by expense management initiatives at the majority of our properties within our operating segments to help mitigate the impact of the difficult operating environment.

Net cash used in investing activities totaled $338.8 million, $736.8 million and $262.7 million for the years ended December 31, 2011, 2010 and 2009, respectively. Net cash used in investing activities for the year ended December 31, 2011 included expenditures for property and equipment totaling $293.1 million and investment in joint ventures, net of proceeds received from the sale of our interest in the Maryland Jockey Club, of $100.4 million, both of which were partially offset by a decrease in cash in escrow of $29.0 million, proceeds from the sale of property and equipment totaling $13.0 million, cash acquired, net of acquisitions of businesses and gaming licenses, of $8.9 million, and insurance proceeds related to damaged property and equipment for the Tunica flood of $3.8 million. The decrease in net cash used in investing activities of $398.0 million for the year ended December 31, 2011 compared to the prior year was primarily due to decreased expenditures for property and equipment as a result of decreased expenditures for Hollywood Casino Perryville which opened in September 2010, for Hollywood Casino Joliet as the permanent land-based pavilion opened in December 2010, and for Hollywood Casino Lawrenceburg due to certain 2010 improvements, all of

which were partially offset by increased expenditures at our two facilities under construction in Ohio. Also contributing to the variance was the purchase of outstanding loans of the M Resort for $230.5 million in 2010, cash proceeds received for the sales of our interest in the Maryland Jockey Club and land in Columbus's Arena District in 2011, and the acquisition of Beulah Park in 2010.

Net cash used in financing activities totaled $236.5 million, $223.2 million and $108.8 million for the years ended December 31, 2011, 2010 and 2009, respectively. Net cash used in financing activities for the year ended December 31, 2011 was impacted by the issuance of our new $2.15 billion senior secured credit facility and the redemption of our $250 million 6¾% senior subordinated notes. We utilized the proceeds of this issuance along with cash on hand to retire our previous senior secured credit facility and $250 million 6¾% senior subordinated notes. See Note 11 to the consolidated financial statements for further details. The increase in net cash used in financing activities for the year ended December 31, 2011 compared to the corresponding period in the prior year was also primarily due to increased repurchases of common stock for $69.3 million for the year ended December 31, 2011 compared to the corresponding period in the prior year, offset by the repurchase of preferred stock and noncontrolling interest for $11.2 million and $25.0 million, respectively, during the year ended December 31, 2010.

**Capital Expenditures**

Capital expenditures are accounted for as either capital project or capital maintenance (replacement) expenditures. Capital project expenditures are for fixed asset additions that expand an existing facility or create a new facility. Capital maintenance expenditures are expenditures to replace existing fixed assets with a useful life greater than one year that are obsolete, worn out or no longer cost effective to repair.

The following table summarizes our capital project expenditures by segment for the year ended December 31, 2011:

| | Actual(1) (in millions) |
|---|---|
| Midwest (2) | $ 187.4 |
| East/West | 22.2 |
| Southern Plains | 2.1 |
| Other | 4.4 |
| Total | $ 216.1 |

(1) Excludes licensing fees and is net of reimbursements.

(2) Capital expenditures for our Midwest segment include $131.0 million and $43.7 million for the construction of Hollywood Casino Toledo and Hollywood Casino Columbus, respectively.

In November 2009, the "Ohio Jobs and Growth Plan," a casino ballot proposal calling for an amendment to Ohio's Constitution to authorize casinos in the state's four largest cities, Cincinnati, Cleveland, Columbus and Toledo, was approved. Construction is underway for Hollywood Casino Toledo, a $320 million Hollywood-themed casino in Toledo, Ohio, inclusive of $50 million in licensing fees, with a planned casino opening of 2,000 slot machines, 60 table games and 20 poker tables, structured and surface parking, as well as food and beverage outlets and an entertainment lounge. The Hollywood Casino Columbus project, a $400 million Hollywood-themed casino in Columbus, Ohio, inclusive of $50 million in licensing fees, is under construction, with a planned casino opening of up to 3,000 slot machines, 70 table games and 30 poker tables, structured and surface parking, as well as food and beverage outlets and an entertainment lounge. We expect the opening of Hollywood Casino Toledo by the end of May 2012 and Hollywood Casino Columbus on November 1, 2012.

During the year ended December 31, 2011, we spent approximately $77.0 million for capital maintenance expenditures, with $18.7 million at our Midwest segment, $29.5 million at our East/West segment, $23.4 million at our Southern Plains segment, and $5.4 million for Other. The majority of the capital maintenance expenditures were for slot machines and slot machine equipment.

Cash generated from operations and cash available under the revolver portion of our senior secured credit facility have funded our capital project and capital maintenance expenditures in 2011.

The following table summarizes our expected capital project expenditures for the year ending December 31, 2012, as well as the projects in their entirety (including licensing fees), by segment:

| | Total for 2012 | Project Total |
|---|---|---|
| | (in millions) | |
| Midwest(1) | $ 449.8 | $ 722.9 |
| East/West | 1.5 | 2.7 |
| Southern Plains | 0.5 | 0.5 |
| Other | 0.6 | 1.8 |
| Total | $ 452.4 | $ 727.9 |

(1) Expected capital expenditures for our Midwest segment include $163.7 million and $284.9 million for the construction of Hollywood Casino Toledo and Hollywood Casino Columbus, respectively.

The table above excludes our share of the anticipated commitments related to our joint venture with International Speedway to develop a casino at Kansas Speedwa since these amounts will be recorded within investments in and advances to unconsolidated affiliates on our consolidated balance sheet.

**Debt**

*Senior Secured Credit Facility*

On July 14, 2011, we entered into a new $2.15 billion senior secured credit facility, which is comprised of a $700 million revolving credit facility that will mature in July 2016, a $700 million variable rate Term Loan A due in July 2016 and a $750 million variable rate Term Loan B due in July 2018. The interest rates payable on the facilities are based on the leverage ratios of the Company as defined in the debt agreements, however, based on current borrowing levels, we will pay LIBOR plus 150 basis points on the revolver and Term Loan A and LIBOR plus 275 basis points on Term Loan B (subject to a 1% LIBOR floor). We utilized the proceeds of the two term loan borrowings and cash on hand to retire our previous senior secured credit facility obligation of $1,518.1 million (which had significant principal repayments due at the end of 2011 and 2012) and pay transaction costs and accrued interest and fees on the retired debt. As a result of this refinancing, we incurred debt extinguishment charges of $10.2 million during the year ended December 31, 2011.

Our senior secured credit facility had a gross outstanding balance of $1,715.8 million at December 31, 2011, consisting of $287.0 million drawn under the revolving credit facility, a $682.5 million Term Loan A facility, and a $746.3 million Term Loan B facility. Additionally, at December 31, 2011, we were contingently obligated under letters of credit issued pursuant to the $2.15 billion senior secured credit facility with face amounts aggregating $24.9 million, resulting in $388.1 million of available borrowing capacity as of December 31, 2011 under the revolving credit facility.

*6¾% Senior Subordinated Notes*

In July 2011, we announced our intention to redeem all of our $250 million 6¾% senior subordinated notes. The redemption price was $1,022.50 per $1,000 principal amount, plus accrued and unpaid interest, which was paid in August 2011. We funded the redemption of our $250 million senior subordinated notes from our new revolving credit facility and available cash. We recorded a $7.6 million loss on early extinguishment of debt during the year ended December 31, 2011 related to debt issuance costs write-offs and the call premium on the $250 million senior subordinated notes.

*8¾% Senior Subordinated Notes*

In August 2009, we completed an offering of $325 million 8¾% senior subordinated notes that mature on August 15, 2019. Interest on the $325 million 8¾% senior subordinated notes is payable on February 15 and August 15 of each year. The $325 million 8¾% senior subordinated notes are general unsecured obligations and are not guaranteed by our subsidiaries and were issued in a private placement pursuant to an exemption from the registration requirements of the Securities Act of 1933, as amended. At any time prior to August 15, 2014, we may redeem all or part of the 8¾% senior subordinated notes at par plus the present value (discounted at the treasury rate plus 50 basis points) of scheduled interest payments through August 15, 2014, along with accrued and unpaid interest, if any, at the date of redemption. On or after August 15, 2014, we may redeem all or part of the 8¾% senior subordinated notes at a redemption price of 104.375% which gradually reduces to par by 2017.

*Other Long-Term Obligations*

In April 2010, we entered into a termination contract with the city of Aurora, Illinois, whereby we will pay $7 million in lieu of perpetual annual payments (of approximately $1 million) to have off duty Aurora police officials provide security at Hollywood Casino Aurora each day. Payments of $1.5 million were made on June 1, 2010 and September 1, 2010 and a payment of $2.0 million was made on June 1, 2011. A final payment of $2.0 million is due on June 1, 2012. This liability was discounted using an estimate of our incremental borrowing rate over the term of the obligation. The accretion of this discount is recorded in interest expense in the consolidated statements of operations.

*Covenants*

Our senior secured credit facility and $325 million 8¾% senior subordinated notes require us, among other obligations, to maintain specified financial ratios and to satisfy certain financial tests, including fixed charge coverage, interest coverage, senior leverage and total leverage ratios. In addition, our senior secured credit facility and $325 million 8¾% senior subordinated notes restrict, among other things, our ability to incur additional indebtedness, incur guarantee obligations, amend debt instruments, pay dividends, create liens on assets, make investments, engage in mergers or consolidations, and otherwise restrict corporate activities.

At December 31, 2011, we were in compliance with all required financial covenants.

*Outlook*

Based on our current level of operations and anticipated earnings growth, we believe that cash generated from operations and cash on hand, together with amounts available under our senior secured credit facility, will be adequate to meet our anticipated debt service requirements, capital expenditures and working capital needs for the foreseeable future. However, we cannot be certain that our business will generate sufficient cash flow from operations, that our anticipated earnings growth will be realized, or that future borrowings will be available under our senior secured credit facility or otherwise will be available to enable us to service our indebtedness, including the senior secured credit facility and the senior subordinated notes, to retire or redeem the senior subordinated notes when required or to make

anticipated capital expenditures. In addition, we expect a majority of our future growth to come from acquisitions of gaming properties at reasonable valuations, greenfield projects, jurisdictional expansions and property expansion in under-penetrated markets. If we consummate significant acquisitions in the future or undertake any significant property expansions, our cash requirements may increase significantly and we may need to make additional borrowings or complete equity or debt financings to meet these requirements. Our future operating performance and our ability to service or refinance our debt will be subject to future economic conditions and to financial, business and other factors, many of which are beyond our control. See "Risk Factors—Risks Related to Our Capital Structure" of this Annual Report on Form 10-K for a discussion of the risk related to our capital structure.

We have historically maintained a capital structure comprising a mix of equity and debt financing. We vary our leverage to pursue opportunities in the marketplace and in an effort to maximize our enterprise value for our shareholders. We expect to meet our debt obligations as they come due through internally generated funds from operations and/or refinancing them through the debt or equity markets prior to their maturity.

*Commitments and Contingencies*

*Contractual Cash Obligations*

At December 31, 2011, there was approximately $388.1 million available for borrowing under our revolving credit facility. The following table presents our contractual cash obligations at December 31, 2011:

| | Payments Due By Period | | | | |
|---|---|---|---|---|---|
| | Total | 2012 | 2013-2014 | 2015-2016 | 2017 and After |
| | | | (in thousands) | | |
| Senior secured credit facility | | | | | |
| Principal | $ 1,715,750 | $ 42,500 | $ 120,000 | $ 844,500 | $ 708,750 |
| Interest | 278,009 | 45,449 | 95,797 | 86,255 | 50,508 |
| 8¾% senior subordinated notes | | | | | |
| Principal | 325,000 | — | — | — | 325,000 |
| Interest | 227,500 | 28,437 | 56,875 | 56,875 | 85,313 |
| Purchase obligations | 38,238 | 32,684 | 4,471 | 896 | 187 |
| Capital expenditure commitments(1) | 205,015 | 205,015 | — | — | — |
| Anticipated additional advances to unconsolidated affiliates(2) | 52,577 | 52,577 | — | — | — |
| Capital leases | 2,215 | 110 | 188 | 219 | 1,698 |
| Operating leases | 51,370 | 6,451 | 8,899 | 4,343 | 31,677 |
| Other liabilities reflected in the Company's consolidated balance sheets(3) | 15,951 | 15,951 | — | — | — |
| Total | $ 2,911,625 | $ 429,174 | $ 286,230 | $ 993,088 | $ 1,203,133 |

(1) The Company anticipates spending approximately $268.3 million (including licensing fees) for future construction projects over the next year that have not been contractually committed to at year-end. These amounts are primarily related to the opening of Hollywood Casino Toledo and Hollywood Casino Columbus that are scheduled to open in 2012.

(2) In February 2010, Kansas Entertainment received the final approval under the Kansas Expanded Lottery Act, along with its gaming license from the Kansas Racing and Gaming Commission, to proceed with the development of a an approximately $411 million Hollywood-themed destination

facility overlooking Turn 2 at Kansas Speedway. Kansas Entertainment began construction of the facility in the second half of 2010 and opened the facility on February 3, 2012. The approximately $411 million facility, inclusive of licensing fees, features a 82,000 square foot casino with approximately 2,000 slot machines, 52 table games and 12 poker tables, a 1,253 space parking structure, as well as a variety of dining and entertainment amenities. We and International Speedway shared equally in the cost of developing and constructing the facility. We estimate that our share of the project will be approximately $155 million, of which approximately $102.4 million has been incurred to date.

(3)

Primarily represents liabilities associated with reward programs that can be redeemed for cash, free play or services. Does not include any liability for unrecognized tax benefits, as the Company cannot make a reasonably reliable estimate of the period of cash settlement with the respective taxing authority.

The table above does not include the redemption of the Company's Preferred Stock which is required to be redeemed on June 30, 2015 for either cash or common shares at the Company's election. See Note 14 to the consolidated financial statements for further details.

*Other Commercial Commitments*

The following table presents our material commercial commitments as of December 31, 2011 for the following future periods:

| | Total Amounts Committed | 2012 | 2013-2014 | 2015-2016 | 2017 and After |
|---|---|---|---|---|---|
| | | | (in thousands) | | |
| Letters of Credit(1) | $ 24,893 | $ 24,893 | $ — | $ — | $ — |
| Total | $ 24,893 | $ 24,893 | $ — | $ — | $ — |

(1)

The available balance under the revolving credit portion of our senior secured credit facility is reduced by outstanding letters of credit.

**New Accounting Pronouncements**

In December 2011, the FASB issued amendments to enhance disclosures about offsetting and related arrangements. This information will enable the users of the financial statements to evaluate the effect or potential effect of netting arrangements on an entity's financial position, including the effect or potential effect of rights of setoff associated with certain financial and derivative instruments. These amendments are effective for annual reporting periods, and interim periods within those years, beginning on or after January 1, 2013. The disclosures required by these amendments should be provided retrospectively for all comparative periods presented. Management does not believe that these amendments will have a material impact on the consolidated financial statements.

In September 2011, the FASB issued amendments to simplify how entities test goodwill for impairment. Under the updated guidance, an entity now has the option to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. If the assessment of qualitative factors leads to a determination that it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then performing the two-step impairment test is unnecessary. However, if an entity concludes otherwise, then the entity is required to perform the first step of the two-step impairment test by calculating the fair value of the reporting unit and comparing it against its carrying amount. If the carrying amount of a reporting unit exceeds its fair value, then the entity is required to perform the second step of the goodwill impairment

test to measure the amount of impairment loss, if any. Under the new guidance, an entity can elect to bypass the qualitative assessment for any reporting unit in any period and proceed directly to performing the first step of the two-step goodwill impairment. The amendments are effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted, however the Company did not early adopt this amendment.

In June 2011, the FASB issued amendments to guidance regarding the presentation of comprehensive income. The amendments eliminate the option to present components of other comprehensive income as part of the statement of changes in stockholders' equity. The amendments require that comprehensive income be presented in either a single continuous statement or in two separate but consecutive statements. In a single continuous statement, the entity would present the components of net income and total net income, the components of other comprehensive income and a total of other comprehensive income, along with the total of comprehensive income in that statement. In the two-statement approach, the entity would present components of net income and total net income in the statement of net income and a statement of other comprehensive income would immediately follow the statement of net income and include the components of other comprehensive income and a total for other comprehensive income, along with a total for comprehensive income. The amendments also require the entity to present on the face of the financial statements any reclassification adjustments for items that are reclassified from other comprehensive income to net income in the statement(s) where the components of net income and the components of other comprehensive income are presented. The amendments do not change the items that must be reported in other comprehensive income, when an item of other comprehensive income must be reclassed to net income or the option to present components of other comprehensive income either net of related tax effects or before related tax effects. The amendments, excluding the specific requirement to present on the face of the financial statements any reclassification adjustments for items that are reclassified from other comprehensive income to net income in the statement(s) where the components of net income and the components of other comprehensive income are presented which was deferred by the FASB in December 2011, are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011 and are to be applied retrospectively. The Company adopted the guidance, except for the deferred requirement to present reclassification adjustments in the statement(s) where the components of net income and the components of other comprehensive income are presented, as of January 1, 2012. The Company plans to present comprehensive income in two separate but consecutive statements.

In May 2011, the FASB issued amendments to existing fair value measurement guidance in order to achieve common requirements for measuring fair value and disclosures in accordance with GAAP and International Financial Reporting Standards. The guidance clarifies how a principal market is determined, addresses the fair value measurement of instruments with offsetting market or counterparty credit risks, addresses the concept of valuation premise and highest and best use, extends the prohibition on blockage factors to all three levels of the fair value hierarchy and requires additional disclosures. The amendments are to be applied prospectively and are effective during interim and annual periods beginning after December 15, 2011. The Company adopted the guidance as of January 1, 2012, which did not have a material impact on the consolidated financial statements.

In April 2010, the FASB issued guidance on accruing for jackpot liabilities. The guidance clarifies that an entity should not accrue jackpot liabilities (or portions thereof) before a jackpot is won if the entity can legally avoid paying that jackpot (for example, by removing the gaming machine from the casino floor). Jackpots should be accrued and charged to revenue when an entity has the obligation to pay the jackpot. This guidance applies to both base jackpots and the incremental portion of progressive jackpots. However, the guidance only affected the accounting for base jackpots, as the guidance uses the same principle that is applied by the Company to the incremental portion of progressive jackpots. The guidance was effective for fiscal years, and interim periods within those fiscal years, beginning on

or after December 15, 2010. This guidance was applied by recording a cumulative-effect adjustment to opening retained earnings in the period of adoption. The Company adopted the guidance as of January 1, 2011, and as such, recorded a cumulative-effect adjustment, which increased retained earnings by $2.9 million.

## ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The table below provides information at December 31, 2011 about our financial instruments that are sensitive to changes in interest rates. For debt obligations, the table presents notional amounts maturing during the year and the related weighted-average interest rates by maturity dates. Notional amounts are used to calculate the contractual payments to be exchanged by maturity date and the weighted-average interest rates are based on implied forward LIBOR rates at December 31, 2011.

| | 2012 | 2013 | 2014 | 2015 | 2016 | Thereafter | Total | Fair Value 12/31/11 |
|---|---|---|---|---|---|---|---|---|
| | | | | (in thousands) | | | | |
| **Long-term debt:** | | | | | | | | |
| Fixed rate | $ — | $ — | $ — | $ — | $ — | $ 325,000 | $ 325,000 | $ 353,438 |
| Average interest rate | | | | | | 8.75% | | |
| Other Long Term Obligations | $ 1,949 | $ — | $ — | $ — | $ — | $ — | $ 1,949 | $ 1,949 |
| Average interest rate | 6.20% | | | | | | | |
| Variable rate | $ 42,500 | $ 51,250 | $ 68,750 | $ 77,500 | $ 767,000 | $ 708,750 | $ 1,715,750 | $ 1,716,720 |
| Average interest rate(1) | 2.63% | 2.81% | 3.00% | 3.21% | 3.33% | 4.73% | | |

(1) Estimated rate, reflective of forward LIBOR plus the spread over LIBOR applicable to variable-rate borrowing.

## ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

### Report of Independent Registered Public Accounting Firm

Board of Directors
Penn National Gaming, Inc. and subsidiaries

We have audited the accompanying consolidated balance sheets of Penn National Gaming, Inc. and subsidiaries as of December 31, 2011 and 2010, and the related consolidated statements of operations, changes in shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2011. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Penn National Gaming, Inc. and subsidiaries at December 31, 2011 and 2010, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2011, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Penn National Gaming, Inc. and subsidiaries' internal control over financial reporting as of December 31, 2011, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 24, 2012 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Philadelphia, Pennsylvania
February 24, 2012

Table of Contents

**Penn National Gaming, Inc. and Subsidiaries**
**Consolidated Balance Sheets**
**(in thousands, except share and per share data)**

| | December 31, | |
|---|---|---|
| | 2011 | 2010 |
| **Assets** | | |
| **Current assets** | | |
| Cash and cash equivalents | $ 238,440 | $ 246,385 |
| Receivables, net of allowance for doubtful accounts of $4,115 and $3,332 at December 31, 2011 and December 31, 2010, respectively | 55,455 | 44,463 |
| Insurance receivable | 1,072 | — |
| Prepaid expenses | 39,801 | 72,393 |
| Deferred income taxes | 32,306 | 25,206 |
| Other current assets | 48,715 | 77,506 |
| Total current assets | 415,789 | 465,953 |
| **Property and equipment, net** | 2,277,200 | 1,965,774 |
| **Other assets** | | |
| Investment in and advances to unconsolidated affiliates | 174,116 | 64,120 |
| Goodwill | 1,180,359 | 1,185,756 |
| Other intangible assets | 421,593 | 415,152 |
| Debt issuance costs, net of accumulated amortization of $4,860 and $45,234 at December 31, 2011 and December 31, 2010, respectively | 33,310 | 27,742 |
| Loan receivable | — | 230,500 |
| Other assets | 103,979 | 107,882 |
| Total other assets | 1,913,357 | 2,031,152 |
| **Total assets** | $ 4,606,346 | $ 4,462,879 |
| **Liabilities** | | |
| **Current liabilities** | | |
| Current maturities of long-term debt | $ 44,559 | $ 357,927 |
| Accounts payable | 39,582 | 17,312 |
| Accrued expenses | 113,699 | 101,447 |
| Accrued interest | 17,947 | 36,597 |
| Accrued salaries and wages | 85,285 | 73,432 |
| Gaming, pari-mutuel, property, and other taxes | 49,559 | 46,449 |
| Income taxes | 5,696 | — |
| Insurance financing | 16,363 | 11,602 |
| Other current liabilities | 53,650 | 46,763 |
| Total current liabilities | 426,340 | 691,529 |
| **Long-term liabilities** | | |
| Long-term debt, net of current maturities | 1,998,606 | 1,813,196 |
| Deferred income taxes | 167,576 | 134,572 |
| Noncurrent tax liabilities | 33,872 | 36,846 |
| Other noncurrent liabilities | 8,321 | 8,970 |
| Total long-term liabilities | 2,208,375 | 1,993,584 |
| **Shareholders' equity** | | |
| Preferred stock ($.01 par value, 1,000,000 shares authorized, 12,275 shares issued and outstanding at December 31, 2011 and 2010) | — | — |
| Common stock ($.01 par value, 200,000,000 shares authorized, 76,213,126 and 78,414,022 shares issued at December 31, 2011 and December 31, 2010, respectively) | 756 | 779 |
| Additional paid-in capital | 1,385,351 | 1,446,939 |

| | | |
|---|---|---|
| | 5 | 2 |
| Retained earnings | 583,202 | 337,940 |
| Accumulated other comprehensive income (loss) | 2,318 | (7,885) |
| | 1,971,63 | 1,777,7( |
| Total shareholders' equity | 1 | 6 |
| | 4,606,34 | 4,462,87 |
| **Total liabilities and shareholders' equity** | $ 6 | $ 9 |

See accompanying notes to the consolidated financial statements.

**Penn National Gaming, Inc. and Subsidiaries**
**Consolidated Statements of Operations**
**(in thousands, except per share data)**

| Year ended December 31, | 2011 | 2010 | 2009 |
|---|---|---|---|
| **Revenues** | | | |
| Gaming | $ 2,468,630 | $ 2,242,515 | $ 2,158,028 |
| Food, beverage and other | 400,258 | 334,808 | 339,235 |
| Management service fee | 15,185 | 15,190 | 14,787 |
| Revenues | 2,884,073 | 2,592,513 | 2,512,050 |
| Less promotional allowances | (141,816) | (133,402) | (142,775) |
| Net revenues | 2,742,257 | 2,459,111 | 2,369,275 |
| **Operating expenses** | | | |
| Gaming | 1,298,938 | 1,198,097 | 1,161,510 |
| Food, beverage and other | 321,801 | 266,800 | 266,351 |
| General and administrative | 423,718 | 411,415 | 403,136 |
| Depreciation and amortization | 211,476 | 212,387 | 194,436 |
| Impairment losses | — | 224,709 | 532,377 |
| Insurance recoveries, net of deductible charges | (13,257) | (7,523) | 6,063 |
| Total operating expenses | 2,242,676 | 2,305,885 | 2,563,873 |
| Income (loss) from operations | 499,581 | 153,226 | (194,598) |
| **Other income (expenses)** | | | |
| Interest expense | (99,564) | (130,215) | (134,984) |
| Interest income | 423 | 1,579 | 6,522 |
| Gain (loss) from unconsolidated affiliates | 7,364 | (25,974) | (1,121) |
| Loss on early extinguishment of debt | (17,838) | (519) | (4,793) |
| Other | (734) | 6,421 | 1,093 |
| Total other expenses | (110,349) | (148,708) | (133,283) |
| **Income (loss) from operations before income taxes** | 389,232 | 4,518 | (327,881) |
| Taxes on income | 146,881 | 66,178 | (60,468) |
| **Net income (loss) including noncontrolling interests** | 242,351 | (61,660) | (267,413) |
| Less: Net loss attributable to noncontrolling interests | — | (2,193) | (2,465) |
| **Net income (loss) attributable to the shareholders of Penn National Gaming, Inc. and subsidiaries** | $ 242,351 | $ (59,467) | $ (264,948) |
| **Earnings (loss) per common share attributable to the shareholders of Penn National Gaming, Inc. and subsidiaries:** | | | |
| Basic earnings (loss) per common share | $ 2.52 | $ (0.76) | $ (3.39) |
| Diluted earnings (loss) per common share | $ 2.26 | $ (0.76) | $ (3.39) |

See accompanying notes to the consolidated financial statements.

**Penn National Gaming, Inc. and Subsidiaries**
**Consolidated Statements of Changes in Shareholders' Equity**
**(in thousands, except share data)**

| | Penn National Gaming, Inc. shareholders | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Preferred Stock | | Common Stock | | Additional Paid-In Capital | Retained Earnings | Accumulated Other Comprehensive (Loss) Income | Noncontrolling Interests | Total Shareholders' Equity | Comprehensive Income (Loss) |
| | Shares | Amount | Shares | Amount | | | | | | |
| Balance, December 31, 2008 | 12,500 | $ — | 78,148,488 | $ 782 | $ 1,442,829 | $ 662,355 | $ (48,693) | $ — | $ 2,057,273 | |
| Stock option activity, including tax benefit of $2,388 | — | — | 491,078 | 4 | 35,173 | — | — | — | 35,177 | $ — |
| Restricted stock activity | — | — | 332,690 | — | 2,474 | — | — | — | 2,474 | — |
| Change in fair value of interest rate swap contracts, net of income taxes of $8,150 | — | — | — | — | — | — | 14,586 | — | 14,586 | 14,586 |
| Change in fair value of corporate debt securities | — | — | — | — | — | — | 6,843 | — | 6,843 | 6,843 |
| Foreign currency translation adjustment | — | — | — | — | — | — | 1,236 | — | 1,236 | 1,236 |
| Contributions from noncontrolling interests | — | — | — | — | — | — | — | 1,900 | 1,900 | — |
| Net loss | — | — | — | — | — | (264,948) | — | (2,465) | (267,413) | (267,413) |
| Balance, December 31, 2009 | 12,500 | — | 78,972,256 | 786 | 1,480,476 | 397,407 | (26,028) | (565) | 1,852,076 | (244,748) |
| Repurchase of preferred stock | (225) | — | — | — | (11,200) | — | — | — | (11,200) | — |
| Repurchase of noncontrolling interest | — | — | — | — | (27,758) | — | — | 2,758 | (25,000) | — |
| Stock option activity, including tax benefit of $3,311 | — | — | 823,056 | 8 | 35,875 | — | — | — | 35,883 | — |
| Share repurchases | — | — | (1,526,400) | (15) | (35,843) | — | — | — | (35,858) | — |
| Restricted stock activity | — | — | 145,110 | — | 5,382 | — | — | — | 5,382 | — |
| Change in fair value of interest rate swap contracts, net of income taxes of $9,427 | — | — | — | — | — | — | 16,410 | — | 16,410 | 16,410 |
| Change in fair value of corporate debt securities | — | — | — | — | — | — | 1,165 | — | 1,165 | 1,165 |
| Foreign currency translation adjustment | — | — | — | — | — | — | 568 | — | 568 | 568 |
| Net loss | — | — | — | — | — | (59,467) | — | (2,193) | (61,660) | (61,660) |
| Balance, December 31, 2010 | 12,275 | — | 78,414,022 | 779 | 1,446,932 | 337,940 | (7,885) | — | 1,777,766 | (43,517) |
| Stock option activity, including tax benefit of $2,557 | — | — | 695,915 | 7 | 39,352 | — | — | — | 39,359 | — |
| Share repurchases | — | — | (2,981,406) | (30) | (105,176) | — | — | — | (105,206) | — |
| Restricted stock activity, net | — | — | 84,595 | — | 4,247 | — | — | — | 4,247 | — |
| Change in fair value of interest rate swap contracts, net of income taxes of $5,238 | — | — | — | — | — | — | 9,374 | — | 9,374 | 9,374 |
| Change in fair value of corporate debt securities | — | — | — | — | — | — | 1,116 | — | 1,116 | 1,116 |
| Foreign currency translation adjustment | — | — | — | — | — | — | (287) | — | (287) | (287) |
| Cumulative-effect of adoption of amendments to ASC 924 regarding jackpot liabilities, net of income taxes of $1,068 | — | — | — | — | — | 2,911 | — | — | 2,911 | — |
| Net income | — | — | — | — | — | 242,351 | — | — | 242,351 | 242,351 |
| Balance, December 31, 2011 | 12,275 | $ — | 76,213,126 | $ 756 | $ 1,385,355 | $ 583,202 | $ 2,318 | $ — | $ 1,971,631 | $ 252,554 |

See accompanying notes to the consolidated financial statements.

Table of Contents

**Penn National Gaming, Inc. and Subsidiaries**
**Consolidated Statements of Cash Flows**
**(in thousands)**

| Year ended December 31, | 2011 | 2010 | 2009 |
|---|---|---|---|
| **Operating activities** | | | |
| Net income (loss) including noncontrolling interests | $ 242,351 | $ (61,660) | $ (267,413) |
| Adjustments to reconcile net income (loss) including noncontrolling interests to net cash provided by operating activities: | | | |
| Depreciation and amortization | 211,476 | 212,387 | 194,436 |
| Amortization of items charged to interest expense and interest income | 9,601 | 12,581 | 10,733 |
| Loss on sale of fixed assets | 340 | 3,104 | 332 |
| (Gain) loss from unconsolidated affiliates | (7,364) | 25,974 | 1,121 |
| Loss on early extinguishment of debt | 12,212 | 519 | 4,793 |
| Hollywood Casino Joliet fire | — | — | 5,186 |
| Loss on police services contract termination at Hollywood Casino Aurora | — | 6,624 | — |
| Gain on accelerated payment of other long-term obligations | — | — | (1,305) |
| Gain on litigation settlement | — | (9,619) | — |
| Gain on sale of corporate debt securities | — | — | (6,598) |
| Impairment loss on corporate debt securities | — | 265 | — |
| Deferred income taxes | 21,560 | (2,204) | (146,408) |
| Charge for stock-based compensation | 24,330 | 25,954 | 28,360 |
| Impairment losses | — | 224,709 | 532,377 |
| (Increase) decrease, net of businesses acquired | | | |
| Accounts receivable | (6,064) | (1,338) | (16,091) |
| Insurance receivable | (1,073) | 28,673 | — |
| Prepaid expenses and other current assets | (4,648) | 3,585 | (13,160) |
| Other assets | (2,556) | 10,160 | (8,138) |
| Increase (decrease), net of businesses acquired | | | |
| Accounts payable | 397 | 477 | (5,292) |
| Accrued expenses | 8,382 | 505 | 4,837 |
| Accrued interest | (4,038) | 648 | 4,332 |
| Accrued salaries and wages | 8,961 | 7,824 | 10,228 |
| Gaming, pari-mutuel, property and other taxes | 2,047 | 7,506 | (5,560) |
| Income taxes | 49,285 | — | — |
| Other current and noncurrent liabilities | 2,849 | 6,827 | 11,401 |
| Other noncurrent tax liabilities | (683) | (10,323) | 75 |
| Net cash provided by operating activities | 567,365 | 493,178 | 338,246 |
| **Investing activities** | | | |
| Expenditures for property and equipment, net of reimbursements | (293,081) | (362,955) | (289,551) |
| Proceeds from sale of property and equipment | 12,966 | 1,627 | 2,628 |
| Proceeds from sale of corporate debt securities | — | — | 50,602 |
| Insurance proceeds related to damaged property and equipment | 3,862 | 4,821 | 20,593 |
| Purchase of outstanding loans of M Resorts LLC | — | (230,500) | — |
| Investment in joint ventures, net of proceeds received | (100,398) | (63,632) | (12,895) |
| Decrease (increase) in cash in escrow | 28,975 | (30,224) | (25,036) |
| Cash acquired, net of acquisitions of businesses and licenses | 8,874 | (55,895) | (9,000) |
| Net cash used in investing activities | (338,802) | (736,758) | (262,659) |
| **Financing activities** | | | |
| Proceeds from exercise of options | 16,719 | 11,488 | 5,431 |
| Repurchase of common stock | (105,206) | (35,858) | — |
| Repurchase of preferred stock | — | (11,200) | — |
| Proceeds from issuance of long-term debt, net of issuance costs | 1,773,232 | 212,732 | 762,068 |
| Principal payments on long-term debt | (1,928,571) | (383,476) | (879,193) |
| Proceeds from insurance financing | 17,406 | 18,271 | 15,454 |
| Payments on insurance financing | (12,645) | (13,421) | (16,795) |
| (Repurchase of)/contributions from noncontrolling interest | — | (25,000) | 1,900 |
| Tax benefit from stock options exercised | 2,557 | 3,311 | 2,388 |
| Net cash used in financing activities | (236,508) | (223,153) | (108,747) |
| **Net decrease in cash and cash equivalents** | (7,945) | (466,733) | (33,160) |
| Cash and cash equivalents at beginning of year | 246,385 | 713,118 | 746,278 |
| Cash and cash equivalents at end of year | $ 238,440 | $ 246,385 | $ 713,118 |
| **Supplemental disclosure** | | | |
| Interest expense paid | $ 98,756 | $ 121,821 | $ 124,992 |
| Income taxes paid | $ 90,702 | $ 72,091 | $ 109,200 |

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

See accompanying notes to the consolidated financial statements.

**Penn National Gaming, Inc. and Subsidiaries**
**Notes to Consolidated Financial Statements**

## 1. Business and Basis of Presentation

Penn National Gaming, Inc. ("Penn") and subsidiaries (collectively, the "Company") is a diversified, multi-jurisdictional owner and manager 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 Bay St. Louis and Boomtown Biloxi, CRC Holdings, Inc., the Bullwhackers properties, Hollywood Casino Corporation, Argosy Gaming Company, Zia Park Casino, Sanford-Orlando Kennel Club and The M Resorts LLC (the "M Resort") in June 2011), greenfield projects (such as at Hollywood Casino at Penn National Race Course, Hollywood Slots Hotel and Raceway and Hollywood Casino Perryville), and property expansions (such as Hollywood Casino at Charles Town Races and Hollywood Casino Lawrenceburg). Most recently, the Company, along with its joint venture partner, opened Hollywood Casino at Kansas Speedway on February 3, 2012, and the Company anticipates opening facilities in Columbus and Toledo, Ohio in 2012.

As of December 31, 2011, the Company owned, managed, or had ownership interests in twenty-five facilities in the following eighteen jurisdictions: Colorado, Florida, Illinois, Indiana, Iowa, Louisiana, Maine, Maryland, Mississippi, Missouri, Nevada, New Jersey, New Mexico, Ohio, Pennsylvania, Texas, West Virginia, and Ontario.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses for the reporting periods. Actual results could differ from those estimates.

For purposes of comparability, certain prior year amounts have been reclassified to conform to the current year presentation.

## 2. Principles of Consolidation

The consolidated financial statements include the accounts of Penn and its subsidiaries, including wholly-owned subsidiaries and subsidiaries that had a noncontrolling interest. Investment in and advances to unconsolidated affiliates are accounted for under the equity method. All significant intercompany accounts and transactions have been eliminated in consolidation.

## 3. Summary of Significant Accounting Policies

### Cash and Cash Equivalents

The Company considers all cash balances and highly-liquid investments with original maturities of three months or less to be cash and cash equivalents.

### Concentration of Credit Risk

Financial instruments that subject the Company to credit risk consist of cash equivalents, corporate securities, interest rate swap contracts and accounts receivable.

The Company's policy is to limit the amount of credit exposure to any one financial institution, and place investments with financial institutions evaluated as being creditworthy, or in short-term money market and tax-free bond funds which are exposed to minimal interest rate and credit risk. The Company has bank deposits and overnight repurchase agreements that exceed federally-insured limits.

Concentration of credit risk, with respect to casino receivables, is limited through the Company's credit evaluation process. The Company issues markers to approved casino customers only following credit checks and investigations of creditworthiness. Marker balances issued to approved casino customers were $7.6 million at December 31, 2011, compared to $4.8 million at December 31, 2010.

The Company's receivables of $55.5 million and $44.5 million at December 31, 2011 and 2010, respectively, primarily consist of $10.9 million and $8.1 million, respectively, due from the West Virginia Lottery for gaming revenue settlements and capital reinvestment projects at the Hollywood Casino at Charles Town Races, $11.2 million and $11.1 million, respectively, for reimbursement of expenses paid on behalf of Casino Rama, $3.6 million and $4.1 million, respectively, for racing settlements due from simulcasting at Hollywood Casino at Penn National Race Course, and markers issued to customers mentioned above.

Accounts are written off when management determines that an account is uncollectible. Recoveries of accounts previously written off are recorded when received. An allowance for doubtful accounts is determined to reduce the Company's receivables to their carrying value, which approximates fair value. The allowance is estimated based on historical collection experience, specific review of individual customer accounts, and current economic and business conditions. Historically, the Company has not incurred any significant credit-related losses.

**Fair Value of Financial Instruments**

The following methods and assumptions are used to estimate the fair value of each class of financial instruments for which it is practicable to estimate:

*Cash and Cash Equivalents*

The fair value of the Company's cash and cash equivalents approximates the carrying value of the Company's cash and cash equivalents, due to the short maturity of the cash equivalents.

*Investment in Corporate Debt Securities*

The fair value of the investment in corporate debt securities is estimated based on a third party broker quote. The investment in corporate debt securities is measured at fair value on a recurring basis.

*Loan Receivable*

On June 1, 2011, following the purchase of all of the outstanding debt of the M Resort for $230.5 million and the receipt of requisite regulatory approvals, the Company acquired the business in exchange for the debt. The Company purchased all of the outstanding bank and subordinated debt of the M Resort in October 2010 at which time the Company also secured the right to acquire the business of the M Resort in exchange for the property's outstanding debt obligations. At December 31, 2010, the $230.5 million loan was recorded as a loan receivable within total other assets on the consolidated balance sheet. See Note 6 for further information.

*Long-term Debt*

The fair value of the Company's Term Loan B component of the senior secured credit facility and senior subordinated notes is estimated based on quoted prices in active markets. The fair value of the

remainder of the Company's senior secured credit facility approximates its carrying value as it is variable rate debt. The fair value of the Company's other long-term obligations approximates its carrying value.

*Interest Rate Swap Contracts*

The fair value of the Company's interest rate swap contracts was measured at the present value of all expected future cash flows based on the LIBOR-based swap yield curve as of the date of the valuation, subject to a credit adjustment to the LIBOR-based yield curve's implied discount rates. The credit adjustment reflected the Company's best estimate as to the Company's credit quality at December 31, 2010. The interest rate swap contracts were measured at fair value on a recurring basis. There were no outstanding interest rate swap contracts as of December 31, 2011.

The estimated fair values of the Company's financial instruments are as follows (in thousands):

| | 2011 | | 2010 | |
|---|---|---|---|---|
| December 31, | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| **Financial assets:** | | | | |
| Cash and cash equivalents | $ 238,440 | $ 238,440 | $ 246,385 | $ 246,385 |
| Investment in corporate debt securities | 6,790 | 6,790 | 5,828 | 5,828 |
| Loan receivable | — | — | 230,500 | 230,500 |
| **Financial liabilities:** | | | | |
| Long-term debt | | | | |
| Senior secured credit facility | 1,714,001 | 1,716,720 | 1,589,125 | 1,589,125 |
| Senior subordinated notes | 325,000 | 353,438 | 575,000 | 612,875 |
| Other long-term obligations | 1,949 | 1,949 | 3,782 | 3,782 |
| Interest rate swap contracts | — | — | 16,746 | 16,746 |

See Note 21 for further information regarding the Company's assessment of the inputs used to measure the fair value for the investment in corporate debt securities and interest rate swap contracts.

**Property and Equipment**

Property and equipment are stated at cost, less accumulated depreciation. Maintenance and repairs that neither add materially to the value of the asset nor appreciably prolong its useful life are charged to expense as incurred. Gains or losses on the disposal of property and equipment are included in the determination of income.

Depreciation of property and equipment is recorded using the straight-line method over the following estimated useful lives:

| | |
|---|---|
| Land improvements | 5 to 15 years |
| Building and improvements | 10 to 40 years |
| Furniture, fixtures, and equipment | 3 to 7 years |

Leasehold improvements are depreciated over the shorter of the estimated useful life of the improvement or the related lease term.

The estimated useful lives are determined based on the nature of the assets as well as the Company's current operating strategy.

The Company reviews the carrying value of its property and equipment for possible impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable based on undiscounted estimated future cash flows expected to result from its use and

eventual disposition. The factors considered by the Company in performing this assessment include current operating results, trends and prospects, as well as the effect of obsolescence, demand, competition and other economic factors. In estimating expected future cash flows for determining whether an asset is impaired, assets are grouped at the individual property level. In assessing the recoverability of the carrying value of property and equipment, the Company must make assumptions regarding future cash flows and other factors. If these estimates or the related assumptions change in the future, the Company 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.

**Goodwill and Other Intangible Assets**

At December 31, 2011, the Company had $1,180.4 million in goodwill and $421.6 million in other intangible assets within its consolidated balance sheet, representing 25.6% and 9.2% of total assets, respectively, resulting from the Company's acquisition of other businesses and payment for gaming licenses and racing permits. Two issues arise with respect to these assets that require significant management estimates and judgment: (i) the valuation in connection with the initial purchase price allocation; and (ii) the ongoing evaluation for impairment.

In connection with the Company's acquisitions, valuations are completed to determine the allocation of the purchase prices. The factors considered in the valuations include data gathered as a result of the Company's due diligence in connection with the acquisitions, projections for future operations, and data obtained from third-party valuation specialists as deemed appropriate. Goodwill is tested annually, or more frequently if indicators of impairment exist, for impairment by comparing the fair value of the reporting units to their carrying amount. If the carrying amount of a reporting unit exceeds its fair value in step 1 of the impairment test, then step 2 of the impairment test is performed to determine the implied value of goodwill for that reporting unit. If the implied value of goodwill is less than the goodwill allocated for that reporting unit, an impairment loss is recognized.

In accordance with Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 350, "Intangibles-Goodwill and Other," the Company considers its gaming licenses, racing permits and the majority of its trademark intangible assets as indefinite-life intangible assets that do not require amortization based on the Company's future expectations to operate its gaming facilities indefinitely as well as its historical experience in renewing these intangible assets at minimal cost with various state gaming and racing commissions. Rather, these intangible assets are tested annually, or more frequently if indicators of impairment exist, for impairment by comparing the fair value of the recorded assets to their carrying amount. If the carrying amounts of the indefinite-life intangible assets exceed their fair value, an impairment loss is recognized.

The evaluation of goodwill and indefinite-life intangible assets requires the use of estimates about future operating results of each reporting unit to determine their estimated fair value. The Company uses a market approach model, which includes the use of forecasted adjusted EBITDA (earnings before interest, taxes, charges for stock compensation, depreciation and amortization, gain or loss on disposal of assets, and certain other income and expenses, and inclusive of loss from unconsolidated affiliates) and adjusted EBITDA multiples, as the Company believes that adjusted EBITDA is a widely-used measure of performance in the gaming industry and as the Company uses adjusted EBITDA as the primary measurement of the operating performance of its properties (including the evaluation of operating personnel). In addition, the Company believes that an adjusted EBITDA multiple is the principal basis for the valuation of gaming companies. Changes in the estimated adjusted EBITDA multiples or forecasted operations can materially affect these estimates.

Forecasted adjusted EBITDA levels (based on the Company's annual operating plan as determined in the fourth quarter) can be significantly impacted by the local economy in which the Company's reporting units operate. For example, increases in unemployment rates can result in decreased customer

visitations and/or lower customer spend per visit. In addition, the impact of new legislation which approves gaming in nearby jurisdictions or further expands gaming in jurisdictions where the Company's reporting units currently operate can result in opportunities for the Company to expand its operations. However, it also has the impact of increasing competition for the Company's established properties which generally will have a negative effect on those locations' profitability once competitors become established as a certain level of cannibalization occurs absent an overall increase in customer visitations. Lastly, increases in gaming taxes approved by state regulatory bodies can negatively impact forecasted adjusted EBITDA.

The adjusted EBITDA multiple utilized by the Company in its goodwill impairment valuation methodology is determined based on the Company's current enterprise value, increased for a control premium. The control premium assumption is based on acquisitions of precedent transactions of comparable businesses. In evaluating the estimates derived by the market based approach, management assesses the relevance and reliability of the multiples by considering factors unique to its reporting units, including recent operating results, business plans, economic projections, anticipated future cash flows, and other market data. These considerations can lead the Company to modify its individual reporting units adjusted EBITDA multiple. EBITDA multiples can be significantly impacted by various factors, such as a company's present and future cost of capital, the future growth opportunities for the industry as well as for the company itself, general market sentiment, investors' perceptions of senior management's effectiveness at deploying capital and managing overall operations, as well as pending or recently completed merger transactions.

Assumptions and estimates about future adjusted EBITDA levels and multiples by individual reporting units are complex and subjective. They are sensitive to changes in underlying assumptions and can be affected by a variety of factors, including external factors, such as industry and economic trends, and internal factors, such as changes in the Company's business strategy, which may reallocate capital and resources to different or new opportunities which management believes will enhance the Company's overall value but may be to the detriment of an individual reporting unit.

Once an impairment of goodwill or other indefinite-life intangible assets has been recorded, it cannot be reversed. Because the Company's goodwill and indefinite-life intangible assets are not amortized, there may be volatility in reported income because impairment losses, if any, are likely to occur irregularly and in varying amounts. Intangible assets that have a definite-life are amortized on a straight-line basis over their estimated useful lives or related service contract. The Company reviews the carrying value of its intangible assets that have a definite-life for possible impairment whenever events or changes in circumstances indicate that their carrying value may not be recoverable. If the carrying amount of the intangible assets that have a definite-life exceed their fair value, an impairment loss is recognized.

**Debt Issuance Costs**

Debt issuance costs that are incurred by the Company in connection with the issuance of debt are deferred and amortized to interest expense using the effective interest method over the contractual term of the underlying indebtedness.

**Comprehensive Income**

The Company accounts for comprehensive income in accordance with ASC 220, "Comprehensive Income," which established standards for the reporting and presentation of comprehensive income in the consolidated financial statements. The Company presents comprehensive income in its consolidated statements of changes in shareholders' equity.

**Income Taxes**

The Company accounts for income taxes in accordance with ASC 740, "Income Taxes" ("ASC 740"). Under ASC 740, deferred tax assets and liabilities are determined based on the differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities and are measured at the prevailing enacted tax rates that will be in effect when these differences are settled or realized. ASC 740 also requires that deferred tax assets be reduced by a valuation allowance if it is more likely than not that some portion or all of the deferred tax assets will not be realized.

The realizability of the deferred tax assets is evaluated quarterly by assessing the valuation allowance and by adjusting the amount of the allowance, if necessary. The factors used to assess the likelihood of realization are the forecast of future taxable income and available tax planning strategies that could be implemented to realize the net deferred tax assets. The Company has used tax-planning strategies to realize or renew net deferred tax assets in order to avoid the potential loss of future tax benefits.

ASC 740 also creates a single model to address uncertainty in tax positions, and clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in an enterprise's financial statements. It also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. The liability for unrecognized tax benefits is included in noncurrent tax liabilities within the consolidated balance sheets at December 31, 2011 and 2010.

**Accounting for Derivatives and Hedging Activities**

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

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

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

Previously, the Company had a number of interest rate swap contracts in place. These contracts served to mitigate income volatility for a portion of the Company's variable-rate funding. In effect, these interest rate swap contracts synthetically converted the portion of variable-rate debt being hedged to the equivalent of fixed-rate funding. Under the terms of the swap contracts, the Company received cash flows from the swap contract counterparties to offset the benchmark interest rate component of

variable interest payments on the hedged financings, in exchange for paying cash flows based on the swap contracts' fixed rates. These two respective obligations were net-settled periodically. The fair value of the Company's interest rate swap contracts was measured at the present value of all expected future cash flows based on the LIBOR-based swap yield curve as of the date of the valuation, subject to a credit adjustment to the LIBOR-based yield curve's implied discount rates. The credit adjustment reflected the Company's best estimate as to the Company's credit quality. The interest rate swap contract liabilities were included in accrued interest within the consolidated balance sheets at December 31, 2010. There were no outstanding interest rate swap contracts as of December 31, 2011.

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

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

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

See Note 11 for additional information related to the Company's derivatives.

**Revenue Recognition and Promotional Allowances**

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

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

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

Revenues are recognized net of certain sales incentives in accordance with ASC 605-50, "Revenue Recognition—Customer Payments and Incentives." The Company records certain sales incentives and points earned in point-loyalty programs as a reduction of revenue.

The retail value of accommodations, food and beverage, and other services furnished to guests without charge is included in gross revenues and then deducted as promotional allowances. The estimated cost of providing such promotional allowances is primarily included in food, beverage and

other expense. The amounts included in promotional allowances for the years ended December 31, 2011, 2010 and 2009 are as follows:

| Year ended December 31, | 2011 | 2010 | 2009 |
|---|---|---|---|
| | | (in thousands) | |
| Rooms | $ 24,646 | $ 23,980 | $ 23,316 |
| Food and beverage | 106,687 | 99,024 | 108,473 |
| Other | 10,483 | 10,398 | 10,986 |
| Total promotional allowances | $ 141,816 | $ 133,402 | $ 142,775 |

The estimated cost of providing such complimentary services for the years ended December 31, 2011, 2010 and 2009 are as follows:

| Year ended December 31, | 2011 | 2010 | 2009 |
|---|---|---|---|
| | | (in thousands) | |
| Rooms | $ 9,149 | $ 9,188 | $ 9,406 |
| Food and beverage | 76,357 | 75,180 | 77,444 |
| Other | 6,430 | 6,544 | 6,590 |
| Total cost of complimentary services | $ 91,936 | $ 90,912 | $ 93,440 |

**Gaming and Racing Taxes**

The Company is subject to gaming and pari-mutuel taxes based on gross gaming revenue and pari-mutuel revenue in the jurisdictions in which it operates. The Company primarily recognizes gaming and pari-mutuel tax expense based on the statutorily required percentage of revenue that is required to be paid to state and local jurisdictions in the states wagering occurs. In certain states in which the Company operates, gaming taxes are based on graduated rates. The Company records gaming tax expense at the Company's estimated effective gaming tax rate for the year, considering estimated taxable gaming revenue and the applicable rates. Such estimates are adjusted each interim period. If gaming tax rates change during the year, such changes are applied prospectively in the determination of gaming tax expense in future interim periods. Finally, the Company recognizes purse expense based on the statutorily required percentage of revenue that is required to be paid out in the form of purses to the winning owners of horseraces run at the Company's racetracks in the period in which wagering occurs. For the years ended December 31, 2011, 2010 and 2009, these expenses, which are recorded primarily within gaming expense in the consolidated statements of operations, was $1.06 billion, $975.7 million, and $947.1 million, respectively.

**Earnings Per Share**

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

At December 31, 2011, the Company had outstanding 12,275 shares of Series B Redeemable Preferred Stock (the "Preferred Stock"), which the Company determined qualified as a participating security as defined in ASC 260. Under ASC 260, a security is considered a participating security if the security may participate in undistributed earnings with common stock, whether that participation is conditioned upon the occurrence of a specified event or not. In accordance with ASC 260, a company is required to use the two-class method when computing EPS when a company has a security that qualifies as a "participating security." The two-class method is an earnings allocation formula that

determines EPS for each class of common stock and participating security according to dividends declared (or accumulated) and participation rights in undistributed earnings. A participating security is included in the computation of basic EPS using the two-class method. Under the two-class method, basic EPS for the Company's Common Stock is computed by dividing net income attributable to the shareholders of Penn National Gaming, Inc. and subsidiaries applicable to common stock by the weighted-average common shares outstanding during the period. Diluted EPS for the Company's Common Stock is computed using the more dilutive of the two-class method or the if-converted method.

The following table sets forth the allocation of net income attributable to the shareholders of Penn National Gaming, Inc. and subsidiaries for the year ended December 31, 2011 under the two-class method:

| Year ended December, 31 | 2011 (in thousands) |
|---|---|
| Net income attributable to the shareholders of Penn National Gaming, Inc. and subsidiaries | $ 242,351 |
| Net income attributable to the shareholders of Penn National Gaming, Inc. and subsidiaries applicable to preferred stock | 46,101 |
| Net income attributable to the shareholders of Penn National Gaming, Inc. and subsidiaries applicable to common stock | $ 196,250 |

The following table reconciles the weighted-average common shares outstanding used in the calculation of basic EPS to the weighted-average common shares outstanding used in the calculation of diluted EPS for the year ended December 31, 2011:

| Year ended December 31, | 2011 (in thousands) |
|---|---|
| Determination of shares: | |
| Weighted-average common shares outstanding | 77,991 |
| Assumed conversion of dilutive employee stock-based awards | 1,782 |
| Assumed conversion of preferred stock | 27,278 |
| Diluted weighted-average common shares outstanding | 107,051 |

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

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

| Year ended December 31, | 2011 (in thousands, except per share data) |
|---|---|
| **Calculation of basic EPS attributable to the shareholders of Penn National Gaming, Inc. and subsidiaries:** | |
| Net income attributable to the shareholders of Penn National Gaming, Inc. and subsidiaries applicable to common stock | $ 196,250 |
| Weighted-average common shares outstanding | 77,991 |
| Basic EPS | $ 2.52 |
| **Calculation of diluted EPS attributable to the shareholders of Penn National Gaming, Inc. and subsidiaries:** | |
| Net income attributable to the shareholders of Penn National Gaming, Inc. and subsidiaries | $ 242,351 |
| Diluted weighted-average common shares outstanding | 107,051 |
| Diluted EPS | $ 2.26 |

Since the Company reported a net loss for the years ended December 31, 2010 and 2009, it was required by ASC 260 to use basic weighted-average common shares outstanding, rather than diluted weighted-average common shares outstanding, when calculating diluted EPS. In addition, since the Company reported a loss from operations for the years ended December 31, 2010 and 2009, the Preferred Stock was not deemed to be a participating security for the years ended December 31, 2010 and 2009, pursuant to ASC 260. The basic weighted-average common shares outstanding for the years ended December 31, 2010 and 2009 were 78,078,602 and 78,121,571, respectively.

Options to purchase 3,004,402 shares were outstanding during the year ended December 31, 2011 but were not included in the computation of diluted EPS because they were antidilutive. Options to purchase 10,834,444 and 9,966,125 shares were outstanding during the years ended December 31, 2010 and 2009, respectively, but were not included in the computation of diluted EPS because they were antidilutive since the Company reported a loss from operations for the years ended December 31, 2010 and 2009.

**Stock-Based Compensation**

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

The fair value for stock options was estimated at the date of grant using the Black-Scholes option-pricing model, which requires management to make certain assumptions. The risk-free interest rate was based on the United States ("U.S.") Treasury spot rate with a term equal to the expected life assumed at the date of grant. Expected volatility was estimated based on the historical volatility of the Company's stock price over a period of 5.82 years, in order to match the expected life of the options at the grant date. There is no expected dividend yield since the Company has not paid any cash dividends on its Common Stock since its initial public offering in May 1994 and since the Company intends to retain all of its earnings to finance the development of its business for the foreseeable future. The weighted-average expected life was based on the contractual term of the stock option and expected employee exercise dates, which was based on the historical and expected exercise behavior of the Company's employees. Forfeitures are estimated at the date of grant based on historical experience.

The following are the weighted-average assumptions used in the Black-Scholes option-pricing model at December 31, 2011, 2010 and 2009:

| Year ended December 31, | 2011 | 2010 | 2009 |
|---|---|---|---|
| Risk-free interest rate | 1.04% | 2.27% | 2.80% |
| Expected volatility | 47.60% | 48.02% | 49.68% |
| Dividend yield | — | — | — |
| Weighted-average expected life (years) | 5.82 | 5.73 | 5.32 |
| Forfeiture rate | 5.00% | 5.00% | 5.00% |

**Segment Information**

During 2011, the Company realigned its reporting structure in connection with the hiring of an additional senior vice president of regional operations. The Company now has three senior vice presidents of regional operations who oversee various properties based primarily on their geographic locations and whom report directly to the Company's President and Chief Operating Officer. This event impacted how the Company's Chief Executive Officer, who is the Company's Chief Operating Decision Maker ("CODM") as that term is defined in ASC 280, "Segment Reporting" ("ASC 280"), measures and assesses the Company's business performance and has caused the Company to conclude that it now has reportable segments. Therefore, the Company has aggregated its properties into three reportable segments: (i) Midwest, (ii) East/West, and (iii) Southern Plains consistent with how the Company's CODM reviews and assesses the Company's financial performance.

The Midwest reportable segment consists of the following properties: Hollywood Casino Lawrenceburg, Hollywood Casino Aurora, Hollywood Casino Joliet, and Argosy Casino Alton. It also includes the Company's Casino Rama management service contract as well as the two Ohio properties that are currently under construction, Hollywood Casino Toledo and Hollywood Casino Columbus, which are scheduled to open by the end of May 2012 and November 1, 2012, respectively.

The East/West reportable segment consists of the following properties: Hollywood Casino at Charles Town Races, Hollywood Casino Perryville, Hollywood Slots Hotel and Raceway, Hollywood Casino at Penn National Race Course, Zia Park Casino, and M Resort.

The Southern Plains reportable segment consists of the following properties: Argosy Casino Riverside, Argosy Casino Sioux City, Hollywood Casino Baton Rouge, Hollywood Casino Tunica, Hollywood Casino Bay St. Louis, and Boomtown Biloxi. It also includes the Company's 50% investment in Kansas Entertainment, LLC ("Kansas Entertainment"), which owns the Hollywood Casino at Kansas Speedway which opened in February 2012.

The Other category consists of the Company's standalone racing operations, namely Beulah Park, Raceway Park, Rosecroft Raceway, Sanford-Orlando Kennel Club, and the Company's joint venture interests in Sam Houston Race Park and Valley Race Park, Freehold Raceway, and Maryland Jockey Club (which was sold in July 2011). If the Company is successful in obtaining gaming operations at these locations, they would be assigned to one of the Company's regional executives and reported in their respective reportable segment. The Other category also includes the Company's corporate overhead operations which does not meet the definition of an operating segment under ASC 280 and our Bullwhackers property.

See Note 17 for further information with respect to the Company's segments.

**Statements of Cash Flows**

The Company has presented the consolidated statements of cash flows using the indirect method, which involves the reconciliation of net income (loss) including noncontrolling interests to net cash flow from operating activities.

**Acquisitions**

The Company accounts for its acquisitions in accordance with ASC 805, "Business Combinations." The results of operations of acquisitions are included in the consolidated financial statements from their respective dates of acquisition.

**Certain Risks and Uncertainties**

The Company faces intense gaming competition in most of the markets where its properties operate. Various states are currently considering or implementing legislation to legalize or expand gaming. Such legislation presents potential opportunities for the Company to establish new properties; however, this also presents potential competitive threats to the Company's existing properties. For example, the Company's two largest properties in terms of net revenues will face new sources of significant competition in the near term. Namely, a casino scheduled to open in 2013 in Cincinnati, Ohio will compete in the same market as Hollywood Casino Lawrenceburg and increased competition to Hollywood Casino at Charles Town Races is anticipated in 2012 from the opening of a significant casino complex at the Arundel Mills mall in Anne Arundel, Maryland. Although these openings will have a significant impact on the Company's operations, they are anticipated to be mitigated by the Company's planned openings of Hollywood Casino Toledo and Hollywood Casino Columbus in Ohio. However, no assurance can be given that these casinos in Toledo and Columbus will open as scheduled or be as successful as anticipated.

The Company's operations are dependent on its continued licensing by state gaming commissions. The loss of a license, in any jurisdiction in which the Company operates, could have a material adverse effect on future results of operations.

The Company is dependent on each gaming property's local market for a significant number of its patrons and revenues. If economic conditions in these areas deteriorate or additional gaming licenses are awarded in these markets, the Company's results of operations could be adversely affected.

The Company is dependent on the economy of the U.S. in general, and any deterioration in the national economic, energy, credit and capital markets could have a material adverse effect on future results of operations.

The Company is dependent upon a stable gaming and admission tax structure in the locations that it operates in. Any change in the tax structure could have a material adverse affect on future results of operations.

**4. New Accounting Pronouncements**

In December 2011, the FASB issued amendments to enhance disclosures about offsetting and related arrangements. This information will enable the users of the financial statements to evaluate the effect or potential effect of netting arrangements on an entity's financial position, including the effect or potential effect of rights of setoff associated with certain financial and derivative instruments. These amendments are effective for annual reporting periods, and interim periods within those years, beginning on or after January 1, 2013. The disclosures required by these amendments should be provided retrospectively for all comparative periods presented. Management does not believe that these amendments will have a material impact on the consolidated financial statements.

In September 2011, the FASB issued amendments to simplify how entities test goodwill for impairment. Under the updated guidance, an entity now has the option to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. If the assessment of qualitative factors leads to a determination that it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, then performing

the two-step impairment test is unnecessary. However, if an entity concludes otherwise, then the entity is required to perform the first step of the two-step impairment test by calculating the fair value of the reporting unit and comparing it against its carrying amount. If the carrying amount of a reporting unit exceeds its fair value, then the entity is required to perform the second step of the goodwill impairment test to measure the amount of impairment loss, if any. Under the new guidance, an entity can elect to bypass the qualitative assessment for any reporting unit in any period and proceed directly to performing the first step of the two-step goodwill impairment. The amendments are effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted, however the Company did not early adopt this amendment.

In June 2011, the FASB issued amendments to guidance regarding the presentation of comprehensive income. The amendments eliminate the option to present components of OCI as part of the statement of changes in stockholders' equity. The amendments require that comprehensive income be presented in either a single continuous statement or in two separate but consecutive statements. In a single continuous statement, the entity would present the components of net income and total net income, the components of OCI and a total of OCI, along with the total of comprehensive income in that statement. In the two-statement approach, the entity would present components of net income and total net income in the statement of net income and a statement of OCI would immediately follow the statement of net income and include the components of OCI and a total for OCI, along with a total for comprehensive income. The amendments also require the entity to present on the face of the financial statements any reclassification adjustments for items that are reclassified from OCI to net income in the statement(s) where the components of net income and the components of OCI are presented. The amendments do not change the items that must be reported in OCI, when an item of OCI must be reclassed to net income or the option to present components of OCI either net of related tax effects or before related tax effects. The amendments, excluding the specific requirement to present on the face of the financial statements any reclassification adjustments for items that are reclassified from OCI to net income in the statement(s) where the components of net income and the components of OCI are presented which was deferred by the FASB in December 2011, are effective for fiscal years, and interim periods within those years, beginning after December 15, 2011 and are to be applied retrospectively. The Company adopted the guidance, except for the deferred requirement to present reclassification adjustments in the statement(s) where the components of net income and the components of OCI are presented, as of January 1, 2012. The Company plans to present comprehensive income in two separate but consecutive statements.

In May 2011, the FASB issued amendments to existing fair value measurement guidance in order to achieve common requirements for measuring fair value and disclosures in accordance with GAAP and International Financial Reporting Standards. The guidance clarifies how a principal market is determined, addresses the fair value measurement of instruments with offsetting market or counterparty credit risks, addresses the concept of valuation premise and highest and best use, extends the prohibition on blockage factors to all three levels of the fair value hierarchy and requires additional disclosures. The amendments are to be applied prospectively and are effective during interim and annual periods beginning after December 15, 2011. The Company adopted the guidance as of January 1, 2012, which did not have a material impact on the consolidated financial statements.

In April 2010, the FASB issued guidance on accruing for jackpot liabilities. The guidance clarifies that an entity should not accrue jackpot liabilities (or portions thereof) before a jackpot is won if the entity can legally avoid paying that jackpot (for example, by removing the gaming machine from the casino floor). Jackpots should be accrued and charged to revenue when an entity has the obligation to pay the jackpot. This guidance applies to both base jackpots and the incremental portion of progressive jackpots. However, the guidance only affected the accounting for base jackpots, as the guidance uses the same principle that is applied by the Company to the incremental portion of progressive jackpots. The guidance was effective for fiscal years, and interim periods within those fiscal years, beginning on

or after December 15, 2010. This guidance was applied by recording a cumulative-effect adjustment to opening retained earnings in the period of adoption. The Company adopted the guidance as of January 1, 2011, and as such, recorded a cumulative-effect adjustment, which increased retained earnings by $2.9 million.

**5. Acquisitions and Other Recent Business Ventures**

*Sale of Maryland Jockey Club Interest*

In July 2011, the Company sold its joint venture interest in the Maryland Jockey Club. See Note 7 for further discussion.

*M Resort Transaction*

On June 1, 2011, following the purchase of all of the outstanding debt of the M Resort for $230.5 million and the receipt of requisite regulatory approvals, the Company acquired the business in exchange for the debt. See Note 6 for further discussion.

*Texas Joint Venture Interest*

On April 8, 2011, the Company established a joint venture that owns and operates racetracks in Texas. See Note 7 for further discussion.

*Rosecroft Acquisition*

On February 28, 2011, the Company completed its acquisition of Rosecroft Raceway in Oxon Hill, Maryland following the completion of a bankruptcy auction and approval of the purchase by a U.S. Bankruptcy Court judge. Rosecroft Raceway, located approximately 13 miles south of Washington, D.C., is situated on approximately 125 acres just outside the Washington I-495 Beltway in Prince George's county. The Rosecroft facility features a ⅝-mile standardbred race track with a seven race paddock, a 53,000 square foot grandstand building, and a 96,000 square foot three story clubhouse building with dining facilities. In August 2011, Rosecroft Raceway re-opened for simulcasting and live standardbred racing resumed in late October 2011.

*Beulah Park Acquisition*

On July 1, 2010, the Company completed its acquisition of Beulah Park in Grove City, Ohio from Heartland Jockey Club Ltd. Located on approximately 210 acres just outside of Columbus, Ohio, Beulah Park is a thoroughbred racing facility that features live thoroughbred racing from October to May as well as simulcast wagering from a number of nationwide tracks. Beulah Park includes a grandstand, outdoor paddock, a clubhouse facility and numerous food and dining options. The results of Beulah Park have been included in the Company's consolidated financial statements since the July 1, 2010 acquisition date.

**6. Loan Receivable**

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

$13.7 million, $2.4 million, and $17.3 million, respectively based on their estimated fair values at June 1, 2011.

## 7. Investment In and Advances to Unconsolidated Affiliates

As of December 31, 2011, investment in and advances to unconsolidated affiliates primarily included the Company's 50% interest in Freehold Raceway, its 50% investment in Kansas Entertainment, which is a joint venture with International Speedway Corporation ("International Speedway"), and its 50% joint venture with MAXXAM, Inc. ("MAXXAM") that owns and operates racetracks in Texas. These investments are more fully described below.

*Texas Joint Venture*

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

Sam Houston Race Park, opened in April 1994, is located 15 miles northwest from downtown Houston along Beltway 8. Sam Houston Race Park hosts thoroughbred and quarter horse racing and offers daily simulcast operations, as well as hosts various special events, private parties and meetings, concerts and national touring festivals throughout the year. Valley Race Park, which was opened in 1990 and acquired by Sam Houston Race Park in 2000, is a 91,000 square foot dog racing and simulcasting facility located in Harlingen, Texas.

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

The Company determined that the Texas joint venture did not qualify as a variable interest entity ("VIE") at December 31, 2011. Using the guidance for entities that are not VIEs, the Company determined that it did not have a controlling financial interest in the joint venture at, and for the year ended December 31, 2011, primarily as it did not have the ability to direct the activities of the joint venture that most significantly impacted the joint venture's economic performance without the input of MAXXAM. Therefore, the Company did not consolidate its investment in the joint venture at, and for the year ended December 31, 2011.

*Kansas Entertainment*

In December 2009, Kansas Entertainment was selected by the Kansas Lottery Gaming Facility Review Board to develop and operate a facility in the North East Gaming Zone in Wyandotte County, Kansas, and in February 2010, Kansas Entertainment received the final approval under the Kansas Expanded Lottery Act, along with its gaming license from the Kansas Racing and Gaming Commission,

to proceed with the development of an approximately $411 million Hollywood-themed destination facility overlooking Turn 2 at Kansas Speedway.

Kansas Entertainment recently completed the construction of its planned $411 million facility, inclusive of licensing fees, which features a 95,000 square foot casino with approximately 2,000 slot machines, 52 table games and 12 poker tables, a 1,253 space parking structure, as well as a variety of dining and entertainment facilities. The Company and International Speedway shared equally in the cost of developing and constructing the facility. The Company estimates that its share of the project will be approximately $155 million. During the years ended December 31, 2011, 2010 and 2009, the Company funded $70.9 million, $30.6 million and $12.9 million, respectively, for capital expenditures and other operating expenses.

The Company determined that Kansas Entertainment qualified as a VIE at December 31, 2011 and 2010. The Company did not consolidate its investment in Kansas Entertainment at, and for the years ended December 31, 2011 and 2010, as the Company determined that it did not qualify as the primary beneficiary of Kansas Entertainment at, and for the years ended December 31, 2011 and 2010, primarily as it did not have the ability to direct the activities of Kansas Entertainment that most significantly impacted Kansas Entertainment's economic performance without the input of International Speedway. In addition, the Company determined that International Speedway had substantive participating rights in Kansas Entertainment at, and for the years ended December 31, 2011 and 2010.

*Sale of Maryland Jockey Club Interest*

In July 2011, the Company sold its joint venture interest in Maryland RE & R LLC, a joint venture with MI Developments, Inc. that owned and operated the Maryland Jockey Club. This transaction resulted in a gain of $20.2 million which was included in gain (loss) from unconsolidated affiliates within the consolidated statement of operations for the year ended December 31, 2011.

For the year ended December 31, 2010, the Company's share of losses in the Maryland Jockey Club included a $14.4 million charge for the Company's share of a goodwill impairment write-down recorded by the Maryland Jockey Club during the fourth quarter of 2010 as a result of the negative outcome related to the zoning referendum in which voters approved a proposed casino complex at the Arundel Mills mall in Anne Arundel, Maryland.

*New Jersey Joint Venture*

During the fourth quarter of 2011, the Company recorded a $5.9 million charge to reflect its share of a goodwill impairment recorded at its joint venture. This charge reduced the Company's investment balance to $11.2 million at December 31, 2011. The Company believes this amount is realizable based on its share of the underlyin fair value of the business which was utilized in the joint venture's goodwill impairment analysis.

The Company determined that the New Jersey joint venture did not qualify as a VIE at December 31, 2011 and 2010. Using the guidance for entities that are not VIEs, the Company determined that it did not have a controlling financial interest in the joint venture at, and for the years ended December 31, 2011 and 2010, primarily as it did not have the ability to direct the activities of the joint venture that most significantly impacted the joint venture's economic performance without the input of Greenwood Limited Jersey, Inc. Therefore, the Company did not consolidate its investment in the joint venture at, and for the years ended December 31, 2011 and 2010.

## 8. Property and Equipment

Property and equipment, net, consists of the following:

| December 31, | 2011 | 2010 |
|---|---|---|
| | (in thousands) | |
| Land and improvements | $ 362,402 | $ 298,482 |
| Building and improvements | 1,715,144 | 1,534,117 |
| Furniture, fixtures, and equipment | 1,021,362 | 938,443 |
| Leasehold improvements | 16,910 | 17,089 |
| Construction in progress | 256,459 | 106,963 |
| Total property and equipment | 3,372,277 | 2,895,094 |
| Less accumulated depreciation | (1,095,077) | (929,320) |
| Property and equipment, net | $ 2,277,200 | $ 1,965,774 |

During the year ended December 31, 2011, total property and equipment increased by $477.2 million primarily due to the M Resort transaction that closed on June 1, 2011, as well as expenditures for the facilities under construction in Ohio.

Depreciation expense, for property and equipment, totaled $209.3 million, $206.6 million, and $187.8 million in 2011, 2010 and 2009, respectively. Interest capitalized in connection with major construction projects was $5.6 million, $5.5 million, and $7.0 million in 2011, 2010 and 2009, respectively.

On May 4, 2010, in a statewide election in Ohio, the voters determined that the Company's casino in Columbus will be located at the site of the former Delphi Automotive plant along Columbus's West Side. As a result of the election, the Company initiated the process to sell the parcel of land that it purchased in Columbus's Arena District, the original site approved by voters, and reclassified the land as held for sale. The Company obtained an appraisal to determine the estimated fair market value of the land and recorded a pre-tax impairment charge of $31.3 million ($20.1 million, net of taxes) during the year ended December 31, 2010, which was comprised of the difference between the land's estimated fair market value less costs to sell and its carrying value. This land was sold in August 2011, which did not have a significant impact on the Company's consolidated statement of operations.

During the year ended December 31, 2009, the Company recorded a pre-tax impairment charge for the replaced Lawrenceburg vessel of $11.9 million ($7.1 million, net of taxes) in conjunction with the opening of the new casino riverboat at Hollywood Casino Lawrenceburg. During the year-ended December 31, 2010, the Company recorded a $0.2 million charge on this replaced vessel.

**9. Goodwill and Other Intangible Assets**

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

| | | |
|---|---|---|
| Balance at January 1, 2010: | | |
| Goodwill | $ | 2,024,963 |
| Accumulated goodwill impairment losses | | (645,002) |
| Goodwill, net | $ | 1,379,961 |
| Goodwill impairment losses | | (188,855) |
| Other | | (5,350) |
| Balance at December 31, 2010: | | |
| Goodwill | $ | 2,019,613 |
| Accumulated goodwill impairment losses | | (833,857) |
| Goodwill, net | $ | 1,185,756 |
| Goodwill impairment losses | | — |
| Other | | (5,397) |
| Balance at December 31, 2011: | | |
| Goodwill | $ | 2,014,216 |
| Accumulated goodwill impairment losses | | (833,857) |
| Goodwill, net | $ | 1,180,359 |

Goodwill consists mainly of goodwill from the acquisitions of Hollywood Casino Corporation in March 2003, Argosy in October 2005 and Zia Park Casino in April 2007.

During the year ended December 31, 2010, goodwill decreased by $194.2 million. Due to decreased earning projections at the Company's properties in the Chicagoland regional market resulting from an anticipated increase in competition from the scheduled opening of a casino in the second half of 2011 in Des Plaines, Illinois, as well as continued challenging market conditions in the Chicagoland regional market, the Company recorded a pre-tax impairment charge of $144.6 million ($144.6 million, net of taxes) and $44.2 million ($28.4 million, net of taxes) for Hollywood Casino Aurora and Hollywood Casino Joliet, respectively, during the year ended December 31, 2010, as the Company determined that a portion of the value of the goodwill associated with the original purchase of Hollywood Casino Aurora and Hollywood Casino Joliet was impaired.

During the year ended December 31, 2009, goodwill decreased by $218.6 million. As a result of the anticipated impact of gaming expansion in Ohio, the Company recorded a pre-tax impairment charge of $213.3 million ($188.7 million, net of taxes) during the year ended December 31, 2009, as the Company determined that a portion of the value of the goodwill associated with the original purchase of Hollywood Casino Lawrenceburg was impaired.

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

| | 2011 | | | 2010 | | |
|---|---|---|---|---|---|---|
| December 31, | Gross Carrying Value | Accumulated Amortization | Net Book Value | Gross Carrying Value | Accumulated Amortization | Net Book Value |
| | | | (in thousands) | | | |
| Indefinite-life intangible assets | $ 421,260 | $ — | $ 421,260 | $ 412,686 | $ — | $ 412,686 |
| Other intangible assets | 49,666 | 49,333 | 333 | 49,600 | 47,134 | 2,466 |
| Total | $ 470,926 | $ 49,333 | $ 421,593 | $ 462,286 | $ 47,134 | $ 415,152 |

Indefinite-life intangible assets consist mainly of gaming licenses and racing permits.

During the year ended December 31, 2010, indefinite-life intangible assets increased by $34.2 million, primarily due to the gaming license for table games at Hollywood Casino at Penn National Race Course and the indefinite-life intangible assets, primarily a racing permit, acquired as part of Beulah Park, which were partially offset by the write-down of the Argosy trademark intangible asset for $4.4 million ($2.8 million, net of taxes) due to management's strategy to transition Argosy properties to the Hollywood Casino brand.

During the year ended December 31, 2009, indefinite-life intangible assets decreased by $310.2 million. As a result of the anticipated impact of gaming expansion in Ohio, the Company recorded a pre-tax impairment charge of $307.2 million ($180.1 million, net of taxes), as the Company determined that a portion of the value of the indefinite-life intangible assets associated with the original purchase of Hollywood Casino Lawrenceburg was impaired.

The Company's intangible asset amortization expense was $2.2 million, $5.8 million, and $6.6 million for the years ended December 31, 2011, 2010 and 2009, respectively.

The following table presents expected intangible asset amortization expense based on existing intangible assets at December 31, 2011 (in thousands):

| | |
|---|---|
| 2012 | $ 237 |
| 2013 | 38 |
| 2014 | 38 |
| 2015 | 20 |
| Total | $ 333 |

The Company's remaining goodwill and other intangible assets by reporting unit at December 31, 2011 is shown below (in thousands):

| Reporting Unit | Remaining Goodwill and other intangible assets at December 31, 2011 |
|---|---|
| Hollywood Casino Lawrenceburg | $ 362,491 |
| Hollywood Casino Joliet | 210,158 |
| Hollywood Casino Aurora | 207,207 |
| Argosy Casino Riverside | 159,296 |
| Zia Park Casino | 145,777 |
| Argosy Casino Alton | 135,511 |
| Argosy Casino Sioux City | 92,795 |
| Hollywood Casino Baton Rouge | 75,521 |
| Others | 213,196 |
| Total | $ 1,601,952 |

**10. Investment in Corporate Securities**

During the year ended December 31, 2008, the Company made a $47.3 million investment in the corporate debt securities of other gaming companies. During the year ended December 31, 2009, the Company sold $42.2 million of this investment and recorded a $6.6 million gain, which is included in other income (expenses) within the consolidated statements of operations. The Company's investment in corporate debt securities are accounted for as an available-for-sale investment security and are included in other assets within the consolidated balance sheets.

The remaining investment had a fair value totaling $6.8 million and $5.8 million at December 31, 2011 and 2010, respectively. During 2010, the issuer of the security went into default on its obligations

as it ceased making interest payments and the security was downgraded by certain rating agencies. As a result, during the year ended December 31, 2010, the Company recorded a pre-tax charge of $0.3 million, which is included in other income (expenses) within the consolidated statements of operations, to write down the investment to its fair value, which was based on the transaction prices of the security subsequent to when the issuer defaulted on its obligations. The Company will continue to account for this security as an available for sale investment and will monitor its realizability in future periods. At December 31, 2011, the investment had an unrealized gain within accumulated other comprehensive loss within the consolidated balance sheet of $1.1 million.

## 11. Long-term Debt and Derivatives

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

| December 31, | 2011 | 2010 |
|---|---|---|
| | (in thousands) | |
| Senior secured credit facility | $ 1,715,750 | $ 1,589,125 |
| $250 million 6¾% senior subordinated notes due March 2015 | — | 250,000 |
| $325 million 8¾% senior subordinated notes due August 2019 | 325,000 | 325,000 |
| Other long-term obligations | 1,949 | 3,782 |
| Capital leases | 2,215 | 3,216 |
| | 2,044,914 | 2,171,123 |
| Less current maturities of long-term debt | (44,559) | (357,927) |
| Less discount on senior secured credit facility Term Loan B | (1,749) | — |
| | $ 1,998,606 | $ 1,813,196 |

The following is a schedule of future minimum repayments of long-term debt as of December 31, 2011 (in thousands):

| | |
|---|---|
| 2012 | $ 44,559 |
| 2013 | 51,340 |
| 2014 | 68,848 |
| 2015 | 77,605 |
| 2016 | 767,114 |
| Thereafter | 1,035,448 |
| Total minimum payments | $ 2,044,914 |

**Senior Secured Credit Facility**

On July 14, 2011, the Company entered into a new $2.15 billion senior secured credit facility, which is comprised of a $700 million revolving credit facility that will mature in July 2016, a $700 million variable rate Term Loan A due in July 2016 and a $750 million variable rate Term Loan B due in July 2018. The interest rates payable on the facilities are based on the leverage ratios of the Company as defined in the debt agreements, however, based on current borrowing levels, the Company will pay LIBOR plus 150 basis points on the revolver and Term Loan A and LIBOR plus 275 basis points on Term Loan B (subject to a 1% LIBOR floor). The Company utilized the proceeds of the two term loan borrowings and cash on hand to retire its previous senior secured credit facility obligation of $1,518.1 million (which had significant principal repayments due at the end of 2011 and 2012) and pay transaction costs and accrued interest and fees on the retired debt. As a result of this refinancing, the Company incurred debt extinguishment charges of $10.2 million during the year ended December 31, 2011.

The Company's senior secured credit facility had a gross outstanding balance of $1,715.8 million at December 31, 2011, consisting of $287.0 million drawn under the revolving credit facility, a $682.5 million Term Loan A facility, and a $746.3 million Term Loan B facility. Additionally, at December 31, 2011, the Company was contingently obligated under letters of credit issued pursuant to the $2.15 billion senior secured credit facility with face amounts aggregating $24.9 million, resulting in $388.1 million of available borrowing capacity as of December 31, 2011 under the revolving credit facility.

**Redemption of 6¾% Senior Subordinated Notes**

In July 2011, the Company announced its intention to redeem all of its $250 million 6¾% senior subordinated notes. The redemption price was $1,022.50 per $1,000 principal amount, plus accrued and unpaid interest, which was paid in August 2011. The Company funded the redemption of its $250 million 6¾% senior subordinated notes from its new revolving credit facility and available cash. The Company recorded a $7.6 million loss on early extinguishment of debt during the year ended December 31, 2011 related to debt issuance costs write-offs and the call premium on the $250 million 6¾% senior subordinated notes.

**8¾% Senior Subordinated Notes**

In August 2009, the Company completed an offering of $325 million 8¾% senior subordinated notes that mature on August 15, 2019. Interest on the $325 million 8¾% senior subordinated notes is payable on February 15 and August 15 of each year. The $325 million 8¾% senior subordinated notes are general unsecured obligations and are not guaranteed by the Company's subsidiaries and were issued in a private placement pursuant to an exemption from the registration requirements of the Securities Act of 1933, as amended. At any time prior to August 15, 2014, the Company may redeem all or part of the 8¾% senior subordinated notes at par plus the present value (discounted at the treasury rate plus 50 basis points) of scheduled interest payments through August 15, 2014, along with accrued and unpaid interest, if any, at the date of redemption. On or after August 15, 2014, the Company may redeem all or part of the 8¾% senior subordinated notes at a redemption price of 104.375% which gradually reduces to par by 2017.

**Other Long-Term Obligations**

In April 2010, the Company entered into a termination contract with the city of Aurora, Illinois, whereby the Company will pay $7 million in lieu of perpetual annual payments (of approximately $1 million) to have off duty Aurora police officials provide security at Hollywood Casino Aurora each day. Payments of $1.5 million were made on June 1, 2010 and September 1, 2010 and a payment of $2.0 million was made on June 1, 2011. A final payment of $2.0 million is due on June 1, 2012. This liability was discounted using an estimate of the Company's incremental borrowing rate over the term of the obligation. The accretion of this discount is recorded in interest expense in the consolidated statements of operations.

**Covenants**

The Company's senior secured credit facility and $325 million 8¾% senior subordinated notes require it, among other obligations, to maintain specified financial ratios and to satisfy certain financial tests, including fixed charge coverage, interest coverage, senior leverage and total leverage ratios. In addition, the Company's senior secured credit facility and $325 million 8¾% senior subordinated notes restrict, among other things, the Company's ability to incur additional indebtedness, incur guarantee obligations, amend debt instruments, pay dividends, create liens on assets, make investments, engage in mergers or consolidations, and otherwise restrict corporate activities.

At December 31, 2011, the Company was in compliance with all required financial covenants.

**Interest Rate Swap Contracts**

In accordance with the terms of its previous senior secured credit facility, the Company was required to enter into fixed-rate debt or interest rate swap agreements in an amount equal to 50% of the Company's consolidated indebtedness, excluding the revolving credit facility, within 100 days of the closing date of the previous senior secured credit facility. This requirement was not included in the new senior secured credit facility. As discussed in Note 3, the Company de-designated its cash flow hedges on July 1, 2011 in connection with its new senior secured credit facility.

The effect of derivative instruments on the consolidated statement of operations for the year ended December 31, 2011 was as follows (in thousands):

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

| Derivatives Not Designated as Hedging Instruments | Location of Gain (Loss) Recognized in Income on Derivative | Gain (Loss) Recognized in Income on Derivative |
|---|---|---|
| Interest rate swap contracts | Interest expense | $ (10) |
| Total | | $ (10) |

The effect of derivative instruments on the consolidated statement of operations for the year ended December 31, 2010 was as follows (in thousands):

| Derivatives in a Cash Flow Hedging Relationship | Gain (Loss) Recognized in OCI on Derivative (Effective Portion) | Location of Gain (Loss) Reclassified from AOCI into Income (Effective Portion) | Gain (Loss) Reclassified from AOCI into Income (Effective Portion) | Location of Gain (Loss) Recognized in Income on Derivative (Ineffective Portion) | Gain (Loss) Recognized in Income on Derivative (Ineffective Portion) |
|---|---|---|---|---|---|
| Interest rate swap contracts | $ (13,998) | Interest expense | $ (24,424) | None | $ — |
| Total | $ (13,998) | | $ (24,424) | | $ — |

| Derivatives Not Designated as Hedging Instruments | Location of Gain (Loss) Recognized in Income on Derivative | Gain (Loss) Recognized in Income on Derivative |
|---|---|---|
| Interest rate swap contracts | Interest expense | $ (60) |
| Total | | $ (60) |

The effect of derivative instruments on the consolidated statement of operations for the year ended December 31, 2009 was as follows (in thousands):

| Derivatives in a Cash Flow Hedging Relationship | Gain (Loss) Recognized in OCI on Derivative (Effective Portion) | Location of Gain (Loss) Reclassified from AOCI into Income (Effective Portion) | Gain (Loss) Reclassified from AOCI into Income (Effective Portion) | Location of Gain (Loss) Recognized in Income on Derivative (Ineffective Portion) | Gain (Loss) Recognized in Income on Derivative (Ineffective Portion) |
|---|---|---|---|---|---|
| Interest rate swap contracts | $ (23,478) | Interest expense | $ (30,358) | None | $ — |
| Total | $ (23,478) | | $ (30,358) | | $ — |

| Derivatives Not Designated as Hedging Instruments | Location of Gain (Loss) Recognized in Income on Derivative | Gain (Loss) Recognized in Income on Derivative |
|---|---|---|
| Interest rate swap contracts | Interest expense | $ 359 |
| Total | | $ 359 |

In addition, during the years ended December 31, 2011, 2010 and 2009, the Company amortized to interest expense $7.2 million, $15.4 million and $15.9 million, respectively, in OCI related to the derivatives that were de-designated as hedging instruments under ASC 815, "Derivatives and Hedging."

There were no outstanding interest rate swap contracts as of December 31, 2011. Unrealized losses for the Company's interest rate swap contracts within accumulated other comprehensive loss within the consolidated balance sheet at December 31, 2010 was $9.4 million. The following table sets forth the fair value of the interest rate swap contract liabilities included in accrued interest within the consolidated balance sheet at December 31, 2010:

| | December 31, 2010 | |
|---|---|---|
| | Balance Sheet Location | Fair Value |
| **Derivatives designated as hedging instruments** | | |
| Interest rate swap contracts | Accrued interest | $ 13,034 |
| **Total derivatives designated as hedging instruments** | | $ 13,034 |
| **Derivatives not designated as hedging instruments** | | |
| Interest rate swap contracts | Accrued interest | $ 3,712 |
| **Total derivatives not designated as hedging instruments** | | $ 3,712 |
| **Total derivatives** | | $ 16,746 |

## 12. Commitments and Contingencies

### Litigation

The Company is subject to various legal and administrative proceedings relating to personal injuries, employment matters, commercial transactions and other matters arising in the normal course of business. The Company does not believe that the final outcome of these matters will have a material adverse effect on the Company's consolidated financial position or results of operations. In addition, the Company maintains what it believes is adequate insurance coverage to further mitigate the risks of such proceedings. However, such proceedings can be costly, time consuming and unpredictable and, therefore, no assurance can be given that the final outcome of such proceedings may not materially impact the Company's consolidated financial condition or results of operations. Further, no assurance can be given that the amount or scope of existing insurance coverage will be sufficient to cover losses arising from such matters.

The following proceedings could result in costs, settlements, damages, or rulings that materially impact the Company's consolidated financial condition or operating results. In each instance, the Company believes that it has meritorious defenses, claims and/or counter-claims, and intends to vigorously defend itself or pursue its claim.

The Illinois Legislature passed into law House Bill 1918, effective May 26, 2006, which singled out four of the nine Illinois casinos, including the Company's Hollywood Casino Joliet and Hollywood Casino Aurora, for a 3% surcharge to subsidize local horse racing interests. On May 30, 2006, Hollywood Casino Joliet and Hollywood Casino Aurora joined with the two other riverboats affected by the law, Harrah's Joliet and the Grand Victoria Casino in Elgin (collectively, the "Four Casinos"), and

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

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

On June 12, 2009, the Four Casinos filed a lawsuit in Illinois Federal Court naming former Illinois Governor Rod Blagojevich, his campaign fund, racetrack owner John Johnston, and his two racetracks as defendants alleging a civil conspiracy in violation of the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. §1962(c),(d) ("RICO"), based on an illegal scheme to secure the enactment of the 3% surcharge legislation in exchange for the payment of money by Johnston and entities controlled by him. The Four Casinos sought to impose a constructive trust over all funds paid under the surcharge, and therefore all of the Illinois racetracks were named as parties to the lawsuit. The defendants in the RICO case filed motions to dismiss. On December 7, 2009, the district court denied the motions to dismiss the RICO count, but it granted the motion to dismiss the constructive trust count, stating that it did not have jurisdiction in this case to impose the constructive trust. The Four Casinos appealed this dismissal to the Seventh Circuit Court of Appeals, which affirmed the dismissal in an en banc opinion. The Illinois racetracks are now free to use the monies that they received from the 3% surcharge. Since the passing of House Bill 1918 into law, Hollywood Casino Joliet and Hollywood Casino Aurora have recognized approximately $55.2 million in expense as a result of the 3% surcharge, including $5.5 million during the year ended December 31, 2011. The 3% surcharge is included in gaming expense within the consolidated statements of operations.

On July 16, 2008, the Company was served with a purported class action lawsuit brought by plaintiffs seeking to represent a class of shareholders who purchased shares of the Company's Common Stock between March 20, 2008 and July 2, 2008. The lawsuit alleges that the Company's disclosure

practices relative to the proposed transaction with Fortress Investment Group LLC ("Fortress") and Centerbridge Partners, L.P. ("Centerbridge") and the eventual termination of that transaction were misleading and deficient in violation of the Securities Exchange Act of 1934. The complaint, which seeks class certification and unspecified damages, was filed in federal court in Maryland. The complaint was amended, among other things, to add three new named plaintiffs and to name Peter M. Carlino, Chairman and Chief Executive Officer, and William J. Clifford, Senior Vice President and Chief Financial Officer, as additional defendants. The Company filed a motion to dismiss the complaint in November 2008, and the court granted the motion and dismissed the complaint with prejudice. The plaintiffs filed a motion for reconsideration, which was denied on October 21, 2009. The plaintiffs subsequently appealed the dismissal to the Fourth Circuit Court of Appeals and an oral argument was heard on October 26, 2010. On March 14, 2011, the Fourth Circuit Court of Appeals affirmed the decision of the lower court. The plaintiffs have requested the U.S. Supreme Court to consider an appeal of the decision. In October 2011, the U.S. Supreme Court denied the application for an appeal.

On September 11, 2008, the Board of County Commissioners of Cherokee County, Kansas (the "County") filed suit against Kansas Penn Gaming, LLC ("KPG," a wholly-owned subsidiary of Penn created to pursue a development project in Cherokee County, Kansas) and the Company in the District Court of Shawnee County, Kansas. The petition alleges that KPG breached its pre-development agreement with the County when KPG withdrew its application to manage a lottery gaming facility in Cherokee County and currently seeks in excess of $50 million in damages. In connection with their petition, the County obtained an ex-parte order attaching the $25 million privilege fee (which is included in current assets) paid to the Kansas Lottery Commission in conjunction with the gaming application for the Cherokee County zone. The defendants have filed motions to dissolve and reduce the attachment. Those motions were denied. Following discovery, both parties have filed dispositive motions.

On September 23, 2008, KPG filed an action against HV Properties of Kansas, LLC ("HV") in the U.S. District Court for the District of Kansas seeking a declaratory judgment from the U.S. District Court finding that KPG has no further obligations to HV under a Real Estate Sale Contract (the "Contract") that KPG and HV entered into on September 6, 2007, and that KPG properly terminated this Contract under the terms of the Repurchase Agreement entered into between the parties effective September 28, 2007. HV filed a counterclaim claiming KPG breached the Contract, and seeks $37.5 million in damages. On October 7, 2008, HV filed suit against the Company claiming the Company is liable to HV for KPG's alleged breach based on a Guaranty Agreement signed by the Company. Both cases were consolidated. Following extensive discovery and briefings, on July 23, 2010, the court granted KPG's motion for summary judgment and dismissed HV's claim. KPG filed a motion requesting reimbursement of the attorneys' fees and costs incurred in litigating this case pursuant to the terms of the Contract and was awarded approximately $0.9 million. HV has appealed both rulings of the district court. In December 2011, the Tenth Circuit Court of Appeals affirmed the district courts' rulings.

On March 11, 2011, CD Gaming Ventures, LLC ("CD Gaming"), a wholly-owned subsidiary of the Company and developer of the Columbus casino, filed suit in U.S. District Court against the City of Columbus (the "City"), Columbus officials, Franklin County and County officials. The lawsuit alleged that the City, Franklin County and various city and county officials violated the Company's rights under the U.S. and Ohio Constitutions, principally by removing preexisting sewer and water service in an effort to force annexation of the constitutionally-authorized casino site into the City. CD Gaming asked the court for an injunction preventing the City and the county from denying water and sewer service to the casino site and also sought monetary damages. On May 24, 2011, the City and CD Gaming announced they had reached a contingent agreement, subject to final documentation, that would result in the annexation of the casino site into the City in exchange for water and sewer service and other considerations. The agreement was conditioned, among other things, on the sale of real estate

previously purchased by the Company in downtown Columbus for $11 million and an acceptable settlement agreement with certain affiliates of the Columbus Dispatch. A sale agreement for the real estate in downtown Columbus closed on August 23, 2011 and a release and settlement agreement has been finalized with certain affiliates of the Columbus Dispatch.

**Operating Lease Commitments**

The Company is liable under numerous operating leases for assets including an airplane, automobiles, land for the property on which some of its casinos operate, other equipment and buildings, which expire at various dates through 2093. Total rental expense under these agreements was $28.9 million, $30.5 million, and $31.5 million for the years ended December 31, 2011, 2010 and 2009, respectively.

The leases for land consist of annual base lease rent payments plus, in some instances, a percentage rent based on a percent of adjusted gaming wins, as described in the respective leases.

The Company has an operating lease with the City of Bangor which covers the permanent facility that opened on July 1, 2008. Under the lease agreement, there is a fixed rent provision, as well as a revenue-sharing provision, which is equal to 3% of gross slot revenue. The final term of the lease, which commenced with the opening of the permanent facility, is for an initial term of fifteen years, with three ten-year renewal options.

On March 23, 2007, BTN, Inc. ("BTN"), one of the Company's wholly-owned subsidiaries, entered into an amended and restated ground lease (the "Amended Lease") with Skrmetta MS, LLC. The lease amends the prior ground lease, dated October 19, 1993. The Amended Lease requires BTN to maintain a minimum gaming operation on the leased premises and to pay rent equal to 5% of adjusted gaming win after gaming taxes have been deducted. The term of the Amended Lease expires on January 1, 2093.

The future minimum lease commitments relating to the base lease rent portion of noncancelable operating leases at December 31, 2011 are as follows (in thousands):

| Year ending December 31, | | |
|---|---|---|
| 2012 | $ | 6,451 |
| 2013 | | 5,156 |
| 2014 | | 3,743 |
| 2015 | | 2,370 |
| 2016 | | 1,973 |
| Thereafter | | 31,677 |
| Total | $ | 51,370 |

**Capital Expenditure Commitments**

The Company's current construction program for 2012 calls for capital expenditures of approximately $452.4 million (including licensing fees), of which the Company was contractually committed to spend approximately $205.0 million at December 31, 2011.

**Employee Benefit Plans**

The Company maintains a profit-sharing plan under the provisions of Section 401(k) of the Internal Revenue Code of 1986, as amended, which covers all eligible employees. The plan enables participating employees to defer a portion of their salary in a retirement fund to be administered by the Company. The Company makes a discretionary match contribution of 50% of employees' elective

salary deferrals, up to a maximum of 6% of eligible employee compensation. The matching contributions for the profit-sharing plan for the years ended December 31, 2011, 2010 and 2009 were $3.7 million, $3.5 million, and $3.6 million, respectively.

The Company also has a defined contribution plan, the Charles Town Races Future Service Retirement Plan, covering substantially all of its union employees at Hollywood Casino at Charles Town Races. Hollywood Casino at Charles Town Races makes annual contributions to this plan for the eligible union employees and to the Penn National Gaming, Inc. 401(k) Plan for the eligible non-union employees for an amount equal to the amount accrued for retirement expense, which is calculated as 0.25% of the daily mutual handle, 1.0% of net video lottery revenue up to a base and, after the base is met, it reverts to 0.5% and 0.84% of table and poker revenue, respectively. The contributions for the two plans at Hollywood Casino at Charles Town Races for the years ended December 31, 2011, 2010 and 2009 were $3.8 million, $3.1 million, and $2.7 million, respectively.

The Company maintains a non-qualified deferred compensation plan that covers most management and other highly-compensated employees. This plan was effective March 1, 2001. The plan allows the participants to defer, on a pre-tax basis, a portion of their base annual salary and/or their annual bonus, and earn tax-deferred earnings on these deferrals. The plan also provides for matching Company contributions that vest over a five-year period. The Company has established a Trust, and transfers to the Trust, on a periodic basis, an amount necessary to provide for its respective future liabilities with respect to participant deferral and Company contribution amounts. The Company's matching contributions for the non-qualified deferred compensation plan for the years ended December 31, 2011, 2010 and 2009 were $2.3 million, $1.8 million, and $1.5 million, respectively. The Company's deferred compensation liability, which was included in other current liabilities within the consolidated balance sheets, was $41.2 million and $37.6 million at December 31, 2011 and 2010, respectively.

**Labor Agreements**

The Company is required to have agreements with the horsemen at each of its racetracks to conduct its live racing and simulcasting activities, with the exception of the Company's tracks in Ohio and New Mexico. In addition, in order to operate gaming machines and table games in West Virginia, the Company must maintain agreements with each of the Charles Town Horsemen, pari-mutuel clerks and breeders.

At Hollywood Casino at Charles Town Races, the Company has an agreement with the Charles Town Horsemen expiring on December 31, 2012, and an agreement with the breeders that expires on June 30, 2012. The pari-mutuel clerks at Charles Town are represented under a collective bargaining agreement with the West Virginia Union of Mutuel Clerks, which expired on December 31, 2010 and has been informally extended on a month-to-month basis while negotiations are in process.

The Company's agreement with the Pennsylvania Thoroughbred Horsemen at Penn National Race Course expired on September 30, 2011 has been extended through February 29, 2012 pending continuing negotiations. The Company has a collective bargaining agreement with Local 137 of the Sports Arena Employees at Penn National Race Course with respect to pari-mutuel clerks, admissions and Telebet personnel which expired on December 31, 2011 and will likely be extended pending negotiations. The Company also has an agreement in place with Local 137 of the Sports Arena Employees with respect to pari-mutuel clerks and admission personnel at the Company's OTWs, which expires on August 31, 2013.

The Company's agreement with the Maine Harness Horsemen Association at Bangor Raceway expired on December 31, 2011. Although not required to have an agreement in place, the Company is in the process of negotiating a new agreement prior to the commencement of live racing which is expected to occur in May 2012.

The Company's agreement with the Ohio Harness Horsemen Association at Raceway Park expires on November 30, 2012. In connection with the acquisition of Beulah Park, the Company has assumed the agreement with the Ohio Horsemen's Protective and Benevolent Association, which expires on November 30, 2012. Rosecroft Raceway entered into agreements with the Cloverleaf Standardbred Owners Association and Maryland Standardbred Breeder's Association as of July 5, 2011. Both of these agreements expire on December 31, 2022.

Across certain of the Company's properties, the Seafarers Entertainment and Allied Trade Union represents approximately 1,860 of the Company's employees under agreements that expire at various times between June 2012 and November 2020. At Hollywood Casino Joliet, the Hotel Employees and Restaurant Employees Union ("UNITE/HERE") Local 1 represents approximately 280 employees under a collective bargaining agreement which expires on March 31, 2015. In addition, at some of the Company's properties, the Seafarer International Union of North America, Atlantic, Gulf, Lakes and Inland Waters District/NMU, AFL-CIO, the Security Police and Fire Professionals of America, the International Brotherhood of Electronic Workers, the UNITE/HERE Local 10, the Local No. 27 United Food and Commercial Workers, and the United Industrial, Service, Transportation, Professional and Government Workers of North America represent certain of the Company's employees under collective bargaining agreements that expire at various times between May 2012 and February 2020. None of these particular unions represent more than 50 of the Company's employees.

If the Company fails to maintain operative agreements with the horsemen at a track, it will not be permitted to conduct live racing and export and import simulcasting at that track and OTWs and, in West Virginia, the Company will not be permitted to operate its gaming machines and table games unless the state intervenes or changes the statute. In addition, the Company's simulcasting agreements are subject to the horsemen's approval. If the Company fails to renew or modify existing agreements on satisfactory terms, this failure could have a material adverse effect on its business, financial condition and results of operations. Except for the closure of the facilities at Penn National Race Course and its OTWs from February 16, 1999 to March 24, 1999 due to a horsemen's strike, and a few days at other times and locations, the Company has been able to maintain the necessary agreements. There can be no assurance that the Company will be able to maintain the required agreements.

**13. Income Taxes**

Deferred tax assets and liabilities are provided for the effects of temporary differences between the tax basis of an asset or liability and its reported amount in the consolidated balance sheets. These temporary differences result in taxable or deductible amounts in future years.

The components of the Company's deferred tax assets and liabilities are as follows:

| Year ended December 31, | 2011 | 2010 |
|---|---|---|
| | (in thousands) | |
| Deferred tax assets: | | |
| Stock-based compensation expense | $ 37,752 | $ 31,836 |
| Accrued expenses | 53,050 | 40,355 |
| Deferred tax assets resulting from unrecognized tax benefits | 12,231 | 10,371 |
| State net operating losses | 6,165 | 6,978 |
| Accumulated other comprehensive loss | 59 | 5,238 |
| Gross deferred tax assets | 109,257 | 94,778 |
| Less valuation allowance | (3,160) | (3,166) |
| Net deferred tax assets | 106,097 | 91,612 |
| Deferred tax liabilities: | | |
| Property, plant and equipment | (123,525) | (105,751) |
| Intangibles | (117,842) | (95,227) |
| Net deferred tax liabilities | (241,367) | (200,978) |
| Net: | $ (135,270) | $ (109,366) |
| Reflected on consolidated balance sheets: | | |
| Current deferred tax assets, net | $ 32,306 | $ 25,206 |
| Noncurrent deferred tax liabilities, net | (167,576) | (134,572) |
| Net deferred taxes | $ (135,270) | $ (109,366) |

For income tax reporting, the Company has gross state net operating loss carryforwards aggregating approximately $143.9 million available to reduce future state income taxes, primarily for the Commonwealth of Pennsylvania and the States of Mississippi, Colorado and Maryland as of December 31, 2011. The tax benefit associated with these net operating loss carryforwards is approximately $6.2 million. Due to state tax statutes on annual net operating loss utilization limits, the availability of gaming tax credits and income and loss projections in the applicable jurisdictions, a $3.2 million valuation allowance has been recorded to reflect the net operating losses which are not presently expected to be realized. If not used, substantially all the carryforwards will expire at various dates from December 31, 2012 to December 31, 2030.

In addition, certain subsidiaries have accumulated gross state net operating loss carryforwards aggregating approximately $857.1 million for which no benefit has been recorded as they are attributable to uncertain tax positions. The unrecognized tax benefits as of December 31, 2011 attributable to these net operating losses was approximately $54.1 million. Due to the uncertain tax position, these net operating losses are not included as components of deferred tax assets as of December 31, 2011. In the event of any benefit from realization of these net operating losses, $8.9 million would be treated as an increase to equity, and the remainder would be treated as a reduction of tax expense. If not used, substantially all the carryforwards will expire at various dates from December 31, 2012 to December 31, 2030.

The provision/(benefit) for income taxes charged to operations for the years ended December 31, 2011, 2010 and 2009 was as follows:

| Year ended December 31, | 2011 | 2010 (in thousands) | 2009 |
|---|---|---|---|
| Current tax expense | | | |
| Federal | $ 106,982 | $ 55,008 | $ 65,941 |
| State | 23,392 | 11,630 | 20,232 |
| Foreign | (5,053) | 1,744 | (233) |
| Total current | 125,321 | 68,382 | 85,940 |
| Deferred tax (benefit) expense | | | |
| Federal | 24,893 | (4,996) | (112,072) |
| State | (3,333) | 2,792 | (34,336) |
| Total deferred | 21,560 | (2,204) | (146,408) |
| Total provision/(benefit) | $ 146,881 | $ 66,178 | $ (60,468) |

The following table reconciles the statutory federal income tax rate to the actual effective income tax rate for 2011, 2010 and 2009:

| Year ended December 31, | 2011 | 2010 | 2009 |
|---|---|---|---|
| Percent of pretax income | | | |
| Federal taxes | 35.0% | 35.0% | 35.0% |
| State and local income taxes | 3.4% | 197.1% | 3.3% |
| Permanent differences | 2.2% | 1263.1% | (20.5)% |
| Foreign | (1.6)% | 16.1% | 0.4% |
| Other miscellaneous items | (1.3)% | (46.5)% | 0.2% |
| | 37.7% | 1464.8% | 18.4% |

| Year ended December 31, | 2011 | 2010 (in thousands) | 2009 |
|---|---|---|---|
| Amount based upon pretax income | | | |
| Federal taxes | $ 136,205 | $ 1,581 | $ (114,758) |
| State and local income taxes | 13,398 | 8,905 | (10,671) |
| Permanent differences | 8,405 | 57,058 | 67,166 |
| Foreign | (6,223) | 729 | (1,291) |
| Other miscellaneous items | (4,904) | (2,095) | (914) |
| | $ 146,881 | $ 66,178 | $ (60,468) |

A reconciliation of the beginning and ending amount for the liability for unrecognized tax benefits is as follows:

| | Noncurrent tax liabilities (in thousands) |
|---|---|
| Balance at December 31, 2009 | $ 46,702 |
| Additions based on current year positions | 5,712 |
| Reductions based on prior year positions | (1,749) |
| Decreases due to settlements and/or reduction in liabilities | (16,436) |
| Currency translation adjustments | 2,617 |
| Balance at December 31, 2010 | 36,846 |
| Additions based on current year positions | 4,309 |
| Additions based on prior year positions | 3,178 |
| Decreases due to settlements and/or reduction in liabilities | (10,422) |
| Currency translation adjustments | (39) |
| Balance at December 31, 2011 | $ 33,872 |

During the year ended December 31, 2011, the Company recorded $4.1 million of tax reserves and $0.2 million of accrued interest related to current year uncertain tax positions. In regards to prior year tax positions, the Company recorded $3.2 million of tax reserves and accrued interest and reversed $6.7 million and $3.7 million of previously recorded tax reserves and accrued interest, respectively, for uncertain tax positions that have settled and/or closed. Out of the $10.4 million of current year tax reverses and accrued interest reversals, $7.3 million related to foreign tax positions and $2.3 million was a reclassification against income taxes payable. The Company recorded $1.9 million of a federal deferred tax benefit in the current year associated with its uncertain tax positions. Overall, the Company recorded a net tax benefit of $2.5 million in connection with its uncertain tax positions as of December 31, 2011.

Included in the liability for unrecognized tax benefits at December 31, 2011 and 2010 were $21.5 million and $32.9 million, respectively, of tax positions that, if reversed, would affect the effective tax rate.

Included in the liability for unrecognized tax benefits at December 31, 2011 and 2010 were ($39) thousand and $2.6 million, respectively, of currency translation adjustments for foreign currency tax positions.

The Company is required under ASC 740 to disclose its accounting policy for classifying interest and penalties, the amount of interest and penalties charged to expense each period, as well as the cumulative amounts recorded in the consolidated balance sheets. The Company will continue to classify any income tax-related penalties and interest accrued related to unrecognized tax benefits in taxes on income within the consolidated statements of operations.

During the years ended December 31, 2011 and 2010, the Company recognized approximately $0.3 million and $1.0 million, respectively, of interest and penalties, net of deferred taxes. In addition, due to the filing of amended income tax returns, settlements and/or reductions in previously recorded liabilities, the Company had reductions in previously accrued interest and penalties of $2.3 million, net of deferred taxes. These accruals are included in income taxes and prepaid expenses within the consolidated balance sheet at December 31, 2011 and 2010, respectively.

The Company is currently in various stages of the examination process in connection with our open audits. Generally, it is difficult to determine when these examinations will be closed, but the

Company reasonably expects that its ASC 740 liabilities will not significantly change over the next twelve months.

As of December 31, 2011, the Company is subject to U.S. federal income tax examinations for the tax years 2008, 2009, and 2010. In addition, the Company is subject to state and local income tax examinations for various tax years in the taxing jurisdictions in which the Company operates.

At December 31, 2010, prepaid expenses within the consolidated balance sheet included prepaid income taxes of $42.4 million.

**14. Shareholders' Equity**

**Repurchase of Common Stock**

On June 9, 2010, the Company's Board of Directors authorized the repurchase of up to $300 million of the Company's Common Stock effective immediately and continuing until the Annual Meeting of Shareholders in 2011, unless otherwise extended or shortened by the Board of Directors. On June 9, 2011, the Board of Directors authorized the extension of the repurchase program previously authorized by the Board of Directors on June 9, 2010 which provided for the purchase of up to $300 million of the Company's Common Stock. The current authorization extends the repurchase program until the Annual Meeting of Shareholders in 2012, unless otherwise extended or shortened by the Board of Directors.

During the year ended December 31, 2011, the Company repurchased 2,981,406 shares of its Common Stock in open market transactions for approximately $105.2 million at an average price of $35.29 per share. During the year ended December 31, 2010, the Company repurchased 1,526,400 shares of its Common Stock in open market transactions for approximately $35.9 million at an average price of $23.49 per share. The Company did not repurchase any shares of its Common Stock in 2009.

**Issuance of the $1.25 billion, Zero Coupon Preferred Equity Investment**

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

On July 3, 2008, the Company entered into an agreement with certain affiliates of Fortress and Centerbridge, terminating the Merger Agreement. In connection with the termination of the Merger Agreement, the Company agreed to receive a total of $1.475 billion, consisting of a nonrefundable $225 million cash termination fee and a $1.25 billion, zero coupon, preferred equity investment (the "Investment"). On October 30, 2008, the Company closed the sale of the Investment and issued 12,500 shares of the Preferred Stock. During the year ended December 31, 2010, the Company repurchased 225 shares of Preferred Stock for $11.2 million.

The Investment is generally non-voting, but possesses voting rights with respect to certain extraordinary events. The Investment is entitled to vote with the Common Stock on an as-converted basis with respect to any change-in-control or other significant transaction if the consideration to be paid to shareholders is less than $45 per share (which amount is subject to adjustment in certain circumstances). In addition, the approval of holders of a majority of the Investment shares is required to authorize (i) special dividends to security holders of the Company; (ii) issuance by the Company of

equity securities senior to or on a parity with the Investment; (iii) stock repurchases, including but not limited to, by means of a tender offer which is funded by an asset sale outside the ordinary course (other than repurchases in the open market and repurchases by tender offer at not greater than a 20% premium); and (iv) certain other amendments to the terms of the Investment. At December 31, 2011, the Investment had an aggregate liquidation preference equal to $1.23 billion, the aggregate purchase price paid for the Investment shares (the "Purchase Price"), subject to certain adjustments. In addition, the Investment terms provide that the Investment participates in any dividends paid on the Common Stock. To the extent that the Company pays a special dividend, such special dividend will reduce the amount to be paid to the holders of the Investment upon a liquidation or redemption.

The Company is required to redeem, for either cash or common shares at the Company's election, all of the outstanding shares of the Investment on June 30, 2015, unless a change-in-control transaction in which all holders of shares of the Common Stock receive consideration in the transaction has occurred prior to that time. In the event of such a change-in-control transaction, the holders of the Investment will receive cash and/or other consideration in such transaction (the same consideration as the holders of Common Stock receive) with a value equal to the net present value of the Purchase Price, subject to increase or decrease in the event that the value of the consideration paid to the holders of the Common Stock is greater than $67 per share or less than $45 per share, respectively, which thresholds are subject to adjustment in certain circumstances.

The redemption price to be paid to the holders of the Investment on June 30, 2015 is equal to the Purchase Price, subject to increase or decrease in the event that the average trading price of the Common Stock (measured over the 20 consecutive trading days prior to May 26, 2015) is greater than $67 per share or less than $45 per share, respectively. There is no coupon payable with respect to the Investment. The Company shall redeem all of the Investment for cash, provided the Company may elect on or prior to June 1, 2015 to pay all or part of the redemption price in shares of the Common Stock. At December 31, 2011, the redemption price was $1.04 billion (27.3 million shares of Common Stock if the Company elected to redeem through the issuance of Common Stock).

The holders of the Investment are subject to the Investor Rights Agreement, dated as of July 3, 2008, by and among the Company, FIF V PFD LLC, Centerbridge Capital Partners, L.P., DB Investment Partners, Inc. and Wachovia Investment Holdings, LLC. (the "Investor Rights Agreement"), which, among other things, contains a voting agreement requiring certain Investment holders to vote all of their shares of Common Stock as directed by the Company and a standstill agreement restricting the activities of certain Investment holders. In addition, Investment holders who may receive 20% or more of the outstanding Common Stock upon redemption would be subject to Subchapter 25G of the Pennsylvania Business Corporation Law of 1988, as amended (the "Control Share Statute"). The Control Share Statute prohibits any person or group that acquires more than 20% of the voting power of the Company from voting any securities held by such person or group unless the shareholders vote to accord voting rights to such securities within 90 days of the time such threshold was exceeded. Under the Investment terms, unless such shareholder approval is obtained, the Investment holders shall execute and deliver a proxy in favor of an attorney-in-fact to be designated by the Board of Directors covering the number of shares of Common Stock necessary to avoid the application of the Control Share Statute.

The Investor Rights Agreement also provides that until Fortress and its affiliates own less than two-thirds of the shares of the Investment issued to them on October 30, 2008, Fortress and the Company must take all action in their power to appoint one designee of the purchasers (the "Purchaser Designee") as a Class II director on the Board of Directors and to use all commercially reasonable efforts to cause the election of the Purchaser Designee at every meeting thereafter at which a Class II director is to be elected. The initial Purchaser Designee is Wesley R. Edens. Mr. Edens is the founding principal and Co-Chairman of the Board of Directors of Fortress.

Under the terms of the Investor Rights Agreement, the Company has agreed to file a short-form registration statement with the U.S. Securities and Exchange Commission for the registration and sale of Investment shares and certain shares of Common Stock owned by the purchasers ("Registrable Securities"), which it filed on December 30, 2008. The Company is required to keep the shelf registration statement continuously effective under the Securities Act of 1933, as amended, until the earlier of (i) such time as all Registrable Securities have been sold and (ii) such time as the purchasers beneficially own (as defined in the Investor Rights Agreement) less than 2.5% of the Common Stock on a fully-diluted basis (including Common Shares issuable upon redemption of the Investment shares at maturity). The purchasers and any permitted transferees of Registrable Securities are also entitled to four demand registrations and unlimited piggyback registration during the term of the Investor Rights Agreement.

Under the Investor Rights Agreement, each Investment holder has preemptive rights with respect to certain sales of Common Stock, stock options or securities convertible into Common Stock for so long as such holder beneficially owns at least two-thirds of the shares of the Investment issued to it on October 30, 2008.

**15. Noncontrolling Interests**

In November 2009, the Company entered into a Funding and Option Agreement with Lakes Entertainment, Inc. ("Lakes"), permitting Lakes to invest up to a 10% equity interest in each of the Company's proposed facilities in Columbus and Toledo, Ohio.

During the year ended December 31, 2010, Lakes made no contribution to the Company towards the proposed facilities, and its portion of the net loss for the proposed facilities was $2.2 million. During the year ended December 31, 2009, Lakes contributed $1.9 million to the Company towards the proposed facilities, and its portion of the net loss for the proposed facilities was $2.5 million.

On July 16, 2010, the Company paid $25 million to Lakes to terminate the agreement. In exchange for this payment, Lakes agreed to relinquish all of its rights, title and interests held in connection with these two projects. In accordance with ASC 810, "Consolidation," the Company accounted for this change in ownership interest as an adjustment through equity attributable to the parent. Therefore, the Company recorded the $25 million payment and the cumulative $2.8 million loss attributable to noncontrolling interests from previous periods to additional paid in capital.

**16. Stock-Based Compensation**

On April 16, 2003, the Company's Board of Directors adopted and approved the 2003 Long Term Incentive Compensation Plan (the "2003 Plan"). On May 22, 2003, the Company's shareholders approved the 2003 Plan. The 2003 Plan was effective June 1, 2003 and permitted the grant of options to purchase Common Stock and other market-based and performance-based awards. Up to 12,000,000 shares of Common Stock were available for awards under the 2003 Plan. The 2003 Plan provided for the granting of both incentive stock options intended to qualify under Section 422 of the Internal Revenue Code of 1986, as amended, and nonqualified stock options, which do not so qualify. The exercise price per share may be no less than (i) 100% of the fair market value of the Common Stock on the date an option is granted for incentive stock options and (ii) 85% of the fair market value of the Common Stock on the date an option is granted for nonqualified stock options. This plan will remain in place until it terminates in 2013. However the shares which remained available for issuance under such plan as of November 12, 2008 are no longer available for issuance and all future equity awards will be pursuant to the 2008 Long Term Incentive Compensation Plan (the "2008 Plan") described below.

On August 20, 2008, the Company's Board of Directors adopted and approved the 2008 Plan. On November 12, 2008, the Company's shareholders approved the 2008 Plan. The 2008 Plan permits the

Company to issue stock options (incentive and/or non-qualified), stock appreciation rights, restricted stock, phantom stock units and other equity and cash awards to employees. Non-employee directors are eligible to receive all such awards, other than incentive stock options. On June 9, 2011, the Company's shareholders approved an amendment to the 2008 Plan to increase the aggregate number of shares of Common Stock that may be issued by 2,350,000 to 9,250,000. Awards of stock options and stock appreciation rights will be counted against the 9,250,000 limit as one share of Common Stock for each share granted. However, each share awarded in the form of restricted stock, or any other full value stock award, will be counted as issuing 2.44 shares of Common Stock for purposes of determining the number of shares available for issuance under the plan. Any awards that are not settled in shares of Common Stock shall not count against this limit. At December 31, 2011, there were 2,929,655 options available for future grants under the 2008 Plan.

Stock options that expire between January 6, 2012 and October 11, 2018 have been granted to officers, directors and employees to purchase Common Stock at prices ranging from $7.95 to $61.82 per share. All options were granted at the fair market value of the Common Stock on the date the options were granted. The Company issues new authorized common shares to satisfy stock option exercises as well as restricted stock lapses.

The following table contains information on stock options issued under the plans for the three-year period ended December 31, 2011:

| | Number of Option Shares | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Term (in years) | Aggregate Intrinsic Value (in thousands) |
|---|---|---|---|---|
| Outstanding at December 31, 2008 | 8,804,578 | $ 28.27 | 6.30 | $ 17,677 |
| Granted | 1,849,375 | 22.32 | | |
| Exercised | (491,078) | 11.06 | | |
| Canceled | (196,750) | 32.27 | | |
| Outstanding at December 31, 2009 | 9,966,125 | $ 27.83 | 5.67 | $ 33,038 |
| Granted | 1,868,500 | 27.19 | | |
| Exercised | (823,056) | 13.96 | | |
| Canceled | (177,125) | 28.84 | | |
| Outstanding at December 31, 2010 | 10,834,444 | $ 28.75 | 5.16 | $ 76,807 |
| Granted | 1,631,000 | 35.47 | | |
| Exercised | (695,915) | 24.02 | | |
| Canceled | (161,500) | 26.96 | | |
| Outstanding at December 31, 2011 | 11,608,029 | $ 30.00 | 4.53 | $ 100,337 |

Included in the above are Common Stock options that were issued in 2003 to the Company's Chairman outside of the Company's stock option plans. These options were issued at $7.95 per share, and are exercisable through February 6, 2013. At December 31, 2011, 2010 and 2009, the number of these Common Stock options that were outstanding was 23,750.

The weighted-average grant-date fair value of options granted during the years ended December 31, 2011, 2010 and 2009 were $16.68, $12.92, and $8.91, respectively.

| Exercisable at December 31, | Number of Option Shares | Weighted-Average Exercise Price |
|---|---|---|
| 2011 | 7,490,154 | $ 30.26 |
| 2010 | 6,586,882 | 29.85 |
| 2009 | 5,872,151 | 27.41 |

The aggregate intrinsic value of stock options exercised during the years ended December 31, 2011, 2010 and 2009 was $9.5 million, $15.1 million, and $8.4 million, respectively.

At December 31, 2011, there were 7,490,154 shares that were exercisable, with a weighted-average exercise price of $30.26, a weighted-average remaining contractual term of 4.08 years, and an aggregate intrinsic value of $64.7 million.

The following table summarizes information about stock options outstanding at December 31, 2011:

| | Exercise Price Range | | | Total |
|---|---|---|---|---|
| | $7.95 to $29.22 | $29.34 to $35.15 | $35.75 to $61.82 | $7.95 to $61.82 |
| **Outstanding options** | | | | |
| Number outstanding | 5,559,390 | 4,484,390 | 1,564,249 | 11,608,029 |
| Weighted-average remaining contractual life (years) | 3.75 | 5.30 | 5.13 | 4.53 |
| Weighted-average exercise price | $ 24.66 | $ 32.63 | $ 41.48 | $ 30.00 |
| **Exercisable options** | | | | |
| Number outstanding | 3,457,765 | 2,628,140 | 1,404,249 | 7,490,154 |
| Weighted-average exercise price | $ 24.48 | $ 31.68 | $ 41.82 | $ 30.26 |

The following table contains information on restricted stock awards issued under the plans for the three-year period ended December 31, 2011:

| | Number of Award Shares |
|---|---|
| Outstanding at December 31, 2008 | 380,000 |
| Awarded | 332,690 |
| Released | (160,000) |
| Canceled | — |
| Outstanding at December 31, 2009 | 552,690 |
| Awarded | 165,110 |
| Released | (203,734) |
| Canceled | (20,000) |
| Outstanding at December 31, 2010 | 494,066 |
| Awarded | 97,005 |
| Released | (234,772) |
| Canceled | (1,010) |
| Outstanding at December 31, 2011 | 355,289 |

Compensation costs related to stock-based compensation for the years ended December 31, 2011, 2010 and 2009 totaled $24.7 million pre-tax ($17.8 million after-tax), $26.0 million pre-tax ($19.1 million after-tax) and $28.4 million pre-tax ($20.9 million after-tax), respectively, and are included within the consolidated statements of operations under general and administrative expense.

At December 31, 2011 and 2010, the total compensation cost related to nonvested awards not yet recognized equaled $40.1 million and $37.2 million, respectively, including $34.2 million and $30.1 million for stock options, respectively, and $5.9 million and $7.1 million for restricted stock, respectively. This cost is expected to be recognized over the remaining vesting periods, which will not exceed five years.

Beginning in the fourth quarter of 2010, the Company issued cash-settled phantom stock unit awards, which vest over a period up to five years. Cash-settled phantom stock unit awards entitle employees and directors to receive cash based on the fair value of the Company's Common Stock on the vesting date. These phantom stock unit awards are accounted for as liability awards and are re-measured at fair value each reporting period until they become vested with compensation expense being recognized over the requisite service period in accordance with ASC 718-30 "Compensation—Stock Compensation, Awards Classified as Liabilities." As of December 31, 2011, there was $5.9 million of total unrecognized compensation cost that will be recognized over the grants remaining vesting period. For the years ended December 31, 2011 and 2010, the Company recognized $2.1 million and $0.4 million, respectively, of compensation expense associated with these awards.

Additionally starting in 2011, the Company issued stock appreciation rights to certain employees, which vest over a period of four years. The Company's stock appreciation rights are accounted for as liability awards since they will be settled in cash. The fair value of these awards is calculated during each reporting period and estimated using the Black-Scholes option pricing model based on the various inputs discussed previously. As of December 31, 2011, there was $5.2 million of total unrecognized compensation cost that will be recognized over the awards remaining weighted average vesting period. For the year ended December 31, 2011, the Company recognized $1.4 million of compensation expense associated with these awards.

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Stock options that expire between January 6, 2012 and October 11, 2018 have been granted to officers, directors and employees to purchase Common Stock at prices ranging from $7.95 to $61.82 per share. All options were granted at the fair market value of the Common Stock on the date the options were granted. The Company issues new authorized common shares to satisfy stock option exercises as well as restricted stock lapses.

The following table contains information on stock options issued under the plans for the three-year period ended December 31, 2011:

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The weighted-average grant-date fair value of options granted during the years ended December 31, 2011, 2010 and 2009 were $16.68, $12.92, and $8.91, respectively.

| Exercisable at December 31, | Number of Option Shares | Weighted-Average Exercise Price |
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| 2011 | 7,490,154 | $ 30.26 |
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| 2009 | 5,872,151 | 27.41 |

The aggregate intrinsic value of stock options exercised during the years ended December 31, 2011, 2010 and 2009 was $9.5 million, $15.1 million, and $8.4 million, respectively.

At December 31, 2011, there were 7,490,154 shares that were exercisable, with a weighted-average exercise price of $30.26, a weighted-average remaining contractual term of 4.08 years, and an aggregate intrinsic value of $64.7 million.

The following table summarizes information about stock options outstanding at December 31, 2011:

| | Exercise Price Range | | | Total |
|---|---|---|---|---|
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| **Outstanding options** | | | | |
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| **Exercisable options** | | | | |
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| Canceled | — |
| Outstanding at December 31, 2009 | 552,690 |
| Awarded | 165,110 |
| Released | (203,734) |
| Canceled | (20,000) |
| Outstanding at December 31, 2010 | 494,066 |
| Awarded | 97,005 |
| Released | (234,772) |
| Canceled | (1,010) |
| Outstanding at December 31, 2011 | 355,289 |

Compensation costs related to stock-based compensation for the years ended December 31, 2011, 2010 and 2009 totaled $24.7 million pre-tax ($17.8 million after-tax), $26.0 million pre-tax ($19.1 million after-tax) and $28.4 million pre-tax ($20.9 million after-tax), respectively, and are included within the consolidated statements of operations under general and administrative expense.

At December 31, 2011 and 2010, the total compensation cost related to nonvested awards not yet recognized equaled $40.1 million and $37.2 million, respectively, including $34.2 million and $30.1 million for stock options, respectively, and $5.9 million and $7.1 million for restricted stock, respectively. This cost is expected to be recognized over the remaining vesting periods, which will not exceed five years.

Beginning in the fourth quarter of 2010, the Company issued cash-settled phantom stock unit awards, which vest over a period up to five years. Cash-settled phantom stock unit awards entitle employees and directors to receive cash based on the fair value of the Company's Common Stock on the vesting date. These phantom stock unit awards are accounted for as liability awards and are re-measured at fair value each reporting period until they become vested with compensation expense being recognized over the requisite service period in accordance with ASC 718-30 "Compensation—Stock Compensation, Awards Classified as Liabilities." As of December 31, 2011, there was $5.9 million of total unrecognized compensation cost that will be recognized over the grants remaining vesting period. For the years ended December 31, 2011 and 2010, the Company recognized $2.1 million and $0.4 million, respectively, of compensation expense associated with these awards.

Additionally starting in 2011, the Company issued stock appreciation rights to certain employees, which vest over a period of four years. The Company's stock appreciation rights are accounted for as liability awards since they will be settled in cash. The fair value of these awards is calculated during each reporting period and estimated using the Black-Scholes option pricing model based on the various inputs discussed previously. As of December 31, 2011, there was $5.2 million of total unrecognized compensation cost that will be recognized over the awards remaining weighted average vesting period. For the year ended December 31, 2011, the Company recognized $1.4 million of compensation expense associated with these awards.

**17. Segment Information**

The following tables present certain information with respect to the Company's segments. Intersegment revenues between the Company's segments were not material in any of the periods presented below.

| | Midwest(1)(2) | East/West(3) | Southern Plains | Other(4) | Total |
|---|---|---|---|---|---|
| | | | (in thousands) | | |
| **Year ended December 31, 2011** | | | | | |
| Net revenues | $ 826,436 | $ 1,290,732 | $ 590,709 | $ 34,380 | $ 2,742,257 |
| Income (loss) from operations | 211,356 | 263,423 | 137,580 | (112,778) | 499,581 |
| Depreciation and amortization | 62,844 | 85,723 | 53,764 | 9,145 | 211,476 |
| (Loss) gain from unconsolidated affiliates | — | — | (4,834) | 12,198 | 7,364 |
| Capital expenditures | 206,081 | 51,701 | 25,488 | 9,811 | 293,081 |
| **Year ended December 31, 2010** | | | | | |
| Net revenues | 825,847 | 997,262 | 602,257 | 33,745 | 2,459,111 |
| (Loss) income from operations | (39,514) | 181,175 | 125,318 | (113,753) | 153,226 |
| Depreciation and amortization | 64,402 | 79,244 | 59,777 | 8,964 | 212,387 |
| Loss from unconsolidated affiliates | — | — | (2,242) | (23,732) | (25,974) |
| Impairment losses | 220,236 | — | — | 4,473 | 224,709 |
| Capital expenditures | 198,282 | 118,398 | 41,215 | 5,060 | 362,955 |
| **Year ended December 31, 2009** | | | | | |
| Net revenues | 806,866 | 896,941 | 632,543 | 32,925 | 2,369,275 |
| (Loss) income from operations | (346,260) | 137,418 | 136,164 | (121,920) | (194,598) |
| Depreciation and amortization | 49,007 | 78,896 | 57,676 | 8,857 | 194,436 |
| Loss from unconsolidated affiliates | — | — | (295) | (826) | (1,121) |
| Impairment losses | 532,377 | — | — | — | 532,377 |
| Capital expenditures | 195,648 | 59,566 | 31,451 | 2,886 | 289,551 |
| **Balance sheet at December 31, 2011** | | | | | |
| Total assets | 1,897,164 | 1,265,438 | 1,034,506 | 409,238 | 4,606,346 |
| Investment in and advances to unconsolidated affiliates | — | 110 | 107,204 | 66,802 | 174,116 |
| Goodwill and other intangible assets, net | 925,822 | 226,234 | 394,018 | 55,878 | 1,601,952 |
| **Balance sheet at December 31, 2010** | | | | | |
| Total assets | 1,730,760 | 1,279,200 | 997,748 | 455,171 | 4,462,879 |
| Investment in and advances to unconsolidated affiliates | — | 120 | 41,028 | 22,972 | 64,120 |
| Goodwill and other intangible assets, net | 923,414 | 226,450 | 394,018 | 57,026 | 1,600,908 |

(1)

As a result of decreased earning projections resulting from an anticipated increase in competition from the scheduled opening of a casino in the second half of 2011 in Des Plaines, Illinois, as well as continued challenging market conditions in the Chicagoland regional market, the Company recorded a pre-tax goodwill impairment charge during the year ended December 31, 2010 of $144.6 million ($144.6 million, net of taxes) at Hollywood Casino Aurora and $44.2 million ($28.4 million, net of taxes) at Hollywood Casino Joliet, respectively. In addition, in conjunction with the voters determining that the Company's casino in Columbus, Ohio will be located at the site of the former Delphi Automotive plant along Columbus's West Side, rather than the original site in the Arena District, the Company recorded a pre-tax impairment charge of $31.3 million ($20.1 million, net of taxes) during the year December 31, 2010 for the parcel of land that the Company purchased in Columbus's Arena District.

(2)

As a result of the anticipated impact of gaming expansion in Ohio, the Company recorded a pre-tax impairment charge of $520.5 million ($368.8 million, net of taxes) during the year ended December 31, 2009, as the Company determined that a portion of the value of the goodwill and indefinite-life intangible assets

associated with the original purchase of Hollywood Casino Lawrenceburg was impaired. In addition, in conjunction with the opening of the new casino riverboat at Hollywood Casino Lawrenceburg, the Company recorded a pre-tax impairment charge for the replaced Lawrenceburg vessel of $11.9 million ($7.1 million, net of taxes) during the year ended December 31, 2009.

(3)

Net revenue and income from operations for the East/West segment increased by $293.5 million and $82.2 million, respectively, for the year ended December 31, 2011, as compared to the corresponding period in the prior year, primarily due to the acquisition of the M Resort on June 1, 2011, as well as the opening of Hollywood Casino Perryville on September 27, 2010. The East/West segment also experienced an increase in net revenue and income from operations for the years ended December 31, 2011 and 2010 from the introduction of table games in July 2010 at Hollywood Casino at Charles Town Races and Hollywood Casino at Penn National Race Course.

(4)

(Loss) gain from unconsolidated affiliates for Other for the year ended December 31, 2011 included a gain of $20.2 million on the sale of the Company's joint venture interest in the Maryland Jockey Club in July 2011, whereas results for the year ended December 31, 2010 included the Company's share of losses in the Maryland Jockey Club, which included a $14.4 million charge for the Company's share of a goodwill impairment write-down recorded by the Maryland Jockey Club during the fourth quarter of 2010 as a result of a negative outcome related to a zoning referendum.

**18. Summarized Quarterly Data (Unaudited)**

The following table summarizes the quarterly results of operations for the years ended December 31, 2011 and 2010:

| | Fiscal Quarter | | | |
|---|---|---|---|---|
| | First | Second | Third | Fourth |
| | (in thousands, except per share data) | | | |
| **2011** | | | | |
| Net revenues | $ 667,023 | $ 687,879 | $ 710,905 | $ 676,450 |
| Income from operations | 122,735 | 140,592 | 130,335 | 105,919 |
| Net income | 51,528 | 75,989 | 70,803 | 44,031 |
| Earnings per common share: | | | | |
| Basic earnings per common share | 0.53 | 0.79 | 0.73 | 0.46 |
| Diluted earnings per common share | 0.48 | 0.71 | 0.66 | 0.41 |
| **2010** | | | | |
| Net revenues | $ 592,323 | $ 598,311 | $ 638,256 | $ 630,221 |
| Income (loss) from operations | 92,351 | 51,711 | 110,462 | (101,298) |
| Net income (loss) including noncontrolling interests | 36,155 | 6,972 | 48,345 | (153,132) |
| Net income (loss) attributable to the shareholders of Penn National Gaming, Inc. and subsidiaries | 36,164 | 9,156 | 48,345 | (153,132) |
| Earnings (loss) per common share attributable to the shareholders of Penn National Gaming, Inc. and shareholders: | | | | |
| Basic earnings (loss) per common share | 0.37 | 0.09 | 0.51 | (1.97) |
| Diluted earnings (loss) per common share | 0.34 | 0.09 | 0.46 | (1.97) |

As a result of decreased earning projections resulting from an anticipated increase in competition from the scheduled opening of a casino in the second half of 2011 in Des Plaines, Illinois, as well as continued challenging market conditions in the Chicagoland regional market, the Company recorded a pre-tax goodwill impairment charge of $144.6 million ($144.6 million, net of taxes) at Hollywood Casino Aurora and $44.2 million ($28.4 million, net of taxes) at Hollywood Casino Joliet, respectively, during the fourth quarter of 2010. Additionally during the fourth quarter of 2010, the Company wrote-down

the remaining value of the Argosy trademark intangible asset of $4.4 million ($2.8 million, net of taxes) due to management's strategy to transition Argosy properties to the Hollywood Casino brand.

In addition, in conjunction with the voters determining that the Company's casino in Columbus, Ohio will be located at the site of the former Delphi Automotive plant along Columbus's West Side, rather than the original site in the Arena District, the Company recorded a pre-tax impairment charge of $30.5 million ($19.6 million, net of taxes) during the second quarter of 2010 for the parcel of land that the Company purchased in Columbus's Arena District.

**19. Related Party Transactions**

The Company currently leases 45,917 square feet of executive office and warehouse space for buildings in Wyomissing, Pennsylvania from affiliates of its Chairman and Chief Executive Officer. Rent expense for the years ended December 31, 2011, 2010 and 2009 amounted to $0.9 million, $0.9 million, and $0.9 million, respectively. The leases for the office space expire in March 2012, May 2012 and May 2013, and the lease for the warehouse space expires in July 2013. The future minimum lease commitments relating to these leases at December 31, 2011 equaled $0.6 million.

**20. Subsidiary Guarantors**

Under the terms of the $2.15 billion senior secured credit facility, all of Penn's subsidiaries are guarantors under the agreement, with the exception of several minor subsidiaries with total assets, excluding intercompany balances, of $202.6 million (approximately 4.4% of total assets at December 31, 2011). Each of the subsidiary guarantors is 100% owned by Penn. In addition, the guarantees provided by Penn's subsidiaries under the terms of the $2.15 billion senior secured credit facility are full and unconditional, joint and several, and Penn had no significant independent assets and no independent operations at, and for the year ended December 31, 2011. There are no significant restrictions within the $2.15 billion senior secured credit facility on the Company's ability to obtain funds from its subsidiaries by dividend or loan. However, in certain jurisdictions, the gaming authorities may impose restrictions pursuant to the authority granted to them with regard to Penn's ability to obtain funds from its subsidiaries.

With regard to the $2.15 billion senior secured credit facility, the Company has not presented condensed consolidating balance sheets, condensed consolidating statements of operations and condensed consolidating statements of cash flows at, and for the year ended December 31, 2011, as Penn had no significant independent assets and no independent operations at, and for the year ended December 31, 2011, the guarantees are full and unconditional and joint and several, and any subsidiaries of Penn other than the subsidiary guarantors are considered minor.

The Company's $325 million 8¾ senior subordinated notes are not guaranteed by the Company's subsidiaries.

**21. Fair Value Measurements**

ASC 820, "Fair Value Measurements and Disclosures," establishes a hierarchy that prioritizes fair value measurements based on the types of inputs used for the various valuation techniques (market approach, income approach, and cost approach). The levels of the hierarchy are described below:

- Level 1: Observable inputs such as quoted prices in active markets for identical assets or liabilities.

- Level 2: Inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly; these include quoted prices for similar assets or liabilities in active markets, such as interest rates and yield curves that are observable at commonly quoted intervals.

- Level 3: Unobservable inputs that reflect the reporting entity's own assumptions, as there is little, if any, related market activity.

The Company's assessment of the significance of a particular input to the fair value measurement requires judgment, and may affect the valuation of assets and liabilities and their placement within the fair value hierarchy.

The following tables set forth the assets and liabilities measured at fair value on a recurring basis, by input level, in the consolidated balance sheets at December 31, 2011 and 2010 (in thousands):

| | Balance Sheet Location | Quoted Prices in Active Markets for Identical Assets or Liabilities (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | December 31, 2011 Total |
|---|---|---|---|---|---|
| Assets: | | | | | |
| Investment in corporate debt securities | Other assets | $ — | $ 6,790 | $ — | $ 6,790 |

| | Balance Sheet Location | Quoted Prices in Active Markets for Identical Assets or Liabilities (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | December 31, 2010 Total |
|---|---|---|---|---|---|
| Assets: | | | | | |
| Investment in corporate debt securities | Other assets | $ 5,828 | $ — | $ — | $ 5,828 |
| Liabilities: | | | | | |
| Interest rate swap contracts | Accrued interest | — | 16,746 | — | 16,746 |

The valuation technique used to measure the fair value of the investment in corporate debt securities and interest rate swap contracts was the market approach. See Note 3 for a description of the inputs used in calculating the fair value measurements of investment in corporate debt securities and interest rate swap contracts. Although the Company determined that the majority of the inputs used to value its interest rate swap contracts fell within Level 2 of the fair value hierarchy, the credit valuation adjustments associated with it utilized Level 3 inputs, such as estimates of current credit spreads to evaluate the likelihood of default by itself and its counterparties. However, as of December 31, 2010, the Company assessed the significance of the impact of the credit valuation adjustments on the overall valuation of its interest rate swap contracts and determined that the credit valuation adjustments were not significant to the overall valuation. As a result, the Company determined that its interest rate swap contracts were classified in Level 2 of the fair value hierarchy. The Company did not have any outstanding interest rate swap contracts as of December 31, 2011.

At December 31, 2011, the Company's investment in corporate debt securities was transferred from Level 1 to Level 2 due to a lack of trading in the security in the fourth quarter of 2011.

There were no significant long-lived assets measured at fair value on a nonrecurring basis during the year ended December 31, 2011. The amounts below represent the assets and liabilities measured at fair value on a nonrecurring basis during the year ended December 31, 2010 (in thousands):

| | Balance Sheet Location | Quoted Prices in Active Markets for Identical Assets or Liabilities (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Balance at December 31, 2010 Total | Total Reduction in Fair Value Recorded at December 31, 2010 |
|---|---|---|---|---|---|---|
| Assets: | | | | | | |
| Goodwill | Goodwill | $ — | $ — | $ 235,924 | $ 235,924 | $ (188,855) |
| Indefinite-life intangible assets | Other intangible assets | — | — | — | — | (4,351) |
| Long-lived assets | Other assets | — | 17,310 | — | 17,310 | (31,503) |
| | | | | | | $ (224,709) |

For the year ended December 31, 2010, as a result of decreased earning projections resulting from an anticipated increase in competition from the scheduled opening of a casino in the second half of 2011 in Des Plaines, Illinois, as well as continued challenging market conditions in the Chicagoland regional market, the Company recorded a pre-tax goodwill impairment charge of $144.6 million at Hollywood Casino Aurora and $44.2 million at Hollywood Casino Joliet.

Additionally, during the year ended December 31, 2010, the Company wrote-off the trademark intangible asset associated with the Argosy acquisition for $4.4 million due to management's strategy to transition Argosy properties to the Hollywood Casino brand.

In addition, in conjunction with the voters determining that the Company's casino in Columbus, Ohio will be located at the site of the former Delphi Automotive plant along Columbus's West Side, the Company recorded a pre-tax impairment charge of $31.3 million for the year ended December 31, 2010 for the parcel of land that the Company purchased in Columbus's Arena District, as the asset was reclassified as held for sale in 2010. This land was sold in August 2011, which did not have a significant impact on the Company's consolidated statement of operations. For the year ended December 31, 2010, the Company recorded a $0.2 million charge on the replaced vessel at Hollywood Casino Lawrenceburg.

The valuation technique used to measure the fair value of goodwill, indefinite-life intangible assets and long-lived assets was the market approach. For the land he for sale in Columbus, Ohio, the Company engaged a qualified external real estate appraiser to assist in the valuation, which was based on the sales prices of properties with similar characteristics to the Company's property in the Columbus Arena District. See Note 3 for a description of the inputs and the information used to develop the inputs in calculating the fair value measurements of goodwill, indefinite-life intangible assets and long-lived assets.

**22. Insurance Recoveries and Deductibles**

*Hollywood Casino Joliet Fire*

On March 20, 2009, Hollywood Casino Joliet, which was undergoing a $55 million renovation, was closed following a fire that started in the land-based pavilion at the facility. All customers and employees were successfully evacuated, and the fire was contained on the land-side of the property before it could spread to the adjacent casino barge. On June 25, 2009, the casino barge was reopened with temporary land-based facilities, and the Company began construction of a new land-based pavilion. In December 2010, the first phase of the new permanent land-based pavilion was opened to the public and in January 2011 the final phase, including a sports bar, was completed.

At the time of the fire, the Company carried a builders' risk insurance policy for the on-going renovations with a policy limit of $57 million, inclusive of $14 million for delay in completion and $43 million for property damage. The builders' risk insurance policy included a $50,000 property damage deductible and a 30-day delay in completion deductible for the peril of fire. In addition, the Company carried comprehensive business interruption and property damage insurance for the operational components of Hollywood Casino Joliet with an overall limit of $228 million. The operational insurance policy included a $2.5 million property damage deductible and a 48-hour business interruption deductible for the peril of fire.

The Company received $81.2 million in insurance proceeds related to the fire at Hollywood Casino Joliet, with $18.6 million, $42.0 million and $20.6 million received during the years ended December 31, 2011, 2010 and 2009, respectively. As the insurance recovery amount exceeded the net book value of assets believed to be damaged, destroyed or abandoned and other costs incurred as a result of the fire at Hollywood Casino Joliet in 2010, the Company recorded a pre-tax gain of $18.5 million and $7.5 million during the years ended December 31, 2011 and 2010, respectively. During the second quarter of 2011, the insurance claim for the fire at Hollywood Casino Joliet was settled and no further proceeds will be received.

During the year ended December 31, 2009, the Company recorded a $6.1 million pre-tax loss for the insurance deductibles for property damage, business interruption and employee lost wages, as well as a write-off of construction fees related to this renovation that were not recoverable under the Company's insurance policies and certain consulting fees.

*Hollywood Casino Tunica Flood*

On May 1, 2011, Hollywood Casino Tunica was forced to close as a result of flooding by the Mississippi River. Due to the flooding, access to the property was temporarily cut off and the property sustained minor damage. The property reopened on May 25, 2011.

At the time of the flood, the Company carried property insurance coverage with a flood limit of $300 million for both property damage and business interruption applicable to this event. This coverage included a $5 million property damage and two day business interruption deductible for the peril of flood.

During the year ended December 31, 2011, the Company recorded a $5.2 million pre-tax loss for the insurance deductibles for property damage and business interruption.

The $1.1 million insurance receivable within the consolidated balance sheet at December 31, 2011 was limited to the net book value of assets believed to be damaged and other costs incurred as a result of the flood at Hollywood Casino Tunica that are expected to be recovered via the insurance claim. During the year ended December 31, 2011, the Company received $7.0 million in insurance proceeds related to the flood at Hollywood Casino Tunica.

## ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None

## ITEM 9A. CONTROLS AND PROCEDURES

### Disclosure Controls and Procedures

The Company's management, under the supervision and with the participation of our principal executive officer and principal financial officer, has evaluated the effectiveness of the Company's disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), as of December 31, 2011, which is the end of the period covered by this Annual Report on Form 10-K. 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 was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on this evaluation, our principal executive officer and principal financial officer concluded that the Company's disclosure controls and procedures were effective as of December 31, 2011 to ensure that information required to be disclosed by the Company in reports we file or submit under the Exchange Act is (i) recorded, processed, summarized, evaluated and reported, as applicable, within the time periods specified in the United States Securities and Exchange Commission's rules and forms and (ii) accumulated and communicated to the Company's management, including the Company's principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosures.

### Changes in Internal Control Over Financial Reporting

There have been no changes in our internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) that occurred during the fiscal quarter ended December 31, 2011, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

### Management's Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)). Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. In addition, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Our management assessed the effectiveness of our internal control over financial reporting, and concluded that it was effective as of December 31, 2011. In making this assessment, we used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in *Internal Control—Integrated Framework*.

The effectiveness of the Company's internal control over financial reporting as of December 31, 2011 has been audited by Ernst & Young LLP, an independent registered public accounting firm, as stated in their report below.

Table of Contents

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors
Penn National Gaming, Inc. and subsidiaries

We have audited Penn National Gaming, Inc. and subsidiaries' internal control over financial reporting as of December 31, 2011, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Penn National Gaming, Inc. and subsidiaries' management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Annual Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Penn National Gaming, Inc. and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Penn National Gaming, Inc. and subsidiaries as of December 31, 2011 and 2010, and the related consolidated statements of operations, changes in shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2011 and our report dated February 24, 2012 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Philadelphia, Pennsylvania
February 24, 2012

**ITEM 9B. OTHER INFORMATION**

None

**PART III**

**ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE**

The information required by this item concerning directors is hereby incorporated by reference to the Company's definitive proxy statement for its 2012 Annual Meeting of Shareholders (the "2012 Proxy Statement"), to be filed with the U.S. Securities and Exchange Commission within 120 days after December 31, 2011, pursuant to Regulation 14A under the Securities Act. Information required by this item concerning executive officers is included in Part I of this Annual Report on Form 10-K.

**ITEM 11. EXECUTIVE COMPENSATION**

The information called for in this item is hereby incorporated by reference to the 2012 Proxy Statement.

**ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDERS MATTERS**

The information called for in this item is hereby incorporated by reference to the 2012 Proxy Statement.

**ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE**

The information called for in this item is hereby incorporated by reference to the 2012 Proxy Statement.

**ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES**

The information called for in this item is hereby incorporated by reference to the 2012 Proxy Statement.

Table of Contents

## PART IV

### ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a) 1 and 2. Financial Statements and Financial Statement Schedules. The following is a list of the Consolidated Financial Statements of the Company and its subsidiaries and supplementary data filed as part of Item 8 hereof:

Report of Independent Registered Public Accounting Firm
Consolidated Balance Sheets as of December 31, 2011 and 2010
Consolidated Statements of Operations for the years ended December 31, 2011, 2010 and 2009
Consolidated Statements of Changes in Shareholders' Equity for the years ended December 31, 2011, 2010 and 2009
Consolidated Statements of Cash Flows for the years ended December 31, 2011, 2010 and 2009
All other schedules are omitted because they are not applicable, or not required, or because the required information is included in the Consolidated Financial Statements or notes thereto.

3. Exhibits, Including Those Incorporated by Reference.

The exhibits to this Report are listed on the accompanying index to exhibits and are incorporated herein by reference or are filed as part of this annual report on Form 10-K.

Table of Contents

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) 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.

PENN NATIONAL GAMING, INC.

By: /s/ PETER M. CARLINO

Peter M. Carlino
*Chairman of the Board and*
*Chief Executive Officer*

Dated: February 24, 2012

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

| Signature | Title | Date |
|---|---|---|
| /s/ PETER M. CARLINO<br>Peter M. Carlino | Chairman of the Board, Chief Executive Officer and Director (Principal Executive Officer) | February 24, 2012 |
| /s/ WILLIAM J. CLIFFORD<br>William J. Clifford | Senior Vice President Finance and Chief Financial Officer (Principal Financial Officer) | February 24, 2012 |
| /s/ DESIREE A. BURKE<br>Desiree A. Burke | Vice President and Chief Accounting Officer (Principal Accounting Officer) | February 24, 2012 |
| /s/ HAROLD CRAMER<br>Harold Cramer | Director | February 24, 2012 |
| /s/ WESLEY R. EDENS<br>Wesley R. Edens | Director | February 24, 2012 |
| /s/ DAVID A. HANDLER | Director | February 24, 2012 |

| | | |
|---|---|---|
| David A. Handler | | |
| /s/ JOHN M. JACQUEMIN | Director | February 24, 2012 |
| John M. Jacquemin | | |
| /s/ ROBERT P. LEVY | Director | February 24, 2012 |
| Robert P. Levy | | |
| /s/ SAUL V. REIBSTEIN | Director | February 24, 2012 |
| Saul V. Reibstein | | |
| /s/ BARBARA Z. SHATTUCK | Director | February 24, 2012 |
| Barbara Z. Shattuck | | |

Table of Contents

## EXHIBIT INDEX

| Exhibit | Description of Exhibit |
|---|---|
| 3.1(a) | Amended and Restated Articles of Incorporation of Penn National Gaming, Inc., filed with the Pennsylvania Department of State on October 15, 1996. (Incorporated by reference to Exhibit 3.1 to the Company's registration statement on Form S-3, File No. 333-63780, dated June 25, 2001). |
| 3.1(b) | Articles of Amendment to the Amended and Restated Articles of Incorporation of Penn National Gaming, Inc., filed with the Pennsylvania Department of State on November 13, 1996. (Incorporated by reference to Exhibit 3.2 to the Company's registration statement on Form S-3, File No. 333-63780, dated June 25, 2001). |
| 3.1(c) | Articles of Amendment to the Amended and Restated Articles of Incorporation of Penn National Gaming, Inc., filed with the Pennsylvania Department of State on July 23, 2001. (Incorporated by reference to Exhibit 3.4 to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2001). |
| 3.1(d) | Articles of Amendment to the Amended and Restated Articles of Incorporation of Penn National Gaming, Inc., filed with the Pennsylvania Department of State on December 28, 2007. (Incorporated by reference to Exhibit 3.1 to the Company's current report on Form 8-K, filed on January 2, 2008). |
| 3.1(e) | Statement with Respect to Shares of Series B Redeemable Preferred Stock of Penn National Gaming, Inc., filed with the Pennsylvania Department of State on July 9, 2008. (Incorporated by reference to Exhibit 4.1 to the Company's current report on Form 8-K, filed on July 9, 2008). |
| 3.2 | Second Amended and Restated Bylaws of Penn National Gaming, Inc. (Incorporated by reference to Exhibit 3.1 to the Company's current report on Form 8-K, filed on November 18, 2008). |
| 4.1 | Specimen copy of Common Stock Certificate (Incorporated by reference to Exhibit 3.6 to the Company's quarterly report on Form 10-Q for the quarter ended June 30, 2003). |
| 4.2 | Indenture dated as of March 9, 2005 by and among Penn National Gaming, Inc. and Wells Fargo Bank, National Association relating to the 6¾% Senior Subordinated Notes due 2015. (Incorporated by reference to Exhibit 10.1 to the Company's current report on Form 8-K, filed March 15, 2005). |
| 4.2(a) | First Supplemental Indenture dated as of July 5, 2005 between Penn National Gaming, Inc. and Wells Fargo Bank, National Association relating to the 6¾% Senior Subordinated Notes due 2015. (Incorporated by reference to Exhibit 10.37 to the Company's registration statement on Form S-4, filed July 7, 2005 (File No. 333-125274)). |
| 4.3 | Form of Penn National Gaming, Inc. 6¾% Senior Subordinated Note due 2015. (Included as Exhibit A to Exhibit 4.2). |
| 4.4 | Specimen copy of Series B Redeemable Preferred Stock Certificate. (Incorporated by reference to Exhibit 4.8 to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2008). |
| 4.5 | Investor Rights Agreement, dated as of July 3, 2008, by and among Penn National Gaming, Inc., FIF V PFD LLC, Centerbridge Capital Partners, L.P., DB Investment Partners, Inc. and Wachovia Investment Holdings, LLC. (Incorporated by reference to Exhibit 4.2 to the Company's current report on Form 8-K, filed on July 9, 2008). |
| 4.6 | Indenture, dated as of August 14, 2009, between Penn National Gaming, Inc. and Wells Fargo Bank, National Association, as trustee, relating to the 8¾% Senior Subordinated Notes due 2019 (Incorporated by reference to Exhibit 4.1 to the Company's current report on Form 8-K, filed on August 14, 2009). |

Table of Contents

| Exhibit | Description of Exhibit |
|---|---|
| 4.7 | Form of Penn National Gaming, Inc. 8¾% Senior Subordinated Notes due 2019 (Included as Exhibit A to Exhibit 4.6) |
| 9.1 | Form of Trust Agreement of Peter D. Carlino, Peter M. Carlino, Richard J. Carlino, David E. Carlino, Susan F. Harrington, Anne de Lourdes Irwin, Robert M. Carlino, Stephen P. Carlino and Rosina E. Carlino Gilbert. (Incorporated by reference to the Company's registration statement on Form S-1, File No. 33-77758, dated May 26, 1994). |
| 10.1# | Penn National Gaming, Inc. 1994 Stock Option Plan. (Incorporated by reference to the Company's registration statement on Form S-1, File No. 33-77758, dated May 26, 1994). |
| 10.2# | Penn National Gaming, Inc. 2003 Long Term Incentive Compensation Plan. (Incorporated by reference to Appendix A of the Company's Proxy Statement dated April 22, 2003 filed pursuant to Section 14(a) of the Securities Exchange Act of 1934, as amended). |
| 10.3# | Employment Agreement dated April 28, 2010 between Penn National Gaming, Inc. and Peter M. Carlino. (Incorporated by reference to Exhibit 10.1 to the Company's current report on Form 8-K, filed on May 4, 2010). |
| 10.4# | Employment Agreement dated December 31, 2008 between Penn National Gaming, Inc. and William Clifford. (Incorporated by reference to Exhibit 10.4 to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2008). |
| 10.4(a)# | First Amendment to Employment Agreement dated June 10, 2011 between Penn National Gaming, Inc. and William Clifford. (Incorporated by reference to Exhibit 10.1 to the Company's current report on Form 8-K, filed on June 15, 2011). |
| 10.5# | Employment Agreement dated December 31, 2008 between Penn National Gaming, Inc. and Jordan B. Savitch. (Incorporated by reference to Exhibit 10.5 to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2008). |
| 10.5(a)# | First Amendment to Employment Agreement dated June 10, 2011 between Penn National Gaming, Inc. and Jordan B. Savitch. (Incorporated by reference to Exhibit 10.2 to the Company's current report on Form 8-K, filed on June 15, 2011). |
| 10.6# | Employment Agreement dated December 31, 2008 between Penn National Gaming, Inc. and Robert S. Ippolito. (Incorporated by reference to Exhibit 10.7 to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2008). |
| 10.6(a)#* | First Amendment to Employment Agreement dated June 10, 2011 between Penn National Gaming, Inc. and Robert S. Ippolito. |
| 10.7# | Employment Agreement dated December 31, 2008 between Penn National Gaming, Inc. and John V. Finamore. (Incorporated by reference to Exhibit 10.35 to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2008). |
| 10.8# | First Amendment to Employment Agreement dated June 16, 2010 between Penn National Gaming, Inc. and John V. Finamore. (Incorporated by reference to Exhibit 10.1 to the Company's current report on Form 8-K filed on June 22, 2010). |
| 10.9 | Form of Change in Control Payment Acknowledgement and Agreement between Penn National Gaming, Inc. and Certain Executive Officers of Penn National Gaming, Inc. (Incorporated by reference to Exhibit 10.1 the Company's current report on Form 8-K, filed on January 2, 2008). |
| 10.9(a) | Schedule of executive officers entering into Change in Control Payment Acknowledgement and Agreement. (Incorporated by reference to Exhibit 10.8(a) to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2007). |
| 10.10 | Consulting Agreement dated August 29, 1994, between Penn National Gaming, Inc. and Peter D. Carlino. (Incorporated by reference to the Company's annual report on Form 10-K for the fiscal year ended December 31, 1994). |

| Exhibit | Description of Exhibit |
|---|---|
| 10.11 | Amended and Restated Lease dated April 5, 2005 between Wyomissing Professional Center III, LP and Penn National Gaming, Inc. for portion of the Wyomissing Corporate Office. (Incorporated by reference to Exhibit 10.1 to the Company's current report on Form 8-K, filed on April 8, 2005). |
| 10.12 | Lease dated January 25, 2002 between Wyomissing Professional Center II, LP and Penn National Gaming, Inc. for portion of the Wyomissing Corporate Office. (Incorporated by reference to Exhibit 10.12 to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2004). |
| 10.12(a) | Commencement Agreement, dated May 21, 2002, in connection with Lease dated January 25, 2002 Wyomissing Professional Center II, LP and Penn National Gaming, Inc. for portion of the Wyomissing Corporate Office. (Incorporated by reference to Exhibit 10.12(a) to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2004). |
| 10.12(b) | First Lease Amendment, dated December 4, 2002, to Lease dated January 25, 2002 Wyomissing Professional Center II, LP and Penn National Gaming, Inc. for portion of the Wyomissing Corporate Office. (Incorporated by reference to Exhibit 10.12(b) to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2004). |
| 10.13 | Lease dated April 5, 2005 between Wyomissing Professional Center, Inc. and Penn National Gaming, Inc. for portion of the Wyomissing Corporate Office. (Incorporated by reference to Exhibit 10.2 to the Company's current report on Form 8-K, filed on April 8, 2005). |
| 10.14 | Lease dated August 22, 2003 between The Corporate Campus at Spring Ridge 1250, L.P. and Penn National Gaming, Inc. for portion of the Wyomissing Corporate Office. (Incorporated by reference to Exhibit 10.13 to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2004). |
| 10.15 | Agreement dated April 7, 2006 by and between PNGI Charles Town Gaming Limited Liability Company and the West Virginia Union of Mutuel Clerks, Local 553, Service Employees International Union, AFL—CIO. (Incorporated by reference to exhibit 10.1 to the Company's current report on Form 8-K, filed on April 24, 2006). |
| 10.16 | Agreement dated February 20, 2009 between PNGI Charles Town Gaming Limited Liability Company and Charles Town HBPA, Inc. (Incorporated by reference to Exhibit 10.16 to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2008). |
| 10.17 | Credit Agreement, dated October 3, 2005 by and among Penn National Gaming, Inc., the subsidiary guarantors party thereto, Deutsche Bank Securities Inc., Goldman Sachs Credit Partners L.P. and Lehman Brothers Inc., as Joint Lead Arrangers and Joint Bookrunners, Goldman Sachs Credit Partners L.P. and Lehman Commercial Paper Inc., as Co-Syndication Agents, Deutsche Bank Trust Company Americas, as Swingline Lender, Administrative Agent and as Collateral Agent, and Calyon New York Branch, Wells Fargo Bank, National Association and Bank of Scotland, as Co-Documentation Agents, and the lenders party thereto. (Incorporated by reference to Exhibit 10.1 to the Company's current report on Form 8-K, filed October 4, 2005). |

| Exhibit | Description of Exhibit |
|---|---|
| 10.17(a) | Amendment, dated September 18, 2006, to the Credit Agreement by and among Penn National Gaming, Inc., the subsidiary guarantors party thereto, Deutsche Bank Securities Inc., Goldman Sachs Credit Partners L.P. and Lehman Brothers Inc., as Joint Lead Arrangers and Joint Bookrunners, Goldman Sachs Credit Partners L.P. and Lehman Commercial Paper Inc., as Co-Syndication Agents, Deutsche Bank Trust Company Americas, as Swingline Lender, Administrative Agent and as Collateral Agent, and Calyon New York Branch, Wells Fargo Bank, National Association and Bank of Scotland, as Co-Documentation Agents, and the lenders party thereto. (Incorporated by reference to Exhibit 10.1 to the Company's current report on Form 8-K, filed on September 21, 2006). |
| 10.17(b) | Second Amendment to Credit Agreement, dated as of September 23, 2009, among Penn National Gaming, Inc., certain of its subsidiaries, Deutsche Bank Securities Inc., Wells Fargo Securities, LLC, Banc of America Securities LLC and RBS Securities Inc., as co-lead arrangers and co-book running managers, Wells Fargo Bank, National Association and Bank of America, N.A., as syndication agents, the lenders party thereto, Deutsche Bank Trust Company Americas, as Swingline Lender, Administrative Agent and Collateral Agent under the Credit Agreement (as defined therein), and Wachovia Bank National Association, as L/C Lender under the Credit Agreement. (Incorporated by reference to Exhibit 10.1 to the Company's current report on Form 8-K, filed on September 25, 2009). |
| 10.18 | Credit Agreement, dated July 14, 2011, by and among the Company; the Subsidiary Guarantors party thereto; the Lenders party thereto; the L/C Lenders party thereto; Merrill Lynch, Pierce, Fenner & Smith Incorporated, Wells Fargo Securities, LLC, Commerz Markets LLC, RBS Securities Inc., and UBS Securities LLC, as Joint Lead Arrangers and Joint Bookrunners; Bank of America, N.A., Commerzbank AG, New York and Grand Cayman Branches, and UBS Securities LLC as Co-Syndication Agents; Wells Fargo Bank, National Association, as Swingline Lender, Administrative Agent and Collateral Agent; The Royal Bank of Scotland PLC, as Documentation Agent; and U.S. Bank National Association, as Senior Managing Agent. (Incorporated by reference to Exhibit 10.1 to the Company's current report on Form 8-K, filed on July 20, 2011). |
| 10.19# | Penn National Gaming, Inc. Nonqualified Stock Option granted to Peter M. Carlino, dated February 6, 2003. (Incorporated by reference to Exhibit 10.26 to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2003). |
| 10.20 | Riverboat Gaming Development Agreement between the City of Lawrenceburg, Indiana and Indiana Gaming Company, L.P. dated as of April 13, 1994, as amended by Amendment Number One to Riverboat Development Agreement between the City of Lawrenceburg, Indiana and Indiana Gaming Company L.P., dated as of December 28, 1995 (Incorporated by reference to Argosy Gaming Company's annual report on Form 10-K for the fiscal year ended December 31, 1995). |
| 10.20(a) | Second Amendment to Riverboat Gaming Development Agreement Between City of Lawrenceburg, Indiana, and the Indiana Gaming Company, L.P. dated August 20, 1996. (Incorporated by reference to Exhibit 10.23(a) to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2005). |
| 10.20(b) | Third Amendment to Riverboat Gaming Development Agreement Between City of Lawrenceburg, Indiana, and the Indiana Gaming Company, L.P. dated June 24, 2004. (Incorporated by reference to Exhibit 10.2 of Argosy Gaming Company's quarterly report on Form 10-Q for the quarter ended September 30, 2004). |
| 10.21# | Penn National Gaming, Inc. Deferred Compensation Plan, as amended. (Incorporated by reference to Exhibit 10.27 to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2006). |

| Exhibit | Description of Exhibit |
|---|---|
| 10.22# | Employment Agreement by and between Penn National Gaming, Inc. and Timothy J. Wilmott dated December 31, 2008. (Incorporated by reference to Exhibit 10.1 to the Company's current report on Form 8-K, filed on January 7, 2009). |
| 10.22(a)#* | Letter Agreement between Penn National Gaming, Inc. and Timothy J. Wilmott dated December 29, 2011. |
| 10.23 | Stock Purchase Agreement, dated as of July 3, 2008, by and among Penn National Gaming, Inc., FIF V PFD LLC, Centerbridge Capital Partners, L.P., DB Investment Partners, Inc. and Wachovia Investment Holdings, LLC. (Incorporated by reference to Exhibit 10.1 to the Company's current report on Form 8-K, filed on July 9, 2008). |
| 10.24 | Termination and Settlement Agreement, dated as of July 3, 2008, by and among Penn National Gaming, Inc., PNG Acquisition Company Inc., PNG Merger Sub Inc., PNG Holdings LLC, FIG PNG Holdings LLC, Fortress Investment Fund V (Fund A) L.P., Fortress Investment Fund V (Fund D) L.P., Fortress Investment Fund V (Fund E) L.P., Fortress Investment Fund V (Fund B) L.P., Fortress Investment Fund V (Fund C) L.P., Fortress Investment Fund V (Fund F) L.P., CB PNG Holdings LLC, Centerbridge Capital Partners, L.P., Centerbridge Capital Partners Strategic, L.P., Centerbridge Capital Partners SBS, L.P., DB Investment Partners, Inc., Wachovia Investment Holdings, LLC, Deutsche Bank Securities Inc., Deutsche Bank AG New York Branch, Wachovia Capital Markets, LLC, Wachovia Bank, National Association and Wachovia Investment Holdings, LLC. (Incorporated by reference to Exhibit 10.2 to the Company's current report on Form 8-K filed on July 9, 2008). |
| 10.25# | Penn National Gaming, Inc. 2008 Long Term Incentive Compensation Plan, as amended. (Incorporated by reference to Exhibit 10.3 to the Company's current report on Form 8-K, filed on June 15, 2011). |
| 10.26 | Form of Non-Qualified Stock Option Certificate for the Penn National Gaming, Inc. 2008 Long Term Incentive Compensation Plan. (Incorporated by reference to Exhibit 10.33 to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2008). |
| 10.27 | Form of Restricted Stock Award for the Penn National Gaming, Inc. 2008 Long Term Incentive Compensation Plan. (Incorporated by reference to Exhibit 10.32 to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2009). |
| 10.28# | Employment Agreement by and between Penn National Gaming, Inc. and Steven T. Snyder dated June 10, 2005. (Incorporated by reference to Exhibit 10.28 to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2010). |
| 10.29 | Registration Rights Agreement, dated as of August 14, 2009, among Penn National Gaming, Inc. and Deutsche Bank Securities Inc., Wells Fargo Securities, LLC, Banc of America Securities LLC and RBS Securities Inc., each for itself and on behalf of each of the other initial purchasers (Incorporated by reference to Exhibit 10.1 to the Company's current report on Form 8-K, filed on August 14, 2009). |
| 10.30 | Lottery Gaming Facility Management Contract dated August 25, 2009 between the Kansas Lottery and Kansas Entertainment, LLC (Incorporated by reference to Exhibit 99.1 to the Company's current report on Form 8-K, filed on February 19, 2010). |
| 10.31 | Development Agreement dated as of September 8, 2009 by and between the Unified Government of Wyandotte County/Kansas City, Kansas and Kansas Entertainment, LLC (Incorporated by reference to Exhibit 99.2 to the Company's current report on Form 8-K, filed on February 19, 2010). |
| 10.32 | Form of Phantom Stock Unit Award for Penn National Gaming, Inc. 2008 Long Term Incentive Compensation Plan. (Incorporated by reference to Exhibit 10.32 to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2011). |

Table of Contents

| Exhibit | Description of Exhibit |
|---|---|
| 10.33#* | Employment Agreement by and between Penn National Gaming, Inc. and Jay Snowden dated April 11, 2011. |
| 21.1* | Subsidiaries of the Registrant. |
| 23.1* | Consent of Ernst & Young LLP, Independent Registered Public Accounting Firm. |
| 31.1* | CEO Certification pursuant to rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934. |
| 31.2* | CFO Certification pursuant to rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934. |
| 32.1* | CEO Certification pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of The Sarbanes-Oxley Act of 2002. |
| 32.2* | CFO Certification pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of The Sarbanes-Oxley Act of 2002. |
| 99.1* | Description of Governmental Regulation. |
| 101 | Interactive data files pursuant to Rule 405 of Regulation S-T: (i) the Consolidated Balance Sheets at December 31, 2011 and 2010, (ii) the Consolidated Statements of Operations for the years ended December 31, 2011, 2010 and 2009, (iii) the Consolidated Statements of Changes in Shareholders' Equity for the years ended December 31, 2011, 2010 and 2009, (iv) the Consolidated Statements of Cash Flows for the years ended December 31, 2011, 2010 and 2009 and (v) the notes to the Consolidated Financial Statements, tagged as blocks of text. |

#

Compensation plans and arrangements for executives and others.

*

Filed herewith.

**

Pursuant to Rule 406T of Regulation S-T, the Indenture Data Files on Exhibit 101 hereto are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities and Exchange Act of 1934, as amended, and otherwise are not subject to liability under these sections.

**Exhibit 10.6(a)**

## FIRST AMENDMENT TO EMPLOYMENT AGREEMENT

This FIRST AMENDMENT to EMPLOYMENT AGREEMENT (this "**Amendment**") is entered into on this 10th day of June by and between Penn National Gaming, Inc., a Pennsylvania corporation (the "**Company**"), and Robert S. Ippolito, an individual residing in Pennsylvania ("**Executive**").

WHEREAS, Executive and Company are party to that certain Employment Agreement dated December 31, 2008 (the "**Agreement**"). All defined terms used in this Amendment, but not defined herein, shall have the meanings given to them in the Agreement;

WHEREAS, the Initial Term of the Agreement will expire on June 10, 2011; and

WHEREAS, pursuant to Section 1.2 of the Agreement, Executive and Company desire to renew of the Agreement on the terms and conditions set forth below.

NOW, THEREFORE, the parties hereto, intending to be legally bound, hereby agree as follows:

### ARTICLE I
### AMENDMENT

SECTION 1.1 Renewal Term. The Agreement is hereby renewed and extended for a period of three (3) years from the expiration of the Initial Term and shall therefore terminate at the close of business on June 10, 2014, unless earlier terminated in accordance with Section 3 of the Agreement.

SECTION 1.2 Amendment to Exhibit A. Exhibit A to the Agreement shall be replaced in its entirety with Exhibit A attached hereto.

### ARTICLE II
### MISCELLANEOUS

SECTION 2.1 Effect of Amendment. This Amendment shall not constitute an amendment or modification of any provision of, or exhibit to, the Agreement not expressly referred to in this Amendment. Except as expressly amended or modified in this Amendment, the provisions of the Agreement are and remain in full force and effect. Whenever the Agreement is referred to herein or in any other agreement, document or instrument, such reference shall be deemed to be to the Agreement, as amended by this Amendment, whether or not specific reference is made to this Amendment.

SECTION 2.3 Counterparts. This Amendment may be executed by facsimile and/or in one or more counterparts, and by the different parties hereto in separate counterparts, each of which when executed shall be deemed to be an original but all of which taken together shall constitute one and the same agreement.

[*Signature Page Follows*]

IN WITNESS WHEREOF, the undersigned, intending to be legally bound, have executed this Amendment on of the date first abov written.

PENN NATIONAL GAMING, INC.

By: /s/ Peter M. Carlino
Name: Peter M. Carlino
Title: Chairman and CEO

EXECUTIVE

/s/ Robert S. Ippolito
Robert S. Ippolito

Exhibit A

SEPARATION AGREEMENT AND GENERAL RELEASE

This is a Separation Agreement and General Release (hereinafter referred to as the "Agreement") between (hereinafter referred to as the "Employee") and Penn National Gaming, Inc. (hereinafter referred to as the "Employer"). In consideration of the mutual promises and commitments made in this Agreement, and intending to be legally bound, Employee, on the one hand, and the Employer on the other hand, agree to the terms set forth in this Agreement.

1. Employer and Employee hereby acknowledge that [the Company notified Employee/Employee notified the Company on that Executive's employment pursuant to that certain Employment Agreement executed on ("Employment Agreement") would be terminated as of [ ]. Upon the termination of the Employment Agreement, Employee will be subject to the obligations and be the beneficiary of the surviving benefits, all as described in the Employment Agreement. Employee's last day of work will be .

2. (a) When used in this Agreement, the word "Releasees" means the Employer and all or any of its past and present parent, subsidiary and affiliated corporations, companies, partnerships, joint ventures and other entities and their groups, divisions, departments and units, and their past and present directors, trustees, officers, managers, partners, supervisors, employees, attorneys, agents and consultants, and their predecessors, successors and assigns.

(b) When used in this Agreement, the word "Claims" means each and every claim, complaint, cause of action, and grievance, whether known or unknown and whether fixed or contingent, and each and every promise, assurance, contract, representation, guarantee, warranty, right and commitment of any kind, whether known or unknown and whether fixed or contingent.

3. In consideration of the promises of the Employer set forth in this Agreement and the Employment Agreement, and intending to be legally bound, Employee hereby irrevocably remises, releases and forever discharges all Releasees of and from any and all Claims that he (on behalf of either himself or any other person or persons) ever had or now has against any and all of the Releasees, or which he (or his heirs, executors, administrators or assigns or any of them) hereafter can, shall or may have against any and all of the Releasees, for or by reason of any cause, matter, thing, occurrence or event whatsoever through the effective date of this Agreement. Employee acknowledges and agrees that the Claims released in this paragraph include, but are not limited to, (a) any and all Claims based on any law, statute or constitution or based on contract or in tort on common law, and (b) any and all Claims based on or arising under any civil rights laws, such as any Pennsylvania employment laws, or Title VII of the Civil Rights Act of 1964 (42 U.S.C. § 2000e et seq.), or the Federal Age Discrimination in Employment Act (29 U.S.C. § 621 et seq.) (hereinafter referred to as the "ADEA"), and (c) any and all Claims under any grievance or complaint procedure of any kind, and (d) any and all Claims based on or arising out of or related to his recruitment by, employment with, the termination of his employment with, his performance of any services in any capacity for, or any business transaction with, each or any of the Releasees. Employee also understands, that by signing this Agreement, he is waiving all Claims against any and all of the Releasees released by this Agreement; provided, however, that as set forth in section 7 (f) (1) (c) of the ADEA, as added by the Older Workers Benefit Protection Act of 1990, nothing in this Agreement constitutes or shall (i) be construed to constitute a waiver by Employee of any rights or claims that may arise after this Agreement is executed by Employee, or (ii) impair Employee's right to file a charge with the U.S. Equal Employment Opportunity Commission ("EEOC"), the National Labor Relations Board or any state agency or to participate in an investigation or proceeding conducted by the EEOC or any state agency. Notwithstanding the foregoing, Employee agrees to waive Employee's right to recover individual relief in any charge, complaint, or lawsuit filed by Employee or anyone on Employee's behalf.

Notwithstanding the foregoing, this Agreement will not release any right of Employee (x) in his capacity as a shareholder or owner in the Company or any of its affiliates, (y) to be indemnified for any act or omission in his capacity as an employee, officer or director of the Company or any of its affiliates (whether arising under contract,

the governing documents of the entity, state law or otherwise), or (z) in respect of vested benefits under the Company's retirement or deferred compensation plans.

4. In consideration of the promises of the Employee set forth in this Agreement and the Employment Agreement and intending to be legally bound, Employer hereby irrevocably remises, releases and forever discharges Employee and his heirs, successors and assigns from any and all Claims that the Employer ever had or now has though the effective date of this Agreement. Employee further certifies that he is not aware of any actual or attempted regulatory, EEOC or legal violations by Employer and that his separation is not a result of retaliation based on any legal rights or opposition to an illegal practice.

5. Employee and Employer covenant and agree not to sue each other or any of the Releasees for any Claims released by this Agreement and to waive any recovery related to any Claims covered by this Agreement.

6. Employee agrees to provide reasonable transition assistance to Employer (including without limitation assistance on regulatory matters, operational matters and in connection with litigation) for a period of one year from the execution of this Agreement at no additional cost; provided, such assistance shall not unreasonably interfere with Employee's pursuit of gainful employment or result in Employee not having a separation from service (as defined in Section 409A of the Internal Revenue Code of 1986). Any assistance beyond this period will be provided at a mutually agreed cost. Employee further agrees that he will return to the Employer all property in his possession, including, but not limited to, keys, identification cards and credit cards, files, records, publications, address lists and documents that belong to each or any of the Releasees. Such documents also include, without limitation, any documents created or made by Employee during his employment with the Employer.

7. Employee agrees that, except as specifically provided in this Agreement and the Employment Agreement, there are no compensation, benefits, or other payments due or owed to him by each or any of the Releasees. Employee further acknowledges that he has not experienced or reported any work-related injury or illness.

8. Except where disclosure has been made by the Company pursuant to applicable federal or state law, rule or regulation, Employee agrees that the terms of this Agreement are confidential and that he will not disclose or publicize the terms of this Agreement and the amounts paid or agreed to be paid pursuant to this Agreement to any person or entity, except to his spouse, his attorney, his accountant, and to a government agency for the purpose of payment or collection of taxes or application for unemployment compensation benefits. Employee agrees that his disclosure of the terms of this Agreement to his spouse, his attorney and his accountant shall be conditioned upon him obtaining agreement from them, for the benefit of the Employer, not to disclose or publicize to any person or entity the terms of this Agreement and the amounts paid or agreed to be paid under this Agreement. Further, Employer and Employee agree not to make any false, misleading, defamatory or disparaging communications about the other party (including without limitation Employer's products, services, partners, investors or personnel) and to refrain from taking any action designed to harm the public perception of the other party or the Releasees. Employee further agrees that he has disclosed to Employer all information, if any, in his possession, custody or control related to any legal, compliance or regulatory obligations of Employer and any failures to meet such obligations.

9. The terms of this Agreement are not to be considered as an admission on behalf of either party. Neither this Agreement nor its terms shall be admissible as evidence of any liability or wrongdoing by each or any of the Releasees in any judicial, administrative or other proceeding now pending or hereafter instituted by any person or entity. The Employer is entering into this Agreement solely for the purpose of effectuating a mutually satisfactory separation of Employee's employment.

10. All provisions of this Agreement are severable and if any of them is determined to be invalid or unenforceable for any reason, the remaining provisions and portions of this Agreement shall be unaffected thereby and shall remain in full force to the fullest extent permitted by law.

11. This Agreement shall be governed by and interpreted under and in accordance with the laws of Pennsylvania. Any suit, claim or cause of action arising under or related to this Agreement shall be submitted by the

parties hereto to the exclusive jurisdiction of the courts of Pennsylvania or to the federal courts located therein if they otherwise have jurisdiction.

12. This Agreement constitutes a complete and final agreement between the parties and supersedes and replaces all prior or contemporaneous agreements, offer letters, negotiations, or discussions relating to the subject matter of this Agreement. With the exception of the Employment Agreement, no other agreement shall be binding upon each or any of the Releasees, including, but not limited to, any agreement made hereafter, unless in writing and signed by an officer of the Employer, and only such agreement shall be binding against the Employer.

13. Employee is advised, and acknowledges that he has been advised, to consult with an attorney before signing this Agreement.

14. Employee acknowledges that he is signing this Agreement voluntarily, with full knowledge of the nature and consequences of its terms.

15. All executed copies of this Agreement and photocopies thereof shall have the same force and effect and shall be as legally binding and enforceable as the original.

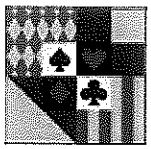
16. Employee acknowledges that he has been given up to twenty-one (21) days within which to consider this Agreement before signing it. Subject to paragraph 17 below, this Agreement will become effective on the date of Employee's signature hereof.

17. For a period of seven (7) calendar days following his signature of this Agreement, Employee may revoke the Agreement, and the Agreement shall not become effective or enforceable until the seven (7) day revocation period has expired. Employee may revoke this Agreement at any time within that seven (7) day period, by sending a written notice of revocation to the . Such written notice must be actually received by the Employer within that seven (7) day period in order to be valid. If a valid revocation is received within that seven (7) day period, this Agreement shall be null and void for all purposes. Payment of the severance pay amount set forth in the Employment Agreement will be paid in the manner and at the time(s) described in the Employment Agreement.

IN WITNESS WHEREOF, the Parties have read, understand and do voluntarily execute this Separation Agreement and General Release which consists of four pages.

| EMPLOYER | EMPLOYEE |
| --- | --- |
| By: | |
| Date: | Date: |

**Exhibit 10.22(**



**PENN NATIONAL**
**GAMING, INC.**

December 29, 2011

Timothy J. Wilmott
President and Chief Operating Officer
825 Berkshire Blvd.
Wyomissing, PA 19610

Subject: Employment Agreement

Dear Tim:

This letter is intended to memorialize our recent discussion regarding your Employment Agreement with Penn National Gaming, Inc. (the "Company") dated December 31, 2008 (the "Employment Agreement"). Except as expressly set forth in this letter, the terms and conditions in the Employment Agreement shall otherwise remain in full force and effect.

Section 8.4(b) of the Employment Agreement is hereby amended to delete the phrase "(iv) failure to appoint Executive as the Chief Executive Officer of the Company within thirty (30) days of the 3rd anniversary of the Commencement Date," and replace it with the word "and", and insert a new final sentence to Section 8.4(b) to read as follows: "Executive may terminate his employment with the Company for Good Reason at any time during the Initial Term if the Company fails to appoint Executive as the Chief Executive Officer of the Company within thirty (30) days of the Company's receipt of written notice from Executive of his intent to terminate employment for such failure."

In addition, the initial paragraph of Section 3.4(b) is hereby amended and restated to read as follows: "Severance Pay and Benefits. Subject to the conditions in subsection (c) hereof, if Executive's employment is terminated under Section 3.1(a), Section 3.3 or by Executive for Good Reason, then Executive will be entitled to receive, and the Company will provide Executive with, the following severance pay and benefits (in addition to any amounts payable under subsection (a) hereof); provided, for purposes of Section 409A, each payment (whether an installment or lump sum) of severance pay under this subsection (b) shall be considered a separate payment:" The remainder of Section 3.4(b) shall continue without amendment as set forth in the Employment Agreement.

Please indicate your acceptance of the amendments to the Employment Agreement set forth in this letter by delivering your signed acceptance to the Company at your earliest convenience.

Very truly yours,

Penn National Gaming, Inc.

By: /s/ Peter M. Carlino
Peter M. Carlino, Chairman and CEO

Accepted and agreed:

/s/ Timothy J. Wilmott
Timothy J. Wilmott

Exhibit 10.

# EMPLOYMENT AGREEMENT

This EMPLOYMENT AGREEMENT (the "Agreement") is entered into on this 11th day of April, 2011 (the "Execution Date") by and between Penn National Gaming, Inc., a Pennsylvania corporation (the "Company"), and Jay Snowden, an individual residing in New Jersey ("Executive").

WHEREAS, the parties wish to enter into an employment agreement upon the terms set forth below in this Agreement, which are intended to be in compliance with the requirements of Section 409A of the Internal Revenue Code of 1986, as amended ("Section 409A", see also Section 21 hereof).

NOW, THEREFORE, the parties hereto, intending to be legally bound, hereby agree as follows:

1. Employment. The Company hereby agrees to employ Executive and Executive hereby accepts such employment, in accordance with the terms, conditions and provisions hereinafter set forth.

1.1. Duties and Responsibilities. Executive shall serve as Senior Vice President, Regional Operations of the Company. Executive shall perform all duties and accept all responsibilities incident to such position as may be reasonably assigned to him by the President and Chief Operating Officer and the Board of Directors of the Company (the "Board"). Executive's principal place of employment shall be in Wyomissing, Pennsylvania.

1.2. Term. The term of this Agreement (inclusive of the services and obligations required from Executive and the compensation to Executive) shall begin on October 11, 2011 ("Commencement Date") and shall terminate at the close of business on the third anniversary of Commencement Date (the "Initial Term"), unless earlier terminated in accordance with Section 3 hereof. The term of this Agreement may be renewed for additional periods (each, a "Renewal Term" and, together with the Initial Term, the "Employment Term") only upon the execution of a written renewal by the parties hereto. Notwithstanding the foregoing to the contrary, Sections 5 through 21 shall survive any termination of the Employment Term until the expiration of any applicable time periods set forth in Sections 5, 6 and 7.

1.3. Extent of Service. Executive agrees to use Executive's best efforts to carry out Executive's duties and responsibilities and, consistent with the other provisions of this Agreement, to devote substantially all of Executive's business time, attention and energy thereto. The foregoing shall not be construed as preventing Executive from serving on the board of philanthropic organizations, or providing oversight with respect to his personal investments, so long as such service does not materially interfere with Executive's duties hereunder.

2. Compensation. For all services rendered by Executive to the Company, the Company shall compensate Executive as set forth below.

2.1. Base Salary. The Company shall pay Executive a base salary ("Base Salary"), commencing on the Commencement Date, at the annual rate of Five Hundred and Fifty Thousand Dollars ($550,000), payable in installments at such times as the Company customarily

pays its other senior executives ("Peer Executives"). Executive's performance and Base Salary shall be reviewed annually. Any increase in Base Salary or other compensation shall be made at the discretion of the Board or the compensation committee of the Board (the "Compensation Committee").

2.2. Cash Bonuses. Executive shall participate in the Company's annual incentive compensation plan applicable to Peer Executives. Each annual bonus award earned in a fiscal year shall be paid pursuant to the terms of the annual incentive plan document (if any) by March 15 of the immediately following fiscal year, unless the written bonus plan provides for a different payment date or unless Executive shall elect to defer the receipt of such bonus award pursuant to an arrangement that meets the requirements of Section 409A.

2.3. Equity Compensation. The Company may grant to Executive options or other equity compensation pursuant to, and subject to the terms and conditions of, the then current equity compensation plan of Penn National Gaming, Inc. Executive will receive a grant of 150,000 options within ten days after the Commencement Date, priced at the closing price for Company stock on the last day of trading prior to the Commencement Date. Within ten days after the Commencement Date, Executive will also receive a grant of Phantom Stock valued at the increase (if any) between the last closing price for Company stock prior to the Execution Date and the Commencement Date, up to a maximum value of Seven Hundred and Fifty Thousand Dollars ($750,000). Such Phantom Stock grant, if any, shall vest in three (3) equal annual installments upon the anniversary of the Commencement Date. The Compensation Committee shall set the amount and terms of such additional options or other equity compensation.

2.4. Other Benefits. Executive shall be entitled to participate in all other employee benefit plans and programs, including, without limitation, health, vacation, retirement, deferred compensation or SERP, made available to other Peer Executives, as such plans and programs may be in effect from time to time and subject to the eligibility requirements of the each plan. Nothing in this Agreement shall prevent the Company from amending or terminating any retirement, welfare or other employee benefit plans or programs from time to time, as the Company deems appropriate. In the first pay period following the Commencement Date, Executive will receive a one time gross payment of Two Hundred Thousand Dollars ($200,000) ("One Time Payment"). If executive is terminated for Cause or resigns within six (6) months after the Commencement Date, then he must promptly return the entire One Time Payment to Company. If executive is terminated for Cause or resigns between six (6) and twelve (12) months after the Commencement Date, then he must promptly return fifty percent (50%) of the entire One Time Payment to Company. Company agrees to indemnify Executive for the reasonable attorneys' fees and costs involved with the defense of any claim by Executive's former employer arising out of Executive's execution of this Agreement. This indemnification obligation is contingent upon: (a) Executive providing notice of any threatened or actual claims as soon as possible (but in no case more than ten days from when he first becomes aware of them), (b) counsel for Executive is mutually agreed upon, (c) unless it becomes a conflict, Company has a right to participate in the defense or prosecution of the case, (d) Executive is either employed by Company or in the post-Execution Date and pre-Commencement Date period of this Agreement, and (e) Executive has not either (i) failed to disclose any material facts to Company prior to the Execution Date or (ii) breached this Agreement.

2.5. Vacation, Sick Leave and Holidays. Executive shall be entitled in each calendar year to four (4) weeks of paid vacation time. Each vacation shall be taken by Executive at such time or times as agreed upon by the Company and Executive, and any portion of Executive's allowable vacation time not used during the calendar year shall be subject to the Company's payroll policies regarding carryover vacation. Executive shall be entitled to holiday and sick leave in accordance with the Company's holiday and other pay for time not worked policies.

2.6. Reimbursement of Expenses. Executive shall be provided with reimbursement of reasonable expenses related to Executive's employment by the Company on a basis no less favorable than that authorized from time to time for Peer Executives. Such reimbursements shall be made in such manner and at such times as provided in the reimbursement policies applicable to Peer Executives.

3. Termination. Executive's employment may be terminated prior to the end of the Employment Term in accordance with, and subject to the terms and conditions, set forth below.

3.1. Termination by the Company.

Without Cause. The Company may terminate Executive's employment at any time without Cause (as such term is defined in subsection (b) below) upon delivery of written notice to Executive, which notice shall set forth the effective date of such termination.

With Cause. The Company may terminate Executive's employment at any time for Cause effective immediately upon delivery of written notice to Executive. As used herein, the term "Cause" shall mean:

Executive shall have been convicted of a felony or any misdemeanor involving allegations of fraud, theft, perjury or conspiracy;

Executive is found disqualified or not suitable to hold a casino or other gaming license by a governmental gaming authority in any jurisdiction where Executive is required to be found qualified, suitable or licensed;

Executive materially breaches any material Company policy or any material term hereof, including, without limitation, Sections 4 through 7 and, in each case, fails to cure such breach within 15 days after receipt of written notice thereof; or

Executive misappropriates corporate funds as determined in good faith by the Board.

3.2. Termination by the Executive. Executive may voluntarily terminate employment for any reason effective upon 60 days' prior written notice to the Company, unless the Company waives such notice requirement (in which case the Company shall notify Executive in writing as to the effective date of termination).

3.3. Termination for Death or Disability. In the event of the death or total disability of Executive, Executive's employment shall terminate effective as of the date of Executive's death

or disability. The term "disability" shall have the definition set forth in the Company's Long Term Disability Insurance Policy in effect at the time of such determination.

3.4. Payments Due Upon Termination.

(a) Already Accrued Base Salary and Expense. Upon any termination of employment during the Employment Term, Executive shall be entitled to receive any amounts due for Base Salary accrued but unpaid through the effective date of termination, and such amounts shall be paid in accordance with the Company's then current payroll system for Peer Executives. Any expenses incurred but not reimbursed through the effective date of termination shall be paid at such time and in such manner as provided under the Company's expense reimbursement policy applicable to Peer Executives.

(b) Severance Pay and Benefits. Subject to the conditions in subsection (c) hereof, if Executive's employment is terminated under Section 3.1(a) or Section 3.3 or if Executive delivers a written notice of resignation within 30 days after the expiration of the Employment Term, the Company does not offer to renew the Employment Term during such 30-day period on terms no less favorable in the aggregate to the Executive than those contained herein and Executive thereupon terminates his employment at the end of such 30-day period, then Executive will be entitled to receive, and the Company will provide Executive with, the following severance pay and benefits (in addition to any amounts payable under subsection (a) hereof); provided, for purposes of Section 409A, each payment (whether an installment or lump sum) of severance pay under this subsection (b) shall be considered a separate payment:

(i) Amount of Post-Employment Base Salary and Bonus. The Company shall pay to Executive an amount equal to the product of (A) the sum of (1) Executive's monthly Base Salary at the highest rate in effect during the 24-month period immediately preceding the date of Executive's termination of employment (the "Termination Date"), and (2) Executive's monthly bonus value (determined by dividing by 12 the highest amount of annual cash bonus compensation paid to Executive in respect of either the first or second full calendar year immediately preceding the Termination Date; and (B) the greater of (1) the number of full and partial months remaining in the Employment Term as of the Termination Date, and (2) 18 (with the period described in clause (B) hereof being referred to as the "Severance Period").

(ii) Payment of Post-Employment Base Salary and Bonus. The amount described in subsection (b)(i) shall be paid to Executive in cash in two lump-sum payments as follows: (A) 75% of such amount shall be paid within 15 days after the Termination Date but no later than March 15 of the calendar year following the year in which this payment vests; and (B) the remaining 25% of such amount shall be paid in a lump sum by March 15 of the calendar year following the calendar year in which this payment vests.

(iii) Continued Medical Benefits Coverage. During the Severance Period, the Company shall provide Executive, and, if any, Executive's spouse and dependents with medical benefits coverage substantially similar to the coverage in effect on the effective date of termination. After the Severance Period, Executive and his dependents will have

the opportunity under the provisions of the Consolidated Omnibus Budget Reconciliation Act of 1986 ("COBRA") to elect COBRA continuation coverage. If elected in a timely manner, COBRA coverage generally will commence as of the first day of the next calendar month after the end of the Severance Period and will end on the last day of the 18th month thereafter (unless an earlier end date or an extension is required under COBRA).

(iv) Vesting of Stock Options. All options granted to Executive that would have vested during the Severance Period shall vest as of the Termination Date, provided , however, that any such options may not be exercised during the Severance Period until the same time(s) as such options would have vested had Executive continued to be employed through the Severance Period. Any options that would not have vested during the Severance Period shall terminate on the Termination Date.

(c) Release Agreement. Executive's entitlement to any severance pay and benefit subsidies under Section 3(b) is conditioned upon Executive's first entering into a release agreement in substantially the form attached hereto as Exhibit "A" provided, such release agreement shall be delivered to Executive within 7 days after the Termination Date. Any payment of severance pay or benefit subsidies due under subsection (b) hereof shall be delayed until after the expiration of the 7-day revocation period required for an effective age-based release, and any amount otherwise due under said subsection (b) before the end of such revocation period shall be paid upon the day after the end of such period in a single lump-sum payment, but not later than March 15 of the calendar year following the calendar year in which the Termination Date occurs.

(d) No Other Payments or Benefits. Except as otherwise provided in this Section 3.4, Section 8 or Section 9, no other payments or benefits shall be due under this Agreement to Executive

3.5. Notice of Termination. Any termination of Executive's employment shall be communicated by a written notice of termination delivered within the time period specified in this Section 3. The notice of termination shall (i) indicate the specific termination provision in this Agreement relied upon, (ii) briefly summarize the facts and circumstances deemed to provide a basis for a termination of employment and the applicable provision hereof, and (iii) specify the termination date in accordance with the requirements of this Agreement.

4. No Conflicts of Interest. Executive agrees that throughout the period of Executive's employment hereunder or otherwise, Executive will not perform any activities or services, or accept other employment that would materially interfere with or present a conflict of interest concerning Executive's employment with the Company. Executive agrees and acknowledges that Executive's employment by the Company is conditioned upon Executive adhering to and complying with the business practices and requirements of ethical conduct set forth in writing from time to time by the Company in its employee manual or similar publication. Executive represents and warrants that no other contract, agreement or understanding to which Executive is a party or may be subject will be violated by the execution of this Agreement by Executive.

5. Confidentiality. Executive recognizes and acknowledges that Executive will have access to certain confidential information of the Company and that such information constitutes valuable, special and unique property of the Company (including, but not limited to, information such as business strategies, identity of acquisition or growth targets, marketing plans, customer lists, and other business related information for the Company's customers). Executive agrees that Executive will not, for any reason or purpose whatsoever, during or after the term of employment, disclose any of such confidential information to any party, and that Executive will keep inviolate and secret all confidential information or knowledge which Executive has access to by virtue of Executive's employment with the Company, except as otherwise may be necessary in the ordinary course of performing Executive's duties with the Company. To the extent Executive possesses non-public proprietary information from a Company competitor, Company expressly prohibits Executive from disclosing that information to Company and Executive expressly agrees to not breach any pre-existing obligations.

6. Non-Competition.

As used herein, the term "Restriction Period" shall mean a period equal to: (i) the remainder of the Employment Term in effect on the effective date of termination if Executive resigns other than for Good Reason, or (ii) the Severance Period if Executive's employment is terminated for one of the events specified in Section 3.4(b). In the event the Executive is terminated by the Company for one of the events specified in Section 3.4(b), during the Severance Period Executive may elect to terminate the Restriction Period at any time by delivering written notice to the Company that Executive has made such election and that, in consideration therefore, is forfeiting the right to receive any payment or the right to receive any future payments under Section 3.4(b) or an equivalent amount under Section 8; provided however, if Executive elects to reduce the geographic limitation of this non-competition provision, and Executive has already received payment pursuant to Section 3.4(b) or an equivalent amount under Section 8, Executive shall reimburse the Company for that portion of the severance payments already received by Executive which relates to the number of days left in the Severance Period. For clarity, regardless of whether Executive shall receive payments pursuant to Section 3.4(b) or Section 8 of this Agreement in order to reduce the Restriction Period, Executive shall only be required to forfeit or re-pay the amounts that Executive would have received pursuant to Section 3.4(b). In that case, Executive may nevertheless receive payments and/or need not reimburse the Company for any amounts paid to Executive pursuant to Section 8 which are in excess of the payments and benefits that Executive would have been entitled to receive under Section 3.4(b). If Executive terminates his employment for good Reason, then Executive shall not be subject to the provisions of this Section 6.

During Executive's employment by the Company and for the duration of the Restriction Period thereafter, Executive shall not, except with the prior written consent of the Company, directly or indirectly, own, manage, operate, join, control, finance or participate in the ownership, management, operation, control or financing of, or be connected as an officer, director, employee, partner, principal, agent, representative, consultant or otherwise with, or use or permit Executive's name to be used in connection with, any business or enterprise which owns or operates, or is actively seeking to own or operate, a gaming or pari-mutuel located within North America.

The foregoing restrictions shall not be construed to prohibit Executive's ownership of less than 5% of any class of securities any corporation which is engaged in any of the foregoing businesses and has a class of securities registered pursuant to the Securities Exchang Act of 1934, provided that such ownership represents a passive investment and that neither Executive nor any group of persons including Executive in any way, either directly or indirectly, manages or exercises control of any such corporation, guarantees any of its financial obligations, otherwise takes any part in its business, other than exercising Executive's rights as a shareholder, or seeks to do any of the foregoing.

Executive acknowledges that the covenants contained in Sections 5 through 7 hereof are reasonable and necessary to protect the legitimate interests of the Company and its affiliates and, in particular, that the duration and geographic scope of such covenants are reasonable given the nature of this Agreement and the position that Executive will hold within the Company. Executive further agrees to disclose the existence and terms of such covenants to any employer that Executive works for during the Restriction Period.

7. Non-Solicitation. During Executive's employment by the Company and for a period equal to the greater of the Restriction Period or one year after the effective date of termination, Executive will not, except with the prior written consent of the Company, (i) directly or indirectly, solicit or hire, or encourage the solicitation or hiring of, any person who is, or was within a six month period prior to such solicitation or hiring, an executive or management employee of the Company or any of its affiliates for any position as an employee, independent contractor, consultant or otherwise or (ii) divert or attempt to divert any existing business of the Company or any of its affiliates.

8. Change of Control.

8.1. Consideration

(a) Change of Control. In the event of a Change of Control (as defined below), and either (A) Executive is terminated without Cause within 12 months after the effective date of the Change of Control, or (B) Executive resigns from employment for Good Reason (as defined below) effective as of a date within 12 months after the effective date of the Change of Control (such date of termination or resignation, the "Trigger Date"),Executive shall be entitled to receive a cash payment in an amount equal to the product of two times the sum of (i) the highest annual rate of Base Salary in effect for Executive during the 24-month period immediately preceding the effective date of the Change in Control and (ii) the highest amount of annual cash bonus compensation paid to Executive in respect of either the first or second full calendar year immediately preceding the Trigger Date.

Restrictive Provisions. As consideration for the foregoing payments, Executive agrees not to challenge the enforceability of any of the restrictions contained in Sections 5, 6 or 7 of this Agreement upon or after the occurrence of a Change of Control.

8.2. Payment Terms. This change of control payment shall be made in two lump sum payments as follows: (i) 75% of such amount shall be paid to Executive in a lump-sum cash

payment upon the Trigger Date; and (ii) 25% of such amount shall be paid to Executive in a lump-sum cash payment upon the 75th day following the Trigger Date, but not later than March 15 of the calendar year following the calendar year in which the Trigger Date occurs. Notwithstanding any of the foregoing to the contrary, the payment contemplated by clause (ii) shall be paid immediately upon the earlier occurrence of any of the following: (a) Executive's employment is terminated by the Company; or (b) Executive terminates employment for Good Reason (as defined below).

8.3. Certain Other Terms. In the event payments are being made to Executive under this Section 8, no payments shall be due under Section 3.4(b)(i) with respect to any termination of Executive's employment following a Change of Control. At the option of the Company, the Company may require Executive to execute the release attached hereto as Exhibit A; provided, however, that this requirement shall not in any way alter the timing of the payments to be made under Section 8.2. In the event that the Company announces that it has signed a definitive agreement with respect to a Change of Control, the provisions of this Section 8 shall continue to apply to Executive if, during the period after the public announcement and immediately preceding the date such transaction is consummated or terminated, the Company terminates Executive's employment without Cause or due to a disability; provided, however, that, in such event, any amount payable under this Section 8 shall be reduced by any payments received pursuant to Section 3.4(b)(i).

8.4. Defined Terms.

The term Change of Control shall have the meaning given to such term in the Company's 2008 Long Term Incentive Compensation Plan, as such may be amended or modified.

Good Reason. The occurrence of any of the following events that the Company fails to cure within 10 days after receiving written notice thereof from Executive: (i) assignment to Executive of any duties inconsistent in any material respect with Executive's position (including status, offices, titles and reporting requirements), authority, duties or responsibilities or inconsistent with Executive's legal or fiduciary obligations; (ii) any reduction in Executive's compensation or substantial reduction in Executive's benefits taken as a whole; (iii) any travel requirements materially greater than Executive's travel requirements prior to the Change of Control; or (iv) breach of any material term of this Agreement by the Company.

9. Certain Tax Matters.

9.1. Generally. In the event Executive becomes entitled to receive the payments (the "Severance Payments") provided under Section 3 or Section 8 hereof or under any other plan or arrangement providing for payments under circumstances similar to those contemplated by such sections, and if any of the Severance Payments will be subject to the tax (the "Excise Tax") imposed by Section 4999 of the Internal Revenue Code of 1986, as amended (the "Code"), the Company shall pay to Executive at the time specified for such payments, an additional amount (the "Gross-Up Payment") such that the net amount retained by Executive shall be equal to the amount of the Severance Payments after deducting normal and ordinary taxes but not deducting

(a) the Excise Tax and (b) any federal, state and local income tax and Excise Tax payable on the payment provided for by this Section 9.

9.2. Illustration. For example, if the Severance Payments are $1,000,000 and if Executive is subject to the Excise Tax, then the Gross-Up Payment will be such that Executive will retain an amount of $1,000,000 less only any normal and ordinary taxes on such amount. The Excise Tax and federal, state and local taxes and any Excise Tax on the payment provided by this Section 9 will not be deemed normal and ordinary taxes.

9.3. Certain Terms. For purposes of determining whether any of the Severance Payments will be subject to the Excise Tax and the amount of such Excise Tax, the following will apply:

Any other payments or benefits received or to be received by Executive in connection with a Change in Control of the Company or Executive's termination of employment (whether pursuant to the terms of this Agreement or any other plan, arrangement or agreement with the Company shall be treated as "parachute payments" within the meaning of Section 280G(b)(2) of the Code, and all "excess parachute payments" within the meaning of Section 280G(b)(1) shall be treated as subject to the Excise Tax, unless in the opinion of tax counsel selected by the Company's Compensation Committee and acceptable to Executive, such other payments or benefits (in whole or in part) do not constitute parachute payments, or such excess parachute payments (in whole or in part) represent reasonable compensation for services actually rendered within the meaning of Section 280G(b)(4) of the Code in excess of the base amount within the meaning of Section 280G(b)(3) of the Code, or are otherwise not subject to the Excise Tax;

The amount of the Severance Payments which shall be treated as subject to the Excise Tax shall be equal to the lesser of (y) the total amount of the Severance Payments or (z) the amount of excess parachute payments within the meaning of Section 280G(b)(1) (after applying subsection (a), above); and

The value of any non-cash benefits or any deferred payment or benefit shall be determined by the Company's independent auditors in accordance with proposed, temporary or final regulations under Sections 280G(d)(3) and (4) of the Code or, in the absence of such regulations, in accordance with the principles of Section 280G(d)(3) and (4) of the Code. For purposes of determining the amount of the Gross-Up Payment, Executive shall be deemed to pay federal income taxes at the highest marginal rate of federal income taxation in the calendar year in which the Gross-Up Payment is to be made and state and local income taxes at the highest marginal rate of taxation in the state and locality of Executive on the Trigger Date, net of the maximum reduction in federal income taxes which could be obtained from deduction of such state and local taxes; and

In the event that the amount of Excise Tax attributable to Severance Payments is subsequently determined to be less than the amount taken into account hereunder at the time of determination then, subject to applicable law, appropriate adjustments will be made with respect to future payment(s) hereunder (if any). If Executive becomes entitled to a Gross-Up Payment in excess of the amount initially determined and paid under Section 9.1, the Company shall pay the

additional Gross-Up Payment within five (5) business days of the date on which the Company is notified of the amount of the Gross-Up Payment, but only to the extent that the Gross-Up Payment would be made by the March 15 following the calendar year in which the Executive would be considered to have vested in the Gross-Up Payment for purposes of Section 409A. To the extent any Gross-Up Payment is greater than initially determined and paid under Section 9.1 and cannot be made by the March 15 following the end of the calendar year in which the Executive vests in such payment, then the Company shall instead make the payment promptly following the date on which the Executive remits the taxes to which the Gross-Up Payment relates to the applicable taxing authority, and in no event later than the last day of the calendar year following the calendar year in which such taxes are remitted; provided, however, that if the Executive is a key employee (within the meaning of Section 409A) and the Gross-Up Payment would be considered deferred compensation payable on account of Executive's separation from service (as defined in Section 409A), payment will in no event be made prior to 6 months after the date of Executive's separation from service.

9.4. Fees and Expenses. The Company shall reimburse Executive for all reasonable legal fees and expenses incurred by Executive in connection with any tax audit or proceeding to the extent attributable to the application of Section 4999 of the Code or any regulations pertaining thereto to any payment or benefit provided hereunder. Any expense reimbursements made to satisfy the terms of this section shall be paid as soon as practicable but no later than 90 days after Employee submits evidence of such expenses to the Company (which payment date shall in no event be later than the last day of the calendar year following the calendar year in which the expense was incurred). The amount of such reimbursements during any calendar year shall not affect the benefits provided in any other calendar year, and the right to any benefits under this paragraph shall not be subject to liquidation or exchange for another benefit.

10. Document Surrender. Upon the termination of Executive's employment for any reason, Executive shall immediately surrender and deliver to the Company all documents, correspondence and any other information, of any type whatsoever, from the Company or any of its agents, servants, employees, suppliers, and existing or potential customers, that came into Executive's possession by any means whatsoever, during the course of employment.

11. Governing Law. This Agreement shall be governed by and construed in accordance with the internal laws (and not the law of conflicts) of the Commonwealth of Pennsylvania.

12. Jurisdiction. The parties hereby irrevocably consent to the jurisdiction of the courts of the Commonwealth of Pennsylvania for all purposes in connection with any action or proceeding which arises out of or relates to this Agreement and agree that any action instituted under this Agreement shall be commenced, prosecuted and continued only in the state or federal courts having jurisdiction for matters arising in Wyomissing, Pennsylvania, which shall be the exclusive and only proper forum for adjudicating such a claim.

13. Notices. All notices and other communications required or permitted under this Agreement or necessary or convenient in connection herewith shall be in writing and shall be deemed to have been given when hand delivered, delivered by guaranteed next-day delivery or sent by facsimile (with confirmation of transmission) or shall be deemed given on the third



business day when mailed by registered or certified mail, as follows (provided that notice of change of address shall be deemed given only when received):

If to the Company, to:

Penn National Gaming, Inc.
825 Berkshire Boulevard, Suite 200
Wyomissing, PA 19610
Fax: (610) 376-2842

Attention: Chairman

If to Executive, to:

His then current home address.

or to such other names or addresses as the Company or Executive, as the case may be, shall designate by notice to each other person entitled to receive notices in the manner specified in this Section.

14. Contents of Agreement; Amendment and Assignment.

14.1. This Agreement sets forth the entire understanding between the parties hereto with respect to the subject matter hereof ar supersedes all prior or contemporaneous agreements or understandings with respect to thereto, including without limitation, the Initial Agreement which is hereby terminated. This Agreement cannot be changed, modified, extended, waived or terminated except upon a written instrument signed by the party against which it is to be enforced.

14.2. Executive may not assign any of his rights or obligations under this Agreement. The Company may assign its rights and obligations under this Agreement to any successor to all or substantially all of its assets or business by means of liquidation, dissolution, merger, consolidation, transfer of assets or otherwise.

15. Severability. If any provision of this Agreement or application thereof to anyone or under any circumstances is adjudicated to be invalid or unenforceable in any jurisdiction, such invalidity or unenforceability shall not affect any other provision or application of this Agreement which can be given effect without the invalid or unenforceable provision or application and shall not invalidate or render unenforceable such provision or application in any other jurisdiction. If any provision is held void, invalid or unenforceable with respect to particular circumstances, it shall nevertheless remain in full force and effect in all other circumstances. In addition, if any court determines that any part of Sections 5, 6 or 7 hereof is unenforceable because of its duration, geographical scope or otherwise, such court will have the power to modify such provision and, in its modified form, such provision will then be enforceable.

16. Remedies.

16.1. No remedy conferred upon a party by this Agreement is intended to be exclusive of any other remedy, and each and every such remedy shall be cumulative and shall be in addition to any other remedy given under this Agreement or now or hereafter existing at law or in equity.

16.2. No delay or omission by a party in exercising any right, remedy or power under this Agreement or existing at law or in equity shall be construed as a waiver thereof, and any such right, remedy or power may be exercised by such party from time to time and as often as may be deemed expedient or necessary by such party in its sole discretion.

16.3. Executive acknowledges that money damages would not be a sufficient remedy for any breach of this Agreement by Executive and that the Company shall be entitled to specific performance and injunctive relief as remedies for any such breach, in addition to all other remedies available at law or equity to the Company.

17. Construction. This Agreement is the result of thoughtful negotiations and reflects an arms' length bargain between two sophisticated parties, each represented by counsel. The parties agree that, if this Agreement requires interpretation, neither party should be considered "the drafter" nor be entitled to any presumption that ambiguities are to be resolved in his or her favor.

18. Beneficiaries/References. Executive shall be entitled, to the extent permitted under any applicable law, to select and change a beneficiary or beneficiaries to receive any compensation or benefit payable under this Agreement following Executive's death by giving the Company written notice thereof. In the event of Executive's death or a judicial determination of Executive's incompetence, reference in this Agreement to Executive shall be deemed, where appropriate, to refer to Executive's beneficiary, estate or other legal representative.

19. Withholding. All payments under this Agreement shall be made subject to applicable tax withholding, and the Company shall withhold from any payments under this Agreement all federal, state and local taxes, as the Company is required to withhold pursuant to any law or governmental rule or regulation. Except as specifically provided otherwise in this Agreement, Executive shall bear all expense of, and be solely responsible for, all federal, state and local taxes due with respect to any payment received under this Agreement.

20. Regulatory Compliance. The terms and provisions hereof shall be conditioned on and subject to compliance with all laws, rules, and regulations of all jurisdictions, or agencies, boards or commissions thereof, having regulatory jurisdiction over the employment or activities of Executive hereunder.

21. Section 409A. This Agreement is intended to comply with the requirements of Section 409A and shall be construed accordingly. Any payments or distributions to be made to Employee under this Agreement upon a separation from service (as defined in Section 409A) of amounts classified as "nonqualified deferred compensation" for purposes of Code Section 409A, shall in no event be made or commence until 6 months after such separation from service. Each payment of nonqualified deferred compensation under this Agreement shall be treated as a separate payment for purposes of Code Section 409A. Any reimbursements made pursuant to this Agreement shall be paid as soon as practicable but no later than 90 days after Employee

submits evidence of such expenses to Corporation (which payment date shall in no event be later than the last day of the calendar year followin the calendar year in which the expense was incurred). The amount of such reimbursements during any calendar year shall not affect the benefits provided in any other calendar year, and the right to any such benefits shall not be subject to liquidation or exchange for another benefit.

[Signatures on the Following Page]

IN WITNESS WHEREOF, the undersigned, intending to be legally bound, have executed this Agreement as of the date first above written.

PENN NATIONAL GAMING, INC.

By: /s/ Timothy Wilmott
Name: Timothy Wilmott
Title: President and Chief Operating Officer

EXECUTIVE

/s/ Jay Snowden
Jay Snowden

**Exhibit A**

SEPARATION AGREEMENT AND GENERAL RELEASE

This is a Separation Agreement and General Release (hereinafter referred to as the "Agreement") between (hereinafter referred to as the "Employee") and Penn National Gaming, Inc. (hereinafter referred to as the "Employer"). In consideration of the mutual promises and commitments made in this Agreement, and intending to be legally bound, Employee, on the one hand, and the Employer on the other hand, agree to the terms set forth in this Agreement.

1. Employer and Employee hereby acknowledge that [the Company notified Employee/Employee notified the Company on that Executive's employment pursuant to that certain Employment Agreement executed on ("Employment Agreement") would be terminated as of [ ]. Upon the termination of the Employment Agreement, Employee will be subject to the obligations and be the beneficiary of the surviving benefits, all as described in the Employment Agreement. Employee's last day of work will be .

2. (a) When used in this Agreement, the word "Releasees" means the Employer and all or any of its past and present parent, subsidiary and affiliated corporations, companies, partnerships, joint ventures and other entities and their groups, divisions, departments and units, and their past and present directors, trustees, officers, managers, partners, supervisors, employees, attorneys, agents and consultants, and their predecessors, successors and assigns.

(b) When used in this Agreement, the word "Claims" means each and every claim, complaint, cause of action, and grievance, whether known or unknown and whether fixed or contingent, and each and every promise, assurance, contract, representation, guarantee, warranty, right and commitment of any kind, whether known or unknown and whether fixed or contingent.

3. In consideration of the promises of the Employer set forth in this Agreement and the Employment Agreement, and intending to be legally bound, Employee hereby irrevocably remises, releases and forever discharges all Releasees of and from any and all Claims that he (on behalf of either himself or any other person or persons) ever had or now has against any and all of the Releasees, or which he (or his heirs, executors, administrators or assigns or any of them) hereafter can, shall or may have against any and all of the Releasees, for or by reason of any cause, matter, thing, occurrence or event whatsoever through the effective date of this Agreement. Employee acknowledges and agrees that th Claims released in this paragraph include, but are not limited to, (a) any and all Claims based on any law, statute or constitution or based on contract or in tort on common law, and (b) any and all Claims based on or arising under any civil rights laws, such as any Pennsylvania employment laws, or Title VII of the Civil Rights Act of 1964 (42 U.S.C. § 2000e et seq.), or the Federal Age Discrimination in Employment Act (29 U.S.C. § 621 et seq.) (hereinafter referred to as the "ADEA"), and (c) any and all Claims under any grievance or complaint procedure of any kind, and (d) any and all Claims based on or arising out of or related to his recruitment by, employment with, the termination of his employment with, his performance of any services in any capacity for, or any business transaction with, each or any of the Releasees. Employee also understands, that by signing this Agreement, he is waiving all Claims against any and all of the Releasees released by this Agreement; provided, however, that as set forth in section 7 (f) (1) (c) of the ADEA, as added by the Older Workers Benefit Protection Act of 1990, nothing in this Agreement constitutes or shall (i) be construed to constitute a waiver by Employee of any rights or claims that may arise after this Agreement is executed by Employee, or (ii) impair Employee's right to file a charge with the U.S. Equal Employment Opportunity Commission ("EEOC") or any state agency or to participate in an investigation or proceeding conducted by the EEOC or any state agency.

4. In consideration of the promises of the Employee set forth in this Agreement and the Employment Agreement and intending to be legally bound, Employer hereby irrevocably remises, releases and forever discharges Employee and his heirs, successors and assigns from any and all Claims that the Employer ever had or now has though the effective date of this Agreement.

5. Employee and Employer covenant and agree not to sue each other or any of the Releasees for any Claims released by this Agreement and to waive any recovery related to any Claims covered by this Agreement.

6. Employee agrees to provide reasonable transition assistance to Employer (including without limitation assistance on regulatory matters, operational matters and in connection with litigation) for a period of one year from the execution of this Agreement at no additional cost; provided, such assistance shall not unreasonably interfere with Employee's pursuit of gainful employment or result in Employee not having a separation from service (as defined in Section 409A of the Internal Revenue Code of 1986). Any assistance beyond this period will be provided at a mutually agreed cost. Employee further agrees that he will return to the Employer all property in his possession, including, but not limited to, keys, identification cards and credit cards, files, records, publications, address lists and documents that belong to each or any of the Releasees. Such documents also include, without limitation, any documents created or made by Employee during his employment with the Employer.

7. Employee agrees that, except as specifically provided in this Agreement and the Employment Agreement, there are no compensation, benefits, or other payments due or owed to him by each or any of the Releasees.

8. Except where disclosure has been made by the Company pursuant to applicable federal or state law, rule or regulation, Employee agrees that the terms of this Agreement are confidential and that he will not disclose or publicize the terms of this Agreement and the amounts paid or agreed to be paid pursuant to this Agreement to any person or entity, except to his spouse, his attorney, his accountant, and to a government agency for the purpose of payment or collection of taxes or application for unemployment compensation benefits. Employee agrees that his disclosure of the terms of this Agreement to his spouse, his attorney and his accountant shall be conditioned upon his obtaining agreement from them, for the benefit of the Employer, not to disclose or publicize to any person or entity the terms of this Agreement and the amounts paid or agreed to be paid under this Agreement. Further, Employer and Employee agree not to make any false, misleading, defamatory or disparaging communications about the other party (including without limitation Employer's products, services, partners, investors or personnel) and to refrain from taking any action designed to harm the public perception of the other party or the Releasees. Employee further agrees that he has disclosed to Employer all information, if any, in his possession, custody or control related to any legal, compliance or regulatory obligations of Employer and any failures to meet such obligations.

9. The terms of this Agreement are not to be considered as an admission on behalf of either party. Neither this Agreement nor its terms shall be admissible as evidence of any liability or wrongdoing by each or any of the Releasees in any judicial, administrative or other proceeding now pending or hereafter instituted by any person or entity. The Employer is entering into this Agreement solely for the purpose of effectuating a mutually satisfactory separation of Employee's employment.

10. All provisions of this Agreement are severable and if any of them is determined to be invalid or unenforceable for any reason, the remaining provisions and portions of this Agreement shall be unaffected thereby and shall remain in full force to the fullest extent permitted by law.

11. This Agreement shall be governed by and interpreted under and in accordance with the laws of Pennsylvania. Any suit, claim or cause of action arising under or related to this Agreement shall be submitted by the parties hereto to the exclusive jurisdiction of the courts of Pennsylvania or to the federal courts located therein if they otherwise have jurisdiction. The breach of any promise in this Agreement by any party shall not invalidate this Agreement or the release and shall not be a defense to the enforcement of the Agreement against any party.

12. This Agreement constitutes a complete and final agreement between the parties and supersedes and replaces all prior or contemporaneous agreements, offer letters, negotiations, or discussions relating to the subject matter of this Agreement. With the exception of the Employment Agreement, no other agreement shall be binding upon each or any of the Releasees, including, but not limited to, any agreement made hereafter, unless in writing and signed by an officer of the Employer, and only such agreement shall be binding against the Employer.

13. Employee is advised, and acknowledges that he has been advised, to consult with an attorney before signing this Agreement.

14. Employee acknowledges that he is signing this Agreement voluntarily, with full knowledge of the nature and consequence of its terms.

15. All executed copies of this Agreement and photocopies thereof shall have the same force and effect and shall be as legally binding and enforceable as the original.

16. Employee acknowledges that he has been given up to twenty-one (21) days within which to consider this Agreement before signing it. Subject to paragraph 17 below, this Agreement will become effective on the date of Employee's signature hereof.

17. For a period of seven (7) calendar days following his signature of this Agreement, Employee may revoke the Agreement, and the Agreement shall not become effective or enforceable until the seven (7) day revocation period has expired. Employee may revoke this Agreement at any time within that seven (7) day period, by sending a written notice of revocation to the . Such written notice must be actually received by the Employer within that seven (7) day period in order to be valid. If a valid revocation is received within that seven (7) day period, this Agreement shall be null and void for all purposes. Payment of the severance pay amount set forth in the Employment Agreement will be paid in the manner and at the time(s) described in the Employment Agreement.

IN WITNESS WHEREOF, the Parties have read, understand and do voluntarily execute this Separation Agreement and General Release which consists of four pages.

EMPLOYER

By:

Date:

EMPLOYEE

Date:

**Exhibit 21.1**

**Subsidiaries of Penn National Gaming, Inc. (a Pennsylvania corporation)**

| Name of Subsidiary | State or Other Jurisdiction of Incorporation |
|---|---|
| Alton Gaming Company (d/b/a Argosy Casino Alton) | Illinois |
| Argosy Gaming Company | Delaware |
| Bangor Historic Track, Inc. (d/b/a Hollywood Slots Hotel and Raceway) | Maine |
| Belle of Sioux City, L.P. (d/b/a Argosy Casino Sioux City) | Iowa |
| Beulah Park Gaming Ventures, Inc. (d/b/a Beulah Park) | Ohio |
| BSL, Inc. (d/b/a Hollywood Casino at Bay St. Louis) | Mississippi |
| BTN, Inc. (d/b/a Boomtown Biloxi) | Mississippi |
| Casino Rama Services, Inc. | Ontario |
| CD Gaming Ventures, LLC | Ohio |
| Central Ohio Gaming Ventures, LLC | Ohio |
| CHC (Ontario) Supplies Limited | Nova Scotia |
| CHC Casinos Canada Limited | Nova Scotia |
| CHC Casinos Corp. | Florida |
| Crazy Horses, Inc. | Ohio |
| CRC Holdings, Inc. | Florida |
| Dayton Real Estate Ventures, LLC | Ohio |
| Delvest Corp. | Delaware |
| Delvest Sub. Corp. | Delaware |
| Empress Casino Joliet Corporation (d/b/a Hollywood Casino Joliet) | Illinois |
| Hollywood Casino Corporation | Delaware |
| Hollywood Casino—Aurora, Inc. (d/b/a Hollywood Casino Aurora) | Illinois |
| Houston Gaming Ventures, Inc. | Texas |
| HWCC—Tunica, Inc. (d/b/a Hollywood Casino Tunica) | Texas |
| Indiana Gaming Company, L.P. (d/b/a Hollywood Casino Lawrenceburg) | Indiana |
| Iowa Gaming Company | Iowa |
| Kansas Entertainment, LLC | Delaware |
| Louisiana Casino Cruises, Inc. (d/b/a Hollywood Casino Baton Rouge) | Louisiana |
| LV Gaming Ventures, LLC (d/b/a M Resort) | Nevada |
| LVGV Properties I, LLC (d/b/a M Resort) | Nevada |
| LVGV Properties II, LLC (d/b/a M Resort) | Nevada |
| Mountainview Thoroughbred Racing Association (d/b/a Hollywood Casino at Penn National Race Course) | Pennsylvania |
| Ohio Racing Company | Ohio |
| Penn Bullpen, Inc. | Colorado |
| Penn Bullwhackers Retail, LLC | Colorado |
| Penn Bullwhackers, Inc. (d/b/a Bullwhackers) | Colorado |
| Penn Cecil Maryland, Inc (d/b/a Hollywood Casino Perryville). | Maryland |
| Penn Hollywood Kansas, Inc. | Delaware |
| Penn Millsite, Inc. | Colorado |
| Penn National GSFR, LLC | Delaware |
| Penn National Holding Company | Delaware |
| Penn Sanford, LLC (d/b/a Sanford-Orlando Kennel Club) | Delaware |
| Pennsylvania National Turf Club, Inc. (d/b/a Hollywood Casino at Penn National Race Course) | Pennsylvania |
| Pennwood Racing, Inc. | Delaware |
| PHK Staffing, LLC | Delaware |

| Name of Subsidiary | State or Other Jurisdiction of Incorporation |
|---|---|
| PNGI Charles Town Gaming Limited Liability Company (d/b/a Hollywood Casino at Charles Town Races) | West Virginia |
| Prince George's Racing Venture, LLC (d/b/a Rosecroft) | Delaware |
| Raceway Park, Inc. (d/b/a Raceway Park) | Ohio |
| SOKC, LLC (d/b/a Sanford-Orlando Kennel Club) | Delaware |
| TGV Holdings, Inc. | Delaware |
| The Indiana Gaming Company | Indiana |
| The Missouri Gaming Company (d/b/a Argosy Casino Riverside) | Missouri |
| Toledo Gaming Ventures, LLC | Ohio |
| Youngstown Real Estate Ventures, LLC | Ohio |
| Zia Park LLC (d/b/a Zia Park Casino) | Delaware |

QuickLinks -- Click here to rapidly navigate through this document

**Exhibit 23.1**

**Consent of Independent Registered Public Accounting Firm**

We consent to the incorporation by reference in the following Registration Statements:

(1) Registration Statement (Form S-4 No. 333-164505) of Penn National Gaming, Inc.,

(2) Registration Statement (Form S-3 No. 333-156487) of Penn National Gaming, Inc.,

(3) Registration Statement (Form S-8 No. 333-176723) pertaining to the 2008 Long Term Incentive Compensation Plan,

(4) Registration Statement (Form S-8 No. 333-157669) pertaining to the 2008 Long Term Incentive Compensation Plan,

(5) Registration Statement (Form S-8 No. 333-125928) pertaining to the Nonqualified Stock Option Agreement with Peter M. Carlino,

(6) Registration Statement (Form S-8 No. 333-108173) pertaining to the Penn National Gaming, Inc. 2003 Long Term Incentive Compensation Plan, and

(7) Registration Statement (Form S-8 No. 333-61684) pertaining to the Amended and Restated Penn National Gaming, Inc. 1994 Stock Option Plan;

of our reports dated February 24, 2012, with respect to the consolidated financial statements of Penn National Gaming, Inc. and the effectiveness of internal control over financial reporting of Penn National Gaming, Inc., included in the Annual Report (Form 10-K) for the year ended December 31, 2011.

/s/ ERNST & YOUNG LLP

Philadelphia, Pennsylvania
February 24, 2012

QuickLinks

Exhibit 23.1

QuickLinks -- Click here to rapidly navigate through this document

**Exhibit 31.1**

**CERTIFICATION PURSUANT TO RULE 13a-14(a) OR 15d-14(a) OF THE SECURITIES AND EXCHANGE ACT OF 1934**

I, Peter M. Carlino, certify that:

1. I have reviewed this annual report on Form 10-K of Penn National Gaming, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 24, 2012

/s/ PETER M. CARLINO

Name: Peter M. Carlino
Title: *Chief Executive Officer*

QuickLinks

Exhibit 31.1

QuickLinks -- Click here to rapidly navigate through this document

**Exhibit 31.2**

**CERTIFICATION PURSUANT TO RULE 13a-14(a) OR 15d-14(a) OF THE SECURITIES AND EXCHANGE ACT OF 1934**

I, William J. Clifford, certify that:

1.

I have reviewed this annual report on Form 10-K of Penn National Gaming, Inc.;

2.

Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3.

Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4.

The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

(a)

Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b)

Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c)

Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d)

Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5.

The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a)

All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b)

Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 24, 2012

/s/ WILLIAM J. CLIFFORD

Name: William J. Clifford
Title: *Chief Financial Officer*

QuickLinks

Exhibit 31.2

QuickLinks -- Click here to rapidly navigate through this document

**EXHIBIT 32.1**

**CERTIFICATION PURSUANT TO**
**SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**
**18 U.S.C. SECTION 1350**

In connection with the Annual Report of Penn National Gaming, Inc. (the "Company") on Form 10-K for the fiscal year ended December 31, 2011 as filed with the U.S. Securities and Exchange Commission on the date hereof (the "Report"), I, Peter M. Carlino, Chief Executive Officer of the Company, certify, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350 that, to my knowledge:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ PETER M. CARLINO

Peter M. Carlino
*Chief Executive Officer*
February 24, 2012

QuickLinks

EXHIBIT 32.1

QuickLinks -- Click here to rapidly navigate through this document

**EXHIBIT 32.2**

**CERTIFICATION PURSUANT TO**
**SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002,**
**18 U.S.C. SECTION 1350**

In connection with the Annual Report of Penn National Gaming, Inc. (the "Company") on Form 10-K for the fiscal year ended December 31, 2011 as filed with the U.S. Securities and Exchange Commission on the date hereof (the "Report"), I, William J. Clifford, Chief Financial Officer of the Company, certify, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350 that, to my knowledge:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ WILLIAM J. CLIFFORD

William J. Clifford
*Chief Financial Officer*
February 24, 2012

QuickLinks

EXHIBIT 32.2

**Exhibit 99**

## Description of Governmental Regulations

*General*

The ownership, operation, and management of our gaming and racing facilities are subject to pervasive regulation under the laws and regulations of each of the jurisdictions in which we operate. Gaming laws are generally based upon declarations of public policy designed to protect gaming consumers and the viability and integrity of the gaming industry. Gaming laws also may be designed to protect and maximize state and local revenues derived through taxes and licensing fees imposed on gaming industry participants as well as to enhance economic development and tourism. To accomplish these public policy goals, gaming laws establish procedures to ensure that participants in the gaming industry meet certain standards of character and fitness. In addition, gaming laws require gaming industry participants to:

- Ensure that unsuitable individuals and organizations have no role in gaming operations;
- Establish procedures designed to prevent cheating and fraudulent practices;
- Establish and maintain responsible accounting practices and procedures;
- Maintain effective controls over their financial practices, including establishment of minimum procedures for internal fiscal affairs and the safeguarding of assets and revenues;
- Maintain systems for reliable record keeping;
- File periodic reports with gaming regulators;
- Ensure that contracts and financial transactions are commercially reasonable, reflect fair market value and are arms-length transactions; and
- Establish programs to promote responsible gaming.

Typically, a state regulatory environment is established by statute and is administered by a regulatory agency with broad discretion to regulate the affairs of owners, managers, and persons with financial interests in gaming operations. Among other things, gaming authorities in the various jurisdictions in which we operate:

- Adopt rules and regulations under the implementing statutes;
- Interpret and enforce gaming laws;
- Impose disciplinary sanctions for violations, including fines and penalties;
- Review the character and fitness of participants in gaming operations and make determinations regarding their suitability or qualification for licensure;
- Grant licenses for participation in gaming operations;
- Collect and review reports and information submitted by participants in gaming operations;
- Review and approve transactions, such as acquisitions or change-of-control transactions of gaming industry participants, securities offerings and debt transactions engaged in by such participants; and
- Establish and collect fees and taxes.

Any change in the laws or regulations of a gaming jurisdiction could have a material adverse effect on our gaming operations.

*Licensing and Suitability Determinations*

Gaming laws require us, each of our subsidiaries engaged in gaming operations, certain of our directors, officers and employees, and in some cases, certain of our shareholders and holders of our debt securities, to obtain licenses from gaming authorities. Licenses typically require a determination that the applicant qualifies or is suitable to hold the license. Gaming authorities have very broad discretion in determining whether an applicant qualifies for licensing or should be deemed suitable. Criteria used in determining whether to grant a license to conduct gaming operations, while varying between jurisdictions, generally include consideration of factors such as:

- The good character, honesty and integrity of the applicant;
- The financial stability, integrity and responsibility of the applicant, including whether the operation is adequately capitalized in the state and exhibits the ability to maintain adequate insurance levels;
- The quality of the applicant's casino facilities;
- The amount of revenue to be derived by the applicable state from the operation of the applicant's casino;
- The applicant's practices with respect to minority hiring and training; and
- The effect on competition and general impact on the community.

In evaluating individual applicants, gaming authorities consider the individual's business experience and reputation for good character, the individual's criminal history and the character of those with whom the individual associates.

Many gaming jurisdictions limit the number of licenses granted to operate casinos within the state, and some states limit the number of licenses granted to any one gaming operator. Licenses under gaming laws are generally not transferable without approval. Licenses in most of the jurisdictions in which we conduct gaming operations are granted for limited durations and require renewal from time to time. There can be no assurance that any of our licenses will be renewed. The failure to renew any of our licenses could have a material adverse effect on our gaming operations. In addition, Iowa law requires that a qualified nonprofit organization hold the gaming license. At Argosy Casino Sioux City, we are the operator of the property. We own the assets (other than the land) and we manage the facility for Missouri River Historical Development, Inc. (the licensed nonprofit organization).

In addition to us and our direct and indirect subsidiaries engaged in gaming operations, gaming authorities may investigate any individual who has a material relationship to or material involvement with, any of these entities to determine whether such individual is suitable or should be licensed as a business associate of a gaming licensee. Our officers, directors and certain key employees must file applications with the gaming authorities and may be required to be licensed, qualify or be found suitable in many jurisdictions. Gaming authorities may deny an application for licensing for any cause which they deem reasonable. Qualification and suitability determinations require submission of detailed personal and financial information followed by a thorough investigation. The applicant must pay all the costs of the investigation. Changes in licensed positions must be reported to gaming authorities and in addition to their authority to deny an application for licensure, qualification or a finding of suitability, gaming authorities have jurisdiction to disapprove a change in a corporate position.

If one or more gaming authorities were to find that an officer, director or key employee fails to qualify or is unsuitable for licensing or unsuitable to continue having a relationship with us, we would be required to sever all relationships with such person. In addition, gaming authorities may require us to terminate the employment of any person who refuses to file appropriate applications.

Moreover, in many jurisdictions, certain of our stockholders or holders of our debt securities may be required to undergo a suitabili investigation similar to that described above. Many jurisdictions require any person who acquires beneficial ownership of more than a certain percentage of our voting securities, typically 5%, to report the acquisition to gaming authorities, and gaming authorities may require such holders to apply for qualification or a finding of suitability. Most gaming authorities, however, allow an "institutional investor" to apply for a waiver. An "institutional investor" is generally defined as an investor acquiring and holding voting securities in the ordinary course of business as an institutional investor, and not for the purpose of causing, directly or indirectly, the election of a member of our board of directors, any change in our corporate charter, bylaws, management, policies or operations, or those of any of our gaming affiliates, or the taking of any other action which gaming authorities find to be inconsistent with holding our voting securities for investment purposes only. Even if a waiver is granted, an institutional investor generally may not take any action inconsistent with its status when the waiver was granted without once again becoming subject to the foregoing reporting and application obligations.

Generally, any person who fails or refuses to apply for a finding of suitability or a license within the prescribed period after being advised it is required by gaming authorities may be denied a license or found unsuitable, as applicable. Any stockholder found unsuitable or denied a license and who holds, directly or indirectly, any beneficial ownership of our voting securities beyond such period of time as may be prescribed by the applicable gaming authorities may be guilty of a criminal offense. Furthermore, we may be subject to disciplinary action if, after we receive notice that a person is unsuitable to be a stockholder or to have any other relationship with us or any of our subsidiaries, we: (i) pay that person any dividend or interest upon our voting securities; (ii) allow that person to exercise, directly or indirectly, any voting right conferred through securities held by that person; (iii) pay remuneration in any form to that person for services rendered or otherwise; or (iv) fail to pursue all lawful efforts to require such unsuitable person to relinquish his voting securities including, if necessary, the immediate purchase of said voting securities for cash at fair market value.

The gaming jurisdictions in which we operate also require that suppliers of certain goods and services to gaming industry participants be licensed and require us to purchase and lease gaming equipment, and certain supplies and services only from licensed suppliers.

*Violations of Gaming Laws*

If we or our subsidiaries violate applicable gaming laws, our gaming licenses could be limited, conditioned, suspended or revoked by gaming authorities, and we and any other persons involved could be subject to substantial fines. Further, a supervisor or conservator can be appointed by gaming authorities to operate our gaming properties, or in some jurisdictions, take title to our gaming assets in the jurisdiction, an under certain circumstances, earnings generated during such appointment could be forfeited to the applicable state or states. Furthermore, violations of laws in one jurisdiction could result in disciplinary action in other jurisdictions. As a result, violations by us of applicable gaming laws could have a material adverse effect on our gaming operations.

Some gaming jurisdictions prohibit certain types of political activity by a gaming licensee, its officers, directors and key people. A violation of such a prohibition may subject the offender to criminal and/or disciplinary action.

*Reporting and Record-keeping Requirements*

We are required periodically to submit detailed financial and operating reports and furnish any other information about us and our subsidiaries which gaming authorities may require. Under federal law, we are required to record and submit detailed reports of currency transactions involving greater than $10,000 at our casinos as well as any suspicious activity that may occur at such facilities. We are required to maintain a current stock ledger which may be examined by gaming authorities at any time. If any securities are held in trust by an agent or by a nominee, the record holder may be required to disclose the identity of the beneficial owner to gaming authorities. A failure to make such disclosure may be grounds for finding the record holder unsuitable. Gaming authorities may require certificates for our securities to bear a legend indicating that the securities are subject to specified gaming laws.

*Review and Approval of Transactions*

Substantially all material loans, leases, sales of securities and similar financing transactions by us and our subsidiaries must be reported to and in some cases approved by gaming authorities. Neither we nor any of our subsidiaries may make a public offering of securities without the prior approval of certain gaming authorities. Changes in control through merger, consolidation, stock or asset acquisitions, management or consulting agreements, or otherwise are subject to receipt of prior approval of gaming authorities. Entities seeking to acquire control of us or one of our subsidiaries must satisfy gaming authorities with respect to a variety of stringent standards prior to assuming control. Gaming authorities may also require controlling stockholders, officers, directors and other persons having a material relationship or involvement with the entity proposing to acquire control, to be investigated and licensed as part of the approval process relating to the transaction.

Because of regulatory restrictions, our ability to grant a security interest in any of our gaming assets is limited and subject to receipt of prior approval by gaming authorities.

*License Fees and Gaming Taxes*

We pay substantial license fees and taxes in many jurisdictions, including some of the counties and cities in which our operations are conducted, in connection with our casino gaming operations, computed in various ways depending on the type of gaming or activity involved. Depending upon the particular fee or tax involved, these fees and taxes are payable with varying frequency. License fees and taxes are based upon such factors as:

- a percentage of the gross gaming revenues received;
- the number of gaming devices and table games operated;
- admission fees for customers boarding our riverboat casinos; and
- one time fees payable upon the initial receipt of license and fees in connection with the renewal of license.

In many jurisdictions, gaming tax rates are graduated such that they increase as gross gaming revenues increase. Furthermore, tax rates are subject to change, sometimes with little notice, and such changes could have a material adverse effect on our gaming operations.

In addition to taxes specifically unique to gaming, we are required to pay all other applicable taxes.

*Operational Requirements*

In most jurisdictions, we are subject to certain requirements and restrictions on how we must conduct our gaming operations. In many states, we are required to give preference to local suppliers and include minority and women-owned businesses as well as organized labor in construction projects to the maximum extent practicable as well as in general vendor business activity. Similarly, we may be required to give employment preference to minorities, women and in-state residents in certain jurisdictions.

Some gaming jurisdictions also prohibit a distribution, except to allow for the payment of taxes, if the distribution would impair the financial viability of the gaming operation. Moreover, many jurisdictions require a gaming operation to maintain insurance and post bonds in amounts determined by their gaming authority.

In addition, our ability to conduct certain types of games, introduce new games or move existing games within our facilities may be restricted or subject to regulatory review and approval. Some of our operations are subject to restrictions on the number of gaming positions we may have and the maximum wagers allowed to be placed by our customers.

In Mississippi, we are required to include a 500 car parking facility in close proximity to each casino complex and infrastructure facilities that will amount to at least twenty five percent of the casino cost. This requirement has recently been increased for any new casinos in Mississippi.

In Pennsylvania, the holder of a Category 1 license is required to create a fund to be used for the improvement and maintenance of the backside area of the racetrack. A Category 1 licensee must deposit into the fund $5,000,000 over the initial five year period of the license and an amount not less than $250,000 or more than $1,000,000 annually for the five years thereafter. We have reached an agreement with the Pennsylvania Horsemen's Benevolent and Protective Association on the allocation of these funds.

*Riverboat Casinos*

In addition to all other regulations generally applicable to the gaming industry generally, certain of our riverboat casinos are also subject to regulations applicable to vessels operating on navigable waterways, including regulations of the U.S. Coast Guard, or alternative inspection requirements. These requirements set limits on the operation of the vessel, mandate that it must be operated by a minimum complement of licensed personnel, establish periodic inspections, including the physical inspection of the outside hull, and establish other mechanical and operations rules. In addition, the riverboat casinos may be subject to future U.S. Coast Guard regulations, or alternative security procedures, designed to increase homeland security which could affect some of our properties and require significant expenditures to bring such properties into compliance.

*Racetracks*

We conduct horse racing operations at our thoroughbred racetracks in Charles Town, West Virginia, Grantville, Pennsylvania, Hobbs, New Mexico, Grove City, Ohio, and at our harness racetracks in Bangor, Maine and Toledo, Ohio. We also have anownership interest in a harness racetrack in Freehold, New Jersey and in thoroughbred racetracks in Baltimore and Laurel, Maryland through various joint venture agreements. We conduct greyhound racing in Seminole County, Florida, at our Sanford Orlando facility. In Pennsylvania, we operate four off track wagering facilities and conduct account wagering operations. We currently operate video lottery terminals and table games at the Charles Town, West Virginia racetrack. Slot machine operations commenced at the Grantville, Pennsylvania racetrack in the first quarter of 2008 and we added table games in July 2010. We also conduct slot operations in Bangor, Maine at a facility located near the racetrack. Generally, our slot and table operations at racetracks are regulated in the same manner as our gaming operations in other jurisdictions. In some jurisdictions, our ability to conduct gaming operations may be conditioned on the maintenance of agreements or certain arrangements with horsemen's or labor groups.

Regulations governing our horse racing operations are administered separately from the regulations governing gaming operations, with separate licenses and license fee structures. The racing authorities responsible for regulating our racing operations have broad oversight authority, which may include: annually reviewing and granting racing licenses and racing dates; approving the opening and operation of off track wagering facilities; approving simulcasting activities; licensing all officers, directors, racing officials and certain other employees of a racing licensee; and approving all contracts entered into by a racing licensee affecting racing, pari-mutuel wagering, account wagering and off track wagering operations.

# Exhibit 3-a

## Penn National Gaming, Inc.

2010 Financial Statements

## ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

### Report of Independent Registered Public Accounting Firm

Board of Directors
Penn National Gaming, Inc. and subsidiaries

We have audited the accompanying consolidated balance sheets of Penn National Gaming, Inc. and subsidiaries as of December 31, 2010 and 2009, and the related consolidated statements of operations, changes in shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2010. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Penn National Gaming, Inc. and subsidiaries at December 31, 2010 and 2009, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2010, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Penn National Gaming, Inc. and subsidiaries' internal control over financial reporting as of December 31, 2010, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 25, 2011 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Philadelphia, Pennsylvania
February 25, 2011

**Penn National Gaming, Inc. and Subsidiaries**
**Consolidated Balance Sheets**
**(in thousands, except share and per share data)**

| | December 31, 2010 | December 31, 2009 |
|---|---|---|
| **Assets** | | |
| **Current assets** | | |
| Cash and cash equivalents | $246,385 | $713,118 |
| Receivables, net of allowance for doubtful accounts of $3,332 and $3,548 at December 31, 2010 and 2009, respectively | 44,463 | 46,672 |
| Insurance receivable | — | 33,494 |
| Prepaid expenses | 72,393 | 70,947 |
| Deferred income taxes | 25,206 | 23,619 |
| Other current assets | 77,506 | 41,021 |
| Total current assets | 465,953 | 928,871 |
| **Property and equipment, net** | 1,965,774 | 1,837,504 |
| **Other assets** | | |
| Investment in and advances to unconsolidated affiliates | 64,120 | 26,305 |
| Goodwill | 1,185,756 | 1,379,961 |
| Other intangible assets | 415,152 | 386,531 |
| Debt issuance costs, net of accumulated amortization of $45,234 and $39,703 at December 31, 2010 and 2009, respectively | 27,742 | 40,889 |
| Loan receivable | 230,500 | — |
| Other assets | 107,882 | 112,555 |
| Total other assets | 2,031,152 | 1,946,241 |
| **Total assets** | $4,462,879 | $4,712,616 |
| **Liabilities** | | |
| **Current liabilities** | | |
| Current maturities of long-term debt | $357,927 | $86,071 |
| Accounts payable | 17,312 | 19,850 |
| Accrued expenses | 101,447 | 110,108 |
| Accrued interest | 36,597 | 61,786 |
| Accrued salaries and wages | 73,432 | 65,608 |
| Gaming, pari-mutuel, property, and other taxes | 46,449 | 38,943 |
| Insurance financing | 11,602 | 6,752 |
| Other current liabilities | 46,763 | 41,138 |
| Total current liabilities | 691,529 | 430,256 |
| **Long-term liabilities** | | |
| Long-term debt, net of current maturities | 1,813,196 | 2,248,706 |
| Deferred income taxes | 134,572 | 127,107 |
| Noncurrent tax liabilities | 36,846 | 46,702 |
| Other noncurrent liabilities | 8,970 | 7,769 |
| Total long-term liabilities | 1,993,584 | 2,430,284 |
| **Shareholders' equity** | | |
| Penn National Gaming, Inc. and subsidiaries shareholders' equity: | | |
| Preferred stock ($.01 par value, 1,000,000 shares authorized, 12,275 and 12,500 shares issued and outstanding at December 31, 2010 and 2009, respectively) | — | — |
| Common stock ($.01 par value, 200,000,000 shares authorized, 78,414,022 and 78,972,256 shares issued at December 31, 2010 and 2009, respectively) | 779 | 786 |
| Additional paid-in capital | 1,446,932 | 1,480,476 |
| Retained earnings | 337,940 | 397,407 |
| Accumulated other comprehensive loss | (7,885) | (26,028) |
| Total Penn National Gaming, Inc. and subsidiaries shareholders' equity | 1,777,766 | 1,852,641 |
| Noncontrolling interests | — | (565) |
| Total shareholders' equity | 1,777,766 | 1,852,076 |
| **Total liabilities and shareholders' equity** | $4,462,879 | $4,712,616 |

See accompanying notes to the consolidated financial statements.

**Penn National Gaming, Inc. and Subsidiaries**
**Consolidated Statements of Operations**
**(in thousands, except per share data)**

| Year ended December 31, | 2010 | 2009 | 2008 |
|---|---|---|---|
| **Revenues** | | | |
| Gaming | $2,242,515 | $2,158,028 | $2,206,500 |
| Food, beverage and other | 334,808 | 339,235 | 334,206 |
| Management service fee | 15,190 | 14,787 | 16,725 |
| Revenues | 2,592,513 | 2,512,050 | 2,557,431 |
| Less promotional allowances | (133,402) | (142,775) | (134,378) |
| Net revenues | 2,459,111 | 2,369,275 | 2,423,053 |
| **Operating expenses** | | | |
| Gaming | 1,198,097 | 1,161,510 | 1,181,870 |
| Food, beverage and other | 266,800 | 266,351 | 257,653 |
| General and administrative | 411,415 | 403,136 | 415,093 |
| Depreciation and amortization | 212,387 | 194,436 | 173,545 |
| Impairment losses | 224,709 | 532,377 | 481,333 |
| Hollywood Casino Joliet fire | (7,523) | 6,063 | — |
| Total operating expenses | 2,305,885 | 2,563,873 | 2,509,494 |
| Income (loss) from operations | 153,226 | (194,598) | (86,441) |
| **Other income (expenses)** | | | |
| Interest expense | (130,215) | (134,984) | (169,827) |
| Interest income | 1,579 | 6,522 | 8,362 |
| Loss from unconsolidated affiliates | (25,974) | (1,121) | (1,526) |
| Merger termination settlement fees, net of related expenses | — | — | 195,426 |
| Loss on early extinguishment of debt | (519) | (4,793) | — |
| Other | 6,421 | 1,093 | 6,421 |
| Total other (expenses) income | (148,708) | (133,283) | 38,856 |
| **Income (loss) from operations before income taxes** | 4,518 | (327,881) | (47,585) |
| Taxes on income | 66,178 | (60,468) | 105,738 |
| **Net loss including noncontrolling interests** | (61,660) | (267,413) | (153,323) |
| Less: Net loss attributable to noncontrolling interests | (2,193) | (2,465) | — |
| **Net loss attributable to the shareholders of Penn National Gaming, Inc. and subsidiaries** | $(59,467) | $(264,948) | $(153,323) |
| **Loss per common share attributable to the shareholders of Penn National Gaming, Inc. and subsidiaries:** | | | |
| Basic loss per common share | $(0.76) | $(3.39) | $(1.81) |
| Diluted loss per common share | $(0.76) | $(3.39) | $(1.81) |

See accompanying notes to the consolidated financial statements.

## Penn National Gaming, Inc. and Subsidiaries

## Consolidated Statements of Changes in Shareholders' Equity

## (in thousands, except share data)

| | Penn National Gaming, Inc. shareholders | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Preferred Stock | | Common Stock | | Treasury | Additional Paid-In | Retained | Accumulated Other Comprehensive | Noncontrolling | Total Shareholders' | Comprehensive |
| | Shares | Amount | Shares | Amount | Stock | Capital | Earnings | (Loss) Income | Interests | Equity | (Loss) Income |
| Balance, December 31, 2007 | — | $— | 88,579,070 | $887 | $(2,379) | $322,760 | $815,678 | $(15,984) | $— | $1,120,962 | |
| Issuance of preferred stock | 12,500 | — | — | — | — | 1,246,400 | — | — | — | 1,246,400 | $— |
| Stock option activity, including tax benefit of $1,060 | — | — | 203,202 | 2 | — | 26,305 | — | — | — | 26,307 | — |
| Share activity | — | — | (10,633,784) | (107) | 2,379 | (154,633) | — | — | — | (152,361) | — |
| Restricted stock activity | — | — | — | — | — | 1,997 | — | — | — | 1,997 | — |
| Change in fair value of interest rate swap contracts, net of income taxes of $13,072 | — | — | — | — | — | — | — | (23,216) | — | (23,216) | (23,216) |
| Change in fair value of corporate debt securities | — | — | — | — | — | — | — | (8,008) | — | (8,008) | (8,008) |
| Foreign currency translation adjustment | — | — | — | — | — | — | — | (1,485) | — | (1,485) | (1,485) |
| Net loss | — | — | — | — | — | — | (153,323) | — | — | (153,323) | (153,323) |
| Balance, December 31, 2008 | 12,500 | — | 78,148,488 | 782 | — | 1,442,829 | 662,355 | (48,693) | — | 2,057,273 | (186,032) |
| Stock option activity, including tax benefit of $2,388 | — | — | 491,078 | 4 | — | 35,173 | — | — | — | 35,177 | — |
| Restricted stock activity | — | — | 332,690 | — | — | 2,474 | — | — | — | 2,474 | — |
| Change in fair value of interest rate swap contracts, net of income taxes of $8,150 | — | — | — | — | — | — | — | 14,586 | — | 14,586 | 14,586 |
| Change in fair value of corporate debt securities | — | — | — | — | — | — | — | 6,843 | — | 6,843 | 6,843 |
| Foreign currency translation adjustment | — | — | — | — | — | — | — | 1,236 | — | 1,236 | 1,236 |
| Contributions from noncontrolling interests | — | — | — | — | — | — | — | — | 1,900 | 1,900 | — |
| Net loss | — | — | — | — | — | — | (264,948) | — | (2,465) | (267,413) | (267,413) |
| Balance, December 31, 2009 | 12,500 | — | 78,972,256 | 786 | — | 1,480,476 | 397,407 | (26,028) | (565) | 1,852,076 | (244,748) |
| Repurchase of preferred stock | (225) | — | — | — | — | (11,200) | — | — | — | (11,200) | — |
| Repurchase of noncontrolling interest | — | — | — | — | — | (27,758) | — | — | 2,758 | (25,000) | — |
| Stock option activity, including tax benefit of $3,311 | — | — | 823,056 | 8 | — | 35,875 | — | — | — | 35,883 | — |
| Share activity | — | — | (1,526,400) | (15) | — | (35,843) | — | — | — | (35,858) | — |
| Restricted stock activity | — | — | 145,110 | — | — | 5,382 | — | — | — | 5,382 | — |
| Change in fair value of interest rate swap contracts, net of income taxes of $9,427 | — | — | — | — | — | — | — | 16,410 | — | 16,410 | 16,410 |
| Change in fair value of corporate debt securities | — | — | — | — | — | — | — | 1,165 | — | 1,165 | 1,165 |
| Foreign currency translation adjustment | — | — | — | — | — | — | — | 568 | — | 568 | 568 |
| Net loss | — | — | — | — | — | — | (59,467) | — | (2,193) | (61,660) | (61,660) |
| Balance, December 31, 2010 | 12,275 | $— | 78,414,022 | $779 | $— | $1,446,932 | $337,940 | $(7,885) | $— | $1,777,766 | $(43,517) |

See accompanying notes to the consolidated financial statements.

## Penn National Gaming, Inc. and Subsidiaries
## Consolidated Statements of Cash Flows
## (in thousands)

| Year ended December 31, | 2010 | 2009 | 2008 |
|---|---|---|---|
| **Operating activities** | | | |
| Net loss including noncontrolling interests | $(61,660) | $(267,413) | $(153,323) |
| Adjustments to reconcile net loss including noncontrolling interests to net cash provided by operating activities: | | | |
| Depreciation and amortization | 212,387 | 194,436 | 173,545 |
| Amortization of items charged to interest expense and interest income | 12,581 | 10,733 | 11,713 |
| Loss on sale of fixed assets | 3,104 | 332 | 1,610 |
| Loss from unconsolidated affiliates | 25,974 | 1,121 | 1,526 |
| Loss on early extinguishment of debt | 519 | 4,793 | — |
| Hollywood Casino Joliet fire | — | 5,186 | — |
| Loss on police services contract termination at Hollywood Casino Aurora | 6,624 | — | — |
| Gain on accelerated payment of other long-term obligations | — | (1,305) | — |
| Gain on litigation settlement | (9,619) | — | — |
| Gain on sale of corporate debt securities | — | (6,598) | — |
| Impairment loss on corporate debt securities | 265 | — | — |
| Deferred income taxes | (2,204) | (146,408) | (91,098) |
| Charge for stock-based compensation | 25,954 | 28,360 | 26,857 |
| Impairment losses | 224,709 | 532,377 | 481,333 |
| (Increase) decrease, net of businesses acquired | | | |
| Accounts receivable | (1,338) | (16,091) | 12,853 |
| Insurance receivable | 28,673 | — | — |
| Prepaid expenses and other current assets | 3,585 | (13,160) | (27,722) |
| Other assets | 10,160 | (8,138) | 25,747 |
| Increase (decrease), net of businesses acquired | | | |
| Accounts payable | 477 | (5,292) | (350) |
| Accrued expenses | 505 | 4,837 | (12,045) |
| Accrued interest | 648 | 4,332 | (12,729) |
| Accrued salaries and wages | 7,824 | 10,228 | 1,231 |
| Gaming, pari-mutuel, property and other taxes | 7,506 | (5,560) | 882 |
| Income taxes | — | — | (6,794) |
| Other current and noncurrent liabilities | 6,827 | 11,401 | 1,014 |
| Other noncurrent tax liabilities | (10,323) | 75 | (13,787) |
| Net cash provided by operating activities | 493,178 | 338,246 | 420,463 |
| **Investing activities** | | | |
| Expenditures for property and equipment | (362,955) | (289,551) | (344,894) |
| Proceeds from sale of property and equipment | 1,627 | 2,628 | 1,066 |
| Purchase of corporate debt securities | — | — | (47,286) |
| Proceeds from sale of corporate debt securities | — | 50,602 | — |
| Proceeds from Hollywood Casino Joliet fire | 4,821 | 20,593 | — |
| Purchase of outstanding loans of M Resorts LLC | (230,500) | — | — |
| Investment in joint ventures | (63,632) | (12,895) | — |
| Increase in cash in escrow | (30,224) | (25,036) | — |
| Acquisition of businesses and licenses | (55,895) | (9,000) | (384) |
| Net cash used in investing activities | (736,758) | (262,659) | (391,498) |
| **Financing activities** | | | |
| Proceeds from exercise of options | 11,488 | 5,431 | 2,397 |
| Repurchase of common stock | (35,858) | — | (152,361) |
| Repurchase of preferred stock | (11,200) | — | — |
| Proceeds from issuance of long-term debt, net of issuance costs | 212,732 | 762,068 | 447,833 |
| Principal payments on long-term debt | (383,476) | (879,193) | (993,966) |
| Proceeds from issuance of preferred stock, net of related expenses | — | — | 1,246,400 |
| Proceeds from insurance financing | 18,271 | 15,454 | 22,255 |
| Payments on insurance financing | (13,421) | (16,795) | (30,677) |
| (Repurchase of)/contributions from noncontrolling interest | (25,000) | 1,900 | — |
| Tax benefit from stock options exercised | 3,311 | 2,388 | 1,060 |
| Net cash (used in) provided by financing activities | (223,153) | (108,747) | 542,941 |
| **Net (decrease) increase in cash and cash equivalents** | (466,733) | (33,160) | 571,906 |
| Cash and cash equivalents at beginning of year | 713,118 | 746,278 | 174,372 |
| Cash and cash equivalents at end of year | $246,385 | $713,118 | $746,278 |
| **Supplemental disclosure** | | | |
| Interest expense paid | $121,821 | $124,992 | $183,264 |
| Income taxes paid | $72,091 | $109,200 | $190,287 |

See accompanying notes to the consolidated financial statements.

## 1. Business and Basis of Presentation

Penn National Gaming, Inc. ("Penn") and subsidiaries (collectively, the "Company") is a diversified, multi-jurisdictional owner and manager 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 Bay St. Louis and Boomtown Biloxi, CRC Holdings, Inc., the Bullwhackers properties, Hollywood Casino Corporation, Argosy Gaming Company ("Argosy"), Black Gold Casino at Zia Park, and Sanford-Orlando Kennel Club), greenfield projects (such as at Hollywood Casino at Penn National Race Course and Hollywood Slots Hotel and Raceway, and most recently Hollywood Casino Perryville, which opened on September 27, 2010 and is Maryland's first casino, as well as the Company's proposed facilities in Ohio and joint venture in Kansas) and property expansions (such as at Hollywood Casino at Charles Town Races and Hollywood Casino Lawrenceburg). On July 1, 2010, the Company closed the transaction to purchase Beulah Park in Grove City, Ohio and established a joint venture that owns and operates the Maryland Jockey Club.

The Company currently owns, manages, or has ownership interests in twenty-three facilities in sixteen jurisdictions, including Colorado, Florida, Illinois, Indiana, Iowa, Louisiana, Maine, Maryland, Mississippi, Missouri, New Jersey, New Mexico, Ohio, Pennsylvania, West Virginia, and Ontario.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses for the reporting periods. Actual results could differ from those estimates.

For purposes of comparability, certain prior year amounts have been reclassified to conform to the current year presentation.

## 2. Principles of Consolidation

The consolidated financial statements include the accounts of Penn and its subsidiaries, including wholly-owned subsidiaries and subsidiaries that had a noncontrolling interest. Investment in and advances to unconsolidated affiliates that are 50% or less owned are accounted for under the equity method. All significant intercompany accounts and transactions have been eliminated in consolidation.

## 3. Merger Announcement and Termination

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

On July 3, 2008, the Company entered into an agreement with certain affiliates of Fortress and Centerbridge, terminating the Merger Agreement. In connection with the termination of the Merger Agreement, the Company agreed to receive a total of $1.475 billion, consisting of a nonrefundable $225 million cash termination fee (the "Cash Termination Fee") and a $1.25 billion, zero coupon, preferred equity investment (the "Investment"). On October 30, 2008, the Company closed the sale of the Investment and issued 12,500 shares of Series B Redeemable Preferred Stock (the "Preferred Stock"). During the year ended December 31, 2010, the Company repurchased 225 shares of Preferred Stock for $11.2 million. See Note 15 for further discussion of the terms of the Preferred Stock.

On December 26, 2007, the Company entered into a Change in Control Payment Acknowledgement and Agreement (the "Acknowledgement and Agreement") with certain members of its management team. Pursuant to the Acknowledgement and Agreement, a portion of the payment due on a change in control to such executives was accelerated and paid on or before December 31, 2007. The Acknowledgement and Agreements were entered into as part of actions taken to reduce the amount of "gross-up" payments pertaining to federal excise taxes that may have otherwise been owed to such executives under the terms of their existing employment agreements in connection with the change in control payments due upon the consummation of the Merger. The accelerated change in control payments were subject to a clawback right in the event the Merger was terminated pursuant to the terms of the Merger Agreement or the closing of the Merger otherwise failed to occur or if the executive's employment with the Company was terminated prior to the effective date of the Merger under circumstances where the executive was not entitled to receive the remainder of his change in control payment under the terms of his employment agreement. In July 2008, the Company exercised its clawback right for the accelerated change in control payments in accordance with the Acknowledgement and Agreement, and advised the affected executives of the amounts to be repaid and the due date. Each executive has repaid to the Company all after-tax cash received by such executive and filed all returns and other instruments necessary to effect the refund of all applicable taxes. Further, each executive has assigned his right to such tax refunds to the Company. As of December 31, 2010, the majority of the accelerated change in control payments have been returned to the Company.

**4. Summary of Significant Accounting Policies**

**Cash and Cash Equivalents**

The Company considers all cash balances and highly-liquid investments with original maturities of three months or less to be cash and cash equivalents.

**Concentration of Credit Risk**

Financial instruments that subject the Company to credit risk consist of cash equivalents, corporate securities, interest rate swap contracts and accounts receivable.

The Company's policy is to limit the amount of credit exposure to any one financial institution, and place investments with financial institutions evaluated as being creditworthy, or in short-term money market and tax-free bond funds which are exposed to minimal interest rate and credit risk. The Company has bank deposits and overnight repurchase agreements that exceed federally-insured limits.

Concentration of credit risk, with respect to casino receivables, is limited through the Company's credit evaluation process. The Company issues markers to approved casino customers only following credit checks and investigations of creditworthiness.

The Company's receivables of $44.5 million and $46.7 million at December 31, 2010 and 2009, respectively, primarily consist of $8.1 million and $12.9 million, respectively, due from the West Virginia Lottery for gaming revenue settlements and capital reinvestment projects at the Hollywood Casino at Charles Town Races, $11.1 million and $11.7 million, respectively, for reimbursement of expenses paid on behalf of Casino Rama, and $4.1 million and $2.7 million, respectively, for racing settlements due from simulcasting at Hollywood Casino at Penn National Race Course.

Accounts are written off when management determines that an account is uncollectible. Recoveries of accounts previously written off are recorded when received. An allowance for doubtful accounts is determined to reduce the Company's receivables to their carrying value, which approximates fair value. The allowance is estimated based on historical collection experience, specific review of individual customer accounts, and current economic and business conditions. Historically, the Company has not incurred any significant credit-related losses.

**Fair Value of Financial Instruments**

The following methods and assumptions are used to estimate the fair value of each class of financial instruments for which it is practicable to estimate:

*Cash and Cash Equivalents*

The fair value of the Company's cash and cash equivalents approximates the carrying value of the Company's cash and cash equivalents, due to the short maturity of the cash equivalents.

*Investment in Corporate Debt Securities*

The fair value of the investment in corporate debt securities is estimated based on quoted prices in active markets for identical investments. The investment in corporate debt securities is measured at fair value on a recurring basis.

*Loan Receivable*

As discussed in Note 7, the Company acquired all of the outstanding bank and subordinated debt of M Resort for $230.5 million. The Company does not anticipate receiving cash proceeds on the loan but rather intends to convert the loan into ownership of the M Resort, a casino located approximately ten miles from the Las Vegas strip in Henderson, Nevada. The fair value of the loan approximates its carrying amount.

*Long-term Debt*

The fair value of the Company's senior secured credit facility approximates its carrying value, as it is variable-rate debt. The fair value of the Company's senior subordinated notes is estimated based on quoted prices in active markets for identical instruments. The fair value of the Company's other long-term obligations and capital leases approximates its carrying value.

*Interest Rate Swap Contracts*

The fair value of the Company's interest rate swap contracts is measured as the present value of all expected future cash flows based on the LIBOR-based swap yield curve as of the date of the valuation, subject to a credit adjustment to the LIBOR-based yield curve's implied discount rates. The credit adjustment reflects the Company's best estimate as to the Company's credit quality at December 31, 2010. The interest rate swap contracts are measured at fair value on a recurring basis.

The estimated fair values of the Company's financial instruments are as follows (in thousands):

| | 2010 | | 2009 | |
|---|---|---|---|---|
| December 31, | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| **Financial assets:** | | | | |
| Cash and cash equivalents | $246,385 | $246,385 | $713,118 | $713,118 |
| Investment in corporate debt securities | 5,828 | 5,828 | 4,550 | 4,550 |
| Loan receivable | 230,500 | 230,500 | — | — |
| **Financial liabilities:** | | | | |
| Long-term debt | | | | |
| Senior secured credit facility | 1,589,125 | 1,589,125 | 1,755,602 | 1,755,602 |
| Senior subordinated notes | 575,000 | 612,875 | 575,000 | 572,375 |
| Other long-term obligations | 3,782 | 3,782 | — | — |
| Capital leases | 3,216 | 3,216 | 4,175 | 4,175 |
| Interest rate swap contracts | 16,746 | 16,746 | 43,925 | 43,925 |

See Note 22 for further information regarding the Company's assessment of the inputs used to measure the fair value for the investment in corporate debt securities and interest rate swap contracts.

**Property and Equipment**

Property and equipment are stated at cost, less accumulated depreciation. Maintenance and repairs that neither add materially to the value of the asset nor appreciably prolong its useful life are charged to expense as incurred. Gains or losses on the disposal of property and equipment are included in the determination of income.

Depreciation of property and equipment is recorded using the straight-line method over the following estimated useful lives:

| | |
|---|---|
| Land improvements | 5 to 15 years |
| Building and improvements | 10 to 40 years |
| Furniture, fixtures, and equipment | 3 to 7 years |

Leasehold improvements are depreciated over the shorter of the estimated useful life of the improvement or the related lease term.

The estimated useful lives are determined based on the nature of the assets as well as the Company's current operating strategy.

The Company reviews the carrying values of its property and equipment for possible impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable based on undiscounted estimated future cash flows expected to result from its use and eventual disposition. The factors considered by the Company in performing this assessment include current operating results, trends and prospects, as well as the effect of obsolescence, demand, competition and other economic factors. In estimating expected future cash flows for determining whether an asset is impaired, assets are grouped at the individual property level. In assessing the recoverability of the carrying value of property and equipment, the Company must make assumptions regarding future cash flows and other factors. If these estimates or the related assumptions change in the future, the Company 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.

**Goodwill and Other Intangible Assets**

At December 31, 2010, the Company had $1,185.8 million in goodwill and $415.2 million in other intangible assets within its consolidated balance sheet, representing 26.6% and 9.3% of total assets, respectively, resulting from the Company's acquisition of other businesses and payment for gaming licenses and racing permits. Two issues arise with respect to these assets that require significant management estimates and judgment: (i) the valuation in connection with the initial purchase price allocation; and (ii) the ongoing evaluation for impairment.

In connection with the Company's acquisitions, valuations are completed to determine the allocation of the purchase prices. The factors considered in the valuations include data gathered as a result of the Company's due diligence in connection with the acquisitions, projections for future operations, and data obtained from third-party valuation specialists as deemed appropriate. Goodwill is tested annually, or more frequently if indicators of impairment exist, for impairment by comparing the fair value of the reporting units to their carrying amount. If the carrying amount of a reporting unit exceeds its fair value in step 1 of the impairment test, then step 2 of the impairment test is performed to determine the implied value of goodwill for that reporting unit. If the implied value of goodwill is less than the goodwill allocated for that reporting unit, an impairment loss is recognized.

In accordance with Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 350, "Intangibles-Goodwill and Other," the Company considers its gaming license, racing permit and trademark intangible assets as indefinite-life intangible assets that do not require amortization based on the Company's future expectations to operate its gaming facilities indefinitely as well as its historical experience in renewing these intangible assets at minimal cost with various state gaming commissions. Rather, these intangible assets are tested annually, or more frequently if indicators of impairment exist, for impairment by comparing the fair value of the recorded assets to their carrying amount. If the carrying amounts of the gaming license, racing permit and trademark intangible assets exceed their fair value, an impairment loss is recognized.

The evaluation of goodwill and indefinite-life intangible assets requires the use of estimates about future operating results of each reporting unit to determine their estimated fair value. The Company uses a market approach model, which includes the use of forecasted adjusted EBITDA (earnings before interest, taxes, charges for stock compensation, depreciation and amortization, gain or loss on disposal of assets, and certain other income and expenses, and inclusive of loss from unconsolidated affiliates) and adjusted EBITDA multiples, as the Company believes that adjusted EBITDA is a widely-used measure of performance in the gaming industry and as the Company uses adjusted EBITDA as the primary measurement of the operating performance of its properties (including the evaluation of operating personnel). In addition, the Company believes that an adjusted EBITDA multiple is the principal basis for the valuation of gaming companies. Changes in the estimated adjusted EBITDA multiples or forecasted operations can materially affect these estimates.

Forecasted adjusted EBITDA levels (based on the Company's annual operating plan as determined in the fourth quarter) can be significantly impacted by the local economy in which the Company's reporting units operate. For example, increases in unemployment rates can result in decreased customer visitations and/or lower customer spend per visit. In addition, the impact of new legislation which approves gaming in nearby jurisdictions or further expands gaming in jurisdictions where the Company's reporting units currently operate can result in opportunities for the Company to expand its operations. However, it also has the impact of increasing competition for the Company's established properties which generally will have a negative effect on those locations' profitability once competitors become established as a certain level of cannibalization occurs absent an overall increase in customer visitations. Lastly, increases in gaming taxes approved by state regulatory bodies can negatively impact forecasted adjusted EBITDA.

The adjusted EBITDA multiple utilized by the Company in its goodwill impairment valuation methodology is determined based on the Company's current enterprise value, increased for a control premium. The control premium assumption is based on acquisitions of precedent transactions of comparable businesses. In evaluating the estimates derived by the market based approach, management assesses the relevance and reliability of the multiples by considering factors unique to its reporting units, including recent operating results, business plans, economic projections, anticipated future cash flows, and other market data. These considerations can lead the Company to modify its individual reporting units adjusted EBITDA multiple. EBITDA multiples can be significantly impacted by various factors, such as a company's present and future cost of capital, the future growth opportunities for the industry as well as for the company itself, general market sentiment, investors' perceptions of senior management's effectiveness at deploying capital and managing overall operations, as well as pending or recently completed merger transactions.

Assumptions and estimates about future adjusted EBITDA levels and multiples by individual reporting units are complex and subjective. They are sensitive to changes in underlying assumptions and can be affected by a variety of factors, including external factors, such as industry and economic trends, and internal factors, such as changes in the Company's business strategy, which may reallocate capital and resources to different or new opportunities which management believes will enhance the Company's overall value but may be to the detriment of an individual reporting unit.

Once an impairment of goodwill or other indefinite-life intangible assets has been recorded, it cannot be reversed. Because the Company's goodwill and indefinite-life intangible assets are not amortized, there may be volatility in reported income because impairment losses, if any, are likely to occur irregularly and in varying amounts. Intangible assets that have a definite-life, including the management service contract for Casino Rama, are amortized on a straight-line basis over their estimated useful lives or related service contract. The Company reviews the carrying value of its intangible assets that have a definite-life for possible impairment whenever events or changes in circumstances indicate that their carrying value may not be recoverable. If the carrying amount of the intangible assets that have a definite-life exceed their fair value, an impairment loss is recognized.

**Debt Issuance Costs**

Debt issuance costs that are incurred by the Company in connection with the issuance of debt are deferred and amortized to interest expense over the life of the underlying indebtedness, adjusted to reflect any early repayments.

**Comprehensive Income**

The Company accounts for comprehensive income in accordance with ASC 220, "Comprehensive Income," which established standards for the reporting and presentation of comprehensive income in the consolidated financial statements. The Company presents comprehensive income in its consolidated statements of changes in shareholders' equity.

**Income Taxes**

The Company accounts for income taxes in accordance with ASC 740, "Income Taxes" ("ASC 740"). Under ASC 740, deferred tax assets and liabilities are determined based on the differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities and are measured at the prevailing enacted tax rates that will be in effect when these differences are settled or realized. ASC 740 also requires that deferred tax assets be reduced by a valuation allowance if it is more likely than not that some portion or all of the deferred tax assets will not be realized.

The realizability of the deferred tax assets is evaluated quarterly by assessing the valuation allowance and by adjusting the amount of the allowance, if necessary. The factors used to assess the likelihood of realization are the forecast of future taxable income and available tax planning strategies that could be implemented to realize the net deferred tax assets. The Company has used tax-planning strategies to realize or renew net deferred tax assets in order to avoid the potential loss of future tax benefits.

ASC 740 also creates a single model to address uncertainty in tax positions, and clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in an enterprise's financial statements. It also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. The liability for unrecognized tax benefits is included in noncurrent tax liabilities within the consolidated balance sheets at December 31, 2010 and 2009.

**Accounting for Derivatives and Hedging Activities**

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

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

Currently, the Company has a number of interest rate swap contracts in place. These contracts serve to mitigate income volatility for a portion of its variable-rate funding. Swap contract coverage extends out through 2011. In effect, these swap contracts synthetically convert the portion of variable-rate debt being hedged to the equivalent of fixed-rate funding. Under the terms of the swap contracts, the Company receives cash flows from the swap contract counterparties to offset the benchmark interest rate component of variable interest payments on the hedged financings, in exchange for paying cash flows based on the swap contracts' fixed rates. These two respective obligations are net-settled periodically. The Company accounts for these swap contracts as cash flow hedges, which requires determining a division of hedge results deemed effective and deemed ineffective. However, most of the Company's hedges were designed in such a way so as to perfectly offset specifically-defined interest payments, such that no ineffectiveness has occurred—nor would any ineffectiveness occur, as long as the forecasted cash flows of the designated hedged items and the associated swap contracts remain unchanged. The notional value of the Company's cash flow hedges totaled $840 million at December 31, 2010.

The fair value of the Company's interest rate swap contracts is measured as the present value of all expected future cash flows based on the LIBOR-based swap yield curve as of the date of the valuation, subject to a credit adjustment to the LIBOR-based yield curve's implied discount rates. The credit adjustment reflects the Company's best estimate as to the Company's credit quality at December 31, 2010.

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

Under cash flow hedge accounting, derivatives are included in the consolidated balance sheets as assets or liabilities at fair value. The interest rate swap contract liabilities are included in accrued interest within the consolidated balance sheets at December 31, 2010 and 2009.

During the years ended December 31, 2010 and 2009, the Company had certain derivative instruments that were not designated to qualify for hedge accounting. The periodic change in the mark-to-market of these derivative instruments is recorded in current period earnings in the consolidated statements of operations. The notional value of these derivatives was $400 million at December 31, 2010.

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

**Revenue Recognition and Promotional Allowances**

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

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

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

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

The retail value of accommodations, food and beverage, and other services furnished to guests without charge is included in gross revenues and then deducted as promotional allowances. The estimated cost of providing such promotional allowances is primarily included in food, beverage and other expense. The amounts included in promotional allowances for the years ended December 31, 2010, 2009 and 2008 are as follows:

| Year ended December 31, | 2010 | 2009 | 2008 |
|---|---|---|---|
| | | (in thousands) | |
| Rooms | $23,980 | $23,316 | $17,750 |
| Food and beverage | 99,024 | 108,473 | 103,038 |
| Other | 10,398 | 10,986 | 13,590 |
| Total promotional allowances | $133,402 | $142,775 | $134,378 |

The estimated cost of providing such complimentary services for the years ended December 31, 2010, 2009 and 2008 are as follows:

| Year ended December 31, | 2010 | 2009 | 2008 |
|---|---|---|---|
| | | (in thousands) | |
| Rooms | $9,188 | $9,406 | $7,280 |
| Food and beverage | 75,180 | 77,444 | 73,565 |
| Other | 6,544 | 6,590 | 6,034 |
| Total cost of complimentary services | $90,912 | $93,440 | $86,879 |

**Earnings Per Share**

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

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

subsidiaries applicable to common stock by the weighted-average common shares outstanding during the period. Diluted EPS for the Company's Common Stock is computed using the more dilutive of the two-class method or the if-converted method. During the year ended December 31, 2010, the Company repurchased 225 shares of Preferred Stock for $11.2 million.

However, since the Company reported a net loss for the years ended December 31, 2010, 2009 and 2008, it was required by ASC 260 to use basic weighted-average common shares outstanding, rather than diluted weighted-average common shares outstanding, when calculating diluted EPS for the years ended December 31, 2010, 2009 and 2008. In addition, since the Company reported a loss from operations for the years ended December 31, 2010, 2009 and 2008, the Preferred Stock was not deemed to be a participating security for the years ended December 31, 2010, 2009 and 2008, pursuant to ASC 260. The basic weighted-average common shares outstanding for the years ended December 31, 2010, 2009 and 2008 were 78,078,602, 78,121,571 and 84,535,877, respectively.

Options to purchase 10,834,444, 9,966,125 and 8,804,578 shares were outstanding during the years ended December 31, 2010, 2009 and 2008, respectively, but were not included in the computation of diluted EPS because they are antidilutive since the Company reported a loss from operations for the years ended December 31, 2010, 2009 and 2008.

**Stock-Based Compensation**

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

The fair value for stock options was estimated at the date of grant using the Black-Scholes option-pricing model, which requires management to make certain assumptions. The risk-free interest rate was based on the United States ("U.S.") Treasury spot rate with a term equal to the expected life assumed at the date of grant. Expected volatility was estimated based on the historical volatility of the Company's stock price over a period of 5.73 years, in order to match the expected life of the options at the grant date. There is no expected dividend yield since the Company has not paid any cash dividends on its Common Stock since its initial public offering in May 1994 and since the Company intends to retain all of its earnings to finance the development of its business for the foreseeable future. The weighted-average expected life was based on the contractual term of the stock option and expected employee exercise dates, which was based on the historical and expected exercise behavior of the Company's employees. Forfeitures are estimated at the date of grant based on historical experience. The following are the weighted-average assumptions used in the Black-Scholes option-pricing model at December 31, 2010, 2009 and 2008:

| Year ended December 31, | 2010 | 2009 | 2008 |
|---|---|---|---|
| Risk-free interest rate | 2.27% | 2.80% | 1.61% |
| Expected volatility | 48.02% | 49.68% | 45.56% |
| Dividend yield | — | — | — |
| Weighted-average expected life (years) | 5.73 | 5.32 | 5.36 |
| Forfeiture rate | 5.00% | 5.00% | 4.00% |

**Segment Information**

In accordance with ASC 280, "Segment Reporting" ("ASC 280"), the Company views each property as an operating segment, and aggregates all of its properties into one reportable segment, as the Company believes that they are economically similar, offer similar types of products and services, cater to the same types of customers and are similarly regulated.

**Statements of Cash Flows**

The Company has presented the consolidated statements of cash flows using the indirect method, which involves the reconciliation of net (loss) income including noncontrolling interests to net cash flow from operating activities.

**Acquisitions**

The Company accounts for its acquisitions in accordance with ASC 805, "Business Combinations" ("ASC 805"). The results of operations of acquisitions are included in the consolidated financial statements from their respective dates of acquisition.

**Certain Risks and Uncertainties**

The Company's operations are dependent on its continued licensing by state gaming commissions. The loss of a license, in any jurisdiction in which the Company operates, could have a material adverse effect on future results of operations.

The Company is dependent on each gaming property's local market for a significant number of its patrons and revenues. If economic conditions in these areas deteriorate or additional gaming licenses are awarded in these markets, the Company's results of operations could be adversely affected.

The Company is dependent on the economy of the U.S. in general, and any deterioration in the national economic, energy, credit and capital markets could have a material adverse effect on future results of operations.

The Company is dependent upon a stable gaming and admission tax structure in the locations that it operates in. Any change in the tax structure could have a material adverse affect on future results of operations.

**5. New Accounting Pronouncements**

In December 2010, the FASB issued guidance to improve disclosures of supplementary pro forma information for business combinations. The guidance specifies that if an entity presents comparative financial statements, the entity should disclose revenue and earnings of the combined entity as though the business combination(s) that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period only. This guidance also expands the supplemental pro forma disclosures required to include a description of the nature and amount of material nonrecurring pro forma adjustments directly attributable to the business combination included in the reported pro forma revenue and earnings. The guidance is effective prospectively for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2010. The Company expects that the adoption of the guidance will have an impact on its consolidated financial statements, in the event that the Company acquires companies significant to its operations in the future.

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

**6. Acquisition and Other Recent Business Ventures**

On July 1, 2010, the Company closed its acquisition of Beulah Park in Grove City, Ohio from Heartland Jockey Club Ltd. Located on approximately 210 acres just outside of Columbus, Ohio, Beulah Park is a thoroughbred racing facility that features live thoroughbred racing from October to May as well as simulcast wagering from a number of nationwide tracks. Beulah Park includes a grandstand, outdoor paddock, a clubhouse facility and numerous food and dining options. The results of Beulah Park have been included in the Company's consolidated financial statements since the July 1, 2010 acquisition date.

On July 1, 2010, the Company established a joint venture that owns and operates the Maryland Jockey Club. See Note 8 for further discussion.

In September 2010, the Company announced an agreement to enter into a joint venture that will own and operate the Sam Houston Race Park in Houston, Texas, the Valley Race Park in Harlingen, Texas, and a planned racetrack in Laredo, Texas. Under the terms of the joint venture, the Company will secure a 50% interest in the joint venture, which will have sole ownership of the above entities including interests in 323 acres at Sam Houston Race Park, 80 acres at Valley Race Park and an option to purchase 135 acres for the planned racetrack in Laredo, Texas. Sam Houston Race Park, opened in April 1994, is located in Northwest Houston along Beltway 8 near the intersection of Highway 249. Sam Houston Race Park hosts thoroughbred and quarter horse racing and offers daily simulcast operations, as well as hosts various special events, private

parties and meetings, concerts and national touring festivals throughout the year. Valley Race Park, which was opened in 1990 and acquired by Sam Houston Race Park in 2000, is a 91,000 square foot dog racing and simulcasting facility located in Harlingen, Texas. This venture is subject to final approval by the Texas Racing Commission and the satisfaction of certain other customary closing conditions.

See Note 7 for a description of the Company's recent developments related to a potential opportunity in Nevada.

**7. Loan Receivable**

On October 8, 2010, the Company announced that it had purchased all of the outstanding bank and subordinated debt of M Resort for $230.5 million, which the Company intends to convert into ownership of the M Resort. Any conversion transaction will be subject to, among other things, the review and approval of the Nevada Gaming Commission and the Nevada Gaming Control Board.

In accordance with ASC 310-30, "Receivables—Loans and Debt Securities Acquired with Deteriorated Credit Quality," the Company has not accrued any income on this asset since the Company intends to convert it into ownership of the M Resort. No cash proceeds are anticipated to be collected from the borrower on the loan. The loan is recorded in loan receivable within total other assets within the consolidated balance sheet at December 31, 2010.

**8. Investment In and Advances to Unconsolidated Affiliates**

Investment in and advances to unconsolidated affiliates primarily includes the Company's 50% interest in Freehold Raceway, its 50% investment in Kansas Entertainment, LLC ("Kansas Entertainment"), which is a joint venture with International Speedway Corporation ("International Speedway"), and the Company's 49% interest in Maryland RE & R LLC, a joint venture with MI Developments, Inc. ("MI Developments") that owns and operates the Maryland Jockey Club (the "Maryland Joint Venture"), which the Company closed on July 1, 2010.

*Kansas Entertainment*

In December 2009, Kansas Entertainment was selected by the Kansas Lottery Gaming Facility Review Board to develop and operate a facility in the North East Gaming Zone in Wyandotte County, Kansas, and in February 2010, Kansas Entertainment received the final approval under the Kansas Expanded Lottery Act, along with its gaming license from the Kansas Racing and Gaming Commission, to proceed with the development of an approximately $411 million Hollywood-themed destination facility overlooking Turn 2 at Kansas Speedway.

The approximately $411 million facility, inclusive of licensing fees, is expected to feature a 82,000 square foot casino with approximately 2,000 slot machines, 52 table games and 12 poker tables, a 1,253 space parking structure, as well as a variety of dining and entertainment amenities. The Company and International Speedway will share equally the cost of developing and constructing the proposed facility. The Company estimates that its share of the project will be approximately $155 million.

The Company determined that Kansas Entertainment qualified as a variable interest entity ("VIE") at December 31, 2010 and 2009. The Company did not consolidate its investment in Kansas Entertainment at, and for the years ended December 31, 2010 and 2009, as the Company determined that it did not qualify as the primary beneficiary of Kansas Entertainment at, and for the years ended December 31, 2010 and 2009, primarily as it did not have the ability to direct the activities of Kansas Entertainment that most significantly impacted Kansas Entertainment's economic performance without the input of International Speedway. In addition, the Company determined that International Speedway had substantive participating rights in Kansas Entertainment at, and for the years ended December 31, 2010 and 2009.

*Maryland Jockey Club*

The Maryland Jockey Club is the owner and operator of two racing venues, Pimlico Race Course ("Pimlico") and Laurel Park. Pimlico, opened in 1870, is the country's second oldest racetrack and features a one-mile oval track, a $^{7}/_{8}$-mile turf course and seating for approximately 15,000 spectators. Pimlico is the annual host of the Preakness® Stakes, the second leg in thoroughbred racing's Triple Crown and the cornerstone event in the facility's annual eight week spring meet. Laurel Park, the sister track to Pimlico, opened in 1911, features a $1^{1}/_{8}$ mile oval track and a one mile turf course with seating for approximately 5,000 spectators. Laurel Park hosts a three month winter meet beginning in January as well as a four month fall meet beginning in September.

On November 2, 2010, zoning was approved by voters for the proposed casino complex at the Arundel Mills mall in Anne Arundel, Maryland. Construction of a temporary facility in late 2011 is being targeted by the developer with construction of the permanent casino being completed in 2012. The Company and MI Developments plan to work collaboratively to maximize the use and value of the Maryland Jockey Club's real estate assets and to pursue other opportunities to maximize the value of the business, as a result of the negative outcome of the zoning referendum.

The Company determined that the Maryland Joint Venture did not qualify as a VIE at December 31, 2010. Using the guidance for entities that are not VIEs, the Company determined that it did not have a controlling financial interest in the Maryland Joint Venture at, and for the year ended December 31, 2010, primarily as it did not have the ability to direct the activities of the Maryland Joint Venture that most significantly impacted the Maryland Joint Venture's economic performance without the input of MI Developments. Therefore, the Company did not consolidate its investment in the Maryland Joint Venture at, and for the year ended December 31, 2010.

For the year ended December 31, 2010, the Company's share of losses in the Maryland Joint Venture is included in loss from unconsolidated affiliates within the consolidated statements of operations. Included in this loss was a $14.4 million charge for the Company's share of a goodwill impairment write-down recorded by the Maryland Jockey Club during the fourth quarter of 2010 as a result of the negative outcome related to the zoning referendum discussed above.

## 9. Property and Equipment

Property and equipment, net, consists of the following:

| December 31, | 2010 | 2009 |
|---|---|---|
| | (in thousands) | |
| Land and improvements | $298,482 | $239,933 |
| Building and improvements | 1,534,117 | 1,433,611 |
| Furniture, fixtures, and equipment | 938,443 | 849,071 |
| Leasehold improvements | 17,089 | 17,204 |
| Construction in progress | 106,963 | 47,299 |
| Total property and equipment | 2,895,094 | 2,587,118 |
| Less accumulated depreciation | (929,320) | (749,614) |
| Property and equipment, net | $1,965,774 | $1,837,504 |

Depreciation expense, for property and equipment, totaled $206.6 million, $187.8 million and $165.9 million in 2010, 2009 and 2008, respectively. Interest capitalized in connection with major construction projects was $5.5 million, $7.0 million and $13.8 million in 2010, 2009 and 2008, respectively.

On May 4, 2010, in a statewide election in Ohio, the voters determined that the Company's casino in Columbus will be located at the site of the former Delphi Automotive plant along Columbus's West Side. As a result of the election, the Company initiated the process to sell the parcel of land that it purchased in Columbus's Arena District, the original site approved by voters, and reclassified the land as held for sale. The Company obtained an appraisal to determine the estimated fair market value of the land and recorded a pre-tax impairment charge of $31.3 million ($20.1 million, net of taxes) during the year ended December 31, 2010, which was comprised of the difference between the land's estimated fair market value less costs to sell and its carrying value.

During the year ended December 31, 2009, the Company recorded a pre-tax impairment charge for the replaced Lawrenceburg vessel of $11.9 million ($7.1 million, net of taxes) in conjunction with the opening of the new casino riverboat at Hollywood Casino Lawrenceburg. During the year-ended December 31, 2010, the Company recorded a $0.2 million charge on this replaced vessel.

## 10. Goodwill and Other Intangible Assets

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

| | |
|---|---|
| Balance at January 1, 2009: | |
| Goodwill | $2,030,313 |
| Accumulated goodwill impairment losses | (431,742) |
| Goodwill, net | $1,598,571 |
| Goodwill impairment losses | (213,260) |
| Other | (5,350) |
| Balance at December 31, 2009: | |
| Goodwill | $2,024,963 |
| Accumulated goodwill impairment losses | (645,002) |
| Goodwill, net | $1,379,961 |
| Goodwill impairment losses | (188,855) |
| Other | (5,350) |
| Balance at December 31, 2010: | |
| Goodwill | $2,019,613 |
| Accumulated goodwill impairment losses | (833,857) |
| Goodwill, net | $1,185,756 |

Goodwill consists mainly of goodwill from the acquisitions of Hollywood Casino Corporation in March 2003, Argosy in October 2005 and Black Gold Casino at Zia Park in April 2007.

During the year ended December 31, 2010, goodwill decreased by $194.2 million. Due to decreased earning projections at the Company's properties in the Chicagoland regional market resulting from an anticipated increase in competition from the scheduled opening of a casino in the second half of 2011 in Des Plaines, Illinois, as well as continued challenging market conditions in the Chicagoland regional market, the Company recorded a pre-tax impairment charge of $144.6 million ($144.6 million, net of taxes) and $44.2 million ($28.4 million, net of taxes) for Hollywood Casino Aurora and Hollywood Casino Joliet, respectively, during the year ended December 31, 2010, as the Company determined that a portion of the value of the goodwill associated with the original purchase of Hollywood Casino Aurora and Hollywood Casino Joliet was impaired.

During the year ended December 31, 2009, goodwill decreased by $218.6 million. As a result of the anticipated impact of gaming expansion in Ohio, the Company recorded a pre-tax impairment charge of $213.3 million ($188.7 million, net of taxes) during the year ended December 31, 2009, as the Company determined that a portion of the value of the goodwill associated with the original purchase of Hollywood Casino Lawrenceburg was impaired.

The table below presents the gross carrying value, accumulated amortization, and net book value of each major class of intangible asset at December 31, 2010 and 2009:

| | 2010 | | | 2009 | | |
|---|---|---|---|---|---|---|
| December 31, | Gross Carrying Value | Accumulated Amortization | Net Book Value | Gross Carrying Value | Accumulated Amortization | Net Book Value |
| | | | (in thousands) | | | |
| Indefinite-life intangible assets | $412,686 | $— | $412,686 | $378,463 | $— | $378,463 |
| Other intangible assets | 49,600 | 47,134 | 2,466 | 49,396 | 41,328 | 8,068 |
| Total | $462,286 | $47,134 | $415,152 | $427,859 | $41,328 | $386,531 |

Indefinite-life intangible assets consist mainly of gaming licenses and racing permits.

During the year ended December 31, 2010, indefinite-life intangible assets increased by $34.2 million, primarily due to the gaming license for table games at Hollywood Casino at Penn National Race Course and the indefinite-life intangible assets, primarily a racing permit, acquired as part of Beulah Park, which were partially offset by the write-down of the Argosy trademark intangible asset for $4.4 million ($2.8 million, net of taxes) due to management's strategy to transition Argosy properties to the Hollywood Casino brand.

During the year ended December 31, 2009, indefinite-life intangible assets decreased by $310.2 million. As a result of the anticipated impact of gaming expansion in Ohio, the Company recorded a pre-tax impairment charge of $307.2 million ($180.1 million, net of taxes), as the Company determined that a portion of the value of the indefinite-life intangible assets associated with the original purchase of Hollywood Casino Lawrenceburg was impaired.

The Company's intangible asset amortization expense was $5.8 million, $6.6 million and $7.7 million for the years ended December 31, 2010, 2009 and 2008, respectively.

The following table presents expected intangible asset amortization expense based on existing intangible assets at December 31, 2010 (in thousands):

| | |
|---|---|
| 2011 | $2,134 |
| 2012 | 237 |
| 2013 | 38 |
| 2014 | 38 |
| 2015 | 19 |
| Total | $2,466 |

The Company's goodwill and other intangible assets by reporting unit at December 31, 2010 is shown below.

| Reporting Unit | Remaining Goodwill and other intangible assets at December 31, 2010 |
|---|---|
| Hollywood Casino Lawrenceburg | $362,491 |
| Hollywood Casino Joliet | 215,555 |
| Hollywood Casino Aurora | 207,207 |
| Argosy Casino Riverside | 159,296 |
| Black Gold Casino at Zia Park | 146,415 |
| Argosy Casino Alton | 135,511 |
| Argosy Casino Sioux City | 92,795 |
| Hollywood Casino Baton Rouge | 75,521 |
| Others | 206,117 |
| Total | $1,600,908 |

## 11. Investment in Corporate Securities

During the year ended December 31, 2008, the Company made a $47.3 million investment in the corporate debt securities of other gaming companies. During the year ended December 31, 2009, the Company sold $42.2 million of this investment and recorded a $6.6 million gain, which is included in other income (expenses) within the consolidated statements of operations. This investment is accounted for as an available-for-sale investment and is included in other assets within the consolidated balance sheets at December 31, 2010 and 2009. This investment was acquired at a discount to its par value and accretion of $0.4 million, $1.5 million and $0.9 million was recorded for the years ended December 31, 2010, 2009 and 2008, respectively.

The remaining investment had a fair value totaling $5.8 million and $4.6 million at December 31, 2010 and 2009, respectively. During 2010, the issuer of the security went into default on its obligations as it ceased making interest payments and the security was downgraded by certain rating agencies. As a result, during the year ended December 31, 2010, the Company recorded a pre-tax charge of $0.3 million, which is included in other income (expenses) within the consolidated statements of operations, to write down the investment to its fair value, which was based on the transaction prices of the security subsequent to when the issuer defaulted on its obligations. The Company will continue to account for this security as an available for sale investment and will monitor its realizability in future periods.

The following is a schedule of the contractual maturities of the Company's investment in corporate securities at December 31, 2010 (in thousands):

| | |
|---|---|
| 2011 | $— |
| 2012 | 5,828 |
| Total | $5,828 |

## 12. Long-term Debt and Derivatives

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

| December 31, | 2010 | 2009 |
|---|---|---|
| | (in thousands) | |
| Senior secured credit facility due October 2012 | $1,589,125 | $1,755,602 |
| $250 million $6^3/_4$% senior subordinated notes due March 2015 | 250,000 | 250,000 |
| $325 million $8^3/_4$% senior subordinated notes due August 2019 | 325,000 | 325,000 |
| Other long-term obligations | 3,782 | — |
| Capital leases | 3,216 | 4,175 |
| | 2,171,123 | 2,334,777 |
| Less current maturities of long-term debt | (357,927) | (86,071) |
| | $1,813,196 | $2,248,706 |

The following is a schedule of future minimum repayments of long-term debt as of December 31, 2010 (in thousands):

| | |
|---|---|
| 2011 | $357,927 |
| 2012 | 1,236,275 |
| 2013 | 82 |
| 2014 | 89 |
| 2015 | 250,097 |
| Thereafter | 326,653 |
| Total minimum payments | $2,171,123 |

**Senior Secured Credit Facility**

The senior secured credit facility historically consisted of three credit facilities comprised of a $750 million revolving credit facility with a maturity date of October 3, 2010, a $325 million Term Loan A Facility with a maturity date of October 3, 2011 and a $1.65 billion Term Loan B Facility with a maturity date of October 3, 2012.

In September 2009, the Company amended its senior secured credit facility, in order to increase the borrowing capacity and to extend the term under the revolving credit facility portion of the senior secured credit facility. Under the new revolving credit facility, two tranches were created, one for those participants who agreed to extend to July 3, 2012 (the "Tranche B Revolving Loan") and one for those that did not extend (the "Tranche A Revolving Loan"), and the total borrowing capacity was increased to $1 billion.

In August 2009, the Company repaid $40 million of borrowings under the Term Loan A Facility, $70 million of borrowings under the Term Loan B Facility, and all outstanding borrowings under the revolving credit facility at the time, using a portion of the proceeds from the offering of $325 million $8^3/_4$% senior subordinated notes. In addition, in September 2009, the Company repaid all of the remaining outstanding borrowings under the Term Loan A Facility, using drawings under the revolving credit facility. During the year ended December 31, 2009, the Company recorded a $2.4 million loss on early extinguishment of debt for the write-off of debt issuance costs related to the Term Loan A Facility.

In May 2010, the Company repaid all of the outstanding borrowings under the Tranche A Revolving Loan using cash on hand and in connection therewith terminated this part of the senior secured credit facility. During the year ended December 31, 2010, the Company recorded a $0.5 million loss on early extinguishment of debt for the write-off of debt issuance costs related to the termination of the Tranche A Revolving Loan.

The Tranche B Revolving Loan permits the Company to borrow up to $640.6 million. As of December 31, 2010, $71.0 million was drawn under the Tranche B Revolving Loan and $1,518.1 million was outstanding under the Term Loan B Facility, for a total of $1,589.1 million. Additionally, at December 31, 2010, the Company was contingently obligated under letters of credit issued pursuant to the senior secured credit facility with face amounts aggregating $35.1 million, resulting in $534.5 million of available borrowing capacity as of December 31, 2010. As of December 31, 2009, $85.0 million was drawn under the Tranche A Revolving Loan, $152.5 million was drawn under the Tranche B Revolving Loan, and $1,518.1 million was outstanding under the Term Loan B Facility, for a total of $1,755.6 million.

During the year ended December 31, 2010, the senior secured credit facility amount outstanding decreased by $166.5 million primarily due to repayment of all of the outstanding borrowings under the Tranche A Revolving Loan and repayments of outstanding borrowings under the Tranche B Revolving Loan using cash on hand, which were partially offset by drawings under the Tranche B Revolving Loan to partially fund the purchase of all of the outstanding bank loans and subordinated debt of M Resort.

**Interest Rate Swap Contracts**

In accordance with the terms of its senior secured credit facility, the Company was required to enter into fixed-rate debt or interest rate swap agreements in an amount equal to 50% of the Company's consolidated indebtedness, excluding the revolving credit facility, within 100 days of the closing date of the senior secured credit facility.

The effect of derivative instruments on the consolidated statement of operations for the year ended December 31, 2010 was as follows (in thousands):

| Derivatives in a Cash Flow Hedging Relationship | Gain (Loss) Recognized in OCI on Derivative (Effective Portion) | Location of Gain (Loss) Reclassified from AOCI into Income (Effective Portion) | Gain (Loss) Reclassified from AOCI into Income (Effective Portion) | Location of Gain (Loss) Recognized in Income on Derivative (Ineffective Portion) | Gain (Loss) Recognized in Income on Derivative (Ineffective Portion) |
|---|---|---|---|---|---|
| Interest rate swap contracts | $(13,998) | Interest expense | $(24,424) | None | $— |
| Total | $(13,998) | | $(24,424) | | $— |

| Derivatives Not Designated as Hedging Instruments | Location of Gain (Loss) Recognized in Income on Derivative | Gain (Loss) Recognized in Income on Derivative |
|---|---|---|
| Interest rate swap contracts | Interest expense | $(60) |
| Total | | $(60) |

The effect of derivative instruments on the consolidated statement of operations for the year ended December 31, 2009 was as follows (in thousands):

| Derivatives in a Cash Flow Hedging Relationship | Gain (Loss) Recognized in OCI on Derivative (Effective Portion) | Location of Gain (Loss) Reclassified from AOCI into Income (Effective Portion) | Gain (Loss) Reclassified from AOCI into Income (Effective Portion) | Location of Gain (Loss) Recognized in Income on Derivative (Ineffective Portion) | Gain (Loss) Recognized in Income on Derivative (Ineffective Portion) |
|---|---|---|---|---|---|
| Interest rate swap contracts | $(23,478) | Interest expense | $(30,358) | None | $— |
| Total | $(23,478) | | $(30,358) | | $— |

| Derivatives Not Designated as Hedging Instruments | Location of Gain (Loss) Recognized in Income on Derivative | Gain (Loss) Recognized in Income on Derivative |
|---|---|---|
| Interest rate swap contracts | Interest expense | $359 |
| Total | | $359 |

In addition, during the years ended December 31, 2010 and 2009, the Company amortized $15.4 million and $15.9 million, respectively, in OCI related to the derivatives that were de-designated as hedging instruments under ASC 815, "Derivatives and Hedging."

In the coming twelve months, the Company anticipates that approximately $14.7 million loss will be reclassified from OCI to earnings, as part of interest expense. As this amount represents effective hedge results, a comparable offsetting amount of incrementally lower interest expense will be realized in connection with the variable funding being hedged.

The following table sets forth the fair value of the interest rate swap contract liabilities included in accrued interest within the consolidated balance sheets at December 31, 2010 and 2009:

| | December 31, 2010 | | December 31, 2009 | |
|---|---|---|---|---|
| | Balance Sheet Location | Fair Value | Balance Sheet Location | Fair Value |
| | | (in thousands) | | |
| **Derivatives designated as hedging instruments** | | | | |
| Interest rate swap contracts | Accrued interest | $13,034 | Accrued interest | $23,485 |
| **Total derivatives designated as hedging instruments** | | $13,034 | | $23,485 |
| **Derivatives not designated as hedging instruments** | | | | |
| Interest rate swap contracts | Accrued interest | $3,712 | Accrued interest | $20,440 |
| **Total derivatives not designated as hedging instruments** | | $3,712 | | $20,440 |
| **Total derivatives** | | $16,746 | | $43,925 |

**Redemption of $6^7/_8$% Senior Subordinated Notes**

In August 2009, the Company called for the redemption of its $200 million $6^7/_8$% senior subordinated notes. The redemption price was $1,000 per $1,000 principal amount, plus accrued and unpaid interest, which was paid in September 2009. Approximately $94.5 million aggregate principal amount of the $6^7/_8$% senior subordinated notes were validly tendered and paid. In October 2009, the Company called for the redemption of all of the $105.5 million outstanding aggregate principal amount of its $6^7/_8$% senior subordinated notes. The redemption price was $1,000 per $1,000 principal amount, plus accrued and unpaid interest. In December 2009, the Company repaid all of the $105.5 million outstanding aggregate principal amount of its $6^7/_8$% senior subordinated notes. The Company funded the $94.5 million redemption from a portion of the proceeds from the offering of $325 million $8^3/_4$% senior subordinated notes and available cash and funded the $105.5 million redemption using drawings under the revolving credit facility.

The Company recorded a $2.4 million loss on early extinguishment of debt during the year ended December 31, 2009 for the write-off of the debt issuance costs related to the $200 million $6^7/_8$% senior subordinated notes.

**$6^3/_4$% Senior Subordinated Notes**

On March 9, 2005, the Company completed an offering of $250 million $6^3/_4$% senior subordinated notes that mature on March 1, 2015. Interest on the $250 million $6^3/_4$% senior subordinated notes is payable on March 1 and September 1 of each year. The $250 million $6^3/_4$% senior subordinated notes are general unsecured obligations and are not guaranteed by the Company's subsidiaries and were issued in a private placement pursuant to an exemption from the registration requirements of the Securities Act of 1933, as amended. Effective March 2010, the Company may redeem all or part of the $250 million $6^3/_4$% senior subordinated notes at a redemption price of 103.375% which gradually reduces to par by 2013.

**$8^3/_4$% Senior Subordinated Notes**

In August 2009, the Company completed an offering of $325 million $8^3/_4$% senior subordinated notes that mature on August 15, 2019. Interest on the $325 million $8^3/_4$% senior subordinated notes is payable on February 15 and August 15 of each year. The $325 million $8^3/_4$% senior subordinated notes are general unsecured obligations and are not guaranteed by the Company's subsidiaries and were issued in a private placement pursuant to an exemption from the registration requirements of the Securities Act of 1933, as amended. At any time prior to August 15, 2014, the Company may redeem all or part of the $8^3/_4$% senior subordinated notes at par plus the present value (discounted at the treasury rate plus 50 basis points) of scheduled interest payments through August 15, 2014, along with accrued and unpaid interest, if any, at the date of redemption. On or after August 15, 2014, the Company may redeem all or part of the $8^3/_4$% senior subordinated notes at a redemption price of 104.375% which gradually reduces to par by 2017.

A portion of the proceeds from the offering were used to repay $40 million of borrowings under the Term Loan A Facility, $70 million of borrowings under the Term Loan B Facility, and all outstanding borrowings under the revolving credit facility at the time. The remainder of the proceeds, plus available cash, was used to pay the validly-tendered principal amounts of the $200 million $6^7/_8$% senior subordinated notes.

**Other Long-Term Obligations**

In April 2010, the Company entered into a termination contract with the city of Aurora, Illinois, whereby the Company will pay $7 million in lieu of perpetual annual payments (of approximately $1 million) to have off duty Aurora police officials provide security at Hollywood Casino Aurora each day. Payments of $1.5 million were made on June 1, 2010 and September 1, 2010 and additional payments of $2.0 million and $2.0 million are due on June 1, 2011 and June 1, 2012, respectively. This liability was discounted using the Company's estimate of its incremental borrowing rate over the term of the obligation. The accretion of this discount is recorded in interest expense in the consolidated statements of operations.

**Covenants**

The Company's senior secured credit facility and $325 million $8^3/_4\%$ and $250 million $6^3/_4\%$ senior subordinated notes require it, among other obligations, to maintain specified financial ratios and to satisfy certain financial tests, including fixed charge coverage, senior leverage and total leverage ratios. In addition, the Company's senior secured credit facility and $325 million $8^3/_4\%$ and $250 million $6^3/_4\%$ senior subordinated notes restrict, among other things, the Company's ability to incur additional indebtedness, incur guarantee obligations, amend debt instruments, pay dividends, create liens on assets, make investments, make acquisitions, engage in mergers or consolidations, make capital expenditures, or engage in certain transactions with subsidiaries and affiliates and otherwise restricts corporate activities.

During the year ended December 31, 2008, the Company placed some of the funds received from the issuance of its Preferred Stock into unrestricted subsidiaries, in order to allow for maximum flexibility in the deployment of the funds. The funds and activity maintained within the unrestricted subsidiaries are excluded from the Company's covenant calculations.

At December 31, 2010, the Company was in compliance with all required financial covenants.

**13. Commitments and Contingencies**

**Litigation**

The Company is subject to various legal and administrative proceedings relating to personal injuries, employment matters, commercial transactions and other matters arising in the normal course of business. The Company does not believe that the final outcome of these matters will have a material adverse effect on the Company's consolidated financial position or results of operations. In addition, the Company maintains what it believes is adequate insurance coverage to further mitigate the risks of such proceedings. However, such proceedings can be costly, time consuming and unpredictable and, therefore, no assurance can be given that the final outcome of such proceedings may not materially impact the Company's consolidated financial condition or results of operations. Further, no assurance can be given that the amount or scope of existing insurance coverage will be sufficient to cover losses arising from such matters.

The following proceedings could result in costs, settlements, damages, or rulings that materially impact the Company's consolidated financial condition or operating results. In each instance, the Company believes that it has meritorious defenses, claims and/or counter-claims, and intends to vigorously defend itself or pursue its claim.

In conjunction with the Company's acquisition of Argosy in 2005, and subsequent disposition of the Argosy Casino Baton Rouge property, the Company became responsible for litigation initiated in 1997 related to the Baton Rouge casino license formerly owned by Argosy. On November 26, 1997, Capitol House filed an amended petition in the Nineteenth Judicial District Court for East Baton Rouge Parish, State of Louisiana, amending its previously filed but unserved suit against Richard Perryman, the person selected by the Louisiana Gaming Division to evaluate and rank the applicants seeking a gaming license for East Baton Rouge Parish, and adding state law claims against Jazz Enterprises, Inc., the former Jazz Enterprises, Inc. shareholders, Argosy, Argosy of Louisiana, Inc. and Catfish Queen Partnership in Commendam, d/b/a the Belle of Baton Rouge Casino. This suit alleged that these parties violated the Louisiana Unfair Trade Practices Act in connection with obtaining the gaming license that was issued to Jazz Enterprises, Inc./Catfish Queen Partnership in Commendam. The plaintiff, an applicant for a gaming license whose application was denied by the Louisiana Gaming Division, sought to prove that the gaming license was invalidly issued and to recover lost profits that the plaintiff contended it could have earned if the gaming license had been issued to the plaintiff. On October 2, 2006, the Company prevailed on a partial summary judgment motion which limited plaintiff's damages to its out-of-pocket costs in seeking its gaming license, thereby eliminating any recovery for potential lost gaming profits. On February 6, 2007, the jury returned a verdict of $3.8 million (exclusive of statutory interest and attorneys' fees) against Jazz Enterprises, Inc. and Argosy. After ruling on post-trial motions, on September 27, 2007, the trial court entered a judgment in the amount of $1.4 million, plus attorneys' fees, costs and interest. The Company has the right to seek indemnification from two of the former Jazz Enterprises, Inc.

shareholders for any liability suffered as a result of such cause of action, however, there can be no assurance that the former Jazz Enterprises, Inc. shareholders will have assets sufficient to satisfy any claim in excess of Argosy's recoupment rights. The Company established an appropriate reserve and bonded the judgment pending its appeal. Both the plaintiff and the Company appealed the judgment to the First Circuit Court of Appeals in Louisiana. On August 31, 2009, the appellate court reversed the trial court's decision and dismissed the case against Argosy in its entirety. Capitol House requested that the Louisiana Supreme Court take its appeal of the dismissal and that request was denied on February 12, 2010. Capitol House requested that the U.S. Supreme Court hear the case and the Company filed a brief opposing that request. In October 2010, the U.S. Supreme Court declined to hear the case and as a result, all appeals have been exhausted, and the order dismissing the case has become a final order, ending this lengthy litigation. As a result, during the year ended December 31, 2010, the Company reversed the previously accrued reserves associated with this case of $9.6 million within other income (expenses) on its consolidated statements of operations.

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

On December 15, 2008, former Illinois Governor Rod Blagojevich signed Public Act No. 95-1008 requiring the Four Casinos to continue paying the 3% tax surcharge to subsidize Illinois horse racing interests. On January 8, 2009, the Four Casinos filed suit in the Court, asking it to declare the law unconstitutional. The 3% tax surcharge being paid pursuant to Public Act No. 95-1008 was being paid into a protest fund where it accrued interest. The defendants filed a motion to dismiss, which was granted on August 17, 2009. Casinos appealed the dismissal and filed motions to keep the payments in the protest fund while the appeal is being litigated. The motion to keep the monies in the protest fund was denied and the funds were released to the racetracks, however, the funds are subject to the order issued by the Seventh Circuit Court of Appeals described below. On January 27, 2011, the Illinois appellate court affirmed the trial court's dismissal of this case.

On June 12, 2009, the Four Casinos filed a lawsuit in Illinois Federal Court naming former Illinois Governor Rod Blagojevich, his campaign fund, racetrack owner John Johnston, and his two racetracks as defendants alleging a civil conspiracy in violation of the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. §1962(c),(d) ("RICO"), based on an illegal scheme to secure the enactment of the 3% tax surcharge legislation in exchange for the payment of money by Johnston and entities controlled by him. The Four Casinos also seek to impose a constructive trust over all funds paid under the tax surcharge, and therefore all of the Illinois racetracks are named as parties to the lawsuit. The defendants in the RICO case filed motions to dismiss. On December 7, 2009, the district court denied the motions to dismiss the RICO count, but it granted the motion to dismiss the constructive trust count, stating that it did not have jurisdiction in this case to impose the constructive trust. The Four Casinos have appealed this dismissal to the Seventh Circuit Court of Appeals. The appellate court has ordered that any monies disbursed to the tracks be maintained until the appeal has been decided. Since the passing of House Bill 1918 into law, Hollywood Casino Joliet and Hollywood Casino Aurora have recognized approximately $49.7 million in incremental gaming tax expense as a result of the 3% tax surcharge, including $9.7 million during the year ended December 31, 2010. The incremental tax is included in gaming expense within the consolidated statements of operations.

On July 16, 2008, the Company was served with a purported class action lawsuit brought by plaintiffs seeking to represent a class of shareholders who purchased shares of the Company's Common Stock between March 20, 2008 and July 2, 2008. The lawsuit alleges that the Company's disclosure practices relative to the proposed transaction with Fortress and Centerbridge and the eventual termination of that transaction were misleading and deficient in violation of the Securities Exchange Act of 1934. The complaint, which seeks class certification and unspecified damages, was filed in federal court in Maryland. The complaint was amended, among other things, to add three new named plaintiffs and to name Peter M. Carlino, Chairman and Chief Executive Officer, and William J. Clifford, Senior Vice President and Chief Financial Officer, as additional defendants. The Company filed a motion to dismiss the complaint in November 2008, and the court granted the motion and dismissed the complaint with prejudice. The plaintiffs filed a motion for reconsideration, which was denied on October 21, 2009. The plaintiffs subsequently appealed the dismissal to the Fourth Circuit Court of Appeals and an oral argument was heard on October 26, 2010.

On September 11, 2008, the Board of County Commissioners of Cherokee County, Kansas (the "County") filed suit against Kansas Penn Gaming, LLC ("KPG," a wholly-owned subsidiary of Penn created to pursue a development project in Cherokee County, Kansas) and the Company in the District Court of Shawnee County, Kansas. The petition alleges that KPG breached its pre-development agreement with the County when KPG withdrew its application to manage a lottery gaming facility in Cherokee County and currently seeks in excess of $50 million in damages. In connection with their petition, the County obtained an ex-parte order attaching the $25 million privilege fee paid to the Kansas Lottery Commission in conjunction with the gaming application for the Cherokee County zone. The defendants have filed motions to dissolve and reduce the attachment. Those motions were denied. Discovery is expected to commence shortly.

On September 23, 2008, KPG filed an action against HV Properties of Kansas, LLC ("HV") in the U.S. District Court for the District of Kansas seeking a declaratory judgment from the U.S. District Court finding that KPG has no further obligations to HV under a Real Estate Sale Contract (the "Contract") that KPG and HV entered into on September 6, 2007, and that KPG properly terminated this Contract under the terms of the Repurchase Agreement entered into between the parties effective September 28, 2007. HV filed a counterclaim claiming KPG breached the Contract, and seeks $37.5 million in damages. On October 7, 2008, HV filed suit against the Company claiming the Company is liable to HV for KPG's alleged breach based on a Guaranty Agreement signed by the Company. Both cases were consolidated. Following extensive discovery and briefings, on July 23, 2010, the court granted KPG's motion for summary judgment and dismissed HV's claim. KPG has filed a motion requesting reimbursement of the attorney's fees and costs incurred in litigating this case pursuant to the terms of the Contract and HV has opposed this motion.

**Operating Lease Commitments**

The Company is liable under numerous operating leases for airplanes, automobiles, land for the property on which some of its casinos operate, other equipment and buildings, which expire at various dates through 2093. Total rental expense under these agreements was $30.5 million, $31.5 million and $30.7 million for the years ended December 31, 2010, 2009 and 2008, respectively.

The leases for land consist of annual base lease rent payments plus, in some instances, a percentage rent based on a percent of adjusted gaming wins, as described in the respective leases.

The Company has an operating lease with the City of Bangor which covers the permanent facility that opened on July 1, 2008. Under the lease agreement, there is a fixed rent provision, as well as a revenue-sharing provision which is equal to 3% of gross slot revenue. The final term of the lease, which commenced with the opening of the permanent facility, is for an initial term of fifteen years, with three ten-year renewal options.

On March 23, 2007, BTN, Inc. ("BTN"), one of the Company's wholly-owned subsidiaries, entered into an amended and restated ground lease (the "Amended Lease") with Skrmetta MS, LLC. The lease amends the prior ground lease, dated October 19, 1993. The Amended Lease requires BTN to maintain a minimum gaming operation on the leased premises and to pay rent equal to 5% of adjusted gaming win after gaming taxes have been deducted. The term of the Amended Lease expires on January 1, 2093.

The future minimum lease commitments relating to the base lease rent portion of noncancelable operating leases at December 31, 2010 are as follows (in thousands):

| Year ending December 31, | |
|---|---|
| 2011 | $6,546 |
| 2012 | 5,203 |
| 2013 | 4,238 |
| 2014 | 3,210 |
| 2015 | 2,041 |
| Thereafter | 30,215 |
| Total | $51,453 |

**Capital Expenditure Commitments**

The Company's current construction program for 2011 calls for capital expenditures of approximately $287.5 million, of which the Company was contractually committed to spend approximately $85.2 million at December 31, 2010.

**Employee Benefit Plans**

The Company maintains a profit-sharing plan under the provisions of Section 401(k) of the Internal Revenue Code of 1986, as amended, which covers all eligible employees. The plan enables participating employees to defer a portion of their salary in a retirement fund to be administered by the Company. The Company makes a discretionary match contribution of 50% of employees' elective salary deferrals, up to a maximum of 6% of eligible employee compensation. The matching contributions for the profit-sharing plan for the years ended December 31, 2010, 2009 and 2008 were $3.5 million, $3.6 million and $3.7 million, respectively.

The Company also has a defined contribution plan, the Charles Town Races Future Service Retirement Plan, covering substantially all of its union employees at Hollywood Casino at Charles Town Races. Hollywood Casino at Charles Town Races makes annual contributions to this plan for the eligible union employees and to the Penn National Gaming, Inc. 401(k) Plan for the eligible non-union employees for an amount equal to the amount accrued for retirement expense, which is calculated as 0.25% of the daily mutual handle, 1.0% of net video lottery revenue up to a base and, after the base is met, it reverts to 0.5% and 0.84% of table and poker revenue, respectively. The matching contributions for the two plans at Hollywood Casino at Charles Town Races for the years ended December 31, 2010, 2009 and 2008 were $3.1 million, $2.7 million and $2.8 million, respectively.

The Company maintains a non-qualified deferred compensation plan that covers most management and other highly-compensated employees. This plan was effective March 1, 2001. The plan allows the participants to defer, on a pre-tax basis, a portion of their base annual salary and/or their annual bonus, and earn tax-deferred earnings on these deferrals. The plan also provides for matching Company contributions that vest over a five-year period. The Company has established a Trust, and transfers to the Trust, on a periodic basis, an amount necessary to provide for its respective future liabilities with respect to participant deferral and Company contribution amounts. The Company's matching contributions for the non-qualified deferred compensation plan for the years ended December 31, 2010, 2009 and 2008 were $1.8 million, $1.5 million and $1.7 million, respectively.

**Agreements with Horsemen and Pari-Mutuel Clerks**

The Company is required to have agreements with the horsemen at each of its racetracks to conduct its live racing and simulcasting activities, with the exception of the Company's tracks in Ohio and New Mexico. In addition, in order to operate gaming machines and table games in West Virginia, the Company must maintain agreements with each of the Charles Town Horsemen, pari-mutuel clerks and breeders.

At Hollywood Casino at Charles Town Races, the Company has an agreement with the Charles Town Horsemen expiring on December 31, 2011, and an agreement with the breeders that expires on June 30, 2011. The pari-mutuel clerks at Charles Town are represented under a collective bargaining agreement with the West Virginia Union of Mutuel Clerks, which expired on December 31, 2010 and has been extended on a month-to-month basis while negotiations are in process.

The Company's agreement with the Pennsylvania Thoroughbred Horsemen at Penn National Race Course expires on September 30, 2011. The Company has a collective bargaining agreement with Local 137 of the Sports Arena Employees at Penn National Race Course with respect to pari-mutuel clerks, admissions and Telebet personnel which expires on December 31, 2011. The Company also has an agreement in place with Local 137 of the Sports Arena Employees with respect to pari-mutuel clerks and admission personnel at the Company's OTWs, which expired on September 30, 2009 and has been extended pending continuing negotiations.

The Company's agreement with the Maine Harness Horsemen Association at Bangor Raceway expires on December 31, 2011.

The Company's agreement with the Ohio Harness Horsemen Association at Raceway Park expires on November 30, 2012. In connection with the acquisition of Beulah Park, the Company has assumed the agreement with the Ohio Horsemen's Protective and Benevolent Association, which expires on November 30, 2012.

Across certain of our properties, the Seafarers Entertainment and Allied Trade Union represents approximately 1,800 of the Company's employees under agreements that expire at various times between June 2012 and November 2015. At Hollywood Casino Joliet, the Hotel Employees and Restaurant Employees Union ("UNITE/HERE") Local 1 represents approximately 270 employees under a collective bargaining agreement which expires on March 31, 2011. In addition, at some of the properties, the Seafarer International Union of North America, Atlantic, Gulf, Lakes and Inland Waters District/NMU, AFL-CIO, the Security Police and Fire Professionals of America, the International Brotherhood of Electronic Workers, the American Maritime Officers Union and the UNITE/HERE Local 10 represent certain of the Company's employees under collective bargaining agreements that expire at various times between May 2012 and September 2016. None of these particular unions represent more than 50 of the Company's employees.

If the Company fails to maintain operative agreements with the horsemen at a track, it will not be permitted to conduct live racing and export and import simulcasting at that track and OTWs and, in West Virginia, the Company will not be permitted to operate its gaming machines and table games unless the state intervenes or changes the statute. In addition, the Company's simulcasting agreements are subject to the horsemen's approval. If the Company fails to renew or modify existing agreements on satisfactory terms, this failure could have a material adverse effect on its business, financial condition and results of operations. Except for the closure of the facilities at Penn National Race Course and its OTWs from February 16, 1999 to March 24, 1999 due to a horsemen's strike, and a few days at other times and locations, the Company has been able to maintain the necessary agreements. There can be no assurance that the Company will be able to maintain the required agreements.

**New Jersey Joint Venture**

On January 28, 1999, the Company, along with its joint venture partner, Greenwood Limited Jersey, Inc. ("Greenwood"), purchased certain assets and assumed certain liabilities of Freehold Racing Association, Garden State Racetrack and related entities, in a transaction accounted for as a purchase transaction.

In 1999, the Company made an $11.3 million loan to the joint venture and an equity investment of $0.3 million. In 2008, the balance of the loan was increased by $0.5 million to $11.8 million to substitute a payment of interest on the loan. The loan is evidenced by a subordinated secured note, which is included in investment in and advances to unconsolidated affiliates within the consolidated balance sheets at December 31, 2010 and 2009. The $11.3 million portion of the note bears interest at prime plus 2.25% or a minimum of 10.00% (at December 31, 2010, the interest rate was 10.00%). The $0.5 million portion of the note bears interest at the lesser of prime plus 2.00% or the 30-day LIBOR plus 3.00% (at December 31, 2010, the interest rate was 3.26%).

The joint venture, through Freehold Racing Association, was part of a multi-employer pension plan. For collectively bargained, multi-employer pension plans, contributions were made in accordance with negotiated labor contracts and generally were based on days worked. With the passage of the Multi-Employer Pension Plan Amendments Act of 1980, the joint venture may, under certain circumstances, become subject to liabilities in excess of contributions made under collective bargaining agreements. Generally, these liabilities are contingent upon the termination, withdrawal, or partial withdrawal from the plans. In June 2006, Freehold Racing Association withdrew from the multi-employer pension plan, and thereby became subject to payment of a withdrawal liability to the multi-employer pension plan. In January 2008, Freehold Racing Association was informed that the multi-employer pension plan experienced a mass withdrawal termination as of December 25, 2007. In November 2009, Freehold Racing Association received notice and demand for payment of the reallocation component of the joint venture withdrawal liability. The reallocation liability was calculated to be $5.1 million as of the date of withdrawal. Freehold Racing Association's obligation will continue until 2055 or such time that it is notified that the obligation has been satisfied. At December 31, 2010, the joint venture withdrawal liability was approximately $3.6 million for Freehold Racing Association.

The Company and Greenwood entered into a Debt Service Maintenance Agreement with a bank in which each joint venture partner has guaranteed up to 50% of a $23.0 million term loan to the joint venture. The Debt Service Maintenance Agreement remains in effect for the life of the loan and was due to expire on September 30, 2009. In 2008, the joint venture borrowed an additional $1.75 million and the maturity date of the term loan was extended to September 30, 2013. In 2009, certain terms and conditions of the agreement were amended, including the interest rates to be applied and the payment schedule. At December 31, 2010, the outstanding balance on the loan to the joint venture amounted to $6.6 million, of which the Company's obligation under its guarantee of the term loan was limited to approximately $3.3 million. The Company's 50% share is included within loss from unconsolidated affiliates on the Consolidated Statement of Operations.

**14. Income Taxes**

Deferred tax assets and liabilities are provided for the effects of temporary differences between the tax basis of an asset or liability and its reported amount in the consolidated balance sheets. These temporary differences result in taxable or deductible amounts in future years.

The components of the Company's deferred tax assets and liabilities are as follows:

| Year ended December 31, | 2010 | 2009 |
|---|---|---|
| | (in thousands) | |
| Deferred tax assets: | | |
| Stock-based compensation expense | $31,836 | $26,499 |
| Accrued expenses | 40,355 | 26,092 |
| Deferred tax assets resulting from unrecognized tax benefits | 10,371 | 11,682 |
| State net operating losses | 6,978 | 7,404 |
| Accumulated other comprehensive loss | 5,238 | 14,916 |
| Gross deferred tax assets | 94,778 | 86,593 |
| Less valuation allowance | (3,166) | (4,268) |
| Net deferred tax assets | 91,612 | 82,325 |
| Deferred tax liabilities: | | |
| Property, plant and equipment | (105,751) | (86,334) |
| Intangibles | (95,227) | (99,479) |
| Net deferred tax liabilities | (200,978) | (185,813) |
| Net: | $(109,366) | $(103,488) |
| Reflected on consolidated balance sheets: | | |
| Current deferred tax assets, net | $25,206 | $23,619 |
| Noncurrent deferred tax liabilities, net | (134,572) | (127,107) |
| Net deferred taxes | $(109,366) | $(103,488) |

For income tax reporting, the Company has gross state net operating loss carryforwards aggregating approximately $156.2 million available to reduce future state income taxes primarily for the Commonwealth of Pennsylvania and the States of Mississippi, Colorado and Maryland as of December 31, 2010. The tax benefit associated with these net operating loss carryforwards is approximately $7.0 million. Due to state tax statutes on annual net operating loss utilization limits, the availability of gaming tax credits and income and loss projections in the applicable jurisdictions, a $3.2 million valuation allowance has been recorded to reflect the net operating losses which are not presently expected to be realized. If not used, substantially all the carryforwards will expire at various dates from December 31, 2011 to December 31, 2030.

In addition, certain subsidiaries have accumulated gross state net operating loss carryforwards aggregating approximately $711.7 million for which no benefit has been recorded as they are attributable to uncertain tax positions. The unrecognized tax benefits as of December 31, 2010 attributable to these net operating losses was approximately $45.5 million. Due to the uncertain tax position, these net operating losses are not included as components of deferred tax assets as of December 31, 2010. In the event of any benefit from realization of these net operating losses, $8.9 million would be treated as an increase to equity, and the remainder would be treated as a reduction of tax expense. If not used, substantially all the carryforwards will expire at various dates from December 31, 2011 to December 31, 2030.

The provision/(benefit) for income taxes charged to operations for the years ended December 31, 2010, 2009 and 2008 was as follows:

| Year ended December 31, | 2010 | 2009 | 2008 |
|---|---|---|---|
| | | (in thousands) | |
| Current tax expense | | | |
| Federal | $55,008 | $65,941 | $157,043 |
| State | 11,630 | 20,232 | 35,461 |
| Foreign | 1,744 | (233) | 4,332 |
| Total current | 68,382 | 85,940 | 196,836 |
| Deferred tax (benefit) expense | | | |
| Federal | (4,996) | (112,072) | (78,895) |
| State | 2,792 | (34,336) | (12,203) |
| Total deferred | (2,204) | (146,408) | (91,098) |
| Total provision/(benefit) | $66,178 | $(60,468) | $105,738 |

The following table reconciles the statutory federal income tax rate to the actual effective income tax rate for 2010, 2009 and 2008:

| Year ended December 31, | 2010 | 2009 | 2008 |
|---|---|---|---|
| Percent of pretax income | | | |
| Federal taxes | 35.0% | 35.0% | 35.0% |
| State and local income taxes | 197.1% | 3.3% | (32.0)% |
| Permanent differences | 1263.1% | (20.5)% | (217.9)% |
| Foreign | 16.1% | 0.4% | (7.5)% |
| Other miscellaneous items | (46.5)% | 0.2% | 0.2% |
| | 1464.8% | 18.4% | (222.2)% |

| Year ended December 31, | 2010 | 2009 | 2008 |
|---|---|---|---|
| | | (in thousands) | |
| Amount based upon pretax income | | | |
| Federal taxes | $1,581 | $(114,758) | $(16,655) |
| State and local income taxes | 8,905 | (10,671) | 15,229 |
| Permanent differences | 57,058 | 67,166 | 103,707 |
| Foreign | 729 | (1,291) | 3,587 |
| Other miscellaneous items | (2,095) | (914) | (130) |
| | $66,178 | $(60,468) | $105,738 |

A reconciliation of the beginning and ending amount for the liability for unrecognized tax benefits is as follows:

| | Noncurrent tax liabilities (in thousands) |
|---|---|
| Balance at January 1, 2009 | $68,632 |
| Additions based on current year positions | 4,614 |
| Additions based on prior year positions | 9,333 |
| Decreases due to settlements and/or reduction in liabilities | (45,848) |
| Currency translation adjustments | 9,971 |
| Balance at December 31, 2009 | 46,702 |
| Additions based on current year positions | 5,712 |
| Reductions based on prior year positions | (1,749) |
| Decreases due to settlements and/or reduction in liabilities | (16,436) |
| Currency translation adjustments | 2,617 |
| Balance at December 31, 2010 | $36,846 |

Included in the liability for unrecognized tax benefits at December 31, 2009 was $9.5 million of tax positions that are indemnified by a third party. The indemnification stems from a transaction the Company completed in 2001 with The Continental Companies ("Continental") and CHC International, Inc. (the "Seller") whereby the Company acquired Casino Rouge in Baton Rouge, Louisiana and the management contract for Casino Rama in Orillia, Ontario, Canada. As part of the acquisition, Continental and the Company entered into an Indemnification Agreement whereby Continental indemnified the Company for any tax liabilities to arise subsequent to the acquisition for taxation years which Continental was the owner. The Canada Revenue Agency ("CRA") proposed a reassessment of CHC Canada in respect to its 1996 through 2000 taxation years. The Company and Seller disagreed with the CRA's position, and the matter was placed in Competent Authority in 2004.

On May 20, 2009, the Company was notified by the Competent Authority Services Division of the CRA that the CRA and the U.S. Competent Authority ("IRS") negotiated a settlement regarding the years under assessment from the CRA. According to the terms of the agreement, the CRA had agreed to reduce their original disallowance of management fees charged by the Company's indirect U.S. subsidiary CRC Holdings, Inc. to CHC Casinos Canada Limited from CND$54,472,752 to CND$13,556,919 in exchange for the IRS granting relief by allowing CRC Holdings-US to decrease its income by $9,130,658 (or CND$13,556,919) and repay the $9,130,658 to CHC Casinos Canada Limited free of any U.S. withholding taxes.

On November 27, 2009, the Company received from the CRA Notice of Reassessments ("Notice") for the taxation years covered under the Component Authority settlement. In accordance with the terms of the Notice, the Company paid CND$8.5 million on December 16, 2009. Based upon the calculations within the Notice, the Company recalculated its pre-acquisition provincial liability/indemnification receivable.

On March 1, 2010, the Company received from the Ontario's Ministry of Revenue Notices of Reassessments ("Notices) for the taxation years 1996-2000. In accordance with the terms of the Notices, the Company paid CND$4.9 million on March 26, 2010. On May 17, 2010, the Company received from the Ontario's Ministry of Revenue a Notice of Reassessment for the short taxation year ended April 27, 2001. In accordance with the terms of the Notice of Reassessment dated May 17, 2010, the Company paid CND$395,767. In addition, the Company had filed formal requests for interest relief to the CRA and the Ontario Ministry of Revenue in conjunction with the reassessments received and paid for the taxation years covered and settled under the Competent Authority and in 2010 the Company was granted $1.6 million and $0.9 million of interest relief from the CRA and Ministry of Revenue, respectfully. Currently the $1.6 million of interest relief granted to the Company by the CRA is held on account with the CRA pending resolution of the CRA's examination of the Company's 2001-2006 taxation years.

In October 2010, the Company reached a tentative agreement to settle its indemnification claim with Continental for $5.3 million and the Company wrote down its indemnification receivable by $2.9 million to match the settlement amount.

For the taxation years after April 27, 2001, where the Company has no indemnification, it has included in the liability for unrecognized tax benefits $1.0 million of tax reserves and reversed $2.8 million of previously accrued interest and penalties. Included within the above mentioned amounts are reversals of $5.3 million of tax reserves and $3.1 million of accrued interest and penalties previously recorded due to CHC Canada's 2002 taxation year becoming statue barred for federal purposes in Canada. Overall, the Company recorded a net tax benefit of $1.8 million in connection with its foreign uncertain tax positions.

Included in the liability for unrecognized tax benefits at December 31, 2010 and 2009 were $2.6 million and $10.0 million, respectively, of currency translation adjustments for foreign currency tax positions.

In 2010, the Commonwealth of Pennsylvania officially closed its tax litigation case against one of the Company's direct subsidiaries. Based upon the executed "Stipulation of Judgment" that was submitted in the Commonwealth Court of Pennsylvania, the Company no longer views this matter as an uncertain tax position. Also, during the course of a year certain "open" tax years for federal and state income tax may become statutorily close due to the statute of limitation term expiring. In cases where the Company has recorded an unrecognized tax benefit associated with a filing position taken in a year that has subsequently closed, the Company is required to reverse all previously recorded tax reserves, interest and penalties. For 2010, the Company reversed $7.0 million of tax reserves and reversed $2.0 million of previously accrued interest for uncertain tax positions that have settled and/or closed. In addition, it has included in the liability for unrecognized tax benefits associated with its domestic uncertain tax positions $3.5 million of additional tax reserves and $1.0 million of accrued interest. Overall, the Company recorded a net tax benefit of $3.1 million in connection with its domestic uncertain tax positions.

Included in the liability for unrecognized tax benefits at December 31, 2010 and 2009 were $32.9 million and $37.2 million, respectively, of tax positions that, if reversed, would affect the effective tax rate.

The Company is required under ASC 740 to disclose its accounting policy for classifying interest and penalties, the amount of interest and penalties charged to expense each period, as well as the cumulative amounts recorded in the consolidated balance sheets. The Company will continue to classify any tax-related penalties and interest accrued related to unrecognized tax benefits in taxes on income within the consolidated statements of operations.

During the years ended December 31, 2010 and 2009, the Company recognized approximately $1.0 million and $2.7 million, respectively, of interest and penalties, net of deferred taxes. In addition, due to settlements and/or reductions in previously recorded liabilities on uncertain tax positions, the Company had reductions in previously accrued interest and penalties of $4.4 million, net of deferred taxes. The Company has accrued approximately $21.9 million (gross) for the payment of interest and penalties at December 31, 2010. These accruals were included in noncurrent tax liabilities within the consolidated balance sheet at December 31, 2010.

The Company is currently in various stages of the examination process in connection with our open audits. Generally, it is difficult to determine when these examinations will be closed, but the Company reasonably expects that its ASC 740 liabilities will not significantly change over the next twelve months.

As of December 31, 2010, the Company is subject to U.S. Federal income tax examinations for the tax years 2007, 2008 and 2009. In addition, the Company is subject to state and local income tax examinations for various tax years in the taxing jurisdictions in which the Company operates.

Included in prepaid expenses were prepaid income taxes of $42.4 million and $40.3 million at December 31, 2010 and December 31, 2009, respectively.

## 15. Shareholders' Equity

### Repurchase of Common Stock

The repurchase of up to $200 million of the Company's Common Stock over the twenty-four month period ending July 2010 was authorized by the Company's Board of Directors in June 2008. On June 9, 2010, the Company's Board of Directors authorized the repurchase of up to $300 million of the Company's Common Stock effective immediately and continuing until the Annual Meeting of Shareholders in 2011, unless otherwise extended or shortened by the Board of Directors. This new repurchase program replaces the program authorized by the Board of Directors in June 2008. During the year ended December 31, 2010, the Company repurchased 1,526,400 shares of its Common Stock in open market transactions for approximately $35.9 million at an average price of $23.49 per share. The Company did not repurchase any shares of its Common Stock in 2009. During the year ended December 31, 2008, the Company repurchased 8,934,984 shares of its Common Stock in open market transactions for approximately $152.6 million, at an average price of $17.05.

### Issuance of the $1.25 billion, Zero Coupon Preferred Equity Investment

On July 3, 2008, the Company entered into an agreement with certain affiliates of Fortress and Centerbridge, terminating the Merger Agreement. In connection with the termination of the Merger Agreement, the Company agreed to receive a total of $1.475 billion, consisting of the Cash Termination Fee and the Investment. On October 30, 2008, the Company closed the sale of the Investment and issued 12,500 shares of Preferred Stock. During the year ended December 31, 2010, the Company repurchased 225 shares of Preferred Stock for $11.2 million.

The Investment is generally non-voting, but possesses voting rights with respect to certain extraordinary events. The Investment is entitled to vote with the Common Stock on an as-converted basis with respect to any change-in-control or other significant transaction if the consideration to be paid to shareholders is less than $45 per share (which amount is subject to adjustment in certain circumstances). In addition, the approval of holders of a majority of the Investment shares is required to authorize (i) special dividends to security holders of the Company; (ii) issuance by the Company of equity securities senior to or on a parity with the Investment; (iii) stock repurchases, including but not limited to, by means of a tender offer which is funded by an asset sale outside the ordinary course (other than repurchases in the open market and repurchases by tender offer at not greater than a 20% premium); and (iv) certain other amendments to the terms of the Investment. At December 31, 2010, the Investment had an aggregate liquidation preference equal to $1.23 billion, the aggregate purchase price paid for the Investment shares (the "Purchase Price"), subject to certain adjustments. In addition, the Investment terms provide that the Investment participates in any dividends paid on the Common Stock. To the extent that the Company pays a special dividend, such special dividend will reduce the amount to be paid to the holders of the Investment upon a liquidation or redemption.

The Company is required to redeem, for either cash or common shares at the Company's election, all of the outstanding shares of the Investment on June 30, 2015, unless a change-in-control transaction in which all holders of shares of the Common Stock receive consideration in the transaction has occurred prior to that time. In the event of such a change-in-control transaction, the holders of the Investment will receive cash and/or other consideration in such transaction (the same consideration as the holders of Common Stock receive) with a value equal to the net present value of the Purchase Price, subject to increase or decrease in the event that the value of the consideration paid to the holders of the Common Stock is greater than $67 per share or less than $45 per share, respectively, which thresholds are subject to adjustment in certain circumstances.

The redemption price to be paid to the holders of the Investment on June 30, 2015 is equal to the Purchase Price, subject to increase or decrease in the event that the average trading price of the Common Stock (measured over the 20 consecutive trading days prior to May 26, 2015) is greater than $67 per share or less than $45 per share, respectively. There is no coupon payable with respect to the Investment. The Company shall redeem all of the Investment for cash, provided the Company may elect on or prior to June 1, 2015 to pay all or part of the redemption price in shares of the Common Stock. At December 31, 2010, the redemption price was $958.8 million (27.3 million shares of Common Stock if the Company elected to redeem through the issuance of Common Stock).

The holders of the Investment are subject to the Investor Rights Agreement, dated as of July 3, 2008, by and among the Company, FIF V PFD LLC, Centerbridge Capital Partners, L.P., DB Investment Partners, Inc. and Wachovia Investment Holdings, LLC. (the "Investor Rights Agreement"), which, among other things, contains a voting agreement requiring certain Investment holders to vote all of their shares of Common Stock as directed by the Company and a standstill agreement restricting the activities of certain Investment holders. In addition, Investment holders who may receive 20% or more of the outstanding Common Stock upon redemption would be subject to Subchapter 25G of the Pennsylvania Business Corporation Law of 1988, as amended (the "Control Share Statute"). The Control Share Statute prohibits any person or group that acquires more than 20% of the voting power of the Company from voting any securities held by such person or group unless the shareholders vote to accord voting rights to such securities within 90 days of the time such threshold was exceeded. Under the Investment terms, unless such shareholder approval is obtained, the Investment holders shall execute and deliver a proxy in favor of an attorney-in-fact to be designated by the Board of Directors covering the number of shares of Common Stock necessary to avoid the application of the Control Share Statute.

The Investor Rights Agreement also provides that until Fortress and its affiliates own less than two-thirds of the shares of the Investment issued to them on October 30, 2008, Fortress and the Company must take all action in their power to appoint one designee of the purchasers (the "Purchaser Designee") as a Class II director on the Board of Directors and to use all commercially reasonable efforts to cause the election of the Purchaser Designee at every meeting thereafter at which a Class II director is to be elected. The initial Purchaser Designee is Wesley R. Edens. Mr. Edens is the founding principal, Chief Executive Officer and Chairman of the Board of Directors of Fortress.

Under the terms of the Investor Rights Agreement, the Company has agreed to file a short-form registration statement with the U.S. Securities and Exchange Commission for the registration and sale of Investment shares and certain shares of Common Stock owned by the purchasers ("Registrable Securities"), which it filed on December 30, 2008. The Company is required to keep the shelf registration statement continuously effective under the Securities Act of 1933, as amended, until the earlier of (i) such time as all Registrable Securities have been sold and (ii) such time as the purchasers beneficially own (as defined in the Investor Rights Agreement) less than 2.5% of the Common Stock on a fully-diluted basis (including Common Shares issuable upon redemption of the Investment shares at maturity). The purchasers and any permitted transferees of Registrable Securities are also entitled to four demand registrations and unlimited piggyback registration during the term of the Investor Rights Agreement.

Under the Investor Rights Agreement, each Investment holder has preemptive rights with respect to certain sales of Common Stock, stock options or securities convertible into Common Stock for so long as such holder beneficially owns at least two-thirds of the shares of the Investment issued to it on October 30, 2008.

## 16. Noncontrolling Interests

In November 2009, the Company entered into a Funding and Option Agreement with Lakes Entertainment, Inc. ("Lakes"), permitting Lakes to invest up to a 10% equity interest in each of the Company's proposed facilities in Columbus and Toledo, Ohio.

During the year ended December 31, 2010, Lakes made no contribution to the Company towards the proposed facilities, and its portion of the net loss for the proposed facilities was $2.2 million. During the year ended December 31, 2009, Lakes contributed $1.9 million to the Company towards the proposed facilities, and its portion of the net loss for the proposed facilities was $2.5 million.

On July 16, 2010, the Company paid $25 million to Lakes to terminate the agreement. In exchange for this payment, Lakes agreed to relinquish all of its rights, title and interests held in connection with these two projects. In accordance with ASC 810, "Consolidation," the Company accounted for this change in ownership interest as an adjustment through equity attributable to the parent. Therefore, the Company recorded the $25 million payment and the cumulative $2.8 million loss attributable to noncontrolling interests from previous periods to additional paid in capital.

## 17. Stock-Based Compensation

In April 1994, the Company's Board of Directors and shareholders adopted and approved the 1994 Stock Option Plan (the "1994 Plan"). The 1994 Plan permitted the grant of options to purchase up to 12,000,000 shares of Common Stock, subject to antidilution adjustments, at a price per share no less than 100% of the fair market value of the Common Stock on the date an option is granted with respect to incentive stock options only. The price would be no less than 110% of fair market value in the case of an incentive stock option granted to any individual who owns more than 10% of the total combined voting power of all classes of outstanding stock. The 1994 Plan provided for the granting of both incentive stock options intended to qualify under Section 422 of the Internal Revenue Code of 1986, as amended, and nonqualified stock options, which do not so qualify. The options granted prior to the 2003 Plan remain outstanding.

On April 16, 2003, the Company's Board of Directors adopted and approved the 2003 Long Term Incentive Compensation Plan (the "2003 Plan"). On May 22, 2003, the Company's shareholders approved the 2003 Plan. The 2003 Plan was effective June 1, 2003 and permitted the grant of options to purchase Common Stock and other market-based and performance-based awards. Up to 12,000,000 shares of Common Stock were available for awards under the 2003 Plan. The 2003 Plan provided for the granting of both incentive stock options intended to qualify under Section 422 of the Internal Revenue Code of 1986, as amended, and nonqualified stock options, which do not so qualify. The exercise price per share may be no less than (i) 100% of the fair market value of the Common Stock on the date an option is granted for incentive stock options and (ii) 85% of the fair market value of the Common Stock on the date an option is granted for nonqualified stock options. This plan will remain in place until it terminates in 2013. However the shares which remained available for issuance under such plan as of November 12, 2008 are no longer available for issuance and all future equity awards will be pursuant to the 2008 Plan described below.

On August 20, 2008, the Company's Board of Directors adopted and approved the 2008 Long Term Incentive Compensation Plan (the "2008 Plan"). On November 12, 2008, the Company's shareholders approved the 2008 Plan. The 2008 Plan permits the Company to issue stock options (incentive and/or non-qualified), stock appreciation rights, restricted stock, phantom stock units and other equity and cash awards to employees. Non-employee directors are eligible to receive all such awards, other than incentive stock options. The aggregate number of shares of Common Stock that may be issued under the 2008 Plan shall not exceed 6,900,000. Awards of stock options and stock appreciation rights will be counted against the 6,900,000 limit as one share of Common Stock for each share granted. However, each share awarded in the form of restricted stock, or any other full value stock award, will be counted as issuing 2.16 shares of Common Stock for purposes of determining the number of shares available for issuance under the plan. Any awards that are not settled in shares of Common Stock shall not count against this limit. At December 31, 2010, there were 2,280,503 options available for future grants under the 2008 Plan.

Stock options that expire between January 29, 2011 and September 11, 2018 have been granted to officers, directors and employees to purchase Common Stock at prices ranging from $7.95 to $61.82 per share. All options were granted at the fair market value of the Common Stock on the date the options were granted. The Company issues new authorized common shares to satisfy stock option exercises as well as restricted stock lapses.

The following table contains information on stock options issued under the plans for the three-year period ended December 31, 2010:

| | Number of Option Shares | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Term (in years) | Aggregate Intrinsic Value (in thousands) |
|---|---|---|---|---|
| Outstanding at December 31, 2007 | 7,249,905 | $27.58 | 4.87 | $231,837 |
| Granted | 1,834,000 | 29.56 | | |
| Exercised | (203,202) | 11.80 | | |
| Canceled | (76,125) | 37.00 | | |
| Outstanding at December 31, 2008 | 8,804,578 | $28.27 | 6.30 | $17,677 |
| Granted | 1,849,375 | 22.32 | | |
| Exercised | (491,078) | 11.06 | | |
| Canceled | (196,750) | 32.27 | | |
| Outstanding at December 31, 2009 | 9,966,125 | $27.83 | 5.67 | $33,038 |
| Granted | 1,868,500 | 27.19 | | |
| Exercised | (823,056) | 13.96 | | |
| Canceled | (177,125) | 28.84 | | |
| Outstanding at December 31, 2010 | 10,834,444 | $28.75 | 5.16 | $76,807 |

Included in the above are Common Stock options that were issued in 2003 to the Company's Chairman outside of the 1994 Plan and the 2003 Plan. These options were issued at $7.95 per share, and are exercisable through February 6, 2013. At December 31, 2010 and 2009, the number of these Common Stock options that were outstanding was 23,750. On December 31, 2008, the Company modified the expiration date of certain of its stock options from the seventh anniversary of the date of grant to the tenth anniversary of the date of grant. This modification resulted in additional compensation costs related to stock-based compensation of $2.3 million pre-tax ($1.6 million after-tax) for the year ended December 31, 2008.

The weighted-average grant-date fair value of options granted during the years ended December 31, 2010, 2009 and 2008 were $12.92, $8.91 and $10.57, respectively.

| Exercisable at December 31, | Number of Option Shares | Weighted-Average Exercise Price |
|---|---|---|
| 2010 | 6,586,882 | $29.85 |
| 2009 | 5,872,151 | 27.41 |
| 2008 | 4,608,441 | 23.60 |

The aggregate intrinsic value of stock options exercised during the years ended December 31, 2010, 2009 and 2008 was $15.1 million, $8.4 million and $4.1 million, respectively.

At December 31, 2010, there were 6,586,882 shares that were exercisable, with a weighted-average exercise price of $29.85, a weighted-average remaining contractual term of 4.62 years, and an aggregate intrinsic value of $41 million.

The following table summarizes information about stock options outstanding at December 31, 2010:

| | Exercise Price Range | | | Total |
|---|---|---|---|---|
| Outstanding options | $7.95 to $27.19 | $27.35 to $29.87 | $30.61 to $61.82 | $7.95 to $61.82 |
| Number outstanding | 4,197,535 | 3,654,005 | 2,982,904 | 10,834,444 |
| Weighted-average remaining contractual life (years) | 4.92 | 5.44 | 5.14 | 5.16 |
| Weighted-average exercise price | $22.13 | $29.47 | $37.19 | $28.75 |
| **Exercisable options** | | | | |
| Number outstanding | 1,176,285 | 2,771,380 | 2,639,217 | 6,586,882 |
| Weighted-average exercise price | $15.59 | $29.40 | $36.68 | $29.85 |

The following table contains information on restricted stock awards issued under the plans for the three-year period ended December 31, 2010:

| | Number of Award Shares |
|---|---|
| Outstanding at December 31, 2007 | 380,000 |
| Awarded | — |
| Released | — |
| Canceled | — |
| Outstanding at December 31, 2008 | 380,000 |
| Awarded | 332,690 |
| Released | (160,000) |
| Canceled | — |
| Outstanding at December 31, 2009 | 552,690 |
| Awarded | 165,110 |
| Released | (203,734) |
| Canceled | (20,000) |
| Outstanding at December 31, 2010 | 494,066 |

Compensation costs related to stock-based compensation for the years ended December 31, 2010, 2009 and 2008 totaled $26 million pre-tax ($19.1 million after-tax), $28.4 million pre-tax ($20.9 million after-tax) and $26.9 million pre-tax ($19.8 million after-tax), respectively, and are included within the consolidated statements of operations under general and administrative expense.

At December 31, 2010 and 2009, the total compensation cost related to nonvested awards not yet recognized equaled $37.2 million and $39.5 million, respectively, including $30.1 million and $31.2 million for stock options, respectively, and $7.1 million and $8.3 million for restricted stock, respectively. This cost is expected to be recognized over the remaining vesting periods, which will not exceed five years.

In October 2010, the Company granted 209,070 cash-settled phantom stock unit awards which vest over a period of five years. Cash-settled phantom stock unit awards entitle employees to receive cash based on the fair value of the Company's Common Stock on the vesting date. These phantom stock unit awards are accounted for as liability awards and are remeasured at fair value each reporting period until they become vested with compensation expense being recognized over the requisite service period in accordance with ASC 718-30 "Compensation—Stock Compensation, Awards Classified as Liabilities." As of December 31, 2010, there was $6.9 million of total unrecognized compensation cost that will be recognized over the grants remaining vesting period. For the year ended December 31, 2010, the Company recognized $0.4 million of compensation expense associated with these awards.

## 18. Segment Information

In accordance with ASC 280, the Company views each property as an operating segment, and aggregates all of its properties into one reportable segment, as the Company believes that they are economically similar, offer similar types of products and services, cater to the same types of customers and are similarly regulated.

## 19. Summarized Quarterly Data (Unaudited)

The following table summarizes the quarterly results of operations for the years ended December 31, 2010 and 2009:

| | Fiscal Quarter | | | |
|---|---|---|---|---|
| | First | Second | Third | Fourth |
| | (in thousands, except per share data) | | | |
| **2010** | | | | |
| Net revenues | $592,323 | $598,311 | $638,256 | $630,221 |
| Income (loss) from operations | 92,351 | 51,711 | 110,462 | (101,298) |
| Net income (loss) attributable to the shareholders of Penn National Gaming, Inc. and subsidiaries | 36,164 | 9,156 | 48,345 | (153,132) |
| Earnings (loss) per common share attributable to the shareholders of Penn National Gaming, Inc. and shareholders: | | | | |
| Basic earnings (loss) per common share | 0.37 | 0.09 | 0.51 | (1.97) |
| Diluted earnings (loss) per common share | 0.34 | 0.09 | 0.46 | (1.97) |
| **2009** | | | | |
| Net revenues | $612,226 | $580,817 | $620,426 | $555,806 |
| Income (loss) from operations | 100,835 | 76,705 | 87,404 | (459,542) |
| Net income (loss) attributable to the shareholders of Penn National Gaming, Inc. and subsidiaries | 40,661 | 28,480 | 21,351 | (355,440) |
| Earnings (loss) per common share attributable to the shareholders of Penn National Gaming, Inc. and shareholders: | | | | |
| Basic earnings (loss) per common share | 0.42 | 0.29 | 0.22 | (4.54) |
| Diluted earnings (loss) per common share | 0.38 | 0.27 | 0.20 | (4.54) |

As a result of decreased earning projections resulting from an anticipated increase in competition from the scheduled opening of a casino in the second half of 2011 in Des Plaines, Illinois, as well as continued challenging market conditions in the Chicagoland regional market, the Company recorded a pre-tax goodwill impairment charge of $144.6 million ($144.6 million, net of taxes) at Hollywood Casino Aurora and $44.2 million ($28.4 million, net of taxes) at Hollywood Casino Joliet, respectively, during the fourth quarter of 2010. Additionally during the fourth quarter of 2010, the Company wrote-down the remaining value of the Argosy trademark intangible asset of $4.4 million ($2.8 million, net of taxes) due to management's strategy to transition Argosy properties to the Hollywood Casino brand.

In addition, in conjunction with the voters determining that the Company's casino in Columbus, Ohio will be located at the site of the former Delphi Automotive plant along Columbus's West Side, rather than the original site in the Arena District, the Company recorded a pre-tax impairment charge of $30.5 million ($19.6 million, net of taxes) during the second quarter of 2010 for the parcel of land that the Company purchased in Columbus's Arena District.

In conjunction with the opening of the new casino riverboat at Hollywood Casino Lawrenceburg, the Company recorded a pre-tax impairment charge for the replaced Lawrenceburg vessel of $11.7 million ($6.8 million, net of taxes) during the second quarter of 2009. In addition, as a result of the anticipated impact of gaming expansion in Ohio, the Company recorded a pre-tax impairment charge of $520.5 million ($368.8 million, net of taxes) during the fourth quarter of 2009, as the Company determined that a portion of the value of the goodwill and indefinite-life intangible assets associated with the original purchase of Hollywood Casino Lawrenceburg was impaired.

## 20. Related Party Transactions

The Company currently leases 45,917 square feet of executive office and warehouse space for buildings in Wyomissing, Pennsylvania from affiliates of its Chairman and Chief Executive Officer. Rent expense for the years ended December 31, 2010, 2009 and 2008 amounted to $0.9 million, $0.9 million and $0.8 million, respectively. The leases for the office space expire in March 2012, May 2012 and May 2013, and the lease for the warehouse space expires in July 2013. The future minimum lease commitments relating to these leases at December 31, 2010 equaled $1.5 million. The Company also paid $0.7 million in construction costs to these same affiliates for the year ended December 31, 2008.

## 21. Subsidiary Guarantors

Under the terms of the senior secured credit facility, many of Penn's subsidiaries are guarantors under the agreement. Each of the subsidiary guarantors is directly or indirectly 100% owned by Penn. In addition, the guarantees provided by such subsidiaries under the terms of the senior secured credit facility are full and unconditional, joint and several. There are no significant restrictions within the senior secured credit facility on the Company's ability to obtain funds from its subsidiaries by dividend or loan. However, in certain jurisdictions, the gaming authorities may impose restrictions pursuant to the authority granted to them with regard to Penn's ability to obtain funds from its subsidiaries.

Summarized financial information for the years ended December 31, 2010, 2009 and 2008 for Penn, the subsidiary guarantors of the senior secured credit facility and the subsidiary non-guarantors is presented below.

The Company's $250 million $6^3/_4$% senior subordinated notes and $325 million $8^3/_4$% senior subordinated notes are not guaranteed by the Company's subsidiaries.

| | Penn | Subsidiary Guarantors | Subsidiary Non-Guarantors | Eliminations | Consolidated |
|---|---|---|---|---|---|
| | | | (in thousands) | | |
| **Senior Secured Credit Facility** | | | | | |
| **At December 31, 2010** | | | | | |
| **Condensed Consolidating Balance Sheet** | | | | | |
| Total current assets | $31,422 | $261,768 | $131,204 | $41,559 | $465,953 |
| Property and equipment, net | 15,328 | 1,775,913 | 174,533 | — | 1,965,774 |
| Total other assets | 3,848,412 | 5,042,516 | 167,466 | (7,027,242) | 2,031,152 |
| Total assets | $3,895,162 | $7,080,197 | $473,203 | $(6,985,683) | $4,462,879 |
| Total current liabilities | $355,018 | $293,588 | $1,370 | $41,553 | $691,529 |
| Total long-term liabilities | 1,762,379 | 3,159,736 | 45,024 | (2,973,555) | 1,993,584 |
| Total shareholders' equity | 1,777,765 | 3,626,873 | 426,809 | (4,053,681) | 1,777,766 |
| Total liabilities and shareholders' equity | $3,895,162 | $7,080,197 | $473,203 | $(6,985,683) | $4,462,879 |
| **Year Ended December 31, 2010** | | | | | |
| **Condensed Consolidating Statement of Operations** | | | | | |
| Net revenues | $— | $2,397,828 | $61,283 | $— | $2,459,111 |
| Total operating expenses | 90,883 | 2,116,370 | 98,632 | — | 2,305,885 |
| (Loss) income from operations | (90,883) | 281,458 | (37,349) | — | 153,226 |
| Other income (expenses) | 76,484 | (198,888) | (26,304) | — | (148,708) |
| (Loss) income from operations before income taxes | (14,399) | 82,570 | (63,653) | — | 4,518 |
| Taxes on income | (37,012) | 128,665 | (25,475) | — | 66,178 |
| Net income (loss) including noncontrolling interests | 22,613 | (46,095) | (38,178) | — | (61,660) |
| Less: Net loss attributable to noncontrolling interests | — | — | (2,193) | — | (2,193) |
| Net income (loss) attributable to the shareholders of Penn National Gaming, Inc. and subsidiaries | $22,613 | $(46,095) | $(35,985) | $— | $(59,467) |
| **Year Ended December 31, 2010** | | | | | |
| **Condensed Consolidating Statement of Cash Flows** | | | | | |
| Net cash provided by (used in) operating activities | $197,525 | $510,889 | $(215,236) | $— | $493,178 |
| Net cash used in investing activities | (3,574) | (494,367) | (238,817) | — | (736,758) |
| Net cash used in financing activities | (194,060) | (4,049) | (25,044) | — | (223,153) |
| Net (decrease) increase in cash and cash equivalents | (109) | 12,473 | (479,097) | — | (466,733) |
| Cash and cash equivalents at beginning of year | 6,385 | 145,519 | 561,214 | — | 713,118 |
| Cash and cash equivalents at end of year | $6,276 | $157,992 | $82,117 | $— | $246,385 |
| **Senior Secured Credit Facility** | | | | | |
| **At December 31, 2009** | | | | | |
| **Condensed Consolidating Balance Sheet** | | | | | |
| Total current assets | $69,290 | $243,073 | $576,563 | $39,945 | $928,871 |
| Property and equipment, net | 23,273 | 1,774,157 | 40,074 | — | 1,837,504 |
| Total other assets | 4,037,883 | 5,109,436 | 257,635 | (7,458,713) | 1,946,241 |
| Total assets | $4,130,446 | $7,126,666 | $874,272 | $(7,418,768) | $4,712,616 |
| Total current liabilities | $83,294 | $285,926 | $21,106 | $39,930 | $430,256 |
| Total long-term liabilities | 2,194,508 | 3,221,642 | 61,739 | (3,047,605) | 2,430,284 |
| Total shareholders' equity | 1,852,644 | 3,619,098 | 791,427 | (4,411,093) | 1,852,076 |
| Total liabilities and shareholders' equity | $4,130,446 | $7,126,666 | $874,272 | $(7,418,768) | $4,712,616 |
| **Year Ended December 31, 2009** | | | | | |
| **Condensed Consolidating Statement of Operations** | | | | | |
| Net revenues | $— | $2,339,014 | $30,261 | $— | $2,369,275 |
| Total operating expenses | 83,823 | 2,424,420 | 55,630 | — | 2,563,873 |
| Loss from operations | (83,823) | (85,406) | (25,369) | — | (194,598) |
| Other income (expenses) | 66,227 | (211,391) | 11,881 | — | (133,283) |

| | Penn | Subsidiary Guarantors | Subsidiary Non-Guarantors | Eliminations | Consolidated |
|---|---|---|---|---|---|
| | | | (in thousands) | | |
| Loss from operations before income taxes | (17,596) | (296,797) | (13,488) | — | (327,881) |
| Taxes on income | (40,838) | (24,896) | 5,266 | — | (60,468) |
| Net income (loss) including noncontrolling interests | 23,242 | (271,901) | (18,754) | — | (267,413) |
| Less: Net loss attributable to noncontrolling interests | — | — | (2,465) | — | (2,465) |
| Net income (loss) attributable to the shareholders of Penn National Gaming, Inc. and subsidiaries | $23,242 | $(271,901) | $(16,289) | $— | $(264,948) |
| **Year Ended December 31, 2009** | | | | | |
| **Condensed Consolidating Statement of Cash Flows** | | | | | |
| Net cash provided by (used in) operating activities | $101,367 | $241,677 | $(4,798) | $— | $338,246 |
| Net cash used in investing activities | (1,877) | (236,242) | (24,540) | — | (262,659) |
| Net cash used in financing activities | (95,565) | (2,020) | (11,162) | — | (108,747) |
| Net increase (decrease) in cash and cash equivalents | 3,925 | 3,415 | (40,500) | — | (33,160) |
| Cash and cash equivalents at beginning of year | 2,460 | 142,104 | 601,714 | — | 746,278 |
| Cash and cash equivalents at end of year | $6,385 | $145,519 | $561,214 | $— | $713,118 |
| **Senior Secured Credit Facility** | | | | | |
| **At December 31, 2008** | | | | | |
| **Condensed Consolidating Balance Sheet** | | | | | |
| Total current assets | $40,598 | $235,862 | $614,787 | $15,056 | $906,303 |
| Property and equipment, net | 17,707 | 1,781,982 | 12,442 | — | 1,812,131 |
| Total other assets | 4,351,845 | 2,351,302 | 262,923 | (4,494,828) | 2,471,242 |
| Total assets | $4,410,150 | $4,369,146 | $890,152 | $(4,479,772) | $5,189,676 |
| Total current liabilities | $105,147 | $332,812 | $17,468 | $15,059 | $470,486 |
| Total long-term liabilities | 2,247,736 | 3,667,014 | 97,151 | (3,349,984) | 2,661,917 |
| Total shareholders' equity | 2,057,267 | 369,320 | 775,533 | (1,144,847) | 2,057,273 |
| Total liabilities and shareholders' equity | $4,410,150 | $4,369,146 | $890,152 | $(4,479,772) | $5,189,676 |
| **Year Ended December 31, 2008** | | | | | |
| **Condensed Consolidating Statement of Operations** | | | | | |
| Net revenues | $— | $2,387,358 | $35,695 | $— | $2,423,053 |
| Total operating expenses | 94,925 | 2,352,864 | 61,705 | — | 2,509,494 |
| (Loss) income from operations | (94,925) | 34,494 | (26,010) | — | (86,441) |
| Other income (expenses) | 239,920 | (198,845) | (2,219) | — | 38,856 |
| Income (loss) from operations before income taxes | 144,995 | (164,351) | (28,229) | — | (47,585) |
| Taxes on income | 38,851 | 66,563 | 324 | — | 105,738 |
| Net income (loss) | $106,144 | $(230,914) | $(28,553) | $— | $(153,323) |
| **Year Ended December 31, 2008** | | | | | |
| **Condensed Consolidating Statement of Cash Flows** | | | | | |
| Net cash (used in) provided by operating activities | $(544,759) | $360,012 | $605,210 | $— | $420,463 |
| Net cash used in investing activities | (2,085) | (388,361) | (1,052) | — | (391,498) |
| Net cash provided by (used in) financing activities | 552,233 | (2,292) | (7,000) | — | 542,941 |
| Net increase (decrease) in cash and cash equivalents | 5,389 | (30,641) | 597,158 | — | 571,906 |
| Cash and cash equivalents at beginning of year | (2,929) | 172,745 | 4,556 | — | 174,372 |
| Cash and cash equivalents at end of year | $2,460 | $142,104 | $601,714 | $— | $746,278 |

## 22. Fair Value Measurements

ASC 820, "Fair Value Measurements and Disclosures," establishes a hierarchy that prioritizes fair value measurements based on the types of inputs used for the various valuation techniques (market approach, income approach, and cost approach). The levels of the hierarchy are described below:

- Level 1: Observable inputs such as quoted prices in active markets for identical assets or liabilities.
- Level 2: Inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly; these include quoted prices for similar assets or liabilities in active markets, such as interest rates and yield curves that are observable at commonly quoted intervals.
- Level 3: Unobservable inputs that reflect the reporting entity's own assumptions, as there is little, if any, related market activity.

The Company's assessment of the significance of a particular input to the fair value measurement requires judgment, and may affect the valuation of assets and liabilities and their placement within the fair value hierarchy.

The following tables set forth the assets and liabilities measured at fair value on a recurring basis, by input level, in the consolidated balance sheets at December 31, 2010 and 2009 (in thousands):

| | Balance Sheet Location | Quoted Prices in Active Markets for Identical Assets or Liabilities (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | December 31, 2010 Total |
|---|---|---|---|---|---|
| Assets: | | | | | |
| Investment in corporate debt securities | Other assets | $5,828 | $— | $— | $5,828 |
| Liabilities: | | | | | |
| Interest rate swap contracts | Accrued interest | — | 16,746 | — | 16,746 |

| | Balance Sheet Location | Quoted Prices in Active Markets for Identical Assets or Liabilities (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | December 31, 2009 Total |
|---|---|---|---|---|---|
| Assets: | | | | | |
| Investment in corporate debt securities | Other assets | $4,550 | $— | $— | $4,550 |
| Liabilities: | | | | | |
| Interest rate swap contracts | Accrued interest | — | 43,925 | — | 43,925 |

During the fourth quarter of 2010, the issuer of the corporate debt security went into default on its obligations as it ceased making interest payments and the security was downgraded by certain rating agencies. As a result, during the year ended December 31, 2010, the Company recorded a pre-tax charge of $0.3 million, which is included in other income (expenses) within the consolidated statements of operations, to write down the investment to its fair value, which was based on the transaction prices of the security subsequent to when the issuer defaulted on its obligations. The Company will continue to account for this security as an available for sale investment and will monitor its realizability in future periods.

The valuation technique used to measure the fair value of the investment in corporate debt securities and interest rate swap contracts was the market approach. See Note 4 for a description of the inputs used in calculating the fair value measurements of investment in corporate debt securities and interest rate swap contracts. Although the Company has determined that the majority of the inputs used to value its interest rate swap contracts fall within Level 2 of the fair value hierarchy, the credit valuation adjustments associated with it utilize Level 3 inputs, such as estimates of current credit spreads to evaluate the likelihood of default by itself and its counterparties. However, as of December 31, 2010 and 2009, the Company has assessed the significance of the impact of the credit valuation adjustments on the overall valuation of its interest rate swap contracts and has determined that the credit valuation adjustments are not significant to the overall valuation. As a result, the Company has determined that its interest rate swap contracts are classified in Level 2 of the fair value hierarchy.

Certain long-lived assets are measured at fair value on a non-recurring basis and are not included in the previous tables. The amounts below represent the assets and liabilities measured at fair value on a nonrecurring basis during the year ended December 31, 2010 and 2009 (in thousands):

| | Balance Sheet Location | Quoted Prices in Active Markets for Identical Assets or Liabilities (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Balance at December 31, 2010 Total | Total Reduction in Fair Value Recorded at December 31, 2010 |
|---|---|---|---|---|---|---|
| Assets: | | | | | | |
| Goodwill | Goodwill | $— | $— | $235,924 | $235,924 | $(188,855) |
| Indefinite-life intangible assets | Other intangible assets | — | — | — | — | (4,351) |
| Long-lived assets | Other assets | — | 17,310 | — | 17,310 | (31,503) |
| | | | | | | $(224,709) |

| | Balance Sheet Location | Quoted Prices in Active Markets for Identical Assets or Liabilities (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Balance at December 31, 2009 Total | Total Reduction in Fair Value Recorded at December 31, 2009 |
|---|---|---|---|---|---|---|
| Assets: | | | | | | |
| Goodwill | Goodwill | $— | $— | $312,491 | $312,491 | $(213,260) |
| Indefinite-life intangible assets | Other intangible assets | — | — | 51,583 | 51,583 | (307,228) |
| Long-lived assets | Other assets | — | 6,750 | — | 6,750 | (11,889) |
| | | | | | | $(532,377) |

For the year ended December 31, 2010, as a result of decreased earning projections resulting from an anticipated increase in competition from the scheduled opening of a casino in the second half of 2011 in Des Plaines, Illinois, as well as continued challenging market conditions in the Chicagoland regional market, the Company recorded a pre-tax goodwill impairment charge of $144.6 million at Hollywood Casino Aurora and $44.2 million at Hollywood Casino Joliet.

Additionally, during the year ended December 31, 2010, the Company wrote-off the trademark intangible asset associated with the Argosy acquisition for $4.4 million due to management's strategy to transition Argosy properties to the Hollywood Casino brand.

In addition, in conjunction with the voters determining that the Company's casino in Columbus, Ohio will be located at the site of the former Delphi Automotive plant along Columbus's West Side, the Company recorded a pre-tax impairment charge of $31.3 million for the year ended December 31, 2010 for the parcel of land that the Company purchased in Columbus's Arena District, as the asset was reclassified as held for sale in 2010.

For the year ended December 31, 2009, as a result of the anticipated impact of gaming expansion in Ohio, the Company recorded a pre-tax goodwill and indefinite-life intangible asset impairment charge of $520.5 million. In addition, in conjunction with the opening of the new casino riverboat at Hollywood Casino Lawrenceburg, the Company recorded a pre-tax impairment charge of $11.9 million on its replaced vessel for the year ended December 31, 2009. For the year ended December 31, 2010, the Company recorded a charge of $0.2 million on this replaced vessel.

The valuation technique used to measure the fair value of goodwill, indefinite-life intangible assets and long-lived assets was the market approach. For the land held for sale in Columbus, Ohio, the Company engaged a qualified external real estate appraiser to assist in the valuation, which was based on the sales prices of properties with similar characteristics to the Company's property in the Columbus Arena District. For the replaced vessel at Hollywood Casino Lawrenceburg, the Company determined the fair value with the assistance of a third party valuation which utilized available market information (sales and asking prices) for comparable gaming vessels. See Note 4 for a description of the inputs and the information used to develop the inputs in calculating the fair value measurements of goodwill, indefinite-life intangible assets and long-lived assets.

**23. Hollywood Casino Joliet Fire**

On March 20, 2009, the Company's Hollywood Casino Joliet, which was undergoing a $55 million renovation, was closed following a fire that started in the land-based pavilion at the facility. All customers and employees were successfully evacuated, and the fire was contained on the land-side of the property before it could spread to the adjacent casino barge. On June 25, 2009, the casino barge was reopened with temporary land-based facilities, and the Company began construction of a new land-based pavilion. On December 22, 2010, the first phase of the new permanent land-based pavilion was opened to the public.

At the time of the fire, the Company carried a builders' risk insurance policy for the on-going renovations with a policy limit of $57 million, inclusive of $14 million for delay in completion and $43 million for property damage. The builders' risk insurance policy included a $50,000 property damage deductible and a 30-day delay in completion deductible for the peril of fire. In addition, the Company carried comprehensive business interruption and property damage insurance for the operational components of Hollywood Casino Joliet with an overall limit of $228 million. The operational insurance policy included a $2.5 million property damage deductible and a 48-hour business interruption deductible for the peril of fire.

During the years ended December 31, 2010 and 2009, the Company received $42.0 million and $20.6 million, respectively, in insurance proceeds related to the fire at Hollywood Casino Joliet. In 2010, the insurance recovery amount exceeded the net book value of assets believed to be damaged, destroyed or abandoned and other costs incurred as a result of the fire at Hollywood Casino Joliet, and as such, the Company recorded a pre-tax gain of $7.5 million during the year ended December 31, 2010.

During the year ended December 31, 2009, the Company recorded a $6.1 million pre-tax loss for the insurance deductibles for property damage, business interruption and employee lost wages, as well as a write-off of construction fees related to the renovation that are not recoverable under the Company's insurance policies and certain consulting fees.

## ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None

## ITEM 9A. CONTROLS AND PROCEDURES

### Disclosure Controls and Procedures

The Company's management, under the supervision and with the participation of our principal executive officer and principal financial officer, has evaluated the effectiveness of the Company's disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), as of December 31, 2010, which is the end of the period covered by this Annual Report on Form 10-K. 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 was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on this evaluation, our principal executive officer and principal financial officer concluded that the Company's disclosure controls and procedures were effective as of December 31, 2010 to ensure that information required to be disclosed by the Company in reports we file or submit under the Exchange Act is (i) recorded, processed, summarized, evaluated and reported, as applicable, within the time periods specified in the United States Securities and Exchange Commission's rules and forms and (ii) accumulated and communicated to the Company's management, including the Company's principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosures.

### Changes in Internal Control Over Financial Reporting

There have been no changes in our internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) that occurred during the fiscal quarter ended December 31, 2010, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

### Management's Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)). Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. In addition, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Our management assessed the effectiveness of our internal control over financial reporting, and concluded that it was effective as of December 31, 2010. In making this assessment, we used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in *Internal Control—Integrated Framework.*

The effectiveness of the Company's internal control over financial reporting as of December 31, 2010 has been audited by Ernst & Young LLP, an independent registered public accounting firm, as stated in their report below.

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors
Penn National Gaming, Inc. and subsidiaries

We have audited Penn National Gaming, Inc. and subsidiaries' internal control over financial reporting as of December 31, 2010, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Penn National Gaming, Inc. and subsidiaries' management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Annual Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Penn National Gaming, Inc. and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2010, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Penn National Gaming, Inc. and subsidiaries as of December 31, 2010 and 2009, and the related consolidated statements of operations, changes in shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2010 and our report dated February 25, 2011 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Philadelphia, Pennsylvania
February 25, 2011

## ITEM 9B. OTHER INFORMATION

None

## PART III

## ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by this item concerning directors is hereby incorporated by reference to the Company's definitive proxy statement for its 2011 Annual Meeting of Shareholders (the "2011 Proxy Statement"), to be filed with the U.S. Securities and Exchange Commission within 120 days after December 31, 2010, pursuant to Regulation 14A under the Securities Act. Information required by this item concerning executive officers is included in Part I of this Annual Report on Form 10-K.

## ITEM 11. EXECUTIVE COMPENSATION

The information called for in this item is hereby incorporated by reference to the 2011 Proxy Statement.

## ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDERS MATTERS

The information called for in this item is hereby incorporated by reference to the 2011 Proxy Statement.

## ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE

The information called for in this item is hereby incorporated by reference to the 2011 Proxy Statement.

## ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information called for in this item is hereby incorporated by reference to the 2011 Proxy Statement.

## PART IV

## ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a) 1 and 2. Financial Statements and Financial Statement Schedules. The following is a list of the Consolidated Financial Statements of the Company and its subsidiaries and supplementary data filed as part of Item 8 hereof:

Report of Independent Registered Public Accounting Firm
Consolidated Balance Sheets as of December 31, 2010 and 2009
Consolidated Statements of Operations for the years ended December 31, 2010, 2009 and 2008
Consolidated Statements of Changes in Shareholders' Equity for the years ended December 31, 2010, 2009 and 2008
Consolidated Statements of Cash Flows for the years ended December 31, 2010, 2009 and 2008
All other schedules are omitted because they are not applicable, or not required, or because the required information is included in the Consolidated Financial Statements or notes thereto.

3. Exhibits, Including Those Incorporated by Reference.

The exhibits to this Report are listed on the accompanying index to exhibits and are incorporated herein by reference or are filed as part of this annual report on Form 10-K.

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

PENN NATIONAL GAMING, INC.

By: /s/ PETER M. CARLINO
Peter M. Carlino
*Chairman of the Board and*
*Chief Executive Officer*

Dated: February 25, 2011

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

| Signature | Title | Date |
|---|---|---|
| /s/ PETER M. CARLINO<br>Peter M. Carlino | Chairman of the Board, Chief Executive Officer and Director (Principal Executive Officer) | February 25, 2011 |
| /s/ WILLIAM J. CLIFFORD<br>William J. Clifford | Senior Vice President Finance and Chief Financial Officer (Principal Financial Officer) | February 25, 2011 |
| /s/ DESIREE A. BURKE<br>Desiree A. Burke | Vice President and Chief Accounting Officer (Principal Accounting Officer) | February 25, 2011 |
| /s/ HAROLD CRAMER<br>Harold Cramer | Director | February 25, 2011 |
| /s/ WESLEY R. EDENS<br>Wesley R. Edens | Director | February 25, 2011 |
| /s/ DAVID A. HANDLER<br>David A. Handler | Director | February 25, 2011 |
| /s/ JOHN M. JACQUEMIN<br>John M. Jacquemin | Director | February 25, 2011 |
| /s/ ROBERT P. LEVY<br>Robert P. Levy | Director | February 25, 2011 |
| /s/ BARBARA Z. SHATTUCK<br>Barbara Z. Shattuck | Director | February 25, 2011 |

## EXHIBIT INDEX

| Exhibit | Description of Exhibit |
|---|---|
| 3.1(a) | Amended and Restated Articles of Incorporation of Penn National Gaming, Inc., filed with the Pennsylvania Department of State on October 15, 1996. (Incorporated by reference to Exhibit 3.1 to the Company's registration statement on Form S-3, File #333-63780, dated June 25, 2001). |
| 3.1(b) | Articles of Amendment to the Amended and Restated Articles of Incorporation of Penn National Gaming, Inc., filed with the Pennsylvania Department of State on November 13, 1996. (Incorporated by reference to Exhibit 3.2 to the Company's registration statement on Form S-3, File #333-63780, dated June 25, 2001). |
| 3.1(c) | Articles of Amendment to the Amended and Restated Articles of Incorporation of Penn National Gaming, Inc., filed with the Pennsylvania Department of State on July 23, 2001. (Incorporated by reference to Exhibit 3.4 to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2001). |
| 3.1(d) | Articles of Amendment to the Amended and Restated Articles of Incorporation of Penn National Gaming, Inc., filed with the Pennsylvania Department of State on December 28, 2007. (Incorporated by reference to Exhibit 3.1 to the Company's current report on Form 8-K, filed on January 2, 2008). |
| 3.1(e) | Statement with Respect to Shares of Series B Redeemable Preferred Stock of Penn National Gaming, Inc., filed with the Pennsylvania Department of State on July 9, 2008. (Incorporated by reference to Exhibit 4.1 to the Company's current report on Form 8-K filed on July 9, 2008). |
| 3.2 | Second Amended and Restated Bylaws of Penn National Gaming, Inc. (Incorporated by reference to Exhibit 3.1 to the Company's current report on Form 8-K filed on November 18, 2008). |
| 4.1 | Specimen copy of Common Stock Certificate (Incorporated by reference to Exhibit 3.6 to the Company's quarterly report on Form 10-Q for the quarter ended June 30, 2003). |
| 4.2 | Indenture dated as of December 4, 2003 by and among Penn National Gaming, Inc., certain guarantors and U.S. Bank National Association relating to the $6^{7}/_{8}$% Senior Subordinated Notes due 2011 (Incorporated by reference to Exhibit 4.12 to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2003). |
| 4.3 | Form of Penn National Gaming, Inc. $6^{7}/_{8}$% Senior Subordinated Note due 2011. (Included as Exhibit A to Exhibit 4.12 to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2003). |
| 4.4 | Form of Supplemental Indenture to be Delivered by Subsequent Guarantors by and among Penn National Gaming, Inc., certain guarantors and U.S. Bank National Association relating to the $6^{7}/_{8}$% Senior Subordinated Notes due 2011. (Included as Exhibit F to Exhibit 4.12 to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2003). |
| 4.5 | Indenture dated as of March 9, 2005 by and among Penn National Gaming, Inc. and Wells Fargo Bank, National Association relating to the $6^{3}/_{4}$% Senior Subordinated Notes due 2015. (Incorporated by reference to Exhibit 10.1 to the Company's current report on Form 8-K, filed March 15, 2005). |
| 4.5(a) | First Supplemental Indenture dated as of July 5, 2005 between Penn National Gaming, Inc. and Wells Fargo Bank, National Association relating to the $6^{3}/_{4}$% Senior Subordinated Notes due 2015. (Incorporated by reference to Exhibit 10.37 to the Company's registration statement on Form S-4, filed July 7, 2005 (File #333-125274)). |
| 4.6 | Form of Penn National Gaming, Inc. $6^{3}/_{4}$% Senior Subordinated Note due 2015. (Included as Exhibit A to Exhibit 4.5). |
| 4.7 | Specimen copy of Series B Redeemable Preferred Stock Certificate. (Incorporated by reference to Exhibit 4.8 to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2008). |
| 4.8 | Investor Rights Agreement, dated as of July 3, 2008, by and among Penn National Gaming, Inc., FIF V PFD LLC, Centerbridge Capital Partners, L.P., DB Investment Partners, Inc. and Wachovia Investment Holdings, LLC. (Incorporated by reference to Exhibit 4.2 to the Company's current report on Form 8-K filed on July 9, 2008). |
| 4.9 | Indenture, dated as of August 14, 2009, between Penn National Gaming, Inc. and Wells Fargo Bank, National Association, as trustee, relating to the $8^{3}/_{4}$% Senior Subordinated Notes due 2019 (Incorporated by reference to Exhibit 4.1 to the Company's current report on Form 8-K, filed on August 14, 2009). |
| 4.10 | Form of Penn National Gaming, Inc. $8^{3}/_{4}$% Senior Subordinated Notes due 2019 (Included as Exhibit A to Exhibit 4.9) |

| Exhibit | Description of Exhibit |
|---|---|
| 9.1 | Form of Trust Agreement of Peter D. Carlino, Peter M. Carlino, Richard J. Carlino, David E. Carlino, Susan F. Harrington, Anne de Lourdes Irwin, Robert M. Carlino, Stephen P. Carlino and Rosina E. Carlino Gilbert. (Incorporated by reference to the Company's registration statement on Form S-1, File #33-77758, dated May 26, 1994). |
| 10.1# | Penn National Gaming, Inc. 1994 Stock Option Plan. (Incorporated by reference to the Company's registration statement on Form S-1, File #33-77758, dated May 26, 1994). |
| 10.2# | Penn National Gaming, Inc. 2003 Long Term Incentive Compensation Plan. (Incorporated by reference to Appendix A of the Company's Proxy Statement dated April 22, 2003 filed pursuant to Section 14(a) of the Securities Exchange Act of 1934, as amended). |
| 10.3# | Employment Agreement dated April 28, 2010 between Penn National Gaming, Inc. and Peter M. Carlino. (Incorporated by reference to Exhibit 10.1 to the Company's current report on Form 8-K filed on May 4, 2010). |
| 10.4# | Employment Agreement dated December 31, 2008 between Penn National Gaming, Inc. and William Clifford. (Incorporated by reference to Exhibit 10.4 to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2008). |
| 10.5# | Employment Agreement dated December 31, 2008 between Penn National Gaming, Inc. and Jordan B. Savitch. (Incorporated by reference to Exhibit 10.5 to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2008). |
| 10.6 | Form of Change in Control Payment Acknowledgement and Agreement between Penn National Gaming, Inc. and Certain Executive Officers of Penn National Gaming, Inc. (Incorporated by reference to Exhibit 10.1 the Company's current report on Form 8-K, filed on January 2, 2008). |
| 10.6(a) | Schedule of executive officers entering into Change in Control Payment Acknowledgement and Agreement. (Incorporated by reference to Exhibit 10.8(a) to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2007). |
| 10.7 | Consulting Agreement dated August 29, 1994, between Penn National Gaming, Inc. and Peter D. Carlino. (Incorporated by reference to the Company's annual report on Form 10-K for the fiscal year ended December 31, 1994). |
| 10.8 | Amended and Restated Lease dated April 5, 2005 between Wyomissing Professional Center III, LP and Penn National Gaming, Inc. for portion of the Wyomissing Corporate Office. (Incorporated by reference to Exhibit 10.1 to the Company's current report on Form 8-K, filed on April 8, 2005). |
| 10.9 | Lease dated January 25, 2002 between Wyomissing Professional Center II, LP and Penn National Gaming, Inc. for portion of the Wyomissing Corporate Office. (Incorporated by reference to Exhibit 10.12 to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2004). |
| 10.9(a) | Commencement Agreement, dated May 21, 2002, in connection with Lease dated January 25, 2002 Wyomissing Professional Center II, LP and Penn National Gaming, Inc. for portion of the Wyomissing Corporate Office. (Incorporated by reference to Exhibit 10.12(a) to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2004). |
| 10.9(b) | First Lease Amendment, dated December 4, 2002, to Lease dated January 25, 2002 Wyomissing Professional Center II, LP and Penn National Gaming, Inc. for portion of the Wyomissing Corporate Office. (Incorporated by reference to Exhibit 10.12(b) to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2004). |
| 10.10 | Lease dated April 5, 2005 between Wyomissing Professional Center, Inc. and Penn National Gaming, Inc. for portion of the Wyomissing Corporate Office. (Incorporated by reference to Exhibit 10.2 to the Company's current report on Form 8-K filed on April 8, 2005). |
| 10.11 | Lease dated August 22, 2003 between The Corporate Campus at Spring Ridge 1250, L.P. and Penn National Gaming, Inc. for portion of the Wyomissing Corporate Office. (Incorporated by reference to Exhibit 10.13 to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2004). |
| 10.12 | Agreement dated April 7, 2006 by and between PNGI Charles Town Gaming Limited Liability Company and the West Virginia Union of Mutuel Clerks, Local 553, Service Employees International Union, AFL—CIO. (Incorporated by reference to exhibit 10.1 to the Company's current report on Form 8-K, filed on April 24, 2006). |

| Exhibit | Description of Exhibit |
|---|---|
| 10.13 | Agreement dated February 20, 2009 between PNGI Charles Town Gaming Limited Liability Company and Charles Town HBPA, Inc. (Incorporated by reference to Exhibit 10.16 to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2008). |
| 10.14 | Credit Agreement, dated October 3, 2005 by and among Penn National Gaming, Inc., the subsidiary guarantors party thereto, Deutsche Bank Securities Inc., Goldman Sachs Credit Partners L.P. and Lehman Brothers Inc., as Joint Lead Arrangers and Joint Bookrunners, Goldman Sachs Credit Partners L.P. and Lehman Commercial Paper Inc., as Co-Syndication Agents, Deutsche Bank Trust Company Americas, as Swingline Lender, Administrative Agent and as Collateral Agent, and Calyon New York Branch, Wells Fargo Bank, National Association and Bank of Scotland, as Co-Documentation Agents, and the lenders party thereto. (Incorporated by reference to Exhibit 10.1 to the Company's current report on Form 8-K, filed October 4, 2005). |
| 10.14(a) | Amendment, dated September 18, 2006, to the Credit Agreement by and among Penn National Gaming, Inc., the subsidiary guarantors party thereto, Deutsche Bank Securities Inc., Goldman Sachs Credit Partners L.P. and Lehman Brothers Inc., as Joint Lead Arrangers and Joint Bookrunners, Goldman Sachs Credit Partners L.P. and Lehman Commercial Paper Inc., as Co-Syndication Agents, Deutsche Bank Trust Company Americas, as Swingline Lender, Administrative Agent and as Collateral Agent, and Calyon New York Branch, Wells Fargo Bank, National Association and Bank of Scotland, as Co-Documentation Agents, and the lenders party thereto. (Incorporated by reference to Exhibit 10.1 to the Company's current report on Form 8-K, filed on September 21, 2006). |
| 10.14(b) | Second Amendment to Credit Agreement, dated as of September 23, 2009, among Penn National Gaming, Inc., certain of its subsidiaries, Deutsche Bank Securities Inc., Wells Fargo Securities, LLC, Banc of America Securities LLC and RBS Securities Inc., as co-lead arrangers and co-book running managers, Wells Fargo Bank, National Association and Bank of America, N.A., as syndication agents, the lenders party thereto, Deutsche Bank Trust Company Americas, as Swingline Lender, Administrative Agent and Collateral Agent under the Credit Agreement (as defined therein), and Wachovia Bank National Association, as L/C Lender under the Credit Agreement. (Incorporated by reference to Exhibit 10.1 to the Company's current report on Form 8-K, filed on September 25, 2009). |
| 10.15 | Ground Lease dated as of October 11, 1993 between R.M. Leatherman and Hugh M. Mageveney, III, as Landlord, and SRCT, as Tenant. (Incorporated by reference to Exhibit 10.4 of HWCC-Tunica, Inc.'s registration statement on Form S-1, File #33-82182, dated August 1, 1994). |
| 10.16 | Letter Agreement dated as of October 11, 1993 between R.M. Leatherman and Hugh M. Mageveney, III, as Landlord, and SRCT, as Tenant (relating to Ground Lease). (Incorporated by reference to Exhibit 10.5 of HWCC-Tunica, Inc.'s registration statement on Form S-1, File #33-82182, dated August 1, 1994). |
| 10.17 | Assignment of Lease and Assumption Agreement dated as of May 31, 1994 between SRCT and STP (relating to Ground Lease). (Incorporated by reference to Exhibit 10.7 of HWCC-Tunica, Inc.'s registration statement on Form S-1, File #33-82182, dated August 1, 1994). |
| 10.18# | Penn National Gaming, Inc. Nonqualified Stock Option granted to Peter M. Carlino, dated February 6, 2003. (Incorporated by reference to Exhibit 10.26 to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2003). |
| 10.19 | Ground Lease, dated March 23, 2007, between Skrmetta MS, LLC as Landlord and BTN, Inc., a wholly-owned subsidiary of Penn National Gaming, Inc., as Tenant. (Incorporated by reference to Exhibit 10.2 to the Company's quarterly report on Form 10-Q for the quarter ended March 31, 2007). |
| 10.20 | Riverboat Gaming Development Agreement between the City of Lawrenceburg, Indiana and Indiana Gaming Company, L.P. dated as of April 13, 1994, as amended by Amendment Number One to Riverboat Development Agreement between the City of Lawrenceburg, Indiana and Indiana Gaming Company L.P., dated as of December 28, 1995 (Incorporated by reference to Argosy Gaming Company's annual report on Form 10-K for the fiscal year ended December 31, 1995). |
| 10.20(a) | Second Amendment to Riverboat Gaming Development Agreement Between City of Lawrenceburg, Indiana, and the Indiana Gaming Company, L.P. dated August 20, 1996. (Incorporated by reference to Exhibit 10.23(a) to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2005). |
| 10.20(b) | Third Amendment to Riverboat Gaming Development Agreement Between City of Lawrenceburg, Indiana, and the Indiana Gaming Company, L.P. dated June 24, 2004. (Incorporated by reference to Exhibit 10.2 of Argosy Gaming Company's quarterly report on Form 10-Q for the quarter ended September 30, 2004). |

| Exhibit | Description of Exhibit |
|---|---|
| 10.21# | Penn National Gaming, Inc. Deferred Compensation Plan, as amended. (Incorporated by reference to Exhibit 10.27 to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2006). |
| 10.22# | Employment Agreement by and between Penn National Gaming, Inc. and Tim Wilmott dated December 31, 2008. (Incorporated by reference to Exhibit 10.1 to the Company's current report on Form 8-K, filed on January 7, 2009). |
| 10.23 | Stock Purchase Agreement, dated as of July 3, 2008, by and among Penn National Gaming, Inc., FIF V PFD LLC, Centerbridge Capital Partners, L.P., DB Investment Partners, Inc. and Wachovia Investment Holdings, LLC. (Incorporated by reference to Exhibit 10.1 to the Company's current report on Form 8-K filed on July 9, 2008). |
| 10.24 | Termination and Settlement Agreement, dated as of July 3, 2008, by and among Penn National Gaming, Inc., PNG Acquisition Company Inc., PNG Merger Sub Inc., PNG Holdings LLC, FIG PNG Holdings LLC, Fortress Investment Fund V (Fund A) L.P., Fortress Investment Fund V (Fund D) L.P., Fortress Investment Fund V (Fund E) L.P., Fortress Investment Fund V (Fund B) L.P., Fortress Investment Fund V (Fund C) L.P., Fortress Investment Fund V (Fund F) L.P., CB PNG Holdings LLC, Centerbridge Capital Partners, L.P., Centerbridge Capital Partners Strategic, L.P., Centerbridge Capital Partners SBS, L.P., DB Investment Partners, Inc., Wachovia Investment Holdings, LLC, Deutsche Bank Securities Inc., Deutsche Bank AG New York Branch, Wachovia Capital Markets, LLC, Wachovia Bank, National Association and Wachovia Investment Holdings, LLC. (Incorporated by reference to Exhibit 10.2 to the Company's current report on Form 8-K filed on July 9, 2008). |
| 10.25# | Penn National Gaming, Inc. 2008 Long Term Incentive Compensation Plan. (Incorporated by reference to Exhibit 10.32 to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2008). |
| 10.26 | Form of Non-Qualified Stock Option Certificate for the Penn National Gaming, Inc. 2008 Long Term Incentive Compensation Plan. (Incorporated by reference to Exhibit 10.33 to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2008). |
| 10.27 | Form of Restricted Stock Award for the Penn National Gaming, Inc. 2008 Long Term Incentive Compensation Plan. (Incorporated by reference to Exhibit 10.32 to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2009). |
| 10.28#* | Employment Agreement by and between Penn National Gaming, Inc. and Steven T. Snyder dated June 10, 2005. |
| 10.29 | Registration Rights Agreement, dated as of August 14, 2009, among Penn National Gaming, Inc. and Deutsche Bank Securities Inc., Wells Fargo Securities, LLC, Banc of America Securities LLC and RBS Securities Inc., each for itself and on behalf of each of the other initial purchasers (Incorporated by reference to Exhibit 10.1 to the Company's current report on Form 8-K, filed on August 14, 2009). |
| 10.30 | Lottery Gaming Facility Management Contract dated August 25, 2009 between the Kansas Lottery and Kansas Entertainment, LLC (Incorporated by reference to Exhibit 99.1 to the Company's current report on Form 8-K filed on February 19, 2010). |
| 10.31 | Development Agreement dated as of September 8, 2009 by and between the Unified Government of Wyandotte County/Kansas City, Kansas and Kansas Entertainment, LLC (Incorporated by reference to Exhibit 99.2 to the Company's current report on Form 8-K filed on February 19, 2010). |
| 10.32* | Form of Phantom Stock Unit Award for Penn National Gaming, Inc. 2008 Long Term Incentive Compensation Plan. |
| 21.1* | Subsidiaries of the Registrant. |
| 23.1* | Consent of Ernst & Young LLP, Independent Registered Public Accounting Firm. |
| 31.1* | CEO Certification pursuant to rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934. |
| 31.2* | CFO Certification pursuant to rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934. |
| 32.1* | CEO Certification pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of The Sarbanes-Oxley Act of 2002. |
| 32.2* | CFO Certification pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of The Sarbanes-Oxley Act of 2002. |
| 99.1* | Description of Governmental Regulation. |

| Exhibit | Description of Exhibit |
|---|---|
| 101 | Interactive data files pursuant to Rule 405 of Regulation S-T: (i) the Consolidated Balance Sheets at December 31, 2010 and 2009, (ii) the Consolidated Statements of Operations for the years ended December 31, 2010, 2009 and 2008, (iii) the Consolidated Statements of Changes in Shareholders' Equity for the years ended December 31, 2010, 2009 and 2008, (iv) the Consolidated Statements of Cash Flows for the years ended December 31, 2010, 2009 and 2008 and (v) the notes to the Consolidated Financial Statements, tagged as blocks of text. |

\# Compensation plans and arrangements for executives and others.

* Filed herewith.

** Pursuant to Rule 406T of Regulation S-T, the Indenture Data Files on Exhibit 101 hereto are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities and Exchange Act of 1934, as amended, and otherwise are not subject to liability under these sections.

**Exhibit 21.1**

## Subsidiaries of Penn National Gaming, Inc. (a Pennsylvania corporation)

| Name of Subsidiary | State or Other Jurisdiction of Incorporation |
|---|---|
| Alton Gaming Company (d/b/a Argosy Casino Alton) | Illinois |
| Argosy Gaming Company | Delaware |
| Bangor Historic Track, Inc. (d/b/a Hollywood Slots Hotel and Raceway) | Maine |
| Belle of Sioux City, L.P. (d/b/a Argosy Casino Sioux City) | Iowa |
| Beulah Park Gaming Ventures, Inc. | Ohio |
| BSL, Inc. (d/b/a Hollywood Casino at Bay St. Louis) | Mississippi |
| BTN, Inc. (d/b/a Boomtown Biloxi) | Mississippi |
| Casino Rama Services, Inc. | Ontario |
| CHC (Ontario) Supplies Limited | Nova Scotia |
| CHC Casinos Canada Limited | Nova Scotia |
| CHC Casinos Corp. | Florida |
| Columbus Gaming Ventures, Inc. | Ohio |
| Concord Gaming Ventures, LLC | Delaware |
| Crazy Horses, Inc. | Ohio |
| CRC Holdings, Inc. | Florida |
| Delvest Corp. | Delaware |
| Delvest Sub. Corp. | Delaware |
| eBetUSA.com, Inc. | Delaware |
| Empress Casino Joliet Corporation (d/b/a Empress Casino Hotel) | Illinois |
| Hollywood Casino Corporation | Delaware |
| Hollywood Casino—Aurora, Inc. (d/b/a Hollywood Casino Aurora) | Illinois |
| Houston Gaming Ventures, Inc. | Texas |
| HWCC—Tunica, Inc. (d/b/a Hollywood Casino Tunica) | Texas |
| Indiana Gaming Company, L.P. (d/b/a Hollywood Casino Lawrenceburg) | Indiana |
| Iowa Gaming Company | Iowa |
| Kansas Entertainment, LLC | Delaware |
| Kansas Penn Gaming LLC | Delaware |
| Louisiana Casino Cruises, Inc. (d/b/a Hollywood Casino Baton Rouge) | Louisiana |
| LV Gaming Ventures, Inc. | Nevada |
| Maryland Gaming Ventures, Inc. | Delaware |
| Maryland Racing Ventures, LLC. | Delaware |
| Mountainview Thoroughbred Racing Association (d/b/a Hollywood Casino at Penn National Race Course) | Pennsylvania |
| Nevada Gaming Ventures, Inc. | Nevada |
| Ohio Racing Company | Ohio |
| Penn Bullpen, Inc. | Colorado |
| Penn Bullwhackers Retail, LLC | Colorado |
| Penn Bullwhackers, Inc. (d/b/a Bullwhackers Casino) | Colorado |
| Penn Cecil Maryland, Inc. | Maryland |
| Penn Hollywood Kansas, Inc. | Delaware |
| Penn National GSFR, LLC | Delaware |
| Penn National Holding Company | Delaware |
| Penn Sanford, LLC (d/b/a Sanford-Orlando Kennel Club) | Delaware |
| Penn Ventures, LLC | Delaware |
| Pennsylvania National Turf Club, Inc. (d/b/a Hollywood Casino at Penn National Race Course) | Pennsylvania |
| Pennwood Racing, Inc. | Delaware |
| PNGI Charles Town Gaming Limited Liability Company (d/b/a Charles Town Races & Slots) | West Virginia |
| Raceway Park, Inc. (d/b/a Raceway Park) | Ohio |
| SOKC, LLC (d/b/a Sanford-Orlando Kennel Club) | Delaware |
| The Indiana Gaming Company | Indiana |
| The Missouri Gaming Company (d/b/a Argosy Casino Riverside) | Missouri |
| Toledo Gaming Ventures, Inc. | Ohio |
| Zia Park LLC (d/b/a Black Gold Casino at Zia Park) | Delaware |

**Exhibit 23.1**

**Consent of Independent Registered Public Accounting Firm**

We consent to the incorporation by reference in the following Registration Statements:

(1) Registration Statement (Form S-4 No. 333-164505) of Penn National Gaming, Inc.,

(2) Registration Statement (Form S-3 No. 333-156487) of Penn National Gaming, Inc.,

(3) Registration Statement (Form S-8 No. 333-157669) pertaining to the 2008 Long Term Incentive Compensation Plan,

(4) Registration Statement (Form S-8 No. 333-125928) pertaining to the Nonqualified Stock Option Agreement with Peter M. Carlino,

(5) Registration Statement (Form S-8 No. 333-108173) pertaining to the Penn National Gaming, Inc. 2003 Long Term Incentive Compensation Plan, and

(6) Registration Statement (Form S-8 No. 333-61684) pertaining to the Amended and Restated Penn National Gaming, Inc. 1994 Stock Option Plan;

of our reports dated February 25, 2011, with respect to the consolidated financial statements of Penn National Gaming, Inc. and the effectiveness of internal control over financial reporting of Penn National Gaming, Inc., included in the Annual Report (Form 10-K) for the year ended December 31, 2010.

/s/ ERNST & YOUNG LLP

Philadelphia, Pennsylvania
February 25, 2011

# Exhibit 3-a

## Penn National Gaming, Inc.

2009 Financial Statements

## ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

### Report of Independent Registered Public Accounting Firm

Board of Directors
Penn National Gaming, Inc. and subsidiaries

We have audited the accompanying consolidated balance sheets of Penn National Gaming, Inc. and subsidiaries as of December 31, 2009 and 2008, and the related consolidated statements of operations, changes in shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2009. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Penn National Gaming, Inc. and subsidiaries at December 31, 2009 and 2008, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2009, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Penn National Gaming, Inc. and subsidiaries' internal control over financial reporting as of December 31, 2009, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 26, 2010 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Philadelphia, Pennsylvania
February 26, 2010

**Penn National Gaming, Inc. and Subsidiaries**
**Consolidated Balance Sheets**
**(in thousands, except share and per share data)**

| | December 31, 2009 | December 31, 2008 |
|---|---|---|
| **Assets** | | |
| **Current assets** | | |
| Cash and cash equivalents | $ 713,118 | $ 746,278 |
| Receivables, net of allowance for doubtful accounts of $3,548 and $3,797 at December 31, 2009 and 2008, respectively | 46,672 | 43,574 |
| Insurance receivable | 33,494 | — |
| Prepaid expenses and other current assets | 121,545 | 95,386 |
| Deferred income taxes | 23,619 | 21,065 |
| Total current assets | 938,448 | 906,303 |
| **Property and equipment, net** | 1,837,504 | 1,812,131 |
| **Other assets** | | |
| Investment in and advances to unconsolidated affiliates | 26,305 | 14,419 |
| Goodwill | 1,379,961 | 1,598,571 |
| Other intangible assets | 376,954 | 693,764 |
| Deferred financing fees, net of accumulated amortization of $39,703 and $38,914 at December 31, 2009 and 2008, respectively | 40,889 | 34,910 |
| Other assets | 112,555 | 129,578 |
| Total other assets | 1,936,664 | 2,471,242 |
| **Total assets** | $4,712,616 | $5,189,676 |
| **Liabilities** | | |
| **Current liabilities** | | |
| Current maturities of long-term debt | $ 86,071 | $ 105,281 |
| Accounts payable | 19,850 | 35,540 |
| Accrued expenses | 110,108 | 106,769 |
| Accrued interest | 61,786 | 80,190 |
| Accrued salaries and wages | 65,608 | 55,380 |
| Gaming, pari-mutuel, property, and other taxes | 38,943 | 44,503 |
| Insurance financing | 6,752 | 8,093 |
| Other current liabilities | 41,138 | 34,730 |
| Total current liabilities | 430,256 | 470,486 |
| **Long-term liabilities** | | |
| Long-term debt, net of current maturities | 2,248,706 | 2,324,899 |
| Deferred income taxes | 127,107 | 265,610 |
| Noncurrent tax liabilities | 46,702 | 68,632 |
| Other noncurrent liabilities | 7,769 | 2,776 |
| Total long-term liabilities | 2,430,284 | 2,661,917 |
| **Shareholders' equity** | | |
| Penn National Gaming, Inc. and subsidiaries shareholders' equity: | | |
| Preferred stock ($.01 par value, 1,000,000 shares authorized, 12,500 issued and outstanding at December 31, 2009 and 2008) | — | — |
| Common stock ($.01 par value, 200,000,000 shares authorized, 78,972,256 and 78,148,488 shares issued at December 31, 2009 and 2008, respectively) | 786 | 782 |
| Additional paid-in capital | 1,480,476 | 1,442,829 |
| Retained earnings | 397,407 | 662,355 |
| Accumulated other comprehensive loss | (26,028) | (48,693) |
| Total Penn National Gaming, Inc. and subsidiaries shareholders' equity | 1,852,641 | 2,057,273 |
| Noncontrolling interests | (565) | — |
| Total shareholders' equity | 1,852,076 | 2,057,273 |
| **Total liabilities and shareholders' equity** | $4,712,616 | $5,189,676 |

See accompanying notes to the consolidated financial statements.

**Penn National Gaming, Inc. and Subsidiaries**
**Consolidated Statements of Operations**
**(in thousands, except per share data)**

| Year ended December 31, | 2009 | 2008 | 2007 |
|---|---|---|---|
| **Revenues** | | | |
| Gaming | $2,158,028 | $2,206,500 | $2,227,944 |
| Management service fee | 14,787 | 16,725 | 17,273 |
| Food, beverage and other | 339,235 | 334,206 | 320,520 |
| Gross revenues | 2,512,050 | 2,557,431 | 2,565,737 |
| Less promotional allowances | (142,775) | (134,378) | (128,944) |
| Net revenues | 2,369,275 | 2,423,053 | 2,436,793 |
| **Operating expenses** | | | |
| Gaming | 1,161,510 | 1,181,870 | 1,180,437 |
| Food, beverage and other | 266,351 | 257,653 | 240,912 |
| General and administrative | 403,136 | 415,093 | 369,720 |
| Impairment losses | 532,377 | 481,333 | — |
| Empress Casino Hotel fire | 6,063 | — | — |
| Depreciation and amortization | 194,436 | 173,545 | 147,915 |
| Total operating expenses | 2,563,873 | 2,509,494 | 1,938,984 |
| (Loss) income from operations | (194,598) | (86,441) | 497,809 |
| **Other income (expenses)** | | | |
| Interest expense | (134,984) | (169,827) | (198,059) |
| Interest income | 6,522 | 8,362 | 4,016 |
| Loss from joint venture | (1,121) | (1,526) | (99) |
| Merger termination settlement fees, net of related expenses | — | 195,426 | — |
| Loss on early extinguishment of debt | (4,793) | — | — |
| Other | 1,093 | 6,421 | (11,427) |
| Total other (expenses) income | (133,283) | 38,856 | (205,569) |
| **(Loss) income from operations before income taxes** | (327,881) | (47,585) | 292,240 |
| Taxes on income | (60,468) | 105,738 | 132,187 |
| **Net (loss) income including noncontrolling interests** | (267,413) | (153,323) | 160,053 |
| Less: Net loss attributable to noncontrolling interests | (2,465) | — | — |
| **Net (loss) income attributable to the shareholders of Penn National Gaming, Inc. and subsidiaries** | $ (264,948) | $ (153,323) | $ 160,053 |
| **(Loss) earnings per common share attributable to the shareholders of Penn National Gaming, Inc. and subsidiaries:** | | | |
| Basic (loss) earnings per common share | $ (3.39) | $ (1.81) | $ 1.87 |
| Diluted (loss) earnings per common share | $ (3.39) | $ (1.81) | $ 1.81 |

See accompanying notes to the consolidated financial statements.

## Penn National Gaming, Inc. and Subsidiaries
## Consolidated Statements of Changes in Shareholders' Equity
## (in thousands, except share data)

| | Penn National Gaming Inc. shareholders | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Preferred Stock | | Common Stock | | Treasury Stock | Additional Paid-In Capital | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Noncontrolling Interests | Total Shareholders' Equity | Comprehensive (Loss) Income |
| | Shares | Amount | Shares | Amount | | | | | | | |
| Balance, December 31, 2006 | — | $ — | 86,814,999 | $ 868 | $(2,379) | $ 251,943 | $ 667,557 | $ 3,174 | $ — | $ 921,163 | |
| Stock option activity, including tax benefit of $20,460 | — | — | 1,824,071 | 19 | — | 68,851 | — | — | — | 68,870 | $ — |
| Restricted stock | — | — | (60,000) | — | — | 1,966 | — | — | — | 1,966 | — |
| Change in fair value of interest rate swap contracts, net of income taxes of $11,203 | — | — | — | — | — | — | — | (19,728) | — | (19,728) | (19,728) |
| Foreign currency translation adjustment | — | — | — | — | — | — | — | 570 | — | 570 | 570 |
| Cumulative effect of adoption of ASC 740 | — | — | — | — | — | — | (11,932) | — | — | (11,932) | — |
| Net income | — | — | — | — | — | — | 160,053 | — | — | 160,053 | 160,053 |
| Balance, December 31, 2007 | — | — | 88,579,070 | 887 | (2,379) | 322,760 | 815,678 | (15,984) | — | 1,120,962 | 140,895 |
| Issuance of Preferred Stock | 12,500 | — | — | — | — | 1,246,400 | — | — | — | 1,246,400 | — |
| Stock option activity, including tax benefit of $1,060 | — | — | 203,202 | 2 | — | 26,305 | — | — | — | 26,307 | — |
| Share activity | — | — | (10,633,784) | (107) | 2,379 | (154,633) | — | — | — | (152,361) | — |
| Restricted stock | — | — | — | — | — | 1,997 | — | — | — | 1,997 | — |
| Change in fair value of interest rate swap contracts, net of income taxes of $13,072 | — | — | — | — | — | — | — | (23,216) | — | (23,216) | (23,216) |
| Change in fair value of corporate debt securities | — | — | — | — | — | — | — | (8,008) | — | (8,008) | (8,008) |
| Foreign currency translation adjustment | — | — | — | — | — | — | — | (1,485) | — | (1,485) | (1,485) |
| Net loss | — | — | — | — | — | — | (153,323) | — | — | (153,323) | (153,323) |
| Balance, December 31, 2008 | 12,500 | — | 78,148,488 | 782 | — | 1,442,829 | 662,355 | (48,693) | — | 2,057,273 | (186,032) |
| Stock option activity, including tax benefit of $2,388 | — | — | 491,078 | 4 | — | 35,173 | — | — | — | 35,177 | — |
| Restricted stock | — | — | 332,690 | — | — | 2,474 | — | — | — | 2,474 | — |
| Change in fair value of interest rate swap contracts, net of income taxes of $8,150 | — | — | — | — | — | — | — | 14,586 | — | 14,586 | 14,586 |
| Change in fair value of corporate debt securities | — | — | — | — | — | — | — | 6,843 | — | 6,843 | 6,843 |
| Foreign currency translation adjustment | — | — | — | — | — | — | — | 1,236 | — | 1,236 | 1,236 |
| Contributions from noncontrolling interests | — | — | — | — | — | — | — | — | 1,900 | 1,900 | — |
| Net loss | — | — | — | — | — | — | (264,948) | — | (2,465) | (267,413) | (267,413) |
| Balance, December 31, 2009 | 12,500 | $ — | 78,972,256 | $ 786 | $ — | $1,480,476 | $ 397,407 | $(26,028) | $ (565) | $1,852,076 | $(244,748) |

See accompanying notes to the consolidated financial statements.

## Penn National Gaming, Inc. and Subsidiaries
## Consolidated Statements of Cash Flows
## (in thousands)

| Year ended December 31, | 2009 | 2008 | 2007 |
|---|---|---|---|
| **Operating activities** | | | |
| Net (loss) income including noncontrolling interests | $(267,413) | $ (153,323) | $ 160,053 |
| Adjustments to reconcile net (loss) income including noncontrolling interests to net cash provided by operating activities: | | | |
| Depreciation and amortization | 194,436 | 173,545 | 147,915 |
| Amortization of items charged to interest expense | 12,255 | 12,625 | 13,011 |
| Amortization of items charged to interest income | (1,522) | (912) | — |
| Loss on sale of fixed assets | 332 | 1,610 | 1,637 |
| Loss from joint venture | 1,121 | 1,526 | 99 |
| Loss on early extinguishment of debt | 4,793 | — | — |
| Empress Casino Hotel fire | 5,186 | — | — |
| Gain on accelerated payment of other long-term obligations | (1,305) | — | — |
| Gain on sale of investment in corporate debt securities | (6,598) | — | — |
| Deferred income taxes | (146,408) | (91,098) | 18,265 |
| Charge for stock compensation | 28,360 | 26,857 | 25,465 |
| Impairment losses | 532,377 | 481,333 | — |
| (Increase) decrease, net of businesses acquired | | | |
| Accounts receivable | (16,091) | 12,853 | (2,168) |
| Insurance receivable | — | — | 100,000 |
| Prepaid expenses and other current assets | (13,160) | (27,722) | 924 |
| Other assets | (8,138) | 25,747 | (7,159) |
| (Decrease) increase, net of businesses acquired | | | |
| Accounts payable | (5,292) | (350) | (22,234) |
| Accrued expenses | 4,837 | (12,045) | (12,436) |
| Accrued interest | 4,332 | (12,729) | (1,594) |
| Accrued salaries and wages | 10,228 | 1,231 | (6,003) |
| Gaming, pari-mutuel, property and other taxes | (5,560) | 882 | (4,629) |
| Income taxes | — | (6,794) | (3,584) |
| Other current and noncurrent liabilities | 11,401 | 1,014 | 9,470 |
| Other noncurrent tax liabilities | 75 | (13,787) | 14,187 |
| Net cash provided by operating activities | 338,246 | 420,463 | 431,219 |
| **Investing activities** | | | |
| Expenditures for property and equipment | (289,551) | (344,894) | (361,155) |
| Proceeds from sale of property and equipment | 2,628 | 1,066 | 15,020 |
| Investment in corporate debt securities | — | (47,286) | — |
| Proceeds from sale of investment in corporate debt securities | 50,602 | — | — |
| Proceeds from Empress Casino Hotel fire | 20,593 | — | — |
| Investment in Kansas Entertainment | (12,895) | — | — |
| Increase in cash in escrow | (25,036) | — | — |
| Acquisition of businesses and licenses, net of cash acquired | (9,000) | (384) | (265,482) |
| Net cash used in investing activities | (262,659) | (391,498) | (611,617) |
| **Financing activities** | | | |
| Proceeds from exercise of options | 5,431 | 2,397 | 24,911 |
| Repurchases of common stock | — | (152,361) | — |
| Proceeds from issuance of long-term debt | 784,929 | 447,833 | 426,065 |
| Principal payments on long-term debt | (879,193) | (993,966) | (282,360) |
| Proceeds from issuance of preferred stock, net of related expenses | — | 1,246,400 | — |
| Proceeds from insurance financing | 15,454 | 22,255 | 29,009 |
| Payments on insurance financing | (16,795) | (30,677) | (31,830) |
| Contributions from noncontrolling interests | 1,900 | — | — |
| Increase in deferred financing fees | (22,861) | — | — |
| Tax benefit from stock options exercised | 2,388 | 1,060 | 20,460 |
| Net cash (used in) provided by financing activities | (108,747) | 542,941 | 186,255 |
| **Net (decrease) increase in cash and cash equivalents** | (33,160) | 571,906 | 5,857 |
| Cash and cash equivalents at beginning of year | 746,278 | 174,372 | 168,515 |
| Cash and cash equivalents at end of year | $ 713,118 | $ 746,278 | $ 174,372 |
| **Supplemental disclosure** | | | |
| Interest expense paid | $ 124,992 | $ 183,264 | $ 199,425 |
| Income taxes paid | $ 109,200 | $ 190,287 | $ 88,546 |

See accompanying notes to the consolidated financial statements.

## 1. Business and Basis of Presentation

Penn National Gaming, Inc. ("Penn") and subsidiaries (collectively, the "Company") is a diversified, multi-jurisdictional owner and manager 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 Bay St. Louis and Boomtown Biloxi, CRC Holdings, Inc., the Bullwhackers properties, Hollywood Casino Corporation, Argosy Gaming Company ("Argosy"), Black Gold Casino at Zia Park, and Sanford-Orlando Kennel Club), greenfield projects (such as at Hollywood Casino at Penn National Race Course and Hollywood Slots Hotel and Raceway) and property expansions (such as at Charles Town Entertainment Complex and Hollywood Casino Lawrenceburg).

The Company currently owns or manages 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.

The preparation of financial statements in conformity with generally accepted accounting principles ("GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses for the reporting periods. Actual results could differ from those estimates.

For purposes of comparability, certain prior year amounts have been reclassified to conform to the current year presentation.

## 2. Principles of Consolidation

The consolidated financial statements include the accounts of Penn and its subsidiaries, including wholly-owned subsidiaries and subsidiaries with a noncontrolling interest. Investment in and advances to unconsolidated affiliates that are 50% owned are accounted for under the equity method. All significant intercompany accounts and transactions have been eliminated in consolidation.

## 3. Merger Announcement and Termination

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

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

the Investment and issued 12,500 shares of Series B Redeemable Preferred Stock (the "Preferred Stock").

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

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

## 4. Summary of Significant Accounting Policies

### Cash and Cash Equivalents

The Company considers all cash balances and highly-liquid investments with original maturities of three months or less to be cash and cash equivalents.

### Concentration of Credit Risk

Financial instruments that subject the Company to credit risk consist of cash equivalents, corporate securities, interest rate swap contracts and accounts receivable.

The Company's policy is to limit the amount of credit exposure to any one financial institution, and place investments with financial institutions evaluated as being creditworthy, or in short-term money market and tax-free bond funds which are exposed to minimal interest rate and credit risk. The Company has bank deposits and overnight repurchase agreements that exceed federally-insured limits.

Concentration of credit risk, with respect to casino receivables, is limited through the Company's credit evaluation process. The Company issues markers to approved casino customers only following credit checks and investigations of creditworthiness.

The Company's receivables of $46.7 million and $43.6 million at December 31, 2009 and 2008, respectively, primarily consist of $12.9 million and $10.8 million, respectively, due from the West Virginia Lottery for gaming revenue settlements and capital reinvestment projects at the Charles Town

Entertainment Complex, and $11.7 million and $11.4 million, respectively, for reimbursement of expenses paid on behalf of Casino Rama.

Accounts are written off when management determines that an account is uncollectible. Recoveries of accounts previously written off are recorded when received. An allowance for doubtful accounts is determined to reduce the Company's receivables to their carrying value, which approximates fair value. The allowance is estimated based on historical collection experience, specific review of individual customer accounts, and current economic and business conditions. Historically, the Company has not incurred any significant credit-related losses.

**Fair Value of Financial Instruments**

The following methods and assumptions are used to estimate the fair value of each class of financial instruments for which it is practicable to estimate:

*Cash and Cash Equivalents*

The fair value of the Company's cash and cash equivalents approximates the carrying value of the Company's cash and cash equivalents, due to the short maturity of the cash equivalents.

*Investment in Corporate Debt Securities*

The fair value of the investment in corporate debt securities is estimated based on quoted prices in active markets for identical investments. The investment in corporate debt securities is measured at fair value on a recurring basis.

*Long-term Debt*

The fair value of the Company's senior secured credit facility approximates its carrying value, as it is variable-rate debt. The fair value of the Company's senior subordinated notes is estimated based on quoted prices in active markets for identical instruments. The fair value of the Company's other long-term obligations and capital leases approximates its carrying value.

*Interest Rate Swap Contracts*

The fair value of the Company's interest rate swap contracts is measured as the present value of all expected future cash flows based on the LIBOR-based swap yield curve as of the date of the valuation, subject to a credit adjustment to the LIBOR-based yield curve's implied discount rates. The credit adjustment reflects the Company's best estimate as to the Company's credit quality at December 31, 2009. The interest rate swap contracts are measured at fair value on a recurring basis.

The estimated fair values of the Company's financial instruments are as follows (in thousands):

| | 2009 | | 2008 | |
|---|---|---|---|---|
| December 31, | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| **Financial assets:** | | | | |
| Cash and cash equivalents | $ 713,118 | $ 713,118 | $ 746,278 | $ 746,278 |
| Investment in corporate debt securities | 4,550 | 4,550 | 40,190 | 40,190 |
| **Financial liabilities:** | | | | |
| Long-term debt | | | | |
| Senior secured credit facility | 1,755,602 | 1,755,602 | 1,959,784 | 1,959,784 |
| Senior subordinated notes and other long-term obligations | 575,000 | 572,375 | 464,201 | 389,201 |
| Capital leases | 4,175 | 4,175 | 6,195 | 6,195 |
| Interest rate swap contracts | 43,925 | 43,925 | 63,185 | 63,185 |

See Note 21 to the Consolidated Financial Statements for further information regarding the Company's assessment of the inputs used to measure the fair value for the investment in corporate debt securities and interest rate swap contracts.

**Property and Equipment**

Property and equipment are stated at cost, less accumulated depreciation. Maintenance and repairs that neither add materially to the value of the asset nor appreciably prolong its useful life are charged to expense as incurred. Gains or losses on the disposal of property and equipment are included in the determination of income.

Depreciation of property and equipment is recorded using the straight-line method over the following estimated useful lives:

| | |
|---|---|
| Land improvements | 5 to 15 years |
| Building and improvements | 25 to 40 years |
| Furniture, fixtures, and equipment | 3 to 7 years |

Leasehold improvements are depreciated over the shorter of the estimated useful life of the improvement or the related lease term.

The estimated useful lives are determined based on the nature of the assets as well as the Company's current operating strategy.

The Company reviews the carrying values of its property and equipment for possible impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable based on undiscounted estimated future cash flows expected to result from its use and eventual disposition. The factors considered by the Company in performing this assessment include current operating results, trends and prospects, as well as the effect of obsolescence, demand, competition and other economic factors. In estimating expected future cash flows for determining whether an asset is impaired, assets are grouped at the individual property level. In assessing the recoverability of the carrying value of property and equipment, the Company must make assumptions regarding future cash flows and other factors. If these estimates or the related assumptions change in the future, the Company 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.

**Goodwill and Other Intangible Assets**

At December 31, 2009, the Company had $1,380.0 million in goodwill and $377.0 million in other intangible assets within its consolidated balance sheet, representing 29.3% and 8.0% of total assets, respectively, resulting from the Company's acquisition of other businesses and payment for gaming licenses and racing permits. Two issues arise with respect to these assets that require significant management estimates and judgment: (i) the valuation in connection with the initial purchase price allocation; and (ii) the ongoing evaluation for impairment.

In connection with the Company's acquisitions, valuations are completed to determine the allocation of the purchase prices. The factors considered in the valuations include data gathered as a result of the Company's due diligence in connection with the acquisitions, projections for future operations, and data obtained from third-party valuation specialists as deemed appropriate. Goodwill is tested annually, or more frequently if indicators of impairment exist, for impairment by comparing the fair value of the reporting units to their carrying amount. If the carrying amount of a reporting unit exceeds its fair value, an impairment test is performed to determine the implied value of goodwill for that reporting unit. If the implied value is less than the carrying amount for that reporting unit, an impairment loss is recognized for that reporting unit. In accordance with Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 350, "Intangibles-Goodwill and Other," the Company considers its gaming license, racing permit and trademark intangible assets as

indefinite-life intangible assets that do not require amortization. Rather, these intangible assets are tested annually, or more frequently if indicators of impairment exist, for impairment by comparing the fair value of the recorded assets to their carrying amount. If the carrying amounts of the gaming license, racing permit and trademark intangible assets exceed their fair value, an impairment loss is recognized. The evaluation of goodwill and indefinite-life intangible assets requires the use of estimates about future operating results of each reporting unit to determine their estimated fair value. The Company uses a market approach model, which includes the use of EBITDA (earnings before interest, taxes, charges for stock compensation, depreciation and amortization, gain or loss on disposal of assets, and certain other income and expenses, and inclusive of loss from joint venture) multiples, as the Company believes that EBITDA is a widely-used measure of performance in the gaming industry and as the Company uses EBITDA as the primary measurement of the operating performance of its properties (including the evaluation of operating personnel). In addition, the Company believes that an EBITDA multiple is the principal basis for the valuation of gaming companies. Changes in the estimated EBITDA multiple or forecasted operations can materially affect these estimates. Once an impairment of goodwill or other indefinite-life intangible assets has been recorded, it cannot be reversed. Because the Company's goodwill and indefinite-life intangible assets are not amortized, there may be volatility in reported income because impairment losses, if any, are likely to occur irregularly and in varying amounts. Intangible assets that have a definite-life, including the management service contract for Casino Rama, are amortized on a straight-line basis over their estimated useful lives or related service contract. The Company reviews the carrying value of its intangible assets that have a definite-life for possible impairment whenever events or changes in circumstances indicate that their carrying value may not be recoverable. If the carrying amount of the intangible assets that have a definite-life exceed their fair value, an impairment loss is recognized.

**Deferred Financing Fees**

Deferred financing fees that are incurred by the Company in connection with the issuance of debt are deferred and amortized to interest expense over the life of the underlying indebtedness, adjusted to reflect any early repayments.

**Comprehensive Income**

The Company accounts for comprehensive income in accordance with ASC 220, "Comprehensive Income," which established standards for the reporting and presentation of comprehensive income in the consolidated financial statements. The Company presents comprehensive income in its consolidated statements of changes in shareholders' equity.

**Income Taxes**

The Company accounts for income taxes in accordance with ASC 740, "Income Taxes" ("ASC 740"). Under ASC 740, deferred tax assets and liabilities are determined based on the differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities and are measured at the prevailing enacted tax rates that will be in effect when these differences are settled or realized. ASC 740 also requires that deferred tax assets be reduced by a valuation allowance if it is more likely than not that some portion or all of the deferred tax assets will not be realized.

The realizability of the deferred tax assets is evaluated quarterly by assessing the valuation allowance and by adjusting the amount of the allowance, if necessary. The factors used to assess the likelihood of realization are the forecast of future taxable income and available tax planning strategies that could be implemented to realize the net deferred tax assets. The Company has used tax-planning strategies to realize or renew net deferred tax assets in order to avoid the potential loss of future tax benefits.

ASC 740 also creates a single model to address uncertainty in tax positions, and clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements by

prescribing the minimum recognition threshold a tax position is required to meet before being recognized in an enterprise's financial statements. It also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. The liability for unrecognized tax benefits is included in noncurrent tax liabilities within the consolidated balance sheet at December 31, 2009.

**Accounting for Derivatives and Hedging Activities**

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

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

Currently, the Company has a number of interest rate swap contracts in place. These contracts serve to mitigate income volatility for a portion of its variable-rate funding. Swap contract coverage extends out through 2011. In effect, these swap contracts synthetically convert the portion of variable-rate debt being hedged to the equivalent of fixed-rate funding. Under the terms of the swap contracts, the Company receives cash flows from the swap contract counterparties to offset the benchmark interest rate component of variable interest payments on the hedged financings, in exchange for paying cash flows based on the swap contracts' fixed rates. These two respective obligations are net-settled, periodically. The Company accounts for these swap contracts as cash flow hedges, which requires determining a division of hedge results deemed effective and deemed ineffective. However, most of the Company's hedges were designed in such a way so as to perfectly offset specifically-defined interest payments, such that no ineffectiveness has occurred—nor would any ineffectiveness occur, as long as the forecasted cash flows of the designated hedged items and the associated swap contracts remain unchanged.

The fair value of the Company's interest rate swap contracts is measured as the present value of all expected future cash flows based on the LIBOR-based swap yield curve as of the date of the valuation, subject to a credit adjustment to the LIBOR-based yield curve's implied discount rates. The credit adjustment reflects the Company's best estimate as to the Company's credit quality at December 31, 2009.

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

Under cash flow hedge accounting, derivatives are included in the consolidated balance sheets as assets or liabilities at fair value. The interest rate swap contract liabilities are included in accrued interest within the consolidated balance sheets at December 31, 2009 and 2008.

During the year ended December 31, 2009, the Company had certain derivative instruments that were not designated to qualify for hedge accounting. The periodic change in the mark-to-market of these derivative instruments is recorded in current period earnings.

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

**Revenue Recognition and Promotional Allowances**

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

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

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

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

The retail value of accommodations, food and beverage, and other services furnished to guests without charge is included in gross revenues and then deducted as promotional allowances. The estimated cost of providing such promotional allowances is primarily included in food, beverage and other expense. The amounts included in promotional allowances for the years ended December 31, 2009, 2008 and 2007 are as follows:

| Year ended December 31, | 2009 | 2008 | 2007 |
|---|---|---|---|
| | | (in thousands) | |
| Rooms | $ 23,316 | $ 17,750 | $ 15,518 |
| Food and beverage | 108,473 | 103,038 | 101,040 |
| Other | 10,986 | 13,590 | 12,386 |
| Total promotional allowances | $142,775 | $134,378 | $128,944 |

The estimated cost of providing such complimentary services for the years ended December 31, 2009, 2008 and 2007 are as follows:

| Year ended December 31, | 2009 | 2008 | 2007 |
|---|---|---|---|
| | | (in thousands) | |
| Rooms | $ 9,406 | $ 7,280 | $ 6,538 |
| Food and beverage | 77,444 | 73,565 | 71,922 |
| Other | 6,590 | 6,034 | 5,471 |
| Total cost of complimentary services | $93,440 | $86,879 | $83,931 |

**Earnings Per Share**

The Company calculates earnings per share ("EPS") in accordance with ASC 260, "Earnings Per Share" ("ASC 260"). Basic EPS is computed by dividing net income applicable to common stock,

excluding net income attributable to noncontrolling interests, by the weighted-average number of common shares outstanding during the period. Diluted EPS reflects the additional dilution for all potentially-dilutive securities such as stock options.

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

However, since the Company reported a loss from operations for the years ended December 31, 2009 and 2008, it was required by ASC 260 to use basic weighted-average common shares outstanding, rather than diluted weighted-average common shares outstanding, when calculating diluted EPS for the years ended December 31, 2009 and 2008. In addition, since the Company reported a loss from operations for the years ended December 31, 2009 and 2008, the Preferred Stock was not deemed to be a participating security for the years ended December 31, 2009 and 2008, pursuant to ASC 260. The basic weighted-average common shares outstanding for the years ended December 31, 2009 and 2008 were 78,121,571 and 84,535,877, respectively.

The following table reconciles the weighted-average common shares outstanding used in the calculation of basic EPS to the weighted-average common shares outstanding used in the calculation of diluted EPS for the year ended December 31, 2007:

| Year ended December 31, | 2007 (in thousands) |
|---|---|
| Determination of shares: | |
| Weighted-average common shares outstanding | 85,578 |
| Assumed conversion of dilutive stock options | 2,806 |
| Diluted weighted-average common shares outstanding | 88,384 |

Options to purchase 9,966,125 and 8,804,578 shares were outstanding during the years ended December 31, 2009 and 2008, respectively, but were not included in the computation of diluted EPS because they are antidilutive since the Company reported a loss from operations for the years ended December 31, 2009 and 2008. Options to purchase 1,395,610 shares were outstanding during the year ended December 31, 2007, but were not included in the computation of diluted EPS because they are antidilutive.

The repurchase of up to $200 million of the Company's Common Stock over the twenty-four month period ending July 2010 was authorized by the Company's Board of Directors in July 2008. During the year ended December 31, 2009, the Company did not repurchase any shares of its Common Stock. During the year ended December 31, 2008, the Company repurchased 8,934,984 shares of its Common Stock in open market transactions for approximately $152.6 million, at an average price of $17.05.

**Stock-Based Compensation**

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

The fair value for stock options was estimated at the date of grant using the Black-Scholes option-pricing model, which requires management to make certain assumptions. The risk-free interest rate was based on the United States ("U.S.") Treasury spot rate with a remaining term equal to the expected life assumed at the date of grant. Expected volatility was estimated based on the historical volatility of the Company's stock price over a period of 5.32 years, in order to match the expected life of the options at the grant date. There is no expected dividend yield since the Company has not paid any cash dividends on its Common Stock since its initial public offering in May 1994 and since the Company intends to retain all of its earnings to finance the development of its business for the foreseeable future. The weighted-average expected life was based on the contractual term of the stock option and expected employee exercise dates, which was based on the historical and expected exercise behavior of the Company's employees. Forfeitures are estimated at the date of grant based on historical experience. The following are the weighted-average assumptions used in the Black-Scholes option-pricing model at December 31, 2009, 2008 and 2007:

| Year ended December 31, | 2009 | 2008 | 2007 |
|---|---|---|---|
| Risk-free interest rate | 2.80% | 1.61% | 4.24% |
| Expected volatility | 49.68% | 45.56% | 37.68% |
| Dividend yield | — | — | — |
| Weighted-average expected life (years) | 5.32 | 5.36 | 4.73 |
| Forfeiture rate | 5.00% | 4.00% | 4.00% |

**Segment Information**

In accordance with ASC 280, "Segment Reporting" ("ASC 280"), the Company views each property as an operating segment, and aggregates all of its properties into one reportable segment, as the Company believes that they are economically similar, offer similar types of products and services, cater to the same types of customers and are similarly regulated.

**Statements of Cash Flows**

The Company has presented the consolidated statements of cash flows using the indirect method, which involves the reconciliation of net (loss) income including noncontrolling interests to net cash flow from operating activities.

**Acquisitions**

The Company accounts for its acquisitions in accordance with ASC 805, "Business Combinations" ("ASC 805"). The results of operations of acquisitions are included in the consolidated financial statements from their respective dates of acquisition.

**Certain Risks and Uncertainties**

The Company's operations are dependent on its continued licensing by state gaming commissions. The loss of a license, in any jurisdiction in which the Company operates, could have a material adverse effect on future results of operations.

The Company is dependent on each gaming property's local market for a significant number of its patrons and revenues. If economic conditions in these areas deteriorate or additional gaming licenses are awarded in these markets, the Company's results of operations could be adversely affected.

The Company is dependent on the economy of the U.S. in general, and any deterioration in the national economic, energy, credit and capital markets could have a material adverse effect on future results of operations.

The Company is dependent upon a stable gaming and admission tax structure in the locations that it operates in. Any change in the tax structure could have a material adverse affect on future results of operations.

**5. New Accounting Pronouncements**

In January 2010, the FASB issued guidance to improve disclosures about fair value measurements. The guidance provides amendments to require new disclosures regarding transfers in and out of Levels 1 and 2 of the fair value measurement hierarchy, and activity in Level 3, and to clarify existing disclosures regarding the level of disaggregation, inputs and valuation techniques. The guidance is effective for interim and annual reporting periods beginning after December 15, 2009, except for the new disclosures regarding purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements, which are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. The Company adopted the guidance, except for the new disclosures regarding purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements, as of January 1, 2010, as required. The Company does not expect that the January 1, 2010 adoption of the guidance will have a material impact on its consolidated financial statements. The Company is currently determining the impact of the new disclosures regarding purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements on its consolidated financial statements.

In January 2010, the FASB issued guidance to address implementation issues related to the changes in ownership provisions in ASC 810, "Consolidation," ("ASC 810"). The guidance clarifies the scope of the decrease in ownership provisions in ASC 810 and expands the disclosures about the deconsolidation of a subsidiary or derecognition of a group of assets within the scope of ASC 810. As the Company previously adopted ASC 810, the guidance is effective beginning in the first interim or annual reporting period ending on or after December 15, 2009, and should be applied retrospectively to the first period that ASC 810 was adopted by the Company. The Company adopted the guidance as of December 31, 2009, as required. This guidance did not have a material impact on the Company's consolidated financial statements.

In September 2009, the FASB issued guidance concerning fair value measurements of investments in certain entities that calculate net asset value per share (or its equivalent). The guidance creates a practical expedient to measure the fair value of an investment that is within the scope of the guidance on the basis of the net asset value per share of the investment (or its equivalent) determined as of the reporting entity's measurement date. Therefore, the guidance allows certain attributes of the investment, which in the past may have indicated that it was necessary to make adjustments to the net asset value per share (or its equivalent) to estimate the fair value of the investment, to not be considered if the practical expedient is used. Additional disclosures are also required under the guidance. The guidance is effective for interim and annual periods ending after December 15, 2009, with early application permitted. The Company adopted the guidance as of December 31, 2009, as required. This guidance did not have a material impact on the Company's consolidated financial statements.

In August 2009, the FASB issued guidance on the measurement of liabilities at fair value. The guidance provides clarification in measuring the fair value of liabilities. The guidance is effective for the first reporting period (including interim periods) beginning after issuance. The Company adopted the guidance as of October 1, 2009, as required. This guidance did not have a material impact on the Company's consolidated financial statements.

In June 2009, the FASB issued the ASC. The ASC became the source of authoritative accounting principles recognized by the FASB to be applied by nongovernmental entities in the preparation of financial statements in conformity with GAAP. The ASC eliminates the previous U.S. GAAP hierarchy

and establishes one level of authoritative GAAP. All other literature is considered non-authoritative. The ASC is effective for most financial statements issued for interim and annual periods ending after September 15, 2009. The Company adopted the ASC as of September 30, 2009, as required. The adoption of the ASC did not have an impact on the Company's consolidated financial statements.

In June 2009, the FASB issued amended guidance for variable interest entities. The objective of the amended guidance is to improve financial reporting by enterprises involved with variable interest entities and to provide more relevant and reliable information to users of financial statements. The amended guidance is effective as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter. Earlier application is prohibited. The Company adopted the amended guidance as of January 1, 2010, as required. The Company does not expect that the adoption of the amended guidance will have a material impact on its consolidated financial statements.

In May 2009, the FASB issued guidance on subsequent events. The guidance establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. In addition, under the guidance, an entity is required to disclose the date through which subsequent events have been evaluated, as well as whether that date is the date the financial statements were issued or the date the financial statements were available to be issued. The guidance does not apply to subsequent events or transactions that are within the scope of other applicable GAAP that provide different guidance on the accounting treatment for subsequent events or transactions. The guidance is effective for interim or annual financial periods ending after June 15, 2009, and shall be applied prospectively. The Company adopted the guidance as of June 30, 2009, as required. The adoption of the guidance did not have a material impact on the Company's consolidated financial statements. In February 2010, the FASB issued amended guidance on subsequent events. The amended guidance removes the requirement for U.S. Securities and Exchange Commission filers to disclose the date through which subsequent events have been evaluated. The amended guidance is effective upon issuance, except for the use of the issued date for conduit debt obligors. The Company adopted the amended guidance upon issuance, as required. The adoption of the amended guidance did not have a material impact on the Company's consolidated financial statements.

In April 2009, the FASB issued additional requirements regarding disclosures about the fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. The new requirements are effective for interim reporting periods ending after June 15, 2009. The Company adopted the additional requirements as of June 30, 2009, as required. The adoption of the new requirements did not have a material impact on the Company's consolidated financial statements.

In April 2009, the FASB issued guidance on the recognition and presentation of other-than-temporary impairments. The guidance amends the other-than-temporary impairment guidance for debt securities to make the guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments on debt and equity securities in the financial statements. The guidance does not amend existing recognition and measurement guidance related to other-than-temporary impairments of equity securities. The guidance is effective for interim and annual reporting periods ending after June 15, 2009. The Company adopted the guidance as of June 30, 2009, as required. The adoption of the guidance did not have a material impact on the Company's consolidated financial statements.

In April 2009, the FASB issued guidance on determining fair value when the volume and level of activity for the asset or liability have significantly decreased and on identifying transactions that are not orderly. The guidance is effective for interim and annual reporting periods ending after June 15, 2009, and shall be applied prospectively. The Company adopted the guidance as of June 30, 2009, as required. The adoption of the guidance did not have a material impact on the Company's consolidated financial statements.

In April 2009, the FASB issued guidance regarding the accounting for assets acquired and liabilities assumed in a business combination that arise from contingencies. The guidance addresses application issues on initial recognition and measurement, subsequent measurement and accounting, and disclosure of assets and liabilities arising from contingencies in a business combination. The guidance is effective for all assets acquired or liabilities assumed arising from contingencies in business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The Company adopted the guidance as of January 1, 2009, as required. The Company expects that the adoption of the guidance will have an impact on its consolidated financial statements, in the event that the Company acquires companies in the future.

In April 2008, the FASB issued guidance regarding the determination of the useful life of intangible assets. The guidance amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset. The guidance is effective for financial statements issued for fiscal years and interim periods beginning after December 15, 2008. Early adoption is prohibited. The Company adopted the guidance as of January 1, 2009, as required. The adoption of the guidance did not have a material impact on the Company's consolidated financial statements.

In March 2008, the FASB issued guidance regarding the disclosure of derivative instruments and hedging activities. The guidance requires enhanced disclosures about an entity's derivative and hedging activities. Specifically, entities are required to provide enhanced disclosures about: a) how and why an entity uses derivative instruments; b) how derivative instruments and related hedged items are accounted; and c) how derivative instruments and related hedged items affect an entity's financial position, financial performance and cash flows. The guidance is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. The guidance encourages, but does not require, comparative disclosures for earlier periods at initial adoption. The Company adopted the guidance as of January 1, 2009, as required. The adoption of the guidance did not have a material impact on the Company's consolidated financial statements.

In December 2007, the FASB issued amended guidance on business combinations. The intention of the amended guidance is to improve reporting by creating greater consistency in the accounting and financial reporting of business combinations. The amended guidance requires that the acquiring entity in a business combination recognize all (and only) the assets and liabilities assumed in the transaction, establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed, and requires the acquirer to disclose to investors and other users all of the information that they need to evaluate and understand the nature and financial effect of the business combination. In addition, the amended guidance modifies the accounting for transaction and restructuring costs. The amended guidance is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The Company adopted the amended guidance as of January 1, 2009, as required. The Company expects that the adoption of the amended guidance will have an impact on its consolidated financial statements, in the event that the Company acquires companies in the future.

In September 2006, the FASB issued guidance on fair value measurements. The guidance defines fair value, establishes a framework for measuring fair value, and expands the disclosure requirements about fair value measurements. In February 2008, the FASB amended the guidance so as to exclude from its scope certain accounting pronouncements that address fair value measurements associated with leases and to delay the effective date of the guidance to fiscal years beginning after November 15, 2008 for nonfinancial assets and nonfinancial liabilities that are not recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). In October 2008, the FASB issued additional guidance that provides clarification on the application of the guidance on fair value measurements in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. The Company adopted the guidance on fair value measurements, as amended, and on a prospective basis,

as of January 1, 2008. The January 1, 2008 adoption did not have a material impact on the Company's consolidated financial statements. The Company adopted the guidance on fair value measurements, as amended, and on a prospective basis, as of January 1, 2009 to nonfinancial assets and nonfinancial liabilities that are not recognized or disclosed at fair value in the financial statements on a recurring basis. The January 1, 2009 adoption did not have a material impact on the Company's consolidated financial statements.

## 6. Acquisitions

### Sanford-Orlando Kennel Club

On October 17, 2007, pursuant to the Asset Purchase Agreement dated July 5, 2007, the Company completed the purchase of Sanford-Orlando Kennel Club in Longwood, Florida from Sanford-Orlando Kennel Club, Inc. and Collins and Collins. In connection with the purchase, the Company also secured a right of first refusal with respect to a majority stake in the Sarasota Kennel Club in Sarasota, Florida. The purchase price for the Sanford-Orlando Kennel Club provides for additional consideration to be paid by the Company based upon certain future regulatory developments. Located on approximately 26 acres in Longwood, Florida, the Sanford-Orlando Kennel Club features year-round greyhound racing, a simulcast wagering facility, a clubhouse lounge and two dining areas. The Company accounted for the acquisition in accordance with ASC 805. The results of the Sanford-Orlando Kennel Club have been included in the Company's consolidated financial statements since the acquisition date.

### Black Gold Casino at Zia Park

On April 16, 2007, pursuant to the Asset Purchase Agreement dated November 7, 2006 among Zia Partners, LLC ("Zia"), Zia Park LLC (the "Buyer"), a wholly-owned subsidiary of Penn, and (solely with respect to specified sections thereof which relate to the Company's guarantee of the Buyer's payment and performance) Penn, the Buyer completed the acquisition of Black Gold Casino at Zia Park and all related assets of Zia. Penn funded this purchase with additional borrowings under its existing revolving credit facility. The Company accounted for the acquisition in accordance with ASC 805. As a result of the acquisition, goodwill of $144.2 million and other intangible assets of $2.9 million are included within the consolidated balance sheet at December 31, 2009. The results of the Black Gold Casino at Zia Park have been included in the Company's consolidated financial statements since the acquisition date.

## 7. Investment In and Advances to Unconsolidated Affiliates

On September 10, 2009, the Company announced that it had entered into an agreement, subject to local and regulatory approvals and certain other closing conditions, with principals of The Cordish Company ("Cordish"), the managing member of Kansas Entertainment, LLC ("Kansas Entertainment"), wherein the Company agreed to acquire Cordish's 50% interest in Kansas Entertainment and to assume their role as managing member.

As a result of the agreement with Cordish, the Company joined Kansas Speedway Development Corporation, a wholly-owned subsidiary of International Speedway Corporation (which owns the other 50% of Kansas Entertainment) in its application with the Kansas Lottery Commission to develop and operate a facility in the North East Gaming Zone in Wyandotte County, Kansas. The Company and International Speedway Corporation will share equally the cost of developing and constructing the proposed facility, and intend to jointly seek third party financing for the project.

On December 1, 2009, Kansas Entertainment was selected by the Kansas Lottery Gaming Facility Review Board to develop and operate a facility in the North East Gaming Zone in Wyandotte County, Kansas.

In February 2010, Kansas Entertainment received the final approval under the Kansas Expanded Lottery Act, along with its gaming license from the Kansas Racing and Gaming Commission, to proceed with the development of the facility.

On September 14, 2009, as a result of the agreement with Cordish, the Company withdrew its license application with the Kansas Lottery Commission to be considered as a Lottery Gaming Facility Manager at another site in Wyandotte County.

The Company's investment in Kansas Entertainment, which consists of the Company's portion of the privilege fee paid to the Kansas Lottery Commission in conjunction with its application and its portion of capital expenditures spent to develop the proposed facility, is accounted for under the equity method and is included in investment in and advances to unconsolidated affiliates within the consolidated balance sheet at December 31, 2009.

In accordance with the agreement, $25.0 million was placed in escrow until certain conditions in the agreement with Cordish are satisfied. This amount is included in other assets within the consolidated balance sheet at December 31, 2009.

## 8. Property and Equipment

Property and equipment, net, consists of the following:

| December 31, | 2009 | 2008 |
|---|---|---|
| | (in thousands) | |
| Land and improvements | $ 239,933 | $ 216,834 |
| Building and improvements | 1,433,611 | 1,298,513 |
| Furniture, fixtures, and equipment | 849,071 | 692,851 |
| Leasehold improvements | 17,204 | 17,128 |
| Construction in progress | 47,299 | 183,056 |
| Total property and equipment | 2,587,118 | 2,408,382 |
| Less accumulated depreciation | (749,614) | (596,251) |
| Property and equipment, net | $1,837,504 | $1,812,131 |

Depreciation expense, for property and equipment, totaled $187.8 million, $165.9 million and $140.3 million in 2009, 2008, and 2007, respectively. Interest capitalized in connection with major construction projects was $7.0 million, $13.8 million and $14.6 million in 2009, 2008 and 2007, respectively.

During the year ended December 31, 2009, the Company recorded a pre-tax impairment charge for the replaced Lawrenceburg vessel of $11.9 million ($7.1 million, net of taxes) in conjunction with the opening of the new casino riverboat at Hollywood Casino Lawrenceburg. During the year ended December 31, 2008, the Company recorded a pre-tax impairment charge of $15.1 million ($10.0 million, net of taxes), as it determined that a portion of the value of its long-lived assets, primarily at its Bullwhackers property, was impaired.

## 9. Goodwill and Other Intangible Assets

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

| | |
|---|---|
| Balance at January 1, 2008: | |
| Goodwill | $2,047,661 |
| Accumulated goodwill impairment losses | (34,522) |
| Goodwill, net | $2,013,139 |
| Goodwill acquired during the year | — |
| Goodwill impairment losses | (397,220) |
| Other | (17,348) |
| Balance at December 31, 2008: | |
| Goodwill | $2,030,313 |
| Accumulated goodwill impairment losses | (431,742) |
| Goodwill, net | $1,598,571 |
| Goodwill acquired during the year | — |
| Goodwill impairment losses | (213,260) |
| Other | (5,350) |
| Balance at December 31, 2009: | |
| Goodwill | $2,024,963 |
| Accumulated goodwill impairment losses | (645,002) |
| Goodwill, net | $1,379,961 |

Goodwill consists mainly of goodwill from the acquisitions of Hollywood Casino Corporation in March 2003, Argosy in October 2005 and Black Gold Casino at Zia Park in April 2007.

During the year ended December 31, 2009, goodwill decreased by $218.6 million. As a result of the anticipated impact of gaming expansion in Ohio, the Company recorded a pre-tax impairment charge of $213.3 million ($188.7 million, net of taxes) during the year ended December 31, 2009, as the Company determined that a portion of the value of the goodwill associated with the original purchase of Hollywood Casino Lawrenceburg was impaired.

During the year ended December 31, 2008, goodwill decreased by $414.6 million, primarily due to the Company recording a pre-tax impairment charge of $397.2 million ($338.5 million, net of taxes), as a portion of the value of the goodwill associated with the original purchase of Empress Casino Hotel, Hollywood Casino Lawrenceburg, Hollywood Casino Aurora and Argosy Casino Alton, and all of the goodwill associated with the original purchase of Hollywood Slots Hotel and Raceway, was impaired.

The table below presents the gross carrying value, accumulated amortization, and net book value of each major class of intangible asset at December 31, 2009 and 2008:

| December 31, | 2009 | | | 2008 | | |
|---|---|---|---|---|---|---|
| | Gross Carrying Value | Accumulated Amortization | Net Book Value | Gross Carrying Value | Accumulated Amortization | Net Book Value |
| | (in thousands) | | | | | |
| Indefinite-life intangible assets | $368,886 | $ — | $368,886 | $679,054 | $ — | $679,054 |
| Other intangible assets | 49,396 | 41,328 | 8,068 | 49,396 | 34,686 | 14,710 |
| Total | $418,282 | $41,328 | $376,954 | $728,450 | $34,686 | $693,764 |

Indefinite-life intangible assets consist mainly of gaming licenses and trademark intangible assets from the acquisition of Argosy and the placement of slot machines at Hollywood Casino at Penn National Race Course.

During the year ended December 31, 2009, indefinite-life intangible assets decreased by $310.2 million. As a result of the anticipated impact of gaming expansion in Ohio, the Company recorded a pre-tax impairment charge of $307.2 million ($180.1 million, net of taxes), as the Company determined that a portion of the value of the indefinite-life intangible assets associated with the original purchase of Hollywood Casino Lawrenceburg was impaired.

During the year ended December 31, 2008, indefinite-life intangible assets decreased by $76.1 million, primarily as the Company recorded a pre-tax impairment charge of $69.0 million ($44.1 million, net of taxes), as a portion of the value of the indefinite-life intangible assets associated with the original purchase of Argosy, and all of the indefinite-life intangible assets associated with the original purchase of Hollywood Slots Hotel and Raceway, was impaired.

The Company's intangible asset amortization expense was $6.6 million, $7.7 million and $7.6 million for the years ended December 31, 2009, 2008 and 2007, respectively.

The following table presents expected intangible asset amortization expense based on existing intangible assets at December 31, 2009 (in thousands):

| | |
|---|---|
| 2010 | $5,773 |
| 2011 | 2,096 |
| 2012 | 199 |
| Total | $8,068 |

**10. Investment in Corporate Securities**

During the year ended December 31, 2008, the Company made a $47.3 million investment in the corporate debt securities of other gaming companies. The investment, which the Company is treating as available-for-sale securities, is included in other assets within the consolidated balance sheets at December 31, 2009 and 2008. During the years ended December 31, 2009 and 2008, the Company recorded a $6.8 million unrealized gain and an $8.0 million unrealized loss, respectively, in OCI for this investment. The change in the fair value also reflects the original issue discount amortization, which was $1.5 million and $0.9 million for the years ended December 31, 2009 and 2008, respectively.

During the year ended December 31, 2009, the Company sold $42.2 million of this investment and recorded a $6.6 million gain, which is included in other income within the consolidated statements of operations.

The following is a schedule of the contractual maturities of the Company's investment in corporate securities at December 31, 2009 (in thousands):

| | |
|---|---|
| 2010 | $ — |
| 2011 | — |
| 2012 | 4,550 |
| Total | $4,550 |

## 11. Long-term Debt

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

| December 31, | 2009 | 2008 |
|---|---|---|
| | (in thousands) | |
| Senior secured credit facility | $1,755,602 | $1,959,784 |
| $200 million 6⅞% senior subordinated notes | — | 200,000 |
| $250 million 6¾% senior subordinated notes | 250,000 | 250,000 |
| $325 million 8¾% senior subordinated notes | 325,000 | — |
| Other long-term obligations | — | 14,201 |
| Capital leases | 4,175 | 6,195 |
| | 2,334,777 | 2,430,180 |
| Less current maturities of long-term debt | (86,071) | (105,281) |
| | $2,248,706 | $2,324,899 |

The following is a schedule of future minimum repayments of long-term debt as of December 31, 2009 (in thousands):

| | |
|---|---|
| 2010 | $ 86,071 |
| 2011 | 356,001 |
| 2012 | 1,315,785 |
| 2013 | 82 |
| 2014 | 89 |
| Thereafter | 576,749 |
| Total minimum payments | $2,334,777 |

At December 31, 2009, the Company was contingently obligated under letters of credit issued pursuant to the senior secured credit facility with face amounts aggregating $27.9 million.

**Senior Secured Credit Facility**

The senior secured credit facility historically consisted of three credit facilities comprised of a $750 million revolving credit facility with a maturity date of October 3, 2010, a $325 million Term Loan A Facility with a maturity date of October 3, 2011 and a $1.65 billion Term Loan B Facility with a maturity date of October 3, 2012. In September 2009, the Company amended its senior secured credit facility, in order to increase the borrowing capacity and to extend the term under the revolving credit facility portion of the senior secured credit facility. Under the new revolving credit facility, two tranches were created, one for those participants who agreed to extend and one for those that did not extend. Tranche A Revolving Loans consist of available borrowings of $359.4 million, which are due on the original maturity date of October 3, 2010, and Tranche B Revolving Loans consist of available borrowings of $640.6 million, which are due on July 3, 2012, for a total borrowing capacity of $1 billion.

In August 2009, the Company repaid $40 million of borrowings under the Term Loan A Facility, $70 million of borrowings under the Term Loan B Facility, and all outstanding borrowings under the revolving credit facility at the time, using a portion of the proceeds from the offering of $325 million 8¾% senior subordinated notes. In addition, in September 2009, the Company repaid all of the remaining outstanding borrowings under the Term Loan A Facility, using drawings under the new revolving credit facility.

As of December 31, 2009, $237.5 million was drawn under the revolving credit facility and $1,518.1 million was outstanding under the Term Loan B Facility, for a total of $1,755.6 million. As of December 31, 2008, $123.7 million was drawn under the revolving credit facility, $239.7 million was

outstanding under the Term Loan A Facility, and $1,596.4 million was outstanding under the Term Loan B Facility, for a total of $1,959.8 million.

The Company recorded a $2.4 million loss on early extinguishment of debt during the year ended December 31, 2009 for the write-off of deferred financing fees related to the Term Loan A Facility.

During the year ended December 31, 2009, the Company's senior secured credit facility amount outstanding decreased by $204.2 million, primarily due to the August 2009 repayment of $40 million of borrowings under the Term Loan A Facility, $70 million of borrowings under the Term Loan B Facility, and all outstanding borrowings under the revolving credit facility at the time, using a portion of the proceeds from the offering of $325 million 8¾% senior subordinated notes. These repayments were partially offset by drawings under the revolving credit facility, primarily to repay $105.5 million outstanding aggregate principal amount of the 6⅞% senior subordinated notes.

The senior secured credit facility is secured by substantially all of the assets of Penn and its restricted subsidiaries.

**Interest Rate Swap Contracts**

In accordance with the terms of its senior secured credit facility, the Company was required to enter into fixed-rate debt or interest rate swap agreements in an amount equal to 50% of the Company's consolidated indebtedness, excluding the revolving credit facility, within 100 days of the closing date of the senior secured credit facility.

The effect of derivative instruments on the consolidated statement of operations for the year ended December 31, 2009 was as follows (in thousands):

| Derivatives in a Cash Flow Hedging Relationship | Gain (Loss) Recognized in OCI on Derivative (Effective Portion) | Location of Gain (Loss) Reclassified from AOCI into Income (Effective Portion) | Gain (Loss) Reclassified from AOCI into Income (Effective Portion) | Location of Gain (Loss) Recognized in Income on Derivative (Ineffective Portion) | Gain (Loss) Recognized in Income on Derivative (Ineffective Portion) |
|---|---|---|---|---|---|
| Interest rate swap contracts | $(23,478) | Interest expense | $(30,358) | None | $— |
| Total | $(23,478) | | $(30,358) | | $— |

| Derivatives Not Designated as Hedging Instruments | Location of Gain (Loss) Recognized in Income on Derivative | Gain (Loss) Recognized in Income on Derivative |
|---|---|---|
| Interest rate swap contracts | Interest expense | $359 |
| Total | | $359 |

In addition, during the year ended December 31, 2009, the Company amortized $15.9 million in OCI related to the derivatives that were de-designated as hedging instruments under ASC 815, "Derivatives and Hedging."

In the coming twelve months, the Company anticipates that approximately a $35.3 million loss will be reclassified from OCI to earnings, as part of interest expense. As this amount represents effective hedge results, a comparable offsetting amount of incrementally lower interest expense will be realized in connection with the variable funding being hedged.

The following table sets forth the fair value of the interest rate swap contract liabilities included in accrued interest within the consolidated balance sheets at December 31, 2009 and 2008:

| | December 31, 2009 | | December 31, 2008 | |
|---|---|---|---|---|
| | Balance Sheet Location | Fair Value | Balance Sheet Location | Fair Value |
| | | (in thousands) | | |
| **Derivatives designated as hedging instruments** | | | | |
| Interest rate swap contracts | Accrued interest | $23,485 | Accrued interest | $63,185 |
| **Total derivatives designated as hedging instruments** | | $23,485 | | $63,185 |
| **Derivatives not designated as hedging instruments** | | | | |
| Interest rate swap contracts | Accrued interest | $20,440 | Accrued interest | $ — |
| **Total derivatives not designated as hedging instruments** | | $20,440 | | $ — |
| **Total derivatives** | | $43,925 | | $63,185 |

**Redemption of 6⅞% Senior Subordinated Notes**

In August 2009, the Company called for the redemption of its $200 million 6⅞% senior subordinated notes. The redemption price was $1,000 per $1,000 principal amount, plus accrued and unpaid interest, which was paid in September 2009. Approximately $94.5 million aggregate principal amount of the 6⅞% senior subordinated notes were validly tendered and paid. In October 2009, the Company called for the redemption of all of the $105.5 million outstanding aggregate principal amount of its 6⅞% senior subordinated notes. The redemption price was $1,000 per $1,000 principal amount, plus accrued and unpaid interest. In December 2009, the Company repaid all of the $105.5 million outstanding aggregate principal amount of its 6⅞% senior subordinated notes. The Company funded the $94.5 million redemption from a portion of the proceeds from the offering of $325 million 8¾% senior subordinated notes and available cash and funded the $105.5 million redemption using drawings under the revolving credit facility.

The Company recorded a $2.4 million loss on early extinguishment of debt during the year ended December 31, 2009 for the write-off of the deferred financing fees related to the $200 million 6⅞% senior subordinated notes.

**6¾% Senior Subordinated Notes**

On March 9, 2005, the Company completed an offering of $250 million 6¾% senior subordinated notes that mature on March 1, 2015. Interest on the $250 million 6¾% senior subordinated notes is payable on March 1 and September 1 of each year, beginning September 1, 2005. The $250 million 6¾% senior subordinated notes are general unsecured obligations and are not guaranteed by the Company's subsidiaries. The $250 million 6¾% senior subordinated notes were issued in a private placement pursuant to an exemption from the registration requirements of the Securities Act of 1933, as amended. Effective March 2010, the Company may redeem all or part of the $250 million 6¾% senior subordinated notes at certain specified redemption prices.

**8¾% Senior Subordinated Notes**

In August 2009, the Company completed an offering of $325 million 8¾% senior subordinated notes that mature on August 15, 2019. Interest on the $325 million 8¾% senior subordinated notes is payable on February 15 and August 15 of each year, beginning February 15, 2010. The $325 million

8¾% senior subordinated notes are general unsecured obligations and are not guaranteed by the Company's subsidiaries. The $325 million 8¾% senior subordinated notes were issued in a private placement pursuant to an exemption from the registration requirements of the Securities Act of 1933, as amended.

A portion of the proceeds from the offering were used to repay $40 million of borrowings under the Term Loan A Facility, $70 million of borrowings under the Term Loan B Facility, and all outstanding borrowings under the revolving credit facility at the time. The remainder of the proceeds, plus available cash, was used to pay the validly-tendered principal amounts of the $200 million 6⅞% senior subordinated notes.

**Other Long-Term Obligations**

On October 15, 2004, the Company announced the sale of The Downs Racing, Inc. and its subsidiaries to the Mohegan Tribal Gaming Authority ("MTGA"). Under the terms of the agreement, the MTGA acquired The Downs Racing, Inc. and its subsidiaries, including Pocono Downs (a standardbred horse racing facility located on 400 acres in Wilkes-Barre, Pennsylvania) and five Pennsylvania OTWs located in Carbondale, East Stroudsburg, Erie, Hazelton and the Lehigh Valley (Allentown). The sale agreement also provided the MTGA with certain post-closing termination rights in the event of certain materially adverse legislative or regulatory events. In January 2005, the Company received $280 million from the MTGA, and transferred the operations of The Downs Racing, Inc. and its subsidiaries to the MTGA. The sale was not considered final for accounting purposes until the third quarter of 2006, as the MTGA had certain post-closing termination rights that remained outstanding. On August 7, 2006, the Company entered into the Second Amendment to the Purchase Agreement and Release of Claims ("Amendment and Release") with the MTGA pertaining to the October 14, 2004 Purchase Agreement (the "Purchase Agreement"), and agreed to pay the MTGA an aggregate of $30 million over five years, beginning on the first anniversary of the commencement of slot operations at Mohegan Sun at Pocono Downs, in exchange for the MTGA's agreement to release various claims it raised against the Company under the Purchase Agreement and the MTGA's surrender of all post-closing termination rights it might have had under the Purchase Agreement. The Company recorded the present value of the $30 million liability within debt, as the amount due to the MTGA was payable over five years. In March 2009, the Company entered into the Third Amendment to the Purchase Agreement, in which the remaining payments due under the Purchase Agreement were accelerated and reduced. Under the Third Amendment to the Purchase Agreement, in exchange for the accelerated payment, which was paid to the MTGA in March 2009, all remaining obligations under the Purchase Agreement were deemed to be satisfied and, as a result, the Company recorded a $1.3 million gain during the year ended December 31, 2009, which is included in other income within the consolidated statements of operations.

**Covenants**

The Company's senior secured credit facility, $325 million 8¾% and $250 million 6¾% senior subordinated notes require it, among other obligations, to maintain specified financial ratios and to satisfy certain financial tests, including fixed charge coverage, senior leverage and total leverage ratios. In addition, the Company's senior secured credit facility, $325 million 8¾% and $250 million 6¾% senior subordinated notes restrict, among other things, the Company's ability to incur additional indebtedness, incur guarantee obligations, amend debt instruments, pay dividends, create liens on assets, make investments, make acquisitions, engage in mergers or consolidations, make capital expenditures, or engage in certain transactions with subsidiaries and affiliates and otherwise restricts corporate activities.

During the year ended December 31, 2008, the Company placed some of the funds received from the issuance of its Preferred Stock into unrestricted subsidiaries, in order to allow for maximum

flexibility in the deployment of the funds. The funds and activity maintained within the unrestricted subsidiaries are excluded from the Company's covenant calculations.

At December 31, 2009, the Company was in compliance with all required financial covenants.

## 12. Commitments and Contingencies

### Litigation

The Company is subject to various legal and administrative proceedings relating to personal injuries, employment matters, commercial transactions and other matters arising in the normal course of business. The Company does not believe that the final outcome of these matters will have a material adverse effect on the Company's consolidated financial position or results of operations. In addition, the Company maintains what it believes is adequate insurance coverage to further mitigate the risks of such proceedings. However, such proceedings can be costly, time consuming and unpredictable and, therefore, no assurance can be given that the final outcome of such proceedings may not materially impact the Company's consolidated financial condition or results of operations. Further, no assurance can be given that the amount or scope of existing insurance coverage will be sufficient to cover losses arising from such matters.

The following proceedings could result in costs, settlements, damages, or rulings that materially impact the Company's consolidated financial condition or operating results. In each instance, the Company believes that it has meritorious defenses, claims and/or counter-claims, and intends to vigorously defend itself or pursue its claim.

In conjunction with the Company's acquisition of Argosy Gaming Company in 2005, and subsequent disposition of the Argosy Casino Baton Rouge property, the Company became responsible for litigation initiated in 1997 related to the Baton Rouge casino license formerly owned by Argosy. On November 26, 1997, Capitol House filed an amended petition in the Nineteenth Judicial District Court for East Baton Rouge Parish, State of Louisiana, amending its previously filed but unserved suit against Richard Perryman, the person selected by the Louisiana Gaming Division to evaluate and rank the applicants seeking a gaming license for East Baton Rouge Parish, and adding state law claims against Jazz Enterprises, Inc., the former Jazz Enterprises, Inc. shareholders, Argosy, Argosy of Louisiana, Inc. and Catfish Queen Partnership in Commendam, d/b/a the Belle of Baton Rouge Casino. This suit alleged that these parties violated the Louisiana Unfair Trade Practices Act in connection with obtaining the gaming license that was issued to Jazz Enterprises, Inc./Catfish Queen Partnership in Commendam. The plaintiff, an applicant for a gaming license whose application was denied by the Louisiana Gaming Division, sought to prove that the gaming license was invalidly issued and to recover lost profits that the plaintiff contended it could have earned if the gaming license had been issued to the plaintiff. On October 2, 2006, the Company prevailed on a partial summary judgment motion which limited plaintiff's damages to its out-of-pocket costs in seeking its gaming license, thereby eliminating any recovery for potential lost gaming profits. On February 6, 2007, the jury returned a verdict of $3.8 million (exclusive of statutory interest and attorneys' fees) against Jazz Enterprises, Inc. and Argosy. After ruling on post-trial motions, on September 27, 2007, the trial court entered a judgment in the amount of $1.4 million, plus attorneys' fees, costs and interest. The Company has the right to seek indemnification from two of the former Jazz Enterprises, Inc. shareholders for any liability suffered as a result of such cause of action, however, there can be no assurance that the former Jazz Enterprises, Inc. shareholders will have assets sufficient to satisfy any claim in excess of Argosy's recoupment rights. The Company established an appropriate reserve and bonded the judgment pending its appeal. Both the plaintiff and the Company appealed the judgment to the First Circuit Court of Appeals in Louisiana. On August 31, 2009, the appellate court reversed the trial court's decision and dismissed the case against Argosy in its entirety. Capitol House has requested that the Louisiana Supreme Court take its appeal of the dismissal and that request is currently pending.

The Illinois Legislature passed into law House Bill 1918, effective May 26, 2006, which singled out four of the nine Illinois casinos, including the Company's Empress Casino Hotel and Hollywood Casino

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

On December 15, 2008, former Illinois Governor Rod Blagojevich signed Public Act No. 95-1008 requiring the Four Casinos to continue paying the 3% tax surcharge to subsidize Illinois horse racing interests. On January 8, 2009, the Four Casinos filed suit in the Court, asking it to declare the law unconstitutional. The 3% tax surcharge being paid pursuant to Public Act No. 95-1008 is paid into a protest fund where it accrues interest. The defendants have filed a motion to dismiss, which was granted on August 17, 2009. The Four Casinos have appealed the dismissal and have filed a motion to keep the funds in the protest fund while the appeal is being litigated. The accumulated funds will be returned to Empress Casino Hotel and Hollywood Casino Aurora if they ultimately prevail in the lawsuit.

On June 12, 2009, the Four Casinos filed a lawsuit in Illinois Federal Court naming former Illinois Governor Rod Blagojevich, his campaign fund, racetrack owner John Johnston, and his two racetracks as defendants alleging a civil conspiracy in violation of the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. §1962(c),(d) ("RICO"), based on an illegal scheme to secure the enactment of the 3% tax surcharge legislation in exchange for the payment of money by Johnston and entities controlled by him. The Four Casinos also seek to impose a constructive trust over all funds paid under the tax surcharge, and therefore all of the Illinois racetracks are named as parties to the lawsuit. The defendants in the RICO case filed motions to dismiss. On December 7, 2009, the district court denied the motion to dismiss the RICO count, but it granted the motion to dismiss the constructive trust count, stating that it did not have jurisdiction in this case to impose the constructive trust. The Four Casinos have appealed this dismissal to the Seventh Circuit Court of Appeals. The appellate court has ordered that any monies disbursed to the tracks be maintained until the appeal has been decided.

In August 2007, a complaint was filed on behalf of a putative class of public shareholders of the Company, and derivatively on behalf of the Company, in the Court of Common Pleas of Berks County, Pennsylvania (the "Complaint"). The Complaint names the Company's Board of Directors as defendants and the Company as a nominal defendant. The Complaint alleges, among other things, that the Board of Directors breached their fiduciary duties by agreeing to the proposed transaction with Fortress and Centerbridge for inadequate consideration, that certain members of the Board of Directors have conflicts with regard to the Merger, and that the Company and its Board of Directors have failed to disclose certain material information with regard to the Merger. The Complaint seeks, among other things, a court order determining that the action is properly maintained as a class action

and a derivative action enjoining the Company and its Board of Directors from consummating the proposed Merger, and awarding the payment of attorneys' fees and expenses. The Company and the plaintiff had reached a tentative settlement, contingent upon consummation of the transaction with Fortress and Centerbridge, in which the Company agreed to pay certain attorneys' fees and to make certain disclosures regarding the events leading up to the transaction with Fortress and Centerbridge in the proxy statement sent to shareholders in November 2007. The case was terminated by the court for inactivity on September 7, 2009, and no payments were made.

On July 16, 2008, the Company was served with a purported class action lawsuit brought by plaintiffs seeking to represent a class of shareholders who purchased shares of the Company's Common Stock between March 20, 2008 and July 2, 2008. The lawsuit alleges that the Company's disclosure practices relative to the proposed transaction with Fortress and Centerbridge and the eventual termination of that transaction were misleading and deficient in violation of the Securities Exchange Act of 1934. The complaint, which seeks class certification and unspecified damages, was filed in federal court in Maryland. The complaint was amended, among other things, to add three new named plaintiffs and to name Peter M. Carlino, Chairman and Chief Executive Officer, and William J. Clifford, Senior Vice President and Chief Financial Officer, as additional defendants. The Company filed a motion to dismiss the complaint in November 2008, and the court granted the motion and dismissed the complaint with prejudice. The plaintiffs filed a motion for reconsideration, which was denied on October 21, 2009. The plaintiffs have appealed the decision and the parties are in the process of filing appellate briefs.

On September 11, 2008, the Board of County Commissioners of Cherokee County, Kansas (the "County") filed suit against Kansas Penn Gaming, LLC ("KPG," a wholly-owned subsidiary of Penn created to pursue a development project in Cherokee County, Kansas) and the Company in the District Court of Shawnee County, Kansas. The petition alleges that KPG breached its pre-development agreement with the County when KPG withdrew its application to manage a lottery gaming facility in Cherokee County and seeks in excess of $50 million in damages. In connection with their petition, the County obtained an ex-parte order attaching the $25 million privilege fee paid to the Kansas Lottery Commission in conjunction with the gaming application for the Cherokee County zone. The defendants have filed motions to dissolve and reduce the attachment. Those motions were denied and the defendants appealed those decisions to the appellate court. The Kansas appellate court declined to hear the appeal on jurisdictional grounds and the defendants have requested that the Kansas Supreme Court review that decision.

On September 23, 2008, KPG filed an action against HV Properties of Kansas, LLC ("HV") in the U.S. District Court for the District of Kansas seeking a declaratory judgment from the U.S. District Court finding that KPG has no further obligations to HV under a Real Estate Sale Contract (the "Contract") that KPG and HV entered into on September 6, 2007, and that KPG properly terminated this Contract under the terms of the Repurchase Agreement entered into between the parties effective September 28, 2007. HV filed a counterclaim claiming KPG breached the Contract, and seeks $37.5 million in damages. On October 7, 2008, HV filed suit against the Company claiming the Company is liable to HV for KPG's alleged breach based on a Guaranty Agreement signed by the Company. Both cases were consolidated. The Company filed a motion to dismiss HV's claims, which was denied on May 6, 2009. Discovery has concluded and dispositive motions are currently being briefed by both sides.

**Operating Lease Commitments**

The Company is liable under numerous operating leases for airplanes, automobiles, land for the property on which some of its casinos operate, other equipment and buildings, which expire at various dates through 2093. Total rental expense under these agreements was $31.5 million, $30.7 million and $29.6 million for the years ended December 31, 2009, 2008, and 2007, respectively.

The leases for land consist of annual base lease rent payments plus, in some instances, a percentage rent based on a percent of adjusted gaming wins, as described in the respective leases.

The Company has an operating lease with the City of Bangor which covers the permanent facility that opened on July 1, 2008. Under the lease agreement, there is a fixed rent provision, as well as a revenue-sharing provision which is equal to 3% of gross slot revenue. The final term of the lease, which commenced with the opening of the permanent facility, is for an initial term of fifteen years, with three ten-year renewal options.

On March 23, 2007, BTN, Inc. ("BTN"), one of the Company's wholly-owned subsidiaries, entered into an amended and restated ground lease (the "Amended Lease") with Skrmetta MS, LLC. The lease amends the prior ground lease, dated October 19, 1993. The Amended Lease requires BTN to maintain a minimum gaming operation on the leased premises and to pay rent equal to 5% of adjusted gaming win after gaming taxes have been deducted. The term of the Amended Lease expires on January 1, 2093.

The future minimum lease commitments relating to the base lease rent portion of noncancelable operating leases at December 31, 2009 are as follows (in thousands):

| Year ending December 31, | |
|---|---|
| 2010 | $ 7,006 |
| 2011 | 6,672 |
| 2012 | 5,480 |
| 2013 | 4,639 |
| 2014 | 3,823 |
| Thereafter | 36,328 |
| Total | $63,948 |

**Capital Expenditure Commitments**

At December 31, 2009, the Company was contractually committed to spend approximately $53.1 million in capital expenditures for projects in progress.

**Employee Benefit Plans**

The Company maintains a profit-sharing plan under the provisions of Section 401(k) of the Internal Revenue Code of 1986, as amended, which covers all eligible employees. The plan enables participating employees to defer a portion of their salary in a retirement fund to be administered by the Company. The Company makes a discretionary match contribution of 50% of employees' elective salary deferrals, up to a maximum of 6% of eligible employee compensation.

The Company also has a defined contribution plan, the Charles Town Races Future Service Retirement Plan, covering substantially all of its union employees at the Charles Town Entertainment Complex. The Company makes annual contributions to this plan for the eligible union employees and to the Penn National Gaming, Inc. 401(k) Plan for the eligible non-union employees for an amount equal to the amount accrued for retirement expense, which is calculated as 0.25% of the daily mutual handle and 1.0% up to a base of the net video lottery revenues and, after the base is met, it reverts to 0.5%.

The Company maintains a non-qualified deferred compensation plan that covers most management and other highly-compensated employees. This plan was effective March 1, 2001. The plan allows the participants to defer, on a pre-tax basis, a portion of their base annual salary and bonus, and earn tax-deferred earnings on these deferrals. The plan also provides for matching Company contributions that vest over a five-year period. The Company has established a Trust, and transfers to the Trust, on a periodic basis, an amount necessary to provide for its respective future liabilities with respect to

participant deferral and Company contribution amounts. The Company's matching contributions in 2009, 2008 and 2007 were $1.5 million, $1.7 million and $2.2 million, respectively.

**Agreements with Horsemen and Pari-Mutuel Clerks**

The Company is required to have agreements with the horsemen at each of its racetracks to conduct its live racing and simulcasting activities, with the exception of the Company's tracks in Ohio and New Mexico. In addition, in order to operate gaming machines in West Virginia, the Company must maintain agreements with each of the Charles Town Horsemen, pari-mutuel clerks and breeders.

At the Charles Town Entertainment Complex, the Company has an agreement with the Charles Town Horsemen with an initial term expiring on December 31, 2011, and an agreement with the breeders that expires on June 30, 2010. The pari-mutuel clerks at Charles Town are represented under a collective bargaining agreement with the West Virginia Division of Mutuel Clerks, which expires on December 31, 2010.

The Company's agreement with the Pennsylvania Thoroughbred Horsemen at Penn National Race Course expires on September 30, 2011. The Company has a collective bargaining agreement with Local 137 of the Sports Arena Employees (AFL-CIO) at Penn National Race Course with respect to pari-mutuel clerks, admissions and Telebet personnel which expires on December 31, 2011. The Company also has an agreement in place with the Sports Arena Employees Local 137 (AFL-CIO) with respect to pari-mutuel clerks and admission personnel at the Company's OTWs, which expired on September 30, 2009 and has been extended pending continuing negotiations.

The Company's agreement with the Maine Harness Horsemen Association at Bangor Raceway expires on December 31, 2011.

The Company's agreement with the Ohio Harness Horsemen Association expires on December 31, 2012.

Pennwood Racing, Inc. also has an agreement in effect with the horsemen at Freehold Raceway, which expires on December 31, 2011.

Throughout the Argosy properties, the Seafarers Entertainment and Allied Trade Union represents approximately one thousand eight hundred of the Company's employees. At the Empress Casino Hotel, the Hotel Employees and Restaurant Employees Union ("UNITE/HERE") Local 1 represents approximately three hundred employees under a collective bargaining agreement which expires on March 31, 2011. At certain of the Company's Argosy properties, the Seafarer International Union of North America, Atlantic, Gulf, Lakes and Inland Waters District/NMU, AFL-CIO, the International Brotherhood of Electrical Workers, the Security Police and Fire Professionals of America, the American Maritime Officers Union, the International Brotherhood of Electrical Workers Local 176, and UNITE/HERE Local 10 represent certain of the Company's employees. The Company has collective bargaining agreements with these unions that expire at various times between July 2010 and October 2015. None of these unions individually represent more than fifty of the Company's employees.

If the Company fails to maintain operative agreements with the horsemen at a track, it will not be permitted to conduct live racing and export and import simulcasting at that track and OTWs and, in West Virginia, the Company will not be permitted to operate its gaming machines. In addition, the Company's simulcasting agreements are subject to the horsemen's approval. If the Company fails to renew or modify existing agreements on satisfactory terms, this failure could have a material adverse effect on its business, financial condition and results of operations. Except for the closure of the facilities at Penn National Race Course and its OTWs from February 16, 1999 to March 24, 1999 due to a horsemen's strike, and a few days at other times and locations, the Company has been able to maintain the necessary agreements. There can be no assurance that the Company will be able to maintain the required agreements.

**New Jersey Joint Venture**

On January 28, 1999, the Company, along with its joint venture partner, Greenwood Limited Jersey, Inc. ("Greenwood"), purchased certain assets and assumed certain liabilities of Freehold Racing Association, Garden State Racetrack and related entities, in a transaction accounted for as a purchase transaction.

In 1999, the Company made an $11.3 million loan to the joint venture and an equity investment of $0.3 million. In 2008, the balance of the loan was increased by $0.5 million to $11.8 million to substitute a payment of interest on the loan. The loan is evidenced by a subordinated secured note, which is included in investment in and advances to unconsolidated affiliates within the consolidated balance sheets. The $11.3 million portion of the note bears interest at prime plus 2.25% or a minimum of 10.00% (at December 31, 2009, the interest rate was 10.00%). The $0.5 million portion of the note bears interest at the lesser of prime plus 2.00% or the 30-day LIBOR plus 3.00% (at December 31, 2009, the interest rate was 3.23%). The Company has recorded interest income within the consolidated statements of operations of $1.2 million, $1.2 million and $1.2 million for the years ended December 31, 2009, 2008 and 2007, respectively.

The joint venture, through Freehold Racing Association, was part of a multi-employer pension plan. For collectively bargained, multi-employer pension plans, contributions were made in accordance with negotiated labor contracts and generally were based on days worked. With the passage of the Multi-Employer Pension Plan Amendments Act of 1980, the joint venture may, under certain circumstances, become subject to liabilities in excess of contributions made under collective bargaining agreements. Generally, these liabilities are contingent upon the termination, withdrawal, or partial withdrawal from the plans. In June 2006, Freehold Racing Association withdrew from the multi-employer pension plan, and thereby became subject to payment of a withdrawal liability to the multi-employer pension plan. In January 2008, Freehold Racing Association was informed that the multi-employer pension plan experienced a mass withdrawal termination as of December 25, 2007. In November 2009, Freehold Racing Association received notice and demand for payment of the reallocation component of the joint venture withdrawal liability. The reallocation liability was calculated to be $5.1 million as of the date of withdrawal. Freehold Racing Association's obligation will continue until 2055 or such time that it is notified that the obligation has been satisfied. At December 31, 2009, the joint venture withdrawal liability was approximately $5.0 million for Freehold Racing Association.

The Company and Greenwood entered into a Debt Service Maintenance Agreement with a bank in which each joint venture partner has guaranteed up to 50% of a $23.0 million term loan to the joint venture. The Debt Service Maintenance Agreement remains in effect for the life of the loan and was due to expire on September 30, 2009. In 2008, the joint venture borrowed an additional $1.75 million and the maturity date of the term loan was extended to September 30, 2013. In 2009, certain terms and conditions of the agreement were amended, including the interest rates to be applied and the payment schedule. At December 31, 2009, the outstanding balance on the loan to the joint venture amounted to $8.7 million, of which the Company's obligation under its guarantee of the term loan was limited to approximately $4.4 million. The Company's investment in the joint venture is accounted for under the equity method. The original investment was recorded at cost and has been adjusted by the Company's share of income (loss) of the joint venture and distributions received. The Company's 50% share of the income (loss) of the joint venture is included in other income (expenses) within the consolidated statements of operations.

**13. Income Taxes**

Deferred tax assets and liabilities are provided for the effects of temporary differences between the tax basis of an asset or liability and its reported amount in the consolidated balance sheets. These temporary differences result in taxable or deductible amounts in future years.

The components of the Company's deferred tax assets and liabilities are as follows:

| Year ended December 31, | 2009 | 2008 |
|---|---|---|
| | (in thousands) | |
| Deferred tax assets: | | |
| Stock-based compensation expense | $ 26,499 | $ 17,510 |
| Accrued expenses | 26,092 | 21,973 |
| Deferred tax assets resulting from unrecognized tax benefits | 11,682 | 12,751 |
| State net operating losses | 7,404 | 6,622 |
| Accumulated other comprehensive loss | 14,916 | 21,929 |
| Gross deferred tax assets | 86,593 | 80,785 |
| Less valuation allowance | (4,268) | (3,860) |
| Net deferred tax assets | 82,325 | 76,925 |
| Deferred tax liabilities: | | |
| Property, plant and equipment | (86,334) | (86,342) |
| Intangibles | (99,479) | (235,128) |
| Net deferred tax liabilities | (185,813) | (321,470) |
| Net: | $(103,488) | $(244,545) |
| Reflected on consolidated balance sheets: | | |
| Current deferred tax assets, net | $ 23,619 | $ 21,065 |
| Noncurrent deferred tax liabilities, net | (127,107) | (265,610) |
| Net deferred taxes | $(103,488) | $(244,545) |

For income tax reporting, the Company has state net operating loss carryforwards aggregating approximately $157.3 million available to reduce future state income taxes primarily for the Commonwealth of Pennsylvania and the State of Mississippi as of December 31, 2009. The tax benefit associated with these net operating loss carryforwards is approximately $7.4 million. Due to state tax statutes on annual net operating loss utilization limits, the availability of gaming tax credits, and income and loss projections in the applicable jurisdictions, a $3.9 million valuation allowance has been recorded to reflect the net operating losses which are not presently expected to be realized. In addition, a $0.4 million valuation has been recorded to reflect the income tax effect of unrealized capital loss carryforwards of the Company which are not presently expected to be realized. If not used, substantially all the carryforwards will expire at various dates from December 31, 2010 to December 31, 2029. In the event that the valuation allowance is ultimately unnecessary, the majority would be treated as a reduction of tax expense.

In addition, certain subsidiaries have accumulated state net operating loss carryforwards aggregating approximately $650.5 million for which no benefit has been recorded as they are attributable to uncertain tax positions. The unrecognized tax benefits as of December 31, 2009 attributable to these net operating losses was approximately $42.1 million. Due to the uncertain tax position, these net operating losses are not included as components of deferred tax assets as of December 31, 2009. In the event of any benefit from realization of these net operating losses, $8.6 million would be treated as an increase to equity, and the remainder would be treated as a reduction of tax expense. If not used, substantially all the carryforwards will expire at various dates from December 31, 2010 to December 31, 2029.

The provision for income taxes charged to operations was as follows:

| Year ended December 31, | 2009 | 2008 | 2007 |
|---|---|---|---|
| | | (in thousands) | |
| Current tax expense | | | |
| Federal | $ 65,941 | $157,043 | $ 75,959 |
| State | 20,232 | 35,461 | 28,536 |
| Foreign | (233) | 4,332 | 9,427 |
| Total current | 85,940 | 196,836 | 113,922 |
| Deferred tax (benefit) expense | | | |
| Federal | (112,072) | (78,895) | 16,223 |
| State | (34,336) | (12,203) | 2,042 |
| Total deferred | (146,408) | (91,098) | 18,265 |
| Total provision | $ (60,468) | $105,738 | $132,187 |

The following table reconciles the statutory federal income tax rate to the actual effective income tax rate for 2009, 2008 and 2007:

| Year ended December 31, | 2009 | 2008 | 2007 |
|---|---|---|---|
| Percent of pretax income | | | |
| Federal taxes | 35.0% | 35.0% | 35.0% |
| State and local income taxes | 3.3% | (32.0)% | 6.8% |
| Permanent differences | (20.5)% | (217.9)% | 2.6% |
| Foreign | 0.4% | (7.5)% | 1.2% |
| Other miscellaneous items | 0.2% | 0.2% | (0.4)% |
| | 18.4% | (222.2)% | 45.2% |

| Year ended December 31, | 2009 | 2008 | 2007 |
|---|---|---|---|
| | | (in thousands) | |
| Amount based upon pretax income | | | |
| Federal taxes | $(114,758) | $(16,655) | $102,284 |
| State and local income taxes | (10,671) | 15,229 | 19,953 |
| Permanent differences | 67,166 | 103,707 | 7,460 |
| Foreign | (1,291) | 3,587 | 3,453 |
| Other miscellaneous items | (914) | (130) | (963) |
| | $ (60,468) | $105,738 | $132,187 |

The Company adopted the provisions of ASC 740 on January 1, 2007. As a result of the implementation of ASC 740, the Company recognized a liability for unrecognized tax benefits of approximately $11.9 million, which was accounted for as a reduction to the January 1, 2007 retained earnings balance. The liability for unrecognized tax benefits is included in noncurrent tax liabilities within the consolidated balance sheet at December 31, 2009 and 2008.

A reconciliation of the beginning and ending amount for the liability for unrecognized tax benefits is as follows:

| | Noncurrent tax liabilities |
|---|---|
| | (in thousands) |
| Balance at January 1, 2008 | $ 82,849 |
| Additions based on current year tax positions | 10,702 |
| Additions based on prior year tax positions | 2,105 |
| Decreases due to settlements and/or reduction in liabilities | (6,984) |
| Currency translation adjustments | (20,040) |
| Balance at December 31, 2008 | 68,632 |
| Additions based on current year tax positions | 4,614 |
| Additions based on prior year tax positions | 9,333 |
| Decreases due to settlements and/or reduction in liabilities | (45,848) |
| Currency translation adjustments | 9,971 |
| Balance at December 31, 2009 | $ 46,702 |

Included in the liability for unrecognized tax benefits at December 31, 2009 and 2008 were $9.5 million and $31.7 million, respectively, of tax positions that are indemnified by a third party. The indemnification stems from a transaction the Company completed in 2001 with The Continental Companies and CHC International, Inc. (the "Seller") whereby the Company acquired Casino Rouge in Baton Rouge, Louisiana and the management contract for Casino Rama in Orillia, Ontario, Canada. As part of the acquisition, Continental and the Company entered into an Indemnification Agreement whereby Continental indemnified the Company for any tax liabilities to arise subsequent to the acquisition for taxation years which Continental was the owner. The Canada Revenue Agency ("CRA") proposed a reassessment of CHC Canada in respect to its 1996 through 2000 taxation years. The Company and Seller disagreed with the CRA's position, and the matter was placed in Competent Authority in 2004.

On May 20, 2009, the Company was notified by the Competent Authority Services Division of the CRA that the CRA and the U.S. Competent Authority ("IRS") negotiated a settlement regarding the years under assessment from the CRA—1996 through 2000 taxation years. According to the terms of the agreement, the CRA had agreed to reduce their original disallowance of management fees charged by the Company's indirect U.S. subsidiary CRC Holdings, Inc. to CHC Casinos Canada, Limited from CND$54,472,752 to CND$13,556,919 in exchange for the IRS granting relief by allowing CRC Holdings-US to decrease its income by $9,130,658 (US$) (or $13,556,919 (CND$)) and repay the $9,130,658 (US$) to CHC Casinos Canada Limited free of any U.S. withholding taxes.

On November 27, 2009, the Company received from the CRA Notice of Reassessment ("Notice") for the taxation years covered under the Component Authority settlement. In accordance with the terms of the Notice, the Company paid CND$8,466,363.09 on December 16, 2009. Based upon the calculations within the Notice, the Company recalculated its pre-acquisition liability/indemnification receivable and decreased its liability/indemnification receivable. As of December 31, 2009, the Company is currently working with Continental to be reimbursed in accordance with the Indemnification Agreement. Once payment is received by the Company, it will reverse the federal portion of the indemnification receivable. For the years after 2001, where the Company has no indemnification, it has included in the liability for unrecognized tax benefits $22.0 million of tax reserves, including $12.6 million of accrued interest and penalties.

Included in the liability for unrecognized tax benefits at December 31, 2009 and 2008 were $10.0 million and ($20.0) million, respectively, of currency translation adjustments for foreign currency tax positions.

Included in the liability for unrecognized tax benefits at December 31, 2009 and 2008 were $37.2 million and $36.6 million, respectively, of tax positions that, if reversed, would affect the effective tax rate.

The Company is required under ASC 740 to disclose its accounting policy for classifying interest and penalties, the amount of interest and penalties charged to expense each period, as well as the cumulative amounts recorded in the consolidated balance sheets. The Company will continue to classify any tax-related penalties and interest accrued related to unrecognized tax benefits in taxes on income within the consolidated statements of operations.

During the years ended December 31, 2009 and 2008, the Company recognized approximately $2.7 million and $2.5 million, respectively, of interest and penalties, net of deferred taxes. In addition, due to settlements and/or reductions in previously recorded liabilities on uncertain tax positions, the Company had reductions in previously accrued interest and penalties of $1.6 million, net of deferred taxes. The Company has accrued approximately $25.9 million (gross) for the payment of interest and penalties at December 31, 2009. These accruals were included in noncurrent tax liabilities within the consolidated balance sheet at December 31, 2009.

The Company is currently in various stages of the examination and appeal process in connection with our open audits. Generally, it is difficult to determine when these examinations will be closed, but the Company reasonably expects that its ASC 740 liabilities will not significantly change over the next twelve months.

As of December 31, 2009, the Company is subject to U.S. Federal income tax examinations for the tax years 2006, 2007 and 2008. In addition, the Company is subject to state and local income tax examinations for various tax years in the taxing jurisdictions in which the Company operates.

## 14. Shareholders' Equity

### Shareholder Rights Plan

On May 20, 1998, the Board of Directors of the Company authorized and declared a dividend distribution of one preferred stock purchase right (the "Right" or "Rights") for each outstanding share of the Company's Common Stock, par value $.01 per share, payable to shareholders of record at the close of business on March 19, 1999. In addition, a Right was issued for each share of the Company's Common Stock issued after March 19, 1999 and prior to the Rights' expiration. Each Right entitled the registered holder to purchase from the Company one one-hundredth of a share (a "Preferred Stock Fraction") of the Company's Series A Preferred Stock (or another series of preferred stock with substantially similar terms), or a combination of securities and assets of equivalent value, at a purchase price of $10.00 per Preferred Stock Fraction, subject to adjustment. The description and terms of the Rights were set forth in a Rights Agreement (the "Rights Agreement") dated March 2, 1999, and amended on June 15, 2007, between the Company and Continental Stock Transfer and Trust Company as Rights Agent. The Rights Agreement and the associated Rights expired on March 18, 2009.

### Issuance of the $1.25 billion, Zero Coupon Preferred Equity Investment

On July 3, 2008, the Company entered into an agreement with certain affiliates of Fortress and Centerbridge, terminating the Merger Agreement. In connection with the termination of the Merger Agreement, the Company agreed to receive a total of $1.475 billion, consisting of the Cash Termination Fee and the Investment. On October 30, 2008, the Company closed the sale of the Investment and issued 12,500 shares of Preferred Stock.

The Investment is generally non-voting, but possesses voting rights with respect to certain extraordinary events. The Investment is entitled to vote with the Common Stock on an as-converted basis with respect to any change-in-control or other significant transaction if the consideration to be paid to shareholders is less than $45 per share (which amount is subject to adjustment in certain circumstances). In addition, the approval of holders of a majority of the Investment shares is required

to authorize (i) special dividends to security holders of the Company; (ii) issuance by the Company of equity securities senior to or on a parity with the Investment; (iii) stock repurchases, including but not limited to, by means of a tender offer which is funded by an asset sale outside the ordinary course (other than repurchases in the open market and repurchases by tender offer at not greater than a 20% premium); and (iv) certain other amendments to the terms of the Investment. The Investment has an aggregate liquidation preference equal to $1.25 billion, the aggregate purchase price paid for the Investment shares (the "Purchase Price"), subject to certain adjustments. In addition, the Investment terms provide that the Investment participates in any dividends paid on the Common Stock. To the extent that the Company pays a special dividend, such special dividend will reduce the amount to be paid to the holders of the Investment upon a liquidation or redemption.

The Company is required to redeem all of the outstanding shares of the Investment on June 30, 2015, unless a change-in-control transaction in which all holders of shares of the Common Stock receive consideration in the transaction has occurred prior to that time. In the event of such a change-in-control transaction, the holders of the Investment will receive cash and/or other consideration in such transaction (the same consideration as the holders of Common Stock receive) with a value equal to the net present value of the Purchase Price, subject to increase or decrease in the event that the value of the consideration paid to the holders of the Common Stock is greater than $67 per share or less than $45 per share, respectively, which thresholds are subject to adjustment in certain circumstances.

The redemption price to be paid to the holders of the Investment on June 30, 2015 is equal to the Purchase Price, subject to increase or decrease in the event that the average trading price of the Common Stock (measured over the 20 consecutive trading days prior to May 26, 2015) is greater than $67 per share or less than $45 per share, respectively. There is no coupon payable with respect to the Investment. The Company shall redeem all of the Investment for cash, provided the Company may elect on or prior to June 1, 2015 to pay all or part of the redemption price in shares of the Common Stock. At December 31, 2009, the redemption price was $755.3 million (27.8 million shares of Common Stock if the Company elected to redeem through the issuance of Common Stock).

The holders of the Investment are subject to the Investor Rights Agreement, dated as of July 3, 2008, by and among the Company, FIF V PFD LLC, Centerbridge Capital Partners, L.P., DB Investment Partners, Inc. and Wachovia Investment Holdings, LLC. (the "Investor Rights Agreement"), which, among other things, contains a voting agreement requiring certain Investment holders to vote all of their shares of Common Stock as directed by the Company and a standstill agreement restricting the activities of certain Investment holders. In addition, Investment holders who may receive 20% or more of the outstanding Common Stock upon redemption would be subject to Subchapter 25G of the Pennsylvania Business Corporation Law of 1988, as amended (the "Control Share Statute"). The Control Share Statute prohibits any person or group that acquires more than 20% of the voting power of the Company from voting any securities held by such person or group unless the shareholders vote to accord voting rights to such securities within 90 days of the time such threshold was exceeded. Under the Investment terms, unless such shareholder approval is obtained, the Investment holders shall execute and deliver a proxy in favor of an attorney-in-fact to be designated by the Board of Directors covering the number of shares of Common Stock necessary to avoid the application of the Control Share Statute.

The Investor Rights Agreement also provides that until Fortress and its affiliates own less than two-thirds of the shares of the Investment issued to them on October 30, 2008, Fortress and the Company must take all action in their power to appoint one designee of the purchasers (the "Purchaser Designee") as a Class II director on the Board of Directors and to use all commercially reasonable efforts to cause the election of the Purchaser Designee at every meeting thereafter at which a Class II director is to be elected. The initial Purchaser Designee is Wesley R. Edens. Mr. Edens is the founding principal, Chief Executive Officer and Chairman of the Board of Directors of Fortress.

Under the terms of the Investor Rights Agreement, the Company has agreed to file a short-form registration statement with the U.S. Securities and Exchange Commission for the registration and sale of Investment shares and certain shares of Common Stock owned by the purchasers ("Registrable Securities"), which it filed on December 30, 2008. The Company is required to keep the shelf registration statement continuously effective under the Securities Act of 1933, as amended, until the earlier of (i) such time as all Registrable Securities have been sold and (ii) such time as the purchasers beneficially own (as defined in the Investor Rights Agreement) less than 2.5% of the Common Stock on a fully-diluted basis (including Common Shares issuable upon redemption of the Investment shares at maturity). The purchasers and any permitted transferees of Registrable Securities are also entitled to four demand registrations and unlimited piggyback registration during the term of the Investor Rights Agreement.

Pursuant to the Investor Rights Agreement, the Investment holders may not directly or indirectly sell, transfer, pledge, encumber, assign or otherwise dispose of any portion of any Investment shares to any person without the prior written consent of the Company prior to July 21, 2009. However, the Investment holders may sell, transfer, pledge, encumber, assign or otherwise dispose of their Investment shares prior to July 21, 2009 if such transaction is made: (i) to an affiliate of any such Investment holder which agrees to be bound by the terms of the Investor Rights Agreement; (ii) with the prior written consent of the Company's Board of Directors, to a person pursuant to a tender or exchange offer for Investment shares or Common Stock by such person or a merger, consolidation or reorganization of the Company with such person; (iii) if the Company acknowledges in writing that it is unable to pay its debts, commences a voluntary case in bankruptcy or a voluntary petition seeking reorganization or makes an assignment for the benefit of creditors; or (iv) if the Company consents to the entry of an order for relief against it seeking liquidation, reorganization or a creditor's arrangement of the Company.

Under the Investor Rights Agreement, each Investment holder has preemptive rights with respect to certain sales of Common Stock, stock options or securities convertible into Common Stock for so long as such holder beneficially owns at least two-thirds of the shares of the Investment issued to it on October 30, 2008.

**15. Noncontrolling Interests**

In November 2009, the Company entered into an agreement with Lakes Entertainment, Inc. ("Lakes"), permitting Lakes to invest in up to a 10% equity interest in each of the Company's proposed facilities in Columbus and Toledo, Ohio. During the year ended December 31, 2009, Lakes contributed $1.9 million to the Company towards the proposed facilities, and its portion of the net loss for the proposed facilities was $2.5 million. The noncontrolling interest is included in shareholders' equity within the consolidated balance sheet at December 31, 2009, stated separately from the Company's shareholders' equity.

**16. Stock-Based Compensation**

In April 1994, the Company's Board of Directors and shareholders adopted and approved the 1994 Stock Option Plan (the "1994 Plan"). The 1994 Plan permitted the grant of options to purchase up to 12,000,000 shares of Common Stock, subject to antidilution adjustments, at a price per share no less than 100% of the fair market value of the Common Stock on the date an option is granted with respect to incentive stock options only. The price would be no less than 110% of fair market value in the case of an incentive stock option granted to any individual who owns more than 10% of the total combined voting power of all classes of outstanding stock. The 1994 Plan provided for the granting of both incentive stock options intended to qualify under Section 422 of the Internal Revenue Code of 1986, as amended, and nonqualified stock options, which do not so qualify. The options granted prior to the 2003 Plan remain outstanding.

On April 16, 2003, the Company's Board of Directors adopted and approved the 2003 Long Term Incentive Compensation Plan (the "2003 Plan"). On May 22, 2003, the Company's shareholders approved the 2003 Plan. The 2003 Plan was effective June 1, 2003 and permitted the grant of options to purchase Common Stock and other market-based and performance-based awards. Up to 12,000,000 shares of Common Stock were available for awards under the 2003 Plan. The 2003 Plan provided for the granting of both incentive stock options intended to qualify under Section 422 of the Internal Revenue Code of 1986, as amended, and nonqualified stock options, which do not so qualify. The exercise price per share may be no less than (i) 100% of the fair market value of the Common Stock on the date an option is granted for incentive stock options and (ii) 85% of the fair market value of the Common Stock on the date an option is granted for nonqualified stock options. This plan will remain in place until it terminates in 2013. However the shares which remained available for issuance under such plan as of November 12, 2008 are no longer available for issuance and all future equity awards will be pursuant to the 2008 Plan described below.

On August 20, 2008, the Company's Board of Directors adopted and approved the 2008 Long Term Incentive Compensation Plan (the "2008 Plan"). On November 12, 2008, the Company's shareholders approved the 2008 Plan. The 2008 Plan permits the Company to issue stock options (incentive and/or non-qualified), stock appreciation rights, restricted stock, phantom stock units and other equity and cash awards to employees. Non-employee directors are eligible to receive all such awards, other than incentive stock options. The aggregate number of shares of Common Stock that may be issued under the 2008 Plan shall not exceed 6,900,000. Awards of stock options and stock appreciation rights will be counted against the 6,900,000 limit as one share of Common Stock for each share granted. However each share awarded in the form of restricted stock, phantom stock units or any other full value stock award will be counted as issuing 2.16 shares of Common Stock for purposes of determining the number of shares available for issuance under the plan. At December 31, 2009, there were 4,401,889 options available for future grants under the 2008 Plan.

Stock options that expire between February 12, 2010 and September 11, 2018 have been granted to officers, directors and employees to purchase Common Stock at prices ranging from $7.75 to $61.82 per share. All options were granted at the fair market value of the Common Stock on the date the options were granted.

The following table contains information on stock options issued under the plans for the three-year period ended December 31, 2009:

| | Number of Option Shares | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Term (in years) | Aggregate Intrinsic Value (in thousands) |
|---|---|---|---|---|
| Outstanding at December 31, 2006 | 8,110,601 | $21.87 | 4.97 | $160,225 |
| Granted | 1,458,750 | 42.21 | | |
| Exercised | (1,824,071) | 13.66 | | |
| Canceled | (495,375) | 28.44 | | |
| Outstanding at December 31, 2007 | 7,249,905 | $27.58 | 4.87 | $231,837 |
| Granted | 1,834,000 | 29.56 | | |
| Exercised | (203,202) | 11.80 | | |
| Canceled | (76,125) | 37.00 | | |
| Outstanding at December 31, 2008 | 8,804,578 | $28.27 | 6.30 | $ 17,677 |
| Granted | 1,849,375 | 22.32 | | |
| Exercised | (491,078) | 11.06 | | |
| Canceled | (196,750) | 32.27 | | |
| Outstanding at December 31, 2009 | 9,966,125 | $27.83 | 5.67 | $ 33,038 |

Included in the above are Common Stock options that were issued in 2003 to the Company's Chairman outside of the 1994 Plan and the 2003 Plan. These options were issued at $7.95 per share, and are exercisable through February 6, 2013. At December 31, 2009 and 2008, the number of these Common Stock options that were outstanding was 23,750. On December 31, 2008, the Company modified the expiration date of certain of its stock options from the seventh anniversary of the date of grant to the tenth anniversary of the date of grant. This modification resulted in additional compensation costs related to stock-based compensation of $2.3 million pre-tax ($1.6 million after-tax) for the year ended December 31, 2008.

The weighted-average grant-date fair value of options granted during the years ended December 31, 2009, 2008 and 2007 were $8.91, $10.57 and $16.08, respectively.

| | Number of Option Shares | Weighted-Average Exercise Price |
|---|---|---|
| Exercisable at December 31, | | |
| 2009 | 5,872,151 | $27.41 |
| 2008 | 4,608,441 | 23.60 |
| 2007 | 3,080,480 | 19.74 |

The aggregate intrinsic value of stock options exercised during the years ended December 31, 2009, 2008 and 2007 was $8.4 million, $4.1 million and $74.6 million, respectively.

At December 31, 2009, there were 5,872,151 shares that were exercisable, with a weighted-average exercise price of $27.41, a weighted-average remaining contractual term of 4.82 years, and an aggregate intrinsic value of $22.3 million.

The following table summarizes information about stock options outstanding at December 31, 2009:

| | Exercise Price Range | | | Total |
|---|---|---|---|---|
| | $7.75 to $29.22 | $29.34 to $38.42 | $38.43 to $61.82 | $7.75 to $61.82 |
| **Outstanding options** | | | | |
| Number outstanding | 5,273,461 | 3,332,915 | 1,359,749 | 9,966,125 |
| Weighted-average remaining contractual life (years) | 4.49 | 7.01 | 6.99 | 5.67 |
| Weighted-average exercise price | $ 21.80 | $ 31.53 | $ 42.10 | $ 27.83 |
| **Exercisable options** | | | | |
| Number outstanding | 3,483,336 | 1,680,540 | 708,275 | 5,872,151 |
| Weighted-average exercise price | $ 22.01 | $ 32.40 | $ 42.07 | $ 27.41 |

The following table contains information on restricted stock awards issued under the plans for the three-year period ended December 31, 2009:

| | Number of Award Shares |
|---|---|
| Outstanding at December 31, 2006 | 160,000 |
| Awarded | 280,000 |
| Released | — |
| Canceled | (60,000) |
| Outstanding at December 31, 2007 | 380,000 |
| Awarded | — |
| Released | — |
| Canceled | — |
| Outstanding at December 31, 2008 | 380,000 |
| Awarded | 332,690 |
| Released | (160,000) |
| Canceled | — |
| Outstanding at December 31, 2009 | 552,690 |

Compensation costs related to stock-based compensation for the years ended December 31, 2009, 2008, and 2007 totaled $28.4 million pre-tax ($20.9 million after-tax), $26.9 million pre-tax ($19.8 million after-tax), and $25.5 million pre-tax ($18.6 million after-tax), respectively, and are included within the consolidated statements of operations under general and administrative expense.

At December 31, 2009 and December 31, 2008, the total compensation cost related to nonvested awards not yet recognized equaled $39.5 million and $67.0 million, respectively, including $31.2 million and $63.9 million for stock options, respectively, and $8.3 million and $3.1 million for restricted stock, respectively. This cost is expected to be recognized over the remaining vesting periods, which will not exceed five years.

**17. Segment Information**

In accordance with ASC 280, the Company views each property as an operating segment, and aggregates all of its properties into one reportable segment, as the Company believes that they are economically similar, offer similar types of products and services, cater to the same types of customers and are similarly regulated.

## 18. Summarized Quarterly Data (Unaudited)

The following table summarizes the quarterly results of operations for the years ended December 31, 2009 and 2008:

| | Fiscal Quarter | | | |
|---|---|---|---|---|
| | First | Second | Third | Fourth |
| | (in thousands, except per share data) | | | |
| **2009** | | | | |
| Net revenues | $612,226 | $580,817 | $620,426 | $ 555,806 |
| Income (loss) from operations | 100,835 | 76,705 | 87,404 | (459,542) |
| Net income (loss) attributable to the shareholders of Penn National Gaming, Inc. and subsidiaries | 40,661 | 28,480 | 21,351 | (355,440) |
| Earnings (loss) per common share attributable to the shareholders of Penn National Gaming, Inc. and shareholders: | | | | |
| Basic earnings (loss) per common share | 0.42 | 0.29 | 0.22 | (4.54) |
| Diluted earnings (loss) per common share | 0.38 | 0.27 | 0.20 | (4.54) |
| **2008** | | | | |
| Net revenues | $613,494 | $620,586 | $617,887 | $ 571,086 |
| Income (loss) from operations | 118,559 | 113,591 | 96,377 | (414,968) |
| Net income (loss) attributable to the shareholders of Penn National Gaming, Inc. and subsidiaries | 40,736 | 37,023 | 147,491 | (378,573) |
| Earnings (loss) per common share attributable to the shareholders of Penn National Gaming, Inc. and shareholders: | | | | |
| Basic earnings (loss) per common share | 0.47 | 0.43 | 1.72 | (4.77) |
| Diluted earnings (loss) per common share | 0.46 | 0.42 | 1.69 | (4.77) |

In conjunction with the opening of the new casino riverboat at Hollywood Casino Lawrenceburg, the Company recorded a pre-tax impairment charge for the replaced Lawrenceburg vessel of $11.7 million ($6.8 million, net of taxes) during the second quarter of 2009. In addition, as a result of the anticipated impact of gaming expansion in Ohio, the Company recorded a pre-tax impairment charge of $520.5 million ($368.8 million, net of taxes) during the fourth quarter of 2009, as the Company determined that a portion of the value of the goodwill and indefinite-life intangible assets associated with the original purchase of Hollywood Casino Lawrenceburg was impaired.

As a result of a decline in the Company's share price, an overall reduction in industry valuations, and property operating performance in the then-current economic environment, the Company recorded a pre-tax impairment charge of $481.3 million ($392.6 million, net of taxes) during the fourth quarter of 2008, as the Company determined that a portion of the value of its goodwill, indefinite-life intangible assets and long-lived assets was impaired. The impairment charge by property was as follows: Hollywood Casino Lawrenceburg, $214.1 million pre-tax ($189.3 million, net of taxes); Hollywood Casino Aurora, $43.7 million pre-tax and net of taxes; Empress Casino Hotel, $94.4 million pre-tax ($60.4 million, net of taxes); Argosy Casino Alton, $14.1 million pre-tax and net of taxes; Bullwhackers, $14.2 million pre-tax ($9.1 million, net of taxes); Hollywood Slots Hotel and Raceway, $82.7 million pre-tax ($64.0 million, net of taxes); and Corporate overhead, $18.1 million pre-tax ($12.0 million, net of taxes).

## 19. Related Party Transactions

### Executive Office Lease

The Company currently leases 42,348 square feet of executive office and warehouse space for buildings in Wyomissing, Pennsylvania from affiliates of its Chairman and Chief Executive Officer. Rent

expense for the years ended December 31, 2009, 2008 and 2007 amounted to $0.9 million, $0.8 million and $0.7 million, respectively. The leases for the office space expire in March 2012, May 2012 and May 2013, and the lease for the warehouse space expires in July 2010. The future minimum lease commitments relating to these leases at December 31, 2009 equaled $2.2 million. The Company also paid $0.7 million and $3.7 million in construction costs to these same affiliates for the years ended December 31, 2008 and 2007, respectively.

**20. Subsidiary Guarantors**

Under the terms of the senior secured credit facility, most of Penn's subsidiaries are guarantors under the agreement. Each of the subsidiary guarantors is 100% owned by Penn. In addition, the guarantees provided by such subsidiaries under the terms of the senior secured credit facility are full and unconditional, joint and several. There are no significant restrictions within the senior secured credit facility on the Company's ability to obtain funds from its subsidiaries by dividend or loan. However, in certain jurisdictions, the gaming authorities may impose restrictions pursuant to the authority granted to them with regard to Penn's ability to obtain funds from its subsidiaries.

With regard to the senior secured credit facility, the Company has not presented condensed consolidating balance sheets, condensed consolidating statements of operations and condensed consolidating statements of cash flows at, and for the year ended, December 31, 2007, as Penn had no significant independent assets and no independent operations at, and for the year ended, December 31, 2007. However, during the year ended December 31, 2008, the Company placed some of the funds received from the issuance of its Preferred Stock into unrestricted subsidiaries, in order to allow for maximum flexibility in the deployment of the funds and this resulted in significant independent assets. Summarized financial information for the years ended December 31, 2009 and 2008 for Penn, the subsidiary guarantors of the senior secured credit facility and the subsidiary non-guarantors is presented below.

Under the terms of the $200 million 6⅞% senior subordinated notes, most of Penn's subsidiaries are guarantors under the agreement. Each of the subsidiary guarantors is 100% owned by Penn. In addition, the guarantees provided by such subsidiaries under the terms of the $200 million 6⅞% senior subordinated notes are full and unconditional, joint and several. There are no significant restrictions within the $200 million 6⅞% senior subordinated notes on the Company's ability to obtain funds from its subsidiaries by dividend or loan. However, in certain jurisdictions, the gaming authorities may impose restrictions pursuant to the authority granted to them with regard to Penn's ability to obtain funds from its subsidiaries.

With regard to the $200 million 6⅞% senior subordinated notes, the Company has not presented condensed consolidating balance sheets, condensed consolidating statements of operations and condensed consolidating statements of cash flows at, and for the year ended, December 31, 2007, as Penn had no significant independent assets and no independent operations at, and for the year ended, December 31, 2007. However, during the year ended December 31, 2008, the Company placed some of the funds received from the issuance of its Preferred Stock into unrestricted subsidiaries, in order to allow for maximum flexibility in the deployment of the funds and this resulted in significant independent assets. Summarized financial information for the year ended December 31, 2008 for Penn, the subsidiary guarantors of the $200 million 6⅞% senior subordinated notes and the subsidiary non-guarantors is presented below. Summarized financial information for the year ended December 31, 2009 is not reported because, during the year ended December 31, 2009, the Company repaid all of the outstanding aggregate principal amount of its $200 million 6⅞% senior subordinated notes.

The Company's $250 million 6¾% senior subordinated notes and $325 million 8¾% senior subordinated notes are not guaranteed by the Company's subsidiaries.

| | Penn | Subsidiary Guarantors | Subsidiary Non-Guarantors | Eliminations | Consolidated |
|---|---|---|---|---|---|
| | | | (in thousands) | | |
| **Senior Secured Credit Facility At December 31, 2009 Condensed Consolidating Balance Sheet** | | | | | |
| Total current assets | $ 69,290 | $ 243,073 | $586,140 | $ 39,945 | $ 938,448 |
| Property and equipment, net | 23,273 | 1,774,157 | 40,074 | — | 1,837,504 |
| Total other assets | 4,037,883 | 5,109,436 | 248,058 | (7,458,713) | 1,936,664 |
| Total assets | $4,130,446 | $7,126,666 | $874,272 | $(7,418,768) | $4,712,616 |
| Total current liabilities | $ 83,294 | $ 285,926 | $ 21,106 | $ 39,930 | $ 430,256 |
| Total long-term liabilities | 2,194,508 | 3,221,642 | 61,739 | (3,047,605) | 2,430,284 |
| Total shareholders' equity | 1,852,644 | 3,619,098 | 791,427 | (4,411,093) | 1,852,076 |
| Total liabilities and shareholders' equity | $4,130,446 | $7,126,666 | $874,272 | $(7,418,768) | $4,712,616 |
| **Year Ended December 31, 2009 Condensed Consolidating Statement of Operations** | | | | | |
| Net revenues | $ — | $2,339,014 | $ 30,261 | $ — | $2,369,275 |
| Total operating expenses | 83,823 | 2,424,420 | 55,630 | — | 2,563,873 |
| Loss from operations | (83,823) | (85,406) | (25,369) | — | (194,598) |
| Other income (expenses) | 66,227 | (211,391) | 11,881 | — | (133,283) |
| Loss from operations before income taxes | (17,596) | (296,797) | (13,488) | — | (327,881) |
| Taxes on income | (40,838) | (24,896) | 5,266 | — | (60,468) |
| Net income (loss) including noncontrolling interests | 23,242 | (271,901) | (18,754) | — | (267,413) |
| Less: Net loss attributable to noncontrolling interests | — | — | (2,465) | — | (2,465) |
| Net income (loss) attributable to the shareholders of Penn National Gaming, Inc. and subsidiaries | $ 23,242 | $ (271,901) | $(16,289) | $ — | $ (264,948) |
| **Year Ended December 31, 2009 Condensed Consolidating Statement of Cash Flows** | | | | | |
| Net cash provided by (used in) operating activities | $ 101,367 | $ 241,677 | $ (4,798) | $ — | $ 338,246 |
| Net cash used in investing activities | (1,877) | (236,242) | (24,540) | — | (262,659) |
| Net cash used in financing activities | (95,565) | (2,020) | (11,162) | — | (108,747) |
| Net increase (decrease) in cash and cash equivalents | 3,925 | 3,415 | (40,500) | — | (33,160) |
| Cash and cash equivalents at beginning of year | 2,460 | 142,104 | 601,714 | — | 746,278 |
| Cash and cash equivalents at end of year | $ 6,385 | $ 145,519 | $561,214 | $ — | $ 713,118 |
| **Senior Secured Credit Facility At December 31, 2008 Condensed Consolidating Balance Sheet** | | | | | |
| Total current assets | $ 40,598 | $ 235,862 | $614,787 | $ 15,056 | $ 906,303 |
| Property and equipment, net | 17,707 | 1,781,982 | 12,442 | — | 1,812,131 |
| Total other assets | 4,351,845 | 2,351,302 | 262,923 | (4,494,828) | 2,471,242 |
| Total assets | $4,410,150 | $4,369,146 | $890,152 | $(4,479,772) | $5,189,676 |
| Total current liabilities | $ 105,147 | $ 332,812 | $ 17,468 | $ 15,059 | $ 470,486 |
| Total long-term liabilities | 2,247,736 | 3,667,014 | 97,151 | (3,349,984) | 2,661,917 |
| Total shareholders' equity | 2,057,267 | 369,320 | 775,533 | (1,144,847) | 2,057,273 |
| Total liabilities and shareholders' equity | $4,410,150 | $4,369,146 | $890,152 | $(4,479,772) | $5,189,676 |

| | Penn | Subsidiary Guarantors | Subsidiary Non-Guarantors | Eliminations | Consolidated |
|---|---|---|---|---|---|
| | | | (in thousands) | | |
| **Year Ended December 31, 2008 Condensed Consolidating Statement of Operations** | | | | | |
| Net revenues | $ — | $2,387,358 | $ 35,695 | $ — | $2,423,053 |
| Total operating expenses | 94,925 | 2,352,864 | 61,705 | — | 2,509,494 |
| (Loss) income from operations | (94,925) | 34,494 | (26,010) | — | (86,441) |
| Other income (expenses) | 239,920 | (198,845) | (2,219) | — | 38,856 |
| Income (loss) from operations before income taxes | 144,995 | (164,351) | (28,229) | — | (47,585) |
| Taxes on income | 38,851 | 66,563 | 324 | — | 105,738 |
| Net income (loss) | $ 106,144 | $ (230,914) | $(28,553) | $ — | $ (153,323) |
| **Year Ended December 31, 2008 Condensed Consolidating Statement of Cash Flows** | | | | | |
| Net cash (used in) provided by operating activities | $ (544,759) | $ 360,012 | $605,210 | $ — | $ 420,463 |
| Net cash used in investing activities | (2,085) | (388,361) | (1,052) | — | (391,498) |
| Net cash provided by (used in) financing activities | 552,233 | (2,292) | (7,000) | — | 542,941 |
| Net increase (decrease) in cash and cash equivalents | 5,389 | (30,641) | 597,158 | — | 571,906 |
| Cash and cash equivalents at beginning of year | (2,929) | 172,745 | 4,556 | — | 174,372 |
| Cash and cash equivalents at end of year | $ 2,460 | $ 142,104 | $601,714 | $ — | $ 746,278 |
| **$200 million 6¾% Senior Subordinated Notes At December 31, 2008 Condensed Consolidating Balance Sheet** | | | | | |
| Total current assets | $ 40,598 | $ 236,431 | $614,218 | $ 15,056 | $ 906,303 |
| Property and equipment, net | 17,707 | 1,794,424 | — | — | 1,812,131 |
| Total other assets | 4,351,845 | 2,460,021 | 154,204 | (4,494,828) | 2,471,242 |
| Total assets | $4,410,150 | $4,490,876 | $768,422 | $(4,479,772) | $5,189,676 |
| Total current liabilities | $ 105,147 | $ 338,765 | $ 11,515 | $ 15,059 | $ 470,486 |
| Total long-term liabilities | 2,247,736 | 3,681,006 | 83,159 | (3,349,984) | 2,661,917 |
| Total shareholders' equity | 2,057,267 | 471,105 | 673,748 | (1,144,847) | 2,057,273 |
| Total liabilities and shareholders' equity | $4,410,150 | $4,490,876 | $768,422 | $(4,479,772) | $5,189,676 |
| **Year Ended December 31, 2008 Condensed Consolidating Statement of Operations** | | | | | |
| Net revenues | $ — | $2,406,328 | $ 16,725 | $ — | $2,423,053 |
| Total operating expenses | 94,925 | 2,376,103 | 38,466 | — | 2,509,494 |
| (Loss) income from operations | (94,925) | 30,225 | (21,741) | — | (86,441) |
| Other income (expenses) | 239,920 | (201,134) | 70 | — | 38,856 |
| Income (loss) from operations before income taxes | 144,995 | (170,909) | (21,671) | — | (47,585) |
| Taxes on income | 38,851 | 66,102 | 785 | — | 105,738 |
| Net income (loss) | $ 106,144 | $ (237,011) | $(22,456) | $ — | $ (153,323) |
| **Year Ended December 31, 2008 Condensed Consolidating Statement of Cash Flows** | | | | | |
| Net cash (used in) provided by operating activities | $ (544,759) | $ 367,455 | $597,767 | $ — | $ 420,463 |
| Net cash used in investing activities | (2,085) | (389,413) | — | — | (391,498) |
| Net cash provided by (used in) financing activities | 552,233 | (9,292) | — | — | 542,941 |
| Net increase (decrease) in cash and cash equivalents | 5,389 | (31,250) | 597,767 | — | 571,906 |
| Cash and cash equivalents at beginning of year | (2,929) | 173,684 | 3,617 | — | 174,372 |
| Cash and cash equivalents at end of year | $ 2,460 | $ 142,434 | $601,384 | $ — | $ 746,278 |

## 21. Fair Value Measurements

ASC 820, "Fair Value Measurements and Disclosures," establishes a hierarchy that prioritizes fair value measurements based on the types of inputs used for the various valuation techniques (market approach, income approach, and cost approach). The levels of the hierarchy are described below:

- Level 1: Observable inputs such as quoted prices in active markets for identical assets or liabilities.
- Level 2: Inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly; these include quoted prices for similar assets or liabilities in active markets and quoted prices for identical or similar assets or liabilities in markets that are not active.
- Level 3: Unobservable inputs that reflect the reporting entity's own assumptions.

The Company's assessment of the significance of a particular input to the fair value measurement requires judgment, and may affect the valuation of assets and liabilities and their placement within the fair value hierarchy.

The following tables set forth the assets and liabilities measured at fair value on a recurring basis, by input level, in the consolidated balance sheet at December 31, 2009 and 2008 (in thousands):

| | Balance Sheet Location | Quoted Prices in Active Markets for Identical Assets or Liabilities (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | December 31, 2009 Total |
|---|---|---|---|---|---|
| Assets: | | | | | |
| Investment in corporate debt securities | Other assets | $4,550 | $ — | $— | $ 4,550 |
| Liabilities: | | | | | |
| Interest rate swap contracts | Accrued interest | — | 43,925 | — | 43,925 |

| | Balance Sheet Location | Quoted Prices in Active Markets for Identical Assets or Liabilities (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | December 31, 2008 Total |
|---|---|---|---|---|---|
| Assets: | | | | | |
| Investment in corporate debt securities | Other assets | $40,190 | $ — | $— | $40,190 |
| Liabilities: | | | | | |
| Interest rate swap contracts | Accrued interest | — | 63,185 | — | 63,185 |

The valuation technique used to measure the fair value of the investment in corporate debt securities and interest rate swap contracts was the market approach.

In conjunction with the opening of the new casino riverboat at Hollywood Casino Lawrenceburg, the Company recorded a pre-tax impairment charge for the replaced Lawrenceburg vessel of $11.9 million ($7.1 million, net of taxes) during the year ended December 31, 2009. In addition, as a result of the anticipated impact of gaming expansion in Ohio, the Company recorded a pre-tax impairment charge of $520.5 million ($368.8 million, net of taxes) during the year ended December 31, 2009, as the Company determined that a portion of the value of goodwill and indefinite-life intangible assets associated with the original purchase of Hollywood Casino Lawrenceburg was impaired.

The following table sets forth the assets and liabilities measured at fair value on a nonrecurring basis, by input level, in the consolidated balance sheet at December 31, 2009 (in thousands):

| | Balance Sheet Location | Quoted Prices in Active Markets for Identical Assets or Liabilities (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | December 31, 2009 Total | Total Reduction in Fair Value Recorded at December 31, 2009 |
|---|---|---|---|---|---|---|
| Assets: | | | | | | |
| Goodwill | Goodwill | $— | $ — | $1,379,961 | $1,379,961 | $(213,260) |
| Indefinite-life intangible assets | Other intangible assets | — | — | 368,886 | 368,886 | (307,228) |
| Long-lived assets | Other assets | — | 6,750 | — | 6,750 | (11,889) |
| | | | | | | $(532,377) |

The valuation technique used to measure the fair value of goodwill, indefinite-life intangible assets and long-lived assets was the market approach. See Note 4 to the Consolidated Financial Statements for a description of the inputs and the information used to develop the inputs in calculating the fair value measurements of goodwill, indefinite-life intangible assets and long-lived assets.

**22. Empress Casino Hotel Fire**

On March 20, 2009, the Company's Empress Casino Hotel, which was undergoing a $55 million renovation, was closed following a fire that started in the land-based pavilion at the facility. All customers and employees were successfully evacuated, and the fire was contained on the land-side of the property before it could spread to the adjacent casino barge. On June 25, 2009, the casino barge was reopened with temporary land-based facilities, and the Company began construction of a new land-based pavilion.

The Company carries a builders' risk insurance policy for the on-going renovations with a policy limit of $57 million, inclusive of $14 million for delay in completion and $43 million for property damage. The builders' risk insurance policy includes a $50,000 property damage deductible and a 30-day delay in completion deductible for the peril of fire. In addition, the Company carries comprehensive business interruption and property damage insurance for the operational components of the Empress Casino Hotel with an overall limit of $228 million. The operational insurance policy includes a $2.5 million property damage deductible and a 48-hour business interruption deductible for the peril of fire.

During the year ended December 31, 2009, the Company recorded a $6.1 million pre-tax loss for the insurance deductibles for property damage, business interruption and employee lost wages, as well as a write-off of construction fees related to the renovation that are not recoverable under the Company's insurance policies.

The $33.5 million insurance receivable recorded at December 31, 2009 was limited to the net book value of assets believed to be damaged, destroyed or abandoned and other costs incurred during the year ended December 31, 2009 as a result of the fire at Empress Casino Hotel that are expected to be recovered via the insurance claim. During the year ended December 31, 2009, the Company received $20.6 million in insurance proceeds related to the fire at Empress Casino Hotel.

**23. Discontinued Operations—Sale of The Downs Racing, Inc. and Subsidiaries**

On October 15, 2004, the Company announced the sale of The Downs Racing, Inc. and its subsidiaries to the MTGA. Under the terms of the agreement, the MTGA acquired The Downs Racing, Inc. and its subsidiaries, including Pocono Downs (a standardbred horse racing facility located on 400 acres in Wilkes-Barre, Pennsylvania) and five Pennsylvania OTWs located in Carbondale, East Stroudsburg, Erie, Hazelton and the Lehigh Valley (Allentown). The sale agreement also provided the

MTGA with certain post-closing termination rights in the event of certain materially adverse legislative or regulatory events. In January 2005, the Company received $280 million from the MTGA, and transferred the operations of The Downs Racing, Inc. and its subsidiaries to the MTGA. The sale was not considered final for accounting purposes until the third quarter of 2006, as the MTGA had certain post-closing termination rights that remained outstanding. On August 7, 2006, the Company entered into the Amendment and Release with the MTGA pertaining to the Purchase Agreement, and agreed to pay the MTGA an aggregate of $30 million over five years, beginning on the first anniversary of the commencement of slot operations at Mohegan Sun at Pocono Downs, in exchange for the MTGA's agreement to release various claims it raised against the Company under the Purchase Agreement and the MTGA's surrender of all post-closing termination rights it might have had under the Purchase Agreement. The Company recorded the present value of the $30 million liability within debt, as the amount due to the MTGA was payable over five years. In March 2009, the Company entered into the Third Amendment to the Purchase Agreement, in which the remaining payments due under the Purchase Agreement were accelerated and reduced. Under the Third Amendment to the Purchase Agreement, in exchange for the accelerated payment, which was paid to the MTGA in March 2009, all remaining obligations under the Purchase Agreement were deemed to be satisfied and, as a result, the Company recorded a $1.3 million gain during the year ended December 31, 2009, which is included in other income within the consolidated statements of operations.

**24. Subsequent Events**

The Company evaluated all subsequent events through the date that the consolidated financial statements were issued. No material subsequent events have occurred since December 31, 2009 that required recognition or disclosure in the consolidated financial statements.

# Exhibit 3-a

## Penn National Gaming, Inc.

2008 Financial Statements

## ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

### Report of Independent Registered Public Accounting Firm

Board of Directors
Penn National Gaming, Inc. and subsidiaries

We have audited the accompanying consolidated balance sheets of Penn National Gaming, Inc. and subsidiaries as of December 31, 2008 and 2007, and the related consolidated statements of operations, changes in shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2008. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Penn National Gaming, Inc. and subsidiaries at December 31, 2008 and 2007, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2008, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 4 to the consolidated financial statements, the Company changed the manner in which it accounts for uncertainty in income taxes in 2007.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Penn National Gaming Inc. and subsidiaries' internal control over financial reporting as of December 31, 2008, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 27, 2009, expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Philadelphia, Pennsylvania
February 27, 2009

**Penn National Gaming, Inc. and Subsidiaries**
**Consolidated Balance Sheets**
**(in thousands, except share and per share data)**

| | December 31, 2008 | December 31, 2007 |
|---|---|---|
| **Assets** | | |
| **Current assets** | | |
| Cash and cash equivalents | $ 746,278 | $ 174,372 |
| Receivables, net of allowance for doubtful accounts of $3,797 and $3,241 at December 31, 2008 and 2007, respectively | 43,574 | 56,427 |
| Prepaid expenses and other current assets | 95,386 | 52,825 |
| Deferred income taxes | 21,065 | 19,079 |
| Total current assets | 906,303 | 302,703 |
| **Property and equipment, net** | 1,812,131 | 1,688,393 |
| **Other assets** | | |
| Investment in and advances to unconsolidated affiliate | 14,419 | 15,548 |
| Goodwill | 1,598,571 | 2,013,139 |
| Other intangible assets | 693,764 | 777,441 |
| Deferred financing costs, net of accumulated amortization of $38,914 and $27,680 at December 31, 2008 and 2007, respectively | 34,910 | 46,144 |
| Other assets | 129,578 | 123,664 |
| Total other assets | 2,471,242 | 2,975,936 |
| **Total assets** | $5,189,676 | $4,967,032 |
| **Liabilities** | | |
| **Current liabilities** | | |
| Current maturities of long-term debt | $ 105,281 | $ 93,452 |
| Accounts payable | 35,540 | 28,581 |
| Accrued expenses | 106,769 | 163,579 |
| Accrued interest | 80,190 | 56,631 |
| Accrued salaries and wages | 55,380 | 54,149 |
| Gaming, pari-mutuel, property, and other taxes | 44,503 | 43,621 |
| Income taxes payable | — | 3,642 |
| Insurance financing | 8,093 | 16,515 |
| Other current liabilities | 34,730 | 33,704 |
| Total current liabilities | 470,486 | 493,874 |
| **Long-term liabilities** | | |
| Long-term debt, net of current maturities | 2,324,899 | 2,881,470 |
| Deferred income taxes | 265,610 | 385,089 |
| Noncurrent tax liabilities | 68,632 | 82,849 |
| Other noncurrent liabilities | 2,776 | 2,788 |
| Total long-term liabilities | 2,661,917 | 3,352,196 |
| **Shareholders' equity** | | |
| Preferred stock ($.01 par value, 1,000,000 shares authorized, 12,500 and 0 issued and outstanding at December 31, 2008 and 2007) | — | — |
| Common stock ($.01 par value, 200,000,000 shares authorized, 78,148,488 and 88,579,070 shares issued at December 31, 2008 and 2007, respectively) | 782 | 887 |
| Treasury stock (1,698,800 shares issued at December 31, 2007) | — | (2,379) |
| Additional paid-in capital | 1,442,829 | 322,760 |
| Retained earnings | 662,355 | 815,678 |
| Accumulated other comprehensive loss | (48,693) | (15,984) |
| Total shareholders' equity | 2,057,273 | 1,120,962 |
| **Total liabilities and shareholders' equity** | $5,189,676 | $4,967,032 |

See accompanying notes to the consolidated financial statements.

**Penn National Gaming, Inc. and Subsidiaries**
**Consolidated Statements of Operations**
**(in thousands, except per share data)**

| Year ended December 31, | 2008 | 2007 | 2006 |
|---|---|---|---|
| **Revenues** | | | |
| Gaming | $2,206,500 | $2,227,944 | $2,057,617 |
| Management service fee | 16,725 | 17,273 | 18,146 |
| Food, beverage and other | 334,206 | 320,520 | 275,700 |
| Gross revenues | 2,557,431 | 2,565,737 | 2,351,463 |
| Less promotional allowances | (134,378) | (128,944) | (106,916) |
| Net revenues | 2,423,053 | 2,436,793 | 2,244,547 |
| **Operating expenses** | | | |
| Gaming | 1,163,458 | 1,155,062 | 1,061,904 |
| Food, beverage and other | 264,012 | 247,576 | 224,673 |
| General and administrative | 427,146 | 388,431 | 349,909 |
| Hurricane | — | — | (128,253) |
| Impairment loss | 481,333 | — | 34,522 |
| Depreciation and amortization | 173,545 | 147,915 | 123,951 |
| Total operating expenses | 2,509,494 | 1,938,984 | 1,666,706 |
| (Loss) income from continuing operations | (86,441) | 497,809 | 577,841 |
| **Other income (expenses)** | | | |
| Interest expense | (169,827) | (198,059) | (196,328) |
| Interest income | 8,362 | 4,016 | 3,525 |
| Loss from joint venture | (1,526) | (99) | (788) |
| Merger termination settlement fees, net of related expenses | 195,426 | — | — |
| Other | 6,421 | (11,427) | (4,296) |
| Loss on early extinguishment of debt | — | — | (10,022) |
| Total other income (expenses) | 38,856 | (205,569) | (207,909) |
| **(Loss) income from continuing operations before income taxes** | (47,585) | 292,240 | 369,932 |
| Taxes on income | 105,738 | 132,187 | 156,852 |
| Net (loss) income from continuing operations | (153,323) | 160,053 | 213,080 |
| Gain on sale of discontinued operations, net of tax | — | — | 114,008 |
| **Net (loss) income** | $ (153,323) | $ 160,053 | $ 327,088 |
| **(Loss) earnings per share-Basic** | | | |
| (Loss) income from continuing operations | $ (1.81) | $ 1.87 | $ 2.53 |
| Discontinued operations, net of tax | — | — | 1.35 |
| **Basic (loss) earnings per share** | $ (1.81) | $ 1.87 | $ 3.88 |
| **(Loss) earnings per share-Diluted** | | | |
| (Loss) income from continuing operations | $ (1.81) | $ 1.81 | $ 2.46 |
| Discontinued operations, net of tax | — | — | 1.32 |
| **Diluted (loss) earnings per share** | $ (1.81) | $ 1.81 | $ 3.78 |

See accompanying notes to consolidated financial statements.

## Penn National Gaming, Inc. and Subsidiaries
## Consolidated Statements of Changes in Shareholders' Equity
## (in thousands, except share data)

| | Preferred Stock | | Common Stock | | Treasury Stock | Additional Paid-In Capital | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Total Shareholders' Equity | Comprehensive Income |
|---|---|---|---|---|---|---|---|---|---|---|
| | Shares | Amount | Shares | Amount | | | | | | |
| Balance, December 31, 2005 | — | $— | 85,064,886 | $ 850 | $(2,379) | $ 206,763 | $ 340,469 | $ 840 | $ 546,543 | |
| Stock option activity, including tax benefit of $12,435 | — | — | 1,310,113 | 14 | — | 43,397 | — | — | 43,411 | $ — |
| Restricted stock | — | — | 440,000 | 4 | — | 1,783 | — | — | 1,787 | — |
| Change in fair value of interest rate swap contracts, net of income taxes of $1,461 | — | — | — | — | — | — | — | 2,380 | 2,380 | 2,380 |
| Foreign currency translation adjustment | — | — | — | — | — | — | — | (46) | (46) | (46) |
| Net income | — | — | — | — | — | — | 327,088 | — | 327,088 | 327,088 |
| Balance, December 31, 2006 | — | — | 86,814,999 | 868 | (2,379) | 251,943 | 667,557 | 3,174 | 921,163 | 329,422 |
| Stock option activity, including tax benefit of $20,460 | — | — | 1,824,071 | 19 | — | 68,851 | — | — | 68,870 | — |
| Restricted stock | — | — | (60,000) | — | — | 1,966 | — | — | 1,966 | — |
| Change in fair value of interest rate swap contracts, net of income taxes of $11,203 | — | — | — | — | — | — | — | (19,728) | (19,728) | (19,728) |
| Foreign currency translation adjustment | — | — | — | — | — | — | — | 570 | 570 | 570 |
| Cumulative effect of adoption of FIN 48 | — | — | — | — | — | — | (11,932) | — | (11,932) | — |
| Net income | — | — | — | — | — | — | 160,053 | — | 160,053 | 160,053 |
| Balance, December 31, 2007 | — | — | 88,579,070 | 887 | (2,379) | 322,760 | 815,678 | (15,984) | 1,120,962 | 140,895 |
| Issuance of Preferred stock | 12,500 | — | — | — | — | 1,246,400 | — | — | 1,246,400 | — |
| Stock option activity, including tax benefit of $1,060 | — | — | 203,202 | 2 | — | 26,305 | — | — | 26,307 | — |
| Share activity | — | — | (10,633,784) | (107) | 2,379 | (154,633) | — | — | (152,361) | — |
| Restricted stock | — | — | — | — | — | 1,997 | — | — | 1,997 | — |
| Change in fair value of interest rate swap contracts, net of income taxes of $13,072 | — | — | — | — | — | — | — | (23,216) | (23,216) | (23,216) |
| Change in fair value of corporate debt securities | — | — | — | — | — | — | — | (8,008) | (8,008) | (8,008) |
| Foreign currency translation adjustment | — | — | — | — | — | — | — | (1,485) | (1,485) | (1,485) |
| Net loss | — | — | — | — | — | — | (153,323) | — | (153,323) | (153,323) |
| Balance, December 31, 2008 | 12,500 | $— | 78,148,488 | $ 782 | $ — | $1,442,829 | $ 662,355 | $(48,693) | $2,057,273 | $(186,032) |

See accompanying notes to the consolidated financial statements.

## Penn National Gaming, Inc. and Subsidiaries
## Consolidated Statements of Cash Flows
## (in thousands)

| Year ended December 31, | 2008 | 2007 | 2006 |
|---|---|---|---|
| **Operating activities** | | | |
| Net (loss) income | $ (153,323) | $ 160,053 | $ 327,088 |
| Adjustments to reconcile net (loss) income to net cash provided by operating activities: | | | |
| Depreciation and amortization | 173,545 | 147,915 | 123,951 |
| Amortization of items charged to interest expense | 12,625 | 13,011 | 11,361 |
| Amortization of items charged to interest income | (912) | — | — |
| Loss on sale of fixed assets | 1,610 | 1,637 | 1,383 |
| Loss from joint venture | 1,526 | 99 | 788 |
| Loss relating to early extinguishment of debt | — | — | 2,255 |
| Deferred income taxes | (91,098) | 18,265 | 14,394 |
| Charge for stock compensation | 26,857 | 25,465 | 20,562 |
| Gain on sale of discontinued operations, net of tax | — | — | (114,008) |
| Gain on hurricane insurance, net of tax | — | — | (81,799) |
| Impairment loss | 481,333 | — | 22,018 |
| Decrease (increase), net of businesses acquired | | | |
| Accounts receivable | 12,853 | (2,168) | (6,197) |
| Insurance receivable | — | 100,000 | (23,048) |
| Prepaid expenses and other current assets | (27,722) | 924 | (26,933) |
| Other assets | 25,747 | (7,159) | 13,536 |
| (Decrease) increase, net of businesses acquired | | | |
| Accounts payable | (350) | (22,234) | 12,379 |
| Accrued expenses | (12,045) | (12,436) | 4,155 |
| Accrued interest | (12,729) | (1,594) | (1,974) |
| Accrued salaries and wages | 1,231 | (6,003) | 5,585 |
| Gaming, pari-mutuel, property and other taxes | 882 | (4,629) | (127) |
| Income taxes payable | (6,794) | (3,584) | (28,748) |
| Other current and noncurrent liabilities | 1,014 | 9,470 | 5,176 |
| Other noncurrent tax liabilities | (13,787) | 14,187 | — |
| Operating cash flows from discontinued operations | — | — | 12 |
| Net cash provided by operating activities | 420,463 | 431,219 | 281,809 |
| **Investing activities** | | | |
| Expenditures for property and equipment | (344,894) | (361,155) | (408,883) |
| Proceeds from hurricane | — | — | 104,136 |
| Proceeds from sale of property and equipment | 1,066 | 15,020 | 2,406 |
| Investment in corporate debt securities | (47,286) | — | — |
| Acquisition of businesses and licenses, net of cash acquired | (384) | (265,482) | — |
| Net cash used in investing activities | (391,498) | (611,617) | (302,341) |
| **Financing activities** | | | |
| Proceeds from exercise of options | 2,397 | 24,911 | 12,201 |
| Repurchases of common stock | (152,361) | — | — |
| Proceeds from issuance of long-term debt | 447,833 | 426,065 | 195,678 |
| Principal payments on long-term debt | (993,966) | (282,360) | (177,066) |
| Proceeds from issuance of preferred stock, net of related expenses | 1,246,400 | — | — |
| Proceeds from insurance financing | 22,255 | 29,009 | 32,522 |
| Payments on insurance financing | (30,677) | (31,830) | (19,301) |
| Increase in deferred financing cost | — | — | (42) |
| Tax benefit from stock options exercised | 1,060 | 20,460 | 12,435 |
| Net cash provided by financing activities | 542,941 | 186,255 | 56,427 |
| **Net increase in cash and cash equivalents** | 571,906 | 5,857 | 35,895 |
| Cash and cash equivalents at beginning of year | 174,372 | 168,515 | 132,620 |
| Cash and cash equivalents at end of year | $ 746,278 | $ 174,372 | $ 168,515 |
| **Supplemental disclosure** | | | |
| Interest expense paid | $ 183,264 | $ 199,425 | $ 198,605 |
| Income taxes paid | $ 190,287 | $ 88,546 | $ 127,787 |

See accompanying notes to consolidated financial statements.

## 1. Business and Basis of Presentation

Penn National Gaming, Inc. ("Penn") and subsidiaries (collectively, the "Company") is a diversified, multi-jurisdictional owner and manager 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 Bay St. Louis and Boomtown Biloxi, CRC Holdings, Inc., the Bullwhackers properties, Hollywood Casino Corporation, Argosy Gaming Company ("Argosy"), Black Gold Casino at Zia Park, and Sanford-Orlando Kennel Club.

The Company currently 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.

The preparation of financial statements in conformity with generally accepted accounting principles ("GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses for the reporting periods. Actual results could differ from those estimates.

For purposes of comparability, certain prior year amounts have been reclassified to conform to the current year presentation.

## 2. Principles of Consolidation

The consolidated financial statements include the accounts of Penn and its wholly-owned subsidiaries. Investment in and advances to an unconsolidated affiliate that is 50% owned is accounted for under the equity method. All significant intercompany accounts and transactions have been eliminated in consolidation.

## 3. Merger Announcement and Termination

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

The Merger Agreement provided that, upon termination under specified circumstances generally related to a competing acquisition proposal, the Company would have been required to pay a termination fee of up to $200 million to Parent and, under certain circumstances if the Company's shareholders had not approved the Merger, the Company would have been required to reimburse Parent for an aggregate amount not to exceed $17.5 million for transaction expenses incurred by Parent

and its affiliates. Since the shareholder vote was obtained, the Company was unable to solicit, or terminate the Merger Agreement to accept, any third-party acquisition proposals. The Company's reimbursement of Parent's expenses would have reduced the amount of any required termination fee that became payable by the Company. The Merger Agreement further provided that, upon termination under specified circumstances related to, among other things, Parent's breach of the Merger Agreement, the failure to obtain financing or failure to obtain regulatory approval, Parent would have been required to pay the Company a termination fee of $200 million. Affiliates of the Funds had agreed to fund Parent in the amount of the termination fee in the event it became payable.

On July 3, 2008, the Company entered into an agreement with certain affiliates of Fortress and Centerbridge, terminating the Merger Agreement. In connection with the termination of the Merger Agreement, the Company agreed to receive a total of $1.475 billion, consisting of a nonrefundable $225 million cash termination fee (the "Cash Termination Fee") and a $1.25 billion, zero coupon, preferred equity investment (the "Investment"). Pursuant to the terms of the preferred equity purchase agreement, the purchasers made a nonrefundable $475 million payment (the "Initial Investment") to the Company on July 3, 2008, in addition to the payment of the Cash Termination Fee. Under the terms of the purchase agreement, the purchasers deposited the remaining preferred equity investment purchase consideration with an escrow agent, with the funds to be released from escrow upon the issuance of the Preferred Stock. On October 30, 2008, following the receipt of required regulatory approvals and the satisfaction of certain other conditions, the Company closed the sale of the Investment and received the remaining preferred equity investment purchase consideration of $775 million from the escrow agent.

The Company used a portion of the net proceeds from the Investment and the after-tax proceeds of the Cash Termination Fee for the repayment of some of its existing debt, repurchases of its Common Stock, lobbying expenses for efforts in Ohio and the investment in corporate debt securities, with the remainder being invested primarily in short-term securities. The repurchase of up to $200 million of the Company's Common Stock over the twenty-four month period ending July 2010 was authorized by the Company's Board of Directors in July 2008. During the year ended December 31, 2008, the Company repurchased 8,934,984 shares of its Common Stock in open market transactions for approximately $152.6 million, at an average price of $17.05.

Pursuant to the terms of the preferred equity purchase agreement, and in conjunction with the closing of the sale of the Investment, Wesley R. Edens, the Chairman and Chief Executive Officer of Fortress, joined the Company's Board of Directors, increasing the size of the Board to seven members.

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

## 4. Summary of Significant Accounting Policies

### Cash and Cash Equivalents

The Company considers all cash balances and highly-liquid investments with original maturities of three months or less to be cash and cash equivalents.

### Concentration of Credit Risk

Financial instruments that subject the Company to credit risk consist of cash equivalents, corporate securities, interest rate swap contracts and accounts receivable.

The Company's policy is to limit the amount of credit exposure to any one financial institution, and place investments with financial institutions evaluated as being creditworthy, or in short-term money market and tax-free bond funds which are exposed to minimal interest rate and credit risk. The Company has bank deposits and overnight repurchase agreements that exceed federally-insured limits.

Concentration of credit risk, with respect to casino receivables, is limited through the Company's credit evaluation process. The Company issues markers to approved casino customers only following credit checks and investigations of creditworthiness.

The Company's receivables of $43.6 million and $56.4 million at December 31, 2008 and 2007, respectively, primarily consist of $10.8 million and $21.9 million, respectively, due from the West Virginia Lottery for gaming revenue settlements and capital reinvestment projects at the Charles Town Entertainment Complex, and $11.4 million and $13.4 million, respectively, for reimbursement of expenses paid on behalf of Casino Rama.

Accounts are written off when management determines that an account is uncollectible. Recoveries of accounts previously written off are recorded when received. An allowance for doubtful accounts is determined to reduce the Company's receivables to their carrying value, which approximates fair value. The allowance is estimated based on historical collection experience, specific review of individual customer accounts, and current economic and business conditions. Historically, the Company has not incurred any significant credit-related losses.

### Fair Value of Financial Instruments

The following methods and assumptions are used to estimate the fair value of each class of financial instruments for which it is practicable to estimate:

*Cash and Cash Equivalents*

The fair value of the Company's cash and cash equivalents approximates the carrying value of the Company's cash and cash equivalents, due to the short maturity of the cash equivalents.

*Investment in Corporate Debt Securities*

The fair value of the investment in corporate debt securities is estimated based on quoted prices in active markets for identical investments. The investment in corporate debt securities are measured at fair value on a recurring basis.

*Long-term Debt*

The fair value of the Company's $2.725 billion senior secured credit facility approximates its carrying value, as it is variable-rate debt. The fair value of the Company's fixed-rate bonds is estimated based on quoted prices in active markets for identical instruments. The fair value of the Company's other long-term obligations and capital leases approximates its carrying value.

*Interest Rate Swap Contracts*

Fair values are measured at the present value of all expected future cash flows based on the LIBOR-based swap yield curve as of the date of the valuation. The fair values of the interest rate swap contracts are estimated based on inputs other than quoted prices that are observable for the interest rate swap contracts (i.e, Level 2 inputs). No adjustment to standard industry pricing practice was made in connection with the Company's assessment of credit risk or the likelihood of nonperformance under the contracts.

The estimated fair values of the Company's financial instruments are as follows (in thousands):

| | 2008 | | 2007 | |
|---|---|---|---|---|
| December 31, | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| **Financial assets:** | | | | |
| Cash and cash equivalents | $ 746,278 | $ 746,278 | $ 174,372 | $ 174,372 |
| Investment in corporate debt securities | 40,190 | 40,190 | — | — |
| **Financial liabilities:** | | | | |
| Long-term debt | | | | |
| Senior secured credit facility | 1,959,784 | 1,959,784 | 2,496,625 | 2,496,625 |
| Fixed-rate bonds and other long-term obligations | 464,201 | 389,201 | 469,810 | 475,247 |
| Capital leases | 6,195 | 6,195 | 8,487 | 8,487 |
| Interest rate swap contracts | 63,185 | 63,185 | 26,896 | 26,896 |

See Note 20 to the Consolidated Financial Statements for further information regarding the Company's assessment of the inputs used to measure the fair value for the investment in corporate debt securities and interest rate swap contracts.

**Property and Equipment**

Property and equipment are stated at cost, less accumulated depreciation. Maintenance and repairs that neither add materially to the value of the asset nor appreciably prolong its useful life are charged to expense as incurred. Gains or losses on the disposal of property and equipment are included in the determination of income.

Depreciation of property and equipment is recorded using the straight-line method over the following estimated useful lives:

| | |
|---|---|
| Land improvements | 5 to 15 years |
| Building and improvements | 25 to 40 years |
| Furniture, fixtures, and equipment | 3 to 7 years |

Leasehold improvements are amortized over the shorter of the estimated useful life of the improvement or the related lease term.

The estimated useful lives are determined based on the nature of the assets as well as the Company's current operating strategy.

The Company reviews the carrying values of its property and equipment for possible impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable based on undiscounted estimated future cash flows expected to result from its use and eventual disposition. The factors considered by the Company in performing this assessment include current operating results, trends and prospects, as well as the effect of obsolescence, demand, competition and other economic factors. In estimating expected future cash flows for determining

whether an asset is impaired, assets are grouped at the individual property level. In assessing the recoverability of the carrying value of property and equipment, the Company must make assumptions regarding future cash flows and other factors. If these estimates or the related assumptions change in the future, the Company 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. As a result of a decline in the Company's share price, an overall reduction in industry valuations, and property operating performance in the current economic environment, the Company believed that there were indicators of impairment as of December 31, 2008. As a result, the Company tested its long-lived assets for impairment as of December 31, 2008, and determined that a portion of the value of these long-lived assets, primarily at its Bullwhackers property, was impaired. Accordingly, the Company recorded a pre-tax impairment charge of $15.1 million ($10.0 million, net of taxes) during the year ended December 31, 2008 for these assets.

**Goodwill and Other Intangible Assets**

At December 31, 2008, the Company had $1,598.6 million in goodwill and $693.8 million in other intangible assets within its consolidated balance sheet, representing 30.8% and 13.4% of total assets, respectively, resulting from the Company's acquisition of other businesses and payment for gaming licenses and racing permits. Two issues arise with respect to these assets that require significant management estimates and judgment: (i) the valuation in connection with the initial purchase price allocation; and (ii) the ongoing evaluation for impairment.

In connection with the Company's acquisitions, valuations are completed to determine the allocation of the purchase prices. The factors considered in the valuations include data gathered as a result of the Company's due diligence in connection with the acquisitions, projections for future operations, and data obtained from third-party valuation specialists as deemed appropriate. Goodwill is tested annually, or more frequently if indicators of impairment exist, for impairment by comparing the fair value of the reporting units to their carrying amount. If the carrying amount of a reporting unit exceeds its fair value, an impairment test is performed to determine the implied value of goodwill for that reporting unit. If the implied value is less than the carrying amount for that reporting unit, an impairment loss is recognized for that reporting unit. In accordance with Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142"), issued by the Financial Accounting Standards Board ("FASB"), the Company considers its gaming license, racing permit and trademark intangible assets as indefinite-life intangible assets that do not require amortization. Rather, these intangible assets are tested annually, or more frequently if indicators of impairment exist, for impairment by comparing the fair value of the recorded assets to their carrying amount. If the carrying amounts of the gaming license, racing permit and trademark intangible assets exceed their fair value, an impairment loss is recognized. The evaluation of goodwill and indefinite-life intangible assets requires the use of estimates about future operating results of each reporting unit to determine their estimated fair value. The Company uses a market approach model, with EBITDA (earnings before interest, taxes, charges for stock compensation, impairment loss, depreciation and amortization, gain or loss on disposal of assets, merger termination settlement fees, net of related expenses, and other expense, and inclusive of loss from joint venture) multiples, as the Company believes that EBITDA is a widely-used measure of performance in the gaming industry and as the Company uses EBITDA as the primary measurement of the operating performance of its properties (including the evaluation of operating personnel). In addition, the Company believes that an EBITDA multiple is the principal basis for the valuation of gaming companies. Changes in the estimated EBITDA multiple or forecasted operations can materially affect these estimates. Once an impairment of goodwill or other indefinite-life intangible assets has been recorded, it cannot be reversed. Because the Company's goodwill and indefinite-life intangible assets are not amortized, there may be volatility in reported income because impairment losses, if any, are likely to occur irregularly and in varying amounts. Intangible assets that have a definite-life, including the management service contract for

Casino Rama, are amortized on a straight-line basis over their estimated useful lives or related service contract. The Company reviews the carrying value of its intangible assets that have a definite-life for possible impairment whenever events or changes in circumstances indicate that their carrying value may not be recoverable. If the carrying amount of the intangible assets that have a definite-life exceed their fair value, an impairment loss is recognized. As a result of a decline in the Company's share price, an overall reduction in industry valuations, and property operating performance in the current economic environment, the Company believed that there were indicators of impairment as of December 31, 2008. As a result, the Company tested its goodwill and other intangible assets for impairment as of December 31, 2008, and determined that a portion of the value of these assets was impaired in certain reporting units. Accordingly, the Company recorded pre-tax impairment charges of $397.2 million ($338.5 million, net of taxes) and $69.0 million ($44.1 million, net of taxes) during the year ended December 31, 2008 for its goodwill and indefinite-life intangible assets, respectively.

**Deferred Financing Costs**

Deferred financing costs that are incurred by the Company in connection with the issuance of debt are deferred and amortized to interest expense over the life of the underlying indebtedness, adjusted to reflect any early repayments.

**Comprehensive Income**

The Company accounts for comprehensive income in accordance with SFAS No. 130, "Reporting Comprehensive Income," which established standards for the reporting and presentation of comprehensive income in the consolidated financial statements. The Company presents comprehensive income in its consolidated statements of changes in shareholders' equity.

**Income Taxes**

The Company accounts for income taxes in accordance with SFAS No. 109, "Accounting for Income Taxes" ("SFAS 109"). Under SFAS 109, deferred tax assets and liabilities are determined based on the differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities and are measured at the prevailing enacted tax rates that will be in effect when these differences are settled or realized. SFAS 109 also requires that deferred tax assets be reduced by a valuation allowance if it is more likely than not that some portion or all of the deferred tax asset will not be realized.

The realizability of the deferred tax assets is evaluated quarterly by assessing the valuation allowance and by adjusting the amount of the allowance, if necessary. The factors used to assess the likelihood of realization are the forecast of future taxable income and available tax planning strategies that could be implemented to realize the net deferred tax assets.

The Company adopted the provisions of FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" ("FIN 48"), which is an interpretation of SFAS 109, on January 1, 2007. FIN 48 creates a single model to address uncertainty in tax positions, and clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS 109 by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in an enterprise's financial statements. FIN 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. The liability for unrecognized tax benefits is included in noncurrent tax liabilities within the consolidated balance sheet at December 31, 2008 and 2007.

**Accounting for Derivatives and Hedging Activities**

The Company does not hold or issue derivative financial instruments for trading or speculative purposes. Thus, uses of derivatives are limited to hedging and risk management purposes, in connection

with managing interest rate exposures. SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133"), as amended, established accounting and reporting standards for derivative instruments and hedging activities.

The Company uses fixed and variable-rate debt to finance its operations. Both funding sources have associated risks and opportunities, and the Company's risk management policy permits the use of derivatives to manage these exposures. Acceptable derivatives for this purpose include interest rate swaps, futures, options, caps, and similar instruments. The Company's use of derivatives is strictly restricted to hedging (i.e., risk management) applications.

Currently, the Company has a number of interest rate swaps in place, where the swaps serve to mitigate the income volatility associated with a portion of its variable-rate funding. Swap coverage extends out through 2011. In effect, these swaps synthetically convert the portion of variable-rate debt being hedged to the equivalent of fixed-rate funding. Under the terms of the swaps, the Company receives cash flows from the swap counterparties to offset the benchmark interest rate component of variable interest payments on the hedged financings, in exchange for paying cash flows based on the swaps' fixed rates. These two respective obligations are net-settled, periodically. The Company accounts for these swaps as cash flow hedges, which requires determining a division of hedge results deemed effective and deemed ineffective. However, all of the Company's hedges were designed in such a way so as to perfectly offset specifically-defined interest payments, such that no ineffectiveness has occurred—nor is any ineffectiveness going to occur, as long as the forecasted cash flows of the designated hedged items and the associated swaps remain unchanged.

Under cash flow hedge accounting, effective derivative results are initially recorded in other comprehensive income and later reclassified to earnings, coinciding with the income recognition relating to the variable interest payments being hedged. During the years ended December 31, 2008 and 2007, the Company recorded a $23.6 million increase and $6.2 million decrease, respectively, in interest expense, which was previously reported in other comprehensive income. In the coming twelve months, the Company anticipates that approximately a $34.0 million loss will be reclassified from other comprehensive income to earnings, as part of interest expense. As this amount represents effective hedge results, a comparable offsetting amount of incrementally lower interest expense will be realized in connection with the variable funding being hedged.

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

Under cash flow hedge accounting, derivatives are included in the consolidated balance sheets as assets or liabilities. Changes in the fair value of a derivative and settlements that are highly effective and qualifying as a cash flow hedge, to the extent that they are effective, are recorded in other comprehensive income and later reclassified to earnings coincidently with the earnings impacts of the hedged transaction (i.e., when the interest expense on the variable-rate liability is recorded in earnings). Any hedge ineffectiveness (which represents the amount by which hedge results exceed the variability in the cash flows of the forecasted transaction due to the risk being hedged) is recorded in current period earnings.

**Revenue Recognition and Promotional Allowances**

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

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

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

Revenues are recognized net of certain sales incentives in accordance with the Emerging Issues Task Force ("EITF") consensus on Issue 01-9, "Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's Products)" ("EITF 01-9"). The consensus in EITF 01-9 requires that sales incentives and points earned in point-loyalty programs be recorded as a reduction of revenue. The Company recognizes incentives related to gaming play and points earned in point-loyalty programs as a direct reduction of gaming revenue.

The retail value of accommodations, food and beverage, and other services furnished to guests without charge is included in gross revenues and then deducted as promotional allowances. The estimated cost of providing such promotional allowances is primarily included in food, beverage and other expense. The amounts included in promotional allowances for the years ended December 31, 2008, 2007 and 2006 are as follows:

| Year ended December 31, | 2008 | 2007 | 2006 |
|---|---|---|---|
| | | (in thousands) | |
| Rooms | $ 17,750 | $ 15,518 | $ 11,970 |
| Food and beverage | 103,038 | 101,040 | 85,884 |
| Other | 13,590 | 12,386 | 9,062 |
| Total promotional allowances | $134,378 | $128,944 | $106,916 |

The estimated cost of providing such complimentary services for the years ended December 31, 2008, 2007 and 2006 are as follows:

| Year ended December 31, | 2008 | 2007 | 2006 |
|---|---|---|---|
| | | (in thousands) | |
| Rooms | $ 7,280 | $ 6,538 | $ 5,156 |
| Food and beverage | 73,565 | 71,922 | 60,762 |
| Other | 6,034 | 5,471 | 5,644 |
| Total cost of complimentary services | $86,879 | $83,931 | $71,562 |

**Earnings Per Share**

The Company calculates earnings per share ("EPS") in accordance with SFAS No. 128, "Earnings Per Share" ("SFAS 128"). Basic EPS is computed by dividing net income applicable to common stock by the weighted-average number of common shares outstanding during the period. Diluted EPS reflects the additional dilution for all potentially-dilutive securities such as stock options.

Beginning in the fourth quarter of 2008, in conjunction with the issuance of 12,500 shares of Preferred Stock, the Company began to calculate EPS in accordance with SFAS 128, as clarified by EITF 03-6, "Participating Securities and the Two-Class Method under FASB Statement No. 128" ("EITF 03-6"). This was necessary as the Company determined that the Preferred Stock qualified as a participating security as defined in EITF 03-6. Under EITF 03-6, a security is considered a participating security if the security may participate in undistributed earnings with common stock, whether that participation is conditioned upon the occurrence of a specified event or not. In accordance with SFAS 128, a Company is required to use the two-class method when computing EPS when a Company has a security that qualifies as a "participating security." The two-class method is an earnings allocation

formula that determines EPS for each class of common stock and participating security according to dividends declared (or accumulated) and participation rights in undistributed earnings. A participating security is included in the computation of basic EPS using the two-class method. Under the two-class method, basic EPS for the Company's Common Stock is computed by dividing net income applicable to Common Stock by the weighted-average common shares outstanding during the period. Diluted EPS for the Company's Common Stock is computed using the more dilutive of the two-class method or the if-converted method.

However, since the Company reported a loss from continuing operations for the year ended December 31, 2008, it was required by SFAS 128 to use basic weighted-average common shares outstanding, rather than diluted weighted-average common shares outstanding, when calculating diluted EPS for the year ended December 31, 2008. In addition, since the Company reported a loss from continuing operations for the year ended December 31, 2008, the Preferred Stock was not deemed to be a participating security for the year ended December 31, 2008, pursuant to EITF 03-6. The basic weighted-average common shares outstanding for the year ended December 31, 2008 was 84,535,877.

The following table reconciles the weighted-average common shares outstanding used in the calculation of basic EPS to the weighted-average common shares outstanding used in the calculation of diluted EPS for the years ended December 31, 2007 and 2006.

| Year ended December 31, | 2007 | 2006 |
|---|---|---|
| | (in thousands) | |
| Determination of shares: | | |
| Weighted-average common shares outstanding | 85,578 | 84,229 |
| Assumed conversion of dilutive stock options | 2,806 | 2,405 |
| Diluted weighted-average common shares outstanding | 88,384 | 86,634 |

Options to purchase 8,804,578 shares were outstanding during the year ended December 31, 2008, but were not included in the computation of diluted EPS because they are antidilutive since the Company reported a loss from continuing operations for the year ended December 31, 2008.

Options to purchase 1,395,610 and 1,966,880 shares were outstanding during the years ended December 31, 2007 and 2006, respectively, but were not included in the computation of diluted EPS because they are antidilutive.

The repurchase of up to $200 million of the Company's Common Stock over the twenty-four month period ending July 2010 was authorized by the Company's Board of Directors in July 2008. During the year ended December 31, 2008, the Company repurchased 8,934,984 shares of its Common Stock in open market transactions for approximately $152.6 million, at an average price of $17.05.

**Stock-Based Compensation**

The Company accounts for stock compensation under SFAS No. 123 (revised 2004), "Share-Based Payment" ("SFAS 123(R)"), which requires the Company to expense the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. This expense must be recognized ratably over the requisite service period following the date of grant.

The fair value for stock options was estimated at the date of grant using the Black-Scholes option-pricing model, which requires management to make certain assumptions. The risk-free interest rate was based on the U.S. Treasury spot rate with a remaining term equal to the expected life assumed at the date of grant. Expected volatility at December 31, 2008 was estimated based on the historical volatility of the Company's stock price over a period of 5.36 years, in order to match the expected life of the options at the grant date. There is no expected dividend yield since the Company has not paid any cash dividends on its Common Stock since its initial public offering in May 1994, and since the Company

intends to retain all of its earnings to finance the development of its business for the foreseeable future. The weighted-average expected life was based on the contractual term of the stock option and expected employee exercise dates, which was based on the historical exercise behavior of the Company's employees. Forfeitures are estimated at the date of grant based on historical experience. Prior to the adoption of SFAS 123(R), the Company recorded forfeitures as they occurred for purposes of estimating pro forma compensation expense under SFAS No. 123, "Accounting for Stock-Based Compensation". The following are the weighted-average assumptions used in the Black-Scholes option-pricing model at December 31, 2008, 2007 and 2006:

| Year ended December 31, | 2008 | 2007 | 2006 |
|---|---|---|---|
| Risk-free interest rate | 1.61% | 4.24% | 5.11% |
| Expected volatility | 45.56% | 37.68% | 43.29% |
| Dividend yield | — | — | — |
| Weighted-average expected life (years) | 5.36 | 4.73 | 4.26 |
| Forfeiture rate | 4.00% | 4.00% | 4.00% |

**Segment Information**

In accordance with SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information" ("SFAS 131"), the Company views each property as an operating segment, and aggregates all of its properties into one reportable segment, as the Company believes that they are economically similar, offer similar types of products and services, cater to the same types of customers and are similarly regulated.

**Statements of Cash Flows**

The Company has presented the consolidated statements of cash flows using the indirect method, which involves the reconciliation of net (loss) income to net cash flow from operating activities.

**Acquisitions**

The Company accounts for its acquisitions in accordance with SFAS No. 141, "Business Combinations" ("SFAS 141"). The results of operations of acquisitions are included in the consolidated financial statements from their respective dates of acquisition.

**Certain Risks and Uncertainties**

The Company's operations are dependent on its continued licensing by state gaming commissions. The loss of a license, in any jurisdiction in which the Company operates, could have a material adverse effect on future results of operations.

The Company is dependent on each gaming property's local market for a significant number of its patrons and revenues. If economic conditions in these areas deteriorate or additional gaming licenses are awarded in these markets, the Company's results of operations could be adversely affected.

The Company is dependent on the economy of the United States ("U.S.") in general, and any deterioration in the national economic, energy, credit and capital markets could have a material adverse effect on future results of operations.

The Company is dependent upon a stable gaming and admission tax structure in the locations that it operates in. Any change in the tax structure could have a material adverse affect on future results of operations.

**5. New Accounting Pronouncements**

In May 2008, the FASB issued SFAS No. 162, "The Hierarchy of Generally Accepted Accounting Principles" ("SFAS 162"), which identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements of nongovernmental entities that

are presented in conformity with GAAP (the GAAP hierarchy). Any effect of applying the provisions of SFAS 162 shall be reported as a change in accounting principle in accordance with SFAS No. 154, "Accounting Changes and Error Corrections." SFAS 162 is effective 60 days following the U.S. Securities and Exchange Commission's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, "The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles." The Company adopted SFAS 162 as of its effective date, as required. SFAS 162 did not have an impact on the Company's consolidated financial statements.

In April 2008, the FASB issued FASB Staff Position ("FSP") FAS 142-3, "Determination of the Useful Life of Intangible Assets" ("FSP FAS 142-3"), which amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS 142. The intent of FSP FAS 142-3 is to improve the consistency between the useful life of a recognized intangible asset under SFAS 142 and the period of expected cash flows used to measure the fair value of the assets under SFAS No. 141 (revised), "Business Combinations" ("SFAS 141(R)"), and other GAAP. FSP FAS 142-3 is effective for financial statements issued for fiscal years and interim periods beginning after December 15, 2008. Early adoption of the standard is prohibited. The Company adopted FSP FAS 142-3 as of January 1, 2009, as required. The Company does not expect that the adoption of FSP FAS 142-3 will have a material impact on its consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities—an amendment of SFAS No. 133" ("SFAS 161"), which requires enhanced disclosures about an entity's derivative and hedging activities. Specifically, entities are required to provide enhanced disclosures about: a) how and why an entity uses derivative instruments; b) how derivative instruments and related hedged items are accounted for under SFAS 133 and its related interpretations; and c) how derivative instruments and related hedged items affect an entity's financial position, financial performance and cash flows. SFAS 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. SFAS 161 encourages, but does not require, comparative disclosures for earlier periods at initial adoption. The Company adopted SFAS 161 as of January 1, 2009, as required. The Company does not expect that the adoption of SFAS 161 will have a material impact on its consolidated financial statements.

In December 2007, the FASB issued SFAS 141(R), which is intended to improve reporting by creating greater consistency in the accounting and financial reporting of business combinations. SFAS 141(R) requires that the acquiring entity in a business combination recognize all (and only) the assets and liabilities assumed in the transaction, establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed, and requires the acquirer to disclose to investors and other users all of the information that they need to evaluate and understand the nature and financial effect of the business combination. In addition, SFAS 141(R) modifies the accounting for transaction and restructuring costs. SFAS 141(R) is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The Company adopted SFAS 141(R) as of January 1, 2009, as required. The Company expects that the adoption of SFAS 141(R) will have an impact on its consolidated financial statements, once the Company acquires companies in the future.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities-including an amendment of SFAS No. 115" ("SFAS 159"), which permits an entity to choose to measure many financial instruments and certain other items at fair value. A business entity shall report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. SFAS 159 is effective as of the beginning of each reporting entity's first fiscal year that begins after November 15, 2007. The Company did not elect the fair value option for any financial assets or financial liabilities.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" ("SFAS 157"), which defines fair value, establishes a framework for measuring fair value, and expands the disclosure requirements about fair value measurements. In February 2008, the FASB amended SFAS 157 through the issuance of FSP FAS 157-1, "Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13" ("FSP FAS 157-1") and FSP FAS 157-2, "Effective Date of FASB Statement No. 157" ("FSP FAS 157-2"). FSP FAS 157-1, which was effective upon the initial adoption of SFAS 157, amends SFAS 157 to exclude from its scope certain accounting pronouncements that address fair value measurements associated with leases. FSP FAS 157-2, which was effective upon issuance, delays the effective date of SFAS 157 to fiscal years beginning after November 15, 2008 for nonfinancial assets and nonfinancial liabilities that are not recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). In October 2008, the FASB issued FSP FAS 157-3, "Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active" ("FSP FAS 157-3"), which was effective upon issuance. FSP FAS 157-3 clarifies the application of SFAS 157 in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. The Company adopted SFAS 157, as amended, and on a prospective basis, as of January 1, 2008. The January 1, 2008 adoption did not have a significant impact on the Company. The Company adopted SFAS 157, as amended, and on a prospective basis, as of January 1, 2009 to nonfinancial assets and nonfinancial liabilities that are not recognized or disclosed at fair value in the financial statements on a recurring basis. The Company does not expect that the adoption of SFAS 157, as amended, and on a prospective basis, to nonfinancial assets and nonfinancial liabilities, will have a material impact on its consolidated financial statements. See Note 20 to the Consolidated Financial Statements for further information regarding the adoption of SFAS 157.

**6. Acquisitions**

**Sanford-Orlando Kennel Club**

On October 17, 2007, pursuant to the Asset Purchase Agreement dated July 5, 2007, the Company completed the purchase of Sanford-Orlando Kennel Club in Longwood, Florida from Sanford-Orlando Kennel Club, Inc. and Collins and Collins. In connection with the purchase, the Company also secured a right of first refusal with respect to a majority stake in the Sarasota Kennel Club in Sarasota, Florida. The purchase price for the Sanford-Orlando Kennel Club provides for additional consideration to be paid by the Company based upon certain future regulatory developments. Located on approximately 26 acres in Longwood, Florida, the Sanford-Orlando Kennel Club features year-round greyhound racing, a simulcast wagering facility, a clubhouse lounge and two dining areas. The Company accounted for the acquisition in accordance with SFAS 141. The results of the Sanford-Orlando Kennel Club have been included in the Company's consolidated financial statements since the acquisition date.

**Black Gold Casino at Zia Park**

On April 16, 2007, pursuant to the Asset Purchase Agreement dated November 7, 2006 among Zia Partners, LLC ("Zia"), Zia Park LLC (the "Buyer"), a wholly-owned subsidiary of Penn, and (solely with respect to specified sections thereof which relate to the Company's guarantee of the Buyer's payment and performance) Penn, the Buyer completed the acquisition of Black Gold Casino at Zia Park and all related assets of Zia. Penn funded this purchase with additional borrowings under its existing $750 million revolving credit facility. The Company accounted for the acquisition in accordance with SFAS 141. As a result of the acquisition, goodwill of $144.2 million and other intangible assets of $3.5 million are included within the consolidated balance sheet at December 31, 2008. The results of the Black Gold Casino at Zia Park have been included in the Company's consolidated financial statements since the acquisition date.

## 7. Hurricane Katrina

As a result of Hurricane Katrina's direct hit on the Mississippi Gulf Coast on August 29, 2005, two of the Company's casinos, Hollywood Casino Bay St. Louis and Boomtown Biloxi, were significantly damaged, many employees were displaced and operations ceased at the two properties. Boomtown Biloxi reopened on June 29, 2006 and Hollywood Casino Bay St. Louis reopened on August 31, 2006.

The Company had significant levels of insurance in place at the time of Hurricane Katrina to cover the losses resulting from the hurricane, including an "all risk" insurance policy covering "named windstorm" damage, flood damage, debris removal, preservation of property expense, demolition and increased cost of construction expense, and losses resulting from business interruption and extra expenses, all as defined in the policies. The comprehensive business interruption and property damage insurance policies had an overall limit of $400 million, and was subject to property damage deductibles for Hollywood Casino Bay St. Louis and Boomtown Biloxi of approximately $6.0 million and $3.5 million, respectively. The business interruption insurance component of this policy was subject to a five-day deductible.

During the year ended December 31, 2006, the Company's financial results benefited from a settlement agreement with its property and business interruption insurance providers for a total of $225 million for Hurricane Katrina-related losses at its Hollywood Casino Bay St. Louis and Boomtown Biloxi properties, as well as minor proceeds related to its National Flood Insurance coverage and auto insurance claims. Reflecting the settlement agreement, the Company recorded a pre-tax gain of $128.3 million ($81.8 million, net of taxes).

In June 2008, the Company entered into the second term of its first layer of property insurance coverage in the amount of $200 million. The $200 million coverage, which is effective from August 8, 2007 through December 31, 2010, is on an "all risk" basis, including, but not limited to, coverage for "named windstorms," floods and earthquakes. In June 2008, the Company also purchased an additional $100 million of "all risk" coverage including, but not limited to, coverage for "named windstorms," floods and earthquakes. The additional $100 million of "all risk" coverage excludes coverage for windstorms, "named windstorms," floods, and earthquakes, for Boomtown Biloxi and Hollywood Casino Bay St. Louis. An additional $300 million of "all risk" coverage was also purchased, which is subject to certain exclusions including, among others, exclusions for windstorms, "named windstorms," floods and earthquakes. The two additional coverage layers are effective from June 1, 2008 through June 1, 2009. There is a $25 million deductible for "named windstorm" events, and lesser deductibles as they apply to other perils. All three layers are subject to specific policy terms, conditions and exclusions.

## 8. Property and Equipment

Property and equipment, net, consists of the following:

| December 31, | 2008 | 2007 |
|---|---|---|
| | (in thousands) | |
| Land and improvements | $ 216,834 | $ 188,379 |
| Building and improvements | 1,298,513 | 998,910 |
| Furniture, fixtures, and equipment | 692,851 | 503,969 |
| Leasehold improvements | 17,128 | 16,145 |
| Construction in progress | 183,056 | 423,209 |
| Total property and equipment | 2,408,382 | 2,130,612 |
| Less accumulated depreciation and amortization | (596,251) | (442,219) |
| Property and equipment, net | $1,812,131 | $1,688,393 |

Depreciation and amortization expense, for property and equipment, totaled $165.9 million, $140.3 million and $117.3 million in 2008, 2007, and 2006, respectively. Interest capitalized in connection with major construction projects was $13.8 million, $14.6 million and $8.0 million in 2008, 2007 and 2006, respectively. During the year ended December 31, 2008, the Company recorded a pre-tax impairment charge of $15.1 million ($10.0 million, net of taxes), as it determined that a portion of the value of its long-lived assets, primarily at its Bullwhackers property, was impaired.

## 9. Goodwill and Other Intangible Assets

The Company's goodwill and intangible assets had a gross carrying value of $2.3 billion and $2.8 billion at December 31, 2008 and 2007, respectively, and accumulated amortization of $34.7 million and $27.0 million at December 31, 2008 and 2007, respectively. The table below presents the gross carrying value, accumulated amortization, and net book value of each major class of goodwill and intangible assets at December 31, 2008 and 2007:

| December 31, | 2008 | | | 2007 | | |
|---|---|---|---|---|---|---|
| | Gross Carrying Value | Accumulated Amortization | Net Book Value | Gross Carrying Value | Accumulated Amortization | Net Book Value |
| | (in thousands) | | | | | |
| Goodwill | $1,598,571 | $ — | $1,598,571 | $2,013,139 | $ — | $2,013,139 |
| Indefinite-life intangible assets | 679,054 | — | 679,054 | 755,166 | — | 755,166 |
| Other intangible assets | 49,396 | 34,686 | 14,710 | 49,316 | 27,041 | 22,275 |
| Total | $2,327,021 | $34,686 | $2,292,335 | $2,817,621 | $27,041 | $2,790,580 |

Goodwill consists mainly of goodwill from the acquisitions of Hollywood Casino Corporation in March 2003, Argosy in October 2005 and Black Gold Casino at Zia Park in April 2007. Indefinite-life intangible assets consist mainly of gaming licenses and trademark intangible assets from the acquisition of Argosy and the placement of slot machines at Hollywood Casino at Penn National Race Course.

During the year ended December 31, 2008, goodwill decreased by $414.6 million, primarily due to the Company recording a pre-tax impairment charge of $397.2 million ($338.5 million, net of taxes), as a portion of the value of the goodwill associated with the original purchase of Empress Casino Hotel, Argosy Casino Lawrenceburg, Hollywood Casino Aurora and Argosy Casino Alton, and all of the goodwill associated with the original purchase of Hollywood Slots Hotel and Raceway, was impaired. In addition, during the year ended December 31, 2008, indefinite-life intangible assets decreased by $76.1 million, primarily as the Company recorded a pre-tax impairment charge of $69.0 million ($44.1 million, net of taxes), as a portion of the value of the indefinite-life intangible assets associated with the original purchase of Argosy, and all of the indefinite-life intangible assets associated with the original purchase of Hollywood Slots Hotel and Raceway, was impaired.

During the year ended December 31, 2007, goodwill increased by $143.7 million, primarily due to goodwill recorded as part of the completion of the Black Gold Casino at Zia Park acquisition in April 2007 and the Sanford-Orlando Kennel Club acquisition in October 2007, offset by deferred tax adjustments relating to litigation accruals. In addition, gaming license, racing permit and trademark intangible assets increased by $54.7 million during the year ended December 31, 2007, due to the Black Gold Casino at Zia Park and Sanford-Orlando Kennel Club acquisitions and payment for the Category 1 slot machine license for the placement of slot machines at Hollywood Casino at Penn National Race Course.

The Company's intangible asset amortization expense was $7.7 million, $7.6 million and $6.7 million for the years ended December 31, 2008, 2007 and 2006, respectively.

The following table presents expected intangible asset amortization expense based on existing intangible assets at December 31, 2008 (in thousands):

| | |
|---|---|
| 2009 | $ 6,642 |
| 2010 | 5,773 |
| 2011 | 2,096 |
| 2012 | 199 |
| 2013 | — |
| Thereafter | — |
| Total | $14,710 |

## 10. Long-term Debt

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

| December 31, | 2008 | 2007 |
|---|---|---|
| | (in thousands) | |
| Senior secured credit facility | $1,959,784 | $2,496,625 |
| $200 million 6⅞% senior subordinated notes | 200,000 | 200,000 |
| $250 million 6¾% senior subordinated notes | 250,000 | 250,000 |
| Other long-term obligations | 14,201 | 19,810 |
| Capital leases | 6,195 | 8,487 |
| | 2,430,180 | 2,974,922 |
| Less current maturities of long-term debt | (105,281) | (93,452) |
| | $2,324,899 | $2,881,470 |

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

| | |
|---|---|
| 2009 | $ 105,281 |
| 2010 | 231,992 |
| 2011 | 677,660 |
| 2012 | 1,163,326 |
| 2013 | 83 |
| Thereafter | 251,838 |
| Total minimum payments | $2,430,180 |

At December 31, 2008, the Company was contingently obligated under letters of credit issued pursuant to the $2.725 billion senior secured credit facility with face amounts aggregating $27.5 million.

### Senior Secured Credit Facility

On October 3, 2005, the Company entered into a $2.725 billion senior secured credit facility to fund the Company's acquisition of Argosy, including payment for all of Argosy's outstanding shares, the retirement of certain long-term debt of Argosy and its subsidiaries, the payment of related transaction costs, and to provide additional working capital. The $2.725 billion senior secured credit facility consists of three credit facilities comprised of a $750 million revolving credit facility (of which $123.7 million was drawn at December 31, 2008) that matures on October 3, 2010, a $325 million Term Loan A Facility that matures on October 3, 2011 and a $1.65 billion Term Loan B Facility that matures on October 3, 2012. The maturity dates for the Term Loan A Facility and the Term Loan B Facility may be accelerated to June 4, 2011 if the $200 million of 6⅞% senior subordinated notes are not retired

before that date. The $2.725 billion senior secured credit facility also allows the Company to raise an additional $300 million in senior secured credit for project development and property expansion.

During the year ended December 31, 2008, the Company's $2.725 billion senior secured credit facility amount outstanding decreased by $536.8 million, primarily due to principal payments on long-term debt, partially offset by the issuance of long-term debt for items such as payment for capital expenditures, funding associated with the opening of the Hollywood Casino at Penn National Race Course, privilege payments to the State of Kansas, payments for income taxes owed and lobbying efforts, primarily in Ohio, Maryland and Maine. During the year ended December 31, 2008, the Company used a portion of the net proceeds from the Investment and the after-tax proceeds of the Cash Termination Fee for the repayment of some of its existing debt, repurchases of its Common Stock, lobbying expenses for efforts in Ohio and the investment in corporate debt securities, with the remainder being invested primarily in short-term securities.

The $2.725 billion senior secured credit facility is secured by substantially all of the assets of Penn and its restricted subsidiaries.

**Interest Rate Swap Contracts**

The Company has a policy designed to manage interest rate risk associated with its current and anticipated future borrowings. This policy enables the Company to use any combination of interest rate swaps, futures, options, caps and similar instruments. To the extent the Company employs such financial instruments pursuant to this policy, they are generally accounted for as hedging instruments. In order to qualify for hedge accounting, the underlying hedged item must expose the Company to risks associated with market fluctuations and the financial instrument used must be designated as a hedge and must reduce the Company's exposure to market fluctuations throughout the hedge period. If these criteria are not met, a change in the market value of the financial instrument and all associated settlements are recognized as gains or losses in the period of change. Net settlements pursuant to the financial instrument are included as interest expense in the period.

In accordance with the terms of its $2.725 billion senior secured credit facility, the Company was required to enter into fixed-rate debt or interest rate swap agreements in an amount equal to 50% of the Company's consolidated indebtedness, excluding the revolving credit facility, within 100 days of the closing date of the $2.725 billion senior secured credit facility.

On October 25, 2005, the Company entered into four interest rate swap contracts with terms from three to five years, notional amounts of $224 million, $274 million, $225 million, and $237 million, for a total of $960 million, and fixed interest rates ranging from 4.678% to 4.753%. The $224 million and $225 million swaps expired on October 27, 2008. The annual weighted-average interest rate of the two remaining contracts is 4.73%. Under these two remaining contracts, the Company pays a fixed interest rate against a variable interest rate based on the 90-day LIBOR rate. As of December 31, 2008, the applicable 90-day LIBOR rate was 3.535% for the two remaining swaps.

On April 6, 2006, the Company entered into three interest rate swap contracts with a term of five years and notional amounts of $100 million each, for a total of $300 million and fixed interest rates ranging from 5.263% to 5.266%. The annual weighted-average interest rate of the three contracts is 5.26%. Under these contracts, the Company pays a fixed interest rate against a variable interest rate based on the 90-day LIBOR rate. As of December 31, 2008, the applicable 90-day LIBOR rate was 2.388% for the $300 million swaps. The counterparty for one of the $100 million swaps is Lehman Brothers, which filed for Chapter 11 bankruptcy protection during the year ended December 31, 2008. The fair value of this $100 million swap was in a liability position at December 31, 2008.

On September 5, 2007, the Company entered into two interest rate swap contracts with terms of nine months and notional amounts of $197 million and $181 million, for a total of $378 million, and

fixed interest rates of 5.01%. The $197 million swap expired on June 17, 2008, while the $181 million swap expired on July 18, 2008.

On December 19, 2007, the Company entered into three monthly interest rate swap contracts, each with notional amounts of $146.25 million and fixed interest rates of 4.97% effective December 31, 2007, 4.47% effective January 31, 2008 and 4.40% effective February 29, 2008. The $146.25 million swap matured on March 31, 2008.

On October 23, 2008, the Company entered into two interest rate swap contracts with terms of two and three years and notional amounts of $200 million each, for a total of $400 million and fixed interest rates ranging from 2.727% to 3.09%. The annual weighted-average interest rate of the two contracts is 2.91%. Under these contracts, the Company pays a fixed interest rate against a variable interest rate based on the one-month LIBOR rate. As of December 31, 2008, the applicable one-month LIBOR rate was 0.471% for the $400 million swaps.

**Redemption of 8⅞% Senior Subordinated Notes**

In February 2006, the Company called for the redemption of its $175 million 8⅞% senior subordinated notes. The redemption price was $1,044.38 per $1,000 principal amount, plus accrued and unpaid interest and was made on March 15, 2006. The Company recorded a $10.0 million loss on early extinguishment of debt during the year ended December 31, 2006 for the call premium and the write-off of the associated deferred financing fees. The Company funded the redemption of the $175 million 8⅞% senior subordinated notes from available cash and borrowings under its revolving credit facility.

**6⅞% Senior Subordinated Notes**

On December 4, 2003, the Company completed an offering of $200 million of 6⅞% senior subordinated notes that mature on December 1, 2011. Interest on the notes is payable on June 1 and December 1 of each year, beginning June 1, 2004.

The Company may redeem all or part of the 6⅞% senior subordinated notes at certain specified redemption prices.

The 6⅞% senior subordinated notes are general unsecured obligations and are guaranteed on a senior subordinated basis by certain of the Company's current and future wholly-owned domestic subsidiaries. The 6⅞% senior subordinated notes rank equally with the Company's future senior subordinated debt and junior to its senior debt, including debt under the Company's $2.725 billion senior secured credit facility. In addition, the 6⅞% senior subordinated notes will be effectively junior to any indebtedness of Penn's non-U.S. unrestricted subsidiaries.

The 6⅞% senior subordinated notes and guarantees were originally issued in a private placement pursuant to an exemption from the registration requirements of the Securities Act of 1933, as amended. On August 27, 2004, the Company completed an offer to exchange the notes and guarantees for notes and guarantees registered under the Securities Act of 1933, as amended, having substantially identical terms.

On May 9, 2008, Merger Sub announced that it had commenced a cash tender offer and consent solicitation for any and all of the Company's $200 million 6⅞% senior subordinated notes. The tender offer and consent solicitation was being conducted in connection with the Merger Agreement and the obligation to accept for purchase and to pay for such notes was subject to the satisfaction or waiver of certain conditions, including the consummation of the Merger. In connection with the termination of the Merger Agreement, these offers were withdrawn.

**6¾% Senior Subordinated Notes**

On March 9, 2005, the Company completed an offering of $250 million of 6¾% senior subordinated notes that mature on March 1, 2015. Interest on the notes is payable on March 1 and September 1 of each year, beginning September 1, 2005.

Effective March 2010, the Company may redeem all or part of the 6¾% senior subordinated notes at certain specified redemption prices.

The 6¾% senior subordinated notes are general unsecured obligations and are not guaranteed by the Company's subsidiaries.

The 6¾% senior subordinated notes were issued in a private placement pursuant to an exemption from the registration requirements of the Securities Act of 1933, as amended.

On May 9, 2008, Merger Sub announced that it had commenced a cash tender offer and consent solicitation for any and all of the Company's $250 million 6¾% senior subordinated notes. The tender offer and consent solicitation was being conducted in connection with the Merger Agreement and the obligation to accept for purchase and to pay for such notes was subject to the satisfaction or waiver of certain conditions, including the consummation of the Merger. In connection with the termination of the Merger Agreement, these offers were withdrawn.

**Other Long-Term Obligations**

On October 15, 2004, the Company announced the sale of The Downs Racing, Inc. and its subsidiaries to the Mohegan Tribal Gaming Authority ("MTGA"). Under the terms of the agreement, the MTGA acquired The Downs Racing, Inc. and its subsidiaries, including Pocono Downs (a standardbred horse racing facility located on 400 acres in Wilkes-Barre, Pennsylvania) and five Pennsylvania OTWs located in Carbondale, East Stroudsburg, Erie, Hazelton and the Lehigh Valley (Allentown). The sale agreement also provided the MTGA with certain post-closing termination rights in the event of certain materially adverse legislative or regulatory events. In January 2005, the Company received $280 million from the MTGA, and transferred the operations of The Downs Racing, Inc. and its subsidiaries to the MTGA. The sale was not considered final for accounting purposes until the third quarter of 2006, as the MTGA had certain post-closing termination rights that remained outstanding. On August 7, 2006, the Company entered into the Second Amendment to the Purchase Agreement and Release of Claims ("Amendment and Release") with the MTGA pertaining to the October 14, 2004 Purchase Agreement (the "Purchase Agreement"), and agreed to pay the MTGA an aggregate of $30 million over five years, beginning on the first anniversary of the commencement of slot operations at Mohegan Sun at Pocono Downs, in exchange for the MTGA's agreement to release various claims it raised against the Company under the Purchase Agreement and the MTGA's surrender of all post-closing termination rights it might have had under the Purchase Agreement. The Company recorded the present value of the $30 million liability within debt, as the amount due to the MTGA is payable over five years. At December 31, 2008, the balance due to the MTGA equaled $14.2 million.

**Covenants**

The Company's $2.725 billion senior secured credit facility, $200 million 6⅞% and $250 million 6¾% senior subordinated notes require it, among other obligations, to maintain specified financial ratios and to satisfy certain financial tests, including fixed charge coverage, senior leverage and total leverage ratios. In addition, the Company's $2.725 billion senior secured credit facility, $200 million 6⅞% and $250 million 6¾% senior subordinated notes restrict, among other things, the Company's ability to incur additional indebtedness, incur guarantee obligations, amend debt instruments, pay dividends, create liens on assets, make investments, make acquisitions, engage in mergers or

consolidations, make capital expenditures, or engage in certain transactions with subsidiaries and affiliates and otherwise restricts corporate activities.

During the year ended December 31, 2008, the Company placed some of the funds received from the Investment into two unrestricted subsidiaries, in order to allow for maximum flexibility in the deployment of the funds. The funds and activity maintained within the unrestricted subsidiaries are excluded from the Company's covenant calculations.

At December 31, 2008, the Company was in compliance with all required financial covenants.

## 11. Commitments and Contingencies

### Litigation

The Company is subject to various legal and administrative proceedings relating to personal injuries, employment matters, commercial transactions and other matters arising in the normal course of business. The Company does not believe that the final outcome of these matters will have a material adverse effect on the Company's consolidated financial position or results of operations. In addition, the Company maintains what it believes is adequate insurance coverage to further mitigate the risks of such proceedings. However, such proceedings can be costly, time consuming and unpredictable and, therefore, no assurance can be given that the final outcome of such proceedings may not materially impact the Company's consolidated financial condition or results of operations. Further, no assurance can be given that the amount or scope of existing insurance coverage will be sufficient to cover losses arising from such matters.

The following proceedings could result in costs, settlements, damages, or rulings that materially impact the Company's consolidated financial condition or operating results. In each instance, the Company believes that it has meritorious defenses, claims and/or counter-claims, and intends to vigorously defend itself or pursue its claim.

In conjunction with the Company's acquisition of Argosy in 2005, and subsequent disposition of the Argosy Casino Baton Rouge property, the Company became responsible for litigation initiated over eight years ago related to the Baton Rouge casino license formerly owned by Argosy. On November 26, 1997, Capitol House filed an amended petition in the Nineteenth Judicial District Court for East Baton Rouge Parish, State of Louisiana, amending its previously filed but unserved suit against Richard Perryman, the person selected by the Louisiana Gaming Division to evaluate and rank the applicants seeking a gaming license for East Baton Rouge Parish, and adding state law claims against Jazz Enterprises, Inc., the former Jazz Enterprises, Inc. shareholders, Argosy, Argosy of Louisiana, Inc. and Catfish Queen Partnership in Commendam, d/b/a the Belle of Baton Rouge Casino. This suit alleged that these parties violated the Louisiana Unfair Trade Practices Act in connection with obtaining the gaming license that was issued to Jazz Enterprises, Inc./Catfish Queen Partnership in Commendam. The plaintiff, an applicant for a gaming license whose application was denied by the Louisiana Gaming Division, sought to prove that the gaming license was invalidly issued and to recover lost gaming revenues that the plaintiff contended it could have earned if the gaming license had been properly issued to the plaintiff. On October 2, 2006, the Company prevailed on a partial summary judgment motion which limited plaintiff's damages to its out-of-pocket costs in seeking its gaming license, thereby eliminating any recovery for potential lost gaming profits. On February 6, 2007, the jury returned a verdict of $3.8 million (exclusive of statutory interest and attorneys' fees) against Jazz Enterprises, Inc. and Argosy. After ruling on post-trial motions, on September 27, 2007, the trial court entered a judgment in the amount of $1.4 million, plus attorneys' fees, costs and interest. The Company has established an appropriate reserve and has bonded the judgment pending its appeal. Both the plaintiff and the Company have appealed the judgment to the First Circuit Court of Appeals in Louisiana and oral arguments took place on August 28, 2008. The Company has the right to seek indemnification from two of the former Jazz Enterprises, Inc. shareholders for any liability suffered as a result of such

cause of action, however, there can be no assurance that the former Jazz Enterprises, Inc. shareholders will have assets sufficient to satisfy any claim in excess of Argosy's recoupment rights.

In May 2006, the Illinois Legislature passed into law House Bill 1918, effective May 26, 2006, which singled out four of the nine Illinois casinos, including the Company's Empress Casino Hotel and Hollywood Casino Aurora, for a 3% tax surcharge to subsidize local horse racing interests. On May 30, 2006, Empress Casino Hotel and Hollywood Casino Aurora joined with the two other riverboats affected by the law, Harrah's Joliet and the Grand Victoria Casino in Elgin, and filed suit in the Circuit Court of the Twelfth Judicial District in Will County, Illinois (the "Court"), asking the Court to declare the law unconstitutional. Empress Casino Hotel and Hollywood Casino Aurora began paying the 3% tax surcharge into a protest fund which accrues interest during the pendency of the lawsuit. In two orders dated March 29, 2007 and April 20, 2007, the Court declared the law unconstitutional under the Uniformity Clause of the Illinois Constitution and enjoined the collection of this tax surcharge. The State of Illinois requested, and was granted, a stay of this ruling. As a result, Empress Casino Hotel and Hollywood Casino Aurora continued paying the 3% tax surcharge into the protest fund until May 25, 2008, when the 3% tax surcharge expired. The State of Illinois appealed the ruling to the Illinois Supreme Court. On June 5, 2008, the Illinois Supreme Court reversed the trial court's ruling and issued a decision upholding the constitutionality of the 3% tax surcharge. On January 21, 2009, the four casino plaintiffs filed a petition for certiorari, requesting the U.S. Supreme Court to hear the case. The accumulated funds will be returned to Empress Casino Hotel and Hollywood Casino Aurora if they ultimately prevail in the lawsuit.

On December 15, 2008, former Illinois Governor Rod Blagojevich signed Public Act No. 95-1008 requiring the same four casinos to continue paying the 3% tax surcharge to subsidize Illinois horse racing interests. On January 8, 2009, the four casinos filed suit in the Circuit Court of the Twelfth Judicial District in Will County, Illinois, asking the Court to declare the law unconstitutional. The 3% tax surcharge being paid pursuant to Public Act No. 95-1008 is paid into a protest fund where it accrues interest. The accumulated funds will be returned to Empress Casino Hotel and Hollywood Casino Aurora if they ultimately prevail in the lawsuit.

In August 2007, a complaint was filed on behalf of a putative class of public shareholders of the Company, and derivatively on behalf of the Company, in the Court of Common Pleas of Berks County, Pennsylvania (the "Complaint"). The Complaint names the Company's Board of Directors as defendants and the Company as a nominal defendant. The Complaint alleges, among other things, that the Board of Directors breached their fiduciary duties by agreeing to the proposed transaction with Fortress and Centerbridge for inadequate consideration, that certain members of the Board of Directors have conflicts with regard to the Merger, and that the Company and its Board of Directors have failed to disclose certain material information with regard to the Merger. The Complaint seeks, among other things, a court order determining that the action is properly maintained as a class action and a derivative action enjoining the Company and its Board of Directors from consummating the proposed Merger, and awarding the payment of attorneys' fees and expenses. The Company and the plaintiff had reached a tentative settlement in which the Company agreed to pay certain attorneys' fees and to make certain disclosures regarding the events leading up to the transaction with Fortress and Centerbridge in the proxy statement sent to shareholders in November 2007. Final settlement was contingent upon court approval and consummation of the transaction with Fortress and Centerbridge. Because the transaction with Fortress and Centerbridge was terminated as described in Note 3, the Company expects to move for a dismissal of the complaint.

On July 16, 2008, the Company was served with a purported class action lawsuit brought by plaintiffs seeking to represent a class of shareholders who purchased shares of the Company's Common Stock between March 20, 2008 and July 2, 2008. The lawsuit alleges that the Company's disclosure practices relative to the proposed transaction with Fortress and Centerbridge and the eventual termination of that transaction were misleading and deficient in violation of the Securities Exchange

Act of 1934. The complaint, which seeks class certification and unspecified damages, was filed in federal court in Maryland. The complaint has been amended, among other things, to add three new named plaintiffs and to name Peter M. Carlino, Chairman and Chief Executive Officer, and William J. Clifford, Senior Vice President and Chief Financial Officer, as additional defendants. The Company filed a motion to dismiss the complaint in November 2008, and oral arguments for the motion were heard by the court on February 23, 2009. Following oral arguments, the court granted the Company's motion and dismissed the complaint with prejudice. The Company anticipates that the plaintiffs will file a motion for reconsideration with the court.

On September 11, 2008, the Board of County Commissioners of Cherokee County, Kansas (the "County") filed suit against Kansas Penn Gaming, LLC ("KPG," a wholly-owned subsidiary of Penn created to pursue a development project in Cherokee County, Kansas) and the Company in the District Court of Shawnee County, Kansas. The petition alleges that KPG breached its pre-development agreement with the County when KPG withdrew its application to manage a lottery gaming facility in Cherokee County and seeks in excess of $50 million in damages. In connection with their petition, the County obtained an ex-parte order attaching the $25 million privilege fee paid to the Kansas Lottery Commission in conjunction with the gaming application for the Cherokee County zone. Defendants are currently contesting the validity and scope of the attachment and intend to defend the merits of the case going forward.

On September 23, 2008, KPG filed an action against HV Properties of Kansas, LLC ("HV") in the U.S. District Court for the District of Kansas seeking a declaratory judgment from the U.S. District Court finding that KPG has no further obligations to HV under a Real Estate Sale Contract (the "Contract") that KPG and HV entered into on September 6, 2007, and that KPG properly terminated this Contract under the terms of the Repurchase Agreement entered into between the parties effective September 28, 2007. HV filed a counterclaim claiming KPG breached the Contract, and seeks $37.5 million in damages. On October 7, 2008, HV filed suit against the Company claiming the Company is liable to HV for KPG's alleged breach based on a Guaranty Agreement signed by the Company. Both cases were consolidated. The Company has filed a motion to dismiss HV's claims against the Company. This motion has been fully briefed and is pending.

The following dispute was concluded in the fourth quarter of 2008:

In November 2005, Capital Seven, LLC and Shawn A. Scott (collectively, "Capital Seven"), the sellers of Bangor Historic Track, Inc. ("BHT"), filed a demand for arbitration with the American Arbitration Association seeking $30 million plus interest and other damages. Capital Seven alleged a breach of contract by the Company based on the Company's payment of a $51 million purchase price for the purchase of BHT instead of an alleged $81 million purchase price Capital Seven claimed was due under the purchase agreement. The parties had agreed that the purchase price of BHT would be determined, in part, by the applicable gaming taxes imposed by Maine on the Company's operations. The arbitrators issued their ruling in November 2008, stating that, under the applicable tax rate, the purchase price was $61 million. The panel awarded $10 million plus contractual interest to Capital Seven. Pursuant to the dispute resolution procedures, the Company had deposited the disputed $30 million in escrow, pending a resolution. This amount was included in other assets within the consolidated balance sheet at December 31, 2007. On December 1, 2008, the escrowed funds were released, with $13.1 million being paid to Capital Seven and the remainder being returned to the Company.

**Operating Lease Commitments**

The Company is liable under numerous operating leases for airplanes, automobiles, land for the property on which some of its casinos operate, other equipment and buildings, which expire at various

dates through 2093. Total rental expense under these agreements was $30.7 million, $29.6 million and $28.1 million for the years ended December 31, 2008, 2007, and 2006, respectively.

The leases for land consist of annual base lease rent payments, plus, in some instances, a percentage rent based on a percent of adjusted gaming wins, as described in the respective leases.

The Company has an operating lease with the City of Bangor which covers the temporary facility and the permanent facility, which opened on July 1, 2008. Under the lease agreement, there is a fixed rent provision, as well as a revenue-sharing provision which is equal to 3% of gross slot revenue. The final term of the lease, which commenced with the opening of the permanent facility, is for an initial term of fifteen years, with three ten-year renewal options.

On March 23, 2007, BTN, Inc. ("BTN"), one of the Company's wholly-owned subsidiaries, entered into an amended and restated ground lease (the "Amended Lease") with Skrmetta MS, LLC. The lease amends the prior ground lease, dated October 19, 1993. The Amended Lease requires BTN to maintain a minimum gaming operation on the leased premises and to pay rent equal to 5% of adjusted gaming win after gaming taxes have been deducted. The term of the Amended Lease expires on January 1, 2093.

The future minimum lease commitments relating to the base lease rent portion of noncancelable operating leases at December 31, 2008 are as follows (in thousands):

| Year ending December 31, | |
|---|---|
| 2009 | $ 6,985 |
| 2010 | 5,148 |
| 2011 | 4,732 |
| 2012 | 3,927 |
| 2013 | 3,228 |
| Thereafter | 22,951 |
| Total | $46,971 |

**Capital Expenditure Commitments**

At December 31, 2008, the Company was contractually committed to spend approximately $67.7 million in capital expenditures for projects in progress.

**Employee Benefit Plans**

The Company maintains a profit-sharing plan under the provisions of Section 401(k) of the Internal Revenue Code of 1986, as amended, which covers all eligible employees. The plan enables participating employees to defer a portion of their salary in a retirement fund to be administered by the Company. The Company makes a discretionary match contribution of 50% of employees' elective salary deferrals, up to a maximum of 6% of eligible employee compensation.

The Company also has a defined contribution plan, the Charles Town Races Future Service Retirement Plan, covering substantially all of its union employees at the Charles Town Entertainment Complex. The Company makes annual contributions to this plan for the eligible union employees and to the Penn National Gaming, Inc. 401(k) Plan for the eligible non-union employees for an amount equal to the amount accrued for retirement expense, which is calculated as 0.25% of the daily mutual handle and 1.0% up to a base of the net video lottery revenues and, after the base is met, it reverts to 0.5%.

The Company maintains a non-qualified deferred compensation plan that covers most management and other highly-compensated employees. This plan was effective March 1, 2001. The plan allows the

participants to defer, on a pre-tax basis, a portion of their base annual salary and bonus, and earn tax-deferred earnings on these deferrals. The plan also provides for matching Company contributions that vest over a five-year period. The Company has established a Trust, and transfers to the Trust, on a periodic basis, an amount necessary to provide for its respective future liabilities with respect to participant deferral and Company contribution amounts. The Company's matching contributions in 2008, 2007 and 2006 were $1.7 million, $2.2 million and $1.5 million, respectively.

**Agreements with Horsemen and Pari-Mutuel Clerks**

The Company is required to have agreements with the horsemen at each of its racetracks to conduct its live racing and simulcasting activities, with the exception of the Company's tracks in Ohio and New Mexico. In addition, in order to operate gaming machines in West Virginia, the Company must maintain agreements with each of the Charles Town Horsemen, pari-mutuel clerks and breeders.

At the Charles Town Entertainment Complex, the Company has an agreement with the Charles Town Horsemen with an initial term expiring on December 31, 2011, and an agreement with the breeders that expires on June 30, 2009. The pari-mutuel clerks at Charles Town are represented under a collective bargaining agreement with the West Virginia Division of Mutuel Clerks, which expires on December 31, 2010.

The Company's agreement with the Pennsylvania Thoroughbred Horsemen at Penn National Race Course expires on September 30, 2011. The Company has a collective bargaining agreement with Local 137 of the Sports Arena Employees (AFL-CIO) at Penn National Race Course with respect to pari-mutuel clerks, admissions and Telebet personnel which expires on December 31, 2011. The Company also has an agreement in place with the Sports Arena Employees Local 137 (AFL-CIO) with respect to pari-mutuel clerks and admission personnel at the Company's OTWs, which will expire on September 30, 2009.

The Company's agreement with the Maine Harness Horsemen Association at Bangor Raceway expired at the end of the 2008 racing season. The parties are currently working cooperatively on a three-year extension, which is expected to be executed before the start of the 2009 racing season.

Pennwood Racing, Inc. also has an agreement in effect with the horsemen at Freehold Raceway, which expires in May 2009.

Throughout the Argosy properties, the Seafarers Entertainment and Allied Trade Union represents approximately one thousand nine hundred of the Company's employees. At the Empress Casino Hotel, the Hotel Employees and Restaurant Employees Union ("UNITE/HERE") Local 1 represents approximately three hundred employees under a collective bargaining agreement which expires on March 31, 2010. At certain of the Company's Argosy properties, the Seafarer International Union of North America, Atlantic, Gulf, Lakes and Inland Waters District/NMU, AFL-CIO, the International Brotherhood of Electrical Workers, the Security Police and Fire Professionals of America, the American Maritime Officers Union, the International Brotherhood of Electrical Workers Local 176, and UNITE/HERE Local 10 represent certain of the Company's employees. The Company has collective bargaining agreements with these unions that expire at various times between July 2009 and October 2015. None of these unions individually represent more than fifty of the Company's employees.

If the Company fails to maintain agreements with the horsemen at a track, it will not be permitted to conduct live racing and export and import simulcasting at that track and where applicable, the OTWs. In West Virginia, the Company will not be permitted to operate its gaming machines if it fails to maintain agreements with the Charles Town Horsemen, pari-mutuel clerks and breeders. In addition, the simulcasting agreements are subject to the horsemen's approval. If the Company fails to maintain necessary agreements, this failure could have a material adverse effect on its business, financial condition and results of operations. Except for the closure of the facilities at Penn National Race

Course and its OTWs from February 16, 1999 to March 24, 1999 due to a horsemen's strike, and a few days at other times and locations, the Company has been able to maintain the necessary agreements. There can be no assurance that the Company will be able to maintain the required agreements.

**New Jersey Joint Venture**

On January 28, 1999, the Company, along with its joint venture partner, Greenwood Limited Jersey, Inc. ("Greenwood"), purchased certain assets and assumed certain liabilities of Freehold Racing Association, Garden State Racetrack and related entities, in a transaction accounted for as a purchase transaction.

In 1999, the Company made an $11.3 million loan to the joint venture and an equity investment of $0.3 million. In 2008, the balance of the loan was increased by $0.5 million to $11.8 million to substitute a payment of interest on the loan. The loan is evidenced by a subordinated secured note, which is included in investment in and advances to unconsolidated affiliate within the consolidated balance sheets. The $11.3 million portion of the note bears interest at prime plus 2.25% or a minimum of 10.00% (at December 31, 2008, the interest rate was 10.00%). The $0.5 million portion of the note bears interest at the lesser of prime plus 2.00% or the 30-day LIBOR plus 3.00% (at December 31, 2008, the interest rate was 3.41%). The Company has recorded interest income within the consolidated statements of operations of $1.2 million, $1.2 million and $1.2 million for the years ended December 31, 2008, 2007 and 2006, respectively.

The joint venture, through Freehold Racing Association, was part of a multi-employer pension plan. For collectively bargained, multi-employer pension plans, contributions were made in accordance with negotiated labor contracts and generally were based on days worked. With the passage of the Multi-Employer Pension Plan Amendments Act of 1980, the joint venture may, under certain circumstances, become subject to liabilities in excess of contributions made under collective bargaining agreements. Generally, these liabilities are contingent upon the termination, withdrawal, or partial withdrawal from the plans. In June 2006, Freehold Racing Association withdrew from the multi-employer pension plan, and thereby became subject to payment of a withdrawal liability to the multi-employer pension plan. In January 2008, the Company was informed that the multi-employer pension plan experienced a mass withdrawal termination as of December 25, 2007. At December 31, 2008, the joint venture withdrawal liability was approximately $3.5 million for Freehold Racing Association, which is payable through November 2028.

The Company and Greenwood entered into a Debt Service Maintenance Agreement with a bank in which each joint venture partner has guaranteed up to 50% of a $23.0 million term loan to the joint venture. The Debt Service Maintenance Agreement remains in effect for the life of the loan and was due to expire on September 30, 2009. In 2008, the joint venture borrowed an additional $1.75 million and the maturity date of the term loan was extended to September 30, 2013. At December 31, 2008, the outstanding balance on the loan to the joint venture amounted to $12.2 million, of which the Company's obligation under its guarantee of the term loan was limited to approximately $6.1 million. The Company's investment in the joint venture is accounted for under the equity method. The original investment was recorded at cost and has been adjusted by the Company's share of income (loss) of the joint venture and distributions received. The Company's 50% share of the income (loss) of the joint venture is included in other income (expenses) within the consolidated statements of operations.

**12. Income Taxes**

Deferred tax assets and liabilities are provided for the effects of temporary differences between the tax basis of an asset or liability and its reported amount in the consolidated balance sheet. These temporary differences result in taxable or deductible amounts in future years.

The components of the Company's deferred tax assets and liabilities are as follows:

| Year ended December 31, | 2008 | 2007 |
|---|---|---|
| | (in thousands) | |
| Deferred tax assets: | | |
| Stock-based compensation expense | $ 17,510 | $ 11,111 |
| Accrued expenses | 21,973 | 18,945 |
| Uncertain tax positions under FIN 48 | 12,751 | 9,458 |
| State net operating losses | 6,622 | 7,687 |
| Accumulated other comprehensive loss | 21,929 | 12,325 |
| Gross deferred tax assets | 80,785 | 59,526 |
| Less valuation allowance | (3,860) | (6,632) |
| Net deferred tax assets | 76,925 | 52,894 |
| Deferred tax liabilities: | | |
| Property, plant and equipment | (86,342) | (102,936) |
| Intangibles | (235,128) | (315,968) |
| Net deferred tax liabilities | (321,470) | (418,904) |
| Net: | $(244,545) | $(366,010) |
| Reflected on consolidated balance sheets: | | |
| Current deferred tax assets, net | $ 21,065 | $ 19,079 |
| Noncurrent deferred tax liabilities, net | (265,610) | (385,089) |
| Net deferred taxes | $(244,545) | $(366,010) |

For income tax reporting, the Company has state net operating loss carryforwards aggregating approximately $179.1 million available to reduce future state income taxes primarily for the Commonwealth of Pennsylvania and the State of Mississippi as of December 31, 2008. The tax benefit associated with these net operating loss carryforwards is approximately $6.7 million. Due to state tax statutes on annual net operating loss utilization limits, the availability of gaming tax credits, and income and loss projections in the applicable jurisdictions, a $3.9 million valuation allowance has been recorded to reflect the net operating losses which are not presently expected to be realized. If not used, substantially all of the carryforwards will expire at various dates from December 31, 2009 to December 31, 2028.

The $3.9 million valuation allowance represents the income tax effect of state net operating loss carryforwards of the Company, which are not presently expected to be utilized. In the event that the valuation allowance is ultimately unnecessary, the majority would be treated as a reduction of tax expense.

In addition, certain subsidiaries have accumulated state net operating loss carryforwards aggregating approximately $553.1 million for which no benefit has been recorded as they are attributable to uncertain tax positions. The unrecognized tax benefits as of December 31, 2008 attributable to these net operating losses was approximately $37.7 million. Due to the uncertain tax position, these net operating losses are not included as components of deferred tax assets as of December 31, 2008. In the event of any benefit from realization of these net operating losses, $8.3 million would be treated as an increase to equity, $0.5 million would be treated as a reduction to goodwill, and the remainder would be treated as a reduction of tax expense. If not used, substantially all the carryforwards will expire at various dates from December 31, 2009 to December 31, 2028.

The provision for income taxes charged to operations was as follows:

| Year ended December 31, | 2008 | 2007 | 2006 |
|---|---|---|---|
| | | (in thousands) | |
| Current tax expense | | | |
| Federal | $157,043 | $ 75,959 | $108,958 |
| State | 35,461 | 28,536 | 33,067 |
| Foreign | 4,332 | 9,427 | 433 |
| Total current | 196,836 | 113,922 | 142,458 |
| Deferred tax expense (benefit) | | | |
| Federal | (78,895) | 16,223 | 16,260 |
| State | (12,203) | 2,042 | (1,866) |
| Total deferred | (91,098) | 18,265 | 14,394 |
| Total provision | $105,738 | $132,187 | $156,852 |

The following table reconciles the statutory federal income tax rate to the actual effective income tax rate for 2008, 2007 and 2006:

| Year ended December 31, | 2008 | 2007 | 2006 |
|---|---|---|---|
| Percent of pretax income | | | |
| Federal taxes | 35.0% | 35.0% | 35.0% |
| State and local income taxes | (32.0)% | 6.8% | 5.5% |
| Permanent differences | (217.9)% | 2.6% | 1.8% |
| Foreign | (7.5)% | 1.2% | 0.1% |
| Other miscellaneous items | 0.2% | (0.4)% | — |
| | (222.2)% | 45.2% | 42.4% |

| Year ended December 31, | 2008 | 2007 | 2006 |
|---|---|---|---|
| | | (in thousands) | |
| Amount based upon pretax income | | | |
| Federal taxes | $(16,655) | $102,284 | $129,475 |
| State and local income taxes | 15,229 | 19,953 | 20,281 |
| Permanent differences | 103,707 | 7,460 | 6,742 |
| Foreign | 3,587 | 3,453 | 266 |
| Other miscellaneous items | (130) | (963) | 88 |
| | $105,738 | $132,187 | $156,852 |

The Company adopted the provisions of FIN 48 on January 1, 2007. As a result of the implementation of FIN 48, the Company recognized a liability for unrecognized tax benefits of approximately $11.9 million, which was accounted for as a reduction to the January 1, 2007 retained earnings balance. The liability for unrecognized tax benefits is included in noncurrent tax liabilities within the consolidated balance sheet at December 31, 2008 and 2007.

A reconciliation of the beginning and ending amount for the liability for unrecognized tax benefits is as follows:

| | Noncurrent tax liabilities |
|---|---|
| | (in thousands) |
| Balance at January 1, 2007 | $ 56,960 |
| Additions based on current year tax positions | 3,122 |
| Additions based on prior year tax positions | 7,676 |
| Currency translation adjustments | 15,091 |
| Balance at December 31, 2007 | $ 82,849 |
| Additions based on current year tax positions | 10,702 |
| Additions based on prior year tax positions | 2,105 |
| Decreases due to settlements and/or reduction in liabilities | (6,984) |
| Currency translation adjustments | (20,040) |
| Balance at December 31, 2008 | $ 68,632 |

Included in the liability for unrecognized tax benefits at December 31, 2008 and 2007 were $31.7 million and $38.7 million, respectively, of tax positions that are indemnified by a third party. The indemnification stems from a transaction that the Company completed in 2001 with The Continental Companies and CHC International, Inc. (the "Seller"), whereby the Company acquired Casino Rouge in Baton Rouge, Louisiana and the management contract for Casino Rama in Orillia, Ontario, Canada. As part of the acquisition, Continental and the Company entered into an Indemnification Agreement, whereby Continental indemnified the Company for any tax liabilities to arise subsequent to the acquisition for taxation years in which Continental was the owner. The Canada Revenue Agency ("CRA") issued reassessments of CHC Canada's 1996 through 2000 taxation years. The Company and the Seller disagree with CRA's position, and the matter has been in Competent Authority since 2004. The Indemnification Agreement provides that the Company does not receive payment until "final determination" by a taxing authority. The Company believes that it is more likely than not that the matter in Competent Authority will be effectively settled within the next twelve months. Upon settlement, the Company will relieve its liability and reverse the indemnification receivable. For years after April 2001 where the Company has no indemnification, it has included an appropriate amount of tax reserves in the liability for unrecognized tax benefits, including accrued interest and penalties.

Included in the liability for unrecognized tax benefits at December 31, 2008 and 2007 were $(20.0) million and $15.1 million, respectively, of currency translation adjustments for foreign currency tax positions.

Included in the liability for unrecognized tax benefits at December 31, 2008 and 2007 were $36.6 million and $27.3 million, respectively, of tax positions that, if reversed, would affect the effective tax rate.

The Company is required under FIN 48 to disclose its accounting policy for classifying interest and penalties, the amount of interest and penalties charge to expense each period, as well as the cumulative amounts recorded in the consolidated balance sheets. The Company will continue to classify any tax-related penalties and interest accrued related to unrecognized tax benefits in taxes on income within the consolidated statements of operations.

During the years ended December 31, 2008 and 2007, the Company recognized approximately $2.5 million and $3.7 million, respectively, of interest and penalties, net of deferred taxes. In addition, due to settlements and/or reductions in previously-recorded liabilities on uncertain tax positions, the Company had reductions in previously-accrued interest and penalties of $0.8 million, net of deferred taxes, and $1.1 million, which were charged off against goodwill. The Company has accrued

approximately $39.2 million (gross) for the payment of interest and penalties at December 31, 2008. These accruals were included in noncurrent tax liabilities within the consolidated balance sheet at December 31, 2008.

As of December 31, 2008, the Company is subject to U.S. Federal income tax examinations for the tax years 2005, 2006 and 2007. In addition, the Company is subject to state and local income tax examinations for various tax years in the taxing jurisdictions in which the Company operates.

**13. Shareholders' Equity**

**Shareholder Rights Plan**

On May 20, 1998, the Board of Directors of the Company authorized and declared a dividend distribution of one preferred stock purchase right (the "Right" or "Rights") for each outstanding share of the Company's Common Stock, par value $.01 per share, payable to shareholders of record at the close of business on March 19, 1999. In addition, a Right is issued for each share of Common Stock issued after March 19, 1999 and prior to the Rights' expiration. Each Right entitles the registered holder to purchase from the Company one one-hundredth of a share (a "Preferred Stock Fraction") of the Company's Series A Preferred Stock (or another series of preferred stock with substantially similar terms), or a combination of securities and assets of equivalent value, at a purchase price of $10.00 per Preferred Stock Fraction, subject to adjustment. The description and terms of the Rights are set forth in a Rights Agreement (the "Rights Agreement") dated March 2, 1999, and amended on June 15, 2007, between the Company and Continental Stock Transfer and Trust Company as Rights Agent.

The Rights are attached to the shares of the Company's Common Stock until they become exercisable. Generally, the Rights will be exercisable beginning on a specified date after a person or group acquires 15% or more of the Company's Common Stock (the "Stock Acquisition Date"), commences a tender or exchange offer that will result in such person or group acquiring 20% or more of the outstanding Common Stock or a determination that a beneficial owner's ownership of a substantial amount of the Company's Common Stock (at least 10%) is intended to pressure the Company to take action not in the long-term best interests of the Company or may have a material adverse impact ("Adverse Person") on the business or prospects of the Company. The Company is entitled to redeem the Rights at a price of $.01 per Right (payable in cash or stock) at any time until 10 days following a Stock Acquisition Date or the date on which a person is determined to be an Adverse Person. Upon the occurrence of certain events described in the Rights Agreement, each holder of Rights (other than Rights owned by a shareholder who has acquired 15% or more of the Company's outstanding Common Stock or who is determined to be an Adverse Person, which Rights become void) will have the right to receive, upon exercise, Preferred Stock Fractions (or, in certain circumstances, the Company's Common Stock, the acquiring company's Common Stock, cash, property or other securities of the Company) having a market value of twice the exercise price of each Right. Following any such event, the Company may permit holders to surrender their Rights in exchange for Preferred Stock Fractions (or other property or securities, as the case may be) equal to half the value otherwise purchasable or exchange each Right for one Preferred Share Fraction. A potential dilutive effect may exist upon the exercise of the Rights. Until a Right is exercised, the holder will have no rights as a stockholder of the Company, including, without limitations, the right to vote as a stockholder or to receive dividends. The Rights are not exercisable until the distribution date, and will expire at the close of business on March 18, 2009, unless earlier redeemed or exchanged by the Company.

On June 15, 2007, immediately prior to the execution of the Merger Agreement, the Company and Continental Stock Transfer and Trust Company entered into Rights Agreement Amendment No. 1. The Company was required to enter into Rights Agreement Amendment No. 1 pursuant to Section 4.12 of the Merger Agreement in order to render the Rights Agreement inapplicable to the proposed Merger and other transactions contemplated under the Merger Agreement. Pursuant to Rights Agreement Amendment No. 1, none of Fortress, Centerbridge, PNG Holdings LLC ("Holdings" and, together with

Fortress, Centerbridge, Parent and Merger Sub, the "Fortress/Centerbridge Entities"), Parent or Merger Sub will be an Acquiring Person or an Adverse Person (as such terms are defined in the Rights Agreement) to the extent any of the Fortress/Centerbridge Entities are beneficial owners of any Common Stock as a result of the approval, execution or delivery of the Merger Agreement or consummation of the Merger.

On July 3, 2008, the Company entered into Amendment No. 2 to the Rights Agreement between the Company and Continental Stock Transfer and Trust Company. Amendment No. 2 supplements and adds certain definitions in the Rights Agreement and provides, among other things, that neither Fortress nor Centerbridge will be deemed to be Acquiring Persons or Adverse Persons (as such terms are defined in the Rights Agreement) solely by virtue of the approval, execution or delivery of the agreement to purchase the Company's Preferred Stock, the purchase and ownership of Preferred Stock pursuant to the terms of such purchase agreement or the receipt and ownership of Common Stock upon a redemption of the Preferred Stock.

**Issuance of the $1.25 billion, Zero Coupon Preferred Equity Investment**

In connection with the termination of the Merger Agreement, the Company issued 12,500 of Preferred Stock for $1.25 billion. Pursuant to the terms of the preferred equity purchase agreement, the purchasers made the Initial Investment to the Company on July 3, 2008, in addition to the payment of the Cash Termination Fee. Under the terms of the purchase agreement, the purchasers deposited the remaining preferred equity investment purchase consideration with an escrow agent, with the funds to be released from escrow upon the issuance of the Preferred Stock. On October 30, 2008, following the receipt of required regulatory approvals and the satisfaction of certain other conditions, the Company closed the sale of the Investment and received the remaining preferred equity investment purchase consideration of $775 million from the escrow agent.

The Investment is generally non-voting, but possesses voting rights with respect to certain extraordinary events. The Investment is entitled to vote with the Common Stock on an as-converted basis with respect to any change-in-control or other significant transaction if the consideration to be paid to shareholders is less than $45 per share (which amount is subject to adjustment in certain circumstances). In addition, the approval of holders of a majority of the Investment shares is required to authorize (i) special dividends to security holders of the Company; (ii) issuance by the Company of equity securities senior to or on a parity with the Investment; (iii) stock repurchases, including but not limited to, by means of a tender offer which is funded by an asset sale outside the ordinary course (other than repurchases in the open market and repurchases by tender offer at not greater than a 20% premium); and (iv) certain other amendments to the terms of the Investment. The Investment has an aggregate liquidation preference equal to $1.25 billion, the aggregate purchase price paid for the Investment shares (the "Purchase Price"), subject to certain adjustments. In addition, the Investment terms provide that the Investment participates in any dividends paid on the Common Stock. To the extent that the Company pays a special dividend, such special dividend will reduce the amount to be paid to the holders of the Investment upon a liquidation or redemption.

The Company is required to redeem all of the outstanding shares of the Investment on June 30, 2015, unless a change-in-control transaction in which all holders of shares of the Common Stock receive consideration in the transaction has occurred prior to that time. In the event of such a change-in-control transaction, the holders of the Investment will receive cash and/or other consideration in such transaction (the same consideration as the holders of Common Stock receive) with a value equal to the net present value of the Purchase Price, subject to increase or decrease in the event that the value of the consideration paid to the holders of the Common Stock is greater than $67 per share or less than $45 per share, respectively, which thresholds are subject to adjustment in certain circumstances.

The redemption price to be paid to the holders of the Investment on June 30, 2015 is equal to the Purchase Price, subject to increase or decrease in the event that the average trading price of the Common Stock (measured over the 20 consecutive trading days prior to May 26, 2015) is greater than $67 per share or less than $45 per share, respectively. There is no coupon payable with respect to the Investment. The Company shall redeem all of the Investment for cash, provided the Company may elect on or prior to June 1, 2015 to pay all or part of the redemption price in shares of the Common Stock. At December 31, 2008, the redemption price was $593.9 million (27.8 million shares of Common Stock if the Company elected to redeem through the issuance of Common Stock).

The holders of the Investment are subject to the Investor Rights Agreement, dated as of July 3, 2008, by and among the Company, FIF V PFD LLC, Centerbridge Capital Partners, L.P., DB Investment Partners, Inc. and Wachovia Investment Holdings, LLC. (the "Investor Rights Agreement"), which, among other things, contains a voting agreement requiring certain Investment holders to vote all of their shares of Common Stock as directed by the Company and a standstill agreement restricting the activities of certain Investment holders. In addition, Investment holders who may receive 20% or more of the outstanding Common Stock upon redemption would be subject to Subchapter 25G of the Pennsylvania Business Corporation Law of 1988, as amended (the "Control Share Statute"). The Control Share Statute prohibits any person or group that acquires more than 20% of the voting power of the Company from voting any securities held by such person or group unless the shareholders vote to accord voting rights to such securities within 90 days of the time such threshold was exceeded. Under the Investment terms, unless such shareholder approval is obtained, the Investment holders shall execute and deliver a proxy in favor of an attorney-in-fact to be designated by the Board of Directors covering the number of shares of Common Stock necessary to avoid the application of the Control Share Statute.

The Investor Rights Agreement also provides that until Fortress and its affiliates own less than two-thirds of the shares of the Investment issued to them on October 30, 2008, Fortress and the Company must take all action in their power to appoint one designee of the purchasers (the "Purchaser Designee") as a Class II director on the Board of Directors and to use all commercially reasonable efforts to cause the election of the Purchaser Designee at every meeting thereafter at which a Class II director is to be elected. The initial Purchaser Designee is Wesley R. Edens. Mr. Edens is the founding principal, Chief Executive Officer and Chairman of the Board of Directors of Fortress.

Under the terms of the Investor Rights Agreement, the Company has agreed to file a short-form registration statement with the U.S. Securities and Exchange Commission for the registration and sale of Investment shares and certain shares of Common Stock owned by the purchasers ("Registrable Securities"), which it filed on December 30, 2008. The Company is required to keep the shelf registration statement continuously effective under the Securities Act of 1933, as amended, until the earlier of (i) such time as all Registrable Securities have been sold and (ii) such time as the purchasers beneficially own (as defined in the Investor Rights Agreement) less than 2.5% of the Common Stock on a fully-diluted basis (including Common Shares issuable upon redemption of the Investment shares at maturity). The purchasers and any permitted transferees of Registrable Securities are also entitled to four demand registrations and unlimited piggyback registration during the term of the Investor Rights Agreement.

Pursuant to the Investor Rights Agreement, the Investment holders may not directly or indirectly sell, transfer, pledge, encumber, assign or otherwise dispose of any portion of any Investment shares to any person without the prior written consent of the Company prior to July 21, 2009. However, the Investment holders may sell, transfer, pledge, encumber, assign or otherwise dispose of their Investment shares prior to July 21, 2009 if such transaction is made: (i) to an affiliate of any such Investment holder which agrees to be bound by the terms of the Investor Rights Agreement; (ii) with the prior written consent of the Company's Board of Directors, to a person pursuant to a tender or exchange offer for Investment shares or Common Stock by such person or a merger, consolidation or reorganization of the Company with such person; (iii) if the Company acknowledges in writing that it is

unable to pay its debts, commences a voluntary case in bankruptcy or a voluntary petition seeking reorganization or makes an assignment for the benefit of creditors; or (iv) if the Company consents to the entry of an order for relief against it seeking liquidation, reorganization or a creditor's arrangement of the Company.

Under the Investor Rights Agreement, each Investment holder has preemptive rights with respect to certain sales of Common Stock, stock options or securities convertible into Common Stock for so long as such holder beneficially owns at least two-thirds of the shares of the Investment issued to it on October 30, 2008.

**14. Stock-Based Compensation**

In April 1994, the Company's Board of Directors and shareholders adopted and approved the 1994 Stock Option Plan (the "1994 Plan"). The 1994 Plan permitted the grant of options to purchase up to 12,000,000 shares of Common Stock, subject to antidilution adjustments, at a price per share no less than 100% of the fair market value of the Common Stock on the date an option is granted with respect to incentive stock options only. The price would be no less than 110% of fair market value in the case of an incentive stock option granted to any individual who owns more than 10% of the total combined voting power of all classes of outstanding stock. The 1994 Plan provided for the granting of both incentive stock options intended to qualify under Section 422 of the Internal Revenue Code of 1986, as amended, and nonqualified stock options, which do not so qualify. The options granted prior to the 2003 Plan remain outstanding.

On April 16, 2003, the Company's Board of Directors adopted and approved the 2003 Long Term Incentive Compensation Plan (the "2003 Plan"). On May 22, 2003, the Company's shareholders approved the 2003 Plan. The 2003 Plan was effective June 1, 2003 and permitted the grant of options to purchase Common Stock and other market-based and performance-based awards. Up to 12,000,000 shares of Common Stock were available for awards under the 2003 Plan. The 2003 Plan provided for the granting of both incentive stock options intended to qualify under Section 422 of the Internal Revenue Code of 1986, as amended, and nonqualified stock options, which do not so qualify. The exercise price per share may be no less than (i) 100% of the fair market value of the Common Stock on the date an option is granted for incentive stock options and (ii) 85% of the fair market value of the Common Stock on the date an option is granted for nonqualified stock options. This plan will remain in place until it terminates in 2013. However the shares which remained available for issuance under such plan as of November 12, 2008 are no longer available for issuance and all future equity awards will be pursuant to the 2008 Plan described below.

On August 20, 2008, the Company's Board of Directors adopted and approved the 2008 Long Term Incentive Compensation Plan (the "2008 Plan"). On November 12, 2008, the Company's shareholders approved the 2008 Plan. The 2008 Plan permits the Company to issue stock options (incentive and/or non-qualified), stock appreciation rights, restricted stock, phantom stock units and other equity and cash awards to employees. Non-employee directors are eligible to receive all such awards, other than incentive stock options. The aggregate number of shares of Common Stock that may be issued under the 2008 Plan shall not exceed 6,900,000. Awards of stock options and stock appreciation rights will be counted against the 6,900,000 limit as one share of Common Stock for each share granted. However each share awarded in the form of restricted stock, phantom stock units or any other full value stock award will be counted as issuing 2.16 shares of Common Stock for purposes of determining the number of shares available for issuance under the plan. At December 31, 2008, there were 6,900,000 options available for future grants under the 2008 Plan.

Stock options that expire between November 1, 2009 and September 11, 2018 have been granted to officers, directors and employees to purchase Common Stock at prices ranging from $7.75 to $61.82 per share. All options were granted at the fair market value of the Common Stock on the date the options were granted.

The following table contains information on stock options issued under the plans for the three-year period ended December 31, 2008:

| | Number of Option Shares | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Term (in years) | Aggregate Intrinsic Value (in thousands) |
|---|---|---|---|---|
| Outstanding at December 31, 2005 | 7,733,814 | $17.09 | 5.34 | $122,844 |
| Granted | 1,784,400 | 33.34 | | |
| Exercised | (1,310,113) | 9.31 | | |
| Canceled | (97,500) | 22.16 | | |
| Outstanding at December 31, 2006 | 8,110,601 | $21.87 | 4.97 | $160,225 |
| Granted | 1,458,750 | 42.21 | | |
| Exercised | (1,824,071) | 13.66 | | |
| Canceled | (495,375) | 28.44 | | |
| Outstanding at December 31, 2007 | 7,249,905 | $27.58 | 4.87 | $231,837 |
| Granted | 1,834,000 | 29.56 | | |
| Exercised | (203,202) | 11.80 | | |
| Canceled | (76,125) | 37.00 | | |
| Outstanding at December 31, 2008 | 8,804,578 | $28.27 | 6.30 | $ 17,677 |

Included in the above are Common Stock options that were issued in 2003 to the Company's Chairman outside of the 1994 Plan and the 2003 Plan. These options were issued at $7.95 per share, and are exercisable through February 6, 2013. At December 31, 2008 and 2007, the number of these Common Stock options that were outstanding was 23,750. In addition, the Company issued 160,000 restricted stock awards in 2004, which fully vest in May 2009, and issued 280,000 restricted stock awards in 2006, which fully vest by 2011. The restricted stock grants in 2004 and 2006 were made pursuant to the 2003 Plan. Due to the departure of one of the Company's senior executives, 60,000 of these awards were forfeited. On December 31, 2008, the Company modified the expiration date of certain of its stock options from the seventh anniversary of the date of grant to the tenth anniversary of the date of grant. This modification resulted in additional compensation costs related to stock-based compensation of $2.3 million pre-tax ($1.6 million after-tax) for the year ended December 31, 2008.

The weighted-average grant-date fair value of options granted during the years ended December 31, 2008, 2007 and 2006 were $10.57, $16.08 and $14.58, respectively.

| | Number of Option Shares | Weighted-Average Exercise Price |
|---|---|---|
| Exercisable at December 31, | | |
| 2008 | 4,608,441 | $23.60 |
| 2007 | 3,080,480 | 19.74 |
| 2006 | 2,848,451 | 14.11 |

The aggregate intrinsic value of stock options exercised during the years ended December 31, 2008, 2007 and 2006 was $4.1 million, $74.6 million and $37.4 million, respectively.

At December 31, 2008, there were 4,608,441 shares that were exercisable, with a weighted-average exercise price of $23.60, a weighted-average remaining contractual term of 4.78 years, and an aggregate intrinsic value of $17.6 million.

The following table summarizes information about stock options outstanding at December 31, 2008:

| | Exercise Price Range | | | Total |
|---|---|---|---|---|
| | $7.75 to $29.22 | $29.34 to $33.12 | $33.17 to $61.82 | $7.75 to $61.82 |
| **Outstanding options** | | | | |
| Number outstanding | 4,006,539 | 2,973,665 | 1,824,374 | 8,804,578 |
| Weighted-average remaining contractual life (years) | 4.33 | 8.33 | 7.35 | 6.30 |
| Weighted-average exercise price | $ 20.64 | $ 31.14 | $ 40.35 | $ 28.27 |
| **Exercisable options** | | | | |
| Number outstanding | 3,426,539 | 613,915 | 567,987 | 4,608,441 |
| Weighted-average exercise price | $ 19.35 | $ 32.94 | $ 39.16 | $ 23.60 |

Compensation costs related to stock-based compensation for the years ended December 31, 2008, 2007, and 2006 totaled $26.9 million pre-tax ($19.8 million after-tax), $25.5 million pre-tax ($18.6 million after-tax), and $20.6 million pre-tax ($14.9 million after-tax), respectively, and are included within the consolidated statements of operations under general and administrative expense.

At December 31, 2008 and December 31, 2007, the total compensation cost related to nonvested awards not yet recognized equaled $67.0 million and $41.6 million, respectively, including $63.9 million and $36.3 million for stock options, respectively, and $3.1 million and $5.3 million for restricted stock, respectively. This cost is expected to be recognized over the remaining vesting periods, which will not exceed five years.

### 15. Segment Information

In accordance with SFAS 131, the Company views each property as an operating segment, and aggregates all of its properties into one reportable segment, as the Company believes that they are economically similar, offer similar types of products and services, cater to the same types of customers and are similarly regulated.

### 16. Summarized Quarterly Data (Unaudited)

The following table summarizes the quarterly results of operations for the years ended December 31, 2008 and 2007:

| | Fiscal Quarter | | | |
|---|---|---|---|---|
| | First | Second | Third | Fourth |
| | (in thousands, except per share data) | | | |
| **2008** | | | | |
| Net revenues | $613,494 | $620,586 | $617,887 | $ 571,086 |
| Income (loss) from operations | 118,559 | 113,591 | 96,377 | (414,968) |
| Net income (loss) | 40,736 | 37,023 | 147,491 | (378,573) |
| Basic earnings (loss) per common share | 0.47 | 0.43 | 1.72 | (4.77) |
| Diluted earnings (loss) per common share | 0.46 | 0.42 | 1.69 | (4.77) |
| **2007** | | | | |
| Net revenues | $596,258 | $625,244 | $629,450 | $ 585,841 |
| Income from operations | 124,780 | 128,420 | 133,879 | 110,730 |
| Net income | 42,941 | 38,299 | 46,590 | 32,223 |
| Basic earnings per common share | 0.51 | 0.45 | 0.54 | 0.37 |
| Diluted earnings per common share | 0.49 | 0.43 | 0.52 | 0.36 |

As a result of a decline in the Company's share price, an overall reduction in industry valuations, and property operating performance in the current economic environment, the Company recorded a pre-tax impairment charge of $481.3 million ($392.6 million, net of taxes) during the fourth quarter of 2008, as it determined that a portion of the value of its goodwill, indefinite-life intangible assets and long-lived assets was impaired.

## 17. Related Party Transactions

### Executive Office Lease

The Company currently leases 42,348 square feet of executive office and warehouse space for buildings in Wyomissing, Pennsylvania from affiliates of its Chairman and CEO. Rent expense for the years ended December 31, 2008, 2007 and 2006 amounted to $0.8 million, $0.7 million and $0.6 million, respectively. The leases for the office space expire in March 2012, May 2012 and May 2013, and the lease for the warehouse space expires in July 2010. The future minimum lease commitments relating to these leases at December 31, 2008 equaled $2.9 million. The Company also paid $0.7 million, $3.7 million and $1.3 million in construction costs to these same affiliates for the years ended December 31, 2008, 2007 and 2006, respectively.

## 18. Subsidiary Guarantors

Under the terms of the $2.725 billion senior secured credit facility, most of Penn's subsidiaries are guarantors under the agreement, with the exception of several subsidiaries. Each of the subsidiary guarantors is 100% owned by Penn. In addition, the guarantees provided by Penn's subsidiaries under the terms of the $2.725 billion senior secured credit facility are full and unconditional, joint and several. There are no significant restrictions within the $2.725 billion senior secured credit facility on the Company's ability to obtain funds from its subsidiaries by dividend or loan. However, in certain jurisdictions, the gaming authorities may impose restrictions pursuant to the authority granted to them with regard to Penn's ability to obtain funds from its subsidiaries.

With regard to the $2.725 billion senior secured credit facility, the Company has not presented condensed consolidating balance sheets, condensed consolidating statements of operations and condensed consolidating statements of cash flows at, and for the years ended, December 31, 2007 and 2006, as Penn had no significant independent assets and no independent operations at, and for the years ended, December 31, 2007 and 2006. However during the year ended December 31, 2008, we placed some of the funds received from the Preferred Stock Investment into two unrestricted subsidiaries, in order to allow for maximum flexibility in the deployment of the funds and this resulted in significant independent assets. Summarized financial information for the year ended December 31, 2008 for Penn, the subsidiary guarantors of the $2.725 billion senior secured credit facility and the subsidiary non-guarantors is presented below.

Under the terms of the $200 million 6⅞% senior subordinated notes, most of Penn's subsidiaries are guarantors under the agreement, with the exception of several subsidiaries. Each of the subsidiary guarantors is 100% owned by Penn. In addition, the guarantees provided by Penn's subsidiaries under the terms of the $200 million 6⅞% senior subordinated notes are full and unconditional, joint and several. There are no significant restrictions within the $200 million 6⅞% senior subordinated notes on the Company's ability to obtain funds from its subsidiaries by dividend or loan. However, in certain jurisdictions, the gaming authorities may impose restrictions pursuant to the authority granted to them with regard to Penn's ability to obtain funds from its subsidiaries.

With regard to the $200 million 6⅞% senior subordinated notes, the Company has not presented condensed consolidating balance sheets, condensed consolidating statements of operations and condensed consolidating statements of cash flows at, and for the years ended, December 31, 2007 and 2006, as Penn had no significant independent assets and no independent operations at, and for the

years ended, December 31, 2007 and 2006. However during the year ended December 31, 2008, we placed some of the funds received from the Preferred Stock Investment into two unrestricted subsidiaries, in order to allow for maximum flexibility in the deployment of the funds and this resulted in significant independent assets. Summarized financial information for the year ended December 31, 2008 for Penn, the subsidiary guarantors of the $200 million 6⅞% senior subordinated notes and the subsidiary non-guarantors is presented below.

| | Penn | Subsidiary Guarantors | Subsidiary Non-Guarantors | Eliminations | Consolidated |
|---|---|---|---|---|---|
| | | | (in thousands) | | |
| **$2.725 Senior Credit Facility** | | | | | |
| **As of December 31, 2008** | | | | | |
| **Condensed Consolidating Balance Sheet** | | | | | |
| Total current assets | $ 40,598 | $ 235,862 | $614,787 | $ 15,056 | $ 906,303 |
| Property and equipment, net | 17,707 | 1,781,982 | 12,442 | — | 1,812,131 |
| Other assets | 4,351,845 | 2,351,302 | 262,923 | (4,494,828) | 2,471,242 |
| Total assets | $4,410,150 | $4,369,146 | $890,152 | $(4,479,772) | $5,189,676 |
| Total current liabilities | $ 105,147 | $ 332,812 | $ 17,468 | $ 15,059 | $ 470,486 |
| Total long-term liabilities | 2,247,736 | 3,667,014 | 97,151 | (3,349,984) | 2,661,917 |
| Total shareholders' equity | 2,057,267 | 369,320 | 775,533 | (1,144,847) | 2,057,273 |
| Total liabilities and shareholders' equity | $4,410,150 | $4,369,146 | $890,152 | $(4,479,772) | $5,189,676 |
| **Year Ended December 31, 2008** | | | | | |
| **Condensed Consolidating Statement of Operations** | | | | | |
| Net revenues | $ — | $2,387,358 | $ 35,695 | $ — | $2,423,053 |
| Total operating expenses | 94,925 | 2,352,864 | 61,705 | — | 2,509,494 |
| (Loss) income from continuing operations | (94,925) | 34,494 | (26,010) | — | (86,441) |
| Other income (expense) | 239,920 | (198,845) | (2,219) | — | 38,856 |
| Income (loss) before income taxes | 144,995 | (164,351) | (28,229) | — | (47,585) |
| Taxes on income | 38,851 | 66,563 | 324 | — | 105,738 |
| Net income (loss) | $ 106,144 | $ (230,914) | $(28,553) | $ — | $ (153,323) |
| **Year Ended December 31, 2008** | | | | | |
| **Condensed Consolidating Statement of Cash Flows** | | | | | |
| Net cash (used in) provided by operating activities | $ (544,759) | $ 360,012 | $605,210 | $ — | $ 420,463 |
| Net cash used in investing activities | (2,085) | (388,361) | (1,052) | — | (391,498) |
| Net cash provided by (used in) financing activities | 552,233 | (2,292) | (7,000) | — | 542,941 |
| Net increase (decrease) in cash and cash equivalents | 5,389 | (30,641) | 597,158 | — | 571,906 |
| Cash and cash equivalents at beginning of year | (2,929) | 172,745 | 4,556 | — | 174,372 |
| Cash and cash equivalents at end of year | $ 2,460 | $ 142,104 | $601,714 | $ — | $ 746,278 |
| **$200 million 6⅞% Senior Subordinated Notes** | | | | | |
| **As of December 31, 2008** | | | | | |
| **Condensed Consolidating Balance Sheet** | | | | | |
| Total current assets | $ 40,598 | $ 236,431 | $614,218 | $ 15,056 | $ 906,303 |
| Property and equipment, net | 17,707 | 1,794,424 | — | — | 1,812,131 |
| Other assets | 4,351,845 | 2,460,021 | 154,204 | (4,494,828) | 2,471,242 |
| Total assets | $4,410,150 | $4,490,876 | $768,422 | $(4,479,772) | $5,189,676 |
| Total current liabilities | $ 105,147 | $ 338,765 | $ 11,515 | $ 15,059 | $ 470,486 |
| Total long-term liabilities | 2,247,736 | 3,681,006 | 83,159 | (3,349,984) | 2,661,917 |
| Total shareholders' equity | 2,057,267 | 471,105 | 673,748 | (1,144,847) | 2,057,273 |
| Total liabilities and shareholders' equity | $4,410,150 | $4,490,876 | $768,422 | $(4,479,772) | $5,189,676 |

| | Penn | Subsidiary Guarantors | Subsidiary Non-Guarantors | Eliminations | Consolidated |
|---|---|---|---|---|---|
| | | | (in thousands) | | |
| **Year Ended December 31, 2008 Condensed Consolidating Statement of Operations** | | | | | |
| Net revenues | $ — | $2,406,328 | $ 16,725 | $ — | $2,423,053 |
| Total operating expenses | 94,925 | 2,376,103 | 38,466 | — | 2,509,494 |
| (Loss) income from continuing operations | (94,925) | 30,225 | (21,741) | — | (86,441) |
| Other income (expense) | 239,920 | (201,134) | 70 | — | 38,856 |
| Income (loss) before income taxes | 144,995 | (170,909) | (21,671) | — | (47,585) |
| Taxes on income | 38,851 | 66,102 | 785 | — | 105,738 |
| Net income (loss) | $ 106,144 | $ (237,011) | $(22,456) | $ — | $ (153,323) |
| **Year Ended December 31, 2008 Condensed Consolidating Statement of Cash Flows** | | | | | |
| Net cash (used in) provided by operating activities | $ (544,759) | $ 367,455 | $597,767 | $ — | $ 420,463 |
| Net cash used in investing activities | (2,085) | (389,413) | — | — | (391,498) |
| Net cash provided by (used in) financing activities | 552,233 | (9,292) | — | — | 542,941 |
| Net increase (decrease) in cash and cash equivalents | 5,389 | (31,250) | 597,767 | — | 571,906 |
| Cash and cash equivalents at beginning of year | (2,929) | 173,684 | 3,617 | — | 174,372 |
| Cash and cash equivalents at end of year | $ 2,460 | $ 142,434 | $601,384 | $ — | $ 746,278 |

## 19. Investment in Corporate Securities

During the year ended December 31, 2008, the Company made a $47.3 million investment in the corporate debt securities of other gaming companies. The investment, which the Company is treating as available-for-sale securities, is included in other assets within the consolidated balance sheet at December 31, 2008. During the year ended December 31, 2008, the Company recorded an $8.0 million unrealized loss in other comprehensive income for this investment.

The following is a schedule of the contractual maturities of the Company's investment in corporate securities at December 31, 2008 (in thousands):

| | |
|---|---|
| Within one year | $ — |
| 1 – 3 years | — |
| 3 – 5 years | 3,815 |
| Over 5 years | 36,375 |
| Total | $40,190 |

## 20. Fair Value Measurements

Effective January 1, 2008, the Company adopted the provisions of SFAS 157 for certain balance sheet items. SFAS 157 establishes a hierarchy that prioritizes fair value measurements based on the types of inputs used for the various valuation techniques (market approach, income approach, and cost approach). The levels of the hierarchy are described below:

- Level 1: Observable inputs such as quoted prices in active markets for identical assets or liabilities.
- Level 2: Inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly; these include quoted prices for similar assets or liabilities in active markets and quoted prices for identical or similar assets or liabilities in markets that are not active.
- Level 3: Unobservable inputs that reflect the reporting entity's own assumptions.

The Company's assessment of the significance of a particular input to the fair value measurement requires judgment, and may affect the valuation of assets and liabilities and their placement within the fair value hierarchy. The following table sets forth the assets and liabilities measured at fair value on a recurring basis, by input level, in the consolidated balance sheet at December 31, 2008 (in thousands):

| | Quoted Prices in Active Markets for Identical Assets or Liabilities (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total |
|---|---|---|---|---|
| Assets: | | | | |
| Investment in corporate debt securities | $40,190 | $ — | $— | $40,190 |
| Liabilities: | | | | |
| Interest rate swap contracts | — | 63,185 | — | 63,185 |

For the year ended December 31, 2008, the valuation technique used to measure the fair value of the investment in corporate debt securities and interest rate swap contracts was the market approach. The investment in corporate debt securities is included in other assets and the interest rate swap contracts are included in accrued interest within the consolidated balance sheet at December 31, 2008.

**21. Discontinued Operations—Sale of The Downs Racing, Inc. and Subsidiaries**

On October 15, 2004, the Company announced the sale of The Downs Racing, Inc. and its subsidiaries to the MTGA. In January 2005, the Company received $280 million from the MTGA, and transferred the operations of The Downs Racing, Inc. and its subsidiaries to the MTGA. The sale was not considered final for accounting purposes until the third quarter of 2006, as the MTGA had certain post-closing termination rights that remained outstanding. On August 7, 2006, the Company entered into the Amendment and Release with the MTGA pertaining to the Purchase Agreement, and agreed to pay the MTGA an aggregate of $30 million over five years, beginning on the first anniversary of the commencement of slot operations at Mohegan Sun at Pocono Downs, in exchange for the MTGA's agreement to release various claims it raised against the Company under the Purchase Agreement and the MTGA's surrender of all post-closing termination rights it might have had under the Purchase Agreement. As a result of the Amendment and Release, the Company recorded, in accordance with GAAP, a net book gain on the $250 million sale ($280 million initial price, less $30 million payable pursuant to the Amendment and Release) of The Downs Racing, Inc. and its subsidiaries to the MTGA of $114.0 million (net of $84.9 million of income taxes) during the year ended December 31, 2006. In addition, the Company recorded the present value of the $30 million liability within debt, as the amount due to the MTGA is payable over five years. At December 31, 2008, the balance due to the MTGA equaled $14.2 million.

## ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None

## ITEM 9A. CONTROLS AND PROCEDURES

### Disclosure Controls and Procedures

We carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)). Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered in this report, our disclosure controls and procedures were effective to ensure that information required to be disclosed in reports filed under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the required time periods and 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.

### Changes in Internal Control Over Financial Reporting

There have been no changes in our internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) that occurred during the fiscal quarter ended December 31, 2008, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

### Management's Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)). Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. In addition, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Our management assessed the effectiveness of our internal control over financial reporting, and concluded that it was effective as of December 31, 2008. In making this assessment, we used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in *Internal Control—Integrated Framework.*

The effectiveness of the Company's internal control over financial reporting as of December 31, 2008 has been audited by Ernst & Young LLP, an independent registered public accounting firm, as stated in their report below.

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors
Penn National Gaming, Inc. and subsidiaries

We have audited Penn National Gaming, Inc. and subsidiaries' internal control over financial reporting as of December 31, 2008, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Penn National Gaming, Inc. and subsidiaries' management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Annual Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Penn National Gaming, Inc. and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2008, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Penn National Gaming, Inc. and subsidiaries as of December 31, 2008 and 2007, and the related consolidated statements of operations, changes in shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2008 and our report dated February 27, 2009 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Philadelphia, Pennsylvania
February 27, 2009

# Exhibit 3-a

## Penn National Gaming, Inc.

2007 Financial Statements

## ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

### Report of Independent Registered Public Accounting Firm

Board of Directors
Penn National Gaming, Inc. and subsidiaries

We have audited the accompanying consolidated balance sheets of Penn National Gaming, Inc. and subsidiaries as of December 31, 2007 and 2006, and the related consolidated statements of income, changes in shareholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Penn National Gaming, Inc. and subsidiaries at December 31, 2007 and 2006, and the consolidated results of their operations and their cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 4 to the consolidated financial statements, the Company changed the manner in which it accounts for share-based compensation in 2006.

As discussed in Note 4 to the consolidated financial statements, the Company changed the manner in which it accounts for uncertainty in income taxes in 2007.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Penn National Gaming Inc. and subsidiaries' internal control over financial reporting as of December 31, 2007, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 22, 2008, expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Philadelphia, Pennsylvania
February 22, 2008

**Report of Independent Registered Public Accounting Firm**

Board of Directors
Penn National Gaming, Inc. and subsidiaries

We have audited the accompanying consolidated statements of income, shareholders' equity and cash flows of Penn National Gaming, Inc. and subsidiaries for the year ended December 31, 2005. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the results of Penn National Gaming, Inc.'s operations and their cash flows for the year ended December 31, 2005 in conformity with accounting principles generally accepted in the United States of America.

/s/ BDO Seidman, LLP

BDO Seidman, LLP
Philadelphia, Pennsylvania
March 7, 2006

**Penn National Gaming, Inc. and Subsidiaries**
**Consolidated Balance Sheets**
**(in thousands, except share and per share data)**

| | December 31, 2007 | December 31, 2006 |
|---|---|---|
| **Assets** | | |
| **Current assets** | | |
| Cash and cash equivalents | $ 174,372 | $ 168,515 |
| Receivables, net of allowance for doubtful accounts of $3,241 and $3,698 at December 31, 2007 and 2006, respectively | 56,427 | 53,829 |
| Insurance receivable | — | 100,000 |
| Prepaid expenses and other current assets | 52,825 | 57,432 |
| Deferred income taxes | 19,079 | 22,187 |
| Total current assets | 302,703 | 401,963 |
| **Property and equipment, net** | 1,688,393 | 1,365,871 |
| **Other assets** | | |
| Investment in and advances to unconsolidated affiliate | 15,548 | 16,138 |
| Goodwill | 2,013,139 | 1,869,444 |
| Other intangible assets | 777,441 | 726,126 |
| Deferred financing costs, net of accumulated amortization of $27,680 and $16,438 at December 31, 2007 and 2006, respectively | 46,144 | 57,386 |
| Other assets | 123,664 | 77,154 |
| Total other assets | 2,975,936 | 2,746,248 |
| **Total assets** | $ 4,967,032 | $ 4,514,082 |
| **Current liabilities** | | |
| Current maturities of long-term debt | $ 93,452 | $ 40,058 |
| Accounts payable | 28,581 | 37,928 |
| Accrued expenses | 163,579 | 130,877 |
| Accrued interest | 56,631 | 31,329 |
| Accrued salaries and wages | 54,149 | 60,164 |
| Gaming, pari-mutuel, property, and other taxes | 43,621 | 48,181 |
| Income taxes payable | 3,642 | 21,020 |
| Insurance financing | 16,515 | 19,336 |
| Other current liabilities | 33,704 | 26,778 |
| Total current liabilities | 493,874 | 415,671 |
| **Long-term liabilities** | | |
| Long-term debt, net of current maturities | 2,881,470 | 2,789,390 |
| Deferred income taxes | 385,089 | 387,615 |
| Noncurrent tax liabilities | 82,849 | — |

| | | |
|---|---|---|
| Other noncurrent liabilities | 2,788 | 243 |
| Total long-term liabilities | 3,352,196 | 3,177,248 |
| **Shareholders' equity** | | |
| Preferred stock ($.01 par value, 1,000,000 shares authorized, none issued and outstanding at December 31, 2007 and 2006) | — | — |
| Common stock ($.01 par value, 200,000,000 shares authorized, 88,579,070 and 86,814,999 shares issued at December 31, 2007 and 2006, respectively) | 887 | 868 |
| Treasury stock (1,698,800 shares issued at December 31, 2007 and 2006) | (2,379) | (2,379) |
| Additional paid-in capital | 322,760 | 251,943 |
| Retained earnings | 815,678 | 667,557 |
| Accumulated other comprehensive (loss) income | (15,984) | 3,174 |
| Total shareholders' equity | 1,120,962 | 921,163 |
| **Total liabilities and shareholders' equity** | $ 4,967,032 | $ 4,514,082 |

See accompanying notes to consolidated financial statements.

**Penn National Gaming, Inc. and Subsidiaries**
**Consolidated Statements of Income**
**(in thousands, except per share data)**

| Year ended December 31, | 2007 | 2006 | 2005 |
|---|---|---|---|
| **Revenues** | | | |
| Gaming | $ 2,227,944 | $ 2,057,617 | $ 1,211,360 |
| Management service fee | 17,273 | 18,146 | 18,596 |
| Food, beverage and other | 320,520 | 275,700 | 213,089 |
| Gross revenues | 2,565,737 | 2,351,463 | 1,443,045 |
| Less promotional allowances | (128,944) | (106,916) | (73,940) |
| Net revenues | 2,436,793 | 2,244,547 | 1,369,105 |
| **Operating expenses** | | | |
| Gaming | 1,155,062 | 1,061,904 | 644,801 |
| Food, beverage and other | 247,576 | 224,673 | 160,796 |
| General and administrative | 388,431 | 349,909 | 198,109 |
| Hurricane | — | (128,253) | 21,145 |
| Goodwill impairment | — | 34,522 | — |
| Settlement costs | — | — | 28,175 |
| Depreciation and amortization | 147,915 | 123,951 | 72,531 |
| Total operating expenses | 1,938,984 | 1,666,706 | 1,125,557 |
| Income from continuing operations | 497,809 | 577,841 | 243,548 |
| **Other income (expenses)** | | | |
| Interest expense | (198,059) | (196,328) | (89,344) |
| Interest income | 4,016 | 3,525 | 4,111 |
| (Loss) earnings from joint venture | (99) | (788) | 1,455 |
| Other | (11,427) | (4,296) | 39 |
| Loss on early extinguishment of debt | — | (10,022) | (18,039) |
| Total other expenses | (205,569) | (207,909) | (101,778) |
| **Income from continuing operations before income taxes** | 292,240 | 369,932 | 141,770 |
| Taxes on income | 132,187 | 156,852 | 54,593 |
| Net income from continuing operations | 160,053 | 213,080 | 87,177 |
| Loss from discontinued operations, net of tax | — | — | (4,135) |
| Gain on sale of discontinued operations, net of tax | — | 114,008 | 37,888 |
| **Net income** | $ 160,053 | $ 327,088 | $ 120,930 |
| **Earnings per share—Basic** | | | |
| Income from continuing operations | $ 1.87 | $ 2.53 | $ 1.05 |
| Discontinued operations, net of tax | — | 1.35 | 0.41 |
| **Basic earnings per share** | $ 1.87 | $ 3.88 | $ 1.46 |

| | | | |
|---|---|---|---|
| **Earnings per share—Diluted** | | | |
| Income from continuing operations | $ 1.81 | $ 2.46 | $ 1.02 |
| Discontinued operations, net of tax | — | 1.32 | 0.39 |
| **Diluted earnings per share** | $ 1.81 | $ 3.78 | $ 1.41 |

See accompanying notes to consolidated financial statements.

**Penn National Gaming, Inc. and Subsidiaries**
**Consolidated Statements of Changes in Shareholders' Equity**
**(in thousands, except share data)**

| | Common Stock | | | | | Accumulated Other | | |
|---|---|---|---|---|---|---|---|---|
| | Shares | Amount | Treasury Stock | Additional Paid-In Capital | Retained Earnings | Comprehensive Income (Loss) | Total Shareholders' Equity | Comprehensive Income |
| Balance, December 31, 2004 | 83,131,940 | $ 831 | $ (2,379) | $ 178,459 | $ 219,539 | $ 1,642 | $ 398,092 | |
| Exercise of stock options, including tax benefit of $16,969 | 1,932,946 | 19 | — | 27,826 | — | — | 27,845 | $ — |
| Restricted stock | — | — | — | 478 | — | — | 478 | — |
| Change in fair value of interest rate swap contracts, net of income taxes of $477 | — | — | — | — | — | (852) | (852) | (852) |
| Amortization of unrealized loss on interest rate swap contracts, net of income taxes of $29 | — | — | — | — | — | (54) | (54) | — |
| Foreign currency translation adjustment | — | — | — | — | — | 104 | 104 | 104 |
| Net income | — | — | — | — | 120,930 | — | 120,930 | 120,930 |
| Balance, December 31, 2005 | 85,064,886 | 850 | (2,379) | 206,763 | 340,469 | 840 | 546,543 | 120,182 |
| Stock option activity, including tax benefit of $12,435 | 1,310,113 | 14 | — | 43,397 | — | — | 43,411 | — |
| Restricted stock | 440,000 | 4 | — | 1,783 | — | — | 1,787 | — |
| Change in fair value of interest rate swap contracts, net of income taxes of $1,461 | — | — | — | — | — | 2,380 | 2,380 | 2,380 |
| Foreign currency translation adjustment | — | — | — | — | — | (46) | (46) | (46) |
| Net income | — | — | — | — | 327,088 | — | 327,088 | 327,088 |
| Balance, December 31, 2006 | 86,814,999 | 868 | (2,379) | 251,943 | 667,557 | 3,174 | 921,163 | 329,422 |
| Stock option activity, including tax benefit of $20,460 | 1,824,071 | 19 | — | 68,851 | — | — | 68,870 | — |
| Restricted stock | (60,000) | — | — | 1,966 | — | — | 1,966 | — |
| Change in fair value of interest rate swap contracts, net of income taxes of $11,203 | — | — | — | — | — | (19,728) | (19,728) | (19,728) |
| Foreign currency translation adjustment | — | — | — | — | — | 570 | 570 | 570 |
| Cumulative effect of | | | | | | | | |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| adoption of FIN 48 | — | — | — | — | (11,932) | — | (11,932) | — |
| Net income | — | — | — | — | 160,053 | — | 160,053 | 160,053 |
| Balance, December 31, 2007 | 88,579,070 | $ 887 | $ (2,379) | $ 322,760 | $ 815,678 | $ (15,984) | $ 1,120,962 | $ 140,895 |

See accompanying notes to consolidated financial statements.

## Penn National Gaming, Inc. and Subsidiaries
## Consolidated Statements of Cash Flows
## (in thousands)

| Year ended December 31, | 2007 | 2006 | 2005 |
|---|---|---|---|
| **Operating activities** | | | |
| Net income | $ 160,053 | $ 327,088 | $ 120,930 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Depreciation and amortization | 147,915 | 123,951 | 72,531 |
| Amortization of items charged to interest expense | 13,011 | 11,361 | 5,269 |
| Amortization of the unrealized gain on interest rate swap contracts charged to interest expense, net of income tax benefit | — | — | (54) |
| Loss on sale of fixed assets | 1,637 | 1,383 | 6,449 |
| Loss (earnings) from joint venture | 99 | 788 | (1,455) |
| Loss relating to early extinguishment of debt | — | 2,255 | 8,611 |
| Deferred income taxes | 18,265 | 14,394 | (28,673) |
| Tax benefit from stock options exercised | — | — | 16,969 |
| Charge for stock compensation | 25,465 | 20,562 | 478 |
| Gain on sale of discontinued operations, net of tax | — | (114,008) | — |
| Gain on hurricane insurance, net of tax | — | (81,799) | — |
| Goodwill impairment, net of tax | — | 22,018 | — |
| (Increase) decrease, net of businesses acquired | | | |
| Accounts receivable | (2,168) | (6,197) | 4,300 |
| Insurance receivable | 100,000 | (23,048) | 1,431 |
| Prepaid expenses and other current assets | 924 | (26,933) | (5,956) |
| Other assets | (7,159) | 13,536 | (32,291) |
| (Decrease) increase, net of businesses acquired | | | |
| Accounts payable | (22,234) | 12,379 | 11,193 |
| Accrued expenses | (12,436) | 4,155 | 24,968 |
| Accrued interest | (1,594) | (1,974) | 19,317 |
| Accrued salaries and wages | (6,003) | 5,585 | (3,419) |
| Gaming, pari-mutuel, property and other taxes | (4,629) | (127) | 13,210 |
| Income taxes payable | (3,584) | (28,748) | (33,900) |
| Other current and noncurrent liabilities | 9,470 | 5,176 | (6,283) |
| Other noncurrent tax liabilities | 14,187 | — | — |
| Operating cash flows from discontinued operations | — | 12 | (43,150) |
| Net cash provided by operating activities | 431,219 | 281,809 | 150,475 |
| **Investing activities** | | | |
| Expenditures for property and equipment | (361,155) | (408,883) | (121,135) |
| Proceeds from hurricane | — | 104,136 | — |
| Proceeds from sale of property and equipment | 15,020 | 2,406 | 720 |
| Payments to joint venture | — | — | (20) |
| Proceeds from sale of business | — | — | 423,139 |
| Acquisition of businesses and licenses, net of cash acquired | (265,482) | — | (2,251,376) |
| Increase in cash in escrow | — | — | (30,000) |
| Investing cash flows from discontinued operations | — | — | (128) |
| Net cash used in investing activities | (611,617) | (302,341) | (1,978,800) |
| **Financing activities** | | | |

| | | | |
|---|---|---|---|
| Proceeds from exercise of options | 24,911 | 12,201 | 10,876 |
| Proceeds from issuance of long-term debt | 426,065 | 195,678 | 2,398,961 |
| Principal payments on long-term debt | (282,360) | (177,066) | (471,839) |
| Proceeds from insurance financing | 29,009 | 32,522 | — |
| Payments on insurance financing | (31,830) | (19,301) | — |
| Increase in deferred financing cost | — | (42) | (64,777) |
| Tax benefit from stock options exercised | 20,460 | 12,435 | — |
| Net cash provided by financing activities | 186,255 | 56,427 | 1,873,221 |
| Effect of exchange rate fluctuations on cash | — | — | 104 |
| **Net increase in cash and cash equivalents** | 5,857 | 35,895 | 45,000 |
| Cash and cash equivalents at beginning of year | 168,515 | 132,620 | 87,620 |
| Cash and cash equivalents at end of year | $ 174,372 | $ 168,515 | $ 132,620 |
| **Supplemental disclosure** | | | |
| Interest expense paid | $ 199,425 | $ 198,605 | $ 65,322 |
| Income taxes paid | $ 88,546 | $ 127,787 | $ 92,971 |

See accompanying notes to consolidated financial statements.

## 1. Business and Basis of Presentation

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.

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.

The preparation of financial statements in conformity with generally accepted accounting principles ("GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses for the reporting periods. Actual results could differ from those estimates.

For purposes of comparability, certain prior year amounts have been reclassified to conform to the current year presentation.

## 2. Principles of Consolidation

The consolidated financial statements include the accounts of Penn and its wholly-owned subsidiaries. Investment in and advances to an unconsolidated affiliate that is 50% owned is accounted for under the equity method. All significant intercompany accounts and transactions have been eliminated in consolidation.

## 3. Merger Announcement

On June 15, 2007, the Company announced that it had entered into a merger agreement that would ultimately 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").

Pursuant to the Merger Agreement, at the effective time of the Merger, each outstanding share of common stock of the Company (the "Common Stock"), other than shares held by the Company as treasury stock or owned directly or indirectly by Parent or Merger Sub, will be cancelled and converted into the right to receive $67.00 in cash, without interest. In the event that the Merger shall not have occurred by June 15, 2008 (the "Adjustment Date"), the $67.00 cash amount per share of Common Stock shall be increased for each day after the Adjustment Date, through and including the closing date, by adding an amount equal to $0.0149 per day.

The Merger Agreement provided that, upon termination under specified circumstances generally related to a competing acquisition proposal, the Company would be required to pay a termination fee of up to $200 million to Parent and, under certain circumstances if the Company's shareholders did not approve the Merger, the Company would be required to reimburse Parent for an aggregate amount not to exceed $17.5 million for transaction expenses incurred by Parent and its affiliates. The Company's reimbursement of Parent's expenses would reduce the amount of any required termination fee that becomes payable by the Company. The Merger Agreement further provides that, upon termination under specified circumstances related to, among other things, Parent's breach of the Merger Agreement, the failure to obtain financing or failure to obtain regulatory approval, Parent would be required to pay the Company a termination fee of $200 million. Affiliates of the Funds have agreed to fund Parent in the amount of the termination fee in the event it becomes payable.

Parent has obtained equity and debt financing commitments for the transactions contemplated by the Merger Agreement, the proceeds of which will be used by Parent to pay the aggregate Merger consideration and related fees and expenses of the transactions contemplated by the Merger Agreement and to repay certain debt of the Company and its subsidiaries. Consummation of the Merger is not subject to a financing condition.

On December 12, 2007, the Company's shareholders approved the Merger Agreement. Based upon the tally of shares voted, with 81.6% of the Company's outstanding shares voting, 99.3% of the shares were voted in favor of the transaction. The Company is seeking to complete the transaction late in the second quarter of 2008. The timing of any closing is subject to obtaining certain regulatory approvals and satisfying other customary closing conditions. See "Risk Factors—Risks Related to the Consummation of the Merger Agreement" on page 17 of this Annual Reporbn Form 10-K for a discussion of the risk in connection with the consummation of the Merger.

On December 26, 2007, the Company entered into a Change in Control Payment Acknowledgement and Agreement (the "Acknowledgement and Agreement") with certain members of its management team. Pursuant to the Acknowledgement and Agreement, a portion of the payment due on a change in control was accelerated and paid on or before December 31, 2007. The Acknowledgement and Agreements were entered into as part of actions taken to reduce the amount of "gross-up" payments pertaining to federal excise taxes that may have otherwise been owed to such executives under the terms of their existing employment agreements in connection with the change in control payments due upon the consummation of the Merger. The accelerated change in control payments, which are subject to repayment in the event the Merger is terminated pursuant to the terms of the Merger Agreement or the closing of the Merger otherwise fails to occur or if the executive's employment with the Company is terminated prior to the effective date of the Merger under circumstances where the Executive is not entitled to receive the remainder of his change in control payment under the terms of his employment agreement, are included in prepaid expenses and other current assets within the consolidated balance sheet at December 31, 2007.

**4. Summary of Significant Accounting Policies**

**Cash and Cash Equivalents**

The Company considers all cash balances and highly-liquid investments with original maturities of three months or less to be cash and cash equivalents.

**Concentration of Credit Risk**

Financial instruments that subject the Company to credit risk consist of cash equivalents and accounts receivable.

The Company's policy is to limit the amount of credit exposure to any one financial institution, and place investments with financial institutions evaluated as being creditworthy, or in short-term money market and tax-free bond funds which are exposed to minimal interest rate and credit risk. The Company has bank deposits and overnight repurchase agreements that exceed federally-insured limits.

Concentration of credit risk, with respect to casino receivables, is limited through the Company's credit evaluation process. The Company issues markers to approved casino customers only following credit checks and investigations of creditworthiness.

The Company's receivables of $56.4 million and $53.8 million at December 31, 2007 and 2006, respectively, primarily consist of $21.9 million and $22.2 million, respectively, due from the West Virginia Lottery for gaming revenue settlements and capital reinvestment projects at the Charles Town Entertainment Complex, and $13.4 million and $11.2 million, respectively, for reimbursement of expenses paid on behalf of Casino Rama.

Accounts are written off when management determines that an account is uncollectible. Recoveries of accounts previously written off are recorded when received. An allowance for doubtful accounts is determined to reduce the Company's receivables to their carrying value, which approximates fair value. The allowance is estimated based on historical collection experience, specific review of individual customer accounts, and current economic and business conditions. Historically, the Company has not incurred any significant credit-related losses.

**Fair Value of Financial Instruments**

The following methods and assumptions are used to estimate the fair value of each class of financial instruments for which it is practicable to estimate:

Cash and Cash Equivalents: The fair value of the Company's cash and cash equivalents approximates the carrying value of the Company's cash and cash equivalents, due to the short maturity of the cash equivalents.

Long-term Debt: The fair value of the Company's senior secured credit facility approximates its carrying value, as it is variable-rate debt. The fair value of the Company's fixed-rate bonds and other long-term obligations as of December 31, 2007 was $475.2 million, which was estimated based on quoted market prices for the same or similar issues or on the current rates offered to the Company for debt of the same remaining maturities. The carrying value of the Company's fixed-rate bonds as of December 31, 2007 and other long-term obligations was $469.8 million. The fair value of the Company's capital leases and other debt approximates their carrying value.

**Property and Equipment**

Property and equipment are stated at cost, less accumulated depreciation. Maintenance and repairs that neither add materially to the value of the asset nor appreciably prolong its useful life are charged to expense as incurred. Gains or losses on the disposal of property and equipment are included in the determination of income.

Depreciation of property and equipment is recorded using the straight-line method over the following estimated useful lives:

| | |
|---|---|
| Land improvements | 5 to 15 years |
| Building and improvements | 25 to 40 years |
| Furniture, fixtures, and equipment | 3 to 7 years |

Leasehold improvements are amortized over the shorter of the estimated useful life of the improvement or the related lease term.

The estimated useful lives are determined based on the nature of the assets as well as the Company's current operating strategy.

The Company reviews the carrying values of its property and equipment for possible impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable based on undiscounted estimated future cash flows expected to result from its use and eventual disposition. The factors considered by the Company in performing this assessment include current operating results, trends and prospects, as well as the effect of obsolescence, demand, competition and other economic factors. In estimating expected future cash flows for determining whether an asset is impaired, assets are grouped at the individual property level. In assessing the recoverability of the carrying value of property and equipment, the Company must make assumptions regarding future cash flows and other factors. If these estimates or the related assumptions change in the future, the Company 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. The Company recognized an impairment charge of $4.3 million associated with the Penn National Race Course building demolition during the year ended December 31, 2005.

**Goodwill**

Goodwill is recorded as part of the Company's acquisitions of businesses where the purchase price exceeds the fair market value of the net tangible and identifiable intangible assets acquired. The Company accounts for goodwill in accordance with Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142"), issued by the Financial Accounting Standards Board ("FASB"). SFAS 142 establishes standards for the accounting of intangible assets that are acquired individually or with a group of other assets and the accounting for goodwill and other intangible assets after they have been initially recognized in the financial statements. In accordance with SFAS 142, amortization of goodwill is not permitted. Goodwill is tested at least annually for impairment by comparing the fair value of the recorded assets to their carrying amount. If the carrying amount of the goodwill exceeds its fair value, an impairment loss is recognized. The annual evaluation of goodwill requires the use of estimates about future operating results of each reporting unit to determine their estimated fair value. Changes in forecasted operations can materially affect these estimates. Once an impairment of goodwill has been recorded, it cannot be reversed. During the year ended December 31, 2006, as a result of the increased asset values resulting from the reconstruction at Hollywood Casino Bay St. Louis, the Company determined that all of the goodwill associated with the original purchase of the property was impaired. Accordingly, the Company recorded a pre-tax charge of $34.5 million ($22.0 million, net of taxes) during the year ended December 31, 2006.

**Other Intangible Assets**

The Company accounts for its other intangible assets in accordance with SFAS 142. In accordance with SFAS 142, the Company considers its gaming license, racing permit and trademark intangible assets as indefinite-life intangible assets that do not require amortization. Rather, these intangible assets are tested at least annually for impairment by comparing the fair value of the recorded assets to their carrying amount. If the carrying amounts of the gaming license, racing permit and trademark intangible assets exceed their fair value, an impairment loss is recognized. The annual evaluation of indefinite-life intangible assets requires the use of estimates about future operating results of each reporting unit to determine their estimated fair value. Changes in forecasted operations can materially affect these estimates. Once an impairment of an indefinite-life intangible asset has been recorded, it cannot be reversed. Intangible assets that have a definite-life are amortized on a straight-line basis over their estimated useful lives or related service contract. The Company reviews the carrying value of its intangible assets that have a definite-life for possible impairment whenever events or changes in

circumstances indicate that their carrying value may not be recoverable. If the carrying amount of the intangible assets that have a definite-life exceed their fair value, an impairment loss is recognized.

**Deferred Financing Costs**

Deferred financing costs that are incurred by the Company in connection with the issuance of debt are deferred and amortized to interest expense over the life of the underlying indebtedness, adjusted to reflect any early repayments.

**Comprehensive Income**

The Company accounts for comprehensive income in accordance with SFAS No. 130, "Reporting Comprehensive Income" ("SFAS 130"), which established standards for the reporting and presentation of comprehensive income in the consolidated financial statements. The Company presents comprehensive income in its consolidated statements of changes in shareholders' equity.

**Income Taxes**

The Company accounts for income taxes in accordance with SFAS No. 109, "Accounting for Income Taxes" ("SFAS 109"). Under SFAS 109, deferred tax assets and liabilities are determined based on the differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities and are measured at the prevailing enacted tax rates that will be in effect when these differences are settled or realized. SFAS 109 also requires that deferred tax assets be reduced by a valuation allowance if it is more likely than not that some portion or all of the deferred tax asset will not be realized.

The realizability of the deferred tax assets is evaluated quarterly by assessing the valuation allowance and by adjusting the amount of the allowance, if necessary. The factors used to assess the likelihood of realization are the forecast of future taxable income and available tax planning strategies that could be implemented to realize the net deferred tax assets. The Company has used tax-planning strategies to realize or renew net deferred tax assets in order to avoid the potential loss of future tax benefits.

The Company adopted the provisions of FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" ("FIN 48"), which is an interpretation of SFAS 109, on January 1, 2007. FIN 48 created a single model to address uncertainty in tax positions, and clarified the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS 109 by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in an enterprise's financial statements. FIN 48 also provided guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition.

As a result of the implementation of FIN 48, the Company recognized a liability for unrecognized tax benefits of approximately $11.9 million, which was accounted for as a reduction to the January 1, 2007 retained earnings balance. The liability for unrecognized tax benefits is included in noncurrent tax liabilities within the consolidated balance sheet at December 31, 2007.

**Accounting for Derivatives and Hedging Activities**

The Company does not hold or issue derivative financial instruments for trading or speculative purposes. SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133"), as amended, established accounting and reporting standards for derivative instruments and hedging activities.

The Company uses fixed and variable-rate debt to finance its operations. Both funding sources have associated risks and opportunities, and the Company's risk management policy permits the use of derivatives to manage these exposures. Acceptable derivatives for this purpose include interest rate swaps, futures, options, caps, and similar instruments. The Company's use of derivatives is strictly restricted to hedging (i.e., risk management) applications.

Currently, the Company has a number of interest rate swaps in place, where the swaps serve to mitigate the income volatility associated with a portion of its variable-rate funding. Swap coverage extends out through 2011. In effect, these swaps synthetically convert the portion of variable-rate debt being hedged to the equivalent of fixed-rate funding. Under the terms of the swaps, the Company receives cash flows from the swap counterparties to offset the variable interest payments on the hedged financings, in exchange for paying cash flows based on the swaps' fixed rates. The Company accounts for these swaps as cash flow hedges, which requires determining a division of hedge results deemed effective and deemed ineffective. However, all of the Company's hedges were designed in such a way so as to perfectly offset specifically-defined interest payments, such that no ineffectiveness has occurred—nor is any ineffectivenesgoing to occur, as long as the forecasted cash flows of the designated hedged items and the associated swaps remain unchanged.

Under cash flow hedge accounting, effective derivative results are initially recorded in other comprehensive income and later reclassified to earnings, coinciding with the income recognition relating to the variable interest payments being hedged. The Company recorded a $6.2 million decrease in interest expense during the year ended December 31, 2007, which was previously reported in other comprehensive income. In the coming twelve months, the Company anticipates that approximately an $8.0 million loss will be reclassified from other comprehensive income to earnings, as part of interest expense. As this amount represents effective hedge results, a comparable offsetting amount of incrementally lower interest expense will be realized in connection with the variable funding being hedged.

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

Under cash flow hedge accounting, derivatives are included in the consolidated balance sheets as assets or liabilities. Changes in the fair value of a derivative that is highly effective and that is designated and qualifies as a cash flow hedge, to the extent that the hedge is effective, are recorded in other comprehensive income, until earnings are affected by the variability of cash flows of the hedged transaction (e.g., until periodic settlements of a variable-rate asset or liability are recorded in earnings). Any hedge ineffectiveness (which represents the amount by which the changes in the fair value of the derivative exceed the variability in the cash flows of the forecasted transaction) is recorded in current period earnings.

The Company formally documents all relationships between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. The Company also formally assesses (both at the hedge's inception and on an ongoing basis) whether the derivatives that are used in hedging transactions have been highly effective in offsetting changes in the cash flows of hedged items and whether those derivatives may be expected to remain highly effective in the future periods. When it is determined that a derivative is not (or has ceased to be) highly effective as a hedge, the Company discontinues hedge accounting prospectively, as discussed below.

The Company discontinues hedge accounting prospectively when (1) it determines that the derivative is no longer effective in offsetting changes in the cash flows of a hedged item (including hedged items such as firm commitments or forecasted transactions, such as future variable rate interest payments); (2) the derivative expires or is sold, terminated, or exercised; (3) it is no longer probable

that the forecasted transaction will occur; or (4) management determines that designating the derivative as a hedging instrument is no longer appropriate.

When the Company discontinues hedge accounting because it is no longer probable that the forecasted transaction will occur in the originally expected period, the gain or loss on the derivative remains in accumulated other comprehensive income and is reclassified into earnings when the forecasted transaction affects earnings. However, if it is probable that a forecasted transaction will not occur by the end of the originally specified time period or within an additional two-month period of time thereafter, the gains and losses that were accumulated in other comprehensive income will be recognized immediately in earnings. In all situations in which hedge accounting is discontinued and the derivative remains outstanding, the Company will carry the derivative at its fair value on the balance sheet, recognizing changes in the fair value in current-period earnings. For purposes of the consolidated statements of cash flows, cash flows from derivative instruments designated and qualifying as hedges are classified with the cash flows from the hedged item.

**Revenue Recognition and Promotional Allowances**

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

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

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

Revenues are recognized net of certain sales incentives in accordance with the Emerging Issues Task Force ("EITF") consensus on Issue 01-9, "Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's products)" ("EITF 01-9"). The consensus in EITF 01-9 requires that sales incentives and points earned in point-loyalty programs be recorded as a reduction of revenue. The Company recognizes incentives related to gaming play and points earned in point-loyalty programs as a direct reduction of gaming revenue.

The retail value of accommodations, food and beverage, and other services furnished to guests without charge is included in gross revenues and then deducted as promotional allowances. The estimated cost of providing such promotional allowances is primarily included in food, beverage and other expense. The amounts included in promotional allowances for the years ended December 31, 2007, 2006 and 2005 are as follows:

| Year ended December 31, | 2007 | 2006 | 2005 |
|---|---|---|---|
| | | (in thousands) | |
| Rooms | $ 15,518 | $ 11,970 | $ 7,901 |
| Food and beverage | 101,040 | 85,884 | 54,479 |
| Other | 12,386 | 9,062 | 11,560 |
| Total promotional allowances | $ 128,944 | $ 106,916 | $ 73,940 |

The estimated cost of providing such complimentary services for the years ended December 31, 2007, 2006 and 2005 are as follows:

| Year ended December 31, | 2007 | 2006 | 2005 |
|---|---|---|---|
| | | (in thousands) | |
| Rooms | $ 6,538 | $ 5,156 | $ 4,917 |
| Food and beverage | 71,922 | 60,762 | 37,561 |
| Other | 5,471 | 5,644 | 5,479 |
| Total cost of complimentary services | $ 83,931 | $ 71,562 | $ 47,957 |

**Earnings Per Share**

Basic earnings per share ("EPS") is computed by dividing net income applicable to common stock by the weighted-average common shares outstanding during the period. Diluted EPS reflects the additional dilution for all potentially-dilutive securities such as stock options.

The following table reconciles the weighted-average common shares outstanding used in the calculation of basic earnings per share to the weighted-average common shares outstanding used in the calculation of diluted earnings per share. Options to purchase 1,395,610, 1,966,880, and 125,000 shares of common stock were outstanding during the years ended December 31, 2007, 2006 and 2005, respectively, but were not included in the computation of diluted earnings per share because they are antidilutive.

| Year ended December 31, | 2007 | 2006 | 2005 |
|---|---|---|---|
| | | (in thousands) | |
| Determination of shares: | | | |
| Weighted-average common shares outstanding | 85,578 | 84,229 | 82,893 |
| Assumed conversion of dilutive stock options | 2,806 | 2,405 | 2,964 |
| Diluted weighted-average common shares outstanding | 88,384 | 86,634 | 85,857 |

**Stock-Based Compensation**

On January 1, 2006, the Company adopted SFAS No. 123 (revised 2004), "Share-Based Payment" ("SFAS 123(R)"), which requires the Company to expense the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. This expense must be recognized ratably over the requisite service period following the date of grant.

The Company elected the modified prospective application method for adoption, which results in the recognition of compensation expense using the provisions of SFAS 123(R) for all share-based awards granted or modified after December 31, 2005, and the recognition of compensation expense using the original provisions of SFAS No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123"), as amended by SFAS No. 148, "Accounting for Stock-Based Compensation—Transition and Disclosure" ("SFAS 148"), with the exception of the method of recognizing forfeitures, for all unvested awards outstanding at the date of adoption. Under this transition method, the results of operations of prior periods were not restated. Accordingly, the Company provides pro forma financial information below for 2005 to illustrate the effect on net income and earnings per share of applying the fair value recognition provisions of SFAS 123, as amended by SFAS 148.

Prior to January 1, 2006, the Company accounted for stock-based compensation using the intrinsic-value method in accordance with Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25"), as interpreted by FASB Interpretation No. 44, "Accounting for Certain Transactions Involving Stock Compensation." Under the intrinsic-value method, because the

exercise price of the Company's employee stock options was equal to the market price of the underlying stock on the date of grant, no compensation expense was recognized. However, there were situations that could have occurred, such as the accelerated vesting of options or the issuance of restricted stock that required a current charge to income.

The most significant difference between the fair value approaches prescribed by SFAS 123 and SFAS 123(R) and the intrinsic-value method prescribed by APB 25 related to the recognition of compensation expense for stock option awards based on their grant-date fair value. Under SFAS 123, the Company estimated the fair value of stock option grants using the Black-Scholes option-pricing model. The following table reflects the pro forma impact on net income and earnings per share for the year ended December 31, 2005 of accounting for the Company's stock-based compensation using the fair value provisions of SFAS 123, as amended by SFAS 148.

| Year ended December 31, | 2005 |
|---|---|
| | (in thousands) |
| Net income, as reported | $ 120,930 |
| Add: Stock-based employee compensation expense included in reported net income, net of related tax effects | 294 |
| Deduct: Total stock-based employee compensation expense determined under fair value method for all awards, net of related tax effects | (9,589) |
| *Pro forma* net income | $ 111,635 |
| Earnings per share: | |
| Basic—as reported | $ 1.46 |
| Basic—*pro forma* | 1.35 |
| Diluted—as reported | 1.41 |
| Diluted—*pro forma* | 1.30 |

Prior to the adoption of SFAS 123(R), the Company included all tax benefits associated with stock-based compensation as operating cash flows in the consolidated statements of cash flows. SFAS 123(R) requires any reduction in taxes payable resulting from tax deductions that exceed the recognized compensation expense ("excess tax benefits") to be classified as financing cash flows. The Company included $20.5 million and $12.4 million of excess tax benefits in the Company's cash flows from financing activities for the years ended December 31, 2007 and 2006, respectively, that would have been classified as operating cash flows had the Company not adopted SFAS 123(R).

The fair value for stock options was estimated at the date of grant using the Black-Scholes option-pricing model, which requires management to make certain assumptions. The risk-free interest rate was based on the U.S. Treasury spot rate with a remaining term equal to the expected life assumed at the date of grant. Expected volatility was estimated based on the historical volatility of the Company's stock price over a period of 4.73 years, in order to match the expected life of the options at the grant date. There is no expected dividend yield since the Company has not paid any cash dividends on its common stock since its initial public offering in May 1994, and since the Company intends to retain all of its earnings to finance the development of its business for the foreseeable future. The weighted-average expected life was based on the contractual term of the stock option and expected employee exercise dates, which was based on the historical exercise behavior of the Company's employees. Forfeitures are estimated at the date of grant based on historical experience. Prior to the adoption of SFAS 123(R), the Company recorded forfeitures as they occurred for purposes of estimating pro forma compensation

expense under SFAS 123. The following are the weighted-average assumptions used in the Black-Scholes option-pricing model at December 31, 2007, 2006 and 2005:

| Year ended December 31, | 2007 | 2006 | 2005 |
|---|---|---|---|
| Risk-free interest rate | 4.24% | 5.11% | 3.40% |
| Expected volatility | 37.68% | 43.29% | 40.00% |
| Dividend yield | — | — | — |
| Weighted-average expected life (years) | 4.73 | 4.26 | 5.45 |
| Forfeiture rate | 4.00% | 4.00% | — |

**Segment Information**

In accordance with SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information" ("SFAS 131"), the Company views each property as an operating segment, and aggregates all of its properties into one reportable segment, as the Company believes that they are economically similar, offer similar types of products and services, cater to the same types of customers and are similarly regulated.

**Statements of Cash Flows**

The Company has presented the consolidated statements of cash flows using the indirect method, which involves the reconciliation of net income to net cash flow from operating activities.

**Acquisitions**

The Company accounts for its acquisitions in accordance with SFAS No. 141, "Business Combinations" ("SFAS 141"). The results of operations of acquisitions are included in the consolidated financial statements from their respective dates of acquisition.

**Certain Risks and Uncertainties**

The Company's operations are dependent on its continued licensing by state gaming commissions. The loss of a license, in any jurisdiction in which the Company operates, could have a material adverse effect on future results of operations.

The Company is dependent on each gaming property's local market for a significant number of its patrons and revenues. If economic conditions in these areas deteriorate or additional gaming licenses are awarded in these markets, the Company's results of operations could be adversely affected.

The Company is also dependent upon a stable gaming and admission tax structure in the locations that it operates in. Any change in the tax structure could have a material adverse affect on future results of operations.

**5. New Accounting Pronouncements**

In December 2007, the FASB issued SFAS No. 141 (revised), "Business Combinations" ("SFAS 141(R)"), which is intended to improve reporting by creating greater consistency in the accounting and financial reporting of business combinations. SFAS 141(R) requires that the acquiring entity in a business combination recognize all (and only) the assets and liabilities assumed in the transaction, establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed, and requires the acquirer to disclose to investors and other users all of the information that they need to evaluate and understand the nature and financial effect of the business combination. In addition, SFAS 141(R) impacts the accounting for transaction and restructuring costs. SFAS 141(R) is effective for business combinations for which the acquisition date is

on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The Company is currently determining the impact of SFAS 141(R) on its consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities-including an amendment of SFAS No. 115" ("SFAS 159"), which permits an entity to choose to measure many financial instruments and certain other items at fair value. A business entity shall report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. SFAS 159 is effective as of the beginning of each reporting entity's first fiscal year that begins after November 15, 2007. The Company adopted SFAS 159 as of January 1, 2008, as required. The Company does not expect that the adoption of SFAS 159 will have a material impact on its consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" ("SFAS 157"), which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. SFAS 157 applies under other accounting pronouncements that require or permit fair value measurements, but does not require any new fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The Company adopted SFAS 157 as of January 1, 2008, as required. The Company does not expect that the adoption of SFAS 157 will have a material impact on its consolidated financial statements.

In July 2006, the FASB issued FIN 48, which is an interpretation of SFAS 109. FIN 48 created a single model to address uncertainty in tax positions, and clarified the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS 109 by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in an enterprise's financial statements. FIN 48 also provided guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. The Company adopted the provisions of FIN 48 on January 1, 2007. As a result of the implementation of FIN 48, the Company recognized a liability for unrecognized tax benefits of approximately $11.9 million, which was accounted for as a reduction to the January 1, 2007 retained earnings balance. The liability for unrecognized tax benefits is included in noncurrent tax liabilities within the consolidated balance sheet at December 31, 2007.

A reconciliation of the beginning and ending amount for the liability for unrecognized tax benefits is as follows:

| | Noncurrent tax liabilities |
|---|---|
| | (in thousands) |
| Balance at January 1, 2007 | $ 56,960 |
| Additions based on current year tax positions | 3,122 |
| Additions based on prior year tax positions | 7,676 |
| Currency translation adjustments | 15,091 |
| Balance at December 31, 2007 | $ 82,849 |

Included in the liability for unrecognized tax benefits at December 31, 2007 were $38.7 million of tax positions that are indemnified by a third party. The receivable for this indemnification is included in other assets within the consolidated balance sheet at December 31, 2007.

Included in the liability for unrecognized tax benefits at December 31, 2007 were $15.1 million of currency translation adjustments for foreign currency tax positions.

Included in the liability for unrecognized tax benefits at December 31, 2007 were $27.3 million of tax positions that, if reversed, would affect the effective tax rate.

During the year ended December 31, 2007, as well as prior to January 1, 2007, the Company recognized interest and penalties accrued related to unrecognized tax benefits in taxes on income within the consolidated statements of income.

During the year ended December 31, 2007, the Company recognized approximately $3.7 million of interest and penalties, net of deferred taxes. The Company has accrued approximately $42.3 million for the payment of interest and penalties at December 31, 2007. These accruals were included in noncurrent tax liabilities within the consolidated balance sheet at December 31, 2007.

As of January 1, 2007, the Company is subject to U.S. Federal income tax examinations for the tax years 2005 and 2006. In addition, the Company is subject to state and local income tax examinations for various tax years in the taxing jurisdictions in which the Company operates.

## 6. Acquisitions

### Sanford-Orlando Kennel Club

On October 17, 2007, pursuant to the Asset Purchase Agreement dated July 5, 2007, the Company completed the purchase of Sanford-Orlando Kennel Club in Longwood, Florida from Sanford-Orlando Kennel Club, Inc. and Collins and Collins. In connection with the purchase, the Company also secured a right of first refusal with respect to a majority stake in the Sarasota Kennel Club in Sarasota, Florida. The purchase price for the Sanford-Orlando Kennel Club provides for additional consideration to be paid by the Company based upon certain future regulatory developments. Located on approximately 26 acres in Longwood, Florida, the Sanford-Orlando Kennel Club features year-round greyhound racing, a simulcast wagering facility, a clubhouse lounge and two dining areas. The results of the Sanford-Orlando Kennel Club have been included in the Company's consolidated financial statements since the acquisition date.

### Black Gold Casino at Zia Park

On April 16, 2007, pursuant to the Asset Purchase Agreement dated November 7, 2006 among Zia Partners, LLC ("Zia"), Zia Park LLC (the "Buyer"), a wholly-owned subsidiary of Penn, and (solely with respect to specified sections thereof which relate to the Company's guarantee of the Buyer's payment and performance) Penn, the Buyer completed the acquisition of Black Gold Casino at Zia Park and all related assets of Zia. Penn funded this purchase with additional borrowings under its existing $750 million revolving credit facility. The Company accounted for the acquisition in accordance with SFAS No. 141. As a result of the acquisition, the Company recorded goodwill of $143.8 million and other intangible assets of $4.6 million, both of which are subject to a final purchase price allocation. The results of the Black Gold Casino at Zia Park have been included in the Company's consolidated financial statements since the acquisition date.

### Argosy

On October 3, 2005, the Company acquired 100% of the stock of Argosy. The acquisition reflects the continuing efforts of the Company to diversify by reducing its dependency on individual properties and legislative jurisdictions. The transaction was accounted for as a purchase transaction, in accordance with SFAS 141. As a result, the net assets of Argosy were recorded at their fair value, with the excess of the purchase price over the fair value of the net assets acquired allocated to goodwill. The total purchase price for the acquisition was approximately $2,320.2 million, including transaction fees of $44.5 million. The price of $47.00 per share represented an approximately 16% premium over the closing price of Argosy on November 2, 2004, and an approximately 30% premium over the average closing price of Argosy over the ninety days preceding November 2, 2004. The purchase price of the acquisition was funded by the proceeds of the Company's $2.725 billion senior secured credit facility.

The Company acquired six Argosy casino entertainment facilities and one racetrack, although the Company agreed to enter into sale agreements for three of those properties to expedite the receipt of the regulatory approvals required to complete the merger. The Company completed the sale of Argosy Casino Baton Rouge to an affiliate of Columbia Sussex for approximately $148.6 million, and had until December 31, 2006 to enter into definitive sale agreements for the Argosy Casino Alton and the Empress Casino Hotel. However, on March 6, 2006, the Illinois Gaming Board agreed to allow the Company to retain the Argosy Casino Alton. In addition, the Illinois Gaming Board granted the Company an extension to the time limit by which the Company is required to reach a definitive sale agreement for the Empress Casino Hotel until June 30, 2008. On February 19, 2008, the Illinois Gaming Board resolved to allow the Company to retain the Empress Casino Hotel.

In order to assist the Company in assigning values of assets acquired and liabilities assumed in this transaction, the Company obtained a third-party valuation of significant identifiable intangible assets acquired, as well as other assets acquired. In addition, the Company recorded a current tax liability for identified tax contingencies and an estimate for the deferred tax liability arising from the acquisition due to the difference between the fair value and the tax basis of the net assets acquired.

The current and deferred tax liabilities, which increased the amount of goodwill recorded in the acquisition, are subject to change upon recognition and/or settlement of tax contingencies. These changes, if any, will also affect goodwill, and will not have a material impact on the Company's consolidated statements of income.

As part of the Argosy acquisition, the Company recorded $2.0 billion in goodwill and other intangible assets. The other intangible assets primarily consisted of a gaming license intangible asset, a trademark intangible asset, a computer software intangible asset, and a customer relationship intangible asset. In accordance with SFAS 142, the Company considers its gaming license and trademark intangible assets as indefinite-life intangible assets that do not require amortization. The computer software and customer relationship intangible assets are amortized using the straight-line method over their estimated useful lives, which are three and five years, respectively. As the acquisition of Argosy was treated as a stock purchase, the estimated goodwill balance and the other intangible assets described above were not expected to be amortized for tax purposes.

The *pro forma* consolidated results of operations, as if the acquisition of Argosy had occurred on January 1, 2005, are as follows:

| | 2005 |
|---|---|
| | (in thousands, except per share data) |
| *Pro Forma* | |
| Net revenues | $ 2,109,609 |
| Income from continuing operations | 391,940 |
| Net income from continuing operations | 111,388 |
| Basic earnings per share | 1.34 |
| Diluted earnings per share | 1.30 |

## 7. Hurricane Katrina

As a result of Hurricane Katrina's direct hit on the Mississippi Gulf Coast on August 29, 2005, two of the Company's casinos, Hollywood Casino Bay St. Louis and Boomtown Biloxi, were significantly damaged, many employees were displaced and operations ceased at the two properties. Boomtown Biloxi reopened on June 29, 2006 and Hollywood Casino Bay St. Louis reopened on August 31, 2006.

The Company had significant levels of insurance in place at the time of Hurricane Katrina to cover the losses resulting from the hurricane, including an "all risk" insurance policy covering "named windstorm" damage, flood damage, debris removal, preservation of property expense, demolition and

increased cost of construction expense, and losses resulting from business interruption and extra expenses, all as defined in the policies. The comprehensive business interruption and property damage insurance policies had an overall limit of $400 million, and was subject to property damage deductibles for Hollywood Casino Bay St. Louis and Boomtown Biloxi of approximately $6.0 million and $3.5 million, respectively. The business interruption insurance component of this policy was subject to a five-day deductible.

During the year ended December 31, 2006, the Company's financial results benefited from a settlement agreement with its property and business interruption insurance providers for a total of $225 million for Hurricane Katrina-related losses at its Hollywood Casino Bay St. Louis and Boomtown Biloxi properties, as well as minor proceeds related to its National Flood Insurance coverage and auto insurance claims. Reflecting the settlement agreement, the Company recorded a pre-tax gain of $128.3 million ($81.8 million, net of taxes).

The Company recognized a pre-tax charge of $21.1 million ($13.7 million after-tax) associated with the expenses incurred from Hurricane Katrina for the year ended December 31, 2005. The costs included property insurance and business interruption policy deductible expense (approximately $10.2 million), compensation being paid to employees through November 30, 2005 that exceeded the ordinary payroll limits under the business interruption policy (approximately $6.1 million), the purchase of replacement flood insurance for coverage during the remaining insurance policy term (approximately $3.6 million), contributions to the Penn National Gaming Foundation's Hurricane Katrina Relief Project (approximately $1.0 million) and costs for insurance claim consultants (approximately $0.2 million).

During the years ended December 31, 2006 and 2005, the Company received $104.1 million and $27.3 million, respectively, from its insurance carriers relating to Hurricane Katrina.

The $100.0 million insurance receivable recorded at December 31, 2006 represented the portion of the $225 million settlement that was received in January 2007.

In June 2007, the Company renewed its first layer of property insurance coverage in the amount of $200 million. The $200 million coverage, which is effective from August 8, 2007 through December 31, 2010, is on an "all risk" basis, including, but not limited to, coverage for "named windstorms," floods and earthquakes. Also, the Company purchased an additional $400 million of "all risk" coverage that is subject to certain exclusions including, among others, exclusions for "named windstorms," floods and earthquakes. The additional $400 million coverage is effective from August 8, 2007 through June 1, 2008. There is a $25 million deductible for "named windstorm" events, and lesser deductibles as they apply to other perils. Both layers are subject to specific policy terms, conditions and exclusions.

## 8. Property and Equipment

Property and equipment, net, consists of the following:

| December 31, | 2007 | 2006 |
|---|---|---|
| | (in thousands) | |
| Land and improvements | $ 188,379 | $ 190,002 |
| Building and improvements | 998,910 | 868,577 |
| Furniture, fixtures, and equipment | 503,969 | 423,201 |
| Leasehold improvements | 16,145 | 15,005 |
| Construction in progress | 423,209 | 187,531 |
| Total property and equipment | 2,130,612 | 1,684,316 |
| Less accumulated depreciation and amortization | (442,219) | (318,445) |
| Property and equipment, net | $ 1,688,393 | $ 1,365,871 |

Depreciation and amortization expense, for property and equipment, totaled $140.3 million, $117.3 million, and $69.0 million in 2007, 2006, and 2005, respectively. Interest capitalized in connection with major construction projects was $14.6 million, $8.0 million, and $1.5 million in 2007, 2006 and 2005, respectively.

## 9. Goodwill and Other Intangible Assets

The Company's goodwill and intangible assets had a gross carrying value of $2.8 billion and $2.6 billion at December 31, 2007 and 2006, respectively, and accumulated amortization of $27.0 million and $19.4 million at December 31, 2007 and 2006, respectively. The table below presents the gross carrying value, accumulated amortization, and net book value of each major class of goodwill and intangible asset at December 31, 2007 and 2006:

| December 31, | 2007 | | | 2006 | | |
|---|---|---|---|---|---|---|
| | Gross Carrying Value | Accumulated Amortization | Net Book Value | Gross Carrying Value | Accumulated Amortization | Net Book Value |
| | | | (in thousands) | | | |
| Goodwill | $ 2,013,139 | $ — | $ 2,013,139 | $ 1,869,444 | $ — | $ 1,869,444 |
| Gaming license, racing permit and trademark intangible assets | 755,166 | — | 755,166 | 700,434 | — | 700,434 |
| Other intangible assets | 49,316 | 27,041 | 22,275 | 45,126 | 19,434 | 25,692 |
| Total | $ 2,817,621 | $ 27,041 | $ 2,790,580 | $ 2,615,004 | $ 19,434 | $ 2,595,570 |

During the year ended December 31, 2007, goodwill increased by $143.7 million, primarily due to goodwill recorded as part of the completion of the Black Gold Casino at Zia Park acquisition in April 2007 and the Sanford-Orlando Kennel Club acquisition in October 2007, offset by deferred tax adjustments relating to litigation accruals. In addition, gaming license, racing permit and trademark intangible assets increased by $54.7 million during the year ended December 31, 2007, due to the Black Gold Casino at Zia Park and Sanford-Orlando Kennel Club acquisitions and payment for the Category 1 slot machine license for the placement of slot machines at the Company's Hollywood Casino at Penn National Race Course.

During the year ended December 31, 2006, as a result of the increased asset values resulting from the reconstruction at Hollywood Casino Bay St. Louis, the Company determined that all of the goodwill associated with the original purchase of the property was impaired. Accordingly, the Company recorded a pre-tax charge of $34.5 million ($22.0 million, net of taxes) during the year ended December 31, 2006.

The Company's intangible asset amortization expense was $7.6 million, $6.7 million, and $3.5 million for the years ended December 31, 2007, 2006 and 2005, respectively.

The following table presents expected intangible asset amortization expense based on existing intangible assets at December 31, 2007 (in thousands):

| | |
|---|---|
| 2008 | $ 7,626 |
| 2009 | 6,626 |
| 2010 | 5,757 |
| 2011 | 2,080 |
| 2012 | 186 |
| Thereafter | — |
| Total | $ 22,275 |

## 10. Long-term Debt

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

| December 31, | 2007 | 2006 |
|---|---|---|
| | (in thousands) | |
| Senior secured credit facility | $ 2,496,625 | $ 2,343,875 |
| $200 million 6 7/8% senior subordinated notes | 200,000 | 200,000 |
| $250 million 6 3/4% senior subordinated notes | 250,000 | 250,000 |
| Other long-term obligations | 19,810 | 25,041 |
| Capital leases | 8,487 | 10,532 |
| | 2,974,922 | 2,829,448 |
| Less current maturities of long-term debt | (93,452) | (40,058) |
| | $ 2,881,470 | $ 2,789,390 |

The following is a schedule of future minimum repayments of long-term debt as of December 31, 2007 (in thousands):

| | |
|---|---|
| 2008 | $ 93,452 |
| 2009 | 105,292 |
| 2010 | 683,271 |
| 2011 | 677,660 |
| 2012 | 1,163,327 |
| Thereafter | 251,920 |
| Total minimum payments | $ 2,974,922 |

At December 31, 2007, the Company was contingently obligated under letters of credit issued pursuant to the $2.725 billion senior secured credit facility with face amounts aggregating $36.5 million.

**Senior Secured Credit Facility**

On October 3, 2005, the Company entered into a $2.725 billion senior secured credit facility to fund the Company's acquisition of Argosy, including payment for all of Argosy's outstanding shares, the retirement of certain long-term debt of Argosy and its subsidiaries, the payment of related transaction costs, and to provide additional working capital. Concurrent with this financing, the Company's previous senior credit facility was terminated, which resulted in an early extinguishment of debt charge of $4.0 million. The $2.725 billion senior secured credit facility consists of three credit facilities comprised of a $750 million revolving credit facility (of which $575.0 million was drawn at December 31, 2007), a $325 million Term Loan A Facility and a $1.65 billion Term Loan B Facility. The $2.725 billion senior secured credit facility also allows the Company to raise an additional $300 million in senior secured credit for project development and property expansion.

During the year ended December 31, 2007, the senior secured credit facility increased by $152.8 million, primarily due to the issuance of long-term debt for items such as partial funding for the Black Gold Casino at Zia Park acquisition and the payment for capital expenditures, partially offset by principal payments on long-term debt.

The senior secured credit facility is secured by substantially all of the assets of the Company.

**Interest Rate Swap Contracts**

The Company has a policy designed to manage interest rate risk associated with its current and anticipated future borrowings. This policy enables the Company to use any combination of interest rate swaps, futures, options, caps and similar instruments. To the extent the Company employs such financial instruments pursuant to this policy, they are generally accounted for as hedging instruments. In order to qualify for hedge accounting, the underlying hedged item must expose the Company to risks associated with market fluctuations and the financial instrument used must be designated as a hedge and must reduce the Company's exposure to market fluctuations throughout the hedge period. If these criteria are not met, a change in the market value of the financial instrument is recognized as a gain or loss in the period of change. Net settlements pursuant to the financial instrument are included as interest expense in the period.

In accordance with the terms of its $2.725 billion senior secured credit facility, the Company was required to enter into interest rate swap agreements in an amount equal to 50% of the outstanding term loan balances within 100 days of the closing date of the senior secured credit facility. On October 25, 2005, the Company entered into four interest rate swap contracts with terms from three to five years, notional amounts of $224 million, $274 million, $225 million, and $237 million, for a total of $960 million, and fixed interest rates ranging from 4.678% to 4.753%. The annual weighted-average interest rate of the four contracts is 4.71%. On April 6, 2006, the Company entered into three interest rate swap contracts with a term of five years and notional amounts of $100 million each, for a total of $300 million and fixed interest rates ranging from 5.263% to 5.266%. The annual weighted-average interest rate of the three contracts is 5.26%. On September 5, 2007, the Company entered into two interest rate swap contracts with terms of nine months and notional amounts of $197 million and $181 million, for a total of $378 million, and fixed interest rates of 5.01%. Under all of these contracts, the Company pays a fixed interest rate against a variable interest rate based on the 90-day LIBOR rate. As of December 31 2007, the applicable 90-day LIBOR rate was 5.01% for the $960 million swaps, 4.90% for the $300 million swaps, 4.99% for the $197 million swap, and 5.21% for the $181 million swap. On December 19, 2007, the Company entered into three monthly interest rate swap contracts, each with notional amounts of $146.25 million and fixed rates of 4.97% effective December 31, 2007, 4.47% effective January 31, 2008 and 4.40% effective February 29, 2008. Under these contracts, the Company pays a fixed interest rate against a variable interest rate based on the 30-day LIBOR rate. As of December 31, 2007, the applicable 30-day LIBOR rate was 4.85% for the $146.25 million swap.

**Redemption of 8 7/8% Senior Subordinated Notes**

In February 2006, the Company called for the redemption of its $175 million 8 7/8% senior subordinated notes. The redemption price was $1,044.38 per $1,000 principal amount, plus accrued and unpaid interest and was made on March 15, 2006. The Company recorded a $10.0 million loss on early extinguishment of debt during the year ended December 31, 2006 for the call premium and the write-off of the associated deferred financing fees. The Company funded the redemption of the notes from available cash and borrowings under its revolving credit facility.

**6 7/8% Senior Subordinated Notes**

On December 4, 2003, the Company completed an offering of $200 million of 6 7/8% senior subordinated notes that mature on December 1, 2011. Interest on the notes is payable on June 1 and December 1 of each year, beginning June 1, 2004.

The Company may redeem all or part of the notes on or after December 1, 2007 at certain specified redemption prices.

The 6 7/8% notes are general unsecured obligations and are guaranteed on a senior subordinated basis by certain of the Company's current and future wholly-owned domestic subsidiaries. The 6 7/8% notes rank equally with the Company's future senior subordinated debt and junior to its senior debt, including debt under the Company's senior secured credit facility. In addition, the 6 7/8% notes will be effectively junior to any indebtedness of Penn's non-U.S. Unrestricted Subsidiaries.

The 6 7/8% notes and guarantees were originally issued in a private placement pursuant to an exemption from the registration requirements of the Securities Act of 1933 (the "Securities Act"). On August 27, 2004, the Company completed an offer to exchange the notes and guarantees for notes and guarantees registered under the Securities Act having substantially identical terms.

**6 3/4% Senior Subordinated Notes**

On March 9, 2005, the Company completed an offering of $250 million of 6 3/4% senior subordinated notes that mature on March 1, 2015. Interest on the notes is payable on March 1 and September 1 of each year, beginning September 1, 2005. The 6 3/4% notes are general unsecured obligations and are not guaranteed by the Company's subsidiaries. The 6 3/4% notes were issued in a private placement pursuant to an exemption from the registration requirements of the Securities Act.

**Other Long-Term Obligations**

On October 15, 2004, the Company announced the sale of The Downs Racing, Inc. and its subsidiaries to the Mohegan Tribal Gaming Authority ("MTGA"). Under the terms of the agreement, the MTGA acquired The Downs Racing, Inc. and its subsidiaries, including Pocono Downs (a standardbred horse racing facility located on 400 acres in Wilkes-Barre, Pennsylvania) and five Pennsylvania off-track wagering facilities located in Carbondale, East Stroudsburg, Erie, Hazelton and the Lehigh Valley (Allentown). The sale agreement also provided the MTGA with certain post-closing termination rights in the event of certain materially adverse legislative or regulatory events. In January 2005, the Company received $280 million from the MTGA, and transferred the operations of The Downs Racing, Inc. and its subsidiaries to the MTGA. The sale was not considered final for accounting purposes until the third quarter of 2006, as the MTGA had certain post-closing termination rights that remained outstanding. On August 7, 2006, the Company entered into the Second Amendment to the Purchase Agreement and Release of Claims ("Amendment and Release") with the MTGA pertaining to the October 14, 2004 Purchase Agreement (the "Purchase Agreement"), and agreed to pay the MTGA an aggregate of $30 million over five years, beginning on the first anniversary of the commencement of slot operations at Mohegan Sun at Pocono Downs, in exchange for the MTGA's agreement to release various claims it raised against the Company under the Purchase Agreement and the MTGA's surrender of all post-closing termination rights it might have had under the Purchase Agreement. The Company recorded the present value of the $30 million liability within debt, as the amount due to the MTGA is payable over five years, with the first payment of $7.0 million having been made in November 2007.

**Covenants**

The Company's $2.725 billion senior secured credit facility, $200 million 6 7/8% and $250 million 6 3/4% senior subordinated notes require it, among other obligations, to maintain specified financial ratios and to satisfy certain financial tests, including fixed charge coverage, senior leverage and total leverage ratios. In addition, the Company's $2.725 billion senior secured credit facility, $200 million 6 7/8% and $250 million 6 3/4% senior subordinated notes restrict, among other things, the Company's ability to incur additional indebtedness, incur guarantee obligations, amend debt instruments, pay dividends, create liens on assets, make investments, make acquisitions, engage in mergers or consolidations, make capital expenditures, or engage in certain transactions with subsidiaries and affiliates and otherwise restricts corporate activities.

At December 31, 2007, the Company was in compliance with all required financial covenants.

## 11. Commitments and Contingencies

### Litigation

The Company is subject to various legal and administrative proceedings relating to personal injuries, employment matters, commercial transactions and other matters arising in the normal course of business. The Company does not believe that the final outcome of these matters will have a material adverse effect on the Company's consolidated financial position or results of operations. In addition, the Company maintains what it believes is adequate insurance coverage to further mitigate the risks of such proceedings. However, such proceedings can be costly, time consuming and unpredictable and, therefore, no assurance can be given that the final outcome of such proceedings may not materially impact the Company's consolidated financial condition or results of operations. Further, no assurance can be given that the amount or scope of existing insurance coverage will be sufficient to cover losses arising from such matters.

The following proceedings could result in costs, settlements, damages, or rulings that materially impact the Company's consolidated financial condition or operating results. In each instance, the Company believes that it has meritorious defenses, claims and/or counter-claims, and intends to vigorously defend itself or pursue its claim.

In November 2005, Capital Seven, LLC and Shawn A. Scott (collectively, "Capital Seven"), the sellers of Bangor Historic Track, Inc. ("BHT"), filed a demand for arbitration with the American Arbitration Association seeking $30 million plus interest and other damages. Capital Seven alleges a breach of contract by the Company based on the Company's payment of a $51 million purchase price for the purchase of BHT instead of an alleged $81 million purchase price Capital Seven claims is due under the purchase agreement. The parties had agreed that the purchase price of BHT would be determined, in part, by the applicable gaming taxes imposed by Maine on the Company's operations, and currently are disputing the effective tax rate. Pursuant to the dispute resolution procedures, the Company deposited $30 million in escrow, pending a resolution. This amount is included in other assets within the consolidated balance sheets at December 31, 2007 and 2006. The parties are actively involved in discovery, and arbitration is currently scheduled for April 2008.

In conjunction with the Company's acquisition of Argosy in 2005, and subsequent disposition of the Argosy Casino Baton Rouge property, the Company became responsible for litigation initiated over eight years ago related to the Baton Rouge casino license formerly owned by Argosy. On November 26, 1997, Capitol House filed an amended petition in the Nineteenth Judicial District Court for East Baton Rouge Parish, State of Louisiana, amending its previously filed but unserved suit against Richard Perryman, the person selected by the Louisiana Gaming Division to evaluate and rank the applicants seeking a gaming license for East Baton Rouge Parish, and adding state law claims against Jazz Enterprises, Inc., the former Jazz Enterprises, Inc. shareholders, Argosy, Argosy of Louisiana, Inc. and Catfish Queen Partnership in Commendam, d/b/a the Belle of Baton Rouge Casino. This suit alleged that these parties violated the Louisiana Unfair Trade Practices Act in connection with obtaining the gaming license that was issued to Jazz Enterprises, Inc./Catfish Queen Partnership in Commendam. The plaintiff, an applicant for a gaming license whose application was denied by the Louisiana Gaming Division, sought to prove that the gaming license was invalidly issued and to recover lost gaming revenues that the plaintiff contended it could have earned if the gaming license had been properly issued to the plaintiff. On October 2, 2006, the Company prevailed on a partial summary judgment motion which limited plaintiff's damages to its out-of-pocket costs in seeking its gaming license, thereby eliminating any recovery for potential lost gaming profits. On February 6, 2007, the jury returned a verdict of $3.8 million (exclusive of statutory interest and attorneys' fees) against Jazz Enterprises, Inc.

and Argosy. After ruling on post-trial motions, on September 27, 2007, the trial court entered a judgment in the amount of $1.4 million, plus attorneys' fees, costs and interest. The Company has established an appropriate reserve and has bonded the judgment pending its appeal. Both the plaintiff and the Company have appealed the judgment to the First Circuit Court of Appeals in Louisiana. The Company has the right to seek indemnification from two of the former Jazz Enterprises, Inc. shareholders for any liability suffered as a result of such cause of action, however, there can be no assurance that the former Jazz Enterprises, Inc. shareholders will have assets sufficient to satisfy any claim in excess of Argosy's recoupment rights.

In May 2006, the Illinois Legislature passed into law House Bill 1918, effective May 26, 2006, which singled out four of the nine Illinois casinos, including the Company's Empress Casino Hotel and Hollywood Casino Aurora, for a 3% tax surcharge to subsidize local horse racing interests. On May 30, 2006, Empress Casino Hotel and Hollywood Casino Aurora joined with the two other riverboats affected by the law, Harrah's Joliet and the Grand Victoria Casino in Elgin, and filed suit in the Circuit Court of the Twelfth Judicial District in Will County, Illinois (the "Court"), asking the Court to declare the law unconstitutional. The casinos began paying the 3% tax surcharge during the three months ended June 30, 2006 into a protest fund which accrues interest during the pendency of the lawsuit. The accumulated funds will be returned to the casinos if they ultimately prevail in the lawsuit. In two orders dated March 29, 2007 and April 20, 2007, the Court declared the law unconstitutional under the Uniformity Clause of the Illinois Constitution and enjoined the collection of this tax surcharge. The State of Illinois requested, and was granted, a stay of this ruling. As a result, the casinos will continue paying the 3% tax surcharge into the protest fund until a final order has been entered in the case. The State of Illinois has appealed the ruling to the Illinois Supreme Court, and oral arguments were heard in November 2007. The Company anticipates that a ruling on the appeal will be made in the next several months.

In August 2007, a complaint was filed on behalf of a putative class of public shareholders of the Company, and derivatively on behalf of the Company, in the Court of Common Pleas of Berks County, Pennsylvania (the "Complaint"). The Complaint names the Company's Board of Directors as defendants and the Company as a nominal defendant. The Complaint alleges, among other things, that the Board of Directors breached their fiduciary duties by agreeing to the proposed transaction with Fortress and Centerbridge for inadequate consideration, that certain members of the Board of Directors have conflicts with regard to the Merger, and that the Company and its Board of Directors have failed to disclose certain material information with regard to the Merger. The Complaint seeks, among other things, a court order: determining that the action is properly maintained as a class action and a derivative action; enjoining the Company and its Board of Directors from consummating the proposed Merger; and awarding the payment of attorneys' fees and expenses. The Company and the plaintiff have reached a tentative settlement in which the Company agreed to pay certain attorneys' fees and to make certain disclosures regarding the events leading up to the transaction with Fortress and Centerbridge in the proxy statement sent to shareholders in November 2007. Final settlement is contingent upon court approval and consummation of the transaction with Fortress and Centerbridge.

**Operating Lease Commitments**

The Company is liable under numerous operating leases for airplanes, automobiles, land for the property on which some of its casinos operate, other equipment and buildings, which expire at various dates through 2093. Total rental expense under these agreements was $29.6 million, $28.1 million, and $5.2 million for the years ended December 31, 2007, 2006, and 2005, respectively.

The leases for land consist of annual base lease rent payments, plus a percentage rent based on a percent of adjusted gaming wins, as described in the respective leases.

The Company has an operating lease with the City of Bangor which covers the temporary facility and the permanent facility that the Company expects to open in the third quarter of 2008. Under the lease agreement, there is a fixed rent provision, as well as a revenue-sharing provision which is equal to 3% of gross slot revenue. The lease is for an initial term of fifteen years, with three ten-year renewal options. The initial term begins with the opening of the permanent facility.

On March 23, 2007, BTN, Inc. ("BTN"), one of the Company's wholly-owned subsidiaries, entered into an amended and restated ground lease (the "Amended Lease") with Skrmetta MS, LLC. The lease amends the prior ground lease, dated October 19, 1993. The Amended Lease requires BTN to maintain a minimum gaming operation on the leased premises and to pay rent equal to 5% of adjusted gaming win after gaming taxes have been deducted. The term of the Amended Lease expires on January 1, 2093.

The future minimum lease commitments relating to the base lease rent portion of noncancelable operating leases at December 31, 2007 are as follows (in thousands):

| Year ending December 31, | |
|---|---|
| 2008 | $ 8,550 |
| 2009 | 6,699 |
| 2010 | 4,998 |
| 2011 | 4,768 |
| 2012 | 4,126 |
| Thereafter | 28,898 |
| Total | $ 58,039 |

**Capital Expenditure Commitments**

At December 31, 2007, the Company is contractually committed to spend approximately $201.9 million in capital expenditures for projects in progress.

**Employee Benefit Plans**

The Company maintains a profit-sharing plan under the provisions of Section 401(k) of the Internal Revenue Code of 1986, as amended, which covers all eligible employees. The plan enables participating employees to defer a portion of their salary in a retirement fund to be administered by the Company. The Company makes a discretionary match contribution of 50% of employees' elective salary deferrals, up to a maximum of 6% of eligible employee compensation.

The Company also has a defined contribution plan, the Charles Town Races Future Service Retirement Plan, covering substantially all of its union employees at the Charles Town Entertainment Complex. The Company makes annual contributions to this plan for the eligible union employees and to the Penn National Gaming, Inc. 401(k) Plan for the eligible non-union employees for an amount equal to the amount accrued for retirement expense, which is calculated as 0.25% of the daily mutual handle and 1.0% up to a base of the net video lottery revenues and, after the base is met, it reverts to 0.5%.

The Company maintains a non-qualified deferred compensation plan that covers most management and other highly-compensated employees. This plan was effective March 1, 2001. The plan allows the participants to defer, on a pre-tax basis, a portion of their base annual salary and bonus, and earn tax-deferred earnings on these deferrals. The plan also provides for matching Company contributions that vest over a five-year period. The Company has established a Trust, and transfers to the Trust, on a

periodic basis, an amount necessary to provide for its respective future liabilities with respect to participant deferral and Company contribution amounts. The Company's matching contributions in 2007, 2006 and 2005 were $2.2 million, $1.5 million, and $1.1 million, respectively.

**Agreements with Horsemen and Pari-Mutuel Clerks**

The Company is required to have agreements with the horsemen at each of its racetracks to conduct its live racing and simulcasting activities, with the exception of the Company's tracks in Ohio and New Mexico. In addition, in order to operate gaming machines in West Virginia, the Company must maintain agreements with each of the Charles Town horsemen, pari-mutuel clerks and breeders.

At the Charles Town Entertainment Complex, the Company has an agreement with the Charles Town horsemen that expires on December 31, 2008, and an agreement with the breeders that expires on June 30, 2008. The pari-mutuel clerks at Charles Town are represented under a collective bargaining agreement with the West Virginia Division of Mutuel Clerks, which expires on December 31, 2010.

The Company's agreement with the Pennsylvania thoroughbred horsemen at Penn National Race Course expires on September 30, 2011. The Company is currently involved in good faith negotiations with Local 137 of the Sports Arena Employees (AFL-CIO) at Penn National Race Course with respect to pari-mutuel clerks, admissions and Telebet personnel relative to the renewal of a contract that will expire on February 28, 2008. The parties are cooperatively working on a successor agreement and expect to briefly extend the current agreement. The Company also has an agreement in place with the Sports Arena Employees Local 137 (AFL-CIO) with respect to pari-mutuel clerks and admission personnel at the Company's OTWs, which will expire on September 30, 2009.

The Company's agreement with the Maine Harness Horsemen Association at Bangor Raceway expires at the end of the 2008 racing season. Pennwood Racing, Inc. also has an agreement in effect with the horsemen at Freehold Raceway, which expires in May 2009.

Throughout the Argosy properties, the Seafarers Entertainment and Allied Trade Union represents approximately two thousand one hundred of the Company's employees. Additionally, at Argosy Casino Alton, the Seafarer International Union of North America, Atlantic, Gulf, Lakes and Inland Waters District/NMU, AFL-CIO represents eight of the Company's employees, the International Brotherhood of Electrical Workers represents eight of the Company's employees, the Security Police and Fire Professionals of America represents fifty-six of the Company's employees. At the Company's Lawrenceburg Indiana property, the American Maritime Officers Union represents seventeen of the Company's employees. The Company has collective bargaining agreements with these unions that expire at various times between July 2008 and October 2015. At the Empress Casino Hotel, the Hotel Employees and Restaurant Employees Union ("UNITE/HERE"), Local 1 represents approximately three hundred employees under a collective bargaining agreement which expires on March 31, 2010. Negotiations are expected to begin in the near term with the International Brotherhood of Electrical Workers, Local 176, who began representing fifteen slot technicians at the Empress Casino Hotel in October 2007. At Raceway Park, UNITE/HERE Local 10 represents the twenty pari-mutuel tellers under a contract which expires on May 31, 2012.

If the Company fails to maintain agreements with the horsemen at a track, it will not be permitted to conduct live racing and export and import simulcasting at that track and where applicable, the OTWs. In West Virginia, the Company will not be permitted to operate its gaming machines if it fails to maintain agreements with the Charles Town horsemen, pari-mutuel clerks and breeders. In addition, the simulcasting agreements are subject to the horsemen's approval. If the Company fails to maintain necessary agreements, this failure could have a material adverse effect on its business, financial condition and results of operations. Except for the closure of the facilities at Penn National Race Course and its OTWs from February 16, 1999 to March 24, 1999 due to a horsemen's strike, and a few

days at other times and locations, the Company has been able to maintain the necessary agreements. There can be no assurance that the Company will be able to maintain the required agreements.

**New Jersey Joint Venture**

On January 28, 1999, the Company, along with its joint venture partner, Greenwood Limited Jersey, Inc. ("Greenwood"), purchased certain assets and assumed certain liabilities of Freehold Racing Association, Garden State Racetrack and related entities, in a transaction accounted for as a purchase transaction.

The Company made an $11.3 million loan to the joint venture and an equity investment of $0.3 million. The loan is evidenced by a subordinated secured note, which is included in investment in and advances to unconsolidated affiliate in the consolidated financial statements. The note bears interest at prime plus 2.25% or a minimum of 10.00% (at December 31, 2007, the interest rate was 10.00%). The Company has recorded interest income in the consolidated statements of income of $1.2 million, $1.2 million and $1.1 million for the years ended December 31, 2007, 2006 and 2005, respectively.

The joint venture, through Freehold Racing Association, was part of a multi-employer pension plan. For collectively bargained, multi-employer pension plans, contributions were made in accordance with negotiated labor contracts and generally were based on days worked. With the passage of the Multi-Employer Pension Plan Amendments Act of 1980, the joint venture may, under certain circumstances, become subject to liabilities in excess of contributions made under collective bargaining agreements. Generally, these liabilities are contingent upon the termination, withdrawal, or partial withdrawal from the plans. In June 2006, Freehold Racing Association withdrew from the multi-employer pension plan, and thereby became subject to payment of a withdrawal liability to the multi-employer pension plan. In January 2008, the Company was informed that the multi-employer pension plan experienced a mass withdrawal termination as of December 25, 2007. At December 31, 2007, the most recent date for which information is available, the joint venture withdrawal liability was approximately $2.9 million for Freehold Racing Association, which is payable through November 2028.

The Company and Greenwood entered into a Debt Service Maintenance Agreement with a bank in which each joint venture partner has guaranteed up to 50% of a $23.0 million term loan to the joint venture. The Debt Service Maintenance Agreement remains in effect for the life of the loan and is due to expire on September 30, 2009. At December 31, 2007, the outstanding balance on the loan to the joint venture amounted to $11.5 million, of which the Company's obligation under its guarantee of the term loan was limited to approximately $5.75 million. The Company's investment in the joint venture is accounted for under the equity method. The original investment was recorded at cost and has been adjusted by the Company's share of income of the joint venture and distributions received. The Company's 50% share of the income of the joint venture is included in other income (expenses) in the consolidated statements of income.

## 12. Income Taxes

Deferred tax assets and liabilities are comprised of the following:

| Year ended December 31, | 2007 | 2006 |
|---|---|---|
| | (in thousands) | |
| Deferred tax assets: | | |
| Stock-based compensation expense | $ 11,111 | $ 5,583 |
| Accrued expenses | 18,945 | 21,875 |
| FIN 48 | 9,458 | — |
| State net operating losses | 7,687 | 28,872 |
| Accumulated other comprehensive income (loss) | 12,325 | (1,461) |
| Gross deferred tax assets | 59,526 | 54,869 |
| Less valuation allowance | (6,632) | (28,510) |
| Net deferred tax assets | 52,894 | 26,359 |
| Deferred tax liabilities: | | |
| Property, plant and equipment | (165,369) | (139,418) |
| Intangibles | (253,535) | (252,369) |
| Net deferred tax liabilities | (418,904) | (391,787) |
| Net: | $ (366,010) | $ (365,428) |
| Reflected on consolidated balance sheets: | | |
| Current deferred tax assets, net | $ 19,079 | $ 22,187 |
| Noncurrent deferred tax liabilities, net | (385,089) | (387,615) |
| Net deferred taxes | $ (366,010) | $ (365,428) |

For income tax reporting, the Company has state net operating loss carryforwards aggregating approximately $173.1 million available to reduce future state income taxes primarily for the Commonwealth of Pennsylvania and the State of Mississippi as of December 31, 2007. The tax benefit associated with these net operating loss carryforwards is approximately $7.7 million. Due to state tax statutes on annual net operating loss utilization limits, the availability of gaming tax credits, and income and loss projections in the applicable jurisdictions, a $6.6 million valuation allowance has been recorded to reflect the net operating losses which are not presently expected to be realized. If not used, substantially all the carryforwards will expire at various dates from December 31, 2008 to December 31, 2027.

The $6.6 million valuation allowance represents the income tax effect of state net operating loss carryforwards of the Company, which are not presently expected to be utilized. In the event that the valuation allowance is ultimately unnecessary, the majority would be treated as a reduction of tax expense.

In addition, certain subsidiaries have accumulated state net operating loss carryforwards aggregating approximately $558.1 million for which no benefit has been recorded as they are attributable to uncertain tax positions. The unrecognized tax benefits as of December 31, 2007 attributable to these net operating losses was approximately $36.4 million. Due to the uncertain tax position, these net operating losses are not included as components of deferred tax assets as of December 31, 2007. In the event of any benefit from realization of these net operating losses, $7.9 million would be treated as an increase to equity, $0.5 million would be treated as a reduction to goodwill, and the remainder would be treated as a reduction of tax expense. If not used, substantially all the carryforwards will expire at various dates from December 31, 2008 to December 31, 2027.

The provision for income taxes charged to operations was as follows:

| Year ended December 31, | 2007 | 2006 | 2005 |
|---|---|---|---|
| | | (in thousands) | |
| Current tax expense | | | |
| Federal | $ 75,959 | $ 108,958 | $ 73,463 |
| State | 28,536 | 33,067 | 12,184 |
| Foreign | 9,427 | 433 | — |
| Total current | 113,922 | 142,458 | 85,647 |
| Deferred tax expense (benefit) | | | |
| Federal | 16,223 | 16,260 | (24,566) |
| State | 2,042 | (1,866) | (6,488) |
| Total deferred | 18,265 | 14,394 | (31,054) |
| Total provision | $ 132,187 | $ 156,852 | $ 54,593 |

The following table reconciles the statutory federal income tax rate to the actual effective income tax rate for 2007, 2006 and 2005:

| Year ended December 31, | 2007 | 2006 | 2005 |
|---|---|---|---|
| Percent of pretax income | | | |
| Federal tax rate | 35.0% | 35.0% | 35.0% |
| State and local income taxes | 6.8% | 5.5% | 2.6% |
| Permanent differences | 2.6% | 1.8% | 0.7% |
| Foreign | 1.2% | 0.1% | 0.1% |
| Other miscellaneous items | (0.4)% | — | 0.1% |
| | 45.2% | 42.4% | 38.5% |

## 13. Shareholders' Equity

### Stock Split

On February 3, 2005, the Company announced that its Board of Directors approved a 2-for-1 split of the Company's common stock. The stock split was in the form of a stock dividend of one additional share of the Company's common stock for each share held. The additional shares were distributed on March 7, 2005 to shareholders of record on February 14, 2005. As a result of the stock dividend, the number of outstanding shares of the Company's common stock increased to approximately 82.8 million. All references in the consolidated financial statements to number of shares and net income per share amounts of the Company's common stock have been retroactively restated to reflect the increased number of common stock shares outstanding.

### Shareholder Rights Plan

On May 20, 1998, the Board of Directors of the Company authorized and declared a dividend distribution of one preferred stock purchase right (the "Right" or "Rights") for each outstanding share of the Company's common stock, par value $.01 per share, payable to shareholders of record at the close of business on March 19, 1999. In addition, a Right is issued for each share of common stock issued after March 19, 1999 and prior to the Rights' expiration. Each Right entitles the registered holder to purchase from the Company one one-hundredth of a share (a "Preferred Stock Fraction") of the Company's Series A Preferred Stock (or another series of preferred stock with substantially similar terms), or a combination of securities and assets of equivalent value, at a purchase price of $10.00 per

Preferred Stock Fraction, subject to adjustment. The description and terms of the Rights are set forth in a Rights Agreement (the "Rights Agreement") dated March 2, 1999, and amended on June 15, 2007, between the Company and Continental Stock Transfer and Trust Company as Rights Agent.

The Rights are attached to the shares of the Company's common stock until they become exercisable. Generally, the Rights will be exercisable beginning on a specified date after a person or group acquires 15% or more of the Company's common stock (the "Stock Acquisition Date"), commences a tender or exchange offer that will result in such person or group acquiring 20% or more of the outstanding common stock or a determination that a beneficial owner's ownership of a substantial amount of the Company's common stock (at least 10%) is intended to pressure the Company to take action not in the long-term best interests of the Company or may have a material adverse impact ("Adverse Person") on the business or prospects of the Company. The Company is entitled to redeem the Rights at a price of $.01 per Right (payable in cash or stock) at any time until 10 days following a Stock Acquisition Date or the date on which a person is determined to be an Adverse Person. Upon the occurrence of certain events described in the Rights Agreement, each holder of Rights (other than Rights owned by a shareholder who has acquired 15% or more of the Company's outstanding common stock or who is determined to be an Adverse Person, which Rights become void) will have the right to receive, upon exercise, Preferred Stock Fractions (or, in certain circumstances, Company common stock, the acquiring company's common stock, cash, property or other securities of the Company) having a market value of twice the exercise price of each Right. Following any such event, the Company may permit holders to surrender their Rights in exchange for Preferred Stock Fractions (or other property or securities, as the case may be) equal to half the value otherwise purchasable or exchange each Right for one Preferred Share Fraction. A potential dilutive effect may exist upon the exercise of the Rights. Until a Right is exercised, the holder will have no rights as a stockholder of the Company, including, without limitations, the right to vote as a stockholder or to receive dividends. The Rights are not exercisable until the distribution date, and will expire at the close of business on March 18, 2009, unless earlier redeemed or exchanged by the Company.

On June 15, 2007, immediately prior to the execution of the Merger Agreement, the Company and Continental Stock Transfer and Trust Company entered into Rights Agreement Amendment No. 1. The Company was required to enter into Rights Agreement Amendment No. 1 pursuant to Section 4.12 of the Merger Agreement in order to render the Rights Agreement inapplicable to the proposed Merger and other transactions contemplated under the Merger Agreement. Pursuant to Rights Agreement Amendment No. 1, none of Fortress, Centerbridge, PNG Holdings LLC ("Holdings" and, together with Fortress, Centerbridge, Parent and Merger Sub, the "Fortress/Centerbridge Entities"), Parent or Merger Sub will be an Acquiring Person or an Adverse Person (as such terms are defined in the Rights Agreement) to the extent any of the Fortress/Centerbridge Entities are beneficial owners of any Common Stock as a result of the approval, execution or delivery of the Merger Agreement or consummation of the Merger.

**14. Stock-Based Compensation**

In April 1994, the Company's Board of Directors and shareholders adopted and approved the 1994 Stock Option Plan (the "1994 Plan"). The 1994 Plan permitted the grant of options to purchase up to 12,000,000 shares of Common Stock, subject to antidilution adjustments, at a price per share no less than 100% of the fair market value of the Common Stock on the date an option is granted with respect to incentive stock options only. The price would be no less than 110% of fair market value in the case of an incentive stock option granted to any individual who owns more than 10% of the total combined voting power of all classes of outstanding stock. The 1994 Plan provided for the granting of both incentive stock options intended to qualify under Section 422 of the Internal Revenue Code of 1986, as amended, and nonqualified stock options, which do not so qualify. The 1994 Plan terminated in April 2004, but options granted prior to the 1994 Plan's termination remain outstanding.

On April 16, 2003, the Company's Board of Directors adopted and approved the 2003 Long Term Incentive Compensation Plan (the "2003 Plan"). On May 22, 2003, the Company's shareholders approved the 2003 Plan. The 2003 Plan was effective June 1, 2003 and permits the grant of options to purchase Common Stock and other market-based and performance-based awards. Up to 12,000,000 shares of Common Stock are available for awards under the 2003 Plan. The 2003 Plan provides for the granting of both incentive stock options intended to qualify under Section 422 of the Internal Revenue Code of 1986, as amended, and nonqualified stock options, which do not so qualify. The exercise price per share may be no less than (i) 100% of the fair market value of the Common Stock on the date an option is granted for incentive stock options and (ii) 85% of the fair market value of the Common Stock on the date an option is granted for nonqualified stock options. Unless this plan is extended, no awards shall be granted or exchanges effected under this plan after May 31, 2013. At December 31, 2007, there were 3,208,225 options availablefor future grants under the 2003 Plan.

Stock options that expire between January 2, 2009 and January 2, 2017 have been granted to officers, directors and employees to purchase Common Stock at prices ranging from $7.42 to $61.82 per share. All options were granted at the fair market value of the Common Stock on the date the options were granted.

The following table contains information on stock options issued under the plans for the three-year period ended December 31, 2007:

| | Number of Option Shares | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Term (in years) | Aggregate Intrinsic Value |
|---|---|---|---|---|
| | | | | (in thousands) |
| Outstanding at December 31, 2004 | 6,941,260 | $ 8.78 | 5.45 | $ 149,229 |
| Granted | 2,813,000 | 29.51 | | |
| Exercised | (1,932,946) | 5.63 | | |
| Canceled | (87,500) | 9.84 | | |
| Outstanding at December 31, 2005 | 7,733,814 | $ 17.09 | 5.34 | $ 122,844 |
| Granted | 1,784,400 | 33.34 | | |
| Exercised | (1,310,113) | 9.31 | | |
| Canceled | (97,500) | 22.16 | | |
| Outstanding at December 31, 2006 | 8,110,601 | $ 21.87 | 4.97 | $ 160,225 |
| Granted | 1,458,750 | 42.21 | | |
| Exercised | (1,824,071) | 13.66 | | |
| Canceled | (495,375) | 28.44 | | |
| Outstanding at December 31, 2007 | 7,249,905 | $ 27.58 | 4.87 | $ 231,837 |

Included in the above are common stock options that were issued in 2003 to the Company's Chairman outside of the 1994 Plan and the 2003 Plan. These options were issued at $7.95 per share, and are exercisable through February 6, 2013. At December 31, 2007 and December 31, 2006, the number of these common stock options that were outstanding was 23,750. In addition, the Company issued 160,000 restricted stock awards in 2004, which fully vest in May 2009, and issued 280,000 restricted stock awards in 2006, which fully vest by 2011. The restricted stockgrants in 2004 and 2006 were made pursuant to the 2003 Plan. Due to the departure of one of the Company's senior executives, 60,000 of these awards were forfeited. The weighted-average grant-date fair value of options granted during the years ended December 31, 2007, 2006 and 2005 were $16.08, $14.58 and $12.17, respectively.

| | Number of Option Shares | Weighted-Average Exercise Price |
|---|---|---|
| Exercisable at December 31, | | |
| 2007 | 3,080,480 | $ 19.74 |
| 2006 | 2,848,451 | 14.11 |
| 2005 | 2,036,064 | 8.44 |

The aggregate intrinsic value of stock options exercised during the years ended December 31, 2007, 2006 and 2005 was $74.6 million, $37.4 million and $53.1 million, respectively.

At December 31, 2007, there were 3,080,480 shares that were exercisable, with a weighted-average exercise price of $19.74, a weighted-average remaining contractual term of 3.88 years, and an aggregate intrinsic value of $122.6 million.

The following table summarizes information about stock options outstanding at December 31, 2007:

| | Exercise Price Range | | | Total |
|---|---|---|---|---|
| | $7.42 to $29.22 | $30.18 to $41.62 | $42.43 to $61.82 | $7.42 to $61.82 |
| **Outstanding options** | | | | |
| Number outstanding | 4,155,491 | 3,002,414 | 92,000 | 7,249,905 |
| Weighted-average remaining contractual life (years) | 3.94 | 6.11 | 6.42 | 4.87 |
| Weighted-average exercise price | $ 20.22 | $ 37.03 | $ 51.21 | $ 27.58 |
| **Exercisable options** | | | | |
| Number outstanding | 2,674,991 | 405,489 | — | 3,080,480 |
| Weighted-average exercise price | $ 17.69 | $ 33.27 | $ — | $ 19.74 |

Compensation costs related to stock-based compensation for the years ended December 31, 2007 and December 31, 2006 totaled $25.5 million pre-tax ($18.6 million after-tax), or $.21 per diluted share, and $20.6 million pre-tax ($14.9 million after-tax), or $.17 per diluted share, respectively, and are included in the consolidated statements of income under general and administrative expense.

At December 31, 2007 and December 31, 2006, the total compensation cost related to nonvested awards not yet recognized equaled $41.6 million and $45.2 million, respectively, including $36.3 million and $38.0 million for stock options, respectively, and $5.3 million and $7.2 million for restricted stock, respectively. This cost is expected to be recognized over the remaining vesting periods, which will not exceed five years.

## 15. Segment Information

In accordance with SFAS No. 131, the Company views each property as an operating segment, and aggregates all of its properties into one reportable segment, as the Company believes that they are economically similar, offer similar types of products and services, cater to the same types of customers and are similarly regulated.

## 16. Summarized Quarterly Data (Unaudited)

Following is a summary of the quarterly results of operations for the years ended December 31, 2007 and 2006:

| | Fiscal Quarter | | | |
|---|---|---|---|---|
| | First | Second | Third | Fourth |
| | (in thousands, except per share data) | | | |
| **2007** | | | | |
| Net revenues | $ 596,258 | $ 625,244 | $ 629,450 | $ 585,841 |
| Income from continuing operations | 124,780 | 128,420 | 133,879 | 110,730 |
| Net income | 42,941 | 38,299 | 46,590 | 32,223 |
| Basic earnings per share | 0.51 | 0.45 | 0.54 | 0.37 |
| Diluted earnings per share | 0.49 | 0.43 | 0.52 | 0.36 |
| **2006** | | | | |
| Net revenues | $ 547,802 | $ 537,773 | $ 586,111 | $ 572,861 |
| Income from continuing operations | 128,901 | 121,837 | 128,055 | 199,048 |
| Net income | 41,983 | 42,695 | 155,060 | 87,350 |
| Basic earnings per share | 0.50 | 0.51 | 1.84 | 1.03 |
| Diluted earnings per share | 0.49 | 0.49 | 1.79 | 1.00 |

## 17. Related Party Transactions

### Life Insurance Policies

Historically, the Company paid premiums on life insurance policies (the "Policies") on behalf of certain irrevocable trusts (the "Trusts") created by the Company's Chairman and Chief Executive Officer ("CEO"). The policies covered the Chairman and CEO's life and that of his spouse. The Trusts were the owners and beneficiaries of the policies and were obligated to reimburse the Company for all premiums paid when the insurance matures or upon death. To secure the Company's interest in each of the Policies, the Trusts executed a collateral assignment of each of the Policies to the Company. As of December 31, 2007, the Trusts terminated these policies and reimbursed the Company for all but $159,000 for these payments.

### Executive Office Lease

The Company currently leases 42,348 square feet of executive office and warehouse space for buildings in Wyomissing, Pennsylvania from affiliates of its Chairman and CEO. Rent expense for the years ended December 31, 2007, 2006 and 2005 amounted to $0.7 million, $0.6 million, and $0.5 million, respectively. The leases for the office space expire in March 2012, May 2012 and May 2013, and the lease for the warehouse space expires in July 2010. The future minimum lease commitments relating to these leases at December 31, 2007 equaled $3.8 million. The Company also paid $3.7 million, $1.3 million and $0.4 million in construction costs to these same affiliates for the years ended December 31, 2007, 2006 and 2005, respectively.

## 18. Subsidiary Guarantors

Under the terms of the $2.725 billion senior secured credit facility, all of Penn's subsidiaries are guarantors under the agreement, with the exception of several minor subsidiaries with total assets, excluding intercompany balances, of $43.9 million (approximately 0.9% of total assets at December 31, 2007). Each of the subsidiary guarantors is 100% owned by Penn. In addition, the guarantees provided by Penn's subsidiaries under the terms of the $2.725 billion senior secured credit facility are full and unconditional, joint and several, and Penn had no significant independent assets and no independent operations at, and for the year ended, December 31, 2007. There are no significant restrictions within

the $2.725 billion senior secured credit facility on the Company's ability to obtain funds from its subsidiaries by dividend or loan. However, in certain jurisdictions, the gaming authorities may impose restrictions pursuant to the authority granted to them with regard to Penn's ability to obtain funds from its subsidiaries.

With regard to the $2.725 billion senior secured credit facility, the Company has not presented condensed consolidating balance sheets, condensed consolidating statements of income and condensed consolidating statements of cash flows at, and for the years ended, December 31, 2007, 2006 and 2005, as Penn had no significant independent assets and no independent operations at, and for the year ended, December 31, 2007, the guarantees are full and unconditional and joint and several, and any subsidiaries of Penn other than the subsidiary guarantors are considered minor.

Under the terms of the $200 million 6 7/8% senior subordinated notes, all of Penn's subsidiaries are guarantors under the agreement, with the exception of several minor subsidiaries with total assets, excluding intercompany balances, of $19.4 million (approximately 0.4% of total assets at December 31, 2007). Each of the subsidiary guarantors is 100% owned by Penn. In addition, the guarantees provided by Penn's subsidiaries under the terms of the $200 million 6 7/8% senior subordinated notes are full and unconditional, joint and several, and Penn had no significant independent assets and no independent operations at, and for the year ended, December 31, 2007. There are no significant restrictions within the $200 million 6 7/8% senior subordinated notes on the Company's ability to obtain funds from its subsidiaries by dividend or loan. However, in certain jurisdictions, the gaming authorities may impose restrictions pursuant to the authority granted to them with regard to Penn's ability to obtain funds from its subsidiaries.

With regard to the $200 million 6 7/8% senior subordinated notes, the Company has not presented condensed consolidating balance sheets, condensed consolidating statements of income and condensed consolidating statements of cash flows at, and for the years ended, December 31, 2007, 2006 and 2005, as Penn had no significant independent assets and no independent operations at, and for the year ended, December 31, 2007, the guarantees are full and unconditional and joint and several, and any subsidiaries of Penn other than the subsidiary guarantors are considered minor.

**19. Discontinued Operations—Disposition of Hollywood Casino Shreveport**

On August 27, 2004, the Company's unrestricted subsidiary, Hollywood Casino Shreveport ("HCS"), in cooperation with an Ad Hoc Committee representing a majority of its noteholders, entered into an agreement with Eldorado Resorts LLC ("Eldorado") providing for the acquisition of HCS by certain affiliates of Eldorado. On September 10, 2004, a group of HCS's creditors, led by Black Diamond Capital Management, LLC, filed with the U.S. Bankruptcy Court, Western District of Louisiana ("U.S. Bankruptcy Court"), located in Shreveport, Louisiana, an involuntary petition against HCS for relief under Chapter 11 of the U.S. Bankruptcy Code. On October 30, 2004, HCS agreed to the entry of an order for relief in the Chapter 11 case that had been filed against it, and HCS I, Inc., HCS II, Inc., HWCC-Louisiana, Inc. and Shreveport Capital Corporation commenced voluntary cases under Chapter 11 of the Bankruptcy Code. HCS's debt was non-recourse to the Company and its other subsidiaries.

On July 6, 2005, the U.S. Bankruptcy Court entered an order confirming a Chapter 11 plan that provided for the acquisition of HCS by certain affiliates of Eldorado and, on July 22, 2005, the acquisition was completed. As a result, the Company recorded a non-cash pre-tax gain of approximately $58.3 million, representing the aggregate amount of previously-recorded losses. The after-tax effect of the gain was approximately $37.9 million.

The Company has historically reflected the results of this transaction by classifying the assets, liabilities and results of operations of HCS as assets and liabilities held for sale and discontinued operations in accordance with the provisions of SFAS No. 144, "Accounting for the Impairment or

Disposal of Long-Lived Assets" ("SFAS 144"). The Company held no HCS assets or liabilities at December 31, 2007 and 2006. Net revenues, income from continuing operations and net loss for HCS for the year ended December 31, 2005 equaled $67.5 million, $2.9 million and ($5.5) million, respectively.

**20. Discontinued Operations—Sale of The Downs Racing, Inc. and Subsidiaries**

On October 15, 2004, the Company announced the sale of The Downs Racing, Inc. and its subsidiaries to the MTGA. In January 2005, the Company received $280 million from the MTGA, and transferred the operations of The Downs Racing, Inc. and its subsidiaries to the MTGA. The sale was not considered final for accounting purposes until the third quarter of 2006, as the MTGA had certain post-closing termination rights that remained outstanding. On August 7, 2006, the Company entered into the Amendment and Release with the MTGA pertaining to the Purchase Agreement, and agreed to pay the MTGA an aggregate of $30 million over five years, beginning on the first anniversary of the commencement of slot operations at Mohegan Sun at Pocono Downs, in exchange for the MTGA's agreement to release various claims it raised against the Company under the Purchase Agreement and the MTGA's surrender of all post-closing termination rights it might have had under the Purchase Agreement. As a result of the Amendment and Release, the Company recorded, in accordance with GAAP, a net book gain on the $250 million sale ($280 million initial price, less $30 million payable pursuant to the Amendment and Release) of The Downs Racing, Inc. and its subsidiaries to the MTGA of $114.0 million (net of $84.9 million of income taxes) during the year ended December 31, 2006. In addition, the Company recorded the present value of the $30 million liability within debt, as the amount due to the MTGA is payable over five years, with the first payment of $7.0 million having been made in November 2007.

The Company held no The Downs Racing, Inc. assets or liabilities at December 31, 2007 and 2006. Net revenues, loss from continuing operations and net loss for The Downs Racing, Inc. and its subsidiaries for the year ended December 31, 2005 equaled $1.8 million, $86,000 and $38,000, respectively.

**21. Discontinued Operations—Sale of Argosy Casino Baton Rouge**

On October 25, 2005, pursuant to the previously-announced Securities Purchase Agreement among Argosy, Wimar Tahoe Corporation and CP Baton Rouge Casino, L.L.C., an affiliate of Columbia Sussex Corporation, the Company completed its sale of Argosy Casino Baton Rouge to Columbia Sussex Corporation for approximately $148.6 million. The Company owned Argosy Casino Baton Rouge for twenty-four days prior to the sale. The Company did not record a gain or loss on sale of the property, as the sale price on date of disposition equaled the estimated fair value of the assets and liabilities acquired, but assigned a purchase price equal to $148.6 million.

Net revenues, income from continuing operations and net income for Argosy Casino Baton Rouge for the year ended December 31, 2005 equaled $9.9 million, $2.5 million and $1.4 million, respectively.

**22. Subsequent Event**

On February 19, 2008, the Illinois Gaming Board resolved to allow the Company to retain the Empress Casino Hotel. Previously, in connection with its acquisition of Argosy, the Company entered into an agreement with the Illinois Gaming Board in which it agreed, in part, to enter into an agreement to divest the Empress Casino Hotel by December 31, 2006, which date was later extended to June 30, 2008, subject to the Company having the right to request that the Illinois Gaming Board review and reconsider the terms of the agreement.