



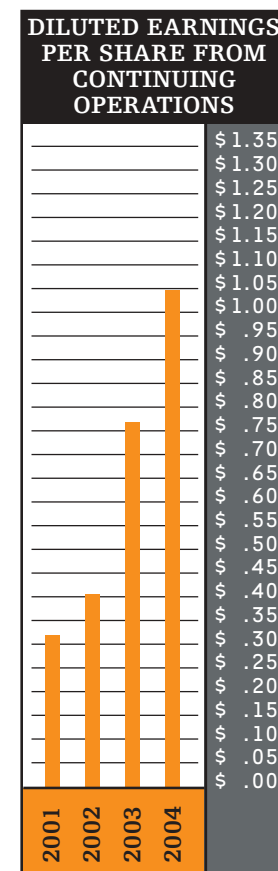
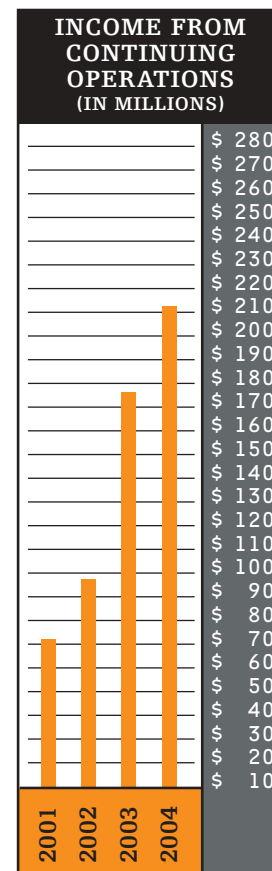
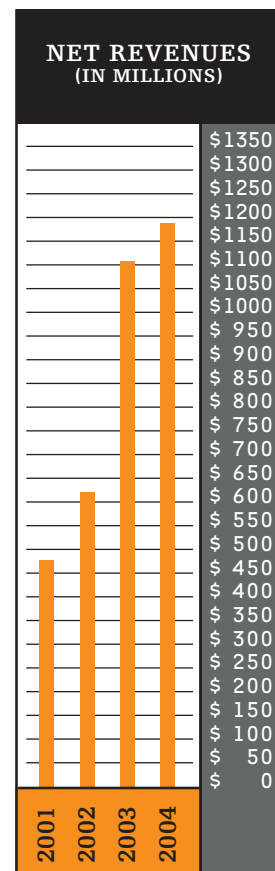
To earn that distinction, we are a company that has earned straight-A ratings, ranked on five year average compound annual total returns through year-end 2004.

We also were in the top 20% of companies evaluated for the past one, three, five and 10 years.

Consolidated Financial Highlights

YEAR ENDED DECEMBER 31,	2001	2002	2003	2004
<i>(In thousands, except per share data)</i>				
Net revenues	\$478,258	\$618,856	\$1,102,998	\$1,140,689
Income from continuing operations	72,103	98,244	176,535	213,780
Income from continuing operating before income taxes	31,578	45,863	99,957	137,628
Net income from continuing operations	20,662	28,329	62,194	87,340
Per share data⁽¹⁾				
Basic				
Net income from continuing operations	\$.34	\$.38	\$.79	\$ 1.09
Diluted				
Net income from continuing operations	\$.32	\$.36	\$.77	\$ 1.05
Weighted shares outstanding				
Basic	61,306	75,550	78,946	80,510
Diluted	63,674	78,188	81,224	83,508
Balance sheet data				
Cash	36,637	54,536	81,567	87,620
Total assets	679,377	765,480	1,609,599	1,643,407
Total debt	458,909	375,018	990,123	858,909
Shareholders' equity	103,265	247,000	309,878	398,092

(1) Reflects March 7, 2005 two-for-one stock split.





It is noteworthy that our success and our forward planning will continue to adhere to a defined set of operating and financial principals that have helped Penn ascend to what will be the third largest gaming operator in the nation. Throughout 2005 we will focus on each of these areas to ensure that we continue to deliver value to our shareholders.



2004 was another very financially successful year for Penn National and one that will prove to be transformational as we laid groundwork for continued growth over the near- and long-term. Specifically, Penn National generated record financial results, made great progress on moving forward with plans to develop new slot facilities at tracks in Pennsylvania and Maine and announced our intention to acquire Argosy Gaming Company.

Our work and success over our first decade as a public company has not gone unnoticed. In its annual "Shareholder Scoreboard," The Wall Street Journal recognized Penn National as number three on their honor roll of best performing companies noting, "Companies that earned straight-A ratings, ranked on five-year average compound annual total returns through year-end 2004. They were in the top 20% of companies evaluated for the past one, three, five and 10 years." The Journal added, "Only one company appeared in the top 25 list of winners in each of the one-year, three-year, five-year and 10-year periods. That was Penn National Gaming, of Wyomissing, PA." Some would think this is a tough act to follow...but we are working on it.

Penn National's record 2004 results included revenue growth of 13%, income from continuing operations growth of 21%, growth in net income from continuing operations of 40% and a rise in diluted earnings per share of 36%. Reflecting the Company's strong overall operating trends, in 2004, Penn National also paid down \$129.7 million of principal on its credit facilities.

Impressive as our results are, the focus at Penn National is, and will remain predicated on the question, What can we achieve tomorrow? In this regard, we rely on the continued application of long-term operating and growth strategies that have been the foundation of our track record of success. The 2004 results and the initiatives to expand and drive further growth remain very consistent with these strategies that have been developed and deployed by Penn National's senior management over the last five years. During this period the Company has grown net income over 11-fold, or at a compound annual growth rate of 61%. Essentially, we seek growth from three areas:

1. Organic – Through careful investment in property upgrades and expansion and the appointment of excellent local management we have been able to derive higher cash flow from existing properties.
2. Jurisdictional/legislative – We deploy an internal team that constantly evaluates and analyzes prospects for legislative change where Penn National's development and property management skills can create new value for the Company and its shareholders.
3. Acquisitions – We identify attractively valued candidates where, through acquisition, we can extend the Company's track record of structuring accretive transactions.

Additionally, we maintain a watchful eye on financing our growth and as such, Penn National has prudently used debt for expansion and carefully managed its capital structure, thereby allowing successful growth to benefit equity holders.

I am pleased to report that our team has developed a number of exciting opportunities that can contribute to the continued expansion of Penn National. The first, of course, is our announced acquisition of Argosy Gaming. Argosy will provide more than \$1 billion of new revenue to Penn National and will also nearly double our EBITDA. Like past major acquisitions, the Argosy transaction is expected to be immediately accretive to our operating results upon closing. Argosy's property portfolio includes six high-quality facilities and we foresee the combined entity benefiting from this broader, deeper base of properties as well as new management resources.

Importantly, like Penn National, Argosy also has several near-term growth and development projects. Argosy's recently-announced acquisition of Raceway Park in Ohio and new expansions in Sioux City, Riverside and Lawrenceburg, are exciting investments that we expect will contribute to future results. Shareholders of Argosy voted to approve the transaction in January and we are in the process of seeking required regulatory approvals and satisfying other conditions to closing that should allow us to complete this deal in the third quarter of 2005.

Also on the horizon are two exciting opportunities in Pennsylvania and Maine. While it appears that the process of creating the regulatory infrastructure to support gaming in Pennsylvania will delay our licensing until late this year, the opening of our new Harrisburg facility in early 2007 will create yet another large, long-term growth opportunity. With respect to Maine, we are in the process of seeking approval to open a temporary facility there later this year, with construction on a permanent facility to start shortly thereafter.

Penn National's team of dedicated employees in Pennsylvania, and at every one of our regional gaming properties, played a role in making 2004 a tremendous year for the Company and its shareholders. Our corporate team has also extended our prospects for growth through a combination of initiatives focused on improving cash flow from existing properties, along with developing the new facilities in Pennsylvania and Maine. And of course, Argosy will make a wonderful partner for Penn as we integrate our operations and move forward as a united company.

Our strategic forward planning will continue to adhere to a defined set of operating and financial principals that have helped Penn ascend to what will be the third largest gaming operator in the nation. Throughout 2005 we will focus on each of these areas to ensure that we continue to deliver value to our shareholders. We are grateful for your support and interest, and appreciate the counsel of our outstanding Board of Directors and the daily effort of our employees.

Sincerely,



Peter M. Carlino
Chairman of the Board &
Chief Executive Officer

April 4, 2004



Officers (l to r): (front row) William J. Clifford, Senior Vice President, Finance, and Chief Financial Officer; Peter M. Carlino, Chairman of the Board and Chief Executive Officer; Leonard M. DeAngelo, Executive Vice President, Operations; (back row) Robert S. Ippolito, Vice President, Secretary and Treasurer; Steven T. Snyder, Sr. Vice President, Corporate Development; John Finamore, Sr. Vice President, Regional Operations; Jordan B. Savitch, Esq., Sr. Vice President and General Counsel; Kevin DeSanctis, President and Chief Operating Officer





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Penn National Gaming, Inc.

2004

annual report

Selected Consolidated Financial Data

The following selected consolidated financial and operating data for the years ended December 31, 2000, 2001, 2002, 2003 and 2004 are derived from our consolidated financial statements that have been audited by BDO Seidman, LLP, an independent registered public accounting firm. The selected consolidated financial and

operating data should be read in conjunction with our consolidated financial statements and Notes thereto, "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the other financial information included herein.

YEAR ENDED DECEMBER 31,	2000 ⁽¹⁾	2001 ⁽²⁾	2002 ⁽³⁾	2003 ⁽⁴⁾	2004
<i>(In thousands, except per share data)</i>					
Income statement data: ⁽⁵⁾					
Net Revenues	\$ 254,302	\$ 478,258	\$ 618,856	\$ 1,012,998	\$ 1,140,689
Total operating expenses	214,811	406,155	520,612	836,463	926,909
Income from continuing operations	39,491	72,103	98,244	176,535	213,780
Other (expenses), net	(27,645)	(40,525)	(52,381)	(76,878)	(76,152)
Income before income taxes	11,846	31,578	45,863	99,657	137,628
Taxes on income	3,682	10,916	17,534	37,463	50,288
Net income from continuing operations	8,164	20,662	28,329	62,194	87,340
Income (Loss) from discontinued operations	3,828	3,096	2,534	(10,723)	(15,856)
Net income	\$ 11,992	\$ 23,758	\$ 30,863	\$ 51,471	\$ 71,484
Per share data: ⁽⁶⁾					
Earnings (loss) per share - basic					
Income from continuing operations	\$ 0.14	\$ 0.34	\$ 0.38	\$ 0.79	\$ 1.09
Discontinued operations, net of tax	\$ 0.06	\$ 0.05	\$ 0.03	\$(0.14)	\$(0.20)
Basic net income per share	\$ 0.20	\$ 0.39	\$ 0.41	\$ 0.65	\$ 0.89
Earnings (loss) per share - diluted					
Income from continuing operations	\$ 0.13	\$ 0.32	\$ 0.36	\$ 0.77	\$ 1.05
Discontinued operations, net of tax	\$ 0.06	\$ 0.05	\$ 0.03	\$(0.14)	\$(0.19)
Diluted net income per share	\$ 0.19	\$ 0.37	\$ 0.39	\$ 0.63	\$ 0.86
Weighted shares outstanding - basic	59,872	61,306	75,550	78,946	80,510
Weighted shares outstanding - diluted	61,772	63,674	78,188	81,224	83,508
Other data:					
Net cash provided by operating activities	\$ 40,976	\$ 84,784	\$ 101,641	\$ 140,036	\$ 195,454
Net cash used in investing activities	(229,027)	(216,039)	(102,064)	(330,864)	(65,404)
Net cash provided by (used in)					
financing activities	201,810	145,593	18,312	217,459	(124,177)
Depreciation and amortization	9,908	29,751	34,518	57,471	65,785
Interest expense	20,644	46,096	42,104	76,616	75,720
Capital expenditures	27,295	41,511	88,533	56,733	68,957

YEAR ENDED DECEMBER 31,	2000 ⁽¹⁾	2001 ⁽²⁾	2002 ⁽³⁾	2003 ⁽⁴⁾	2004
<i>(In thousands)</i>					
Balance sheet data:					
Cash and cash equivalents ⁽⁷⁾	\$ 22,299	\$ 36,637	\$ 54,536	\$ 81,567	\$ 87,620
Total assets	439,900	679,377	765,480	1,609,599	1,643,407
Total debt ⁽⁷⁾	309,299	458,909	375,018	990,123	858,909
Shareholders' equity	79,221	103,265	247,000	309,878	398,092

(1) Reflects operations included since the August 8, 2000 acquisition of Casino Magic-Bay St. Louis casino and Boomtown Biloxi casino.

(2) Reflects operations included since the April 27, 2001 acquisition of all of the gaming assets of CRC Holdings, Inc. and the minority interest in Louisiana Casino Cruises, Inc.

(3) Reflects operations included since the April 25, 2002 acquisition of Bullwhackers.

(4) Reflects the operations of the Hollywood Casino properties since the March 3, 2003 acquisition date.

(5) Certain prior year amounts have been reclassified to conform to the current year presentation.

(6) Per share data has been retroactively restated to reflect the increased number of common stock shares outstanding as a result of our June 25, 2002 and March 7, 2005 stock splits.

(7) Does not include discontinued operations.

Market for Registrant's Common Equity and Related Shareholder Matters

Range of Market Price

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

	HIGH	LOW
2004		
First Quarter	\$14.78	\$11.51
Second Quarter	16.60	13.63
Third Quarter	20.20	15.99
Fourth Quarter	31.17	19.34
2003		
First Quarter	\$ 9.71	\$ 7.35
Second Quarter	11.80	7.38
Third Quarter	11.73	9.77
Fourth Quarter	12.98	10.51

The closing sale price per share of common stock on The NASDAQ National Market on March 28, 2005, was \$29.60. As of March 28, 2005, there were approximately 638 holders of record of common stock. All references to sales prices of our common stock have been retroactively restated to reflect the increased number of common stock shares outstanding pursuant to the March 7, 2005 stock split.

Dividend Policy

Since our initial public offering of common stock in May 1994, we have not paid any cash dividends on our common stock. We intend to retain all of our earnings to finance the development of our business, and thus, do not anticipate paying cash dividends on our common stock for the foreseeable future. Payment of any cash dividends in the future will be at the discretion of our Board of Directors and will depend upon, among other things, our future earnings, operations and capital requirements, our general financial condition and general business conditions. Moreover, our existing credit facility prohibits us from authorizing, declaring or paying any dividends until our commitments under the credit facility have been terminated and all amounts outstanding thereunder have been repaid. In addition, future financing arrangements may prohibit the payment of dividends under certain conditions.

Management's Discussion & Analysis of Financial Condition & Results of Operations

Forward Looking Statements

The Annual Report may contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Actual results may vary materially from expectations. Although we 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 which could cause actual results to differ from expectations include, but are not limited to, risks related to the following:

- the passage of state, federal or local legislation that would expand, restrict, further tax or prevent gaming operations in the jurisdictions in which we do business;
- the activities of our competitors;

- increases in our effective rate of taxation at any of our properties or at the corporate level;
- successful completion of capital projects at our gaming and pari-mutuel facilities;
- the existence of attractive acquisition candidates and the costs and risks involved in the pursuit of those acquisitions;
- the maintenance of agreements with our horsemen and pari-mutuel clerks;
- our dependence on key personnel;
- the impact of terrorism and other international hostilities; and other factors as discussed in our filings with the United States Securities and Exchange Commission. We do not intend to update publicly any forward-looking statements except as required by law.

Our Operations

We are a leading, diversified, multi-jurisdictional owner and operator of gaming properties, as well as horse race-tracks and associated off-track wagering facilities, or OTWs. We own or operate nine gaming properties located in Colorado, Illinois, Louisiana, Mississippi, Ontario and West Virginia that are focused primarily on serving customers within driving distance of the properties. We also own one racetrack and six OTWs in Pennsylvania, one racetrack in West Virginia, one racetrack in Maine, and through a joint venture, own and operate a racetrack in New Jersey. On February 12, 2004, we completed the purchase of Bangor Historic Track, Inc. which operates harness racing at the city owned track at Bass Park in Bangor, Maine. We operate in two segments, gaming and racing, and derive substantially all of our revenues from such operations. We believe that our portfolio of assets provides us with a diversified cash flow from operations.

We have made significant acquisitions in the past few years and expect to continue to pursue additional acquisition and development opportunities in the future. On March 3, 2003, we completed our largest acquisition to date, the acquisition of Hollywood Casino Corporation. The Hollywood Casino Corporation acquisition significantly increased our revenues and cash flow. In Maine, subsequent to our February 12, 2004 purchase of Bangor Historic Track, Inc., we were granted an unconditional racing license for 2004 (and a renewal for 2005) and operated a 27-day harness meet at Bass Park in Bangor. The annual license represents the first regulatory approval necessary for us to proceed with our anticipated \$74 million development project for a 1,500 slot machine gaming facility and to satisfy a condition precedent to completing our purchase of Bangor Historic Track. On July 5, 2004, Pennsylvania Governor Edward G. Rendell signed into law the Pennsylvania Race Horse Development and Gaming Act. Our plan is to develop a completely new gaming and racing facility at our Penn National Race Course in Grantville, Pennsylvania. Under this plan, we expect to open in a new permanent facility with 2,000 slot machines within approximately one year after receiving a license at an estimated cost of \$240 million, inclusive of the \$50 million gaming license fee, and expand to up to 5,000 machines based on demand. While we would have preferred to develop the site, as a result of the ownership restrictions on a second slot license in the Pennsylvania gaming law, on October 15, 2004 we announced our agreement to sell our Pocono

Downs facilities, land and OTWs to the Mohegan Tribal Gaming Authority. This sale was completed on January 25, 2005. Most notably, on November 3, 2004, we and Argosy Gaming Company announced that our boards of directors unanimously approved a definitive merger agreement under which we will acquire all of the outstanding shares of Argosy for \$47.00 per share in cash. The transaction is valued at approximately \$2.2 billion, including approximately \$805 million of long-term debt of Argosy and its subsidiaries. Upon closing, the transaction is expected to be immediately accretive to our earnings per share. On January 20, 2005, Argosy's shareholders approved the Merger Agreement. This transaction is an extremely significant step for us.

The vast majority of our revenue is gaming revenues derived primarily from gaming on slot machines and, to a lesser extent, table games. Racing revenues are derived from wagering on our live races, wagering on import simulcasts at our racetracks and OTWs and through telephone account wagering, and fees from wagering on export simulcasting our races. Other revenues are derived from hotel, dining, retail, admissions, program sales, concessions and certain other ancillary activities.

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 of gaming properties particularly in attractive regional markets. Key performance indicators related to revenues are:

- Gaming revenue indicators—slot handle (volume indicator), table game drop (volume indicator) and “win” or “hold” percentages, which are not fully controllable by us. Our typical slot win percentage is in the range of 5% to 9% of slot handle and our typical table games win percentage is in the range of 15% to 21% of table game drop; and
- Racing revenue indicators—pari-mutuel wagering commissions (volume indicator) earned on wagering on our live races, wagering on import simulcasts at our racetracks and OTWs and through telephone account wagering, and fees from wagering on export simulcasting our races.

Our properties generate significant operating cash flow since most of our revenue is cash-based from slot machines and pari-mutuel wagering. Our business is capital intensive and we rely on cash flow from our properties to generate operating cash to repay debt, fund capital maintenance

expenditures, fund new capital projects at existing properties and provide excess cash for future development and acquisitions.

We have reflected the results of the transactions for the disposition of Hollywood Casino Shreveport and The Downs Racing, Inc. by classifying the assets, liabilities and results of operations of Hollywood Casino Shreveport and The Downs Racing, Inc. as assets and liabilities held for sale and discontinued operations in accordance with the provisions of Financial Accounting Standards Board Statement No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." A gain or loss on either of these transactions has not been recorded or recognized as of December 31, 2004

since the sales have not yet been deemed completed. Financial information for HCS was previously reported as part of the gaming reporting segment and financial information for The Downs Racing, Inc. and its subsidiaries was previously reported as part of the racing reporting segment. For a discussion of these discontinued operations please see the subsection entitled "Discontinued Operations" below.

Results of Continuing Operations

The results of continuing operations for the years ended December 31, 2002, 2003, and 2004 are summarized below (in thousands):

YEAR ENDED DECEMBER 31,	2002	2003	2004
Revenue:			
Gaming	\$491,930	\$ 871,218	\$ 992,088
Racing	56,116	52,075	49,948
Management service fee	11,479	13,726	16,277
Food, beverage and other revenue	87,136	131,915	147,991
Gross revenues	646,661	1,068,934	1,206,304
Less: Promotional allowances	(27,805)	(55,936)	(65,615)
Net Revenues	618,856	1,012,998	1,140,689
Operating expenses:			
Gaming	289,448	475,407	544,746
Racing	41,777	41,752	38,997
Food, beverage and other expenses	57,743	92,663	97,712
General and administrative	97,126	169,170	179,669
Depreciation and amortization	34,518	57,471	65,785
Total operating expenses	520,612	836,463	926,909
Income from continuing operations	\$ 98,244	\$ 176,535	\$ 213,780

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

- Most of our properties operate largely in mature competitive markets. As a result, we expect a majority of our future growth to come from acquisitions of gaming properties at reasonable valuations, jurisdictional expansions and, to a lesser extent, property expansion in under-penetrated markets.
- 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, as illustrated by our experience in Illinois in 2003.

- Consistent with the consolidation trend in the gaming industry, the Company has been very active in acquisitions. We have acquired five casino properties, the Casino Rama management contract, and Bangor Historic Track, Inc. since January 1, 2001, and on November 3, 2004 we announced the proposed acquisition of Argosy Gaming Company.
- 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 Pennsylvania and Maine) and potential competitive threats to business

at our existing properties (such as Maryland). The timing and occurrence of these events remain uncertain. Legalized gaming from casinos located on Native American lands can also have a significant competitive effect.

- The continued demand for, and the Company's emphasis on, slot wagering entertainment at our properties, which revenue is the consistently profitable segment of the gaming industry.
- The continued expansion and revenue gains at our Charles Town Entertainment Complex.

- Financing in a favorable interest environment and under an improved credit profile facilitates our growth.
- The racing revenues continue to decline at each of our racing properties. However, our gaming revenues have increased and, as a result, our racing revenues represent a less significant percentage of our overall revenue.

The results of continuing operations by reporting segment and property level for the years ended December 31, 2002, 2003, and 2004 are summarized below (in thousands):

	REVENUES ⁽¹⁾			INCOME FROM OPERATIONS		
	2002	2003	2004	2002	2003	2004
Gaming Segment						
Charles Town Entertainment Complex	\$253,539	\$ 329,147	\$ 400,129	\$ 56,891	\$ 72,929	\$ 96,031
Hollywood Casino Aurora ⁽²⁾	-	201,938	232,584	-	54,547	59,372
Casino Rouge ⁽³⁾	105,034	106,940	108,409	21,608	23,650	25,543
Casino Magic-Bay St. Louis	95,756	106,641	106,236	10,333	12,333	9,996
Hollywood Casino Tunica ⁽²⁾	-	96,648	117,509	-	11,041	18,525
Boomtown Biloxi	73,225	72,644	70,391	9,264	9,766	8,739
Bullwhackers ⁽⁴⁾	16,723	26,467	32,035	948	1,626	3,206
Casino Rama Management Contract ⁽⁴⁾	11,479	13,726	16,277	10,608	12,343	15,485
Corporate overhead	-	-	-	(17,005)	(26,210)	(26,318)
Total Gaming Segment	555,756	954,151	1,083,570	92,647	172,025	210,579
Racing Segment						
Pennsylvania Racing Operations	63,100	58,847	57,119	5,597	4,510	3,552
Bangor Historic Track	-	-	-	-	-	(351)
Total Racing Segment	\$618,856	\$1,012,998	\$1,140,689	\$ 98,244	\$176,535	\$213,780

(1) Net revenues are net of promotional allowances.

(2) Reflects results since the March 3, 2003 acquisition. For the year ended December 31, 2003, Hollywood Casino Aurora revenues were \$248.1 million and income from operations was \$65.7 million and Hollywood Casino Tunica revenues were \$113.0 million and income from operations was \$12.2 million.

(3) Reflects results since the April 27, 2001 acquisition.

(4) Reflects results since the April 25, 2002 acquisition.

**Year Ended December 31, 2004
Compared to Year Ended
December 31, 2003**

Revenues

NET REVENUES, YEAR ENDED DECEMBER 31, 2004	GAMING	RACING	TOTAL
<i>(In thousands)</i>			
Gaming	\$ 992,088	\$ -	\$ 992,088
Racing	-	49,948	49,948
Management Service fee	16,277	-	16,277
Food, beverage and other revenue	140,820	7,171	147,991
Gross revenue	1,149,185	57,119	1,206,304
Less: Promotional allowances	(65,615)	-	(65,615)
Net revenues	\$1,083,570	\$57,119	\$1,140,689

NET REVENUES, YEAR ENDED DECEMBER 31, 2003	GAMING	RACING	TOTAL
<i>(In thousands)</i>			
Gaming	\$ 871,218	\$ -	\$ 871,218
Racing	-	52,075	52,075
Management Service fee	13,726	-	13,726
Food, beverage and other revenue	125,143	6,772	131,915
Gross revenue	1,010,087	58,847	1,068,934
Less: Promotional allowances	(55,936)	-	(55,936)
Net revenues	\$ 954,151	\$58,847	\$1,012,998

Net revenues increased in 2004 by \$127.7 million, or 12.6%, to \$1,140.7 million from \$1,013.0 million in 2003. The two Hollywood Casino properties contributed \$51.5 million of the increase primarily due to comparing a full year of operations in 2004 to a ten-month period of operations in 2003. Had we owned the properties for the full year 2003, the Hollywood Casino properties revenues would have decreased by \$11.0 million between 2003 and 2004 primarily due to the effects of the increase in the gaming tax structure at the Hollywood Casino Aurora property. From the properties we owned prior to the acquisition of the Hollywood Casino properties, revenues increased by \$76.2 million, or 11.7%. The Charles Town Entertainment Complex had another record year as revenues increased by \$71.0 million due to

a full year of results from the 2003 gaming area expansion and the addition of 300 new slot machines during 2004.

Gaming Revenues

Gaming revenue increased in 2004 by \$120.9 million, or 13.9%, to \$992.1 million from \$871.2 million in 2003. The Hollywood Casino properties contributed \$47.9 million of the increase and the properties we owned prior to the acquisition contributed the remaining \$73.0 million of the increased gaming revenue. Of this total, Charles Town Entertainment Complex increased gaming revenue by \$68.6 million as a result of the expansion that added 700 gaming machines in July 2003 and the addition of 300 new slot machines during 2004. The average number of gaming

machines in play at Charles Town Entertainment Complex increased to 3,659 in 2004 from 3,089 in 2003, with the average win per machine increasing to \$273 in 2004 from \$264 per day in 2003 as a result of increased patronage by mid-week and drive-in customers due to the success of our marketing program targeted toward such customers. At Bullwhackers Casinos gaming revenue increased by \$5.0 million in 2004. The revenue gains were a result of an increase in patronage from more effective marketing programs and a change in product mix that resulted in a higher hold percentage and average win per unit per day. Casino Rouge had an increase in gaming revenue of \$1.3 million even though there was a decrease in visitation in 2004. The revenue increase was a result of a change in product mix to more low denomination video slot machines which generated higher win per day and hold percentages than higher denomination machines and an increase in table game play. These revenue gains were partially offset by a \$1.6 million decline at Boomtown Biloxi caused by a loss of patronage to our competitors and Hurricane Ivan in September 2004.

Management service fees from Casino Rama increased in 2004 by \$2.6 million, or 18.6%, to \$16.3 million from \$13.7 million in 2003. The increase in management service fees is a result of continued emphasis on marketing programs which focus on trip generation, favorable weather (mild winter months and rainy summer months), favorable table games hold percentages, compressed prior year business levels resulting from SARS and increased patronage resulting from the institution of a no-smoking policy at the largest race track beginning in June 2004. These factors more than offset the opening of the permanent Niagara Fallsview Casino and Resort.

Food, beverage and other revenue increased in 2004 by \$15.7 million, or 12.5%, to \$140.8 million from \$125.1 million in 2003. The Hollywood Casino properties contributed \$10.6 million of the increase and the properties we owned prior to the acquisition contributed \$5.1 million. Charles Town increased its food, beverage and other revenue by \$4.1 million as a result of expanded food court and restaurant operations, increased attendance and increased revenues

from other ancillary services. At Casino Magic-Bay St. Louis, food, beverage and other revenue, including hotel revenues, increased by \$1.1 million primarily as a result of marketing programs that were implemented to increase hotel occupancy and feature our dining outlets. Bullwhackers had a \$.8 million, or 50%, increase in food, beverage and other revenues as a result of better food quality, the opening of a new bakery and deli on the casino floor and offering additional cash services for our patrons. At Boomtown Biloxi, revenues decreased by \$.9 million as a result of lost business from Hurricane Ivan and a change in our food and beverage marketing programs.

Promotional allowances increased in 2004 by \$9.7 million to \$65.6 million from \$55.9 million in 2003. The Hollywood Casino properties accounted for \$6.9 million of the increase and the properties we owned prior to the acquisition increased by \$2.8 million. Charles Town had an increase in its promotional allowance costs of \$1.6 million primarily due to the increase in slot machine play and attendance at the expanded facility and increased membership in its players' club. Casino Magic-Bay St. Louis also had an increase of \$1.3 million in promotional allowances as a result of changes to our marketing programs that focus on increasing casino play and facility utilization.

Racing revenues

Racing revenues decreased in 2004 by \$2.1 million, or 4.1%, to \$49.9 million from \$52.0 million in 2003. In 2004, due to inclement weather, we lost thirteen race days at Penn National Race Course and had a decline in attendance at the OTWs that remained open during any inclemency. We also experienced a decline in our call center revenue as a result of restrictions placed on telephone and internet wagering account activity by various state gaming regulatory agencies. These factors caused a decrease in racing revenue of \$2.9 million in Pennsylvania. In Bangor, Maine, we ran a 27-day harness meet and had racing revenues of \$.8 million in 2004.

Food, beverage and other revenues increased by approximately \$.2 million in Pennsylvania and were approximately \$.2 million at the Bangor Historic Track.

Operating Expenses

OPERATING EXPENSES, YEAR ENDED DECEMBER 31, 2004	GAMING	RACING	TOTAL
<i>(In thousands)</i>			
Gaming	\$544,746	\$ -	\$544,746
Racing	-	38,997	38,997
Food, beverage and other expenses	93,029	4,683	97,712
General and administrative	171,070	8,599	179,669
Depreciation and amortization	64,149	1,636	65,785
Total operating expenses	\$872,994	\$53,915	\$926,909

OPERATING EXPENSES, YEAR ENDED DECEMBER 31, 2003	GAMING	RACING	TOTAL
<i>(In thousands)</i>			
Gaming	\$475,407	\$ -	\$475,407
Racing	-	41,752	41,752
Food, beverage and other expenses	88,054	4,609	92,663
General and administrative	162,720	6,450	169,170
Depreciation and amortization	55,936	1,535	57,471
Total operating expenses	\$782,117	\$54,346	\$836,463

Total operating expenses increased in 2004 by \$90.4 million, or 10.8%, to \$926.9 million from \$836.5 million in 2003. The two Hollywood Casino properties contributed \$39.2 million of the increase primarily due to comparing a full year of operations in 2004 to a ten-month period of operations in 2003. However, had we owned the properties for the full year 2003, the Hollywood Casino properties operating expenses would have decreased by \$11.0 million between 2003 and 2004 primarily due to the effects of the increase in the gaming tax structure at the Hollywood Casino Aurora property. From the properties we owned prior to the acquisition of the Hollywood Casino properties, operating expenses increased by \$51.2 million, or 8.5%.

Gaming operating expenses

Gaming expenses increased in 2004 by \$69.3 million, or 14.4%, to \$544.7 million from \$475.4 million in 2003. The Hollywood Casino properties accounted for \$26.1 million of the increase and the expenses at the properties we owned prior to the acquisition increased by \$43.2 million. At Charles Town, gaming expenses increased by \$41.8 million and included gaming taxes attributable to the increased gaming revenue and salaries, wages and benefits due to the additional staffing levels needed to accommodate the expanded gaming floor area and increased customer

volumes. Gaming expenses increased at Casino Magic-Bay St. Louis by \$2.0 million as a result of marketing expenditures, primarily for entertainment expenses, promotional giveaways and VIP function-related expenses that were focused on driving attendance and slot machine play. Boomtown Biloxi had a decrease in gaming expenses of \$2.1 million resulting primarily from changes made in the marketing and promotion programs and a decrease in gaming taxes that were directly attributable to lower gaming revenues. Casino Rouge also had a decrease in gaming expenses of \$1.7 million in 2004. The decrease was a result of a change in product mix that also included a reduction in the number of participation games on the floor and lower participation fees, lower marketing costs and lower labor costs as a result of a change to ticket-in-ticket-out slot machines. At the Bullwhackers Casinos, gaming expenses increased by \$3.3 million in 2004 as a result of an increase in gaming taxes that resulted from higher gaming revenues and a higher effective gaming tax rate and an increase in marketing expenses.

Food, beverage and other expenses increased in 2004 by \$5.0 million to \$93.0 million from \$88.0 million in 2003. The Hollywood Casino properties accounted for \$1.4 million of the increase and the properties we owned prior to the

acquisition produced the remaining \$3.6 million increase. These expenses increased at Charles Town by \$3.5 million due to increased food and beverage volumes from increased attendance, increases in food costs and increases in staffing. Boomtown Biloxi had a decrease in expenses primarily as a result of decreased food and beverage revenues. The other properties had minor fluctuations in food, beverage and other expenses as a result of volume changes and higher food costs.

General and administrative expenses increased by \$8.4 million to \$171.1 million in 2004 from \$162.7 million in 2003. The increase was generated entirely by our gaming properties and corporate overhead. The addition of the two Hollywood properties increased general and administrative expenses by \$8.8 million, the properties we owned prior to acquisition had an decrease in general and administrative expenses of \$1.3 million and corporate overhead increased by \$9.9 million. General and administrative expenses at the properties includes facility maintenance, utilities, property and liability insurance, housekeeping, and all administration departments such as accounting, purchasing, human resources, legal and internal audit. The general and administrative expenses at Charles Town increased by \$1.5 million primarily due to additional payroll related costs for the expanded facility and increased property and general liability insurance costs. Our other properties had small decreases in general and administrative expenses due to decreases in property and general liability expenses, and payroll related expenses. Corporate overhead expenses increased by \$9.9 million in 2004 as compared to 2003. Corporate expenses such as payroll and employees benefits, outside services and travel have increased as a result of the Hollywood Casino acquisition in 2003. Lobbying expenses in connection with Pennsylvania slot legislation and Maine gaming regulations also increased corporate costs. However, our corporate overhead as a percentage of our net revenues decreased.

Depreciation and amortization expense increased by \$8.2 million, or 14.7%, to \$64.1 million in 2004 from \$55.9 million in 2003. The addition of the Hollywood Casino properties increased depreciation and amortization expense by \$3.0 million. The remaining increase of \$5.2 million was primarily a result of the expansion at Charles Town for additional gaming space and the parking structure and the purchase of new slot machines at many of our properties.

Racing operating expenses

Racing expenses decreased in 2004 by \$2.8 million, or 6.6%, to \$39.0 million from \$41.8 million in 2003. The decrease in Pennsylvania racing expenses were partially offset by \$9.9 million in racing expenses at the Bangor Historic Track in Maine. Expenses that have a direct relationship to racing revenue such as purse expense, pari-mutuel taxes, simulcast fees and totalisator expense all decreased with the decrease in racing revenues.

Other racing related expenses such as food, beverage and other expenses, general and administrative expenses and depreciation expenses decreased slightly or have remained at the same levels as the prior year.

Income from operations

Income from operations increased by \$37.3 million, or 21.1%, to \$213.8 million in 2004 from \$176.5 million in 2003. The increase was generated entirely by our gaming properties. The Hollywood Casino properties contributed \$12.3 million. Our overall profit margin increased to 18.7% in 2004 from 17.4% in 2003. We credit our property management teams for these results as their continued focus on customer and employee satisfaction, market share gains and operating margin improvements contribute to our consolidated improvement in income from continuing operations and operating margins.

Other income (expense) summary (in thousands):

YEAR ENDED DECEMBER 31,	2003	2004
Other income (expense):		
Interest expense	\$(76,616)	\$(75,720)
Interest income	1,649	2,093
Earnings from joint venture	1,825	1,634
Other	(1,899)	(392)
Loss on change in fair values of interest rate swaps	(527)	-
Loss on early extinguishment of debt	(1,310)	(3,767)
Total other expense	\$(76,878)	\$(76,152)

Interest expense

Interest expense decreased by \$.9 million in 2004 primarily due to the principal payments of \$129.7 million we made on our senior secured credit facility term loans. In conjunction with the accelerated principal loan payments, we recorded a loss on early extinguishment of debt of \$3.8 million for deferred finance fees. Subject to the availability of attractive acquisition or project opportunities, we expect to continue to accelerate our principal payments as free cash flow allows.

Other non-recurring expenses

In 2003, we incurred other expenses of \$1.9 million. These expenses included costs for the write-off of an option on a greyhound race track and costs incurred for due diligence in connection with the Wembley plc potential acquisition. There were no charges incurred in 2004.

Discontinued Operations

Discontinued operations reflect the results of Hollywood Casino Shreveport and Pocono Downs. We had a loss, net of tax benefit, from discontinued operations of \$15.9 million and \$10.7 million in 2004 and 2003, respectively, and a gain,

net of tax, from discontinued operations of \$2.5 million in 2002. On August 27, 2004 Hollywood Casino Shreveport entered into an agreement of sale with Eldorado Resorts LLC. On September 10, 2004, a group of creditors led by Black Diamond Capital Management, LLC filed an involuntary Chapter 11 case against HCS. As a result of the Chapter 11 bankruptcy filing by Hollywood Casino Shreveport, the sale has not yet been consummated. On October 15, 2004 we announced the sale of Pocono Downs and its related OTW facilities to the Mohegan Tribal Gaming Authority. The sale was completed on January 25, 2005. We have reflected the results of these transactions by classifying the assets, liabilities and results of operations as assets and liabilities held for sale and discontinued operations. 2002 and 2003 results from these properties have been reclassified to conform to the 2004 presentation. (See Note 15 to our Consolidated Financial Statements).

Year Ended December 31, 2003 Compared to Year Ended December 31, 2002

Revenues

NET REVENUES, YEAR ENDED DECEMBER 31, 2003	GAMING	RACING	TOTAL
<i>(In thousands)</i>			
Gaming	\$ 871,218	\$ -	\$ 871,218
Racing	-	52,075	52,075
Management Service fee	13,726	-	13,726
Food, beverage and other revenue	125,143	6,772	131,915
Gross revenue	1,010,087	58,847	1,068,934
Less: Promotional allowances	(55,936)	-	(55,936)
Net revenues	\$ 954,151	\$58,847	\$1,012,998

NET REVENUES, YEAR ENDED DECEMBER 31, 2002	GAMING	RACING	TOTAL
<i>(In thousands)</i>			
Gaming	\$491,930	\$ -	\$491,930
Racing	-	56,116	56,116
Management Service fee	11,479	-	11,479
Food, beverage and other revenue	80,152	6,984	87,136
Gross revenue	583,561	63,100	646,661
Less: Promotional allowances	(27,805)	-	(27,805)
Net revenues	\$555,756	\$63,100	\$618,856

Net revenues increased in 2003 by \$394.1 million, or 64.2%, to \$1,013.0 million from \$618.9 million in 2002. The two new Hollywood Casino properties contributed \$298.6 million of the increase. From the properties we owned prior to the acquisition of the Hollywood Casino properties, revenues increased by \$95.5 million. The Charles Town Entertainment Complex had another record year as revenues increased by \$75.6 million due to the opening of an additional 38,000 square feet of gaming space with 700 new slot machines in July and a full year of results from the 2002 expansion. At Casino Magic-Bay St. Louis revenues increased by \$10.9 million due to the impact of a full year of operations of the 291-room Bay Tower Hotel and Conference Center that opened in May of 2002.

Gaming Revenues

Gaming revenue increased in 2003 by \$379.3 million, or 77.1%, to \$871.2 million from \$491.9 million in 2002. The Hollywood Casino properties contributed \$286.9 million of the increase and the properties we owned prior to the acquisition contributed the remaining \$92.4 million of the increased gaming revenue. Of this total, Charles Town Entertainment Complex increased gaming revenue by \$74.5 million as a result of the expansion that added 715 gaming machines in September 2002 and another 700 gaming machines in July 2003. The average number of gaming machines in play increased to 3,089 in 2003 from 2,312 in 2002 with the average win per machine remaining at \$264 per day. At Casino Magic-Bay St. Louis, gaming revenue increased by \$6.5 million due to the impact of a full year of operations for the Bay Tower Hotel and Conference Center that opened in May 2002. The increase in occupancy at the hotel was the major volume driver for the increase in revenue from gaming machines. At Bullwhackers Casinos, our April 2002 acquisition, gaming revenue increased by \$9.7 million in 2003 and reflects a comparison of a full year of operations in 2003 to eight months of operations in 2002.

Management service fees from Casino Rama increased by \$2.2 million, or 19.6%, to \$13.7 million from \$11.5 million

in 2002. The increase in management service fees is a result of marketing programs that focus on trip generation, recent visitors and the hotel and convention center that opened in July 2002. These programs have increased attendance, hotel occupancy and slot play in the casino.

Food, beverage and other revenue increased in 2003 by \$45.0 million, or 56.1%, to \$125.1 million from \$80.1 million in 2002. The Hollywood Casino properties contributed \$36.6 million of the increase and the properties we owned prior to the acquisition contributed \$8.4 million. Charles Town increased its food, beverage and other revenue by \$1.8 million as a result of a full year of operations for the new food court that opened in July 2002 and increased revenues from other ancillary services. At Casino Magic-Bay St. Louis, food, beverage and other revenue, including hotel revenues, increased by \$6.2 million as a result of a full year of operations for the hotel and convention center and the marketing programs that were implemented to increase hotel occupancy and feature our dining outlets.

Promotional allowances increased in 2003 by \$28.1 million to \$55.9 million from \$27.8 million in 2002. The Hollywood Casino properties accounted for \$24.9 million of the increase and the properties we owned prior to the acquisition increased by \$3.2 million. Of the \$3.2 million, over \$1.7 million was attributable to the marketing of the new hotel and convention center at Casino Magic-Bay St. Louis.

Racing revenues

Racing revenues at our Pennsylvania facilities decreased in 2003 by \$4.0 million, or 7.2%, to \$52.1 million from \$56.1 million in 2002. In 2003, due to inclement weather, we lost thirteen race days at Penn National Race Course and had a decline in attendance at the OTWs that remained open during any inclemency. We also experienced a decline in our call center revenue as a result of restrictions placed on telephone and internet wagering account activity by various state gaming regulatory agencies.

There was no significant changes in food, beverage and other revenues at our racing properties.

Operating expenses

OPERATING EXPENSES, YEAR ENDED DECEMBER 31, 2003	GAMING	RACING	TOTAL
<i>(In thousands)</i>			
Gaming	\$475,407	\$ -	\$475,407
Racing	-	41,752	41,752
Food, beverage and other expenses	88,054	4,609	92,663
General and administrative	162,720	6,450	169,170
Depreciation and amortization	55,936	1,535	57,471
Total operating expenses	\$782,117	\$54,346	\$836,463

OPERATING EXPENSES, YEAR ENDED DECEMBER 31, 2002	GAMING	RACING	TOTAL
<i>(In thousands)</i>			
Gaming	\$289,448	\$ -	\$289,448
Racing	-	41,777	41,777
Food, beverage and other expenses	53,225	4,518	57,743
General and administrative	90,744	6,382	97,126
Depreciation and amortization	32,823	1,695	34,518
Total operating expenses	\$466,240	\$54,372	\$520,612

Gaming operating expenses

Gaming expenses increased in 2003 by \$186.0 million, or 64.2%, to \$475.4 million from \$289.4 million in 2002. The Hollywood Casino properties accounted for \$137.8 million of the increase and the expenses at the properties we owned prior to the acquisition increased by \$48.2 million. At Charles Town, gaming expenses increased by \$45.3 million and included gaming taxes attributable to the increased gaming revenue and salaries, wages and benefits due to the additional staffing levels needed to accommodate the expanded gaming floor area and increased customer volumes. Gaming expenses increased at Casino Magic-Bay St. Louis by \$4.4 million as a result of gaming taxes attributable to increased gaming revenue and marketing expenditures, primarily for entertainment expenses, promotional giveaways and VIP function-related expenses that were focused on driving attendance and slot machine play. Boomtown Biloxi had a decrease in gaming expenses of \$2.2 million resulting primarily from changes made in the marketing and promotion programs. At Bullwhackers Casinos, gaming expenses increased by \$6.5 million in

2003 as a result of comparing a full year of operations in 2003 to eight months of operations in 2002.

Food, beverage and other expenses increased in 2003 by \$34.8 million to \$88.0 million from \$53.2 million in 2002. The Hollywood Casino properties accounted for \$30.4 million of the increase and the properties we owned prior to the acquisition produced the remaining \$4.4 million increase. Most of the remaining increase is attributable to Charles Town and Casino Magic-Bay St. Louis, which had expansion projects that increased capacity that resulted in gains in attendance during the year, and Bullwhackers Casinos which we operated for a full year in 2003, compared to eight months in 2002.

General and administrative expenses increased by \$72.0 million to \$162.7 million in 2003 from \$90.7 million in 2002. The increase was generated entirely by our gaming properties and corporate overhead. The addition of the Hollywood Casino properties increased general and administrative expenses by \$50.7 million, the properties we owned prior to the acquisition had an increase in general and administrative expenses of \$12.1 million and corporate overhead

increased by \$9.2 million. General and administrative expenses at the properties includes facility maintenance, utilities, property and liability insurance, housekeeping, and all administration departments such as accounting, purchasing, human resources, legal and internal audit. At the properties, general and administrative expenses increased at Charles Town and Casino Magic-Bay St. Louis primarily as a result of the expansion projects that added new gaming space and a new hotel at these properties and at Bullwhackers Casinos which had a full year of operations in 2003, compared to eight months in 2002. The other properties did not have any significant changes in these expenses. Corporate overhead expenses increased by \$9.2 million in 2003, primarily due to additional CRC acquisition cost, lobbying and site development expenses in connection with Pennsylvania slot legislation, Scarborough, Maine referendum expenses, and legal fees. Other corporate expenses also increased as a result of the Hollywood Casino acquisition in March of 2003. However, our corporate overhead as a percentage of our net revenues decreased.

Depreciation and amortization expense increased by \$23.1 million, or 70.4%, to \$55.9 million in 2003 from \$32.8 million in 2002. The addition of the Hollywood Casino properties increased depreciation and amortization expense by \$14.1 million. The remaining increase of \$9.0 million was primarily a result of the expansion at Charles Town for additional gaming space and the parking structure, the new hotel at Casino Magic-Bay St. Louis and the purchase of new slot machines at many of our properties.

Racing operating expenses

Racing expenses at our Pennsylvania properties were \$41.8 million in 2003 and 2002. Expenses that have a direct relationship to racing revenue such as purse expense, pari-mutuel taxes, simulcast fees and totalisator expense all decreased with the decrease in racing revenues, but were offset by increases in other operating expenses.

Other racing related expenses such as food, beverage and other expenses, general and administrative expenses and depreciation expenses decreased slightly or have remained at the same levels as the prior year.

Income from operations

Income from operations increased by \$78.3 million, or 79.7%, to \$176.5 million in 2003 from \$98.2 million in 2002. The increase was generated entirely by our gaming properties. The Hollywood Casino properties contributed \$65.6 million. Our overall profit margin increased to 17.4% in 2003 from 15.9% in 2002. For properties we owned for more than one year, our operating margins, not including corporate overhead, improved to 19.2% from 18.6% in 2002. We credit our property management teams for these results as their continued focus on customer and employee satisfaction, market share gains and operating margin improvements contribute to the consolidated improvement in income from operations and operating margins.

Other income (expense) summary (in thousands):

YEAR ENDED DECEMBER 31,	2002	2003
Other income (expense):		
Interest expense	\$(42,104)	\$(76,616)
Interest income	1,553	1,649
Earnings from joint venture	1,965	1,825
Other	(52)	(1,899)
Loss on change in fair values of interest rate swaps	(5,819)	(527)
Loss on early extinguishment of debt	(7,924)	(1,310)
Total other expense	\$(52,381)	\$(76,878)

Interest expense

Interest expense increased by \$34.5 million in 2003 due to borrowing an additional \$700 million for the acquisition of Hollywood Casino Corporation. During 2003 we restructured our debt by reducing the principal amount due on the credit facility by \$100 million, negotiating a reduction in the interest rate applicable to loans under the credit facility and replacing approximately \$200 million in term loans under the credit facility with new 6 7/8% senior subordinated notes. Subject to the availability of attractive acquisition or project opportunities, we expect to continue to accelerate our principal payments as free cash flow allows.

Other non-recurring expenses

In 2003, we incurred other expenses of \$1.9 million. These expenses included costs for the write-off of an option on a greyhound race track and costs incurred for due diligence in connection with the Wembley plc potential acquisition. During 2002, we incurred a \$5.8 million pre-tax charge to earnings as a result of the change in fair value of our interest rate swaps. The financial institutions that provided our \$350 million senior credit facility required the interest rate swap agreements for the variable rate term loans. The term loans were repaid in March 2002 from the proceeds of our equity and senior subordinated note offerings. Generally accepted accounting principles require the change in fair value of the swaps be recognized in our financial statements as if they were settled at the end of each reporting period until the agreements expire. Also in 2002, as part of our debt restructuring, we charged operations for deferred financing costs of \$5.9 million related to the prepayment of the variable rate term loans provided by our \$350 million senior credit facility. In addition, we paid a prepayment penalty of \$2.0 million.

Liquidity and Capital Resources

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

Net cash provided by operating activities was \$195.5 million for the year ended December 31, 2004. This consisted of net income from continuing operations of \$87.3 million, non-cash reconciling items of \$101.9 million and net decreases in current liability accounts along with net

decreases in current asset accounts of \$6.3 million, net of assets and liabilities acquired in the Bangor Historic Track, Inc. acquisition.

Cash flows used in investing activities totaled \$65.4 million for the year ended December 31, 2004. Expenditures for property, plant, and equipment totaled \$69.0 million in 2004 and included \$25.4 million at Charles Town for additional gaming space, \$4.6 million at Boomtown for the land acquisition and \$39.0 million in capital maintenance expenditures including new slot machines. The aggregate cash purchase price for the Bangor Historic Track, Inc. acquisition, net of cash acquired, was \$.9 million which does not include \$9.7 million recorded in miscellaneous other assets. Distributions from our New Jersey Joint venture totaled \$3.1 million and proceeds from sales of property and equipment totaled \$1.4 million.

Cash flows used in financing activities totaled \$124.2 million for the year ended December 31, 2004. We also incurred \$.8 million in deferred financing. Principal payments on long-term debt included \$131.4 million in payments under our credit facility. Net proceeds from capital leases was \$.2 million. Net proceeds from the exercise of stock options totaled \$7.8 million.

Outlook

Based on our current level of operations, and anticipated revenue growth, we believe that cash generated from operations, amounts available under our credit facility, and net proceeds from the sale of Pocono Downs will be adequate to meet our anticipated debt service requirements, except for the defaults under the Hollywood Casino Shreveport notes (which are non-recourse to us), capital expenditures and working capital needs for the foreseeable future. We cannot assure you, however, that our business will generate sufficient cash flow from operations, that our anticipated revenue growth will be realized, or that future borrowings will be available under our credit facility or otherwise will be available to enable us to service our indebtedness, including the credit facility and the notes, to retire or redeem the notes when required or to make anticipated capital expenditures. In addition, we expect a majority of our future growth to come from acquisitions of gaming properties at reasonable valuations, jurisdictional expansions and, to a lesser extent, property expansion in

under-penetrated markets. If we consummate significant acquisitions in the future or undertake any significant property expansions, our cash requirements may increase significantly and we may need to make additional borrowings or complete equity or debt financings to meet these requirements. We may need to refinance all or a portion of our debt on or before maturity. Our future operating performance and our ability to service or refinance our debt will be subject to future economic conditions and to financial, business and other factors, many of which are beyond our control.

Capital Expenditures

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

The following table summarizes our capital project expenditures, other than capital maintenance expenditures, by property for the fiscal year ended December 31, 2004 (in thousands):

PROPERTY	BUDGET	ACTUAL
Charles Town Entertainment Complex	\$24,000	\$25,369
Boomtown Biloxi	5,500	4,625
Total	\$29,500	\$29,994

The Charles Town Entertainment Complex has substantially completed work on Phase III of the facility expansion. Phase III includes the expansion of the parking garage by approximately 1,050 spaces, adding an additional 500 slot machines and related equipment, a new buffet area with seating for approximately 500 people and infrastructure improvements, including a loading dock, dry storage area, offices and a maintenance shop. The parking garage was completed and opened on July 1, 2004. We have installed 300 slot machines and the new gaming area, with an additional 200 slot machines, opened in the third quarter.

At Boomtown Biloxi, we signed an option to purchase approximately 4 acres of land adjacent to our Boomtown Biloxi property in January 2002. This purchase was completed in January 2004 at a cost of \$3.7 million and was part of our 2004 budget. We expect to use the land for additional parking and to develop the property in the event that we move the casino barge. The decision to move the casino barge is contingent upon the outcome of an appeal of the lawsuit filed by our landlord that is scheduled to be heard in April 2005. Due to the ongoing litigation with our landlord at the Boomtown Biloxi property, we elected not to budget for any additional project-related capital expenditures in 2004 other than the acquisition of the land. In the event that this dispute can be resolved in 2005, we may elect to revisit the decision.

For 2004, we spent approximately \$39 million for capital maintenance (replacement) expenditures at our properties.

Cash generated from operations funded all of our project capital expenditures and capital maintenance expenditures in 2004.

The following table summarizes our planned capital project expenditures, other than capital maintenance expenditures, by property for the fiscal year ending December 31, 2005 (in thousands):

PROPERTY	YEAR ENDING DECEMBER 31, 2005
Charles Town Entertainment Complex	\$ 63,800
Boomtown Biloxi	3,450
Penn National Race Course & OTWs	70,000
Bangor Historic Track Corporate	61,500
	1,000
Total	\$199,750

The Charles Town Entertainment Complex will continue its facility expansion in 2005. Plans call for additional gaming floor space for 700 more slot machines. This will bring the slot machine count to 4,500 when completed in 2006. Plans also include a new buffet, additional land purchases, a new entrance road to the facility, a new

perimeter road, a second parking garage for 2,700 vehicles and a small, detached hotel.

At Boomtown Biloxi, we are planning to spend \$3.4 million on warehouse space and the relocation and construction of a new welcome center. The lease for the property that the current welcome center is located on expires in May, 2005.

Capital expenditures at Penn National Race Course are estimated to be \$240 million of which \$70 million is budgeted in 2005 and is contingent upon the granting of a gaming license by the Pennsylvania Gaming Control Board and the granting of a building permit by the local municipality. Our construction budget includes the payment of the \$50 million gaming license fee in 2005.

In Bangor, Maine we plan to start construction on our new gaming facility that will contain 1,500 slot machines. Our plans are subject to the approval of our gaming license application by the Gambling Control Board and the issuance of appropriate legislation, an unconditional gaming license to develop and operate the facility, and any other required approvals. We anticipate opening the facility in mid-2006. The project budget includes the final payment due for the purchase of Bangor Historic Track, Inc. which is subject to our receipt of an unconditional gaming license.

At our corporate headquarters in Wyomissing, Pennsylvania, we have a budget of \$1.0 million for the expansion and renovation of our office space. Additional office space will likely be required as a result of the Argosy acquisition.

For 2005, we expect to spend approximately \$61.3 million for capital maintenance (replacement) projects at our properties. Of this total, approximately \$31.8 million will be spent on slot machines and ticket-in-ticket-out slot technology at our facilities in states where the new technology is approved.

We expect to use cash generated from operations and cash available under the revolver portion of our credit facility to fund our anticipated capital expenditure and capital maintenance expenditures in 2005.

Debt

Senior Secured Credit Facility

On March 3, 2003, we entered into an \$800 million senior secured credit facility with a syndicate of lenders that replaced our \$350 million credit facility.

The credit facility was initially comprised of a \$100 million revolving credit facility maturing on September 1, 2007, a \$100 million Term A facility loan maturing on September 1, 2007 and a \$600 million Term B facility loan maturing on September 1, 2007. On March 3, 2003 we borrowed the entire Term A and Term B term loans to complete the purchase of Hollywood Casino Corporation and to call Hollywood Casino Corporation's \$360 million senior secured notes.

On September 30, 2003, we made an optional prepayment of \$27 million toward our \$800 million senior secured credit facility. Based on our consolidated EBITDA (as defined in the credit agreement) for the 12 months ended September 30, 2003, the payment triggered a reduction of the interest rate margin on the Term A portion of the credit facility by 0.25% and a reduction of the interest rate margin on the Term B portion of the credit facility by 0.5%. The reductions of the interest rate margins became effective on October 23, 2003.

On December 3, 2003, we made a pre-payment of \$10.5 million plus accrued interest to satisfy in full our Term Loan A Facility due March 2008. Additionally, we made a pre-payment of \$195.1 million plus accrued interest against our Term Loan B Facility due March 2009, which had approximately \$596.3 million outstanding at September 30, 2003. The pre-payments were funded with the net proceeds of the \$200 million 6⁷/₈% senior subordinated note offering and with cash from operations.

On December 5, 2003, the \$800 million senior credit facility was amended and restated. The amended agreement reduced the total credit facility from \$800 million to \$500 million and converted the Term Loan B facility to a Term Loan D facility due September 2007. The Term Loan D facility will initially accrue interest at 250 basis points over LIBOR, representing a 100 basis point reduction from the original terms of the Term Loan B facility.

During 2004, we paid down \$129.7 million of principal on the Term Loan D facility including \$50.0 million in the fourth quarter. As a result of the accelerated principal payments on the credit facility, the Company recorded a loss on early extinguishment of debt of \$3.8 million for the write-off of the associated deferred finance fees.

At December 31, 2004, we had an outstanding balance of \$270.0 million on Term Loan D facility and \$91.6 million available to borrow under the revolving credit facility after

giving effect to outstanding letters of credit of \$8.4 million. The weighted average interest rate on the Term D facility is 4.99% at year-end excluding swaps and deferred finance fees.

The senior secured credit facility is secured by substantially all of our assets of, except for the assets of Hollywood Casino Shreveport, which serve as collateral for the notes of Hollywood Casino Shreveport. See "Discontinued Operations-Hollywood Casino Shreveport Notes" below.

Redemption of 11 1/8% Senior Subordinated Notes due 2008; Issuance of 6 3/4% Senior Subordinated Notes due 2015

On February 8, 2005, we called for redemption of all the \$200 million aggregate principal amount of our outstanding 11 1/8% Senior Subordinated Notes due March 1, 2008, in accordance with the related indenture. The redemption price was \$1,055.63 per \$1,000 principal amount, plus accrued and unpaid interest and payment was made on March 10, 2005.

On March 9, 2005, we completed an offering of \$250 million of 6 3/4% senior subordinated notes due 2015. Interest on the notes is payable on March 1 and September 1 of each year, beginning September 1, 2005. These notes mature on March 1, 2015. We used the net proceeds from this offering to redeem the \$200 million 11 1/8% Senior Subordinated Notes due March 1, 2008 and repay a portion of the term loan indebtedness under our current senior secured credit facility. The 6 3/4% notes are general unsecured obligations and are not guaranteed by our subsidiaries.

8 7/8% Senior Subordinated Notes due 2010

On February 28, 2002, we completed a public offering of \$175 million of 8 7/8% senior subordinated notes due 2010. Interest on the 8 7/8% notes is payable on March 15 and September 15 of each year, beginning September 15, 2002. The 8 7/8% notes mature on March 15, 2010. As of December 31, 2003, the entire principal amount of the 8 7/8% notes is outstanding. We used the net proceeds from the offering to repay term loan indebtedness under our prior senior secured credit facility. The 8 7/8% notes are general unsecured obligations and are guaranteed on a senior subordinated basis by certain of our current and future wholly-owned domestic subsidiaries.

6 7/8% Senior Subordinated Notes due 2011

On December 4, 2003, we completed an offering of \$200 million of 6 7/8% senior subordinated notes due 2011. Interest on the notes is payable on June 1 and December 1 of each year, beginning June 1, 2004. These notes mature on December 1, 2011. We used the net proceeds from the offering to repay term loan indebtedness under our current senior secured credit facility. The 6 7/8% notes are general unsecured obligations and are guaranteed on a senior subordinated basis by certain current and future wholly-owned domestic subsidiaries.

Anticipated Financing for Argosy Acquisition

Concurrently with the closing of the Argosy merger we plan to enter into new senior secured credit facilities upon terms and conditions to be negotiated. We have received commitments from Deutsche Bank Trust Company Americas, Deutsche Bank Securities Inc., Goldman Sachs Credit Partners L.P., Lehman Brothers Inc. and Lehman Commercial Paper Inc. to provide up to \$2.725 billion of senior secured credit facilities (which we may elect to increase to up to \$3.025 billion as described below) to finance the transactions contemplated by the Merger Agreement pursuant to which we will acquire the outstanding shares of Argosy, refinance certain of our and Argosy's indebtedness and pay certain fees and expenses in connection therewith. It is contemplated that such senior secured credit facilities would be comprised of a \$750.0 million revolving credit facility, up to a \$325.0 million term loan A facility and up to a \$1.65 billion term loan B facility. During the first three years of the term of the senior secured credit facilities, we may elect to increase the senior secured credit facilities by up to \$300 million in the aggregate, subject to some limitations; provided that any increase in commitments under the new revolving credit facility cannot exceed \$100 million. The senior secured credit facilities are to be guaranteed by substantially all of our and Argosy's domestic subsidiaries and secured by substantially all of our, Argosy's and such guarantors' assets, in each case except to the extent prohibited by relevant gaming authorities after we have used commercially reasonable efforts to arrange for such guarantees or collateral or as otherwise excluded. Material conditions to funding include, without limitation, absence of a material adverse change at

Argosy, refinancing of Argosy's existing indebtedness and our existing senior secured credit facility, receipt of necessary regulatory approvals and consummation of the Argosy merger in compliance in all material respects with the Merger Agreement.

Covenants

Our senior secured credit facility requires us, among other obligations, to maintain specified financial ratios and satisfy certain financial tests, including interest coverage and total leverage ratios. In addition, our senior secured credit facility restricts, 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 restrict corporate activities. The terms of our senior subordinated notes contain similar restrictions. Except for the defaults under the Hollywood Casino Shreveport notes, for which we (other than the Shreveport entities) are not liable, at December 31, 2004, we were in compliance with all required financial covenants.

Commitments and Contingencies

Contractual Cash Obligations

As of December 31, 2004, there was no indebtedness outstanding under our revolving credit portion of our credit facility and there was approximately \$91.6 million available for borrowing. The following table presents our contractual cash obligations as of December 31, 2004 (in thousands):

	TOTAL	PAYMENTS DUE BY PERIOD			
		2005	2006 - 2007	2008 - 2009	2010 & AFTER
Senior secured credit facility ⁽¹⁾	\$ 270,000	\$ 2,728	\$267,272	\$ -	\$ -
11 1/8% senior subordinated notes due 2008 ⁽²⁾					
Principal	200,000	-	-	200,000	-
Interest	77,875	22,250	44,500	11,125	-
8 7/8% senior subordinated notes due 2010 ⁽³⁾					
Principal	175,000	-	-	-	175,000
Interest	85,422	15,531	31,063	31,063	7,766
6 7/8% senior subordinated notes due 2011 ⁽⁴⁾					
Principal	200,000	-	-	-	200,000
Interest	96,250	13,750	27,500	27,500	27,500
Purchase obligations	24,174	17,396	4,176	2,602	-
Construction commitments	8,895	8,895	-	-	-
Capital Leases	13,908	1,766	3,965	4,267	3,910
Operating Leases	22,178	5,260	8,352	6,659	1,907
Total	\$1,173,702	\$87,576	\$386,828	\$283,216	\$416,083

(1) As of December 31, 2004 there was no indebtedness outstanding under the credit facility and there was approximately \$91.6 million available for borrowing under the revolving credit portion of the credit facility.

(2) All \$200.0 million aggregate principal amount of the outstanding 11 1/8% notes were redeemed in accordance with the related indenture on March 10, 2005. Interest payments of approximately \$11.1 million were due on each March 1 and September 1.

(3) The \$175.0 million aggregate principal amount of 8 7/8% notes matures on March 15, 2010. Interest payments of approximately \$7.8 million are due on each March 15 and September 15 until March 15, 2010.

(4) The \$200.0 million aggregate principal amount of 6 7/8% notes matures on December 1, 2011. Interest payments of approximately \$6.8 million are due on each June 1 and December 1 until December 1, 2011.

For a discussion of the \$150.0 million aggregate principal amount of 13% senior secured notes and the \$39.0 million aggregate principal amount of 13% first mortgage notes issued by Hollywood Casino Shreveport and Shreveport Capital Corporation, which are non-recourse to Penn

National, see "Discontinued Operations-Hollywood Casino Shreveport Notes" below.

Other Commercial Commitments

The following table presents our material commercial commitments as of December 31, 2004 for the following future periods:

	TOTAL AMOUNTS COMMITTED	AMOUNT OF COMMITMENT EXPIRATION PER PERIOD			
		2005	2006 - 2007	2008 - 2009	2010 & AFTER
<i>(In thousands)</i>					
Revolving Credit Facility ⁽¹⁾	\$ -	\$ -	\$ -	\$ -	\$-
Letters of Credit ⁽¹⁾	8,398	8,398	-	-	-
Guarantees of New Jersey Joint Venture Obligations ⁽²⁾	8,050	767	1,533	5,750	-
Total	\$16,448	\$9,165	\$1,533	\$5,750	\$-

(1) The available balance under the revolving portion of the \$100.0 senior secured credit facility is diminished by outstanding letters of credit.

(2) In connection with our 50% ownership interest in Pennwood Racing, Inc., our joint venture in New Jersey, we have entered into a debt service maintenance agreement with Pennwood's lender to guarantee up to 50% of Pennwood's \$16.1 million term loan. Our obligation as of December 31, 2004 under this guarantee is approximately \$8.1 million.

Interest Rate Swap Agreements

See "Quantitative and Qualitative Disclosures About Market Risk" below.

Discontinued Operations

On August 27, 2004, our unrestricted subsidiary, Hollywood Casino Shreveport, in cooperation with an Ad Hoc Committee representing a majority of its noteholders, entered into an agreement with Eldorado providing for acquisition of HCS by certain affiliates of Eldorado. On September 10, 2004, a group of creditors led by Black Diamond Capital Management, LLC filed an involuntary Chapter 11 case against HCS. On October 28, 2004, HCS filed a joint plan and disclosure statement that incorporates the Eldorado Transaction. On October 30, 2004, HCS agreed to the entry of an order for relief in the Chapter 11 case that has been filed against it and HCS I, Inc., HCS II, Inc., HWCC-Louisiana, Inc. and Shreveport Capital Corporation

commenced voluntary cases under Chapter 11 of the Bankruptcy Code.

HCS filed a revised reorganization plan and disclosure statement with the Bankruptcy Court on March 3, 2005. The plan continues to provide for the acquisition of the hotel and casino by Eldorado under the agreement announced last year. The Official Bondholder Committee in the Chapter 11 case has joined HCS as a proponent of the plan. The Bankruptcy Court has set a hearing on the approval of the Disclosure Statement for April 11, 2005. Black Diamond Capital Management, LLC and KOAR International (Paul Alanis) continue to express interest in acquiring the hotel and casino and have asked the Bankruptcy Court for permission to file their own competing plan. HCS intends to oppose that request.

On January 25, 2005, we completed the sale of The Downs Racing, Inc. and its subsidiaries to the MTGA. Under the terms of the agreement, MTGA acquired The Downs Racing

and its subsidiaries including Pocono Downs (a standardbred horse racing facility located on approximately 400 acres in Wilkes-Barre, Pennsylvania) and five Pennsylvania OTW facilities located in Carbondale, East Stroudsburg, Erie, Hazleton and the Lehigh Valley (Allentown).

We have reflected the results of the transactions for the disposition of Hollywood Casino Shreveport and The Downs Racing, Inc. by classifying the assets, liabilities and results of operations of Hollywood Casino Shreveport and The Downs Racing, Inc. as assets and liabilities held for sale and discontinued operations in accordance with the provisions of Financial Accounting Standards Board Statement No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." A gain or loss on either of these transactions has not been recorded or recognized as of December 31, 2004, the sales had not yet been deemed completed. Financial information for HCS was previously reported as part of the gaming reporting segment and financial information for The Downs Racing, Inc. and its subsidiaries was previously reported as part of the racing reporting segment.

Hollywood Casino Shreveport Notes

Hollywood Casino Shreveport, or HCS, and Shreveport Capital Corporation are co-issuers of \$150 million aggregate principal amount of 13% senior secured notes due 2006 and \$39 million aggregate principal amount of 13% first mortgage notes due 2006, which we refer to in this document as the Hollywood Casino Shreveport notes. Hollywood Casino Shreveport is a general partnership that owns the casino operations. Shreveport Capital Corporation is a wholly-owned subsidiary of Hollywood Casino Shreveport formed solely for the purpose of being a co-issuer of the Hollywood Casino Shreveport notes.

The Hollywood Casino Shreveport notes are non-recourse to us and our subsidiaries (other than Hollywood Casino Shreveport, Shreveport Capital Corporation, HCS I, Inc., HCS II, Inc. and HWCC-Louisiana, Inc., which we refer to as the Shreveport entities) and are secured by substantially all of the assets of the casino, the first mortgage notes are secured by the partnership interests held by HCS I, Inc. and HCS II, Inc. and the stock held by HWCC-Louisiana,

Inc. Further, an event of default under the indentures for the Hollywood Casino Shreveport notes does not cause an event of default under the Company's senior secured credit facility or senior subordinated notes.

The Hollywood Casino Shreveport notes have been in default under the terms of their respective note indentures since May 2003 and accordingly are classified as current obligations within liabilities held for sale at December 31, 2004.

Critical Accounting Estimates

Financial Reporting Release No. 60 requires all companies to include a discussion of critical accounting policies or methods and estimates used in the preparation of financial statements. We prepare our Consolidated Financial Statements in conformity with accounting principles generally accepted in the United States. Certain of our accounting policies, including the estimated lives assigned to our assets, asset impairment, insurance reserves, the purchase price allocations made in connection with our acquisitions and the calculation of our income tax liabilities, require that we apply significant judgment in defining the appropriate assumptions for calculating financial estimates. By their nature, these judgments are subject to an inherent degree of uncertainty. Our judgments are based on our historical experience, terms of existing contracts, our observance of trends in the industry, information provided by our customers and information available from other outside sources, as appropriate. There can be no assurance that actual results will not differ from our estimates. The policies and estimates discussed below are considered by management to be those in which our policies, estimates and judgments have a significant impact on issues that are inherently uncertain.

Long-lived assets

At December 31, 2004, we had a net property and equipment balance of \$597.4 million, representing 36.4% of total assets. We depreciate property and equipment on a straight-line basis over their estimated useful lives. The estimated useful lives are based on the nature of the assets as well as our current operating strategy. We review the carrying value of our property and equipment whenever events and circum-

stances indicate that the carrying value of an asset may not be recoverable from the estimated future cash flows expected to result from its use and eventual disposition. The factors considered by management 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 impairment loss for these assets. Such an impairment loss would be recognized as a non-cash component of operating income.

Intangible assets, including goodwill

As a result of our recent acquisitions, we have approximately \$589.9 million in goodwill on our Consolidated Balance Sheet resulting from our acquisition of other businesses. 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, a valuation was completed to determine the allocation of the purchase prices. The factors considered in the valuation included data gathered as result of our due diligence in connection with the acquisition and projections for future operations. The annual evaluation of goodwill requires the use of estimates about future operating results of each reporting unit to determine their estimated fair value. Changes in forecasted operations can materially affect these estimates. Once an impairment of goodwill or other intangible assets has been recorded, it cannot be reversed. Because our goodwill is no longer amortized, there may be more volatility in reported income than under previous accounting standards because impairment losses, if any, are likely to occur irregularly in varying amounts.

Accounting for income taxes

We account for income taxes in accordance with FASB Statement No. 109, "Accounting for Income Taxes," or SFAS 109, which requires that deferred tax assets and liabilities be recognized using enacted tax rates for the effect of temporary differences between the book and tax basis of recorded assets and liabilities. SFAS 109 also requires that deferred tax assets be reduced by a valuation allowance if it is more likely than not that some portion of all of the deferred tax asset will not be realized.

The realizability of the deferred tax assets is evaluated quarterly by assessing the valuation allowance and by adjusting the amount of the allowance, if necessary. The factors used to assess the likelihood of realization are the forecast of future taxable income and available tax planning strategies that could be implemented to realize the net deferred tax assets. 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.

In addition, 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.

Accounting Pronouncements Issued or Adopted in 2004

In December 2004, the FASB issued Statement No. 123 (revised 2004), "Stock-Based Payment" (SFAS 123R). This statement replaces SFAS 123, "Accounting for Stock-Based Compensation," supersedes APB Opinion No. 25, "Accounting

for Stock Issued to Employees" (APB 25) and amends SFAS 95, "Statement of Cash Flows," to require that excess tax benefits be reported as a financing cash inflow rather than as a reduction of taxes paid. SFAS 123R is effective the first interim or annual reporting period that begins after June 15, 2005, which will be for the period covered by our quarterly report on Form 10-Q for the third quarter of 2005. We currently account for stock option grants using the intrinsic-value method in accordance with APB 25. Under the intrinsic-value method, because the exercise price of the Company's employee stock options is equal to the market price of the underlying stock on the date of grant, no compensation expense is recognized. If we would have applied the fair value recognition provisions of SFAS 123R, we would have had a charge to earnings of \$4.7 million for stock-based employee compensation, net of related income taxes, for 2004.

Quantitative and Qualitative Disclosures About Market Risk

The table below provides information as of December 31, 2004, 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 and weighted average interest rates by maturity dates. For interest rate swaps, the table presents notional amounts and weighted average interest rates by contractual maturity dates. 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 as of December 31, 2004.

	2005	2006	2007	2008	2009	THERE-AFTER	TOTAL
<i>(In thousands)</i>							
Long-term debt:							
Fixed rate	\$ -	\$ -	\$ -	\$200,000	\$ -	\$375,000	\$575,000
Average interest rate					11.12%	7.81%	8.96%
Variable rate	\$2,728	\$ 2,728	\$264,544	\$ -	\$ -	\$ -	\$270,000
Average interest rate ⁽¹⁾	4.99%	4.99%	4.99%				4.99%
Leases	\$1,766	\$ 1,895	\$ 2,071	\$ 2,270	\$1,997	\$ 3,910	\$ 13,909
Average interest rate	6.73%	6.73%	6.73%	6.73%	6.73%	6.73%	6.73%
Interest rate derivatives:							
Interest rate swaps							
Variable to fixed	\$ -	\$120,000	\$135,000	\$ -	\$ -	\$ -	\$255,000
Average pay rate		1.92%	2.48%				
Average receive rate ⁽²⁾		2.55%	2.55%				

(1) Interest payable is based on the Three Month London Interbank Offer Rate (LIBOR) plus a spread.

(2) Interest payable is based on the Three Month London Interbank Offer Rate (LIBOR).

On December 20, 2000, we entered into an interest rate swap with a notional amount of \$100 million and a termination date of December 22, 2003. Under this agreement, we pay a fixed rate of 5.835% against a variable interest rate based on the 90-day LIBOR rate. On August 3, 2001, we entered into an interest rate swap with a notional amount of \$36 million with a termination date of June 30, 2004. Under this agreement, we pay a fixed rate of 4.8125% against a variable interest rate based on the 90-day LIBOR rate. At December 31, 2003, the 90-day LIBOR rate was 1.15%. We entered into these interest rate swap agreements due to the requirements of the then current senior secured credit facility and to reduce the impact of future variable interest payments related to such senior secured credit facility.

In 2001, we accounted for the effective interest rate swap agreements as cash flow hedges. The changes in the fair values of effective interest rate swaps were recorded as adjustments to accrued interest in the accompanying consolidated balance sheet with the offset recorded in accumulated other comprehensive loss, which as of December 31, 2001 amounted to \$3.8 million, net of an income tax benefit of \$2.0 million. The amount of ineffectiveness related to the cash flow hedges in 2001 and 2002 was immaterial. In March 2002, we repaid all of our then outstanding variable rate debt with the issuance of the 8% Senior Subordinated Notes, fixed rate debt. The hedge designation was removed. Subsequent changes in the fair value of the interest rate swap contracts are recognized as adjustments to loss on change in fair values of interest rate swaps in the accompanying statements of income in the period in which they occur. Accordingly, we have recorded a non-cash pre-tax loss of \$5.8 million, or \$.09 per diluted share after tax, for the year ended December 31, 2002.

Amounts previously recognized in other comprehensive income will be reclassified to income over the remaining term of the swap as we incur interest expense on the replacement debt. Over the next twelve months, approximately \$125,000 will be reclassified to income. On March 3, 2003, we terminated our \$36 million notional amount interest rate swap originally scheduled to expire in June 2004. We paid \$1.9 million to terminate the swap agreement.

On March 27, 2003, we entered into interest rate swap agreements with a total notional amount of \$375.0 million

in accordance with the terms of the \$800 million senior secured credit facility. There are three two-year swap contracts totaling \$175 million with an effective date of March 27, 2003 and a termination date of March 27, 2005. Under these contracts, we pay a fixed rate of 1.92% and receive a variable rate based on the 90-day LIBOR rate. We also entered into three three-year swap contracts totaling \$200 million with a termination date of March 27, 2006. We accounted for these effective interest rate swap agreements as cash flow hedges. The changes in the fair values of effective interest rate swaps were recorded as adjustments to accrued interest in the accompanying consolidated balance sheet with the offset recorded in accumulated other comprehensive loss. The amount of ineffectiveness related to the cash flow hedges in 2003, was immaterial. Under these contracts, we pay fixed rates of 2.48% to 2.49% against a variable rate based on the 90-day LIBOR rate. The difference between amounts received and amounts paid under such agreements, as well as any costs or fees, is recorded as a reduction of, or addition to, interest expense as incurred over the life of the swap.

On September 3, 2004, we terminated our \$55 million notional amount interest rate swap originally scheduled to expire on March 27, 2005. We paid \$27,500 to terminate the swap agreement. On December 5, 2004, we terminated our \$65 million notional amount interest rate swap originally scheduled to expire on March 27, 2006. We received \$379,000 to terminate the swap agreement. We terminated our swap agreements early in conjunction with accelerated payments of principal on the senior secured credit facility Term D loans.

U.S. and Foreign Revenues

Our revenues from continuing operations in the U.S. for 2002, 2003 and 2004 were approximately \$618.9 million, \$1,013.0 million and \$1,140.7 million, respectively. Our revenues from operations in Canada for 2002, 2003 and 2004 were approximately \$11.5 million, \$13.7 million and \$16.3 million, respectively. We currently do not derive revenue from any countries other than the U.S. and Canada.

Penn National Gaming, Inc. & Subsidiaries Consolidated Balance Sheets

YEAR ENDED DECEMBER 31, <i>(In thousands, except share and per share data)</i>	2003	2004
Assets		
Current assets:		
Cash and cash equivalents	\$ 81,567	\$ 87,620
Receivables, net of allowance for doubtful accounts of \$2,062 and \$1,883, respectively	25,739	40,812
Prepaid expenses and other current assets	25,447	19,517
Deferred income taxes	17,284	18,274
Prepaid income taxes	7,593	7,980
Total current assets	157,630	174,203
Net property, plant and equipment	594,152	597,394
Other assets:		
Investment in and advances to unconsolidated affiliate	17,187	15,709
Excess of cost over fair market value of net assets acquired	586,969	588,085
Management service contract (net of amortization of \$6,719 and \$9,231, respectively)	19,027	16,515
Deferred financing costs, net	28,214	20,063
Miscellaneous	10,813	42,752
Assets held for sale	195,607	188,686
Total other assets	857,817	871,810
Total Assets	\$1,609,599	\$1,643,407
Liabilities and Shareholders' Equity		
Current liabilities:		
Current maturities of long-term debt	\$5,634	\$4,494
Accounts payable	10,785	13,629
Accrued expenses	45,950	56,732
Accrued interest	11,736	13,124
Accrued salaries and wages	27,482	27,648
Gaming, pari-mutuel, property and other taxes	11,940	14,941
Income taxes payable	9,313	23,105
Other current liabilities	7,698	24,438
Total current liabilities	130,538	178,111
Long-term liabilities:		
Long-term debt, net of current maturities	984,489	854,415
Deferred income taxes	13,354	31,806
Liabilities held for sale	171,340	180,983
Total long-term liabilities	1,169,183	1,067,204
Commitments and contingencies		
Shareholders' equity:		
Preferred stock, \$.01 par value; 1,000,000 shares authorized; no shares issued	-	-
Common stock, \$.01 par value; 200,000,000 shares authorized; shares issued 81,242,700 and 83,131,940, respectively	812	831
Restricted stock, 160,000 shares issued	-	(2,114)
Treasury stock, shares at cost 1,698,800 shares	(2,379)	(2,379)
Additional paid-in capital	162,039	180,573
Retained earnings	148,055	219,539
Accumulated other comprehensive income, net	1,351	1,642
Total shareholders' equity	309,878	398,092
Total Liabilities and Shareholders' Equity	\$1,609,599	\$1,643,407

See accompanying notes to consolidated financial statements.

Penn National Gaming, Inc. & Subsidiaries Consolidated Statements of Income

YEAR ENDED DECEMBER 31, <i>(In thousands, except share and per share data)</i>	2002 ⁽³⁾	2003 ⁽⁴⁾	2004
Revenues:			
Gaming	\$491,930	\$ 871,218	\$ 992,088
Racing	56,116	52,075	49,948
Management service fee	11,479	13,726	16,277
Food, beverage and other revenue	87,136	131,915	147,991
Gross revenues	646,661	1,068,934	1,206,304
Less: Promotional allowances	(27,805)	(55,936)	(65,615)
Net revenues	618,856	1,012,998	1,140,689
Operating expenses:			
Gaming	289,448	475,407	544,746
Racing	41,777	41,752	38,997
Food, beverage and other expenses	57,743	92,663	97,712
General and administrative	97,126	169,170	179,669
Depreciation and amortization	34,518	57,471	65,785
Total operating expenses	520,612	836,463	926,909
Income from continuing operations	98,244	176,535	213,780
Other income (expenses):			
Interest expense	(42,104)	(76,616)	(75,720)
Interest income	1,553	1,649	2,093
Earnings from joint venture	1,965	1,825	1,634
Other	(52)	(1,899)	(392)
Loss on change in fair value of interest rate swaps	(5,819)	(527)	-
Loss on early extinguishment of debt	(7,924)	(1,310)	(3,767)
Total other expenses, net	(52,381)	(76,878)	(76,152)
Income from continuing operations before income taxes	45,863	99,657	137,628
Taxes on income	17,534	37,463	50,288
Net income from continuing operations	28,329	62,194	87,340
Income (Loss) from discontinued operations, net of tax (benefit) of \$1,396 and \$(5,762) and \$(8,460) respectively	2,534	(10,723)	(15,856)
Net income	\$30,863	\$51,471	\$71,484
Earnings (loss) per share — basic			
Income from continuing operations	\$0.38	\$0.79	\$1.09
Discontinued operations, net of tax	0.03	(0.14)	(0.20)
Basic net income per share	\$0.41	\$0.65	\$0.89
Earnings (loss) per share — diluted			
Income from continuing operations	\$0.36	\$0.77	\$1.05
Discontinued operations, net of tax	0.03	(0.14)	(0.19)
Diluted net income per share	\$0.39	\$0.63	\$0.86
Weighted average shares outstanding			
Basic	75,550	78,946	80,510
Diluted	78,188	81,224	83,508

See accompanying notes to consolidated financial statements.

Penn National Gaming, Inc. & Subsidiaries Consolidated Statements of Shareholders' Equity

	COMMON STOCK		RESTRICTED STOCK	TREASURY STOCK	ADDTL. PAID-IN CAPITAL	RETAINED EARNINGS	COMPREHENSIVE (LOSS) INCOME	TOTAL	COMPREHENSIVE INCOME
	SHARES	AMOUNT							
<i>(In thousands, except share data)</i>									
Balance, December 31, 2001	63,733,700	\$637	\$ -	\$(2,379)	\$ 43,128	\$ 65,721	\$(3,842)	\$103,265	\$19,916
Exercise of stock options including tax benefit of \$3,528	2,933,668	29	-	-	14,147	-	-	14,176	-
Issuance of common stock	13,400,000	134	-	-	95,943	-	-	96,077	-
Accelerated vesting of stock options	-	-	-	-	434	-	-	434	-
Change in fair value of interest rate swap contracts, net of income taxes of \$495	-	-	-	-	-	-	918	918	918
Amortization of unrealized loss on interest rate swap contracts, net of income taxes of \$676	-	-	-	-	-	-	1,257	1,257	-
Foreign currency translation adjustment	-	-	-	-	-	-	10	10	10
Net income	-	-	-	-	-	30,863	-	30,863	30,863
Balance, December 31, 2002	80,067,368	800	-	(2,379)	153,652	96,584	(1,657)	247,000	\$31,791
Exercise of stock options including tax benefit of \$6,067	1,175,332	12	-	-	8,387	-	-	8,399	-
Change in fair value of interest rate swap contracts, net of income taxes of \$669	-	-	-	-	-	-	1,091	1,091	1,091
Amortization of unrealized loss on interest rate swap contracts, net of income taxes of \$810	-	-	-	-	-	-	1,517	1,517	-
Foreign currency translation adjustment	-	-	-	-	-	-	400	400	400
Net income	-	-	-	-	-	51,471	-	51,471	51,471
Balance, December 31, 2003	81,242,700	812	-	(2,379)	162,039	148,055	1,351	309,878	\$52,962
Exercise of stock options including tax benefit of \$8,344	1,889,240	19	-	-	16,140	-	-	16,159	-
Restricted Stock Issue	-	-	(2,114)	-	2,394	-	-	280	-
Change in fair value of interest rate swap contracts, net of income taxes of \$16	-	-	-	-	-	-	29	29	29
Amortization of unrealized loss on interest rate swap contracts, net of income taxes of \$44	-	-	-	-	-	-	82	82	-
Foreign currency translation adjustment	-	-	-	-	-	-	180	180	180
Net income	-	-	-	-	-	71,484	-	71,484	71,484
Balance, December 31, 2004	83,131,940	\$831	\$(2,114)	\$(2,379)	\$180,573	\$219,539	\$ 1,642	\$398,092	\$71,693

See accompanying notes to consolidated financial statements.

Penn National Gaming, Inc. & Subsidiaries Consolidated Statements of Cash Flows

YEAR ENDED DECEMBER 31,	2002 ⁽³⁾	2003 ⁽⁴⁾	2004
<i>(In thousands)</i>			
Cash flows from operating activities:			
Net income from operations	\$ 30,863	\$ 51,471	\$ 71,484
Loss (income) from discontinued operations	(2,534)	10,723	15,856
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	34,518	57,471	65,785
Amortization of deferred financing costs charged to interest expense	2,036	4,247	5,163
Amortization of the unrealized loss on interest rate swap contracts charged to interest expense, net of income tax benefit	1,257	1,517	82
Loss on sale of fixed assets	735	1,823	1,824
Earnings from joint venture	(1,965)	(1,825)	(1,634)
Loss relating to early extinguishment of debt	5,906	1,310	3,767
Deferred income taxes	10,079	1,798	18,184
Accelerated vesting of stock options	434	-	-
Tax benefit from stock options exercised	3,528	6,067	8,344
Loss on change in value of interest rate swap contracts	5,819	527	-
Amortization of restricted stock	-	-	280
Decrease (increase), net of businesses acquired, in Receivables	2,021	(877)	(15,073)
Prepaid income taxes	(6,415)	(1,159)	(387)
Prepaid expenses and other current assets	(1,065)	(9,612)	5,965
Miscellaneous other assets	(1,827)	34,582	(32,204)
Increase (decrease), net of businesses acquired, in Accounts payable and accrued liabilities	13,695	(16,623)	15,209
Gaming, pari-mutuel, property and other taxes	3,625	(9,785)	3,001
Income taxes payable	(222)	7,960	13,068
Other current liabilities	1,153	421	16,740
Net cash provided by operating activities	101,641	140,036	195,454
Cash flows from investing activities:			
Expenditures for property and equipment	(88,533)	(56,733)	(68,957)
Net payments under interest rate swaps	(3,830)	(1,902)	-
Proceeds from sale of property and equipment	369	663	1,395
Distributions from joint venture	-	790	3,112
Acquisition of businesses, net of cash acquired	(9,570)	(274,682)	(954)
(Increase) decrease in cash in escrow	(500)	1,000	-
Net cash used in investing activities	(102,064)	(330,864)	(65,404)
Cash flows from financing activities:			
Proceeds from exercise of options	10,646	2,332	7,816
Proceeds from sale of common stock	96,077	-	-
Proceeds from issuance of long-term debt	173,752	900,000	156
Principal payments on long-term debt	(258,891)	(661,566)	(131,370)
Increase in deferred financing cost	(3,272)	(23,307)	(779)
Net cash provided by financing activities	18,312	217,459	(124,177)
Effect of exchange rate fluctuations on cash	10	400	180
Net increase in cash and cash equivalents	17,899	27,031	6,053
Cash and cash equivalents at beginning of year	36,637	54,536	81,567
Cash and cash equivalents at end of year	\$ 54,536	\$ 81,567	\$ 87,620

See accompanying notes to consolidated financial statements.

Penn National Gaming, Inc. & Subsidiaries

Notes to Consolidated Financial Statements

1. Summary of Significant Accounting Policies

Business

Penn National Gaming, Inc. ("Penn") and subsidiaries (collectively, the "Company") is a diversified, multi-jurisdictional owner and operator of gaming and pari-mutuel properties. Penn is the successor to several businesses that have operated as Penn National Race Course since 1972. Penn was incorporated in Pennsylvania in 1982 as PNRC Corp. and adopted its current name in 1994. In 1997, the Company began its transition from a pari-mutuel company to a diversified gaming company with the acquisition of the Charles Town property and the introduction of video lottery terminals in West Virginia. From 2000 to 2003, the Company acquired seven other gaming properties through its Mississippi (Casino Magic-Bay St. Louis and Boomtown Biloxi), CRC Holdings, Inc. (Casino Rouge and Casino Rama management contract), Bullwhackers properties and Hollywood Casino Corporation (Aurora and Tunica) acquisitions.

The consolidated financial statements include the accounts of Penn and its wholly-owned subsidiaries. The Company owns and operates, through its subsidiaries, seven gaming properties in Charles Town, West Virginia; Bay St. Louis, Biloxi and Tunica, Mississippi; Baton Rouge, Louisiana; Black Hawk, Colorado; and Aurora, Illinois. The Company also owns Penn National Race Course, a thoroughbred racetrack in Grantville, Pennsylvania, six off-track wagering ("OTW") facilities located throughout Pennsylvania and Bangor Historic Race Track in Bangor, Maine. The Company has a 50% interest in Pennwood Racing, Inc., which owns and operates Freehold Raceway in New Jersey. In addition, the Company has a management contract and receives a management service fee for operating a gaming facility in Orillia, Ontario, Canada ("Casino Rama").

The Company views each property as an operating segment. The Company has aggregated its gaming properties that are economically similar, offer similar types of products and services (table games and/or slot machines), cater to the same types of customers (local patronage) and are heavily regulated into one reporting segment called gaming. The Company has aggregated its racing properties that are economically similar, offer similar products and services (live and simulcast racing), cater to the similar types of customers (local patronage) and are similarly regulated into one reporting segment called racing.

Principles of Consolidation

The consolidated financial statements include the accounts of Penn and its subsidiaries. Investment in and advances to an unconsolidated affiliate that is 50% owned is accounted for under the equity method. All significant intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates

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

Cash and Cash Equivalents

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

Concentration of Credit Risk

Financial instruments that potentially subject the Company to credit risk consist of cash equivalents and accounts receivable.

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

Concentration of credit risk, with respect to casino receivables, is limited through the Company's credit evaluation process. The Company issues markers to approved casino customers only following background checks and investigations of creditworthiness.

The Company's trade receivables consist principally of amounts due from other racetracks and their OTWs for the settlement of simulcast fees, amounts due from the West Virginia Lottery for gaming revenue settlements and \$11.6 million due from Casino Rama for management service fees of \$1.3 million and reimbursement of \$10.3 million of expenses to be paid on behalf of Casino Rama as of

December 31, 2004. The payable on behalf of Casino Rama is included in accrued salaries in the accompanying consolidated balance sheet at December 31, 2004.

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

Fair Value of Financial Instruments

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

Cash and Cash Equivalents: The carrying amount approximates the fair value due to the short maturity of the cash equivalents.

Long-term Debt: The fair value of the Company's long-term debt approximates carrying value and is estimated based on the quoted market prices for the same or similar issues or on the current rates offered to the Company for debt of the same remaining maturities.

Property, Equipment and Management Contract

Property and equipment are stated at cost. Maintenance and repairs that do not add materially to the value of the asset nor appreciably prolong its useful life are charged to expense as incurred. Gains or losses on the disposal of property and equipment are included in the determination of income.

Depreciation of property and equipment and amortization of leasehold improvements are provided using the straight-line method over the following estimated useful lives:

Land improvements	5 to 15 years
Building and improvements	25 to 40 years
Furniture, fixtures, and equipment	3 to 7 years
Transportation equipment	5 years
Leasehold Improvements	10 to 20 years

Amortization of the management contract for Casino Rama is computed by the straight-line method through July 2011, the expiration date of the agreement.

The Company reviews the carrying values of its long-lived and identifiable intangible assets, other than goodwill, for possible impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable based on undiscounted estimated future operating cash flows. As of December 31, 2004, the Company has determined that no impairment has occurred.

Excess of Cost Over Fair Market Value of Net Assets Acquired (Goodwill)

In 2002, the Company adopted the Financial Accounting Standards Board ("FASB") Statement No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142"). SFAS 142 establishes standards for the accounting of intangible assets that are acquired individually or with a group of other assets and the accounting for goodwill and other intangible assets after they have been initially recognized in the financial statements. Under SFAS No. 142, amortization of goodwill and intangible assets with an indefinite useful life is discontinued and additional financial statement disclosure for goodwill and other intangibles is required. Goodwill and intangible assets of each reporting unit are tested at least annually for impairment by comparing the fair value of the recorded assets to their carrying amount. If the carrying amount of the intangible asset exceeds its fair value, an impairment loss is recognized. The Company has determined that the gaming and racing reporting segments as defined by FASB Statement No. 131, "Disclosures about Segments of an Enterprise and Related Information" are its two reporting units for purposes of testing Goodwill for impairment. See Note 11 for more information regarding the segment information.

Because the Company's goodwill is no longer being amortized, the reported amounts of goodwill will not decrease in the same manner as under previous accounting pronouncements. There may be more volatility in reported income than under previous accounting pronouncements because impairment losses, if any, are likely to occur irregularly and in varying amounts. For the years ended December 31, 2002, 2003 and 2004, no impairment charges were required as a result of the annual impairment test.

Deferred Financing Costs

Deferred financing costs that are incurred by the Company in connection with the issuance of debt are deferred and amortized to interest expense over the life of the underlying indebtedness using the interest method adjusted to reflect any early repayments.

Income Taxes

The Company recognizes deferred tax assets and liabilities for the expected future tax consequences of events that have been recognized in the Company's financial statements or tax returns. Under this method, deferred tax assets and liabilities are determined based on the difference between the financial statement carrying amounts and the tax basis of assets and liabilities using enacted tax rates in effect in the years in which the differences are expected to reverse.

Accounting for Derivatives and Hedging Activities

Effective January 1, 2001, the Company adopted Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133"), which requires that all derivative instruments be recorded on the balance sheet at fair value.

The Company uses fixed and variable rate-debt to finance its operations. Variable rate debt obligations expose the Company to variability in interest payments due to changes in interest rates. The Company continuously monitors changes in interest rate exposures and evaluates hedging opportunities. The Company's risk management policy permits the Company to use any combination of interest rate swaps, futures, options, caps and similar instruments.

The Company's objective is to limit the impact of interest rate changes on earnings and cash flows. The Company currently achieves this by entering into interest rate swap agreements to convert a percentage of its debt from variable to fixed rates. Under interest rate swap contracts, the Company agrees to pay an amount equal to a specified fixed rate of interest times a notional principal amount, and to receive in return an amount equal to a specified variable rate of interest times a notional amount. Net settlements are made quarterly. If the contracts are terminated prior to maturity, the amount paid or received in settlement is established by agreement at the time of the termination and usually represents the net present value, at current rates of interest, of the remaining obligations to exchange

payments under the terms of the contract. The Company accounts for these swaps as cash flow hedges. Generally, the Company does not issue or hold derivative contracts for speculative purposes.

The Company is exposed to credit losses in the event of non-performance by counterparties to these interest rate swap agreements, but it does not expect any of the counterparties to fail to meet their obligations. To manage credit risks, the Company selects counterparties based on credit ratings, limits its exposure to a single counterparty under defined Company guidelines, and monitors the market position with each counterparty.

The fair value of derivatives is included in the balance sheets as an asset or liability. Changes in the fair value of a derivative that is highly effective and that is designated and qualifies as a cash flow hedge, to the extent that the hedge is effective, are recorded in other comprehensive income, until earnings are affected by the variability of cash flows of the hedged transaction (e.g., until periodic settlements of a variable-rate asset or liability are recorded in earnings). Any hedge ineffectiveness (which represents the amount by which the changes in the fair value of the derivative exceed the variability in the cash flows of the forecasted transaction) is recorded in current-period earnings.

The Company formally documents all relationships between hedging instruments and hedged items, as well as its risk-management objective and strategy for undertaking various hedge transactions. The Company also formally assesses (both at the hedge's inception and on an ongoing basis) whether the derivatives that are used in hedging transactions have been highly effective in offsetting changes in the cash flows of hedged items and whether those derivatives may be expected to remain highly effective in the future periods. When it is determined that a derivative is not (or has ceased to be) highly effective as a hedge, the Company discontinues hedge accounting prospectively, as discussed below.

The Company discontinues hedge accounting prospectively when (1) it determines that the derivative is no longer effective in offsetting changes in the cash flows of a hedged item (including hedged items such as firm commitments or forecasted transactions, such as future variable rate interest payments); (2) the derivative expires or is sold, terminated, or exercised; (3) it is no longer probable that the forecasted transaction will occur; or (4) management determines that designating the derivative as a hedging instrument is no longer appropriate.

When the Company discontinues hedge accounting because it is no longer probable that the forecasted transaction will occur in the originally expected period, the gain or loss on the derivative remains in accumulated other comprehensive income and is reclassified into earnings when the forecasted transaction affects earnings. However, if it is probable that a forecasted transaction will not occur by the end of the originally specified time period or within an additional two-month period of time thereafter, the gains and losses that were accumulated in other comprehensive income will be recognized immediately in earnings. In all situations in which hedge accounting is discontinued and the derivative remains outstanding, the Company will carry the derivative at its fair value on the balance sheet, recognizing changes in the fair value in current-period earnings. For purposes of the cash flows statement, cash flows from derivative instruments designated and qualifying as hedges are classified with the cash flows from the hedged item.

Revenue Recognition and Promotional Allowances

Casino revenue is the aggregate net difference between gaming wins and losses, with liabilities recognized for

funds deposited by customers before gaming play occurs and for chips in the customers' possession. Hotel, food and beverage, entertainment and other operating revenues are recognized as services are performed.

Revenues are recognized net of certain sales incentives in accordance with the Emerging Issues Task Force ("EITF") consensus on Issue 01-9, "Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's products)." The consensus in EITF 01-9 requires that sales incentives be recorded as a reduction of revenue and that points earned in point-loyalty programs must be recorded as a reduction of revenue. The Company recognizes incentives related to casino play and points earned in loyalty programs as a direct reduction of casino revenue.

The retail value of accommodations, food and beverage, and other services furnished to guests without charge is included in gross revenue and then deducted as promotion allowances. The estimated cost of providing such promotional allowances is primarily included in casino expenses. These amounts that are included in promotional allowances were as follows:

YEAR ENDED DECEMBER 31,	2002	2003	2004
<i>(In thousands)</i>			
Rooms	\$ 1,720	\$ 6,560	\$ 7,812
Food and beverage	23,506	42,474	46,617
Other	2,579	6,902	11,186
Total promotional allowances	\$27,805	\$55,936	\$65,615

The estimated cost of providing such complimentary services that is included in gaming expenses was as follows:

YEAR ENDED DECEMBER 31,	2002	2003	2004
<i>(In thousands)</i>			
Rooms	\$ 1,108	\$ 4,664	\$ 5,136
Food and beverage	13,364	30,304	31,906
Other	1,576	2,696	3,147
Total cost of complimentary services	\$16,048	\$37,664	\$40,189

Racing revenues include the Company's share of pari-mutuel wagering on live races after payment of amounts returned as winning wagers, and the Company's share of wagering from import and export simulcasting, as well as its share of wagering from its OTWs.

Revenues from the Management Contract for Casino Rama (see Note 2) are based upon contracted terms and are recognized when services are performed.

Earnings Per Share

Basic earnings per share ("EPS") are computed by dividing net income applicable to common stock by the weighted

average common shares outstanding during the period. Diluted EPS reflects the additional dilution for all potentially dilutive securities such as stock options.

Options to purchase 675,000, 260,000 and 220,000 shares of common stock were outstanding during the years ended December 31, 2002, 2003 and 2004, respectively, but were not included in the computation of diluted earnings per share because the options' exercise prices were greater than the average market price of the common shares and, therefore the effect would be antidilutive. The following represents a reconciliation from basic earnings per share to diluted earnings per share.

YEAR ENDED DECEMBER 31,	2002	2003	2004
(In thousands)			
Determination of shares:			
Weighted average common shares outstanding	75,550	78,946	80,510
Assumed conversion of dilutive stock options	2,638	2,278	2,998
Diluted weighted average common shares outstanding	78,188	81,224	83,508

Stock-Based Compensation

The Company grants stock options for a fixed number of shares to employees with an exercise price equal to or greater than the fair value of the shares at the date of grant. The Company accounts for stock option grants using the intrinsic-value method in accordance with APB Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25") and related Interpretations. Under the intrinsic-value method, because the exercise price of the Company's employee stock options is equal to the market price of the underlying stock on the date of grant, no compensation expense is recognized.

The Company accounts for the plans under the recognition and measurement principles of APB 25 and related Interpretations. No stock-based employee compensation

cost is reflected in net income for options granted since all options granted under the plan had an exercise price equal to the market value of the underlying common stock on the date of grant. However, there are situations that may occur, such as the accelerated vesting of options or the issuance of restricted stock, that require a current charge to income.

The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123"), as amended by Statement of Financial Accounting Standards No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure" ("SFAS 148"), to stock-based employee compensation:

YEAR ENDED DECEMBER 31,	2002	2003	2004
(In thousands)			
Net income, as reported	\$30,863	\$51,471	\$71,484
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects	270	-	177
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(1,971)	(2,912)	(4,894)
Pro forma net income	\$29,162	\$48,559	\$66,767
Earnings per share:			
Basic - as reported	\$.41	\$.65	\$.89
Basic - pro forma	\$.39	\$.62	\$.83
Diluted - as reported	\$.39	\$.63	\$.86
Diluted - pro forma	\$.38	\$.60	\$.80

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions used for grants in 2002, 2003 and 2004:

YEAR ENDED DECEMBER 31,	2002	2003	2004
(In thousands)			
Risk-free interest rate	3.0%	3.0%	3.4%
Volatility	50.0%	41.0%	51.0%
Dividend yield	0.0%	0.0%	0.0%
Expected life (years)	5	5	5

The effects of applying SFAS 123 and SFAS 148 in the above pro forma disclosure are not indicative of future amounts. SFAS 123 and SFAS 148 does not apply to awards prior to 1995. Additional awards in future years are anticipated.

Certain Risks and Uncertainties

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

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

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

Reclassification

Certain prior years amounts have been reclassified to conform to the current year presentation.

Recent Accounting Pronouncements

In December 2004, the FASB issued Statement No. 123 (revised 2004), "Stock-Based Payment" (SFAS 123R). This statement replaces SFAS 123, "Accounting for Stock-Based Compensation", supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees" (APB 25) and amends SFAS 95, "Statement of Cash Flows", to require that excess tax benefits be reported as a financing cash inflow rather than as a reduction of taxes paid. SFAS 123R is effective the first interim or annual reporting period that begins after June 15, 2005, which will be for the period covered by the Company's quarterly report on Form 10-Q for the third quarter of 2005. The Company currently accounts for stock option grants using the intrinsic-value method in accordance with APB 25. Under the intrinsic-value method, because the exercise price of the Company's employee stock

options is equal to the market price of the underlying stock on the date of grant, no compensation expense is recognized. If the Company would have applied the fair value recognition provisions of SFAS 123R, it would have had a charge to earnings of \$4.7 million for stock-based employee compensation, net of related income taxes, for 2004. (See Note 1-Summary of Significant Accounting Policies and Note 10-Stock-Based Compensation)

In April 2002, the FASB issued Statement No. 145, "Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections" ("SFAS 145"). The rescission of FASB No. 4, "Reporting Gains and Losses from Extinguishment of Debt" applies to the Company. FASB No. 4 required that gains and losses from extinguishment of debt that were included in the determination of net income be aggregated and, if material, classified as an extraordinary item, net of the related income tax effect. SFAS 145 is effective for the fiscal year beginning January 1, 2003. The Company had losses on early extinguishment of debt, net of income taxes of \$5.2, \$.8 and \$2.4 million for the years ended December 31, 2002, 2003 and 2004, respectively. These losses reflect the write-off of deferred finance fees and pre-payment fees associated with bank debt that was repaid with the proceeds of new financing. Effective January 1, 2003, pursuant to SFAS 145, the losses on early extinguishment of debt will be included in "Other income (expenses)" in the Company's consolidated statements of income.

2. Acquisitions

Acquisition Accounting

The Company has accounted for its acquisitions subsequent to June 30, 2001 under SFAS No. 141, "Business Combinations." For purchase acquisitions completed prior to June 30, 2001, the Company accounted for acquisitions in accordance with APB Opinion No. 16, "Business Combinations." The results of operations of acquisitions are included in the consolidated financial statements from their respective dates of acquisition.

Hollywood Casino Corporation

On March 3, 2003, the Company completed its acquisition of Hollywood Casino Corporation and acquired 100 percent of its outstanding common stock for approximately \$843.3 million, including \$397.9 million cash paid and \$445.4 million in net liabilities assumed.

The primary reason the Company acquired Hollywood Casino Corporation was to acquire the cash flow generated by the operation of the Hollywood Casino Corporation properties. Other significant reasons considered by the Company included the following: acquiring a relatively large property would reduce the relative importance of the Company's Charles Town Entertainment Complex; operating in additional states would make it less likely that a single legislative action could have a material adverse affect on the Company's financial results; and the resulting geographic diversification of the Company's assets would be in the Company's best interest. The purchase price reflected a multiple of acquired cash flow and the value of the assets in setting the purchase price was not as significant. Accordingly, the purchase price, including the net liabilities assumed, less the appraised value of the assets gave rise to the recognition of a significant amount of goodwill.

Under the terms of the purchase agreement, a wholly-owned subsidiary of the Company merged with and into Hollywood Casino Corporation, and Hollywood Casino Corporation stockholders received cash in the amount of \$12.75 per share at closing or \$328.1 million and holders of Hollywood Casino Corporation stock options received \$19.0 million (representing the aggregate difference between \$12.75 per share and their option exercise prices). The Company also incurred acquisition costs of \$50.8 million.

The Company assumed Hollywood Casino Corporation's current and other liabilities of \$80.4 million and total outstanding long-term indebtedness of \$365.0 million. The long-term indebtedness (net of \$133.9 million cash acquired) included Hollywood Casino's \$310 million of 11.25% senior secured notes due 2007 and \$50 million of floating rate senior secured notes, due 2006, Hollywood Casino Shreveport and Shreveport Capital Corporation co-issued debt of \$150 million aggregate principal amount of 13% first mortgage notes due 2006 and \$39 million aggregate principal amount of 13% senior secured notes due 2006 (net of a valuation allowance of \$70.0 million), and \$19.9 million for the Hollywood Casino Aurora capital leases for two parking garages.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition.

	AT MARCH 3, 2003
<i>(In thousands)</i>	
Current assets (including \$133.9 million in cash acquired)	\$170,718
Property and equipment	299,109
Other assets, including deferred income taxes of \$32,604	64,669
Goodwill	444,853
Total assets acquired	979,349
Current liabilities	(74,214)
Other liabilities	(8,277)
Debt, current and non-current	(498,910)
Total liabilities assumed	(581,401)
Net assets acquired	\$397,948

In determining the purchase price allocation associated with the Hollywood Casino Corporation acquisition, the Company engaged an independent professional service firm ("valuation firm") to perform an appraisal of the acquired assets. The tangible assets acquired included land, buildings and improvements, equipment, dock side casino barges, memorabilia and a 33% interest in a golf course. The total purchase price allocated to these tangible assets, net of liabilities assumed, was \$397.9 million.

The remaining purchase price was allocated to intangible assets. No value was assigned to the trademarks acquired,

based on the Company's assessment that there is no market for similar types of registered trademarks in the industry and the immateriality of the assessed value per the valuation firm's report. The Company did not allocate any value to the customer database, since these customers are not exclusive to the Hollywood Casino properties. No value was assigned to the gaming licenses because all gaming licenses, by statute or regulation, are revocable privileges, non-transferable, and subject to renewal at the discretion of the respective gaming authority, in which the holder is not deemed to possess any vested rights. The Company noted no other identifiable intangible assets. Therefore, the amount by which the purchase price (\$843.3 million) exceeded the estimated fair value of the assets (excluding cash) acquired (\$398.4 million) was allocated to goodwill. This amount totaled \$444.9 million, which is not tax deductible.

The results of operations for Hollywood Casino® are included in the consolidated financial statements from March 1, 2003. Hollywood Casino Corporation owns and operates distinctively themed casino entertainment facilities in major gaming markets in Aurora, Illinois, Tunica, Mississippi and Shreveport, Louisiana.

Unaudited pro forma financial information for the years ended December 31, 2002 and 2003, as though the Hollywood Casino acquisition had occurred on January 1, 2002, is as follows:

	2002	2003
<i>(In thousands)</i>		
Revenues	\$1,156,134	\$1,244,242
Net income	\$ 43,044	\$ 52,965
Net income per common share		
Basic	\$.57	\$.67
Diluted	\$.55	\$.65
Weighted average shares outstanding		
Basic	75,550	78,946
Diluted	78,188	81,224

Bullwhackers Casinos

On April 25, 2002, the Company acquired all of the assets of the Bullwhackers Casino operations, in Black Hawk, Colorado, from Colorado Gaming and Entertainment Co., a subsidiary of Hilton Group plc, for \$7.1 million in cash

including acquisition costs of \$.6 million. The acquisition was accounted for as a purchase and accordingly the results of operations are included from the date of acquisition. There was no goodwill recognized for this transaction. The Bullwhackers assets consist of the Bullwhackers Casino,

the adjoining Bullpen Sports Casino, the Silver Hawk Saloon and Casino, an administrative building and a 475-car parking area, all located in the Black Hawk, Colorado gaming jurisdiction.

3. Property and Equipment

Property and equipment consist of the following (in thousands):

DECEMBER 31,	2003	2004
Land and improvements	\$ 100,164	\$ 109,363
Building and improvements	416,710	429,281
Furniture, fixtures, and equipment	191,363	217,676
Transportation equipment	1,246	1,503
Leasehold improvements	11,005	12,190
Construction in progress	6,093	18,797
Total property and equipment	726,581	788,810
Less: accumulated depreciation and amortization	(132,429)	(191,416)
Property and equipment, net	\$ 594,152	\$ 597,394

Interest capitalized in connection with major construction projects was \$1.6 million, \$.3 million, and \$.4 million in 2002, 2003 and 2004, respectively. Depreciation and amortization expense, for property and equipment, totaled \$32.0 million, \$55.0 million, and \$63.3 million in 2002, 2003, and 2004, respectively.

4. Other Intangible Assets

As part of the CRC acquisition in April 2001, the Company acquired the management contract (the "Contract") for Casino Rama. This intangible asset is being amortized over

its contractual life on the straight-line method through July 31, 2011, the expiration date of the Contract. The gross carrying amount of the Contract is \$25.7 million and the accumulated amortization is \$9.2 million as of December 31, 2004. The average annual amortization expense for the remaining life of the Contract is approximately \$2.5 million.

Amortization expense for the Contract totaled \$2.5 million in 2002, 2003 and 2004, respectively.

5. Long-term Debt

Long-term debt is as follows (in thousands):

YEAR ENDED DECEMBER 31,	2003	2004
Senior secured credit facility. This credit facility is secured by substantially all of the assets of the Company	\$399,700	\$270,000
\$200 million 11 1/8% senior subordinated notes. These notes are general unsecured obligations of the Company	200,000	200,000
\$175 million 8 7/8% senior subordinated notes. These notes are general unsecured obligations of the Company	175,000	175,000
\$200 million 6 7/8% senior subordinated notes. These notes are general unsecured obligations of the Company	200,000	200,000
Capital leases	15,423	13,909
	990,123	858,909
Less current maturities	(5,634)	(4,494)
	\$984,489	\$854,415

The following is a schedule of future minimum repayments of long-term debt as of December 31, 2004 (in thousands):

2005	\$ 4,494
2006	4,622
2007	266,616
2008	202,270
2009	1,997
Thereafter	378,910
Total minimum payments	\$858,909

At December 31, 2004, the Company was contingently obligated under letters of credit issued pursuant to the senior secured credit facility with face amounts aggregating \$8.4 million.

Senior Secured Credit Facility

On March 3, 2003, the Company entered into an \$800 million senior secured credit facility with a syndicate of lenders.

The credit facility was initially comprised of a \$100 million revolving credit facility maturing on September 1, 2007, a \$100 million Term A facility loan maturing on September 1, 2007 and a \$600 million Term B facility loan maturing on September 1, 2007. On March 3, 2003 the Company borrowed the entire Term A and Term B term loans to complete the purchase of Hollywood Casino Corporation and to call Hollywood Casino Corporation's \$360 million senior secured notes.

On September 30, 2003, the Company made an optional prepayment of \$27 million toward its \$800 million senior secured credit facility. Based on the Company's consolidated EBITDA (as defined in the credit agreement) for the 12 months ended September 30, 2003, the payment triggered a reduction of the interest rate margin on the Term A portion of the credit facility by 0.25% and a reduction of the interest rate margin on the Term B portion of the credit facility by 0.5%. The reductions of the interest rate margins became effective on October 23, 2003.

On December 3, 2003, the Company made a pre-payment of \$10.5 million plus accrued interest to satisfy in full its Term Loan A Facility due March 2008. Additionally, the Company made a pre-payment of \$195.1 million plus accrued interest against the Company's Term Loan B Facility due March 2009, which had approximately \$596.3 million outstanding at September 30, 2003. The pre-payments were funded with the net proceeds of the \$200 million 6 7/8% senior subordinated

note offering and with cash from operations. Following the payments, the Term Loan B Facility had approximately \$399.7 million outstanding.

On December 5, 2003, the \$800 million senior credit facility was amended and restated. The amended agreement reduced the total credit facility from \$800 million to \$500 million and converted the Term Loan B facility to a Term Loan D facility due September 2007. The Term Loan D facility will initially accrue interest at 250 basis points over LIBOR, representing a 100 basis point reduction from the original terms of the Term Loan B facility. In addition, the amended credit facility allows the Company to raise an additional \$225 million in senior secured credit to expand its Pennsylvania racetrack operations if legislation is passed permitting slot machines or video lottery terminals at these facilities.

During 2004, the Company paid down \$129.7 million of principal on the Term Loan D facility including \$50.0 million in the fourth quarter. As a result of the accelerated principal payments on the credit facility, the Company recorded a loss on early extinguishment of debt of \$3.8 million for the write-off of the associated deferred finance fees.

At December 31, 2004, the Company had an outstanding balance of \$270.0 million on Term Loan D facility and \$91.6 million available to borrow under the revolving credit facility after giving effect to outstanding letters of credit of \$8.4 million. The weighted average interest rate on the Term D facility is 4.99% at year-end excluding swaps and deferred finance fees.

The senior secured credit facility is secured by substantially all of the assets of the Company, except for the assets of Hollywood Casino Shreveport, which serve as collateral for the Hollywood Casino Shreveport notes. See "Hollywood Casino Shreveport Notes" below.

Interest Rate Swap Contracts

The Company has a policy designed to manage interest rate risk associated with its current and anticipated future borrowings. This policy enables the Company to use any combination of interest rate swaps, futures, options, caps and similar instruments. To the extent the Company employs such financial instruments pursuant to this policy, they are generally accounted for as hedging instruments. In order to qualify for hedge accounting, the underlying hedged item must expose the Company to risks associated with market fluctuations and the financial instrument used must be designated as a hedge and must reduce the Company's

exposure to market fluctuations throughout the hedge period. If these criteria are not met, a change in the market value of the financial instrument is recognized as a gain or loss in the period of change. Net settlements pursuant to the financial instrument are included as interest expense in the period.

On December 20, 2000, the Company entered into an interest rate swap with a notional amount of \$100 million and a termination date of December 22, 2003. Under this agreement, the Company pays a fixed rate of 5.835% against a variable interest rate based on the 90-day LIBOR rate.

On August 3, 2001, the Company entered into an interest rate swap with a notional amount of \$36 million with a termination date of June 30, 2004. Under this agreement, the Company pays a fixed rate of 4.8125% against a variable interest rate based on the 90-day LIBOR rate. The Company entered into these interest rates swap agreements due to the requirements of the then current senior secured credit facility and to reduce the impact of future variable interest payments related to the such senior secured credit facility.

In 2001, the Company accounted for the effective interest rate swap agreements as cash flow hedges. The changes in the fair values of effective interest rate swaps were recorded as adjustments to accrued interest in the accompanying consolidated balance sheet with the offset recorded in accumulated other comprehensive loss. The amount of ineffectiveness related to the cash flow hedges in 2001 and 2002 was immaterial. In March 2002, the Company repaid all of its then outstanding variable rate debt with the issuance of the 8 7/8% Senior Subordinated Notes, fixed rate debt. The hedge designation was removed. Subsequent changes in the fair value of the interest rate swap contracts are recognized as adjustments to loss on change in fair values of interest rate swaps in the accompanying statements of income in the period in which they occur. Accordingly, the Company has recorded a non-cash pre-tax loss of \$5.8 million, or \$.09 per diluted share after tax, for the year ended December 31, 2002 and \$.5 million, or \$.01 per diluted share after tax, for the year ended December 31, 2003. Amounts previously recognized in other comprehensive income will be reclassified to income over the remaining term of the swap as the Company incurs interest expense on the replacement debt.

On March 27, 2003, the Company entered into interest rate swap agreements with a total notional amount of \$375.0 million in accordance with the terms of the \$800 million senior secured credit facility. There are three two-year

swap contracts totaling \$175 million with an effective date of March 27, 2003 and a termination date of March 27, 2005. Under these contracts, the Company pays a fixed rate of 1.92% and receive a variable rate based on the 90-day LIBOR rate. The Company also entered into three three-year swap contracts totaling \$200 million with a termination date of March 27, 2006. The Company accounted for these effective interest rate swap agreements as cash flow hedges. The changes in the fair values of effective interest rate swaps were recorded as adjustments to accrued interest in the accompanying consolidated balance sheet with the offset recorded in accumulated other comprehensive loss. The amount of ineffectiveness related to the cash flow hedges in 2004, was immaterial. Under these contracts, the Company pays fixed rates of 2.48% to 2.49% against a variable rate based on the 90-day LIBOR rate. The difference between amounts received and amounts paid under such agreements, as well as any costs or fees, is recorded as a reduction of, or addition to, interest expense as incurred over the life of the swap.

At December 31, 2004, the 90-day LIBOR rate was 2.56%.

Termination of Interest Rate Swap Agreement

Effective March 3, 2003, the Company terminated its \$36 million notional amount interest rate swap originally scheduled to expire in June 2004. The Company paid \$1.9 million to terminate the swap agreement.

On September 3, 2004, the Company terminated its \$55 million notional amount interest rate swap originally scheduled to expire on March 27, 2005. The Company paid \$27,500 to terminate the swap agreement. On December 5, 2004, the Company terminated its \$65 million notional amount interest rate swap originally scheduled to expire on March 27, 2006. The Company received \$379,000 to terminate the swap agreement. The Company terminates its swap agreements early in conjunction with accelerated payments of principal on the senior secured credit facility Term D loans.

11 1/8% Senior Subordinated Notes due 2008

On March 12, 2001, the Company completed an offering of \$200 million of its 11 1/8% Senior subordinated notes that mature on March 1, 2008. Interest on the notes is payable on March 1 and September 1 of each year, beginning September 1, 2001. The proceeds from these notes were used, in part, to finance the CRC Acquisition.

The Company may redeem all or part of the notes on or after March 1, 2005 at certain specified redemption prices. Prior to March 1, 2004, the Company may redeem up to 35% of the notes from proceeds of certain sales of its equity securities. The notes are also subject to redemption requirements imposed by state and local gaming laws and regulations.

The notes are general unsecured obligations and are guaranteed on a senior subordinated basis by certain of the Company's current and future wholly-owned domestic subsidiaries. The notes rank equally with the Company's future senior subordinated debt and junior to its senior debt, including debt under the Company's senior credit facility. In addition, the notes will be effectively junior to any indebtedness of Penn's non-U.S. subsidiaries or subsidiaries that do not guarantee the notes ("Unrestricted Subsidiaries").

The 11 1/8% notes and guarantees were originally issued in a private placement pursuant to an exemption from the registration requirements of the Securities Act of 1933, as amended (the "Securities Act"). On July 30, 2001, the Company completed an offer to exchange the notes and guarantees for notes and guarantees registered under the Securities Act having substantially identical terms.

8 7/8% Senior Subordinated Notes due 2010

On February 28, 2002, the Company completed an offering of \$175 million of its 8 7/8% senior subordinated notes that mature on March 15, 2010. Interest on the 8 7/8% notes is payable on March 15 and September 15 of each year, beginning September 15, 2002. The Company used the net proceeds from the offering, totaling approximately \$170.0 million after deducting underwriting discounts and related expenses, to repay term loan indebtedness under its existing senior secured credit facility.

The Company may redeem all or part of the 8 7/8% notes on or after March 15, 2006 at certain specified redemption prices. Prior to March 15, 2005, the Company may redeem up to 35% of the 8 7/8% notes from proceeds of certain sales of its equity securities. The 8 7/8% notes also are subject to redemption requirements imposed by state and local gaming laws and regulations.

The 8 7/8% notes are general unsecured obligations and are guaranteed on a senior subordinated basis by certain of the Company's current and future wholly-owned domestic subsidiaries. The 8 7/8% notes rank equally with the Company's future senior subordinated debt and the 11 1/8% senior subordinated notes, and junior to its senior debt,

including debt under the Company's senior credit facility. In addition, the 8 7/8% notes will be effectively junior to any indebtedness of Penn's non-U.S. subsidiaries or Unrestricted Subsidiaries, none of which have guaranteed the 8 7/8% notes.

6 7/8% Senior Subordinated Notes due 2011

On December 1, 2003, the Company completed an offering of \$200 million of its 6 7/8% senior subordinated notes that mature on December 1, 2011. Interest on the notes is payable on June 1 and December 1 of each year, beginning June 1, 2004. The Company used the net proceeds from the offering, totaling approximately \$196.6 million after deducting underwriting discounts and related expenses, to repay term loan indebtedness under its existing senior secured credit facility.

The Company may redeem all or part of the notes on or after December 1, 2007 at certain specified redemption prices. Prior to December 1, 2006, the Company may redeem up to 35% of the notes from proceeds of certain sales of its equity securities. The notes are also subject to redemption requirements imposed by state and local gaming laws and regulations.

The 6 7/8% notes are general unsecured obligations and are guaranteed on a senior subordinated basis by certain of the Company's current and future wholly-owned domestic subsidiaries. The 6 7/8% notes rank equally with the Company's future senior subordinated debt and junior to its senior debt, including debt under the Company's senior credit facility. In addition, the 6 7/8% notes will be effectively junior to any indebtedness of Penn's non-U.S. Unrestricted Subsidiaries.

The 6 7/8% notes and guarantees were originally issued in a private placement pursuant to an exemption from the registration requirements of the Securities Act. On August 27, 2004, the Company completed an offer to exchange the notes and guarantees for notes and guarantees registered under the Securities Act having substantially identical terms.

Covenants

The terms of the Company's senior secured credit facility and senior subordinated notes require the Company to satisfy certain financial covenants, including, but not limited to, leverage and fixed charges coverage ratios and limitations on indebtedness, liens, investments and capital expenditures. Except for the defaults under the Hollywood Casino Shreveport notes, for which the Company (other than

the Shreveport entities) is not liable, at December 31, 2004, we were in compliance with all required financial covenants.

6. Commitments and Contingencies

Litigation

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

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

In August 2002, the lessor of the property on which Casino Rouge conducts a significant portion of its dockside operations filed a lawsuit against the Company in the 19th Judicial District Court for the Parish of East Baton Rouge, Louisiana seeking a declaratory judgment that the plaintiff landlord is entitled to terminate the lease and/or void the Company's option to renew the lease due to certain alleged defaults by the Company or its predecessors-in-interest. The term of the Company's lease expired in January 2004 and the Company exercised its automatic right to renew for an additional five year term (which, as previously noted is being contested by the landlord). In September 2003 the court granted the Company a partial motion for summary judgment. On October 26, 2004, in ruling on a motion for summary judgment filed by the plaintiff, the court determined that the Company was in default of an obligation in the lease and that the lease is dissolved. The Company plans to vigorously appeal this

decision, which will suspend any effect of the October 26, 2004 order during the pendency of the appeal. Depending on the outcome of the appeal, the Company may eventually choose from options which may include entering into a new lease with the plaintiff, purchasing the property from the plaintiff or relocating. Any of these options are likely to involve significant costs. A relocation of the boat will require regulatory and/or local approvals, which we may not be able to obtain. In March 2005, the plaintiff filed an additional lawsuit against us seeking (i) a ruling that additional rent is due to the landlord as a result of the default, (ii) that a lessor's lien should be recognized as encumbering certain property to secure the payment of such rent, and (iii) a declaration that certain improvements revert to the landlord upon termination of the lease. A hearing regarding the lessor's lien is scheduled for May 2005.

In October 2002, in response to the Company's plans to relocate the river barge underlying the Boomtown Biloxi casino to an adjacent property, the lessor of the property on which the Boomtown Biloxi casino conducts a portion of its dockside operations, filed a lawsuit against the Company in the U.S. District Court for the Southern District of Mississippi seeking a declaratory judgment that (i) the Company must use the leased premises for a gaming use or, in the alternative, (ii) after the move, the Company will remain obligated to make the revenue based rent payments to plaintiff set forth in the lease. The plaintiff filed this suit immediately after the Mississippi Gaming Commission approved the Company's request to relocate the barge. Since such approval, the Mississippi Department of Marine Resources and the U.S. Army Corps of Engineers have also approved the Company's plan to relocate the barge. The Company filed a motion for summary judgment in October 2003 and the plaintiff filed its own motion for summary judgment in January 2004. In March 2004, the trial court ruled in favor of the Company on all counts. The plaintiff's subsequent motion for reconsideration was denied and plaintiff has appealed the decision to the Fifth Circuit. A hearing on the appeal is scheduled for April 4, 2005.

On August 27, 2004, our unrestricted subsidiary, Hollywood Casino Shreveport, or HCS, in cooperation with an Ad Hoc Committee representing a majority of its noteholders, entered into an agreement with Eldorado Resorts LLC ("Eldorado") providing for acquisition of HCS by certain affiliates of Eldorado ("Eldorado Transaction"). On September 10, 2004, a group of creditors, led by Black Diamond Capital Management, LLC, of the Hollywood

Casino Shreveport (the Company's unrestricted subsidiary) filed with the U.S. Bankruptcy Court, Western District of Louisiana, located in Shreveport, Louisiana, an involuntary petition against Hollywood Casino Shreveport for relief under Chapter 11 of the U.S. Bankruptcy Code. On October 28, 2004, HCS filed a joint plan and disclosure statement that incorporates the Eldorado Transaction. On October 30, 2004, the Bankruptcy Court entered an order for relief. Hollywood Casino Shreveport will continue to manage its assets and business as a "debtor in possession" subject to the powers and supervision of the Bankruptcy Court pursuant to Chapter 11. In addition, on October 30, 2004, HCS I, Inc. and HCS II, Inc., the general partners of Hollywood Casino Shreveport, HWCC-Louisiana, Inc., the parent company of both HCS I, Inc. and HCS II, Inc., and Shreveport Capital Corporation commenced voluntary cases under Chapter 11 in the U.S. Bankruptcy Court, Western District of Louisiana, which cases are pending. The debt is non-recourse to the Company and its other subsidiaries.

Operating Leases

The Company is liable under numerous operating leases for an airplane, automobiles, other equipment and buildings, which expire through 2010. Total rental expense under these agreements was \$2.1 million, \$3.5 million, and \$4.3 million for the years ended December 31, 2002, 2003, and 2004, respectively.

The Company is also liable for several land leases for the property on which some of its casinos operate. The lease terms are from one to ninety-nine years. The leases consist of annual base lease rent payments, which are included in the table below, plus a percentage rent based on a percent of adjusted gaming win as described in the respective leases. For the years ended December 31, 2002, 2003 and 2004, the Company paid land lease rent under these agreements of \$7.0 million, \$11.5 million, and \$11.2 million, respectively.

The future minimum lease commitments relating to noncancelable operating leases as of December 31, 2004 are as follows (in thousands):

2005	\$ 5,260
2006	4,551
2007	3,801
2008	3,485
2009	3,174
Thereafter	1,907
Total minimum payments	\$22,178

Commitments

As of December 31, 2004, the Company is contractually committed to spend approximately \$11.3 million in capital expenditures for projects in progress.

Employee Benefit Plans

The Company has profit sharing plans under the provisions of Section 401(k) of the Internal Revenue Code of 1986, as amended, that cover all eligible employees who are not members of a bargaining unit. The plans enable employees choosing to participate to defer a portion of their salary in a retirement fund to be administered by the Company. The Company's contributions to the plans are set at 50% of employees' elective salary deferrals up to a maximum of 6% of employee compensation. The Company also has a defined contribution plan, the Charles Town Races Future Service Retirement Plan, covering substantially all of its union employees at the Charles Town Entertainment Complex. The Company makes monthly contributions equal to the amount accrued for retirement expense, which is calculated as .25% of the daily mutual handle and .5% of the net video lottery revenues. Total contributions to the plans for the years ended December 31, 2002, 2003 and 2004 were \$2.5 million, \$2.8 million and \$3.8 million, respectively.

The Company maintains a deferred compensation plan that covers most management and other highly compensated employees. This plan was effective March 1, 2001. The plan allows the participants to defer, on a pre-tax basis, a portion of their base annual salary and bonus and earn tax-deferred earnings on these deferrals. The plan also provides for matching Company contributions that vest over a five-year period. The Company has established a Trust and transfers to the Trust, on an annual basis, an amount necessary to provide on a present value basis for its respective future liabilities with respect to participant deferral and Company contribution amounts. Company contributions in 2002, 2003 and 2004 were \$.3 million, \$.6 million and \$.8 million respectively.

Agreements with Horsemen and Pari-Mutuel Clerks

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

At the Charles Town Entertainment Complex, there is an agreement with the Charles Town horsemen that expires on December 31, 2007 and an agreement with the breeders that expires on June 30, 2005. The pari-mutuel clerks at Charles Town are represented under a collective bargaining agreement with the West Virginia Division of Mutuel Clerks which expires on April 30, 2005. The Company is in active discussions with the pari-mutuel clerks at Charles Town regarding a new agreement or an extension of the existing agreement, however, there can be no assurance that the Company will be able to enter into a new agreement or an extension of the existing agreement on satisfactory terms or at all.

The Company's agreement with the Pennsylvania Thoroughbred horsemen at Penn National Race Course expires on September 30, 2011.

The Company has an agreement in place with the Sports Arena Employees Local 137 (AFL-CIO) with respect to pari-mutuel clerks and admission personnel at its six OTWs. That agreement expires on September 30, 2005. The Company also has an agreement with Local 137 at Penn National Race Course with respect to pari-mutuel clerks and admissions and Telebet personnel that expires on December 31, 2007.

Pennwood Racing also has an agreement in effect with the horsemen at Freehold Raceway which expires in May, 2006.

If the Company fails to maintain agreements with the horsemen at a track, it will not be permitted to conduct live racing and export and import simulcasting at that track and where applicable, the OTWs. In West Virginia, the Company will not be permitted to operate its gaming machines if it fails to maintain agreements with the Charles Town horsemen, pari-mutuel clerks and breeders. In addition, the simulcasting agreements are subject to the horsemen's approval. If the Company fails to maintain necessary agreements, this failure could have a material adverse effect on its business, financial condition and results of operations. Except for the closure of the facilities at Penn National Race Course and its OTWs from February 16, 1999 to March 24, 1999 due to a horsemen's strike, and a few days at other times and locations, the Company has been able to maintain the necessary agreements. There can be no assurance that the Company will be able to maintain the required agreements.

New Jersey Joint Venture

On January 28, 1999, the Company, along with its joint venture partner, Greenwood New Jersey, Inc. ("Greenwood"), purchased certain assets and assumed certain liabilities of Freehold Racing Association, Garden State Racetrack and related entities, in a transaction accounted for as a purchase. During 2001, Garden State Racetrack ceased operations.

The Company made an \$11.3 million loan to the joint venture and an equity investment of \$.3 million. The loan is evidenced by a subordinated secured note, which has been included in investment in and advances to an unconsolidated affiliate in the consolidated financial statements. The note bears interest at prime plus 2.25% or a minimum of 10% (as of December 31, 2004 the interest rate was 10%). The Company has recorded interest income in the accompanying consolidated financial statements of \$1.2 million, \$1.1 million, and \$1.1 million for the years ended December 31, 2002, 2003 and 2004, respectively.

The joint venture, through Freehold Racing Association, is part of a multi-employer pension plan. For collectively bargained, multi-employer pension plans, contributions are made in accordance with negotiated labor contracts and generally are based on the number of hours worked. With the passage of the Multi-Employer Pension Plan Amendments Act of 1980 (the "Act"), the joint venture may, under certain circumstances, become subject to liabilities in excess of contributions made under collective bargaining agreements. Generally, these liabilities are contingent upon the termination, withdrawal, or partial withdrawal from the plans. As of December 31, 2003, the most recent date for which information is available, the joint venture has been informed that its withdrawal liability was approximately \$1.5 million. This amount, and the joint venture's obligation to fund any portion of it, are subject to many factors outside of the joint venture's control, including actuarial experience and investment performance of the underlying multi-employer pension plan.

The Company and Greenwood entered into a Debt Service Maintenance Agreement with a bank in which each joint venture partner has guaranteed up to 50% of a \$23.0 million term loan to the joint venture. The guarantee remains in effect for the life of the loan and is due to expire on September 30, 2009. As of December 31, 2004, the outstanding balance on the loan to the joint venture amounted to \$16.1 million of which the Company's obligation under its

guarantee of the term loan was limited to approximately \$8.0 million. The Company's investment in the joint venture is accounted for under the equity method. The original investment was recorded at cost and has been adjusted by the Company's share of income of the joint venture and distributions received. The Company's 50% share of the

income of the joint venture is included in other income (expenses) in the accompanying consolidated statements of income.

7. Income Taxes

Deferred tax assets and liabilities are comprised of the following (in thousands):

YEAR ENDED DECEMBER 31,	2003	2004
Deferred tax assets:		
Federal net operating losses	\$ 35,230	\$ 23,960
Federal general business credits	743	-
Accrued expenses	8,852	9,666
State net operating losses	12,058	13,295
Accumulated other comprehensive (loss)	(559)	(602)
Gross deferred tax assets	56,324	46,319
Less Valuation Allowance	(10,488)	(11,610)
Net Deferred Tax Asset	45,836	34,709
Deferred tax liabilities:		
Property, plant and equipment	(41,906)	(48,241)
Net deferred taxes	\$3,930	\$(13,532)
Reflected on consolidated balance sheets:		
Current deferred tax asset, net	\$ 17,284	\$ 18,274
Noncurrent deferred tax liabilities, net	(13,354)	(31,806)
Net deferred taxes	\$3,930	\$(13,532)

The valuation allowance represents the income tax effect of state net operating loss carryforwards of the Company, which are not presently expected to be utilized.

For income tax reporting, the Company has net operating loss carryforwards aggregating approximately \$139.9 million available to reduce future state income taxes primarily for the Commonwealth of Pennsylvania as of December 31, 2004. Due to Pennsylvania's tax statute on annual net operating loss utilization limit, a substantial valuation allowance has been recorded to reflect the net operating losses which are not presently expected to be realized. If not used, substantially all the carryforwards will expire at various dates from December 31, 2006 to December 31, 2024.

The federal net operating loss and general business credits resulted from the acquisition of Hollywood Casino Corporation during 2003. Section 382 of the Internal Revenue Code of 1986, as amended, limits the utilization

of the net operating loss to \$15.3 million per year or a \$5.4 million per year tax benefit.

The prepaid income taxes of \$7,980 and \$7,593 for 2004 and 2003, respectively, represent the approximate overpayments on the income tax returns. It is a result of recording the current year provision, the tax benefit associated with discontinued operations, and the tax benefit for the exercise of stock options less tax payments made or applied and applicable tax credits.

The income taxes payable of \$24,438 and \$7,698 for 2004 and 2003, respectively, is a result of the discontinued operations presentation. For tax purposes, the discontinued operations are a result are included in the consolidated income tax return until disposition. The payable represents the income taxes that would have been payable had the net tax benefit from discontinued operations not been included in the consolidated income tax return.

The provision for income taxes charged to operations was as follows (in thousands):

YEAR ENDED DECEMBER 31,	2002	2003	2004
Current tax expense			
Federal	\$ 8,423	\$ 7,842	\$32,025
State	740	720	845
Total current	\$ 9,163	\$ 8,562	\$32,870
Deferred tax expense (benefit)			
Federal	\$ 8,329	\$29,024	\$17,423
State	42	(123)	(5)
Total deferred	8,371	28,901	17,418
Total provision	\$17,534	\$37,463	\$50,288

The following is a reconciliation of the statutory federal income tax rate to the actual effective income tax rate for the following periods:

YEAR ENDED DECEMBER 31,	2002	2003	2004
Percent of pretax income			
Federal tax rate	35.0%	35.0%	35.0%
State and local income taxes, net of federal tax benefit	1.0	.5	.4
Permanent differences, including amortization of management contract	2.0	1.6	1.0
Other miscellaneous items	.2	.5	.1
	38.2%	37.6%	36.5%

8. Supplemental Disclosures of Cash Flow Information

YEAR ENDED DECEMBER 31,	2002	2003	2004
<i>(In thousands)</i>			
Cash payments of interest	\$39,886	\$ 75,340	\$70,816
Cash payments of income taxes	12,752	-	13,388
Acquisitions:			
Cash paid	7,114	397,948	10,551
Fair value of assets acquired	7,504	979,349	-
Fair value of liabilities assumed	1,495	581,401	-

9. Shareholder's Equity

Equity Offering

On February 20, 2002, the Company completed a public offering of 18,400,000 shares of its common stock at a public offering price of \$7.63 per share. Of the common stock sold in the offering, the Company sold 13,400,000 shares and The Carlino Family Trust, a related party, sold 5,000,000 shares. The Company used its net proceeds from the offering, totaling approximately \$96.1 million after deducting underwriting discounts and related expenses, to repay term loan indebtedness under its existing senior secured credit facility. The Company did not receive any proceeds from the offering by The Carlino Family Trust.

Stock Split

On February 3, 2005 the Company announced that its Board of Directors approved a 2-for-1 split of the Company's common stock. The stock split was in the form of a stock dividend of one additional share of the Company's common stock for each share held. The additional shares were distributed on March 7, 2005 to shareholders of record on February 14, 2005. As a result of the stock dividend, the number of outstanding shares of the Company's common stock increased to approximately 82.8 million. All references in the financial statements to number of shares and net income per share amounts of the Company's common stock have been retroactively restated to reflect the increased number of common stock shares outstanding.

Shareholder Rights Plan

On May 20, 1998, the Board of Directors of the Company authorized and declared a dividend distribution of one Preferred Stock purchase right (the "Rights") for each outstanding share of the Company's common stock, par value \$.01 per share (the "Common Shares"), payable to shareholders of record at the close of business on March 19, 1999. Each Right entitles the registered holder to purchase from the Company one one-hundredth of a share (a "Preferred Stock Fraction"), or a combination of securities and assets of equivalent value, at a purchase price of \$20.00 per Preferred Stock Fraction (the "Purchase Price"), subject to adjustment. The description and terms of the Rights are set forth in a Rights Agreement (the "Rights Agreement")

dated March 2, 1999 between the Company and Continental Stock Transfer and Trust Company as Rights Agent. All terms not otherwise defined herein are used as defined in the Rights Agreement.

The Rights will be exercisable only if a person or group acquires 15% or more of the Company's common stock (the "Stock Acquisition Date"), announces a tender or exchange offer that will result in such person or group acquiring 20% or more of the outstanding common stock or is a beneficial owner of a substantial amount of Common Shares (at least 10%) whose ownership may have a material adverse impact ("Adverse Person") on the business or prospects of the Company. The Company will be entitled to redeem the Rights at a price of \$.01 per Right (payable in cash or stock) at any time until 10 days following the Stock Acquisition Date or the date on which a person has been determined to be an Adverse Person. If the Company is involved in certain transactions after the Rights become exercisable, a Holder of Rights (other than Rights owned by a shareholder who has acquired 15% or more of the Company's outstanding common stock or is determined to be an Adverse Person, which Rights become void) is entitled to buy a number of the acquiring company's Common Shares or the Company's common stock, as the case may be, having a market value of twice the exercise price of each Right. A potential dilutive effect may exist upon the exercise of the Rights. Until a Right is exercised, the holder will have no rights as a stockholder of the Company, including, without limitations, the right to vote as a stockholder or to receive dividends. The Rights are not exercisable until the Distribution Date and will expire at the close of business on March 18, 2009, unless earlier redeemed or exchanged by the Company.

10. Stock Based Compensation

In April 1994, the Company's Board of Directors and shareholders adopted and approved the Stock Option Plan (the "1994 Plan"). The 1994 Plan permits the grant of options to purchase up to 12,000,000 shares of Common Stock, subject to antidilution adjustments, at a price per share no less than 100% of the fair market value of the Common Stock on the date an option is granted with respect to incentive stock options only. The price would be

no less than 110% of fair market value in the case of an incentive stock option granted to any individual who owns more than 10% of the total combined voting power of all classes of outstanding stock. The 1994 Plan provides for the granting of both incentive stock options intended to qualify under Section 422 of the Internal Revenue Code of 1986, as amended, and nonqualified stock options, which do not so qualify. The 1994 Plan terminated in April 2004.

On April 16, 2003, the Company's Board of Directors adopted and approved the 2003 Long Term Incentive Compensation Plan (the "2003 Plan"). On May 22, 2003, the Company's shareholders approved the 2003 Plan. The 2003 Plan was effective June 1, 2003 and permits the grant of options to purchase Common Stock and other market-based and performance-based awards. Up to 12,000,000 shares of Common Stock are available for awards under the 2003 Plan. The 2003 Plan provides for the granting of both incentive stock options intended to qualify under Section 422 of the Internal Revenue Code of 1986, as amended, and nonqualified stock options, which do not so qualify. The exercise price per share may be no less than (i) 100% of the fair market value of the Common Stock on the date an option is granted for incentive stock options and (ii) 85% of the fair market value of the Common Stock on the date an option is granted for nonqualified stock options. Unless this plan is extended, no awards shall be granted or exchanges effected under this plan after May 31, 2013. At December 31, 2004, there were 8,930,000 options available for future grants under the 2003 Plan.

Stock options that expire between January 19, 2006 and January 29, 2014 have been granted to officers and directors to purchase Common Stock at prices ranging from \$1.83 to \$26.59 per share. All options were granted at market prices at date of grant.

The following table contains information on stock options issued under the plans for the three-year period ended December 31, 2004:

	OPTION SHARES	AVERAGE EXERCISE PRICE
Outstanding at December 31, 2001	5,806,784	\$2.54
Granted	2,071,000	7.93
Exercised	(1,734,668)	3.11
Canceled	(276,784)	2.50
Outstanding at December 31, 2002	5,866,332	4.28
Granted	2,240,000	8.79
Exercised	(1,175,332)	4.48
Canceled	(72,500)	4.71
Outstanding at December 31, 2003	6,858,500	6.13
Granted	2,006,000	13.44
Exercised	(1,888,240)	4.14
Canceled	(35,000)	7.91
Outstanding at December 31, 2004	6,941,260	\$8.78

In addition, common stock options in the amount of 1,295,000 were issued to the Company's Chairman outside of the 1994 Plan and the 2003 Plan. 1,200,000 shares were issued in 1996 and 95,000 shares were issued in 2003. These options were issued at prices ranging from \$4.41 to \$7.95 per share and are exercisable through February 6, 2013. During the year 2002, 1,200,000 of these options were exercised.

Exercisable at year-end:

	OPTION SHARES	WEIGHTED AVERAGE EXERCISE PRICE
2002	1,835,750	\$1.77
2003	2,108,250	3.81
2004	1,946,010	5.74

The following table summarizes information about stock options outstanding at December 31, 2004:

	EXERCISE PRICE RANGE			TOTAL
	\$1.83 TO \$7.42	\$7.74 TO \$10.66	\$10.72 TO \$26.59	\$1.83 TO \$26.59
Outstanding options				
Number outstanding	2,382,500	2,320,260	2,238,500	6,941,260
Weighted average remaining contractual life (years)	2.19	2.75	3.27	2.73
Weighted average exercise price	4.76	8.61	13.22	8.78
Exercisable options				
Number outstanding	1,298,000	595,510	52,500	1,946,010
Weighted average exercise price	\$4.22	\$8.65	\$11.44	\$5.74

11. Segment Information

The Company views each property as an operating segment. The Company has aggregated its gaming properties that are economically similar, offer similar types of products and services (table games and/or slot machines), cater to the same types of customers (local patronage) and are heavily regulated into one reporting segment called gaming. The Company has aggregated its racing properties that are

economically similar, offer similar products and services (live and simulcast racing), cater to the similar types of customers (local patronage) and are similarly regulated into one reporting segment called racing. The accounting policies for each segment are the same as those described in the "Summary of Significant Accounting Policies." The table below presents information about reported segments (in thousands):

	GAMING ⁽¹⁾	RACING	ELIMINATIONS	TOTAL
Year ended December 31, 2002				
Revenue	\$ 555,886	\$62,970	\$ -	\$ 618,856
Income from Continuing Operations	92,647	5,597	-	98,244
Depreciation and Amortization	33,012	1,506	-	34,518
Total Assets	1,198,009	98,358	(530,887) ⁽²⁾	765,480
Year ended December 31, 2003				
Revenue	\$954,151	\$58,847	\$ -	\$1,012,998
Income from Continuing Operations	172,032	4,503	-	176,535
Depreciation and Amortization	55,936	1,535	-	57,471
Total Assets	1,600,614	78,399	(69,414) ⁽²⁾	1,609,599
Year ended December 31, 2004				
Revenue	\$1,083,570	\$57,119	\$ -	\$1,140,689
Income from Continuing Operations	210,580	3,200	-	213,780
Depreciation and Amortization	64,149	1,636	-	65,785
Total Assets	1,632,282	76,575	(65,450) ⁽²⁾	1,643,407

(1) Reflects results of the Bullwhackers acquisition since the April 25, 2002 and the Hollywood Casino acquisition since March 3, 2003.

(2) Primarily reflects elimination of intercompany investments, receivables and payable.

12. Summarized Quarterly Data (Unaudited)

Following is a summary of the quarterly results of operations for the years ended December 31, 2003 and 2004:

	FISCAL QUARTER			
	FIRST	SECOND	THIRD	FOURTH
<i>(In thousands, except per share data)</i>				
2003				
Total revenues	\$204,532	\$280,060	\$271,017	\$257,389
Income from continuing operations	36,369	50,137	48,448	41,581
Net income	13,186	15,475	13,618	9,192
Basic earnings per share	.17	.20	.17	.11
Diluted earnings per share	.16	.19	.17	.11
2004				
Total revenues	\$286,219	\$289,051	\$288,731	\$276,688
Income from continuing operations	52,389	56,041	55,450	49,900
Net income	17,771	19,658	17,190	16,865
Basic earnings per share	.23	.25	.21	.20
Diluted earnings per share	.21	.24	.21	.20

13. Related Party Transactions

Life Insurance Policies

The Company has paid premiums on life insurance policies (the "Policies") on behalf of certain irrevocable trusts (the "Trusts") created by the Company's Chief Executive Officer ("CEO"). The policies cover the CEO's life and that of his spouse. The Trusts are the owners and beneficiaries of the policies and are obligated to reimburse the Company for all premiums paid when the insurance matures or upon death. To secure the Company's interest in each of the Policies, the Trusts have executed a collateral assignment of each of the Policies to the Company. As of December 31, 2004, the Company has recorded a receivable in other assets from such trusts in the amount of \$1,950,000. The Company paid premiums of \$227,000, \$249,000 and \$241,000 in 2002, 2003, and 2004, respectively.

Executive Office Lease

The Company currently leases approximately 19,196 square feet of office and warehouse space in two office buildings in Wyomissing, Pennsylvania for its executive offices from an affiliate of its Chief Executive Officer. Rent expense for the years ended December 31, 2002, 2003 and 2004 amounted to \$154,000, \$326,000 and \$369,000, respectively. The leases for the office space expire in March 2012 and June 2012 and the lease for the warehouse space expires August 2006 and they provide for minimum annual future payments of \$362,000.

14. Subsidiary Guarantors

Under the terms of the senior subordinated notes, all of the Company's domestic subsidiaries are guarantors under the agreement, except for HWCC-Argentina, Inc., an inactive subsidiary, HWCC-Louisiana, Inc., HWCC-Shreveport, Inc.

HCS I, Inc, HCS II Inc., HCS-Golf Course, LLC, Hollywood Casino Shreveport and Shreveport Capital Corporation and their respective subsidiaries, if any, (the "Subsidiary Non-Guarantors"). The guarantees provided by the Company's subsidiaries are full and unconditional, joint and several. There are no significant restrictions in the indentures on the Company's ability to obtain funds from its subsidiaries, except for the Subsidiary Non-Guarantors, by dividend or loan. However, we note that in certain jurisdictions, the gaming authorities may impose restrictions pursuant to the authority granted to them with regard to

the Company's ability to obtain funds from its subsidiaries.

The Company has not presented a condensed consolidating balance sheet as of December 31, 2002 or condensed consolidating statements of operations and cash flows for the year ended December 31, 2002 because the balance sheet, income statement and cash flow amounts for subsidiary non-guarantors were not material prior to the acquisition of Hollywood Casino Corporation.

Summarized financial information as of and for the year ended December 31, 2003 and 2004 for Penn, the Subsidiary Guarantors and Subsidiary Non-Guarantors is as follows:

	PENN	SUBSIDIARY GUARANTORS	SUBSIDIARY NON-GUARANTORS	ELIMINATIONS	CONSOLIDATED
As of December 31, 2003					
Condensed Consolidating Balance Sheet (In thousands)					
Current assets	\$ 18,859	\$ 124,213	\$ 45,231	\$ 759	\$ 189,062
Net property and equipment, at cost	1,792	627,973	110,742	-	740,507
Other assets	1,208,444	677,573	(1,630)	(1,204,357)	680,030
Total	\$1,229,095	\$1,429,759	\$ 154,343	\$(1,203,598)	\$ 1,609,599
Current liabilities	\$46,379	\$64,337	\$172,093	\$4,228	\$287,037
Long-term liabilities	981,341	1,205,836	403	(1,174,895)	1,012,685
Shareholder's equity	201,375	159,586	(18,153)	(32,931)	309,877
Total	\$1,229,095	\$1,429,759	\$ 154,343	\$(1,203,598)	\$1,609,599
Year Ended December 31, 2003					
Condensed Consolidating Statement of Income (In thousands)					
Total revenues	\$ -	\$1,037,257	\$ 127,651	\$ (1,612)	\$1,163,296
Total operating expenses	21,749	836,150	123,831	(1,612)	980,118
Income (loss) from operations	(21,749)	201,107	3,820	-	183,178
Other income (expense)	34,677	(111,068)	(23,624)	-	(100,015)
Income (loss) before income taxes	12,928	90,039	(19,804)	-	83,163
Taxes on income	7,325	24,238	129	-	31,692
Net income (loss)	\$ 5,603	\$ 65,801	\$ (19,933)	\$ -	\$ 51,471

	PENN	SUBSIDIARY GUARANTORS	SUBSIDIARY NON- GUARANTORS	ELIMINATIONS	CONSOLIDATED
Year Ended December 31, 2003					
Condensed Consolidating Statement of Cash Flows					
<i>(In thousands)</i>					
Net cash provided by (used in)					
operating activities	\$ (330,393)	\$ 455,480	\$ 14,949	\$ -	\$ 140,036
Net cash used in investing activities	(240,461)	(90,034)	(369)	-	(330,864)
Net cash provided by (used in)					
financing activities	578,727	(360,184)	(1,084)	-	217,459
Effect of exchange rate fluctuations on cash	-	507	(107)	-	400
Net increase in cash and cash equivalents	7,873	5,769	13,389	-	27,031
Cash and cash equivalents					
at beginning of year	3,339	37,647	13,550	-	54,536
Cash and cash equivalents at end of year	\$ 11,212	\$ 43,416	\$ 26,939	\$ -	\$ 81,567
As of December 31, 2004					
Condensed Consolidating Balance Sheet					
<i>(In thousands)</i>					
Current assets	\$ 16,312	\$ 139,769	\$ 46,840	\$ 5,046	\$ 207,967
Net property and equipment, at cost	12,166	619,603	102,564	-	734,333
Other assets	1,164,341	667,261	(6,213)	(1,124,283)	701,106
Total	\$1,192,819	\$1,426,633	\$143,191	\$(1,119,237)	\$1,643,406
Current liabilities	\$73,786	\$80,202	\$191,067	\$(4,281)	\$340,774
Long-term liabilities	854,749	1,131,308	509	(1,082,026)	904,540
Shareholder's equity	264,284	215,123	(48,385)	(32,930)	398,092
Total	\$1,192,819	\$1,426,633	\$143,191	\$(1,119,237)	\$1,643,406
Year Ended December 31, 2004					
Condensed Consolidating Statement of Income					
<i>(In thousands)</i>					
Total revenues	\$ -	\$1,163,836	\$150,427	\$ (1,543)	\$1,312,720
Total operating expenses	23,831	923,024	151,078	(1,543)	1,096,390
Income (loss) from operations	(23,831)	240,812	(651)	-	216,330
Other income (expense)	33,881	(109,818)	(27,073)	(8)	(103,018)
Income (loss) before income taxes	10,050	130,994	(27,724)	(8)	113,312
Taxes on income	9,416	32,255	157	-	41,828
Net income (loss)	\$ 634	\$ 98,739	\$(27,881)	\$ (8)	\$ 71,484

	PENN	SUBSIDIARY GUARANTORS	SUBSIDIARY NON- GUARANTORS	ELIMINATIONS	CONSOLIDATED
Year Ended December 31, 2004					
Condensed Consolidating Statement of Cash Flows					
<i>(In thousands)</i>					
Net cash provided by (used in)					
operating activities	\$ 76,909	\$ 119,726	\$ (1,181)	\$ -	\$ 195,454
Net cash provided by (used in)					
investing activities	37,277	(101,199)	(1,482)	-	(65,404)
Net cash provided by (used in)					
financing activities	(122,383)	(5,883)	4,089	-	(124,177)
Effect of exchange rate fluctuations on cash	-	252	(72)	-	180
Net increase in cash and cash equivalents	(8,197)	12,896	1,354	-	6,053
Cash and cash equivalents					
at beginning of year	11,217	43,412	26,938	-	81,567
Cash and cash equivalents at end of year	\$ 3,020	\$ 56,308	\$ 28,292	\$ -	\$ 87,620

15. Discontinued Operations

Hollywood Casino Shreveport

On January 30, 2004, the Board of Directors of HCS I, the managing general partner of Hollywood Casino Shreveport (the Company's unrestricted subsidiary), approved a resolution to sell Hollywood Casino Shreveport and authorized its financial advisor, Libra Securities, LLC, to begin contacting potential acquirers. The Board also authorized the creation of a committee of independent Board Members to oversee the sale process. The Board created the independent committee in the event that Penn decided to participate as a bidder in the sales process. A press release was issued on February 3, 2004 announcing the sale of the property. Prospective bidders were invited to tour the property, perform diligence and prepare a bid. Invitations to bid were mailed to all interested parties, including Penn, on May 4, 2004 and responses were due at Libra Securities, LLC in New York on June 4, 2004. Oral presentations by the four highest bidders were presented to HCS and the ad hoc committee on June 15, 2004 and their revised bids were due on July 6, 2004. Prior to June 30,

2004, Penn decided not to participate in the bid process.

On August 27, 2004, Hollywood Casino Shreveport, acting by and through its managing general partner, HCS I, Inc., entered into an agreement with Eldorado Resorts, LLC ("Eldorado") providing for the acquisition of Hollywood Casino Shreveport by certain affiliates of Eldorado. On September 10, 2004, a group of creditors led by Black Diamond Capital Management, LLC filed an involuntary Chapter 11 case against HCS. On October 18, 2004, Hollywood Casino Shreveport, acting by and through its managing general partner, HCS I, Inc., entered into a definitive Investment Agreement (the "Agreement") with Eldorado, Eldorado Shreveport #1, LLC ("Investor 1") and Eldorado Shreveport #2, LLC ("Investor II", and together with Investor I, the "Investors") providing for the acquisition of the reorganized Hollywood Casino Shreveport by the Investors. The Investors are each an affiliate of Eldorado. The Agreement contemplates a financial restructuring of Hollywood Casino Shreveport that will significantly reduce outstanding secured debt obligations and annual cash interest payments and transfer ownership and control of

the casino to Eldorado. Hollywood Casino Shreveport intends to effectuate the sale and related financial restructuring transaction through a Chapter 11 bankruptcy reorganization which was filed on October 28, 2004. On October 30, 2004, HCS agreed to the entry of an order for relief in the Chapter 11 case that has been filed against it and HCS I, Inc., HCS II, Inc., HWCC-Louisiana, Inc. and Shreveport Capital Corporation commenced voluntary cases under Chapter 11 of the Bankruptcy Code debt. The debt is non-recourse to Penn National and its other subsidiaries.

The Company has reflected the results of this transaction by classifying the assets, liabilities and results of operations

of Hollywood Casino Shreveport as assets and liabilities held for sale and discontinued operations in accordance with the provisions of SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." A gain or loss on this transaction has not been recorded or recognized at this time since the sale has not yet been completed and is subject to various approvals. Financial information for Hollywood Casino Shreveport was previously reported as part of the gaming reporting segment.

Summarized financial information as of and for the periods ended December 31, 2003 and 2004 for Hollywood Casino Shreveport is as follows:

DECEMBER 31,	2003	2004
<i>(In thousands)</i>		
HWCC-Louisiana, Inc. & Subsidiaries Consolidated Balance Sheets		
Assets		
Current assets	\$ 30,828	\$ 32,779
Property and equipment, net	110,743	102,564
Other assets	1,266	1,347
Total assets held for sale	\$142,837	\$136,690
Liabilities		
Current liabilities	\$151,046	\$158,046
Other noncurrent liabilities	5,732	8,232
Total liabilities held for sale	\$156,778	\$166,278

DECEMBER 31,	2003	2004
<i>(In thousands)</i>		
HWCC-Louisiana, Inc. & Subsidiaries Consolidated Statements Of Operations		
Net revenues	\$113,925	\$134,150
Income (loss) from operations	\$ 2,943	\$ (1,239)
Net (loss)	\$(13,125)	\$(18,261)

Pocono Downs

On October 15, 2004, the Company announced that it entered into an agreement whereby a subsidiary of the Company would sell The Downs Racing, Inc., which does business as Pocono Downs, and its subsidiaries, to the Mohegan Tribal Gaming Authority (MTGA). The transaction, which contemplated a \$280 million purchase price before adjustments, fees, taxes and other costs, and was subject to customary closing conditions and regulatory approvals including approvals from the Pennsylvania Harness Racing Commission. The agreement also provides MTGA with both pre- and post-closing termination rights in the event of certain materially adverse legislative or regulatory events. Under generally accepted accounting principles, the transaction will not be recorded as a sale until the post closing termination rights have expired. The Company expects to use the net proceeds of approximately \$175 million for debt reduction and capital plans.

The Company is divesting Pocono Downs to satisfy a condition of Pennsylvania's new slot machine legislation

that restricts ownership to 100% of one licensed operation and no more than 33% ownership in a second operation. In addition to Pocono Downs, the Company owns Penn National Race Course in Grantville, Pennsylvania, for which it has announced plans to develop a slot machine facility.

The Company has reflected the results of this transaction by classifying the assets, liabilities and results of operations of The Downs Racing, Inc. and its subsidiaries as assets and liabilities held for sale and discontinued operations in accordance with the provisions of SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." A gain or loss on this transaction has not been recorded or recognized at this time since the sale has not yet been deemed completed. Financial information for The Downs Racing, Inc. and its subsidiaries was previously reported as part of the racing reporting segment (See Note 16).

Summarized financial information as of and for periods ended December 31, 2003 and 2004 for The Downs Racing, Inc. and its subsidiaries is as follows:

DECEMBER 31,	2003	2004
<i>(In thousands)</i>		
The Downs Racing, Inc. & Subsidiaries Consolidated Balance Sheets		
Assets		
Current assets	\$ 603	\$ 985
Property and equipment, net	35,610	34,375
Other assets	16,557	16,636
Total assets held for sale	\$52,770	\$51,996
Liabilities		
Current liabilities	\$ 5,453	\$ 5,341
Other noncurrent liabilities	9,109	9,364
Total liabilities held for sale	\$14,562	\$14,705

Report of Independent Registered Public Accounting Firm

DECEMBER 31,

(In thousands)

The Downs Racing, Inc. & Subsidiaries Consolidated Statements Of Operations

	2003	2004
Net revenues	\$36,374	\$37,881
Income from operations	\$ 3,712	\$ 3,789
Net income	\$ 2,402	\$ 2,405

16. Subsequent Events

Pocono Downs

On January 25, 2005, the Company completed the previously announced sale of The Downs Racing, Inc. and its subsidiaries to the Mohegan Tribal Gaming Authority (MTGA) for approximately \$280 million. Reflecting taxes, post closing adjustments, fees and other expenses, the Company realized net proceeds of approximately \$175 million, which the Company intends to apply to a combination of debt reduction and previously announced development projects. Under the terms of the agreement, MTGA acquired The Downs Racing and its subsidiaries including Pocono Downs (a standardbred horse racing facility located on 400 acres in Wilkes-Barre, Pennsylvania) and five Pennsylvania off-track wagering facilities located in Carbondale, East Stroudsburg, Erie, Hazelton and Lehigh Valley (Allentown). The sale agreement provides MTGA with certain post-closing termination rights in the event of certain materially adverse legislative or regulatory events. Under generally accepted accounting principles, the transaction will not be recorded as a sale until the post closing termination rights have expired.

Redemption of 11 1/8% Senior Subordinated Notes due 2008; Issuance of 6 3/4% Senior Subordinated Notes due 2015

On February 8, 2005, the Company called for redemption all of the \$200 million aggregate principal amount of our out-

standing 11 1/8% Senior Subordinated Notes due March 1, 2008, in accordance with the related indenture. The redemption price was \$1,055.63 per \$1,000 principal amount, plus accrued and unpaid interest and payment was made on March 10, 2005.

On March 9, 2005, the Company completed an offering of \$250 million of 6 3/4% senior subordinated notes due 2015. Interest on the notes is payable on March 1 and September 1 of each year, beginning September 1, 2005. These notes mature on March 1, 2015. The Company used the net proceeds from the offering to redeem the \$200 million 11 1/8% Senior Subordinated Notes due March 1, 2008 and repay a portion of the term loan indebtedness under our current senior secured credit facility. The 6 3/4% notes are general unsecured obligations and are not guaranteed by the Company's Subsidiaries.

The 6 3/4% notes and guarantees were originally issued in a private placement pursuant to an exemption from the registration requirements of the Securities Act. On March 9, 2005 the Company completed an offer to exchange the notes and guarantees for notes and guarantees registered under the Securities Act having substantially identical terms.

Board of Directors Penn National Gaming, Inc. and Subsidiaries Wyomissing, Pennsylvania

We have audited the accompanying consolidated balance sheets of Penn National Gaming, Inc. and subsidiaries as of December 31, 2003 and 2004, and the related consolidated statements of income, shareholders' equity and cash flows for each of the three years in the period ended December 31, 2004. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Penn National Gaming, Inc. and subsidiaries at December 31, 2003 and 2004, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2004 in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Penn National Gaming, Inc. and subsidiaries' internal control over financial reporting as of December 31, 2004, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO criteria) and our report dated March 25, 2005 expressed an unqualified opinion thereon.

BDO Seidman, LLP

BDO Seidman, LLP
Philadelphia, Pennsylvania
March 25, 2005

Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We have established disclosure controls and procedures to ensure that the information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized, evaluated and reported, as applicable, within the time periods specified in the rules and forms of the Securities and Exchange Commission.

In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

Based upon the evaluation of the Company's disclosure controls and procedures by the Company's management, under the supervision and with the participation of our principal executive officer and principal financial officer, as of December 31, 2004, our principal executive officer and principal financial officer have concluded that our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934) are effective to ensure that the information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized, evaluated and reported, as applicable, within the time periods specified in the rules and forms of the Securities and Exchange Commission.

Management's Annual Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). There are inherent limitations in the effectiveness of any internal controls over financial reporting, including the possibility of human error and the circumvention or

overriding of controls. Accordingly, even effective internal controls over financial reporting can provide only reasonable assurance with respect to financial statement preparation. Our internal control system was designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation under the framework in Internal Control-Integrated Framework, our management concluded that our internal control over financial reporting was effective as of December 31, 2004 to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Our management's assessment of the effectiveness of our internal control over financial reporting as of December 31, 2004 has been audited by BDO Seidman, LLP, independent registered public accounting firm, as stated in their report which is included below.

Changes in Internal Controls Over Financial Reporting

There were no significant changes in the Company's internal controls over financial reporting that occurred during the last fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.

Report of Independent Registered Public Accounting Firm on Internal Control Over Financial Reporting

To The Board of Directors of Penn National Gaming, Inc. and Subsidiaries:

We have audited management's assessment, included in Management's Annual Report on Internal Control Over Financial Reporting, that Penn National Gaming, Inc. and subsidiaries (the "Company") maintained effective internal control over financial reporting as of December 31, 2004, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

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

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that

transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

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

In our opinion, management's assessment that Penn National Gaming, Inc. and subsidiaries maintained effective internal control over financial reporting as of December 31, 2004, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2004, based on the COSO criteria.

We have also audited, in accordance with standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Penn National Gaming, Inc. and subsidiaries as of December 31, 2004 and 2003, and the related consolidated statements of operations, changes in shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2004, and our report dated March 25, 2005 expressed an unqualified opinion thereon.

BDO Seidman, LLP

Philadelphia, Pennsylvania
March 25, 2005

Officers & Directors

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

Kevin DeSanctis
President, Chief Operating Officer

Leonard M. DeAngelo
Executive Vice President, Operations

William J. Clifford
Sr. Vice President, Finance, and Chief Financial Officer

Robert S. Ippolito
Vice President, Secretary & Treasurer

Steven T. Snyder
Sr. Vice President, Corporate Development

John Finamore
Sr. Vice President, Regional Operations

Jordan B. Savitch, Esq.
Sr. Vice President and General Counsel

Harold Cramer, Esq.
Director, Retired Partner, Schnader Harrison
Segal & Lewis LLP

David A. Handler
Director, Senior Managing Director of Bear,
Stearns & Co. Inc.

Robert P. Levy
Director, Chairman of the Board, DRT Industries

John M. Jacquemin
Director, President, Mooring Financial Corporation

Barbara Z. Shattuck
Director, Principal, Shattuck Hammond Partners LLC

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BDO Seidman, LLP
Independent Certified Public Accountants
1700 Market Street, Philadelphia, Pennsylvania 19103

Transfer Agent and Registrar
Continental Stock Transfer & Trust Company
17 Battery Place, New York, New York 10004

Company Website
www.pngaming.com

Form 10-K
The annual report to the Securities and Exchange
Commission may be obtained free of charge upon
written request at its corporate offices.

Market Information
The Common Stock of the Company is listed on the NAS-
DAQ National Market under the symbol PENN.