

PENN NATIONAL GAMING INC

Form 10-Q

May 07, 2010

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**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549



# FORM 10-Q



(Mark One)

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

For the quarterly period ended March 31, 2010

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)

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**Pennsylvania**  
(State or other jurisdiction of  
incorporation or organization)

**23-2234473**  
(I.R.S. Employer  
Identification No.)

**825 Berkshire Blvd., Suite 200**  
**Wyomissing, PA 19610**  
(Address of principal executive offices) (Zip Code)



**610-373-2400**

(Registrant's telephone number, including area code)



**Not Applicable**

(Former name, former address, and former fiscal year, if changed since last report)



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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

**Title**  
Common Stock, par value \$.01 per share

**Outstanding as of May 3, 2010**  
79,361,906 (includes 592,800 shares of restricted stock)



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This report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Actual results may vary materially from expectations. Although Penn National Gaming, Inc. and its subsidiaries (collectively, the Company) believe that our expectations are based on reasonable assumptions within the bounds of our knowledge of our business and operations, there can be no assurance that actual results will not differ materially from our expectations. Meaningful factors that could cause actual results to differ from expectations include, but are not limited to, risks related to the following: our ability to maintain regulatory approvals for our existing businesses and to receive regulatory approvals for our new businesses; the passage of state, federal or local legislation (including referenda) that would expand, restrict, further tax, prevent or negatively impact operations in the jurisdictions in which we do business (such as a smoking ban at any of our facilities) or in jurisdictions where we seek to do business; the activities of our competitors and the emergence of new competitors; increases in the effective rate of taxation at any of our properties or at the corporate level; delays or changes to, or cancellations of, planned capital projects at our gaming and pari-mutuel facilities or an inability to achieve the expected returns from such projects; construction factors, including delays, unexpected remediation costs, local opposition and increased cost of labor and materials; the ability to recover proceeds on significant insurance claims; our ability to identify attractive acquisition and development opportunities and to agree to terms with partners for such transactions; the costs and risks involved in the pursuit of such opportunities, and our ability to complete the acquisition or development of, and achieve the expected returns from, such opportunities; the availability and cost of financing; the maintenance of agreements with our horsemen, pari-mutuel clerks and other organized labor groups; the outcome of pending legal proceedings; the effects of local and national economic, credit, capital market, housing, and energy conditions on the economy in general and on the gaming and lodging industries in particular; changes in accounting standards; third-party relations and approvals; our dependence on key personnel; the impact of terrorism and other international hostilities; the impact of weather; and other factors as discussed in the Company's Annual Report on Form 10-K for the year ended December 31, 2009, subsequent Quarterly Reports on Form 10-Q and Current Reports on Form 8-K as filed with the SEC. The Company does not intend to update publicly any forward-looking statements except as required by law.

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

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Table of Contents**PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****Penn National Gaming, Inc. and Subsidiaries****Consolidated Balance Sheets****(in thousands, except share and per share data)**

	<b>March 31, 2010 (unaudited)</b>	<b>December 31, 2009</b>
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents	\$ 642,507	\$ 713,118
Receivables, net of allowance for doubtful accounts of \$3,594 and \$3,548 at March 31, 2010 and December 31, 2009, respectively	37,846	46,672
Insurance receivable	13,654	33,494
Prepaid expenses and other current assets	105,586	121,545
Deferred income taxes	20,375	23,619
Total current assets	819,968	938,448
<b>Property and equipment, net</b>	<b>1,909,192</b>	<b>1,837,504</b>
<b>Other assets</b>		
Investment in and advances to unconsolidated affiliates	38,503	26,305
Goodwill	1,378,623	1,379,961
Other intangible assets	375,294	376,954
Deferred financing fees, net of accumulated amortization of \$43,125 and \$39,703 at March 31, 2010 and December 31, 2009, respectively	37,507	40,889
Other assets	96,661	112,555
Total other assets	1,926,588	1,936,664
<b>Total assets</b>	<b>\$ 4,655,748</b>	<b>\$ 4,712,616</b>
<b>Liabilities</b>		
<b>Current liabilities</b>		
Current maturities of long-term debt	\$ 74,640	\$ 86,071
Accounts payable	23,230	19,850
Accrued expenses	83,533	110,108
Accrued interest	47,080	61,786
Accrued salaries and wages	51,188	65,608
Gaming, pari-mutuel, property, and other taxes	39,734	38,943
Insurance financing	2,537	6,752
Other current liabilities	42,184	41,138
Total current liabilities	364,126	430,256
<b>Long-term liabilities</b>		
Long-term debt, net of current maturities	2,228,188	2,248,706
Deferred income taxes	132,141	127,107
Noncurrent tax liabilities	36,695	46,702

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Other noncurrent liabilities	8,369	7,769
Total long-term liabilities	2,405,393	2,430,284
<b>Shareholders' equity</b>		
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 March 31, 2010 and December 31, 2009, respectively)		
Common stock (\$.01 par value, 200,000,000 shares authorized, 79,202,810 and 78,972,256 shares issued at March 31, 2010 and December 31, 2009, respectively)	787	786
Additional paid-in capital	1,476,153	1,480,476
Retained earnings	433,571	397,407
Accumulated other comprehensive loss	(23,708)	(26,028)
Total Penn National Gaming, Inc. and subsidiaries shareholders' equity	1,886,803	1,852,641
Noncontrolling interests	(574)	(565)
Total shareholders' equity	1,886,229	1,852,076
<b>Total liabilities and shareholders' equity</b>	<b>\$ 4,655,748</b>	<b>\$ 4,712,616</b>

See accompanying notes to the consolidated financial statements.

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

	<b>Three Months Ended March 31,</b>	
	<b>2010</b>	<b>2009</b>
<b>Revenues</b>		
Gaming	\$ 543,373	\$ 559,903
Management service fee	3,194	3,033
Food, beverage and other	80,432	84,622
Gross revenues	626,999	647,558
Less promotional allowances	(34,676)	(35,332)
Net revenues	592,323	612,226
<b>Operating expenses</b>		
Gaming	290,861	297,562
Food, beverage and other	63,220	64,529
General and administrative	94,516	99,470
Impairment loss for replaced Lawrenceburg vessel	136	
Empress Casino Hotel fire	59	5,400
Depreciation and amortization	51,180	44,430
Total operating expenses	499,972	511,391
Income from operations	92,351	100,835
<b>Other income (expenses)</b>		
Interest expense	(34,292)	(31,238)
Interest income	730	3,091
Loss from unconsolidated affiliates	(1,412)	(303)
Other	(1,321)	2,092
Total other expenses	(36,295)	(26,358)
<b>Income from operations before income taxes</b>	<b>56,056</b>	<b>74,477</b>
Taxes on income	19,901	33,816
<b>Net income including noncontrolling interests</b>	<b>36,155</b>	<b>40,661</b>
Less: Net loss attributable to noncontrolling interests	(9)	
<b>Net income attributable to the shareholders of Penn National Gaming, Inc. and subsidiaries</b>	<b>\$ 36,164</b>	<b>\$ 40,661</b>
<b>Earnings per common share attributable to the shareholders of Penn National Gaming, Inc. and subsidiaries:</b>		
Basic earnings per common share	\$ 0.37	\$ 0.42
Diluted earnings per common share	\$ 0.34	\$ 0.38

See accompanying notes to the consolidated financial statements.



Table of Contents**Penn National Gaming, Inc. and Subsidiaries****Consolidated Statements of Changes in Shareholders' Equity**

(in thousands, except share data) (unaudited)

	Penn National Gaming, Inc. shareholders									
	Preferred Stock		Common Stock		Additional Paid-In	Retained	Accumulated Other Comprehensive (Loss)	Noncontrolling	Total	Comprehensive
	Shares	Amount	Shares	Amount	Capital	Earnings	Income	Interests	Equity	Income (Loss)
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 \$327			82,892		9,496					9,496
Restricted stock			93,500		496					496
Change in fair value of interest rate swap contracts, net of income taxes of \$1,339							2,380		2,380	2,380
Change in fair value of corporate debt securities							1,564		1,564	1,564
Foreign currency translation adjustment							(223)		(223)	(223)
Net income						40,661			40,661	40,661
Balance, March 31, 2009	12,500	\$	78,324,880	\$ 782	\$ 1,452,821	\$ 703,016	\$ (44,972)	\$	\$ 2,111,647	\$ 44,382
Balance, December 31, 2009	12,500	\$	78,972,256	\$ 786	\$ 1,480,476	\$ 397,407	\$ (26,028)	\$ (565)	\$ 1,852,076	
Repurchase of preferred stock	(225)				(11,200)				(11,200)	
Stock option activity, including tax expense of \$660			65,444	1	4,881					4,882
Restricted stock			165,110		1,996					1,996
Change in fair value of interest rate swap contracts, net of income taxes of \$1,369							1,987		1,987	1,987
Change in fair value of corporate debt securities							(8)		(8)	(8)
Foreign currency translation adjustment							341		341	341
Net income (loss)						36,164		(9)	36,155	36,155
Balance, March 31, 2010	12,275	\$	79,202,810	\$ 787	\$ 1,476,153	\$ 433,571	\$ (23,708)	\$ (574)	\$ 1,886,229	\$ 38,475

See accompanying notes to the consolidated financial statements.

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

<b>Three Months Ended March 31,</b>	<b>2010</b>	<b>2009</b>
<b>Operating activities</b>		
Net income including noncontrolling interests	\$ 36,155	\$ 40,661
Adjustments to reconcile net income including noncontrolling interests to net cash provided by operating activities:		
Depreciation and amortization	51,180	44,430
Amortization of items charged to interest expense	3,422	2,975
Amortization of items charged to interest income	(113)	(874)
Loss on sale of fixed assets	64	12
Loss from unconsolidated affiliates	1,412	303
Empress Casino Hotel fire	59	4,318
Gain on accelerated payment of other long-term obligations		(1,305)
Deferred income taxes	4,782	982
Charge for stock compensation	6,384	8,485
Impairment loss for replaced Lawrenceburg vessel	136	
Decrease, net of businesses acquired		
Accounts receivable	6,654	3,828
Insurance receivable	15,019	
Prepaid expenses and other current assets	16,636	13,714
Other assets	9,590	4,275
Increase (decrease), net of businesses acquired		
Accounts payable	1,476	(3,409)
Accrued expenses	(26,167)	(26,711)
Accrued interest	(11,350)	(1,818)
Accrued salaries and wages	(14,420)	(1,454)
Gaming, pari-mutuel, property and other taxes	791	(24)
Income taxes		14,718
Other current and noncurrent liabilities	1,646	(611)
Other noncurrent tax liabilities	(9,620)	1,618
Net cash provided by operating activities	93,736	104,113
<b>Investing activities</b>		
Expenditures for property and equipment	(120,385)	(63,575)
Proceeds from sale of property and equipment	1,103	1,212
Proceeds from Empress Casino Hotel fire	4,821	
Investment in Kansas Entertainment	(13,550)	
Decrease in cash in escrow	10,982	
Net cash used in investing activities	(117,029)	(62,363)
<b>Financing activities</b>		
Proceeds from exercise of options	746	776
Repurchase of preferred stock	(11,200)	
Proceeds from issuance of long-term debt	33,925	25,919
Principal payments on long-term debt	(65,874)	(70,744)
Payments on insurance financing	(4,215)	(6,070)
Increase in deferred financing fees	(40)	
Tax impact from stock options exercised	(660)	327
Net cash used in financing activities	(47,318)	(49,792)
<b>Net decrease in cash and cash equivalents</b>	<b>(70,611)</b>	<b>(8,042)</b>



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Cash and cash equivalents at beginning of year		713,118		746,278
Cash and cash equivalents at end of period	\$	642,507	\$	738,236
<b>Supplemental disclosure</b>				
Interest expense paid	\$	43,234	\$	32,943
Income taxes paid	\$	7,271	\$	445

See accompanying notes to the consolidated financial statements.

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

**Notes to the Consolidated Financial Statements**

**1. Basis of Presentation**

The accompanying unaudited consolidated financial statements of Penn National Gaming, Inc. ( Penn ) and its subsidiaries (collectively, the Company ) have been prepared in accordance with United States ( U.S. ) generally accepted accounting principles ( GAAP ) for interim financial information and with the instructions for Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete consolidated financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. The notes to the consolidated financial statements contained in the Annual Report on Form 10-K for the year ended December 31, 2009 should be read in conjunction with these consolidated financial statements. For purposes of comparability, certain prior year amounts have been reclassified to conform to the current year presentation. Operating results for the three months ended March 31, 2010 are not necessarily indicative of the results that may be expected for the year ending December 31, 2010.

**2. Summary of Significant Accounting Policies**

**Revenue Recognition and Promotional Allowances**

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

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

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

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

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The retail value of accommodations, food and beverage, and other services furnished to guests without charge is included in gross revenues and then deducted as promotional allowances. The estimated cost of providing such promotional allowances is primarily included in food, beverage and other expense. The amounts included in promotional allowances for the three months ended March 31, 2010 and 2009 are as follows:

	Three Months Ended March 31,	
	2010	2009
	(in thousands)	
Rooms	\$ 5,970	\$ 5,324
Food and beverage	26,104	27,285
Other	2,602	2,723
Total promotional allowances	\$ 34,676	\$ 35,332

The estimated cost of providing such complimentary services for the three months ended March 31, 2010 and 2009 are as follows:

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	<b>Three Months Ended March 31,</b>	
	<b>2010</b>	<b>2009</b>
	(in thousands)	
Rooms	\$ 2,284	\$ 2,207
Food and beverage	19,194	18,573
Other	1,729	1,504
Total cost of complimentary services	\$ 23,207	\$ 22,284

**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 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. During the three months ended March 31, 2010, the Company repurchased 225 shares of Preferred Stock for \$11.2 million.

The following table sets forth the allocation of net income attributable to the shareholders of Penn National Gaming, Inc. and subsidiaries for the three months ended March 31, 2010 and 2009 under the two-class method:

	<b>Three Months Ended March 31,</b>	
	<b>2010</b>	<b>2009</b>
	(in thousands)	
Net income attributable to the shareholders of Penn National Gaming, Inc. and subsidiaries	\$ 36,164	\$ 40,661
Net income attributable to the shareholders of Penn National Gaming, Inc. and subsidiaries applicable to preferred stock	6,931	7,864
Net income attributable to the shareholders of Penn National Gaming, Inc. and subsidiaries applicable to common stock	\$ 29,233	\$ 32,797

The following table reconciles the weighted-average common shares outstanding used in the calculation of basic EPS to the weighted-average common shares outstanding used in the calculation of diluted EPS for the three months ended March 31, 2010 and 2009:



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	<b>Three Months Ended March 31,</b>	
	<b>2010</b>	<b>2009</b>
	<b>(in thousands)</b>	
<b>Determination of shares:</b>		
Weighted-average common shares outstanding	78,563	77,813
Assumed conversion of dilutive stock options	741	943
Assumed conversion of preferred stock	27,733	27,778
Diluted weighted-average common shares outstanding	107,037	106,534

Reflecting the issuance of the Preferred Stock and the repurchase of 225 shares of Preferred Stock during the three months ended March 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).

Options to purchase 10,167,592 shares and 8,759,082 shares were outstanding during the three months ended March 31, 2010 and 2009, respectively, but were not included in the computation of diluted EPS because they are antidilutive.

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

	<b>Three Months Ended March 31,</b>	
	<b>2010</b>	<b>2009</b>
	<b>(in thousands, except per share data)</b>	
<b>Calculation of basic EPS attributable to the shareholders of Penn National Gaming, Inc. and subsidiaries:</b>		
Net income attributable to the shareholders of Penn National Gaming, Inc. and subsidiaries applicable to common stock	\$ 29,233	\$ 32,797
Weighted-average common shares outstanding	78,563	77,813
Basic EPS	\$ 0.37	\$ 0.42

	<b>Three Months Ended March 31,</b>	
	<b>2010</b>	<b>2009</b>
	<b>(in thousands, except per share data)</b>	
<b>Calculation of diluted EPS attributable to the shareholders of Penn National Gaming, Inc. and subsidiaries:</b>		
Net income attributable to the shareholders of Penn National Gaming, Inc. and subsidiaries	\$ 36,164	\$ 40,661
Diluted weighted-average common shares outstanding	107,037	106,534
Diluted EPS	\$ 0.34	\$ 0.38

**Stock-Based Compensation**

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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 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

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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 March 31, 2010 and 2009:

Three Months Ended March 31,	2010	2009
Risk-free interest rate	2.80%	1.61%
Expected volatility	49.68%	45.56%
Dividend yield		
Weighted-average expected life (years)	5.32	5.36
Forfeiture rate	5.00%	4.00%

**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 March 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



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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 March 31, 2010 and December 31, 2009.

During the three months ended March 31, 2010, 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.

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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.

**3. New Accounting Pronouncements**

In April 2010, the Financial Accounting Standards Board (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 avoid paying that jackpot. 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 is 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 is currently determining the impact of this guidance on its 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 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 January 1, 2010 adoption did not have a material impact on the Company's 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 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 amended guidance did not have a material impact on the Company's consolidated financial statements. In February 2010, the FASB deferred the effective date of the amendments in this guidance for a reporting entity's interest in certain entities. The deferral did not have an impact on the Company's consolidated financial statements.

**4. Investment In and Advances to Unconsolidated Affiliates**

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Investment in and advances to unconsolidated affiliates that are 50% owned, which primarily include the Company's investments in Kansas Entertainment, LLC ( Kansas Entertainment ) and Freehold Raceway, are accounted for under the equity method.

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 a Hollywood-themed destination facility overlooking Turn 2 at Kansas Speedway.

The Company's investment in Kansas Entertainment consists of the Company's portion of the privilege fee paid to the Kansas Lottery Commission in conjunction with its application, its portion of capital expenditures spent to develop the proposed facility, and its share of Kansas Entertainment's losses. The Company's share of losses in Kansas Entertainment was \$1.1 million for the three months ended March 31, 2010, which is also included in loss from unconsolidated affiliates within the consolidated statement of income.

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The Company determined that Kansas Entertainment qualified as a variable interest entity at March 31, 2010. The Company did not consolidate its investment in Kansas Entertainment at, and for the three months ended March 31, 2010, as the Company determined that it did not qualify as the primary beneficiary of Kansas Entertainment at, and for the three months ended March 31, 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 its partner in Kansas Entertainment, International Speedway Corporation ( International Speedway ). In addition, the Company determined that International Speedway had substantive participating rights in Kansas Entertainment at, and for the three months ended March 31, 2010.

The \$410 million facility, inclusive of licensing fees, is expected to feature a 100,000 square foot casino with capacity for 2,300 slot machines, 61 table games and 25 poker tables, a 1,500 parking structure, as well as a variety of dining and entertainment amenities. The Company, along with International Speedway, will share equally the cost of developing and constructing the proposed facility, and intend to jointly seek third party financing for the project. The Company estimates that its share of the project will be approximately \$155 million.

**5. Property and Equipment**

Property and equipment, net, consists of the following:

	March 31, 2010	December 31, 2009
	(in thousands)	
Land and improvements	\$ 306,965	\$ 239,933
Building and improvements	1,435,540	1,433,611
Furniture, fixtures, and equipment	868,251	849,071
Leasehold improvements	17,215	17,204
Construction in progress	78,139	47,299
Total property and equipment	2,706,110	2,587,118
Less accumulated depreciation	(796,918)	(749,614)
Property and equipment, net	\$ 1,909,192	\$ 1,837,504

Depreciation expense, for property and equipment, totaled \$49.5 million and \$42.7 million for the three months ended March 31, 2010 and 2009, respectively. Interest capitalized in connection with major construction projects was \$1.1 million and \$2.9 million for the three months ended March 31, 2010 and 2009, respectively.

**6. Goodwill and Other Intangible Assets**

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

Balance at December 31, 2009:

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Goodwill	\$	2,024,963
Accumulated goodwill impairment losses		(645,002)
Goodwill, net	\$	1,379,961
Goodwill acquired during the year		
Goodwill impairment losses		
Other		(1,338)
Balance at March 31, 2010:		
Goodwill	\$	2,023,625
Accumulated goodwill impairment losses		(645,002)
Goodwill, net	\$	1,378,623

The table below presents the gross carrying value, accumulated amortization, and net book value of each major class of intangible asset at March 31, 2010 and December 31, 2009:

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	March 31, 2010			December 31, 2009		
	Gross Carrying Value	Accumulated Amortization	Net Book Value	Gross Carrying Value	Accumulated Amortization	Net Book Value
Indefinite-life intangible assets	\$ 368,886	\$	\$ 368,886	\$ 368,886	\$	\$ 368,886
Other intangible assets	49,396	42,988	6,408	49,396	41,328	8,068
Total	\$ 418,282	\$ 42,988	\$ 375,294	\$ 418,282	\$ 41,328	\$ 376,954

The Company's intangible asset amortization expense was \$1.7 million for each of the three months ended March 31, 2010 and 2009.

The following table presents expected intangible asset amortization expense based on existing intangible assets at March 31, 2010 (in thousands):

2010 (9 months)	\$ 4,113
2011	2,096
2012	199
Total	\$ 6,408

## 7. 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. The remaining investment, which the Company is treating as available-for-sale securities, is included in other assets within the consolidated balance sheets at March 31, 2010 and December 31, 2009.

During the three months ended March 31, 2010 and 2009, the Company recorded an \$8,000 unrealized loss and an \$1.6 million unrealized gain, respectively, in OCI for this investment. The change in the fair value also reflects the original issue discount amortization, which was \$0.1 million and \$0.8 million for the three months ended March 31, 2010 and 2009, respectively.

The following is a schedule of the contractual maturities of the Company's investment in corporate securities at March 31, 2010 (in thousands):

Within one year	\$
1-3 years	4,655
Total	\$ 4,655

## 8. Long-term Debt

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

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	March 31, 2010	December 31, 2009
	(in thousands)	
Senior secured credit facility	\$ 1,723,673	\$ 1,755,602
\$250 million 6 ¾% senior subordinated notes	250,000	250,000
\$325 million 8 ¾% senior subordinated notes	325,000	325,000
Capital leases	4,155	4,175
	2,302,828	2,334,777
Less current maturities of long-term debt	(74,640)	(86,071)
	\$ 2,228,188	\$ 2,248,706

The following is a schedule of future minimum repayments of long-term debt as of March 31, 2010 (in thousands):

Within one year	\$ 74,640
1-3 years	1,651,288
3-5 years	250,175
Over 5 years	326,725
Total minimum payments	\$ 2,302,828

At March 31, 2010, the Company was contingently obligated under letters of credit issued pursuant to the senior secured credit facility with face amounts aggregating \$26.5 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.

As of March 31, 2010, \$205.6 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 \$1,723.7 million. During the year ended December 31, 2009, all of the outstanding borrowings under the Term Loan A Facility were repaid.

**Interest Rate Swap Contracts**



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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 income for the three months ended March 31, 2010 was as follows (in thousands):

Derivatives in a Cash Flow Hedging Relationship	Gain (Loss) Recognized in	Location of Gain (Loss) Reclassified from	Gain (Loss) Reclassified from	Location of Gain (Loss) Recognized in Income on	Gain (Loss)
	OCI on Derivative (Effective Portion)	AOCI into Income (Effective Portion)	AOCI into Income (Effective Portion)	Derivative (Ineffective Portion)	Recognized in Income on Derivative (Ineffective Portion)
Interest rate swap contracts	\$ (7,386)	Interest expense	\$ (6,496)	None	\$
Total	\$ (7,386)		\$ (6,496)		\$

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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	\$ (34)
Total		\$ (34)

The effect of derivative instruments on the consolidated statement of income for the three months ended March 31, 2009 was as follows (in thousands):

Derivatives in a Cash Flow Hedging Relationship	Gain (Loss)	Location of Gain (Loss)	Gain (Loss)	Location of Gain (Loss)	Gain (Loss)
	Recognized in OCI on Derivative (Effective Portion)	Reclassified from AOCI into Income (Effective Portion)	Reclassified from AOCI into Income (Effective Portion)	Recognized in Income on Derivative (Ineffective Portion)	Recognized in Income on Derivative (Ineffective Portion)
Interest rate swap contracts	\$ 2,380	Interest expense	\$ (9,516)	None	\$
Total	\$ 2,380		\$ (9,516)		\$

In addition, during the three months ended March 31, 2010, the Company amortized \$4.2 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 \$33.1 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 March 31, 2010 and December 31, 2009:

	March 31, 2010		December 31, 2009	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
<b>Derivatives designated as hedging instruments</b>				
Interest rate swap contracts	Accrued interest	\$ 24,342	Accrued interest	\$ 23,485
<b>Total derivatives designated as hedging instruments</b>		\$ 24,342		\$ 23,485

**Derivatives not designated as hedging instruments**

Interest rate swap contracts	Accrued interest	\$	16,257	Accrued interest	\$	20,440
<b>Total derivatives not designated as hedging instruments</b>		\$	16,257	\$		20,440
<b>Total derivatives</b>		\$	40,599	\$		43,925

**Covenants**

The Company's senior secured credit facility, \$325 million 83/4% and \$250 million 63/4% 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,

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\$325 million 83/4% and \$250 million 63/4% 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 March 31, 2010, the Company was in compliance with all required financial covenants.

**9. Income Taxes**

A reconciliation of the liability for unrecognized tax benefits is as follows:

	<b>Noncurrent tax liabilities (in thousands)</b>	
Balance at January 1, 2010	\$	46,702
Additions based on current year tax positions		350
Additions based on prior year tax positions		1,541
Decreases due to settlements and/or reduction in liabilities		(13,534)
Currency translation adjustments		1,636
Balance at March 31, 2010	\$	36,695

The decrease in the Company's liability for unrecognized tax benefits during the three months ended March 31, 2010 was primarily due to the Commonwealth of Pennsylvania officially closing 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, as defined under ASC 740, Income Taxes. Therefore the Company reversed previously-recorded tax reserves of \$6.3 million and interest accruals of \$1.8 million. On March 26, 2010, the Company received from Ontario's Ministry of Revenue Notices 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\$4.9 million.

**10. 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

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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 ( 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

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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. The dismissal becomes final in 90 days (second quarter of 2010), unless Capitol House requests the U.S. Supreme Court to hear the case and the U.S. Supreme Court agrees to hear it.

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. 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.

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. The Four Casinos appealed the dismissal and filed motions to keep the funds in the protest fund while the appeal is being litigated. These motions were denied and the funds have been released to the racetracks. However, currently these funds are also subject to the order issued by the Seventh Circuit Court of Appeals described above.

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

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disbursed to the tracks be maintained until the appeal has been decided.

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

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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 have appealed the decision to the Fourth Circuit Court of Appeals and the parties have fully briefed the 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 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 were filed 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 \$7.6 million and \$8.0 million for the three months ended March 31, 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.



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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 March 31, 2010 are as follows (in thousands):

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Within one year	\$	6,970
1-3 years		11,738
3-5 years		7,944
Over 5 years		35,619
Total	\$	62,271

**11. Shareholders Equity**

In connection with the termination of the merger agreement between the Company and certain affiliates of Fortress and Centerbridge, 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 Preferred Stock.

During the three months ended March 31, 2010, the Company repurchased 225 shares of Preferred Stock for \$11.2 million.

**12. Noncontrolling Interests**

In November 2009, the Company entered into an 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 three months ended March 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 \$9,000. 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 sheets at March 31, 2010 and December 31, 2009, stated separately from the Company's shareholders' equity.

**13. 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.

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. Condensed consolidating balance sheets at March 31, 2010 and December 31, 2009, and condensed consolidating statements of income and cash flows for the three months ended March 31, 2010 and 2009, for Penn, the subsidiary guarantors of the senior secured credit facility and the subsidiary non-guarantors are presented below.

The Company's \$250 million 63/4% senior subordinated notes and \$325 million 83/4% senior subordinated notes are not guaranteed by the Company's subsidiaries.

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	Penn	Subsidiary Guarantors	Subsidiary Non-Guarantors (in thousands)	Eliminations	Consolidated
<b>Senior Secured Credit Facility</b>					
<b>At March 31, 2010</b>					
<b>Condensed Consolidating Balance Sheet</b>					
Total current assets	\$ 63,154	\$ 242,425	\$ 497,107	\$ 17,282	\$ 819,968
Property and equipment, net	24,713	1,771,185	113,294		1,909,192
Total other assets	4,106,497	4,640,157	348,419	(7,168,485)	1,926,588
Total assets	\$ 4,194,364	\$ 6,653,767	\$ 958,820	\$ (7,151,203)	\$ 4,655,748
Total current liabilities	\$ 134,654	\$ 193,275	\$ 18,945	\$ 17,252	\$ 364,126
Total long-term liabilities	2,172,905	3,188,129	81,531	(3,037,172)	2,405,393
Total shareholders' equity	1,886,805	3,272,363	858,344	(4,131,283)	1,886,229
Total liabilities and shareholders' equity	\$ 4,194,364	\$ 6,653,767	\$ 958,820	\$ (7,151,203)	\$ 4,655,748
<b>Three Months Ended March 31, 2010</b>					
<b>Condensed Consolidating Statement of Income</b>					
Net revenues	\$	\$ 585,378	\$ 6,945	\$	\$ 592,323
Total operating expenses	22,878	470,833	6,261		499,972
(Loss) income from operations	(22,878)	114,545	684		92,351
Other income (expenses)	11,407	(46,873)	(829)		(36,295)
(Loss) income from operations before income taxes	(11,471)	67,672	(145)		56,056
Taxes on income	(9,902)	33,627	(3,824)		19,901
Net (loss) income including noncontrolling interests	(1,569)	34,045	3,679		36,155
Less: Net loss attributable to noncontrolling interests			(9)		(9)
Net (loss) income attributable to the shareholders of Penn National Gaming, Inc. and subsidiaries	\$ (1,569)	\$ 34,045	\$ 3,688	\$	\$ 36,164
<b>Three Months Ended March 31, 2010</b>					
<b>Condensed Consolidating Statement of Cash Flows</b>					
Net cash provided by (used in) operating activities	\$ 68,158	\$ 33,155	\$ (7,577)	\$	\$ 93,736
Net cash used in investing activities	(792)	(36,644)	(79,593)		(117,029)
Net cash used in financing activities	(47,299)	(19)			(47,318)
Net increase (decrease) in cash and cash equivalents	20,067	(3,508)	(87,170)		(70,611)
Cash and cash equivalents at beginning of year	6,385	145,519	561,214		713,118
Cash and cash equivalents at end of period	\$ 26,452	\$ 142,011	\$ 474,044	\$	\$ 642,507
<b>At December 31, 2009</b>					
<b>Condensed Consolidating Balance Sheet</b>					
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
<b>Three Months Ended March 31, 2009</b>					

**Condensed Consolidating Statement of Income**

Net revenues	\$		\$	605,023	\$	7,203	\$	612,226
Total operating expenses		22,907		480,942		7,542		511,391
(Loss) income from operations		(22,907)		124,081		(339)		100,835
Other income (expenses)		19,651		(49,445)		3,436		(26,358)
(Loss) income from operations before income taxes		(3,256)		74,636		3,097		74,477
Taxes on income		(7,467)		39,458		1,825		33,816
Net income including noncontrolling interests		4,211		35,178		1,272		40,661
Less: Net loss attributable to noncontrolling interests								
Net income attributable to the shareholders of Penn National Gaming, Inc. and subsidiaries	\$	4,211	\$	35,178	\$	1,272	\$	40,661

**Three Months Ended March 31, 2009****Condensed Consolidating Statement of Cash Flows**

Net cash provided by operating activities	\$	56,013	\$	38,748	\$	9,352	\$	104,113
Net cash used in investing activities		(1,381)		(60,949)		(33)		(62,363)
Net cash used in financing activities		(36,382)		(348)		(13,062)		(49,792)
Net increase (decrease) in cash and cash equivalents		18,250		(22,549)		(3,743)		(8,042)
Cash and cash equivalents at beginning of year		2,460		142,104		601,714		746,278
Cash and cash equivalents at end of period	\$	20,710	\$	119,555	\$	597,971	\$	738,236

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**14. 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 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 March 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):

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	March 31, 2010		December 31, 2009	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
<b>Financial assets:</b>				
Cash and cash equivalents	\$ 642,507	\$ 642,507	\$ 713,118	\$ 713,118
Investment in corporate debt securities	4,655	4,655	4,550	4,550
<b>Financial liabilities:</b>				
Long-term debt				
Senior secured credit facility	\$ 1,723,673	\$ 1,723,673	\$ 1,755,602	\$ 1,755,602
Senior subordinated notes	575,000	579,000	575,000	572,375
Capital leases	4,155	4,155	4,175	4,175
Interest rate swap contracts	40,599	40,599	43,925	43,925

See Note 15 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.

### 15. 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.

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- 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 sheets at March 31, 2010 and 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)	March 31, 2010 Total
<b>Assets:</b>					
Investment in corporate debt securities	Other assets	\$ 4,655	\$	\$	\$ 4,655
<b>Liabilities:</b>					
Interest rate swap contracts	Accrued interest		40,599		40,599

	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
<b>Assets:</b>					
Investment in corporate debt securities	Other assets	\$ 4,550	\$	\$	\$ 4,550
<b>Liabilities:</b>					
Interest rate swap contracts	Accrued interest		43,925		43,925

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 14 for a description of the inputs used in calculating the fair value measurements of investment in corporate debt securities and interest rate swap contracts.

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 \$0.1 million and \$11.9 million during the three months ended March 31, 2010 and the year ended December 31, 2009, respectively. 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 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 tables set forth the assets and liabilities measured at fair value on a nonrecurring basis, by input level, in the consolidated balance sheets at March 31, 2010 and December 31, 2009 (in thousands):



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	<b>Balance Sheet Location</b>	<b>Quoted Prices in Active Markets for Identical Assets or Liabilities (Level 1)</b>	<b>Significant Other Observable Inputs (Level 2)</b>	<b>Significant Unobservable Inputs (Level 3)</b>	<b>March 31, 2010 Total</b>	<b>Total Reduction in Fair Value Recorded at March 31, 2010</b>
<b>Assets:</b>						
Long-lived assets	Other assets	\$	\$ 6,750	\$	\$ 6,750	\$ (136)
						\$ (136)

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	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 contained in the Annual Report on Form 10-K for the year ended December 31, 2009 for a description of the inputs used in calculating the fair value measurements of goodwill, indefinite-life intangible assets and long-lived assets.

**16. 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.

At that time, 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 the Empress Casino Hotel 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 three months ended March 31, 2010 and 2009, the Company recorded a \$0.1 million and \$5.4 million pre-tax loss, respectively, 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.

The \$13.7 million and \$33.5 million insurance receivable within the consolidated balance sheets at March 31, 2010 and December 31, 2009, respectively, was limited to the net book value of assets believed to be damaged, destroyed or abandoned and other costs incurred as a result of the fire at Empress Casino Hotel that are expected to be recovered via the insurance claim. During the three months ended March 31, 2010 and the year ended December 31, 2009, the Company received \$20.0 million and \$20.6 million, respectively, in insurance proceeds related to the fire at Empress Casino Hotel.

**17. Acquisition**

On March 8, 2010, the Company announced that it had entered into a definitive agreement to purchase Beulah Park in Grove City, Ohio from Heartland Jockey Club Ltd. Located on approximately 210 acres just outside 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 lounge and four dining options. The acquisition of Beulah Park is subject to the approval of the Ohio State Racing Commission.

**18. 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 March 31, 2010 that required recognition or disclosure in the consolidated financial statements, except for those disclosed below.

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 in Columbus's West Side. As a result of the election, the Company will initiate the process to sell the parcel of land that it had purchased in Columbus's Arena District, and will classify that land as an asset held for sale. In addition, the Company will review the fair market value of the parcel of land

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that it had purchased in Columbus's Arena District, and will record the parcel of land at its fair market value less costs to sell during the second quarter of 2010. An estimate of any potential charge cannot currently be made.

On May 7, 2010, the Company announced that it had agreed to establish a joint venture with MI Developments, Inc. (MI Developments) to own and operate the Maryland Jockey Club. Under the terms of the joint venture, the Company and MI Developments will work collaboratively to strengthen and enhance the racing operations at Laurel Park and Pimlico, to maximize the use and value of the Maryland Jockey Club's real estate assets and to pursue other opportunities, including the potential for gaming, to maximize the overall value of the business. Pimlico Race Course, opened in 1870, is the country's second oldest racetrack and 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. Pimlico Race Course features a one-mile oval track, a 7/8-mile turf course and fixed seating for approximately 15,000 spectators. Laurel Park, the sister track to Pimlico, opened in 1911 and hosts a 3½ month winter meet beginning in January as well as a four month fall meet beginning in September. Laurel Park features a 1 1/8 mile oval track and a one mile turf course with fixed seating for approximately 5,000 spectators. The closing of the transaction is subject to approvals from the Maryland Racing Commission and the satisfaction of certain other customary closing conditions.

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**ITEM 2. 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. We currently own or manage 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. We believe that our portfolio of assets provides us with a 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, 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 vast majority of our revenues is gaming revenue, derived primarily from gaming on slot machines and, to a lesser extent, table games. 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 off-track wagering facilities.

We intend to continue to expand our gaming operations through the implementation of a disciplined capital expenditure program at our existing properties and the continued pursuit of strategic acquisitions and the development of gaming properties, particularly in attractive regional markets. Current capital projects are ongoing at several of our existing properties, including Empress Casino Hotel, Charles Town Entertainment Complex, Hollywood Casino at Penn National Race Course, and Hollywood Casino Perryville, as well as at our proposed facilities in Kansas and Ohio.

Key performance indicators related to gaming revenue are slot handle (volume indicator), table game drop (volume indicator) and win or hold percentages. 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 15% 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.

**Executive Summary**

Factors affecting our results for the three months ended March 31, 2010, as compared to the three months ended March 31, 2009, included the impact of inclement weather, decreases in consumer spending on gaming activities caused by current economic conditions, the continued impact of the opening of the new casino riverboat in late June 2009 at Hollywood Casino Lawrenceburg, the continued growth at Hollywood Casino at Penn National Race Course, decreased general and administrative expense, the fire at Empress Casino Hotel in March 2009, increased depreciation and amortization expense, increased interest expense, foreign currency translation losses, and decreased interest income.

*Financial Highlights:*

- Income from operations decreased by \$8.5 million, or 8.4%, for the three months ended March 31, 2010, as compared to the three months ended March 31, 2009, primarily due to the impact of inclement weather, decreases in consumer spending on gaming activities caused by current economic conditions, and increased depreciation and amortization expense, all of which were partially offset by the continued impact of the opening of the new casino riverboat in late June 2009 at Hollywood Casino Lawrenceburg, the continued growth at Hollywood Casino at Penn National Race Course, a decrease in general and administrative expense, and the fire at Empress Casino Hotel in March 2009.

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- Net income attributable to the shareholders of Penn National Gaming, Inc. and subsidiaries decreased by \$4.5 million, or 11.1%, for the three months ended March 31, 2010, as compared to the three months ended March 31, 2009, primarily due to the variances explained above, increases in interest expense and loss from unconsolidated affiliates, and decreases in interest income and income taxes.

*Other Developments:*

- On May 7, 2010, we announced that we had agreed to establish a joint venture with MI Developments, Inc. ( MI Developments ) to own and operate the Maryland Jockey Club. Under the terms of the joint venture, we and MI Developments will work collaboratively to strengthen and enhance the racing operations at Laurel Park and Pimlico, to maximize the use and value of the Maryland Jockey Club's real estate assets and to pursue other opportunities, including the potential for gaming, to maximize the overall value of the business. Pimlico Race Course, opened in 1870, is the country's second oldest racetrack and 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. Pimlico Race Course features a one-mile oval track, a 3/8-mile turf course and fixed seating for approximately 15,000 spectators. Laurel Park, the sister track to Pimlico, opened in 1911 and hosts a 3½ month winter meet beginning in January as well as a four month fall meet beginning in September. Laurel Park features a 1 1/8 mile oval track and a one mile turf course with fixed seating for approximately 5,000 spectators. The closing of the transaction is subject to approvals from the Maryland Racing Commission and the satisfaction of certain other customary closing conditions.

- On May 4, 2010, in a statewide election in Ohio, the voters determined that our casino in Columbus will be located at the site of the former Delphi Automotive plant in Columbus's West Side. As a result of the election, we will initiate the process to sell the parcel of land that we had purchased in Columbus's Arena District, and will classify that land as an asset held for sale. In addition, we will review the fair market value of the parcel of land that we had purchased in Columbus's Arena District, and will record the parcel of land at its fair market value less costs to sell during the second quarter of 2010. An estimate of any potential charge cannot currently be made. In February 2010, we completed the purchase of the 123-acre site of the former Delphi Automotive plant in Columbus's West Side as an alternate location for our planned development of Hollywood Casino Columbus. In January 2010, we purchased the approximately 18-acre location approved as part of the amendment to Ohio's Constitution in Columbus's Arena District. However, we agreed to consider alternate sites at the request of public officials and others in the Columbus community. In January 2010, the Ohio Legislature approved the language for a Constitutional amendment changing the designated casino location in Columbus to the Delphi site. Plans are currently being developed for a \$400 million Hollywood-themed casino in Columbus, Ohio, inclusive of \$50 million in licensing fees. Hollywood Casino Columbus is expected to feature a 180,000 square foot casino, up to 4,000 slot machines, 100 table games and 25 poker tables, a 4,000 parking space garage, as well as food and beverage outlets and an entertainment lounge. Hollywood Casino Columbus is estimated to be completed in the second half of 2012. In December 2009, we announced that we had completed the purchase of a 44-acre site in Toledo, Ohio that was expressly authorized for casino gaming as part of the amendment to Ohio's Constitution. Plans are also currently being developed for a \$300 million Hollywood-themed casino in Toledo, Ohio, inclusive of \$50 million in licensing fees. Hollywood Casino Toledo is expected to feature a 125,000 square foot casino, up to 3,000 slot machines, 80 table games and 20 poker tables, a 2,500 parking space garage, as well as food and beverage outlets and an entertainment lounge. Hollywood Casino Toledo is estimated to be completed in the second half of 2012.

- In April 2010, we announced that Charles Town Entertainment Complex will be renamed Hollywood Casino at Charles Town Races. The name change will occur in July 2010, as the property transitions to a full casino with the introduction of table games and other new amenities. In December 2009, we announced that we intend to install table games at Charles Town Entertainment Complex following voter approval of table games in the December 5, 2009 special election. Plans currently include the estimated addition of 85 table games and 27 poker tables, a high-end steakhouse/lounge, and a Hollywood on the Roof entertainment lounge. The table games, poker tables and the entertainment lounge are expected to be completed in the third quarter of 2010, and the high-end steakhouse/lounge is expected to be completed in the fourth quarter of 2010.

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- In March 2010, we repurchased 225 shares of Series B Redeemable Preferred Stock (the Preferred Stock ) for \$11.2 million.
- In March 2010, we announced that we had entered into a definitive agreement to purchase Beulah Park in Grove City, Ohio from Heartland Jockey Club Ltd. Located on approximately 210 acres just outside 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 lounge and four dining options. The acquisition of Beulah Park is subject to the approval of the Ohio State Racing Commission.
- In February 2010, Kansas Entertainment, LLC ( 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 Hollywood-themed destination facility overlooking Turn 2 at Kansas Speedway. Kansas Entertainment will begin construction of the facility in the second quarter of 2010 with a planned opening in early 2012. The \$410 million facility, inclusive of licensing fees, is expected to feature a 100,000 square foot casino with capacity for 2,300 slot machines, 61 table games and 25 poker tables, a 1,500 parking structure, as well as a variety of dining and entertainment amenities. We, along with our partner in Kansas Entertainment, International Speedway Corporation ( International Speedway ), will share equally the cost of developing and constructing the proposed facility, and intend to jointly seek third party financing for the



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project. If such third party financing cannot be obtained on satisfactory terms, we and International Speedway are prepared to finance the project. We estimate that our share of the project will be approximately \$155 million.

- In January 2010, the Pennsylvania legislature passed legislation permitting table games for gaming licensees. We intend to install table games at Hollywood Casino at Penn National Race Course in two phases. Phase I includes the addition of an estimated 40 table games and 12 poker tables within the existing facility, and is expected to be completed in the third quarter of 2010.
- In October 2009, the Maryland Video Lottery Facility Location Commission selected us to develop and manage a video lottery terminal facility in Cecil County, Maryland. Following our selection, we exercised our option and completed the purchase of approximately 36 acres of land located in Perryville, Maryland, and commenced construction of a \$97.5 million Hollywood-themed facility, inclusive of licensing fees of \$9.0 million. The new facility will feature 75,000 square feet of gaming space, 1,500 video lottery terminals, food and beverage offerings, and parking for over 1,600 vehicles. The facility is expected to open to the public in the fourth quarter of 2010.
- On March 20, 2009, 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 we began construction of a new land-based pavilion. At that time, 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 the Empress Casino Hotel 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 three months ended March 31, 2010 and 2009, we recorded a \$0.1 million and \$5.4 million pre-tax loss, respectively, 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. During the three months ended March 31, 2010 and the year ended December 31, 2009, we received \$20.0 million and \$20.6 million, respectively, in insurance proceeds related to the fire at Empress Casino Hotel.
- Current capital projects are ongoing at several of our existing properties, including Empress Casino Hotel, Charles Town Entertainment Complex, Hollywood Casino at Penn National Race Course, and Hollywood Casino Perryville, as well as at our proposed facilities in Kansas and Ohio. Additional information regarding our capital projects is discussed in detail in the section entitled "Liquidity and Capital Resources - Capital Expenditures" below.

**Critical Accounting Policies**

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 policies related to the accounting for long-lived assets, goodwill and other intangible assets, income taxes and litigation, claims and assessments as critical accounting policies, which require us to make significant judgments, estimates and assumptions.

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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 policies, and the related disclosures, have been reviewed with the Audit Committee of our Board of Directors.

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*Long-lived assets*

At March 31, 2010, we had a net property and equipment balance of \$1,909.2 million within our consolidated balance sheet, representing 41.0% 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 March 31, 2010, we had \$1,378.6 million in goodwill and \$375.3 million in other intangible assets within our consolidated balance sheet, representing 29.6% and 8.1% 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, 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 Accounting Standards Codification (ASC) 350, Intangibles-Goodwill and Other, we consider our 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. We use 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 unconsolidated affiliates) multiples, as we believe that EBITDA is a widely-used measure of performance in the gaming industry and as we use EBITDA as the primary measurement of the operating performance of our properties (including the evaluation of operating personnel). In addition, we believe 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 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, including the management service contract for Casino Rama, 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.

*Income taxes*

At March 31, 2010, we had a net deferred tax liability balance of \$111.8 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.

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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 March 31, 2010, we had a liability for unrecognized tax benefits of \$36.7 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 property openings in Pennsylvania and Maine, as well as the anticipated openings in Maryland, Kansas and Ohio) 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 Illinois, Colorado and Pennsylvania smoking bans that became effective on January 1, 2008).
- 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, Ohio and Maryland) and potential competitive threats to business at our existing properties (such as the potential introduction of commercial casinos in Kansas, Maryland, Ohio, and Kentucky, an additional gaming license in Illinois, and the introduction of tavern licenses in several states). We also face uncertainty regarding anticipated gaming expansion by a potential competitor in Baton Rouge, Louisiana. Legalized gaming from Native American casinos can also have a significant competitive effect.

- The continued demand for, and our emphasis on, slot wagering entertainment at our properties.
- The closing of Empress Casino Hotel from March 20, 2009 until June 25, 2009 due to a fire, and the timing of the recognition of insurance proceeds relating to the insurance claim.
- 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.

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The results of operations for the three months ended March 31, 2010 and 2009 are summarized below:

	Three Months Ended March 31,	
	2010	2009
	(in thousands)	
<b>Revenues:</b>		
Gaming	\$ 543,373	\$ 559,903
Management service fee	3,194	3,033
Food, beverage and other	80,432	84,622
Gross revenues	626,999	647,558
Less promotional allowances	(34,676)	(35,332)
Net revenues	592,323	612,226
<b>Operating expenses:</b>		
Gaming	290,861	297,562
Food, beverage and other	63,220	64,529
General and administrative	94,516	99,470
Impairment loss for replaced Lawrenceburg vessel	136	
Empress Casino Hotel fire	59	5,400
Depreciation and amortization	51,180	44,430
Total operating expenses	499,972	511,391
Income from operations	\$ 92,351	\$ 100,835

The results of operations by property for the three months ended March 31, 2010 and 2009 are summarized below:

Three Months Ended March 31,	Net Revenues		Income (loss) from Operations	
	2010	2009	2010	2009
	(in thousands)			
Charles Town Entertainment Complex	\$ 103,215	\$ 117,904	\$ 22,081	\$ 27,821
Hollywood Casino Lawrenceburg	111,046	101,501	24,286	26,448
Hollywood Casino at Penn National Race Course	75,610	72,955	6,816	6,626
Hollywood Casino Aurora	43,989	48,754	10,999	13,448
Empress Casino Hotel	36,044	32,869	6,021	(858)
Argosy Casino Riverside	48,719	50,295	14,340	14,526
Hollywood Casino Baton Rouge	30,549	35,089	9,491	12,508
Argosy Casino Alton	18,618	20,599	2,786	3,567
Hollywood Casino Tunica	22,362	24,410	4,979	4,676
Hollywood Casino Bay St. Louis	21,330	25,989	482	2,581
Argosy Casino Sioux City	14,674	13,917	4,425	3,879
Boomtown Biloxi	18,207	19,943	2,188	3,851
Hollywood Slots Hotel and Raceway	16,225	14,365	(407)	(853)
Bullwhackers	4,883	4,852	(600)	(468)
Black Gold Casino at Zia Park	20,626	22,346	6,034	7,117
Casino Rama management service contract	3,194	3,033	2,809	2,734
Raceway Park	1,311	1,489	(238)	(266)
Sanford-Orlando Kennel Club	1,721	1,916	67	156
Unconsolidated affiliates				
Corporate overhead			(24,208)	(26,658)
<b>Total</b>	<b>\$ 592,323</b>	<b>\$ 612,226</b>	<b>\$ 92,351</b>	<b>\$ 100,835</b>





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Revenues for the three months ended March 31, 2010 and 2009 were as follows (in thousands):

Three Months Ended March 31,	2010		2009		Variance	Percentage Variance
Gaming	\$	543,373	\$	559,903	\$ (16,530)	(3.0)%
Management service fee		3,194		3,033	161	5.3%
Food, beverage and other		80,432		84,622	(4,190)	(5.0)%
Gross revenues		626,999		647,558	(20,559)	(3.2)%
Less promotional allowances		(34,676)		(35,332)	656	(1.9)%
Net revenues	\$	592,323	\$	612,226	\$ (19,903)	(3.3)%

*Gaming revenue*

Gaming revenue decreased by \$16.5 million, or 3.0%, for the three months ended March 31, 2010, as compared to the three months ended March 31, 2009, primarily due to decreases at several of our properties, which were partially offset by increases at Hollywood Casino Lawrenceburg and Hollywood Casino at Penn National Race Course.

Gaming revenue at Charles Town Entertainment Complex decreased by \$13.4 million for the three months ended March 31, 2010, as compared to the three months ended March 31, 2009, primarily due to the impact of inclement weather.

Gaming revenue at Hollywood Casino Aurora decreased by \$4.6 million for the three months ended March 31, 2010, as compared to the three months ended March 31, 2009, primarily due to decreases in consumer spending on gaming activities caused by current economic conditions.

Gaming revenue at Hollywood Casino Baton Rouge decreased by \$4.5 million for the three months ended March 31, 2010, as compared to the three months ended March 31, 2009, primarily due to decreases in consumer spending on gaming activities caused by current economic conditions.

Gaming revenue at Hollywood Casino Bay St. Louis decreased by \$4.1 million for the three months ended March 31, 2010, as compared to the three months ended March 31, 2009, primarily due to decreases in consumer spending on gaming activities caused by current economic conditions as well as competitive pressures.

Gaming revenue at Hollywood Casino Lawrenceburg increased by \$8.2 million for the three months ended March 31, 2010, as compared to the three months ended March 31, 2009, primarily due to the continued impact of the opening of the new casino riverboat in late June 2009 and

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additional revenue from the World Poker Tour® event held at Hollywood Casino Lawrenceburg in March 2010.

Gaming revenue at Hollywood Casino at Penn National Race Course increased by \$5.5 million for the three months ended March 31, 2010, as compared to the three months ended March 31, 2009, primarily due to the continued growth from a new gaming market.

### *Food, beverage and other revenue*

Food, beverage and other revenue decreased by \$4.2 million, or 5.0%, for the three months ended March 31, 2010, as compared to the three months ended March 31, 2009, primarily due to decreases at Hollywood Casino at Penn National Race Course, Charles Town Entertainment Complex and Hollywood Casino Bay St. Louis.

Food, beverage and other revenue at Hollywood Casino at Penn National Race Course decreased by \$1.9 million for the three months ended March 31, 2010, as compared to the three months ended March 31, 2009, primarily due to the impact of inclement weather on its racing operations.

Food, beverage and other revenue at Charles Town Entertainment Complex decreased by \$1.4 million for the three months ended March 31, 2010, as compared to the three months ended March 31, 2009, primarily due to the impact of inclement weather.

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Food, beverage and other revenue at Hollywood Casino Bay St. Louis decreased by \$1.2 million for the three months ended March 31, 2010, as compared to the three months ended March 31, 2009, primarily due to decreases in consumer spending on gaming activities caused by current economic conditions as well as competitive pressures.

### Operating Expenses

Operating expenses for the three months ended March 31, 2010 and 2009 were as follows (in thousands):

Three Months Ended March 31,	2010	2009	Variance	Percentage Variance
Gaming	\$ 290,861	\$ 297,562	\$ (6,701)	(2.3)%
Food, beverage and other	63,220	64,529	(1,309)	(2.0)%
General and administrative	94,516	99,470	(4,954)	(5.0)%
Impairment loss for replaced Lawrenceburg vessel	136		136	100.0%
Empress Casino Hotel fire	59	5,400	(5,341)	(98.9)%
Depreciation and amortization	51,180	44,430	6,750	15.2%
Total operating expenses	\$ 499,972	\$ 511,391	\$ (11,419)	(2.2)%

### *Gaming expense*

Gaming expense decreased by \$6.7 million, or 2.3%, for the three months ended March 31, 2010, as compared to the three months ended March 31, 2009, primarily due to decreases at several of our properties, which were partially offset by increases at Hollywood Casino Lawrenceburg and Hollywood Casino at Penn National Race Course.

Gaming expense at Charles Town Entertainment Complex decreased by \$8.8 million for the three months ended March 31, 2010, as compared to the three months ended March 31, 2009, primarily due to a decrease in gaming taxes resulting from lower gaming revenue.

Gaming expense at Hollywood Casino Aurora decreased by \$2.6 million for the three months ended March 31, 2010, as compared to the three months ended March 31, 2009, primarily due to a decrease in gaming taxes resulting from lower gaming revenue, which was partially offset by increased marketing expenses.

Gaming expense at Hollywood Casino Baton Rouge decreased by \$1.9 million for the three months ended March 31, 2010, as compared to the three months ended March 31, 2009, primarily due to a decrease in gaming taxes resulting from lower gaming revenue.

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Gaming expense at Hollywood Casino Bay St. Louis decreased by \$1.3 million for the three months ended March 31, 2010, as compared to the three months ended March 31, 2009, primarily due to a decrease in gaming taxes resulting from lower gaming revenue.

Gaming expense at Hollywood Casino Lawrenceburg increased by \$6.1 million for the three months ended March 31, 2010, as compared to the three months ended March 31, 2009, primarily due to an increase in gaming taxes resulting from higher gaming revenue and increased marketing expenses.

Gaming expense at Hollywood Casino at Penn National Race Course increased by \$2.3 million for the three months ended March 31, 2010, as compared to the three months ended March 31, 2009, primarily due to an increase in gaming taxes resulting from higher gaming revenue.

### *Food, beverage and other expense*

Food, beverage and other expense decreased by \$1.3 million, or 2.0%, for the three months ended March 31, 2010, as compared to the three months ended March 31, 2009, primarily due to a decrease at Hollywood Casino at Penn National Race Course.

Food, beverage and other expense at Hollywood Casino at Penn National Race Course decreased by \$1.3 million for the three months ended March 31, 2010, as compared to the three months ended March 31, 2009, primarily due to the impact of inclement weather on its racing operations.

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*General and administrative expense*

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

General and administrative expense decreased by \$5.0 million, or 5.0%, for the three months ended March 31, 2010, as compared to the three months ended March 31, 2009, primarily due to decreases in corporate overhead expense and at Hollywood Casino Bay St. Louis and Hollywood Casino Tunica.

Corporate overhead expense decreased by \$2.6 million for the three months ended March 31, 2010, as compared to the three months ended March 31, 2009, primarily due to the expensing of equity-based compensation awards having decreased by \$2.1 million.

General and administrative expense at Hollywood Casino Bay St. Louis decreased by \$1.0 million for the three months ended March 31, 2010, as compared to the three months ended March 31, 2009, primarily due to decreased payroll and insurance claim costs.

General and administrative expense at Hollywood Casino Tunica decreased by \$0.9 million for the three months ended March 31, 2010, as compared to the three months ended March 31, 2009, primarily due to lower payroll and property operation expenses.

*Empress Casino Hotel fire*

As a result of the Empress Casino Hotel fire, during the three months ended March 31, 2010 and 2009, we recorded a \$0.1 million and \$5.4 million pre-tax loss, respectively, 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.

*Depreciation and amortization expense*

Depreciation and amortization expense increased by \$6.8 million, or 15.2%, for the three months ended March 31, 2010, as compared to the three months ended March 31, 2009, primarily due to increases at Hollywood Casino Lawrenceburg and Hollywood Casino at Penn National Race Course.

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Depreciation and amortization expense at Hollywood Casino Lawrenceburg increased by \$5.0 million for the three months ended March 31, 2010, as compared to the three months ended March 31, 2009, primarily due to the opening of the new casino riverboat in late June 2009.

Depreciation and amortization expense at Hollywood Casino at Penn National Race Course increased by \$1.9 million for the three months ended March 31, 2010, as compared to the three months ended March 31, 2009, primarily due to incremental depreciation expense being recorded during the three months ended March 31, 2010.

### Other income (expenses)

Other income (expenses) for the three months ended March 31, 2010 and 2009 were as follows (in thousands):

Three Months Ended March 31,	2010		2009		Variance	Percentage Variance
Interest expense	\$	(34,292)	\$	(31,238)	\$ (3,054)	(9.8)%
Interest income		730		3,091	(2,361)	(76.4)%
Loss from unconsolidated affiliates		(1,412)		(303)	(1,109)	(366.0)%
Other		(1,321)		2,092	(3,413)	(163.1)%
Total other expenses	\$	(36,295)	\$	(26,358)	\$ (9,937)	(37.7)%

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*Interest expense*

Interest expense increased by \$3.1 million, or 9.8%, for the three months ended March 31, 2010, as compared to the three months ended March 31, 2009, primarily due to incremental interest expense due to the issuance of the \$325 million 83/4% senior subordinated notes in August 2009, increased interest expense resulting from interest rate swaps, and lower capitalized interest during the three months ended March 31, 2010, all of which were partially offset by decreased interest expense resulting from lower outstanding balances and lower interest rates on our senior secured credit facility and the redemption of the 67/8% senior subordinated notes in late 2009.

*Interest income*

Interest income decreased by \$2.4 million, or 76.4%, for the three months ended March 31, 2010, as compared to the three months ended March 31, 2009, primarily due to the partial sale of our investment in corporate debt securities in the second quarter of 2009.

*Loss from unconsolidated affiliates*

Loss from unconsolidated affiliates increased by \$1.1 million, or 366.0%, for the three months ended March 31, 2010, as compared to the three months ended March 31, 2009, primarily due to our share of losses in Kansas Entertainment for the three months ended March 31, 2010.

*Other*

Other decreased by \$3.4 million, or 163.1%, for the three months ended March 31, 2010, as compared to the three months ended March 31, 2009, primarily due to foreign currency translation losses that were recorded during the three months ended March 31, 2010.

*Taxes*

Our effective tax rate (income taxes as a percentage of income from operations before income taxes) decreased to 35.5% for the three months ended March 31, 2010, as compared to 45.4% for the three months ended March 31, 2009, primarily as we received a favorable resolution for an uncertain tax position during the three months ended March 31, 2010.

Our effective 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 of pre-tax earnings, are taken into account in assessing our

ability to realize our net deferred tax assets. We expect our effective tax rate to normalize for the year ending December 31, 2010.

### **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 decreased by \$10.4 million for the three months ended March 31, 2010, as compared to the three months ended March 31, 2009, primarily due to lower net income including noncontrolling interests, higher accrued interest payments resulting from the issuance of the \$325 million 83/4% senior subordinated notes in August 2009, increased bonus payments, and higher tax payments as we received a favorable resolution for an uncertain tax position, all of which were partially offset by increased depreciation and amortization expense at Hollywood Casino Lawrenceburg primarily due to the opening of the new casino riverboat in late June 2009. Net cash provided by operating activities for the three months ended March 31, 2010 included non-cash reconciling items, such as depreciation, amortization, and the charge for stock compensation, of \$67.3 million, and net income including noncontrolling interests of \$36.2 million, partially offset by net changes in asset and liability accounts of \$9.8 million.

Net cash used in investing activities increased by \$54.7 million for the three months ended March 31, 2010, as compared to the three months ended March 31, 2009, primarily due to increased expenditures for property and equipment primarily due to the purchase of land for our proposed facility in Columbus, Ohio. Net cash used in investing activities for the three months ended March 31, 2010 included expenditures for property and equipment totaling \$120.4 million and investment in Kansas Entertainment of \$13.5 million, both of which were partially offset by decrease in cash in escrow of \$11.0 million and proceeds from the sale of property and equipment and insurance proceeds received as a result of the Empress Casino Hotel fire totaling \$1.1 million and \$4.8 million, respectively.



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Net cash used in financing activities decreased by \$2.5 million for the three months ended March 31, 2010, as compared to the three months ended March 31, 2009. Net cash used in financing activities for the three months ended March 31, 2010 included the repurchase of Preferred Stock for \$11.2 million, principal payments on long-term debt and payments on insurance financing totaling \$65.9 million and \$4.2 million, respectively, and the tax impact from stock options exercised totaling \$0.7 million. All of these were partially offset by proceeds from the exercise of stock options totaling \$0.8 million and proceeds from the issuance of long-term debt of \$33.9 million.

*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 expected capital project expenditures by property for the fiscal year ending December 31, 2010, and actual expenditures for the three months ended March 31, 2010 (excluding licensing fees):

Property	Expected for Year Ending December 31, 2010	Our Share of Expected for Year Ending December 31, 2010	Expenditures for Three Months Ended March 31, 2010	Our Share of Expenditures for Three Months Ended March 31, 2010	Balance to Expend in 2010	Our Share of Balance to Expend in 2010
Hollywood Casino Lawrenceburg	\$ 14.9	\$ 14.9	\$ 5.0	\$ 5.0	\$ 9.9	\$ 9.9
Empress Casino Hotel (1)	63.5	63.5	11.0	11.0	52.5	52.5
Charles Town Entertainment Complex	38.6	38.6	2.2	2.2	36.4	36.4
Hollywood Casino at Penn National Race Course	8.9	8.9	0.6	0.6	8.3	8.3
Hollywood Casino Perryville	67.1	67.1	5.7	5.7	61.4	61.4
Hollywood Casino Columbus	84.0	75.6	68.1	61.3	15.9	14.3
Hollywood Casino Toledo	14.8	13.3	0.2	0.2	14.6	13.1
Other	17.0	17.0	3.0	3.0	14.0	14.0
<b>Total</b>	<b>\$ 308.8</b>	<b>\$ 298.9</b>	<b>\$ 95.8</b>	<b>\$ 89.0</b>	<b>\$ 213.0</b>	<b>\$ 209.9</b>

(1) Net of anticipated amounts to be received from insurance proceeds.

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At Hollywood Casino Lawrenceburg, new meeting space partially opened in December 2009 and was fully completed in February 2010. In addition, a new steakhouse/lounge was opened in April 2010. A new mid-priced restaurant is scheduled for completion in the third quarter of 2010.

At Empress Casino Hotel, we started the facility enhancements in late 2008. On March 20, 2009, 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 we began construction of a new land-based pavilion. Construction on a new 1,100 space parking garage was completed in February 2010. The permanent land-based pavilion is expected to be completed in the fourth quarter of 2010 and upgrades to the gaming vessel and other areas are expected to be completed by the first quarter of 2011.

In December 2009, we announced that we intend to install table games at Charles Town Entertainment Complex following voter approval of table games in the December 5, 2009 special election. Plans currently include the estimated addition of 85 table games and 27 poker tables, a high-end steakhouse/lounge, and a Hollywood on the Roof entertainment lounge. The table games, poker tables and the entertainment lounge are expected to be completed in the third quarter of 2010, and the high-end steakhouse/lounge is expected to be completed in the fourth quarter of 2010.

In January 2010, the Pennsylvania legislature passed legislation permitting table games for gaming licensees. We intend to install table games at Hollywood Casino at Penn National Race Course in two phases. Phase I includes the addition of an estimated 40 table games and 12 poker tables within the existing facility, and is expected to be completed in the third quarter of 2010.

In Cecil County, Maryland, following our selection by the Maryland Video Lottery Facility Location Commission to develop and manage a video lottery terminal facility in 2009, we exercised our option and completed the purchase of

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approximately 36 acres of land located in Perryville, Maryland, and commenced construction of a \$97.5 million Hollywood-themed facility, inclusive of licensing fees of \$9.0 million. The new facility will feature 75,000 square feet of gaming space, 1,500 video lottery terminals, food and beverage offerings, and parking for over 1,600 vehicles. The facility is expected to open to the public in the fourth quarter of 2010.

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. Plans are currently being developed for a \$300 million Hollywood-themed casino in Toledo, Ohio, inclusive of \$50 million in licensing fees, and a \$400 million Hollywood-themed casino in Columbus, Ohio, inclusive of \$50 million in licensing fees. Hollywood Casino Toledo is expected to feature a 125,000 square foot casino, up to 3,000 slot machines, 80 table games and 20 poker tables, a 2,500 parking space garage, as well as food and beverage outlets and an entertainment lounge. Hollywood Casino Columbus is expected to feature a 180,000 square foot casino, up to 4,000 slot machines, 100 table games and 25 poker tables, a 4,000 parking space garage, as well as food and beverage outlets and an entertainment lounge. Hollywood Casino Toledo and Hollywood Casino Columbus are estimated to be completed in the second half of 2012.

During the three months ended March 31, 2010, we spent approximately \$24.6 million for capital maintenance expenditures at our properties. The majority of the capital maintenance expenditures were for slot machines and slot machine equipment.

Cash generated from operations and cash available under the revolving credit facility portion of our senior secured credit facility have funded our capital project and capital maintenance expenditures in 2010 to date.

*Debt*

*Senior Secured Credit Facility*

Our 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, we amended our 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.

As of March 31, 2010, \$205.6 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 \$1,723.7 million. During the year ended December 31, 2009, all of the outstanding borrowings under the Term Loan A Facility were repaid.

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During the three months ended March 31, 2010, our senior secured credit facility amount outstanding decreased by \$31.9 million, primarily due to repayments under the revolving credit facility portion of our senior secured credit facility using excess cash from operations.

### *Covenants*

Our senior secured credit facility, \$325 million 8<sup>3</sup>/<sub>4</sub>% and \$250 million 6<sup>3</sup>/<sub>4</sub>% senior subordinated notes require us, 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, our senior secured credit facility, \$325 million 8<sup>3</sup>/<sub>4</sub>% and \$250 million 6<sup>3</sup>/<sub>4</sub>% 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, 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 March 31, 2010, we were in compliance with all required financial covenants.

Table of Contents**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The table below provides information at March 31, 2010 about our financial instruments that are sensitive to changes in interest rates, including debt obligations and interest rate swaps. For debt obligations, the table presents notional amounts maturing during the period and the related weighted-average interest rates at period-end. For interest rate swaps, the table presents notional amounts and weighted-average interest rates outstanding at each period-end. Notional amounts are used to calculate the contractual payments to be exchanged under the contract and the weighted-average variable rates are based on implied forward rates in the yield curve at March 31, 2010.

	4/1/10 - 3/31/11	4/1/11 - 3/31/12	4/1/12 - 3/31/13	4/1/13 - 3/31/14	4/1/14 - 3/31/15	Thereafter	Total	Fair Value 3/31/10
<b>(in thousands)</b>								
<b>Long-term debt:</b>								
Fixed rate	\$	\$	\$	\$	\$ 250,000	\$ 325,000	\$ 575,000	\$ 579,000
Average interest rate					6.75%	8.75%		
Variable rate	\$ 73,588	\$ 742,625	\$ 907,460	\$	\$	\$	\$ 1,723,673	\$ 1,723,673
Average interest rate (1)	3.07%	4.20%	4.79%					
Leases	\$ 1,052	\$ 1,125	\$ 78	\$ 84	\$ 91	\$ 1,725	\$ 4,155	\$ 4,155
Average interest rate	5.68%	5.67%	7.72%	7.72%	7.72%	7.72%		
<b>Interest rate derivatives:</b>								
Interest rate swaps								
Variable to fixed (2)	\$ 1,240,000	\$	\$	\$	\$	\$	N/A	\$ (40,599)
Average pay rate	2.57%						N/A	
Average receive rate (3)	1.82%						N/A	

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

(2) Notional amounts outstanding at each period-end.

(3) Estimated rate, reflective of forward LIBOR.

In accordance with the terms of our senior secured credit facility, we were required to enter into fixed-rate debt or interest rate swap agreements in an amount equal to 50% of our consolidated indebtedness, excluding the revolving credit facility, within 100 days of the closing date of the senior secured credit facility.

**ITEM 4. CONTROLS AND PROCEDURES**

### **Evaluation of Controls and Procedures**

Our management, under the supervision and with the participation of our principal executive officer and principal financial officer, have evaluated the effectiveness of our disclosure controls and procedures as of March 31, 2010, which is the end of the period covered by this Quarterly Report on Form 10-Q. 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 that evaluation, our principal executive officer and principal financial officer have concluded that these disclosure controls and procedures are effective in providing that (a) material information relating to us, including our consolidated subsidiaries, is made known to these officers by other employees of us and our consolidated subsidiaries, particularly material information related to the period for which this periodic report is being prepared; and (b) this information is recorded, processed, summarized, evaluated and reported, as applicable, within the time periods specified in the rules and forms of the United States Securities and Exchange Commission.

### **Changes in Internal Control over Financial Reporting**

There were no changes that occurred during the fiscal quarter covered by this Quarterly Report on Form 10-Q that

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have materially affected, or are reasonable likely to materially affect, our internal controls over financial reporting.

**PART II. OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

Information in response to this Item is incorporated by reference to the information set forth in Note 10: Commitments and Contingencies in the Notes to the Consolidated Financial Statements in Part I of this Quarterly Report on Form 10-Q.

**ITEM 6. EXHIBITS**

<b>Exhibit</b>	<b>Description of Exhibit</b>
10.1	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).
10.2	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).
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.

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\* Filed herewith

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**SIGNATURES**



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

PENN NATIONAL GAMING, INC.

May 7, 2010

By:

/s/ William J. Clifford  
William J. Clifford  
Senior Vice President Finance and Chief Financial  
Officer (Principal Financial Officer)

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