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# SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

## FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2004

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 0-24206

### **PENN NATIONAL GAMING, INC.**

(Exact name of registrant as specified in its charter)

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

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

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

**610-373-2400**  
(Registrant's telephone number including area code:)

**Not Applicable**  
(Former name, former address, and former fiscal year, if changed since last report)

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

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

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

<u>Title</u>	<u>Outstanding as of August 4, 2004</u>
Common Stock, par value \$.01 per share	<u>40,491,446</u>

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This report contains information that are not statements of historical fact, but merely reflect our intent, belief or expectations regarding the anticipated effect of events, circumstances and trends. Such statements should be considered forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. 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; our ability to maintain regulatory approvals for our existing businesses and to receive regulatory approvals for our new businesses; delays in the process of finalizing gaming regulations and the establishment of related governmental infrastructure in Pennsylvania and Maine, the maintenance of agreements with our horsemen and pari-mutuel clerks; our dependence on key personnel; the impact of terrorism and other international hostilities; the availability and cost of financing; and other factors as discussed in our other 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.

**PENN NATIONAL GAMING, INC. AND SUBSIDIARIES**  
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**PART I. FINANCIAL INFORMATION**

**ITEM 1. FINANCIAL STATEMENTS**

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

	<u>December 31, 2003</u>	<u>June 30, 2004</u> <u>(unaudited)</u>
<b>Current assets:</b>		
Cash and cash equivalents	\$ 81,952	\$ 122,573
Receivables, net of allowance for doubtful accounts of \$2,791 and \$2,183, respectively	25,750	32,446
Prepaid income taxes	7,593	7,583
Prepaid expenses and other current assets	25,653	16,485
Deferred income taxes	17,284	18,026
<b>Total current assets</b>	<u>158,232</u>	<u>197,113</u>
<b>Net property and equipment, at cost</b>	<u>629,764</u>	<u>625,509</u>
<b>Other assets:</b>		
Investment in and advances to unconsolidated affiliate	17,187	15,167
Excess of cost over fair market value of net assets acquired	603,470	604,257
Management service contract (net of amortization of \$6,719 and \$7,776, respectively)	19,027	17,771
Deferred financing costs, net	28,214	26,170
Miscellaneous	14,034	33,339
Assets held for sale	142,842	145,069
<b>Total other assets</b>	<u>824,774</u>	<u>841,773</u>
<b>Total assets</b>	<u>\$ 1,612,770</u>	<u>\$ 1,664,395</u>
<b>Liabilities and Shareholders' Equity</b>		
<b>Current liabilities:</b>		
Current maturities of long-term debt	\$ 5,634	\$ 5,473
Accounts payable	12,796	16,457
<b>Accrued Liabilities:</b>		
Expenses	46,896	42,752
Interest	11,736	8,085
Salaries and wages	27,713	24,109
Gaming, pari-mutuel, property and other taxes	12,191	15,806
Income taxes payable	—	8,710
Other current liabilities	9,644	11,197
<b>Total current liabilities</b>	<u>126,610</u>	<u>132,589</u>
<b>Long term liabilities:</b>		
Long-term debt, net of current maturities	984,489	962,059
Deferred income taxes	27,793	32,208
Liabilities held for sale	164,000	181,445
<b>Total long-term liabilities</b>	<u>1,176,282</u>	<u>1,175,712</u>
<b>Commitments and contingencies</b>		
<b>Shareholders' equity:</b>		

Preferred stock, \$.01 par value, 1,000,000 shares authorized, none issued	—	—
Common stock, \$.01 par value, 200,000,000 shares authorized; shares issued 40,621,350 and 41,037,096, respectively	409	414
Restricted Stock, 80,000 shares issued	—	(2,354)
Treasury stock, at cost 849,400 shares	(2,379)	(2,379)
Additional paid-in capital	162,442	171,483
Retained earnings	148,055	185,492
Accumulated other comprehensive income	1,351	3,438
<b>Total shareholders' equity</b>	<b>309,878</b>	<b>356,094</b>
<b>Total Liabilities and Shareholder's Equity</b>	<b>\$ 1,612,770</b>	<b>\$ 1,664,395</b>

See accompanying notes to consolidated financial statements.

**Penn National Gaming, Inc. and Subsidiaries**  
**Consolidated Statements of Income**  
(In thousands, except per share data)  
(Unaudited)

	Six Months Ended June 30,	
	2003	2004
<b>Revenues</b>		
Gaming	\$ 414,370	\$ 499,793
Racing	44,392	43,695
Management service fee	5,864	7,366
Food, beverage and other revenue	64,310	77,160
Gross revenues	528,936	628,014
Less: Promotional allowances	(25,269)	(32,694)
Net revenues	503,667	595,320
<b>Operating Expenses</b>		
Gaming	227,456	272,831
Racing	33,230	32,639
Food, beverage and other expenses	46,142	50,574
General and administrative	81,168	94,835
Depreciation and amortization	26,958	33,673
Total operating expenses	414,954	484,552
Income from continuing operations	88,713	110,768
<b>Other income (expenses)</b>		
Interest expense	(35,344)	(38,623)
Interest income	868	816
Earnings from joint venture	1,305	1,092
Other	(754)	(609)
Loss on change in fair values of interest rate swaps	(527)	—
Loss on early extinguishment of debt	(1,310)	—
Total other expenses, net	(35,762)	(37,324)
Income from continuing operations before income taxes	52,951	73,444
Taxes on income	20,286	27,029
Net income from continuing operations	32,665	46,415
(Loss) from discontinued operations, net of tax benefit of \$2,596 and \$4,911, respectively	(4,005)	(8,978)
Net income	\$ 28,660	\$ 37,437
<b>Earnings per share – basic</b>		
Income from continuing operations	\$ 0.83	\$ 1.16
Discontinued operations, net of tax	(0.10)	(0.22)
Basic net income per share	\$ 0.73	\$ 0.94
<b>Earnings per share – diluted</b>		
Income from continuing operations	\$ 0.81	\$ 1.12
Discontinued operations, net of tax	(0.10)	(0.21)
Diluted net income per share	\$ 0.71	\$ 0.91
<b>Weighted shares outstanding</b>		
Basic	39,320	39,974
Diluted	40,413	41,290

See accompanying notes to consolidated financial statements.

**Penn National Gaming, Inc. and Subsidiaries**  
**Consolidated Statements of Income**  
(In thousands, except per share data)  
(Unaudited)

	Three Months Ended June 30,	
	2003	2004
<b>Revenues</b>		
Gaming	\$ 242,053	\$ 250,290
Racing	23,879	23,981
Management service fee	3,165	3,909
Food, beverage and other revenue	37,229	39,731
Gross revenues	306,326	317,911
Less: Promotional allowances.	(15,082)	(16,458)
Net revenues	291,244	301,453
<b>Operating Expenses</b>		
Gaming	130,022	135,623
Racing	17,837	18,001
Food, beverage and other expenses	29,672	28,041
General and administrative	46,896	45,084
Depreciation and amortization	14,920	16,833
Total operating expenses	239,347	243,582
Income from continuing operations	51,897	57,871
<b>Other income (expenses)</b>		
Interest expense	(21,288)	(19,207)
Interest income	444	466
Earnings from joint venture	719	632
Other	(651)	(528)
Total other expenses, net	(20,776)	(18,637)
Income from continuing operations before income taxes	31,121	39,234
Taxes on income	11,811	14,374
Net income from continuing operations	19,310	24,860
(Loss) from discontinued operations, net of tax benefit of \$2,467 and \$2,836, respectively	(3,835)	(5,203)
Net income	\$ 15,475	\$ 19,657
<b>Earnings per share – basic</b>		
Income from continuing operations	\$ 0.49	\$ 0.62
Discontinued operations, net of tax	(0.10)	(0.13)
Basic net income per share	\$ 0.39	\$ 0.49
<b>Earnings per share – diluted</b>		
Income from continuing operations	\$ 0.48	\$ 0.60
Discontinued operations, net of tax	(0.10)	(0.12)
Diluted net income per share	\$ 0.38	\$ 0.48
<b>Weighted shares outstanding</b>		
Basic	39,343	39,872
Diluted	40,478	41,243

See accompanying notes to consolidated financial statements.

**Penn National Gaming, Inc. and Subsidiaries**  
**Consolidated Statements of Shareholders' Equity and Comprehensive Income**  
(Unaudited)  
(In thousands, except share data)

	Common Stock		Restricted Stock	Treasury Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total	Comprehensive Income
	Shares	Amount							
Balance, December 31, 2003	40,621,350	\$ 409	—	\$ (2,379)	\$ 162,442	\$ 148,055	\$ 1,351	\$ 309,878	\$ —
Exercise of stock options including tax benefit of \$2,707	415,746	5	—	—	6,647	—	—	6,652	—
Restricted Stock Issue	—	—	\$ (2,354)	—	2,394	—	—	40	—
Change in fair value of interest rate swap contracts, net of income taxes of \$1,303	—	—	—	—	—	—	2,126	2,126	2,126
Amortization of unrealized loss on interest rate contracts, net of income taxes of \$36	—	—	—	—	—	—	67	67	—
Foreign currency translation adjustment	—	—	—	—	—	—	(106)	(106)	(106)

Net income	—	—	—	—	37,437	—	37,437	37,437
Balance June 30, 2004	41,037,096	\$ 414	\$ (2,354)	\$ (2,379)	\$ 171,483	\$ 185,492	\$ 3,438	\$ 356,094
								\$ 39,457

See accompanying notes to consolidated financial statements.

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

	Six Months Ended June 30,	
	2003	2004
Cash flows from continuing operating activities		
Net income from continuing operations	\$ 32,665	\$ 46,415
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	26,958	33,673
Amortization of deferred financing costs charged to interest expense	1,876	2,694
Amortization of the unrealized loss on interest rate swap contracts charged to interest expense	774	67
Earnings from joint venture	(1,305)	(1,092)
Loss on sale of net assets	1,642	1,080
Loss relating to early extinguishment of debt, before income tax benefit	1,310	—
Deferred income taxes	4,494	3,674
Tax benefit from stock options exercised	899	2,707
Loss on change in value of interest rate swap contracts	527	—
Decrease (increase), net of businesses acquired		
Accounts receivable	(2,868)	(6,696)
Prepaid expenses and other current assets	(10,003)	9,168
Prepaid income taxes	6,415	10
Miscellaneous other assets	9,921	(19,305)
Increase (decrease), net of businesses acquired		
Accounts payable	1,980	3,661
Accrued expenses	(11,538)	(4,144)
Accrued interest	(8,519)	(1,525)
Accrued salaries and wages	(918)	(3,604)
Gaming, pari-mutuel, property and other taxes	1,337	3,615
Income taxes payable	14,211	15,348
Other current liabilities	(1,981)	1,553
Net cash provided by continuing operating activities	67,877	87,299
Cash flows from investing activities		
Expenditures for property and equipment	(32,392)	(28,827)
Payments to terminate interest rate swap contract	(1,902)	—
Proceeds from sale of property and equipment	508	434
Acquisition of business, net of cash acquired	(264,081)	(954)
Cash in escrow	1,000	(43)
Distributions from joint venture	790	3,112
Net cash (used) in continuing investing activities	(296,077)	(26,278)
Cash flows from financing activities		
Proceeds from exercise of options	1,390	3,945
Proceeds from long term debt	700,000	17
Principal payments on long-term debt	(422,220)	(22,603)
(Increase) in unamortized financing cost	(19,021)	(650)
Increase (decrease) in balances due to/from discontinued subsidiaries	(823)	(1,003)
Net cash provided by (used in) continuing financing activities	259,326	(20,294)
Effect of exchange rate fluctuations on cash	281	(106)
Net increase in cash and cash equivalents from continuing operations	31,407	40,621
Cash and cash equivalents for continuing operations, beginning of period	42,649	81,952
Cash and cash equivalents for continuing operations, end of period	\$ 74,056	\$ 122,573
Net increase in cash and cash equivalents from discontinued operations	7,670	4,697
Cash and cash equivalents for discontinued operations, beginning of period	12,472	25,017
Cash and cash equivalents for discontinued operations, end of period	\$ 20,142	\$ 29,714

See accompanying notes to consolidated financial statements.

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## 1. Basis of Presentation

The consolidated financial statements are unaudited and include the accounts of Penn National Gaming, Inc. ("Penn") and its subsidiaries (collectively, the "Company"). Investment in and advances to an unconsolidated affiliate that is 50% owned are accounted for under the equity method. All significant intercompany accounts and transactions have been eliminated in consolidation. Certain prior year amounts have been reclassified to conform to current year presentation.

In the opinion of management, all adjustments (consisting of normal recurring accruals) have been made that are necessary to present fairly the financial position of the Company as of June 30, 2004 and the results of its continuing operations for the three and six month periods ended June 30, 2003 and 2004. The results of continuing operations experienced for the three and six month periods ended June 30, 2004 are not necessarily indicative of the results to be experienced for the fiscal year ending December 31, 2004. The Company has classified the assets, liabilities and results of operations of Hollywood Casino Shreveport as assets and liabilities held for sale and discontinued operations at June 30, 2004. (See Note 12).

The statements and related notes have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been omitted pursuant to such rules and regulations. The accompanying notes should therefore be read in conjunction with the Company's December 31, 2003 annual consolidated financial statements filed on Form 10-K, as amended.

## 2. Revenue Recognition

In accordance with gaming industry practice, the Company recognizes casino revenues as the net of gaming wins less losses. Net revenues exclude the retail value of complimentary rooms, and food and beverage furnished gratuitously to customers. These amounts, which are included in promotional allowances, were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2004	2003	2004
	(In thousands)		(In thousands)	
Rooms	\$ 1,794	\$ 2,014	\$ 2,720	\$ 3,808
Food and beverage	11,837	11,668	20,224	23,480
Other	1,451	2,776	2,325	5,406
Total promotional allowances	\$ 15,082	\$ 16,458	\$ 25,269	\$ 32,694

The estimated cost of providing such complimentary services, which is included in operating expenses, was as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2004	2003	2004
	(In thousands)		(In thousands)	
Rooms	\$ 1,685	\$ 1,895	\$ 2,583	\$ 3,649
Food and beverage	8,898	8,450	14,338	16,841
Other	837	862	1,309	1,588
Total cost of complimentary services	\$ 11,420	\$ 11,207	\$ 18,230	\$ 22,078

Racing revenues include the Company's share of pari-mutuel wagering on live races after payment of amounts returned as winning wagers, 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 service contract the Company has with Casino Rama (the "Casino Rama Management Contract") are recognized as those services are performed.

## 3. Earnings Per Share

The weighted average number of shares of common stock and common stock equivalents used in the computation of basic and diluted earnings per share are set forth in the table below. For the three and six month periods ended June 30, 2003 and 2004, the effect of all outstanding stock options have been included in the calculation of diluted earnings per share.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2004	2003	2004
	(In thousands)		(In thousands)	
Weighted average number of shares outstanding-Basic earnings per share	39,343	39,872	39,320	39,974
Dilutive effect of stock options	1,135	1,371	1,093	1,316
Weighted average number of shares outstanding-Diluted earnings per share	40,478	41,243	40,413	41,290

## 4. Stock-Based Compensation

The Company grants stock options for a fixed number of shares to employees with an exercise price equal to the fair market value of the shares at the date of grant. The Company accounts for stock option grants using the intrinsic-value method in accordance with Accounting Principles Board 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 greater than or equal to the market price of the underlying stock on the date of grant, no compensation expense is recognized.

The Company accounts for the plan 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 fair 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 affect on net income and earnings per share if the Company had applied the fair value recognition provisions of Financial Accounting Standards Board Statement 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.

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	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2004	2003	2004
	(In thousands)		(In thousands)	
Net income, as reported	\$ 15,475	\$ 19,657	\$ 28,660	\$ 37,437
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects	—	25	—	25
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(656)	(2,598)	(1,217)	(3,566)
Pro forma net income	\$ 14,819	\$ 17,084	\$ 27,443	\$ 33,896
Earnings per share:				
Basic-as reported	\$ .39	\$ .49	\$ .73	\$ .94
Basic-pro forma	\$ .38	\$ .43	\$ .70	\$ .85
Diluted-as reported	\$ .38	\$ .48	\$ .71	\$ .91
Diluted-pro forma	\$ .37	\$ .41	\$ .68	\$ .82

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:

Six months ended June 30,	2003	2004
Risk-free interest rate	3.0%	3.0%
Volatility	50.0%	31.0%
Dividend yield	0.0%	0.0%
Expected life (years)	5	6

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 do not apply to awards prior to 1995. Additional awards in future years are anticipated.

## 5. Certain Risks and Uncertainties

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

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

The Company is also dependant 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 affect on future results of operations.

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## 6. Property and Equipment

Property and equipment consist of the following:

	December 31, 2003	June 30, 2004
	(In thousands)	
Land and improvements	\$ 113,660	\$ 119,086
Building and improvements	440,410	441,356
Furniture, fixtures, and equipment	198,095	208,083
Transportation equipment	1,246	1,499
Leasehold improvements	14,495	15,529
Construction in progress	6,093	14,057
Total property and equipment	773,999	799,610
Less: accumulated depreciation and amortization	144,235	174,101
Property and equipment, net	\$ 629,764	\$ 625,509

Interest capitalized in connection with major construction projects was \$.3 million and \$.1 for the year ended December 31, 2003 and for the six months ended June 30, 2004, respectively. Depreciation and amortization expense, for property and equipment, totaled \$25.7 million and \$32.4 million for

the six months ended June 30, 2003 and 2004, respectively.

## 7. Supplemental Disclosures of Cash Flow Information

	Six Months Ended June 30,	
	2003	2004
	(In thousands)	
Cash payments of interest	\$ 44,602	\$ 35,998
Cash payments of income taxes	\$ —	\$ 8,311
<i>Acquisitions: Hollywood Casino Corporation</i>		
Cash Paid	\$ 397,948	\$ —
Fair value of assets acquired, including cash acquired of \$133,867 in 2003	\$ 977,292	\$ —
Fair value of liabilities assumed	\$ 579,344	\$ —

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## 8. Long-term Debt

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

	December 31, 2003	June 30, 2004
	(In thousands)	
Senior secured credit facility. This credit facility is secured by substantially all of the assets of the Company.	\$ 399,700	\$ 377,605
\$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	14,927
	990,123	967,532
Less: current maturities	5,634	5,473
Total long-term debt	\$ 984,489	\$ 962,059

The following is a schedule of future minimum repayments of long-term debt as of June 30, 2004 (in thousands):

2004 (6 months)	\$ 3,039
2005	5,578
2006	5,708
2007	370,204
2008	202,288
2009	2,015
Thereafter	378,700
Total minimum payments	\$ 967,532

At June 30, 2004, the Company had a contingent obligation under letters of credit issued pursuant to the senior secured credit facility with face amounts aggregating \$8.2 million.

The senior secured credit facility requires the Company, among other obligations, to maintain specified financial ratios and satisfy certain financial tests, including interest coverage and total leverage ratios. In addition, the senior secured credit facility restricts, among other things, the Company's ability to incur additional indebtedness, incur guarantee obligations, amend debt instruments, pay dividends, create liens on assets, make investments, make acquisitions, engage in mergers or consolidations, make capital expenditures, or engage in certain transactions with subsidiaries and affiliates and otherwise restrict corporate activities. The terms of the senior subordinated notes contain similar restrictions. Except for the defaults under the Hollywood Casino Shreveport notes, for which the Company (other than the Shreveport entities) is not liable, at June 30, 2004, the Company was in compliance with all required financial covenants.

## 9. 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" section of the Company's Annual Report on Form 10-K, as amended, for the year ended December 31, 2003.

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The table below presents information about reporting segments (in thousands):

As of and for the six months ended	Gaming	Racing	Eliminations	Total
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June 30, 2004					
Revenue	\$	545,589	\$	49,731	\$ — \$ 595,320
Income from operations		106,094		4,674	— 110,768
Depreciation and Amortization		32,106		1,567	— 33,673
Total Assets		2,717,677		101,217	(1,154,499)(2) 1,664,395

**As of and for the six months ended  
June 30, 2003**

		Gaming(1)	Racing	Eliminations	Total
Revenue	\$	453,456	\$ 50,211	\$ —	\$ 503,667
Income from operations		83,284	5,429	—	88,713
Depreciation and Amortization		25,222	1,736	—	26,958
Total Assets		2,729,745	99,852	(1,190,230)(2)	1,639,367

- (1) Reflects results of Hollywood Casino Tunica and Hollywood Casino Aurora since the March 3, 2003 acquisition, which the Company accounts for as of March 1, 2003.
- (2) Primarily reflects elimination of intercompany investments, receivables and payables.

## 10. Litigation

Penn and its subsidiaries are 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 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. In February 2004, the Company filed another motion for partial judgment on most of the remaining issues. A hearing date has been rescheduled for October, 2004. Further litigation on the remaining issues is anticipated.

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 our 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.

## 11. Subsidiary Guarantors

Under the terms of the senior subordinated notes, all of the Company's domestic subsidiaries are guarantors under the agreement, except for Onward Development, LLC, an inactive subsidiary, 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 (the "Subsidiary Non-Guarantors"). The guarantees provided by our 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.

Summarized financial information as of December 31, 2003 and June 30, 2004 and for the three and six months ended June 30, 2004 and 2003 for Penn, the Subsidiary Guarantors and Subsidiary Non-guarantors is as follows:

	Penn	Subsidiary Guarantors	Subsidiary Non-Guarantors	Eliminations	Consolidated
<i>As of June 30, 2004</i>					
<i>Condensed Consolidating Balance Sheet (In thousands)</i>					
Current assets	\$ 54,139	\$ 131,351	\$ 11,052	\$ 571	\$ 197,113
Net property and equipment, at cost	12,974	612,535	—	—	625,509
Other assets	1,169,643	681,909	145,291	(1,155,070)	841,773
Total	\$ 1,236,756	\$ 1,425,795	\$ 156,343	\$ (1,154,499)	\$ 1,664,395

Current liabilities	\$ 40,632	\$ 80,031	\$ 8,260	\$ 3,666	\$ 132,589
Long-term liabilities	962,005	1,157,494	181,443	(1,125,230)	1,175,712
Shareholder's equity	234,119	188,270	(33,360)	(32,935)	356,094
Total	<u>\$ 1,236,756</u>	<u>\$ 1,425,795</u>	<u>\$ 156,343</u>	<u>\$ (1,154,499)</u>	<u>\$ 1,664,395</u>

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	<u>Penn</u>	<u>Subsidiary Guarantors</u>	<u>Subsidiary Non- Guarantors</u>	<u>Eliminations</u>	<u>Consolidated</u>
<i>Six months ended June 30, 2004</i>					
<i>Condensed Consolidating Statement of Income (Loss) (In thousands)</i>					
Total revenues	\$ —	\$ 588,713	\$ 78,420	\$ (759)	\$ 666,374
Total operating expenses	12,132	465,877	77,873	(759)	555,123
Income (loss) from operations	(12,132)	122,836	547	—	111,251
Other income (expense)	19,088	(56,544)	(14,242)	—	(51,698)
Income (loss) before income taxes	6,956	66,292	(13,695)	—	59,553
Taxes on income (loss)	5,263	16,778	75	—	22,116
Net income (loss)	<u>\$ 1,693</u>	<u>\$ 49,514</u>	<u>\$ (13,770)</u>	<u>\$ —</u>	<u>\$ 37,437</u>

<i>Three months ended June 30, 2004</i>					
<i>Condensed Consolidating Statement of Income (Loss) (In thousands)</i>					
Total revenues	\$ —	\$ 297,987	\$ 38,061	\$ (443)	\$ 335,605
Total operating expenses	5,941	234,232	38,909	(443)	278,639
Income (loss) from operations	(5,941)	63,755	(848)	—	56,966
Other income (expense)	9,149	(27,806)	(7,114)	—	(25,771)
Income (loss) before income taxes	3,208	35,949	(7,962)	—	31,195
Taxes on income (loss)	2,258	9,250	30	—	11,538
Net income (loss)	<u>\$ 950</u>	<u>\$ 26,699</u>	<u>\$ (7,992)</u>	<u>\$ —</u>	<u>\$ 19,657</u>

<i>Six months ended June 30, 2004</i>					
<i>Condensed Consolidating Statement of Cash Flows (In thousands)</i>					
Net cash provided by operating activities	\$ 23,402	\$ 63,797	\$ 6,374	\$ —	\$ 93,573
Net cash used in investing activities	31,784	(58,063)	(1,013)	—	(27,292)
Net cash provided by (used in) financing activities	(20,242)	61	(675)	—	(20,856)
Effect of exchange rate fluctuations on cash	—	(117)	11	—	(106)
Net increase (decrease) in cash and cash equivalents	34,944	5,678	4,697	—	45,319
Cash and cash equivalents at beginning of period	11,217	68,814	26,938	—	106,969
Less cash and cash equivalents from discontinued operations	—	—	(29,715)	—	(29,715)
Cash and cash equivalents at end of period	<u>\$ 46,161</u>	<u>\$ 74,492</u>	<u>\$ 1,920</u>	<u>\$ —</u>	<u>\$ 122,573</u>

<i>As of December 31, 2003</i>					
<i>Condensed Consolidating Balance Sheet (In thousands)</i>					
Current assets	\$ 1,153,015	\$ 124,220	\$ 14,720	\$ (1,133,723)	\$ 158,232
Net property and equipment, at cost	1,793	627,971	—	—	629,764
Other assets	70,634	679,151	146,576	(71,587)	824,774
Total	<u>\$ 1,225,442</u>	<u>\$ 1,431,342</u>	<u>\$ 161,296</u>	<u>\$ (1,205,310)</u>	<u>\$ 1,612,770</u>
Current liabilities	\$ 55,944	\$ 64,489	\$ 2,280	\$ 3,897	\$ 126,610
Long-term liabilities	976,012	1,207,221	169,333	(1,176,284)	1,176,282
Shareholder's equity	193,486	159,632	(10,317)	(32,923)	309,878
Total	<u>\$ 1,225,442</u>	<u>\$ 1,431,342</u>	<u>\$ 161,296</u>	<u>\$ (1,205,310)</u>	<u>\$ 1,612,770</u>

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	<u>Penn</u>	<u>Subsidiary Guarantors</u>	<u>Subsidiary Non- Guarantors</u>	<u>Eliminations</u>	<u>Consolidated</u>
<i>Six months ended June 30, 2003</i>					
<i>Condensed Consolidating Statement of Income (Loss) (In thousands)</i>					
Total revenues	\$ —	\$ 498,622	\$ 52,334	\$ (819)	\$ 550,137
Total operating expenses	9,572	400,846	48,888	(819)	458,487
Income (loss) from operations	(9,572)	97,776	3,446	—	91,650

Other income (expense)	17,530	(52,955)	(9,871)	\$ —	(45,296)
Income (loss) before income taxes (benefit)	7,958	44,821	(6,425)	\$ —	46,354
Taxes (benefit) on income (loss)	5,099	12,527	(68)	—	17,694
Net income (loss)	<u>\$ 2,859</u>	<u>\$ 32,294</u>	<u>\$ (6,493)</u>	<u>\$ —</u>	<u>\$ 28,660</u>

*Three Months ended June 30, 2003*

*Condensed Consolidating Statement of  
Income (Loss) (In thousands)*

Total revenues	\$ —	\$ 288,551	\$ 36,924	\$ (472)	\$ 325,003
Total operating expenses	4,973	231,953	35,700	(472)	272,154
Income (loss) from operations	(4,973)	56,598	1,224	—	52,849
Other income (expense)	14,118	(34,704)	(7,437)	—	(28,023)
Income (loss) before income taxes (benefit)	9,145	21,894	(6,213)	—	24,826
Taxes (benefit) on income (loss)	2,828	6,216	35	272	9,351
Net income (loss)	<u>\$ 6,317</u>	<u>\$ 15,678</u>	<u>\$ (6,248)</u>	<u>\$ (272)</u>	<u>\$ 15,475</u>

*Six months ended June 30, 2003*

*Condensed Consolidating Statement of Cash  
Flows (In thousands)*

Net cash provided by operating activities	\$ 37,511	\$ 28,964	\$ 8,321	\$ —	\$ 74,796
Net cash provided by (used in) investing activities	(659,283)	363,206	(69)	—	(296,146)
Net cash provided by (used in) financing activities	620,369	(359,776)	(447)	—	260,146
Effect of exchange rate fluctuations on cash	125	156	—	—	281
Net increase in cash and cash equivalents	(1,278)	32,550	7,805	—	39,077
Cash and cash equivalents at beginning of period	3,339	38,430	13,352	—	55,121
Less cash and cash equivalents from discontinued operations	—	—	(20,142)	—	(20,142)
Cash and cash equivalents at end of period	<u>\$ 2,061</u>	<u>\$ 70,980</u>	<u>\$ 1,015</u>	<u>\$ —</u>	<u>\$ 74,056</u>

**12. Discontinued Operations**

On January 30, 2004, the Board of Directors of HCS I, the managing general partner of Hollywood Casino Shreveport, approved a resolution to sell Hollywood Casino Shreveport and authorized their financial advisor Libra Securities, LLC to begin contacting potential acquirers. The Board also authorized the creation of an independent 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. Prior to June 30, 2004, Penn decided not to participate in the bid process. Oral presentations by the four highest bidders were presented to the ad hoc committee on June 15, 2004 and their revised bids were due on July 6, 2004.

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 Statement of Financial Accounting Standards ("FASB") 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 three and six month periods ended June 30, 2004 for Hollywood Casino Shreveport is as follows:

**HWCC-Louisiana, Inc. And Subsidiaries  
Consolidated Balance Sheets  
(In thousands)**

	<u>December 31, 2003</u>	<u>June 30, 2004</u> (Unaudited)
<b>Assets</b>		
Current assets	\$ 30,828	\$ 36,949
Property and equipment, net	110,743	106,917
Other assets	1,271	1,203
Total assets	<u>\$ 142,842</u>	<u>\$ 145,069</u>
<b>Liabilities and Shareholders' (Deficiency)</b>		
Current liabilities	\$ 163,597	\$ 180,987
Other noncurrent liabilities	403	458
Commitments and Contingencies		
Shareholders' (deficiency)	(21,158)	(36,376)
Total liabilities and shareholders' (deficiency)	<u>\$ 142,842</u>	<u>\$ 145,069</u>

**HWCC-Louisiana, Inc. And Subsidiaries**  
**Consolidated Statements Of Operations**  
(In thousands)  
(Unaudited)

	Three Months Ended June 30, 2003	Three Months Ended June 30, 2004	March 1, 2003 – June 30, 2003	Six Months Ended June 30, 2004
Net revenues	\$ 33,759	\$ 34,152	\$ 46,470	\$ 71,054
Income (loss) from operations	\$ 744	\$ (1,232)	\$ 2,489	\$ (180)
Net (loss)	\$ (3,835)	\$ (5,203)	\$ (4,005)	\$ (8,978)

### 13. Commitments and Contingencies

#### Employment Agreements

The Company has entered into employment agreements with the Chairman and Chief Executive Officer and the President and Chief Operating Officer for an initial term of five years and three years, respectively, renewable thereafter for additional terms. Each agreement includes a base compensation and bonus provision, a severance clause, a change of control provision and provides for other employee benefits.

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### Our Operations

We are a leading, diversified, multi-jurisdictional owner and operator of gaming properties, as well as horse racetracks 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 two racetracks and eleven OTWs in Pennsylvania, one racetrack in West Virginia, and through a joint venture, own and operate a racetrack in New Jersey. We operate in two reporting 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 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.

Gaming revenues are derived primarily from gaming on slot machines and 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 at out-of-state locations. Other revenues are derived from hotel, dining, retail, admissions, program sales, concessions and certain other ancillary activities.

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

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- 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 at out-of-state locations.

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

#### *Results of Operations*

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

- The continued emphasis on slot revenue 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.
- Recent economic conditions 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.
- A number of states are currently considering 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 and Texas). The timing and occurrence of these events remain uncertain. Legalized gaming from casinos located on Native American lands could also have a significant competitive effect.

### Six Months ended June 30, 2003 compared to six months ended June 30, 2004

The results of continuing operations by property level for the six months ended June 30, 2003 and 2004 are summarized below (in thousands):

	Revenues(1)		Income from operations	
	2003	2004	2003	2004
<b>Gaming Segment</b>				
Charles Town Entertainment Complex	\$ 155,256	\$ 195,576	\$ 35,233	\$ 44,937
Hollywood Casino Aurora (2)	93,937	116,345	23,142	29,232
Casino Rouge	55,328	55,958	12,970	14,411
Casino Magic-Bay St. Louis	53,335	56,658	6,715	7,124
Hollywood Casino Tunica (2)	39,462	60,753	4,721	10,212
Boomtown Biloxi	37,537	36,968	5,681	5,085
Bullwhackers	12,737	15,965	793	1,666
Casino Rama Management Contract	5,864	7,366	5,424	6,822
Corporate overhead	—	—	(11,395)	(13,395)
<b>Total Gaming Segment</b>	<b>453,456</b>	<b>545,589</b>	<b>83,284</b>	<b>106,094</b>
<b>Racing Segment</b>				
Pennsylvania Racing Operations	50,211	49,349	5,429	4,837
Bangor Historic Track (3)	—	382	—	(163)
<b>Total Racing Segment</b>	<b>50,211</b>	<b>49,731</b>	<b>5,429</b>	<b>4,674</b>
<b>Total</b>	<b>\$ 503,667</b>	<b>\$ 595,320</b>	<b>\$ 88,713</b>	<b>\$ 110,768</b>

- (1) Net revenues are net of promotional allowances.  
(2) Reflects results since March 3, 2003 acquisition.  
(3) Reflects results since February 12, 2004 acquisition.

### Revenues

#### Net revenues, six months ended June 30, 2004

	Gaming	Racing	Total
Gaming	\$ 499,793	\$ —	\$ 499,793
Racing	—	43,695	43,695
Management Service fee	7,366	—	7,366
Food, beverage and other revenue	71,096	6,064	77,160
Gross revenue	578,255	49,759	628,014
Less: Promotional allowances	(32,666)	(28)	(32,694)
<b>Net revenues</b>	<b>\$ 545,589</b>	<b>\$ 49,731</b>	<b>\$ 595,320</b>

#### Net revenues, six months ended June 30, 2003

	Gaming	Racing	Total
Gaming	\$ 414,370	\$ —	\$ 414,370
Racing	—	44,392	44,392
Management Service fee	5,864	—	5,864
Food, beverage and other revenue	58,463	5,847	64,310
Gross revenue	478,697	50,239	528,936
Less: Promotional allowances	(25,241)	(28)	(25,269)
<b>Net revenues</b>	<b>\$ 453,456</b>	<b>\$ 50,211</b>	<b>\$ 503,667</b>

Net revenues for the six month period ended June 30, 2004 increased by \$91.6 million, or 18.2%, to \$595.3 million from \$503.7 million in 2003. The two new Hollywood Casino properties contributed \$43.7 million of the increase in revenue. The revenue increase for the two Hollywood Casino properties was a result of comparing a six month period of operations in 2004 to a four month period of operations in 2003. For the properties we owned prior to the acquisition of the Hollywood Casino properties, revenues increased by \$47.9 million, or 9.5%. The properties with the largest revenue gains this quarter were Charles Town Entertainment Complex with a net revenue increase of \$40.3 million, Casino Magic-Bay St. Louis with an increase of \$3.3 million and Bullwhackers Casinos with an increase of \$3.2 million.

#### Gaming revenues

Gaming revenue increased in 2004 by \$85.4 million, or 20.6%, to \$499.8 million from \$414.4 million in 2003. The two Hollywood Casino properties contributed \$40.5 million of the increase and the properties we owned prior to the acquisition contributed \$44.9 million. Of this total, Charles Town Entertainment Complex increased gaming revenue by \$38.5 million, or 27.6%, over the same period last year due to the opening of an additional 38,000 square feet of gaming space with 700 new slot machines in July of 2003. The average number of gaming machines in play increased to 3,538 in 2004 from 2,708 in 2003 with the average win per machine of \$276 and \$284 per day, respectively. At Casino-Magic-Bay St. Louis, gaming revenue increased by \$3.2 million, or 6.9%. The primary driver in the revenue increase was a higher occupancy rate at the 291-room Bay Tower Hotel and Conference Center. The occupancy rate for the six months ended June 30, 2004 was 90.2% compared to 78.7% in 2003 and was the result of a marketing program that focused on better utilization of the hotel and increased play on the gaming floor. Gaming revenue at Bullwhackers increased by \$2.9 million, or 23.3%, due to the

introduction of penny machines that were part of the facility renovations completed in 2003 and a more aggressive marketing program that is focused on the "locals" market.

Management service fees from Casino Rama increased by \$1.5 million, or 25.6%, to \$7.4 million from \$5.9 million in 2003. The increase in management service fees is a result of mild winter weather in the first quarter and marketing programs that focus on trip generation, recent visitors, the hotel and convention center and the concert program. These programs have increased attendance, hotel occupancy and slot play in the casino.

Food, beverage and other revenue increased in 2004 by \$12.6 million, or 21.6%, to \$71.1 million from \$58.5 million in 2003. The two Hollywood Casino properties contributed \$9.2 million of the increase and the

properties we owned prior to the acquisition contributed \$4.4 million. Charles Town increased its food, beverage and other revenue by \$2.3 million as a result of the increased attendance. At Casino Magic-Bay St. Louis, food, beverage and other revenue, including hotel revenues, increased by \$1.1 million as a result of the marketing programs that were implemented to increase hotel occupancy and feature our dining outlets.

Promotional allowances increased in 2004 by \$7.4 million to \$32.6 million from \$25.2 million in 2003. The two Hollywood Casino properties accounted for \$6.1 million of the increase and the properties we owned prior to the acquisition increased by \$1.3 million. Of the \$1.3 million, approximately \$.6 million of the increase was attributed to Charles Town because of the expansion of the facility and \$.8 million was attributable to the marketing of the hotel and convention center at Casino Magic-Bay St. Louis.

#### Racing revenues

Total racing revenues for our Pennsylvania racing operations and the Bangor Historic Track decreased by \$.5 million, or 1.0%, to \$49.7 million in 2004 from \$50.2 million in 2003.

Racing revenues at our Pennsylvania facilities decreased in 2004 by \$1.1 million, or 2.4%, to \$44.1 million from \$45.2 million in 2003. Adverse winter weather conditions during the first quarter were a factor as we had a number of race day cancellations and lower attendance on a number of other days. The Bangor Historic Track had racing revenues for their 12 days of racing of \$.4 million.

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

#### *Operating Expenses*

##### **Operating expenses, six months ended June 30, 2004**

	<u>Gaming</u>	<u>Racing</u>	<u>Total</u>
Gaming	\$ 272,831	\$ —	\$ 272,831
Racing	—	32,639	32,639
Food, beverage and other expenses	46,440	4,134	50,574
General and administrative	88,118	6,717	94,835
Depreciation and amortization	32,106	1,567	33,673
Total operating expenses	<u>\$ 439,495</u>	<u>\$ 45,057</u>	<u>\$ 484,552</u>

##### **Operating expenses, six months ended June 30, 2003**

	<u>Gaming</u>	<u>Racing</u>	<u>Total</u>
Gaming	\$ 227,456	\$ —	\$ 227,456
Racing	—	33,230	33,230
Food, beverage and other expenses	42,154	3,988	46,142
General and administrative	75,340	5,828	81,168
Depreciation and amortization	25,222	1,736	26,958
Total operating expenses	<u>\$ 370,172</u>	<u>\$ 44,782</u>	<u>\$ 414,954</u>

Operating expenses for the six month period ended June 30, 2004 increased by \$69.6 million, or 16.8%, to \$484.5 million from \$414.9 million in 2003. The two Hollywood Casino properties were responsible for \$32.1 million of the increase in operating expenses. The increase was a result of comparing a six month period of operations in 2004 to a four month period of operations in 2003. For the properties we owned prior to the acquisition of the Hollywood Casino properties, expenses increased by \$37.5 million, or 12.1%. Our largest increases in operating expenses occurred at Charles Town, Casino Magic-Bay St. Louis and Bullwhackers Casino.

#### Gaming operating expenses

Gaming expenses increased in 2004 by \$45.4 million, or 19.9%, to \$272.8 million from \$227.4 million in 2003. The two Hollywood Casino properties accounted for \$17.8 million of the increase and the properties we owned prior to the acquisition increased by \$27.6 million. At the Charles Town Entertainment Complex, gaming expenses increased by \$27.8 million, or 27.9%, over the same period from last year due to the opening of an

additional 38,000 square feet of gaming space with 700 new slot machines in July of 2003. For the period we paid an additional \$22.7 million in gaming taxes as a result of the higher gaming revenues. At Casino Magic—Bay St. Louis, gaming expenses increased by \$2.8 million and included higher gaming taxes and slot machine participation fees that increased with revenues and higher marketing expenses for entertainment and players' club promotions.



Gaming expenses at Bullwhackers increased by \$2.4 million primarily as a result of the higher gaming taxes associated with higher revenues and increased marketing expenses for advertising and players' club promotions.

Food, beverage and other expenses increased in 2004 by \$4.3 million to \$46.4 million from \$42.1 million in 2003. The two Hollywood Casino properties accounted for \$2.8 million of the increase and the properties we owned prior to the acquisition increased by \$1.5 million. Most of the increase occurred at Charles Town which had significant gains in attendance during the period compared to last year as a result of the gaming space expansion in July of 2003 and had increased staffing costs to properly service our customers and increased cost of sales due to increased food and beverage revenues.

General and administrative expenses increased by \$12.8 million to \$88.1 million in 2004 from \$75.3 million in 2003. The addition of the two Hollywood Casino properties increased general and administrative expenses by \$8.5 million, the properties we owned prior to acquisition had an increase in general and administrative expenses of \$2.3 million and corporate overhead increased by \$2.0 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 by \$2.9 million primarily as a result of the expansion project that added new gaming space. The other properties did not have any significant changes in these expenses. Corporate overhead expenses increased by \$2.0 million for the six months ended June 30, 2004 as compared to 2003. We continue to incur expenses for lobbying and site development expenses in connection with Pennsylvania slot legislation and Maine slot legislation. Other corporate expenses such as payroll and employee benefits, legal, outside services and travel have increased as a result of the Hollywood Casino acquisition in March of 2003. Notably, our corporate overhead as a percentage of our net revenues has decreased to 2.2% in 2004 compared to 2.3% in 2003.

Depreciation and amortization expense increased by \$6.9 million, or 27.3%, to \$32.1 million in 2004 from \$25.2 million in 2003. The addition of the two Hollywood Casino properties increased depreciation and amortization expense by \$3.1 million. The remaining increase of \$3.8 million was primarily a result of the expansion at Charles Town for additional gaming space and the parking structure, the hotel complex at Casino Magic-Bay St. Louis and the purchase of new slot machines at many of our properties.

#### Racing operating expenses

Total racing expenses for our Pennsylvania racing operations and the Bangor Historic Track increased in 2004 by \$.3 million, or less than 1%, to \$45.1 million from \$44.8 million in 2003. The Bangor Historic Track had racing expenses of \$.4 million for the 12 days of racing.

Racing expenses that have a direct relationship to racing revenue such as purse expense, pari-mutuel taxes, simulcast fees and totalisator expense all decreased along with the decrease in racing revenues at our Pennsylvania facilities. The decrease in racing expenses at our Pennsylvania facilities was partially offset by the addition of the Bangor Historic Track racing expenses.

Other racing related expenses such as food, beverage and other expenses, general and administrative expenses have increased as a result of the Bangor Historic Track expenses and depreciation expenses decreased slightly due to the age of the facilities and equipment.

#### *Income from operations*

Operating income increased by \$22.0 million, or 25.0%, to \$110.8 million for the six months ended June 30, 2004 from \$88.7 million in 2003. The primary drivers, as discussed above, in the growth of income from

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operations were the two Hollywood Casino properties, which accounted for \$11.6 million of the increase, and Charles Town, which accounted for \$9.7 million.

#### *Other income (expense)*

Other income (expense) summary (in thousands):

<b>Six Months Ended June 30,</b>	<b>2003</b>	<b>2004</b>
Other income (expense):		
Interest expense	\$ (35,344)	\$ (38,623)
Interest income	868	816
Earnings from joint venture	1,305	1,092
Other	(754)	(609)
Loss on change in fair values of interest rate swaps	(527)	—
Loss on early extinguishment of debt	(1,310)	—
Total other expenses, net	<u>\$ (35,762)</u>	<u>\$ (37,324)</u>

Interest expense increased by \$3.3 million for the six months ended June 30, 2004 compared to 2003 as a result of borrowing an additional \$700 million for the acquisition of Hollywood Casino Corporation. During 2004, we made principal payments of \$22.1 million on our senior secured credit facility, including an accelerated payment of \$20 million on March 31, 2004. Subject to the availability of attractive acquisition or project opportunities, we expect to continue to accelerate our principal payments as free cash flow allows.

#### **Three Months ended June 30, 2003 compared to three months ended June 30, 2004**

The results of continuing operations by property level for the three months ended June 30, 2003 and 2004 are summarized below (in thousands):

	<u>Revenues(1)</u>		<u>Income from operations</u>	
	2003	2004	2003	2004
<b>Gaming Segment</b>				
Charles Town Entertainment Complex	\$ 84,773	\$ 101,524	\$ 20,036	\$ 24,664
Hollywood Casino Aurora (2)	69,146	57,475	16,571	14,624
Casino Rouge	26,259	27,503	5,453	7,111

Casino Magic-Bay St. Louis	26,670	28,057	3,223	3,272
Hollywood Casino Tunica (2)	28,914	29,865	3,084	4,998
Boomtown Biloxi	18,621	17,373	2,672	2,133
Bullwhackers	6,540	8,208	599	857
Casino Rama Management Contract	3,165	3,909	2,930	3,622
Corporate overhead	—	—	(6,049)	(6,470)
<b>Total Gaming Segment</b>	<b>264,088</b>	<b>273,914</b>	<b>48,519</b>	<b>54,811</b>
<b>Racing Segment</b>				
Pennsylvania Racing Operations	27,156	27,157	3,378	3,223
Bangor Historic Track (3)	—	382	—	(163)
<b>Total Racing Segment</b>	<b>27,156</b>	<b>27,539</b>	<b>3,378</b>	<b>3,060</b>
<b>Total</b>	<b>\$ 291,244</b>	<b>\$ 301,453</b>	<b>\$ 51,897</b>	<b>\$ 57,871</b>

- (1) Net revenues are net of promotional allowances.
- (2) Reflects results since March 3, 2003 acquisition.
- (3) Reflects results since February 12, 2004 acquisition.

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## Revenues

### **Net revenues, three months ended June 30, 2004**

	<b>Gaming</b>	<b>Racing</b>	<b>Total</b>
Gaming	\$ 250,290	\$ —	\$ 250,290
Racing	—	23,981	23,981
Management Service fee	3,909	—	3,909
Food, beverage and other revenue	36,158	3,573	39,731
Gross revenue	290,357	27,554	317,911
Less: Promotional allowances	(16,443)	(15)	(16,458)
<b>Net revenues</b>	<b>\$ 273,914</b>	<b>\$ 27,539</b>	<b>\$ 301,453</b>

### **Net revenues, three months ended June 30, 2003**

	<b>Gaming</b>	<b>Racing</b>	<b>Total</b>
Gaming	\$ 242,053	\$ —	\$ 242,053
Racing	—	23,879	23,879
Management Service fee	3,165	—	3,165
Food, beverage and other revenue	33,938	3,291	37,229
Gross revenue	279,156	27,170	306,326
Less: Promotional allowances	(15,068)	(14)	(15,082)
<b>Net revenues</b>	<b>\$ 264,088</b>	<b>\$ 27,156</b>	<b>\$ 291,244</b>

Net revenues for the three month period ended June 30, 2004 increased by \$10.2 million, or 3.5%, to \$301.4 million from \$291.2 million in 2003. The properties with the largest revenue changes this quarter were Charles Town Entertainment Complex with a net revenue increase of \$16.7 million, due to the addition of gaming space and slot machines in July of 2003, and Hollywood Casino Aurora, with a net revenue decrease of \$11.7 million that resulted from an increase in the Illinois gaming tax rates and changes in operations to maintain operating margins with the new gaming tax rate structure.

#### Gaming revenues

Gaming revenue increased in 2004 by \$8.2 million, or 3.4%, to \$250.3 million from \$242.1 million in 2003. Of this total, Charles Town Entertainment Complex increased gaming revenue by \$16.3 million, or 21.5%, over the same period last year due to the opening of an additional 38,000 square feet of gaming space with 700 new slot machines in July of 2003. An additional 120 new slot machines have been added during May and June of 2004. The average number of gaming machines in play increased to 3,572 in 2004 from 2,704 in 2003 with the average win per machine of \$283 and \$308 per day, respectively. At Hollywood Casino Aurora, gaming revenues decreased \$11.8 million, or 17.6%, to \$55.4 million from \$67.2 million in 2003. The primary driver in the revenue decline was the Illinois gaming tax increase that became effective on July 1, 2003 and the changes in operations that were made. Some of the operations changes that were made included the elimination of incentives for patrons that were marginally profitable, a reduction in the hours of operations and charging patrons for services that were previously offered as complimentary. These changes resulted in a 38.2% decline in attendance and reduced gaming revenue.

At Casino Magic-Bay St. Louis, gaming revenue increased by \$1.4 million, or 6.0%. The primary driver in the revenue increase was a higher occupancy rate at the 291-room Bay Tower Hotel and Conference Center. The occupancy rate for the three months ended June 30, 2004 was 92.5% compared to 84.6% in 2003 and was the result of a marketing program that focused on better utilization of the hotel and increased play on the gaming floor. We also changed the mix of slot machines and table games on the casino floor by adding 50 slot machines and dropping 7 tables games. Gaming revenue at Bullwhackers increased by \$1.6 million, or 24.1%, due to the introduction of penny machines that were part of the facility renovations completed in 2003 and a more aggressive marketing program that is focused on the "locals" market.

Management service fees from Casino Rama increased by \$0.7 million, or 23.5%, to \$3.9 million from \$3.2 million in 2003. The increase in management service fees is a result of marketing programs that focus on

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trip generation, recent visitors, the hotel and convention center and the concert program. These programs have increased attendance, hotel occupancy and slot play in the casino.

Food, beverage and other revenue increased in 2004 by \$2.2 million, or 6.5%, to \$36.1 million from \$33.9 million in 2003. Charles Town increased its food, beverage and other revenue by \$.7 million as a result of the increased attendance. At Casino Magic-Bay St. Louis, food, beverage and other revenue, including hotel revenues, increased by \$.4 million as a result of the marketing programs that were implemented to increase hotel occupancy and feature our dining outlets. Hollywood Casino Aurora increased its food, beverage and other revenue by \$1.0 million as the new admission charge offset the decline in food and beverage revenue that resulted from the 38.2% decline in attendance.

Promotional allowances increased in 2004 by \$1.4 million to \$16.4 million from \$15.1 million in 2003. Of the \$1.4 million, approximately \$.2 million of the increase was attributed to Charles Town because of the expansion of the facility and \$.4 million was attributable to the marketing of the hotel and convention center at Casino Magic-Bay St. Louis. At Hollywood Casino Aurora, promotional allowances increased by \$.8 million as a result of providing complimentary admissions to our most profitable customers.

#### Racing revenues

Net racing revenues at our Pennsylvania facilities and the Bangor Historic Track increased in 2004 by \$.4 million, or 1.4%, to \$27.5 million from \$27.1 million in 2003.

Pennsylvania racing had a slight decline in racing revenues despite successful triple crown race days involving Pennsylvania-bred Smarty Jones. This slight decline was offset by the revenue from the Bangor Historic Track harness meet run as part of the Company for the first time.

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

#### *Operating Expenses*

##### Operating expenses, three months ended June 30, 2004

	<u>Gaming</u>	<u>Racing</u>	<u>Total</u>
Gaming	\$ 135,623	\$ —	\$ 135,623
Racing	—	18,001	18,001
Food, beverage and other expenses	25,708	2,333	28,041
General and administrative	41,723	3,361	45,084
Depreciation and amortization	16,049	784	16,833
Total operating expenses	<u>\$ 219,103</u>	<u>\$ 24,479</u>	<u>\$ 243,582</u>

##### Operating expenses, three months ended June 30, 2003

	<u>Gaming</u>	<u>Racing</u>	<u>Total</u>
Gaming	\$ 130,022	\$ —	\$ 130,022
Racing	—	17,837	17,837
Food, beverage and other expenses	27,494	2,178	29,672
General and administrative	44,010	2,886	46,896
Depreciation and amortization	14,043	877	14,920
Total operating expenses	<u>\$ 215,569</u>	<u>\$ 23,778</u>	<u>\$ 239,347</u>

#### Gaming operating expenses

Operating expenses for the three month period ended June 30, 2004 increased by \$4.2 million, or 1.8%, to \$243.6 million from \$239.3 million in 2003. Our largest increases in operating expenses occurred at Charles Town, Casino Magic-Bay St. Louis and Bullwhackers Casino.

Gaming expenses increased in 2004 by \$5.6 million, or 4.3%, to \$135.6 million from \$130.0 million in 2003. At the Charles Town Entertainment Complex, gaming expenses increased by \$10.7 million, or 22.9%, over the same period from last year due to the opening of an additional 38,000 square feet of gaming space with 700 new slot machines in July of 2003. Of this total, gaming taxes increased by \$9.6 million. At Casino Magic—Bay St. Louis, gaming expenses increased by \$1.4 million and included higher gaming taxes and slot machine participation fees that increased with revenues and higher marketing expenses for entertainment and players' club promotions. Gaming expenses at Bullwhackers increased by \$1.4 million or, 40.4%, primarily as a result of the higher gaming taxes associated with higher revenues and increased marketing expenses for advertising and players' club promotions. Gaming expenses at Hollywood Casino Aurora declined by \$6.8 million due to the changes made in the operation of the facility and lower gaming and admissions taxes paid because of the 17.6% decrease in gaming revenue.

Food, beverage and other expenses decreased in 2004 by \$1.8 million to \$25.7 million from \$27.5 million in 2003. Most of the decrease is attributed to Hollywood Casino Aurora and was a direct result of the 38.2% decrease in attendance. At Charles Town, food, beverage and other expenses increased due to the significant gains in attendance during the period compared to last year as a result of the gaming space expansion in July of 2003. With the additional gaming space, we had to increase staff to properly service our customers and we had increased cost of sales due to increased food and beverage revenues.

General and administrative expenses decreased by \$2.3 million to \$41.7 million in 2004 from \$44.0 million in 2003. 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. Our Hollywood Casino Aurora operation had a \$1.4 million reduction in general and administrative overhead expenses primarily as a result of reduced staffing. Hollywood Casino Tunica and Casino Rouge reduced their general and administration costs by approximately \$.5 million each as expenses were lower for property and general liability insurance, health insurance and outside services. The other properties did not have any significant changes in their expenses. Corporate overhead expenses increased by \$.4 million for the three

months ended June 30, 2004 as compared to 2003. We continued to incur expenses for lobbying and site development expenses in connection with Pennsylvania slot legislation and Maine slot regulations. Other corporate expenses such as payroll and employee benefits, legal, outside services and travel have increased as a result of the Hollywood Casino acquisition in March of 2003. Notably, our corporate overhead as a percentage of our net revenues has remained at 2.1% in both years.

Depreciation and amortization expense increased by \$2.0 million, or 14.3%, to \$16.0 million in 2004 from \$14.0 million in 2003. The increase was primarily a result of the expansion at Charles Town for additional gaming space and the parking structure, the hotel complex at Casino Magic-Bay St. Louis and the purchase of new slot machines at many of our properties.

#### Racing operating expenses

Total racing expenses at our Pennsylvania facilities and Bangor Historic Track increased in 2004 by \$.7 million, or 2.9%, to \$24.5 million from \$23.8 million in 2003. Bangor Historic Track had racing expenses of \$.4 million for its racing meet this period.

Racing expenses that have a direct relationship to racing revenue such as purse expense, pari-mutuel taxes, simulcast fees and totalisator expense all decreased along with the decrease in racing revenues at our Pennsylvania facilities and were offset by the racing expenses at Bangor Historic Track.

Other racing related expenses such as food, beverage and other expenses, general and administrative expenses have increased as a result of the Bangor Historic Track expenses and depreciation expenses decreased slightly due to the age of the facilities and equipment.

#### *Income from operations*

Operating income increased by \$6.0 million, or 11.5%, to \$57.9 million for the three months ended June 30, 2004 from \$51.9 million in 2003. The primary drivers, as discussed above, in the growth of income from operations was Charles Town, which accounted for \$4.6 million and Casino Rouge, which accounted for \$1.7 million of the change.

#### *Other income (expense)*

Other income (expense) summary (in thousands):

<u>Three Months Ended June 30,</u>	<u>2003</u>	<u>2004</u>
<b>Other income (expense):</b>		
Interest expense	\$ (21,288)	\$ (19,207)
Interest income	444	466
Earnings from joint venture	719	632
Other	(651)	(528)
Total other expenses, net	<u>\$ (20,776)</u>	<u>\$ (18,637)</u>

Interest expense decreased by \$2.1 million for the three months ended June 30, 2004 compared to 2003 as a result of reducing our debt by \$60.4 million since June 30, 2003. Subject to the availability of attractive acquisition or project opportunities, we expect to continue to accelerate our principal payments as free cash flow allows.

#### *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 continuing operating activities was \$87.3 million for the six months ended June 30, 2004. This consisted of net income of \$46.4 million, non-cash reconciling items of \$42.8 million and net decreases in current liability accounts along with net decreases in current asset accounts of \$1.9 million.

Cash flows used in continuing investing activities totaled \$20.3 million for the six months ended June 30, 2004. Expenditures for property, plant, and equipment totaled \$28.8 million and included \$10.0 million at Charles Town for the Phase III expansion project, \$3.5 million for a land purchase at Boomtown and \$15.3 million in maintenance capital expenditures including new slot machines. We also received a \$3.1 million cash distribution from our New Jersey joint venture.

Cash used in continuing financing activities was \$21.5 million for the six months ended June 30, 2004. Principal payments on long-term debt included \$22.6 million in payments under our credit facility. Net proceeds from the exercise of stock options totaled \$3.9 million.

#### *Outlook*

Based on our current level of continuing operations, and anticipated revenue growth, we believe that cash generated from operations and amounts available under our credit facility will be adequate to meet our anticipated debt service requirements, 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, if we consummate significant acquisitions in the future, our cash requirements may increase significantly. 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 are for fixed asset additions that expand an existing facility. Capital maintenance (replacement) expenditures are expenditures to replace existing fixed assets with a useful life greater than one year that are obsolete, worn out or it is no longer cost effective to repair.

The following table summarizes our expected capital expenditures, other than maintenance capital expenditures, by property for the fiscal year ended December 31, 2004 and actual expenditures during the second quarter of 2004 (in thousands):

Property	Expected for Year Ended December 31, 2004	Expenditures Through June 30, 2004	Balance to Expend
Charles Town Entertainment Complex	\$ 34,100	\$ 9,970	\$ 24,130
Boomtown Biloxi and others	5,500	3,481	2,019
Totals	\$ 39,600	\$ 13,451	\$ 26,149

The Charles Town Entertainment Complex has started the work for Phase III of the facility expansion. Phase III includes the expansion of the parking garage by approximately 1,050 spaces, adding an additional 1,000 slot machines and related equipment 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 700 slot machines should be open by the third quarter 2005.

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 is 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 the lawsuit filed by our landlord that goes to trial in 2004. Due to the ongoing litigation with our landlord at the Boomtown Biloxi property, we have 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, we may elect to revisit the decision.

During the six months ended June 30, 2004, we spent approximately \$15.3 million for maintenance capital expenditures at our properties.

For 2004, we expect to spend approximately \$49.7 million for maintenance capital expenditures at our properties. Of this total, approximately \$12.5 million will be spent on ticket-in, ticket-out slot technology at our facilities in states where the new technology is approved.

Cash generated from operations funded our capital expenditures and maintenance capital expenditures.

### Debt

#### — Senior Secured Credit Facility

At June 30, 2004, we had an outstanding balance of \$377.6 million on the Term Loan D facility and \$91.8 million available to borrow under the revolving credit facility after giving effect to outstanding letters of credit of \$8.2 million. The weighted average interest rate on the Term D facility is 4.05% at June 30, 2004, excluding swaps and deferred finance fees.

#### — Hollywood Casino Shreveport Notes, Liabilities Held for Sale

Hollywood Casino Shreveport 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 collectively 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, and the partnership interests held by HCS I, Inc. and HCS II, Inc. and the stock held by HWCC-Louisiana, Inc.

On February 3, 2004, our indirect subsidiary, HCS I, Inc., the managing general partner of Hollywood Casino Shreveport general partnership, or HCS, announced that its Board of Directors had initiated a process that it hoped would result in the sale or other disposition of the riverboat casino/hotel complex of HCS located in Shreveport, Louisiana. The announcement followed action by the Board authorizing HCS's financial advisor, Libra Securities LLC, to begin contacting potential acquirers. The Board also authorized the creation of an independent committee to oversee the sale process. The Board created the independent committee in case we had decided to participate as a bidder in the sale process. The Board took action after consultation with an ad hoc committee of holders of the Hollywood Casino Shreveport notes. Although no formal agreement has been reached with the ad hoc committee regarding the sale process, HCS anticipates that it will consult with the ad hoc committee throughout the process. Subsequently, we decided not to participate in the bidding process. There can be no assurance that the process will result in the sale or other disposition of the riverboat casino/hotel complex or that, if it does, the sale proceeds will be adequate to pay the Hollywood Casino Shreveport notes in full. Further, the holders of the Hollywood Casino Shreveport notes might pursue all rights and remedies that they may have under the indentures as a result of the event of default. Any such action on the part of the note holders may prompt HCS to seek the protection of the bankruptcy laws or other similar remedies. HCS currently anticipates that any transaction would be effected through a federal bankruptcy proceeding. HCS did not make the August 1, 2003, the February 1, 2004 and August 1, 2004 interest payments, aggregating \$36.9 million, due on the Hollywood Casino Shreveport notes. The Hollywood Casino Shreveport notes have been in default under the terms of their respective note indentures since May 2003. The Hollywood Casino Shreveport notes are classified as liabilities held for sale at June 30, 2004.

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 the Company (other than the Shreveport entities) is not liable, at June 30, 2004, we were in compliance with all required financial covenants.

## Commitments and Contingencies

### —Contractual Cash Obligations

The following table presents our contractual cash obligations as of June 30, 2004:

	Total	2004	Payments Due By Period		2009 and After
			2005 - 2006	2007 - 2008	
			(In thousands)		
Senior secured credit facility(1)	\$ 377,606	\$ 1,898	\$ 7,591	\$ 368,117	\$ —
11 1/8% senior subordinated notes due 2008(2)					
Principal	200,000	—	—	200,000	—
Interest	89,000	11,125	44,500	33,375	—
8 7/8% senior subordinated notes due 2010(3)					
Principal	175,000	—	—	—	175,000
Interest	93,188	7,766	31,063	31,062	23,297
6 7/8% senior subordinated notes due 2011(4)					
Principal	200,000	—	—	—	200,000
Interest	103,125	6,875	27,500	27,500	41,250
Purchase obligations	15,149	6,341	5,303	2,485	1,020
Construction commitments	5,600	5,600	—	—	—
Capital Leases	14,927	1,142	3,694	4,375	5,716
Operating Leases	24,947	2,919	8,422	5,595	8,011
<b>Total</b>	<b>\$ 1,298,542</b>	<b>\$ 43,666</b>	<b>\$ 128,073</b>	<b>\$ 672,509</b>	<b>\$ 454,294</b>

(1) As of June 30, 2004 there was no indebtedness outstanding under the credit facility and there was approximately \$91.8 million available for borrowing under the revolving credit portion of the credit facility.

(2) The \$200.0 million aggregate principal amount of 11 1/8% notes matures on March 1, 2008. Interest payments of approximately \$11.1 million are due on each March 1 and September 1 until March 1, 2008.

(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.

### —Other Commercial Commitments

The following table presents our material commercial commitments as of June 30, 2004 for the following future periods:

	Total Amounts Committed	Amount of Commitment Expiration Per Period			2009 and After
		2004	2005 - 2006	2007 2008	
			(In thousands)		
Revolving Credit Facility(1)	\$ —	\$ —	\$ —	\$ —	\$ —
Letters of Credit(1)	8,174	8,174	—	—	—
Guarantees of New Jersey Joint Venture Obligations(2)	8,433	8,433	—	—	—
<b>Total</b>	<b>\$ 16,607</b>	<b>\$ 16,607</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$ —</b>

(1) The available balance under the revolving portion of the \$100 million 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 \$16.9 million term loan. Our obligation as of June 30, 2004 under this guarantee is approximately \$8.4 million.

### —Interest Rate Swap Agreements

See Item 3, "Quantitative and Qualitative Disclosures About Market Risk" below.

#### Accounting Pronouncements Issued or Adopted in 2004

There are no accounting standards issued before June 30, 2004 but effective after December 31, 2003 which are expected to have a material impact on our financial reporting.

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### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The table below provides information as of June 30, 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 June 30, 2004.

	2004	2005	2006	2007	2008	Thereafter	Total
	(In thousands)						
<b>Long-term debt:</b>							
Variable rate	\$ 1,898	\$ 3,795	\$ 3,795	\$ 368,117	\$ —	\$ —	\$ 377,605
Average interest rate	4.05%	4.05%	4.05%	4.05%			
<b>Leases</b>							
	\$ 1,142	\$ 1,783	\$ 1,912	\$ 2,087	\$ 2,288	\$ 5,715	\$ 14,927
Average interest rate(1)	6.74%	6.74%	6.74%	6.74%	6.74%	6.74%	
<b>Interest rate derivatives:</b>							
<b>Interest rate swaps</b>							
Variable to fixed	\$ —	\$ 175,000	\$ 200,000	\$ —	\$ —	\$ —	\$ 375,000
Average pay rate		1.92%	2.48%				
Average receive rate (2)		1.59%	1.59%				

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

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

We have a policy designed to manage interest rate risk associated with our current and anticipated future borrowings. This policy enables us to use any combination of interest rate swaps, futures, options, caps and similar instruments. To the extent we employ such financial instruments pursuant to this policy, they are accounted for as hedging instruments. In order to qualify for hedge accounting, the underlying hedged item must expose us to risks associated with market fluctuations and the financial instrument used must be designated as a hedge and must reduce our exposure to the market in 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. Interest paid or received pursuant to the financial instrument is included as interest expense in the period.

On March 27, 2003, we entered into forward 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 six 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% against a variable rate based on the 90-day LIBOR rate. We also entered into six six-year swap contracts totaling \$200 million with a termination date of March 27, 2006. Under these contracts, we pay a fixed rate 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 reduction of, or addition to, interest expense as incurred over the life of the swap or similar financial instrument. At June 30, 2004, the 90-day LIBOR rate was 1.61%.

### ITEM 4. CONTROLS AND PROCEDURES

Our management, under the supervision and with the participation of the principal executive officer and principal financial officer, have evaluated the effectiveness of our controls and procedures related to our reporting and disclosure obligations as of June 30, 2004, which is the end of the period covered by this Quarterly Report on

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Form 10-Q. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on that evaluation, the principal executive officer and principal financial officer have concluded that these disclosure controls and procedures are sufficient to provide that (a) material information relating to us, including our consolidated subsidiaries, is made known to these officers by other employees of us and our consolidated subsidiaries, particularly material information related to the period for which this periodic report is being prepared; and (b) this information is recorded, processed, summarized, evaluated and reported, as applicable, within the time periods specified in the rules and forms of the Securities and Exchange Commission.

There were no changes that occurred during the fiscal quarter covered by this Quarterly Report on Form 10-Q that have materially affected, or are reasonable likely to materially affect, our internal controls over financial reporting.

## PART II. OTHER INFORMATION

## ITEM 1. LEGAL PROCEEDINGS

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

## ITEM 3. DEFAULTS UPON SENIOR SECURITIES

As discussed in the Liquidity and Capital Resources Section of Management's Discussion and Analysis of Financial Condition and Results of Operations, following the March 3, 2003 consummation of the merger of our wholly-owned subsidiary with and into Hollywood Casino Corporation, HCS and Shreveport Capital Corporation were required under the indentures governing the Hollywood Casino Shreveport notes, of which there were aggregate of \$189 million outstanding, to make an offer to purchase the Hollywood Casino Shreveport notes. On March 14, 2003, the HCS and Shreveport Capital Corporation were notified by an ad hoc committee of holders of the Hollywood Shreveport notes that they have 60 days from receipt of the notice to cure the failure to offer to purchase the Hollywood Casino Shreveport notes or an event of default will have occurred under the indentures. Neither HCS nor Shreveport Capital Corporation made a Change of Control offer to purchase the Hollywood Casino Shreveport notes within the 60 days and, as a result, a default occurred.

On February 3, 2004, our indirect subsidiary, HCS I, Inc., the managing general partner of HCS, announced that its Board of Directors has initiated a process that it hopes will result in the sale or other disposition of the riverboat casino/hotel complex of HCS located in Shreveport, Louisiana. We anticipate that any transaction may be effected through a federal bankruptcy proceeding. There can be no assurance that the process will result in the sale or other disposition of the riverboat casino/hotel complex or that, if it does, the sale proceeds will be adequate to pay the Hollywood Casino Shreveport notes in full. Further, the holders of the Hollywood Casino Shreveport notes might pursue all rights and remedies that they may have under the indentures as a result of the event of default. Any such action on the part of the note holders may prompt HCS to seek the protection of the bankruptcy laws or other similar remedies. On August 1, 2003, February 1, 2004 and August 1, 2004, interest payments of \$12.3 million each became due on the Hollywood Casino Shreveport notes. The managing general partner of Hollywood Casino Shreveport did not make those payments.

The Hollywood Casino Shreveport notes are non-recourse to Penn and its subsidiaries (other than Hollywood Casino Shreveport, Shreveport Capital Corporation, HCS I, Inc., HCS II, Inc. and HWCC-Louisiana, Inc.) and are secured by substantially all of the assets of the casino, and 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. The Hollywood Casino Shreveport notes are classified as liabilities held for sale at June 30, 2004.

## ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

- (a) The Annual Meeting of Shareholders of the Company was held on May 26, 2004.
- (b) All director nominees were elected.
- (c) Certain matters voted upon at the meeting and the votes cast with respect to such matters are as follows:

Election of Directors:

<u>Name</u>	<u>Votes For</u>	<u>Votes Withheld</u>
Robert P. Levy	30,773,183	8,042,347
Barbara Z. Shattuck	37,221,595	1,593,935

Peter M. Carlino, Harold Cramer, David A. Handler and John M. Jacquemin also serve as directors of the Company, and their terms of office continued after the Annual Meeting.

Ratification of the appointment of BDO Seidman, LLP, as independent auditors of the Company's books, records and accounts for the year ending December 31, 2004:

<u>Votes For</u>	<u>Votes Against</u>	<u>Votes Withheld</u>
38,584,415	230,111	37,106

## ITEM 5. OTHER INFORMATION

### Recent Developments

Since the filing of our last Annual Report on Form 10-K, as amended, several developments have occurred with respect to certain matters noted in our annual report.

On July 5, 2004, Pennsylvania Governor Edward G. Rendell signed into law the Pennsylvania Race Horse Development and Gaming Act. Under this new law, we are entitled to one category 1 slot machine license per facility. The law provides that a single company and its affiliates may own only one slot machine license and not more than a one third interest in another slot machine license. Given these ownership restrictions, our current plan is to develop a slots facility at our Penn National Race Course near Harrisburg. Under this plan, we expect to open in a permanent facility with 2,000 slot machines in early 2006 and expand to up to 5,000 machines based on demand. With respect to Pocono Downs, we intend to continue to evaluate the new law and weigh our options and potential opportunities. It is expected that the Pennsylvania Gaming Control Board will be operational by the end of 2004.

With respect to Bangor Historic Track, Inc., we are still awaiting licensing approval and final regulatory provisions. Under the current law, we would be permitted to operate up to 1,500 slot machines at this facility. While slot machine operator licensing, as required by statute, could be completed as early as September 30, 2004, we anticipate the required licensing of machine manufacturers and distributors, and finalization of rules necessary for slots to become operational, to be completed next year.

**ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K**

## (a) Exhibits

<b>Exhibit</b>	<b>Description of Exhibit</b>
3.1	Second Amended and Restated Bylaws of Penn National Gaming, Inc.
10.1	Employment Agreement dated May 26, 2004 between Penn National Gaming, Inc. and Peter M. Carlino
10.2	Employment Agreement dated May 26, 2004 between Penn National Gaming, Inc. and Kevin DeSanctis
10.3	Amendment dated July 30, 2004 to Live Racing Agreement among Penn National Turf Club, Inc., Mountainview Thoroughbred Racing Association and the Pennsylvania Horsemen's Benevolent and Protective Association, Inc.
10.4	Amendment No. 1 to Credit Agreement dated as of June 9, 2004, to the Credit Agreement dated as of March 3, 2003, as amended and restated as of December 5, 2003 among Penn National Gaming, Inc., Bear Stearns & Co., Inc., Merrill Lynch, Pierce, Fenner & Smith Incorporated, Bear Stearns Corporate Lending Inc., Societe Generale, Credit Lyonnais New York Branch and the lenders party thereto.
10.5	Agreement dated June 15, 2004 between PNGI Charles Town Gaming and the West Virginia Thoroughbred Breeders Association
31.1	CEO Certification pursuant to rule 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934
31.2	CFO Certification pursuant to rule 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934
32.1	CEO Certification pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of The Sarbanes—Oxley Act of 2002
32.2	CFO Certification pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of The Sarbanes—Oxley Act of 2002

## (b) Reports on Form 8-K

<b>Report</b>	<b>Item(s) No.</b>	<b>Date of Report</b>	<b>Date Filed or Furnished</b>
Form 8-K	12 and 7	April 21, 2004	Furnished April 23, 2004

**SIGNATURES**

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

PENN NATIONAL GAMING, INC.

August 9, 2004

By:

/s/ William J. Clifford  
 William J. Clifford  
 Senior Vice President-Finance  
 and Chief Financial Officer



**SECOND AMENDED AND RESTATED BYLAWS  
OF  
PENN NATIONAL GAMING, INC.  
(a Pennsylvania corporation)**

**Effective as of May 26, 2004**

**ARTICLE I**

**Offices**

*Section 1.01. Registered Office.* The registered office of the corporation in the Commonwealth of Pennsylvania shall be at Wyomissing Professional Center, 825 Berkshire Boulevard, Suite 200, Wyomissing, Pennsylvania 19610, until otherwise established by an amendment to the Articles of Incorporation (as amended, the "Articles") or by the board of directors and a record of such change is filed with the Department of State in the manner provided by law.

*Section 1.02. Other Offices.* The corporation may also have offices at such other places within or without the Commonwealth of Pennsylvania as the board of directors may from time to time appoint or the business of the corporation may require.

**ARTICLE II**

**Notice – Waivers – Meetings Generally**

*Section 2.01. Manner of Giving Notice.*

(a) General Rule. Whenever written notice is required to be given to any person under the provisions of the Pennsylvania Business Corporation Law of 1988 (as amended from time to time, the "Business Corporation Law") or by the Articles or these Bylaws, it may be given to the person: (i) by personal delivery, (ii) by facsimile number, e-mail or other electronic communication to his or her facsimile number or address for e-mail or other electronic communications supplied by him or her to the corporation for the purpose of notice, or (iii) by sending a copy thereof by first class or express mail, postage prepaid, or by telegram (with messenger service specified), telex or TWX (with answerback received) or courier service, charges prepaid, to the address (or to the telex or TWX number) of the person appearing on the books of the corporation or, in the case of notice to be given to a director, to the address (or to the telex or TWX number) supplied by the director to the corporation for the purpose of notice. If the notice is sent by mail, telegraph or courier service, it shall be deemed to have been given to the person entitled thereto when deposited in the United States mail or with a telegraph office or courier service for delivery to that person or, in the case of telex or TWX, when dispatched. Notice given by facsimile transmission, e-mail or other electronic communication shall be deemed to have been given to the person entitled thereto when sent. A notice of meeting shall specify the place, day and hour of the meeting and any other information required by any other provision of the Business Corporation Law, the Articles or these Bylaws.

(b) Adjourned Shareholder Meetings. When a meeting of shareholders is adjourned, it shall not be necessary to give any notice of the adjourned meeting or of the business to be transacted at an adjourned meeting, other than by announcement at the meeting at which the adjournment is taken, unless the

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board fixes a new record date for the adjourned meeting, in which event the notice shall be given in accordance with this section.

*Section 2.02. Notice of Meetings of Board of Directors.* Notice of a regular meeting of the board of directors need not be given. Notice of every special meeting of the board of directors shall be given to each director personally, by telephone, telex, TWX, facsimile, e-mail or other electronic communication, or in writing at least 24 hours (in the case of notice by telephone, telex, TWX, facsimile transmission, e-mail or other electronic communication) or 48 hours (in the case of notice by telegraph, courier service or express mail) or five days (in the case of notice by first class mail) before the time at which the meeting is to be held. Every such notice shall state the time and place of the meeting. Neither the business to be transacted at, nor the purpose of, any regular or special meeting of the board need be specified in a notice of a meeting.

*Section 2.03. Notice of Meetings of Shareholders.*

(a) General Rule. Written notice of every meeting of the shareholders shall be given by, or at the direction of, the secretary or other authorized person to each shareholder of record entitled to vote at the meeting (and, in case of a meeting called to consider a merger, consolidation, share exchange or division, to each shareholder of record not entitled to vote at the meeting) at least (i) ten days prior to the day named for a meeting called to consider a fundamental change under Chapter 19 of the Business Corporation Law or (ii) five days prior to the day named for the meeting in any other case. If the secretary neglects or refuses to give notice of a meeting, the person or persons calling the meeting may do so. In the case of a special meeting of shareholders, the notice shall specify the general nature of the business to be transacted.

(b) Notice of Action by Shareholders on Bylaws. In the case of a meeting of shareholders that has as one of its purposes action on these Bylaws, written notice shall be given to each shareholder that the purpose, or one of the purposes, of the meeting is to consider the adoption, amendment or repeal of these Bylaws. There shall be included in, or enclosed with, the notice a copy of the proposed amendment or a summary of the changes to be effected thereby.

*Section 2.04. Waiver of Notice.*

(a) Written Waiver. Whenever any written notice is required to be given under the provisions of the Business Corporation Law, the Articles or these Bylaws, a waiver thereof in writing, signed by the person or persons entitled to the notice, whether before or after the time stated therein, shall be deemed equivalent to the giving of the notice. Except as provided in the next sentence, neither the business to be transacted at, nor the purpose of, a



meeting need be specified in the waiver of notice of the meetings. In the case of a special meeting of shareholders, the waiver of notice shall specify the general nature of the business to be transacted at the meeting.

(b) Waiver by Attendance. Attendance of a person at any meeting shall constitute a waiver of notice of the meeting except where a person attends a meeting for the express purpose of objecting, at the beginning of the meeting, to the transaction of any business because the meeting was not lawfully called or convened.

*Section 2.05.* Modification of Proposal Contained in Notice. Whenever the language of a proposed resolution is included in a written notice of a meeting required to be given under the provisions of the Business Corporation, the Articles or these Bylaws, the meeting considering the resolution may without further notice adopt it with such clarifying or other amendments as do not enlarge its original purpose.

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*Section 2.06.* Exception to requirement of Notice.

(a) General Rule. Whenever any notice or communication is required to be given to any person under the provisions of the Business Corporation Law or by the Articles or these Bylaws or by the terms of any agreement or other instrument or as a condition precedent to taking any corporate action and communication with that person is then unlawful, the giving of the notice or communication to that person shall not be required.

(b) Shareholders Without Forwarding Addresses. Notice or other communications need not be sent to any shareholder with whom the corporation has been unable to communicate for more than 24 consecutive months because communications to the shareholder are returned unclaimed or the shareholder has otherwise failed to provide the corporation with a current mail or e-mail address or facsimile, telex or TWX number. Whenever the shareholder provides the corporation with a current mail or e-mail address or facsimile, telex or TWX number, the corporation shall commence sending notices and other communications to the shareholder in the same manner as to other shareholders.

*Section 2.07.* Use of Conference Telephone and Similar Equipment.

(a) Any director may participate in meetings of the board of directors by conference telephone, similar communications equipment or other electronic communications technology in a fashion pursuant to which the directors have the opportunity to read or hear the proceedings substantially concurrently with their occurrence, vote on matters submitted to the directors and pose questions to the participants in the meeting. Directors so participating will be deemed present at the meeting.

(b) Shareholders may participate in any shareholders' meeting by conference telephone, similar communications equipment or other electronic means, including, without limitation, the Internet. Shareholders so participating will be deemed present at the meeting.

### ARTICLE III

#### Shareholders

*Section 3.01.* Place of Meeting. All meetings of the shareholders of the corporation shall be held at the registered office of the corporation, such other place within or without the Commonwealth of Pennsylvania as may be designated by the board of directors in the notice of a meeting, or by means of the Internet or other electronic communications technology in a fashion pursuant to which the shareholders have the opportunity to read or hear the proceedings substantially concurrently with their occurrence, vote on matters submitted to the shareholders and pose questions to the directors of the corporation.

*Section 3.02.* Annual Meeting.

(a) The board of directors may fix and designate the date and time of the annual meeting of the shareholders, but if no such date and time is fixed and designated by the board, the meeting for any calendar year shall be held on the fourth Thursday in May in such year, if not a legal holiday under the laws of Pennsylvania, and, if a legal holiday, then on the next succeeding business day, not a Saturday, at an appropriate time and place designated by the board of directors, and at said meeting the shareholders then entitled to vote shall elect directors and shall transact such other business as may properly be brought before the meeting as set forth in Section 3.02(b) below. If the annual meeting shall not have been called and held within six months after the designated time, any shareholder may call the meeting at any time thereafter.

(b) No business may be transacted at an annual meeting of the shareholders, other than business that is either:

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(1) specified in the notice of meeting (or any supplement thereto) given by or at the direction of the board of directors (or any duly authorized committee thereof);

(2) otherwise properly brought before the annual meeting by or at the direction of the board of directors (or any duly authorized committee thereof); or

(3) otherwise properly brought before the annual meeting by any shareholder of the corporation who (A) is a shareholder of record on the date of the giving of the notice of such meeting and on the record date for the determination of shareholders entitled to vote at such annual meeting and (B) complies with the notice procedures set forth in Sections 3.02(c) and 3.02(d) below.

(c) In addition to any other applicable requirements, for a matter to be properly brought before an annual meeting by a shareholder, (i) such matter must be a proper matter for shareholder action under the Business Corporation Law and (ii) such shareholder must have owned beneficially at least 1% of the Company's common stock for a continuous period of not less than 12 months before making such proposal and have given timely notice thereof in proper written form (as set forth in Section 3.02(d) below) to the secretary of the corporation. To be timely, a shareholder's notice to the secretary

must be delivered to or mailed and received at the principal executive offices of the corporation not less than 120 days nor more than 150 days prior to the anniversary date of the immediately preceding annual meeting of the shareholders; provided, however, that in the event that the annual meeting is called for a date that is not within 60 days before or after such anniversary date, notice by the shareholder in order to be timely must be so received not later than the close of business on the tenth (10th) day following the day on which notice of the date of the annual meeting was mailed. In no event shall the public announcement of an adjournment or postponement of an annual meeting commence a new time period (or extend any time period) for the giving of a shareholder's notice as described above.

(d) To be in proper written form, a shareholder's notice to the secretary must set forth as to each matter such shareholder proposes to bring before the annual meeting (i) a brief description of the matter desired to be brought before the annual meeting and the reasons for considering such matter at the annual meeting, (ii) the name and record address of such shareholder, (iii) a representation as to the class or series and number of shares of capital stock of the corporation which are owned beneficially or of record by such shareholder, (iv) a description of all arrangements or understandings between such shareholder and any other person or persons (including their names) in connection with the proposal of such matter by such shareholder and any material interest of such shareholder in such matter and (v) a representation that such shareholder intends to appear in person or by proxy at the annual meeting to bring such matter before the meeting. In addition, notwithstanding anything in this Section 3.02(d) to the contrary, a shareholder intending to recommend one or more persons for election as a director at an annual or special meeting must comply with the provisions of Section 4.02 of these Bylaws.

(e) No business shall be conducted at the annual meeting of shareholders except business brought before the annual meeting in accordance with the procedures set forth in this Section 3.02; provided, however, that, once business has been properly brought before the annual meeting in accordance with such procedures, nothing in this Section 3.02 shall be deemed to preclude discussion by any shareholder of any such business. If the presiding officer of an annual meeting determines that business was not properly brought before the annual meeting in accordance with the foregoing procedures, the presiding officer shall declare to the meeting that the business was not properly brought before the meeting and such business shall not be transacted.

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(f) Nothing in this Section 3.02 shall be deemed to affect any rights of shareholders to request inclusion of proposals in the corporation's proxy statement pursuant to Rule 14a-8 under the Securities Exchange Act of 1934, as amended (the "Exchange Act").

*Section 3.03. Special Meetings.* Special meetings of the shareholders may be called at any time by the chairman of the board of directors or by any four or more directors. The shareholders of the corporation shall be entitled to call a special meeting of shareholders only to the extent, if any, expressly provided in the Business Corporation Law.

*Section 3.04. Quorum and Adjournment.*

(a) General Rule. A meeting of shareholders of the corporation duly called shall not be organized for the transaction of business unless a quorum is present. The presence, in person, by proxy or by means of electronic technology, including, without limitation, the Internet, of shareholders entitled to cast at least a majority of the votes that all shareholders are entitled to cast on a particular matter to be acted upon at the meeting shall constitute a quorum for the purposes of consideration and action on the matter. Shares of the corporation owned, directly or indirectly, by it and controlled, directly or indirectly, by the board of directors of this corporation, as such, shall not be counted in determining the total number of outstanding shares for quorum purposes at any given time.

(b) Withdrawal of a Quorum. The shareholders present at a duly organized meeting can continue to do business until adjournment notwithstanding the withdrawal of enough shareholders to leave less than a quorum.

(c) Adjournments Generally. Any regular or special meeting of the shareholders, including one at which directors are to be elected, which cannot be organized because a quorum has not attended, may be adjourned for such period and to such place as a majority of the shareholders present and entitled to vote shall direct.

(d) Electing Directors at Adjourned Meeting. Those shareholders entitled to vote who attend a meeting called for the election of directors that has been previously adjourned for lack of a quorum, although less than a quorum as fixed in this section, shall nevertheless constitute quorum for the purpose of electing directors.

(e) Other Action in Absence of Quorum. Those shareholders entitled to vote who attend a meeting of shareholders that has been previously adjourned for one or more periods aggregating at least 15 days because of an absence of a quorum, although less than a quorum as fixed in this section, shall nevertheless constitute a quorum for the purpose of acting upon any matter set forth in the original notice of the meeting if the notice states that those shareholders who attend the adjourned meeting shall nevertheless constitute a quorum for the purpose of acting upon the matter.

*Section 3.05. Action by Shareholders.*

(a) Except as otherwise provided in the Business Corporation, the Articles or these Bylaws, whenever any corporate action is to be taken by vote of the shareholders of the corporation, it shall be authorized by a majority of the votes cast at a duly organized meeting of shareholders by the holders of shares entitled to vote thereon. Except when acting by consent, as permitted by the Articles and Section 3.05(b), the shareholders of the corporation may act only at a duly organized meeting.

(b) Any action required or permitted to be taken at a meeting of the shareholders or a class of shareholders may be taken without a meeting upon the unanimous consent of shareholders who would have been entitled to vote at a meeting.

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*Section 3.06. Organization.* At every meeting of the shareholders, the chairman of the board of directors, or, in the case of vacancy in office or absence of the chairman of the board of directors, one of the following persons present in the order stated: the president or a person chosen by the

board of directors shall act as the presiding officer. The secretary or, in the absence of both the secretary and assistant secretaries, a person appointed by the presiding officer, shall act as secretary of the meeting.

*Section 3.07. Voting Rights of Shareholders.* Except as otherwise provided in the Articles or by law, the holders of Common Stock shall have the exclusive voting power, and every holder of Common Stock shall be entitled to one vote for every share of Common Stock standing in the name of the shareholder on the books of the corporation.

*Section 3.08. Voting and Other Action by Proxy.*

(a) General Rule.

(1) Every shareholder entitled to vote at a meeting of shareholders may authorize another person to act for the shareholder by proxy.

(2) The presence of, or vote or other action at a meeting of shareholders by a proxy of a shareholder shall constitute the presence of, or vote or action by the shareholder.

(3) Where a shareholder has named two or more proxies and such proxies are present, the corporation shall, unless otherwise expressly provided in the proxy, accept as the vote of all shares represented thereby the vote cast by a majority of them and, if a majority of the proxies cannot agree whether the shares represented shall be voted or upon the manner of voting the shares, the voting of the shares shall be divided equally among those persons.

(b) Minimum Requirements. Every proxy shall be executed or authenticated by a shareholder in writing or by the duly authorized attorney-in-fact of the shareholder and filed with or transmitted to the secretary of the corporation or his or her designated agent.

A shareholder or his or her duly authorized attorney-in-fact may execute or authenticate a writing or transmit an electronic message authorizing another person to act for him or her by proxy. A telegram, telex, cablegram, datagram, e-mail, Internet communication or other means of electronic transmission from a shareholder or attorney-in-fact, or a photographic, facsimile or similar reproduction of a writing executed by a shareholder or attorney-in-fact may be treated as properly executed or authenticated for purposes of this subsection and shall be so treated if it sets forth or utilizes a confidential and unique identification number of other mark furnished by the corporation to the shareholder for the purposes of a particular meeting or transaction.

A proxy, unless coupled with an interest, shall be revocable at will, notwithstanding any other agreement or any provision in the proxy to the contrary, but the revocation of a proxy shall not be effective until notice thereof has been given to the secretary of the corporation or its designated agent in writing or by electronic transmission. An unrevoked proxy shall not be valid after three years from the date of its execution, authentication or transmission unless a longer time is expressly provided therein. A proxy shall not be revoked by the death or incapacity of the maker unless, before the vote is counted or the authority is exercised, written notice of the death or incapacity is given to the secretary of the corporation or its designated agent.

(c) Expenses. The corporation shall pay the reasonable expenses of solicitation of votes or proxies of shareholders by or on behalf of the board of directors or its nominees for election to the board, including solicitation by professional proxy solicitors and otherwise.

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*Section 3.09. Voting by Fiduciaries and Pledges.* Shares of the corporation standing in the name of a trustee or other fiduciary and shares held by an assignee for the benefit of creditors or by a receiver may be voted by the trustee, fiduciary, assignee or receiver. A shareholder whose shares are pledged shall be entitled to vote the shares until the shares have been transferred into the name of the pledgee, or a nominee of the pledgee, but nothing in this section shall affect the validity of a proxy given to a pledgee or nominee.

*Section 3.10. Voting by Joint Holders of Shares.*

(a) General Rule. Where shares of the corporation are held jointly or as tenants in common by two or more persons, as fiduciaries or otherwise:

(1) if only one or more of such persons is present in person or by proxy, all of the shares standing in the names of such persons shall be deemed to be represented for the purpose of determining a quorum and the corporation shall accept as the vote of all the shares the vote cast by a joint owner or a majority of them; and

(2) if the persons are equally divided upon whether the shares held by them shall be voted or upon the manner of voting the shares, the voting of the shares shall be divided equally among the persons without prejudice to the rights of the joint owners or the beneficial owners thereof among themselves.

(b) Exception. If there has been filed with the secretary of the corporation a copy, certified by an attorney at law to be correct, of the relevant portions of the agreement under which the shares are held or the instrument by which the trust or estate was created or the order of court appointing them or of an order of court directing the voting of the shares, the persons specified as having such voting power in the document latest in date of operative effect so filed, and only those persons, shall be entitled to vote the shares but only in accordance therewith.

*Section 3.11. Voting by Entities.*

(a) Voting by Shareholders that are Entities. Any corporation, limited liability company, partnership or other entity that is a shareholder of this corporation may vote at meetings of shareholders of this corporation by any of its officers or agents, or by proxy appointed by any officer or agent, unless some other person, by resolution of the governing body of the entity in question or by a provision of its articles, bylaws, operating agreement, partnership agreement or other governing documents, as applicable, a copy of which resolution or provision certified to be correct by one of its officers or

agents has been filed with the secretary of this corporation, is appointed its general or special proxy in which case the person so appointed shall be entitled to vote the shares.

(b) Controlled Shares. Shares of this corporation owned, directly or indirectly, by it and controlled, directly or indirectly, by the board of directors of this corporation, as such, shall not be voted at any meeting and shall not be counted in determining the total number of outstanding shares for voting purposes at any given time.

*Section 3.12. Determination of Shareholders of Record.*

(a) Fixing Record Date. The board of directors may fix a time prior to the date of any meeting of shareholders as a record date for the determination of the shareholders entitled to notice of, or to vote at, the meeting. Except in the case of an adjourned meeting, the record date shall be not more than 90 days prior to the date of the meeting of shareholders. Only shareholders of record on the date so fixed shall be entitled to notice of and to vote at any such meeting notwithstanding any transfer of shares on the books

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of the corporation after any record date fixed as provided in this subsection. The board of directors may similarly fix a record date for the determination of shareholders of record for any other purpose. When a determination of shareholders of record has been made as provided in this section for purposes of a meeting, the determination shall apply to any adjournment thereof unless the board fixes a new record date for the adjourned meeting.

(b) Determination When a Record Date is Not Fixed. If a record date is not fixed:

(1) the record date for determining shareholders entitled to notice of or to vote at a meeting of shareholders shall be at the close of business on the day next preceding the day on which notice is given, or, if notice is waived, at the close of business on the day immediately preceding the day on which the meeting is held; and

(2) the record date for determining shareholders for any other purpose shall be at the close of business on the day on which the board of directors adopts the resolution relating thereto.

(c) Certification by Nominee. The board of directors may adopt a procedure whereby a shareholder of the corporation may certify in writing to the corporation that all or a portion of the shares registered in the name of the shareholder are held for the account of a specified person or persons. Upon receipt by the corporation of a certification complying with the procedure, the persons specified in the certification shall be deemed, for the purposes set forth in the certification, to be the holders of record of the number of shares specified in place of the shareholder making the certification.

*Section 3.13. Voting Lists.*

(a) General Rule. The officer or agent having charge of the transfer books for shares of the corporation shall make a complete list of the shareholders entitled to vote at any meeting of shareholders, arranged in alphabetical order, with the address of and the number of shares held by each. The list shall be produced and kept open at the time and place of every meeting and shall be subject to the inspection of any shareholder during the whole time of a meeting for the purposes thereof except that, if the corporation has 5,000 or more shareholders, in lieu of the making of the list the corporation may make the information therein available at a meeting by any other means.

(b) Effect of List. Failure to comply with the requirements of this section shall not affect the validity of any action taken at a meeting prior to a demand at the meeting by any shareholder entitled to vote thereat to examine the list. The original share register or transfer book, or a duplicate thereof kept in the Commonwealth of Pennsylvania, shall be prima facie evidence as to who are the shareholders entitled to examine the list or share register or transfer book or to vote at any meeting of shareholders.

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*Section 3.14. Presiding Officer.* There shall be a presiding officer at every meeting of the shareholders. Unless the Board of Directors designates otherwise, the presiding officer shall be the chairman of the board of directors. The presiding officer shall have the authority to determine the order of business and to establish rules for the conduct of each shareholders' meeting; provided that the presiding officer shall be fair to the shareholders in adopting such rules for and in conducting the meeting. The presiding officer shall announce at the meeting when the polls close for each matter voted upon. If no announcement is made, the polls shall be deemed to have closed upon the final adjournment of the meeting. After the polls close, no ballots, proxies or votes, nor any revocations or changes thereto, may be accepted.

*Section 3.15. Judges of Election.*

(a) Appointment. In advance of any meeting of shareholders of the corporation, the board of directors may appoint one or more judges of election, who need not be shareholders, to act at the meeting or any adjournment thereof. If judges of election are not so appointed, the presiding officer of the meeting may, and on the request of any shareholder shall, appoint judges of election at the meeting. The number of judges shall be one or three. A person who is a candidate for an office to be filled at the meeting shall not act as a judge.

(b) Vacancies. In case any person appointed as a judge fails to appear or fails or refuses to act, the vacancy may be filled by appointment made by the board of directors in advance of the convening of the meeting or at the meeting by the presiding officer thereof.

(c) Duties. The judges of election shall determine the number of shares outstanding and the voting power of each, the shares represented at the meeting, the existence of a quorum, and the authenticity, validity and effect of proxies, receive votes or ballots, hear and determine all challenges and questions in any way arising in connection with the right to vote, count and tabulate all votes, determine the result and do such acts as may be proper to conduct the election or vote with fairness to all shareholders. The judges of election shall perform their duties impartially, in good faith, to the best of their ability and as expeditiously as is practical. If there are three judges of election, the decision, act or certificate of a majority shall be effective in all respects as the decision, act or certificate of all.

(d) Report. On request of the presiding officer of the meeting or of any shareholder, the judges shall make a report in writing of any challenge or question or matter determined by them, and execute a certificate of any fact found by them. Any report or certificate made by them shall be prima facie evidence of the facts stated therein.

*Section 3.16.* Minors as Security Holders. The corporation may treat a minor who holds shares or obligations of the corporation as having capacity to receive and to empower others to receive dividends, interest, principal and other payments or distributions, to vote or express consent or dissent and to make elections and exercise rights relating to such shares or obligations unless, in the case of payments or distributions on shares, the corporate officer responsible for maintaining the list of shareholders or the transfer agent of the corporation or, in the case of payments or distributions on obligations, the treasurer or paying officer or agent has received written notice that the holder is a minor.

*Section 3.17.* Proposal of Amendments to the Articles. The shareholders of the corporation shall be entitled to propose an amendment to the Articles only to the extent, if any, expressly provided in the Articles.

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## ARTICLE IV

### Board of Directors

*Section 4.01.* Powers; Personal Liability.

(a) General Rule. Unless otherwise provided by statute, all powers vested by law in the corporation shall be exercised by or under the authority of, and the business and affairs of the corporation shall be managed under the direction of, the board of directors.

(b) Personal Liability of Directors.

(1) A director shall not be personally liable, as such, for monetary damages for any action taken, or any failure to take any action, unless:

(i) the director has breached or failed to perform the duties of his or her office under Subchapter B of Chapter 17 of the Business Corporation Law (or any successor provision(s)); and

(ii) the breach or failure to perform constitutes self-dealing, willful misconduct or recklessness.

(2) The provisions of paragraph (1) shall not apply to the responsibility or liability of a director pursuant to any criminal statute, or the liability of a director for the payment of taxes pursuant to local, state or federal law.

*Section 4.02.* Qualifications and Selection of Directors.

(a) Qualifications. Each director of the corporation shall be a natural person of full age who need not be a resident of the Commonwealth of Pennsylvania or a shareholder of the corporation.

(b) Director Nominees. Each nominee for election to the board of directors must be recommended for the board of director's selection by a nominating committee comprised solely of "independent directors" formed by the board of directors pursuant to Section 4.11 below (the "Nominating Committee"); provided, however, that independent director oversight of director nominations shall not apply in cases where the right to nominate a director legally belongs to a third party. As used in this Section 4.02(b), the term "independent directors" has such meaning as shall be promulgated by the Securities and Exchange Commission and the Nasdaq Stock Market (or such other securities exchange on which the capital stock of the corporation is listed).

(c) Shareholder Recommendations.

(1) The Nominating Committee will consider for recommendation to the board of directors for nomination for election to the board of directors nominees for director to be elected at an annual or special meeting of shareholders who are recommended for nomination by the shareholders in accordance with the provisions of this Section 4.02(c). In addition to any other applicable requirements, for a recommendation made by a shareholder pursuant to this Section 4.02(c) to be considered by the Nominating Committee, such shareholder must have owned beneficially at least 1% of the Company's common stock for a continuous period of not less than 12 months before making such proposal and have given timely notice thereof in proper written form (as set forth in Section 4.02(c)(2) below) to the secretary of the corporation. To be timely, a shareholder's notice to the secretary must be delivered to or mailed and received at the principal executive offices of the corporation (A) in the case of an annual meeting, not less

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than 120 nor more than 150 days prior to the anniversary date of the immediately preceding annual meeting of shareholders; provided, however, that in the event that the annual meeting is called on a date that is not within 60 days before or after such anniversary date, notice by the shareholder in order to be timely must be so received not later than the close of business on the tenth (10th) day following the day on which notice of the date of the annual meeting was mailed or public disclosure of the date of the annual meeting was made, whichever first occurs; and (B) in the case of a special meeting of shareholders called for the purpose of electing directors, not later than the close of business on the tenth (10th) day following the day on which notice of the date of the special meeting was mailed.

(2) To be in proper written form, a shareholder's notice to the secretary must set forth (A) as to each person whom the shareholder recommends for election as a director (i) the name, age, business address and residence address of the person, (ii) the principal occupation or employment of the person, (iii) the class or series and number of shares of capital stock of the corporation which are owned beneficially or of record by the person and (iv) any other information relating to the person that would be required to be disclosed in a proxy statement or other filings required to be made in

connection with solicitations of proxies for election of directors pursuant to Section 14 of the Exchange Act, and the rules and regulations promulgated thereunder; and (B) as to the shareholder giving the notice (i) the name and record address of such shareholder, (ii) the class or series and number of shares of capital stock of the corporation which are owned beneficially or of record by such shareholder, (iii) a description of all arrangements or understandings between such shareholder and each recommended nominee and any other person or persons (including their names) pursuant to which the recommendations are to be made by such shareholder and (iv) any other information relating to such shareholder that would be required to be disclosed in a proxy statement or other filings required to be made in connection with solicitations of proxies for election of directors pursuant to Section 14 of the Exchange Act and the rules and regulations promulgated thereunder. Such notice must also be accompanied by a written consent of each recommended nominee to: (A) provide (i) all information necessary to respond fully to any suitability inquiry conducted under the executive, administrative, judicial and/or legislative rules, regulations, laws and orders of any jurisdiction to which the corporation is then subject and (ii) such additional information concerning the nominee as may be requested by the Nominating Committee and/or board of directors and (B) being named as a nominee and to serve as a director if nominated and if elected.

(d) Election of Directors. Except as otherwise provided in these Bylaws, directors of the corporation shall be elected by the shareholders. In elections for directors, voting need not be by ballot, except upon demand made by a shareholder entitled to vote at the election and before the voting begins. The shareholders of the corporation (except holders of Preferred Stock when the right to elect directors accrues to them) shall not have the right to cumulate their votes for the election of directors of the corporation. The candidates receiving the highest number of votes from each class or group of classes, if any, entitled to elect directors separately up to the number of directors to be elected by the class or group of classes shall be elected. If at any meeting of shareholders, directors of more than one class are to be elected, each class of directors shall be elected in a separate election.

(e) Director Emeritus.

(1) The board of directors may appoint any former director of the corporation or of any predecessor corporation as a director emeritus to serve in an advisory capacity to the board for such period of time as the board wishes to avail itself of the services, knowledge and experience of such former director.

(2) Such director emeritus may upon invitation by the board of directors attend meetings of the board of directors and its committees and, if requested by the board, may participate in the proceedings of the board of directors, but shall not vote on or give written consent to any matters before the board.

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(3) A director emeritus shall be compensated for such services as may be determined by the board of directors.

*Section 4.03. Number and Term of Office.*

(a) Number. The number of directors of the corporation constituting the whole board and the number of directors constituting each class of directors as provided by Section 4.03(d) shall be fixed solely by resolution of the board of directors.

(b) Term of Office. Each director shall hold office until the expiration of the term for which he or she was selected and until a successor has been selected and qualified or until his or her earlier death, resignation or removal. A decrease in the number of directors shall not have the effect of shortening the term of any incumbent director.

(c) Resignation. Any director may resign at any time upon written notice to the corporation. The resignation shall be effective upon receipt thereof by the corporation or at such subsequent time as shall be specified in the notice of resignation.

(d) Classified Board of Directors. The Board of Directors of this Corporation shall be divided into three classes and are hereby designated as Class I, Class II and Class III, respectively, the members of which are to be elected for staggered terms. The term of office of at least one class shall expire in each year. At each election, directors shall be chosen for a full term, as the case may be, to succeed those whose terms expire.

*Section 4.04. Vacancies.*

(a) General Rule. Vacancies in the board of directors, including vacancies resulting from an increase in the number of directors, may be filled by a majority vote of the remaining members of the board though less than a quorum, or by a sole remaining director, and each person so selected shall be a director to serve until the next selection of the class for which such director has been chosen, and until a successor has been selected and qualified or until his or her earlier death, resignation or removal.

(b) Action by Resigned Directors. When one or more directors resign from the board effective at a future date, the directors then in office, including those who have so resigned, shall have power by the applicable vote to fill the vacancies, the vote thereon to take effect when the resignations become effective.

*Section 4.05. Removal of Directors.*

(a) By Shareholders. Any director or the entire board of directors may be removed by the shareholders without cause only by consent and not at a meeting.

(b) Successor Directors. In case a director or class of directors or the board is so removed, new directors may be elected at the same meeting or in the same consent.

(c) Removal by the Board. The board of directors may declare vacant the office of a director:

(1) Who has been judicially declared of unsound mind or who has been convicted of an offense punishable by imprisonment for a term of more than one year;

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(2) If, within 60 days after notice of his or her selection, the director does not accept the office either in writing or by attending a meeting of the board of directors; or

(3) Who has been determined to be unsuitable to serve as a director by (A) any federal, state or local regulatory body having jurisdiction over the corporation and its activities, or (B) the compliance committee.

*Section 4.06. Place of Meetings.* Meetings of the board of directors may be held at such place within or without the Commonwealth of Pennsylvania as the board of directors may from time to time appoint or as may be designated in the notice of the meeting.

*Section 4.07. Organization of Meetings.* At every meeting of the board of directors, the chairman of the board of directors, or, in the case of a vacancy in the office or absence of the chairman of the board of directors, one of the following officers present in the order stated: the president or a person chosen by a majority of the directors present shall act as chairman of the meeting. The secretary or, in the absence of the secretary, an assistant secretary, or, in the absence of the secretary and the assistant secretaries, any person appointed by the chairman of the meeting, shall act as secretary of the meeting.

*Section 4.08. Regular Meetings.* Regular meetings of the board of directors shall be held at such time and place as shall be designated from time to time by resolution of the board of directors.

*Section 4.09. Special Meetings.* Special meetings of the board of directors shall be held whenever called by the chairman of the board of directors or by four or more of the directors.

*Section 4.10. Quorum of and Action by Directors.*

(a) General Rule. A majority of the directors in office of the corporation shall be necessary to constitute a quorum for the transaction of business and the acts of a majority of the directors present and voting at a meeting at which a quorum is present shall be the acts of the board of directors.

(b) Action by Unanimous Consent. Any action required or permitted to be taken at a meeting of the directors may be taken without a meeting if, prior or subsequent to the action, a consent or consents thereto by all of the directors in office is filed with the secretary of the corporation. A photographic, facsimile or similar reproduction of a consent executed by a director shall be treated as properly executed for purposes of this Section 4.10(b).

(c) Notation of Dissent. A director who is present at a meeting of the board of directors, or of a committee of the board, at which action on any corporate matter is taken shall be presumed to have assented to the action taken unless his or her dissent is entered in the minutes of the meeting or unless the director files a written dissent to the action with the secretary of the meeting before the adjournment thereof or transmits the dissent in writing to the secretary of the corporation immediately after the adjournment of the meeting. The right of dissent shall not apply to a director who voted in favor of the action. Nothing in this section shall bar a director from asserting that minutes of the meeting incorrectly omitted his or her dissent if, promptly upon receipt of a copy of such minutes, the director notifies the secretary, in writing, of the asserted omission or inaccuracy.

*Section 4.11. Committees of the Board.*

(a) Establishment and Powers. The board of directors may, by resolution adopted by a majority of the directors in office, establish one or more committees to consist of one or more directors of the corporation possessing such characteristics and experience as may be required under any applicable federal, state or local law or regulation, or any applicable rule or regulation of a securities exchange on which the

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securities of the corporation are listed, setting forth requirements as to the composition of committees established by the corporation. Any committee, to the extent provided in the resolution of the board of directors, shall have and may exercise all of the powers and authority of the board of directors and may adopt such charter or governing provisions as are consistent with the resolution forming such committee, except that a committee shall not have any power or authority as to the following:

- (1) The submission to shareholders of any action requiring approval of shareholders under the Business Corporation law.
- (2) The creation or filling of vacancies in the board of directors.
- (3) The adoption, amendment or repeal of these Bylaws.
- (4) The amendment or repeal of any resolution of the board that by its terms is amendable or repealable only by the board.
- (5) Action on matters committed by a resolution of the board of directors to another committee of the board.

(b) Alternate Committee Members. The board may designate one or more directors as alternate members of any committee who may replace any absent or disqualified member at any meeting of the committee or for the purposes of any written action by the committee. In the absence or disqualification of a member and alternate member or members of a committee, the member or members thereof present at any meeting and not disqualified from voting, whether or not constituting a quorum, may unanimously appoint another director to act at the meeting in the place of the absent or disqualified member.

(c) Term. Each committee of the board shall serve at the pleasure of the board.

(d) Committee Procedures. The term "board of directors" or "board," when used in any provision of these Bylaws relating to the organization or procedures of or the manner of taking action by the board of directors, shall be construed to include and refer to any committee of the board.

Section 4.12. Compensation. The board of directors shall have the authority to fix the compensation of directors for their services as directors and a director may be a salaried officer of the corporation.

## ARTICLE V

### Officers

#### Section 5.01. Officers Generally.

(a) Number, Qualifications and Agents. The officers of the corporation shall be a chairman of the board of directors, a president, vice president(s), a secretary and a treasurer, and such other officers and assistant officers as may be elected in accordance with the provisions of Section 5.03. Officers may but need not be directors or shareholders of the corporation. The officers of the corporation shall be natural persons of full age. The treasurer may be a corporation, but if a natural person shall be of full age. Any number of offices may be held by the same person.

(b) Bonding. The corporation may secure the fidelity of any or all of its officers by bond or otherwise.

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#### Section 5.02. Election, Term of Office and Resignations.

(a) Election and Term of Office. The chairman of the board of directors, the chief executive officer, chief financial officer, chief operating officer, president, executive vice president, operations, vice president, finance, secretary, treasurer and general counsel (collectively, the "Executive Officers") of the corporation shall be elected annually by the board of directors and shall hold office for a term of one year and until a successor has been selected and qualified or until his or her earlier death, resignation or removal. All other officers shall be appointed by the chairman of the board of directors or by delegated authority pursuant to Section 5.03 and shall serve at will.

(b) Resignations. Any officer may resign at any time upon written notice to the corporation. The resignation shall be effective upon receipt thereof by the corporation or at such subsequent time as may be specified in the notice of resignation.

Section 5.03. Subordinate Officers. The chairman of the board of directors may from time to time appoint such other officers as the business of the corporation may require, each of whom shall hold office for such period, have such authority, and perform such duties as are provided in these Bylaws, or as the chairman of the board of directors may from time to time determine, subject to removal by the chairman of the board of directors. The chairman of the board of directors may delegate to any officer or committee the power to appoint and to remove subordinate officers and to retain or appoint other agents or committees thereof, and to prescribe the authority and duties of such subordinate officers, committees or other agents. Removal of an officer appointed pursuant to this Section 5.03 shall be without prejudice to the contract rights, if any, of any person so removed. Election or appointment of an officer or agent pursuant to this Section 5.03 shall not of itself create contract rights.

Section 5.04. Removal of Officers and Agents. Any officer or agent of the corporation appointed by the board of directors may be removed by the board of directors with or without cause. The removal shall be without prejudice to the contract rights, if any, of any person so removed. Election or appointment of an officer or agent shall not of itself create contract rights.

Section 5.05. Vacancies. A vacancy in any office because of death, resignation, removal, disqualification, or any other cause, may be filled by the board of directors or by the officer or committee to which the power to fill such office has been delegated pursuant to Section 5.03, as the case may be, and if the office is one for which these Bylaws prescribe a term, shall be filled for the unexpired portion of the term.

Section 5.06. Authority. All officers of the corporation, as between themselves and the corporation, shall have such authority and perform such duties in the management of the corporation as may be provided by the person(s) appointing such officers or, in the absence of such provision, as may be determined by or pursuant to these Bylaws.

Section 5.07. The Chairman of the Board of Directors. The chairman of the board of directors shall be the chief executive officer of the corporation and shall have general supervision over the business and operations of the corporation, subject, however, to the control of the board of directors. The chairman of the board of directors shall be a member, ex officio, of all standing committees. The chairman of the board of directors shall perform all duties incident to the office of chairman of the board of directors, and such other duties as from time to time may be assigned by the board of directors.

Section 5.08. The President. The president shall be the chief operating officer of the corporation. During the absence or disability of the chairman of the board of directors, the president shall exercise all the powers and discharge all the duties of the chairman of the board of directors. The president shall perform all duties incident to the office of president and such other duties as from time to time may be assigned by the board of directors or the chairman of the board of directors.

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Section 5.09. The Vice Presidents. The vice presidents shall perform the duties of the president in the absence of the president and such other duties as may from time to time be assigned to them by the board of directors, the chairman of the board of directors or the president.

Section 5.10. The Secretary. The secretary shall attend all meetings of the shareholders, of the board of directors and all committees thereof and shall record all the votes of the shareholders and of the directors and the minutes of the meetings of the shareholders and of the board of directors and of committees of the board in a book or books to be kept for that purpose; shall see that notices are given and records and reports properly kept and filed by the corporation as required by law; shall be the custodian of the seal of the corporation and see that it is affixed to all documents to be executed on behalf of the corporation under its seal; and, in general, shall perform all duties incident to the office of secretary, and such other duties as may from time to time be assigned by the board of directors, the chairman of the board of directors or the president.



*Section 5.11.* Assistant Secretaries. In the absence or disability of the secretary, any assistant secretary may perform all the duties of the secretary, and, when so acting, shall have all the powers of and be subject to all the restrictions upon, the secretary. The assistant secretaries shall perform such other duties as from time to time may be assigned to them, respectively, by the board of directors, the chairman of the board of directors, the president or the secretary.

*Section 5.12.* The Treasurer. The treasurer shall have or provide for the custody of the funds or other property of the corporation; shall collect and receive or provide for the collection and receipt of moneys earned by or in any manner due to or received by the corporation; shall deposit all funds in his or her custody as treasurer in such banks or other places of deposit as the board of directors may from time to time designate; shall, whenever so required by the board of directors, render an account showing all transactions as treasurer, and the financial condition of the corporation; and, in general, shall discharge such other duties as may from time to time be assigned by the board of directors, the chairman of the board of directors or the president.

*Section 5.13.* Assistant Treasurers. In the absence or disability of the treasurer, any assistant treasurer may perform all the duties of the treasurer, and, when so acting, shall have all the powers of and be subject to all the restrictions upon the treasurer. The assistant treasurers shall perform such other duties as from time to time may be assigned to them, respectively, by the board of directors, the chairman of the board of directors, the president or the treasurer.

*Section 5.14.* Salaries. The salary and other remuneration of the Executive Officers of the corporation shall be fixed from time to time by the board of directors. The salaries and other remuneration of all other officers and employees shall be fixed from time to time by the chairman of the board of directors or by delegated authority pursuant to Section 5.03. No officer shall be prevented from receiving such salary or other compensation by reason of the fact that the officer is also a director of the corporation.

*Section 5.15.* Liability of Officers. An officer of the corporation shall not be personally liable, as such, to the corporation, for monetary damages, including, as such, to the corporation, for monetary damages, including, without limitation, any judgment, amount paid in settlement, penalty, punitive damages or expense of any nature (including, without limitation, attorneys' fees and disbursements), for any action taken, or any failure to take any action, unless the officer has breached or failed to perform the duties of his or her office under the Articles, these Bylaws or applicable provisions of law and the breach or failure to perform constitutes self-dealing, willful misconduct or recklessness. The provisions of this section shall not apply to the responsibility or liability of an officer, as such, pursuant to any criminal statute or for the payment of taxes pursuant to local, state or federal law.

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*Section 5.16.* Conduct of Officers. Officers of the corporation shall be subject to the standards of conduct set forth in a Code of Ethics adopted by the corporation and to such additional standards of conduct applicable to such officers as shall be provided by law at the time and shall comply fully with all applicable suitability requirements set forth in the executive, administrative, judicial and/or legislative rules, regulations, laws and orders of any jurisdiction to which the corporation is then subject. In the absence of a Code of Ethics adopted by the corporation, officers of the corporation shall be subject to the same standards of conduct, including standards of care and loyalty and rights of justifiable reliance, as shall at the time be applicable to directors of the corporation and to such additional standards of conduct applicable to such officers as shall be provided by law at the time. If it is determined by an applicable governmental authority that an officer does not satisfy the suitability requirements of the governmental authority at issue, such officer may be removed by the board of directors and shall immediately submit such officer's resignation for consideration by the board of directors.

## ARTICLE VI

### Certificates of Stock, Transfer, Etc.

*Section 6.01.* Share Certificates.

(a) Form of Certificates. Certificates for shares of the corporation shall be in such form as approved by the board of directors, and shall state that the corporation is incorporated under the laws of the Commonwealth of Pennsylvania, the name of the person to whom issued, and the number and class of shares and the designation of the series (if any) that the certificate represents. Certificates for shares of the corporation shall set forth upon the face or back of the certificate (or shall state on the face or back of the certificate that the corporation will furnish to any shareholder upon request and without charge), a full or summary statement of the designations, voting rights, preferences, limitations and special rights of the shares of each class or series authorized to be issued so far as they have been fixed and determined and the authority of the board of directors to fix and determine the designations, voting rights, preferences, limitations and special rights of the classes and series of shares of the corporation.

(b) Share Register. The share register or transfer books and blank share certificates shall be kept by the secretary or by any transfer agent or registrar designated by the board of directors for that purpose.

(c) Uncertificated Shares. Any or all classes and series of shares, or any part thereof, shall be uncertificated shares except that such a provision shall not apply to shares represented by a certificate until the certificate is surrendered to the corporation. Within a reasonable time after the issuance or transfer of uncertificated shares, the corporation shall send to the registered owner thereof a written notice containing the information required to be set forth or stated on certificates by Section 6.01(a). Except as otherwise expressly provided by law, the rights and obligations of the holders of shares represented by certificates and the rights and obligations of the holders of uncertificated shares of the same class and series shall be identical.

*Section 6.02.* Issuance. The share certificates of the corporation shall be numbered and registered in the share register or transfer books of the corporation as they are issued. They shall be executed in such manner as the board of directors shall determine.

*Section 6.03.* Transfer. Transfers of shares shall be made on the share register or transfer books of the corporation upon surrender of the certificate therefore, endorsed by the person named in the certificate or by an attorney lawfully constituted in writing. No transfer shall be made inconsistent with the

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Section 6.04. Record Holders of Shares. The corporation shall be entitled to treat the person in whose name any share or shares of the corporation stand on the books of the corporation as the absolute owner thereof, and shall not be bound to recognize any equitable or other claim to, or interest in, such share or shares on the part of any other person.

Section 6.05. Lost, Destroyed or Mutilated Certificates. The holder of any shares of the corporation shall immediately notify the corporation when the shareholder has notice of any loss, destruction or mutilation of the certificate therefor. If the corporation receives such notice prior to notice that the certificate at issue has been acquired by a protected purchaser, the corporation shall cause a new certificate or certificates to be issued to such holder, in case of mutilation of the certificate, upon the surrender of the mutilated certificate or, in the case of loss or destruction of the certificate, upon satisfactory proof of such loss or destruction and, in either such instance, upon the deposit of an indemnity bond in such form and in such sum, and with such surety or sureties, as the corporation may direct.

## ARTICLE VII

### Indemnification of Directors, Officers and Other Authorized Representatives

Section 7.01. Scope of Indemnification.

(a) General Rule. The corporation shall indemnify an Indemnified Representative against any Liability incurred in connection with any Proceeding in which the Indemnified Representative may be involved as a party or otherwise by reason of the fact that such person is or was serving in an Indemnified Capacity, including, without limitation, Liabilities resulting from any actual or alleged breach or neglect of duty, error, misstatement or misleading statement, negligence, gross negligence or act giving rise to strict or products liability, except:

- (1) where such indemnification is expressly prohibited by applicable law;
- (2) where the conduct of the Indemnified Representative has been finally determined pursuant to Section 7.06 or otherwise:
  - (i) to constitute willful misconduct or recklessness within the meaning of 15 Pa.C.S. §§ 518(b) and 1746(b) or any superseding provision of law sufficient in the circumstances to bar indemnification against liabilities arising from the conduct; or
  - (ii) to be based upon or attributable to the receipt by the Indemnified Representative from the corporation of a personal benefit to which the Indemnified Representative is not legally entitled; or
- (3) to the extent such indemnification has been finally determined in a final adjudication pursuant to Section 7.06 to be otherwise unlawful.

(b) Partial Payment. If an Indemnified Representative is entitled to indemnification in respect of a portion, but not all, of any Liabilities to which such person may be subject, the corporation shall indemnify such Indemnified Representative to the maximum extent for such portion of the Liabilities.

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(c) Presumption. The termination of a Proceeding by judgment, order, settlement or conviction or upon a plea of nolo contendere or its equivalent shall not of itself create a presumption that the Indemnified Representative is not entitled to indemnification.

(d) Definitions. For purposes of this Article VII:

- (1) "Certifying Employee" means an employee of the corporation requested, as part of the corporation's disclosure controls and procedures and in connection with the performance of the employee's responsibilities in service to the corporation, to provide to the corporation a certification or certifications to be used by the corporation in connection with the preparation of its periodic reports under the Exchange Act;
- (2) "Indemnified Capacity" means any and all past, present and future service by an Indemnified Representative in one or more capacities as a director, officer, employee or agent of the corporation, or, at the request of the corporation, as a director, officer, employee, agent, fiduciary or trustee of another corporation, partnership, joint venture, trust, employee benefit plan or other entity or enterprise;
- (3) "Indemnified Representative" means any (3) all directors and officers of the corporation, Certifying Employees and any other person designated as an Indemnified Representative by the board of directors of the corporation (which may, but need not, include any person serving at the request of the corporation, as a director, officer, employee, agent, fiduciary or trustee of another corporation, partnership, joint venture, trust, employee benefit plan or other entity or enterprise);
- (4) "Liability" means any damage, judgment, amount paid in settlement, fine, penalty, punitive damages, excise tax assessed with respect to an employee benefit plan, or cost or expense of any nature (including, without limitation, attorneys' fees and disbursements); and
- (5) "Proceeding" means any threatened, pending or completed investigation, action, suit, appeal or other proceeding of any nature, whether civil, criminal, administrative or investigative, whether formal or informal, and whether brought by or in the right of the corporation, a class of its security holders or otherwise.

Section 7.02. Proceedings Initiated by Indemnified Representatives. Notwithstanding any other provision of this Article VII, the corporation shall not indemnify under this Article VII an Indemnified Representative for any Liability incurred in a proceeding initiated (which shall not be deemed to include counterclaims or affirmative defenses) or participated in as an intervenor or amicus curiae by the person seeking indemnification unless

such initiation of or participation in the proceeding is authorized, either before or after its commencement, by the affirmative vote of a majority of the directors in office. This section does not apply to reimbursement of expenses incurring in successfully prosecuting or defending an arbitration under Section 7.06 or otherwise successfully prosecuting or defending the rights of an Indemnified Representative granted by or pursuant to this Article VII.

*Section 7.03. Advancing Expenses.* Except where such advance is expressly prohibited by applicable law, the corporation shall pay the expenses (including attorneys' fees and disbursements) incurred in good faith by an Indemnified Representative in advance of the final disposition of a Proceeding described in Section 7.01 or the initiation of or participation in which is authorized pursuant to Section 7.02 upon receipt of an undertaking by or on behalf of the Indemnified Representative to repay the amount if it is ultimately determined pursuant to Section 7.06 that such person is not entitled to be indemnified by the

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corporation pursuant to this Article VII. The financial ability of an Indemnified Representative to repay an advance shall not be a prerequisite to the making of such advance.

*Section 7.04. Securing of Indemnification Obligations.* To further effect, satisfy or secure the indemnification obligations provided herein or otherwise, the corporation may maintain insurance, obtain a letter of credit, act as self-insurer, create a reserve, trust, escrow, cash collateral or other fund or account, enter into indemnification agreements, pledge or grant a security interest in any assets or properties of the corporation, or use any other mechanism or arrangement whatsoever in such amounts, at such costs, and upon such other terms and conditions as the board of directors shall deem appropriate. Absent fraud, the determination of the board of directors with respect to such amounts, costs, terms and conditions shall be conclusive against all security holders, officers and directors and shall not be subject to voidability.

*Section 7.05. Payment of Indemnification.* An Indemnified Representative shall be entitled to indemnification within 30 days after a written request for indemnification has been delivered to the secretary of the corporation.

*Section 7.06. Indemnification Procedure.*

(a) *Notification of claim.* An Indemnified Representative shall use such Indemnified Representative's best efforts to notify promptly the secretary of the corporation of the commencement of any Proceeding or other occurrence of any event which might give rise to a Liability under this Article VII, but, unless the corporation has been prejudiced thereby, the failure so to notify the corporation shall not relieve the corporation of any liability which it may have to the Indemnified Representative under this Article VII or otherwise.

(b) *Assumption of defense.* The corporation shall be entitled, upon notice to any such Indemnified Representative, to assume the defense of any Proceeding with counsel reasonably satisfactory to the Indemnified Representative, or a majority of the Indemnified Representatives involved in such Proceeding if there be more than one. If the corporation notifies the Indemnified Representative of its election to defend the Proceeding, the corporation shall have no liability for the expenses (including attorneys' fees and disbursements) of the Indemnified Representative incurred in connection with the defense of such Proceeding subsequent to such notice, unless:

- (1) such expenses (including attorneys' fees and disbursements) have been authorized by the corporation,
- (2) the corporation shall not in fact have employed counsel reasonably satisfactory to such Indemnified Representative or Indemnified Representatives to assume the defense of such Proceeding, or
- (3) it shall have been determined pursuant to Section 7.06(d) that the Indemnified Representative was entitled to indemnification for such expenses under this Article VII or otherwise.

Notwithstanding the foregoing, the Indemnified Representative may elect to retain counsel at the Indemnified Representative's own cost and expense to participate in the defense of such proceeding.

(c) *Settlement by corporation.* The corporation shall not be required to obtain the consent of the Indemnified Representative to the settlement of any Proceeding which the corporation has undertaken to defend if the corporation assumes full and sole responsibility for such settlement and the settlement grants the Indemnified Representative an unqualified release in respect of all Liabilities at issue in the proceeding. Whether or not the corporation has elected to assume the defense of any Proceeding, no

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Indemnified Representative shall have any right to enter into any full or partial settlement of a Proceeding without the prior written consent of the corporation (which consent shall not be unreasonably withheld), nor shall the corporation be liable for any amount paid by an Indemnified Representative pursuant to any settlement to which the corporation has not so consented.

(d) *Arbitration.* Any dispute related to the right to indemnification, contribution or advancement of expenses as provided under this Article VII, except with respect to indemnification for liabilities arising under the Securities Act of 1933, as amended, that the corporation has undertaken to submit to a court of adjudication, shall be decided only by arbitration in the county in which the principal executive offices of the corporation are located at the time, in accordance with the commercial arbitration rules then in effect of the American Arbitration Association (the "AAA Rules"), before a panel of three arbitrators (the "Panel"), one of whom shall be selected by the corporation, the second of whom shall be selected by the Indemnified Representative and the third of whom shall be selected by the other two arbitrators. In the absence of the American Arbitration Association, or if for any reason arbitration under the arbitration rules of the American Arbitration Association cannot be initiated, and if one of the parties fails or refuses to select an arbitrator or the arbitrators selected by the corporation and the Indemnified Representative cannot agree on the selection of the third arbitrator within 30 days after such time as the corporation and the Indemnified Representative have each been notified of the selection of the other's arbitrator, the necessary arbitrator or arbitrators shall be selected by the presiding judge of the court of general jurisdiction in such county. The arbitration shall be conducted pursuant to the Federal Arbitration Act and such procedures as the parties subject to such arbitration (each, a "Party") may agree, or, in the absence of or failing such agreement, pursuant to the AAA Rules. Notwithstanding the foregoing: (1) each Party shall provide to the other, reasonably in advance of any hearing, copies of all

documents which a Party intends to present in such hearing; (2) each Party shall be allowed to conduct reasonable discovery through written document requests and depositions, the nature and extent of which discovery shall be determined by the Parties; provided, however, that if the Parties cannot agree on the terms of such discovery, the nature and extent thereof shall be determined by the Panel which shall take into account the needs of the Parties and the purposes of arbitration to make discovery expeditious and cost effective; (3) each Party shall be entitled to make an oral presentation to the Panel; and (4) the Panel shall select as a resolution the position of either Party for each item of disagreement and may not impose an alternative resolution. The award shall be in writing and shall specify the factual and legal basis for the award.

(e) Burden of Proof. The party or parties challenging the right of an Indemnified Representative to the benefits of this Article VII shall have the burden of proof.

(f) Expenses. The corporation may advance and shall reimburse an Indemnified Representative for the expenses (including attorneys' fees and disbursements) incurred in successfully prosecuting or defending such arbitration.

(g) Effect. Any award entered by the arbitrators shall be final, binding and nonappealable and judgment may be entered thereon by any party in accordance with applicable law in any court of competent jurisdiction, except that the corporation shall be entitled to interpose as a defense in any such judicial enforcement proceeding any prior final judicial determination adverse to the Indemnified Representative under Section 7.01(a)(2) in a Proceeding not directly involving indemnification under this Article VII. This arbitration provision shall be specifically enforceable.

*Section 7.07.* Contribution. If the indemnification provided for in this Article VII or otherwise is unavailable for any reason in respect of any liability or portion thereof, the corporation shall contribute to the liabilities to which the Indemnified Representative may be subject in such proportion as is appropriate to reflect the intent of this Article VII or otherwise.

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*Section 7.08.* Mandatory Indemnification of Directors, Officers and Indemnified Representatives. To the extent that an authorized representative of the corporation has been successful on the merits or otherwise in defense of any action, suit or Proceeding referred to in Section 1741 or 1742 of the Business Corporation Law or in defense of any claim, issue or matter therein, such person shall be indemnified against expenses (including attorneys' fees and disbursements) actually and reasonable incurred by such person in connection therewith.

*Section 7.09.* Contract Rights; Amendment or Repeal. All rights under this Article VII shall be deemed a contract between the corporation and the Indemnified Representative pursuant to which the corporation and each Indemnified Representative intend to be legally bound. Any repeal, amendment or modification hereof shall be prospective only and shall not affect any rights or obligations then existing.

*Section 7.10.* Scope of Article. The rights granted by this Article VII shall not be deemed exclusive of any other rights to which those seeking indemnification, contribution or advancement of expenses may be entitled under any statute, agreement, vote of shareholders or disinterested directors or otherwise, both as to action in an indemnified capacity and as to action in any other capacity. The indemnification, contribution and advancement of expenses provided by or granted pursuant to this Article VII shall continue as to a person who has ceased to be an Indemnified Representative in respect of matters arising prior to such time, and shall inure to the benefit of the heirs, executors, administrators and personal representatives of such a person.

*Section 7.11.* Reliance on Provisions. Each person who shall act as an Indemnified Representative of the corporation shall be deemed to be doing so in reliance upon the rights provided by this Article VII.

*Section 7.12.* Interpretation. The provisions of this Article VII are intended to constitute bylaws authorized by 15 Pa.C.S. §§ 518 and 1746.

## ARTICLE VIII

### Miscellaneous

*Section 8.01.* Corporate Seal. The corporation shall have a corporate seal in the form of a circle containing the name of the corporation, the year of incorporation and such other details as may be approved by the board of directors. The affixation of the corporate seal shall not be necessary to the valid execution, assignment or endorsement by the corporation of any instrument or other document unless otherwise required by law.

*Section 8.02.* Checks. All checks, notes, bills of exchange or other similar orders in writing shall be signed by such person or persons as the board of directors or any person authorized by resolution of the board of directors may from time to time designate.

*Section 8.03.* Contracts; Borrowing. Except as otherwise provided in the Business Corporation Law in the case of transactions that require action by the shareholders, the board of directors may authorize any officer, agent or employee to enter into any contract or to execute or deliver any instrument on behalf of the corporation. Such authority may be general or confined to specific instances, and no officer or officers, agent or agents, employee or employees of the corporation shall have any power or authority to bind the corporation by any contract or engagement to borrow money, to pledge its credit or to mortgage or pledge its real or personal property, except within the scope and to the extent of the authority so delegated.

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*Section 8.04.* Interested Directors or Officers; Quorum.

(a) General Rule. A contract or transaction between the corporation and one or more of its directors or officers or between the corporation and another corporation, partnership, joint venture, trust or other enterprise in which one or more of its directors or officers are directors or officers or have a financial or other interest, shall not be void or voidable solely for that reason, or solely because the director or officer is present at or participates in the meeting of the board of directors that authorizes the contract or transaction, or solely because his, her or their votes are counted for that purpose, if:

(1) the material facts as to the relationship or interest and as to the contract or transaction are disclosed or are known to the board of directors and the board authorizes the contract or transaction by the affirmative votes of a majority of the disinterested directors even though the disinterested directors are less than a quorum;

(2) the material facts as to his or her relationship or interest and as to the contract or transaction are disclosed or are known to the shareholders entitled to vote thereon and the contract or transaction is specifically approved in good faith by vote of those shareholders; or

(3) the contract or transaction is fair as to the corporation as of the time it is authorized, approved or ratified by the board of directors or the shareholders.

(b) Quorum. Common or interested directors may be counted in determining the presence of a quorum at a meeting of the board which authorizes a contract or transaction specified in Section 8.04(a).

*Section 8.05. Deposits.* All funds of the corporation shall be deposited from time to time to the credit of the corporation in such banks, trust companies or other depositories as the board of directors may approve or designate, and all such funds shall be withdrawn only upon checks signed by such one or more officers or employees as the board of directors shall from time to time determine.

*Section 8.06. Corporate Records.*

(a) Required Records. The corporation shall keep complete and accurate books and records of account, minutes of the proceedings of the incorporators, shareholders and directors and a share register giving the names and addresses of all shareholders and the number and class of shares held by each. The share register shall be kept at either the registered office of the corporation in the Commonwealth of Pennsylvania or at its principal place of business wherever situated or at the office of its registrar or transfer agent. Any books, minutes or other records may be in written form or any other form capable of being converted into written form within a reasonable time.

(b) Right of Inspection. Every shareholder shall, upon written verified demand stating the purpose thereof, have a right to examine, in person or by agent or attorney, during the usual hours for business for any proper purpose, the share register, books and records of account, and records of the proceedings of the incorporators, shareholders and directors and to make copies or extracts therefrom. A proper purpose shall mean a purpose reasonably related to the interest of the person as a shareholder. In every instance where an attorney or other agent is the person who seeks the right of inspection, the demand shall be accompanied by a verified power of attorney or other writing that authorizes the attorney or other agent to so act on behalf of the shareholder. The demand shall be directed to the corporation (i) at its registered office in the Commonwealth of Pennsylvania, (ii) at its principal place of business wherever situated, or (iii) in care of the person in charge of an actual business office of the corporation.

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*Section 8.07. Voting.* Unless otherwise ordered by the board of directors, the corporation may cast (by consent or at a meeting) the votes which the corporation may be entitled to cast as a shareholder, member, partner or otherwise in any other corporation, limited liability company, partnership or other entity any of whose shares or other securities are held by or for the corporation by any of its officers or agents, or by proxy appointed by any officer or agent, unless some other person, by resolution of the board of directors or a provision of the other corporation's articles or bylaws, is appointed its general or special proxy in which case that person shall be entitled to vote the shares or other securities.

*Section 8.08. Fiscal Year.* The fiscal year of the corporation shall begin on the first day of January in each year.

*Section 8.09. Amendment of Bylaws.*

(a) General Rule. Except as otherwise provided in the express terms of any series of the shares of the corporation, the authority to adopt, amend and repeal these Bylaws of the corporation is hereby vested in the board of directors of the corporation. These Bylaws may be amended or repealed, or new bylaws may be adopted, by vote of a majority of the board of directors of the corporation in office at any regular or special meeting of directors, including in circumstances otherwise reserved by statute exclusively to the shareholders (except as otherwise provided in Section 1504(b) of the Business Corporation Law), subject to the power of the shareholders to change such action. Any bylaw adopted by the board of directors under this paragraph shall be consistent with the Articles.

(b) Effective Date. Any change in these Bylaws shall take effect when adopted unless otherwise provided in the resolution effecting the change.

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**EMPLOYMENT AGREEMENT**

This EMPLOYMENT AGREEMENT (the "Agreement") is entered into as of this 26th day of May, 2004 (the "Commencement Date") by and between Penn National Gaming, Inc., a Pennsylvania corporation (the "Company"), and Peter M. Carlino, an individual residing in Pennsylvania ("Executive").

WHEREAS, Executive and the Company are party to a certain Employment Agreement, dated as of April 12, 1994 (as amended from time to time, the "Initial Agreement") which, by its terms, has automatically renewed from year to year; and

WHEREAS, the parties now desire to terminate the Initial Agreement and to enter into a new agreement reflecting, among other things, certain additional covenants and consideration exchanged by the parties, all as more specifically set forth herein.

NOW, THEREFORE, the parties hereto, intending to be legally bound, hereby agree as follows:

1. **Employment.** The Company hereby agrees to employ Executive and Executive hereby accepts such employment, in accordance with the terms, conditions and provisions hereinafter set forth.

1.1. **Duties and Responsibilities.** Executive shall serve as Chairman of the Board and Chief Executive Officer of the Company. Executive shall perform all duties and accept all responsibilities incident to such position as may be reasonably assigned to him by the Board of Directors of the Company (the "Board"). Executive's principal place of employment shall be in Wyomissing, Pennsylvania.

1.2. **Term.** The term of this Agreement shall begin on the date hereof and shall terminate at the close of business on the fifth anniversary of the Commencement Date (the "Initial Term"), unless earlier terminated in accordance with Section 3 hereof. This Agreement shall automatically renew for additional five-year periods (each, a "Renewal Term" and, together with the Initial Term, the "Employment Term") unless either party has delivered written notice of non-renewal at least 60 days prior to the start of a Renewal Term or unless earlier terminated in accordance with Section 3 hereof.

1.3. **Extent of Service.** Executive agrees to use Executive's best efforts to carry out Executive's duties and responsibilities and, consistent with the other provisions of this Agreement, to devote substantially all of Executive's business time, attention and energy thereto. The foregoing shall not be construed as preventing Executive from serving on the board of philanthropic organizations, or providing oversight with respect to his personal investments (including Carlino Development Group and its Affiliates) and the Carlino Family Trust and its Affiliates, so long as such service does not materially interfere with Executive's duties hereunder.

2. **Compensation.** For all services rendered by Executive to the Company, the Company shall compensate Executive as set forth below.

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2.1. **Base Salary.** The Company shall pay Executive a base salary ("Base Salary"), commencing on the Commencement Date, at the annual rate of eight hundred thirty-two thousand (\$832,000), payable in installments at such times as the Company customarily pays its other senior executives ("Peer Executives"). Executive's performance and Base Salary shall be reviewed annually. Any increase in Base Salary or other compensation shall be made at the discretion of the compensation committee of the Board (the "Compensation Committee").

2.2. **Cash Bonuses.** Executive shall participate in the Company's incentive compensation plan for senior management as such may be adopted, amended and approved, from time to time, by the Compensation Committee.

2.3. **Equity Compensation.** The Company may grant to Executive options or other equity compensation pursuant to, and subject to the terms and conditions of, the then current equity compensation plan of Penn National Gaming, Inc. The Compensation Committee shall set the amount and terms of such options or other equity compensation.

2.4. **Other Benefits.** Executive shall be entitled to participate in all other employee benefit plans and programs, including, without limitation, health, vacation, retirement, deferred compensation or SERP, made available to other Peer Executives, as such plans and programs may be in effect from time to time and subject to the eligibility requirements of the each plan. Nothing in this Agreement shall prevent the Company from amending or terminating any retirement, welfare or other employee benefit plans or programs from time to time, as the Company deems appropriate.

2.5. **Vacation, Sick Leave and Holidays.** Executive shall be entitled in each calendar year to four (4) weeks of paid vacation time. Each vacation shall be taken by Executive at such time or times as agreed upon by the Company and Executive, and any portion of Executive's allowable vacation time not used during the calendar year shall be subject to the Company's payroll policies regarding carryover vacation. Executive shall be entitled to holiday and sick leave in accordance with the Company's holiday and other pay for time not worked policies.

2.6. **Reimbursement of Expenses.** Executive shall be provided with reimbursement of reasonable expenses related to Executive's employment by the Company on a basis no less favorable than that authorized from time to time for Peer Executives.

2.7. **Automobile.** During the term of this Agreement, the Company shall provide Executive with an automobile of such make and model consistent with the Company's policy for its provision of automobiles to Peer Executives. The Company shall reimburse Executive for all expenses arising from or related to the maintenance, repair and daily operation of such automobile in carrying out Executive's duties hereunder, including but not limited to, fuel, service and insurance costs, provided that Executive presents vouchers evidencing such expenses as required by the Company.

2.8. **Perquisites.** The Company shall continue to reimburse Executive for annual membership fees and assessments for a country club of Executive's choice. The Company shall also continue to pay the premiums for all split dollar life insurance policies issued as of the date hereof and held by those certain irrevocable trusts created by Executive.

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3. Termination. Executive's employment may be terminated prior to the end of the Employment Term in accordance with, and subject to the terms and conditions, set forth below.

3.1. Termination by the Company.

(a) Without Cause. The Company may terminate Executive at any time without Cause (as such term is defined in subsection (b) below) upon delivery of written notice to Executive, which notice shall set forth the effective date of such termination.

(b) With Cause. The Company may terminate Executive at any time for Cause effective immediately upon delivery of written notice to Executive. As used herein, the term "Cause" shall mean:

(i) Executive shall have been convicted of a felony or any misdemeanor involving allegations of fraud, theft, perjury or conspiracy;

(ii) Executive is found disqualified or not suitable to hold a casino or other gaming license by a governmental gaming authority in any jurisdiction where Executive is required to be found qualified, suitable or licensed;

(iii) Executive materially breaches any material Company policy or any material term hereof, including, without limitation, Sections 4 through 7 and, in each case, fails to cure such breach within 15 days after receipt of written notice thereof; or

(iv) Executive misappropriates corporate funds as determined in good faith by the Board.

3.2. Termination by the Executive. Executive may voluntarily terminate employment for any reason effective upon 60 days' prior written notice to the Company, unless the Company waives such notice requirement (in which case the Company shall notify Executive in writing as to the effective date of termination). The Company and Executive, however, recognize and agree that they mutually agreed upon the term of this Agreement and that Executive is expected to complete fully the Employment Term.

3.3. Termination for Death or Disability. In the event of the death or total disability of Executive, this Agreement shall terminate effective as of the date of Executive's death or total disability. The term "total disability" shall have the definition set forth in the Company's Long Term Disability Insurance Policy in effect at the time of such determination.

3.4. Payments Due Upon Termination.

(a) Generally. Upon any termination described in Sections 3.1, 3.2 or 3.3 above, Executive shall be entitled to receive any amounts due for Base Salary earned or expenses incurred through the effective date of termination and any benefits accrued or earned on or prior to such date in accordance with the terms of any applicable benefit plans and programs.

(b) Certain Circumstances. In the event the Company terminates Executive's employment without Cause or due to a total disability or in the event that the Company elects not

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to renew this Agreement, and subject to Executive executing the release attached hereto as Exhibit A, Executive shall be entitled to receive the following in lieu of any other severance:

(i) Executive shall receive a payment equal to Executive's monthly Base Salary at the highest rate in effect for Executive during the 24-month period immediately preceding the effective date of termination and Executive's monthly bonus value (determined by dividing the highest amount of annual cash bonus compensation paid to Executive in respect of either the first or second full calendar year immediately preceding the effective date of termination by twelve) for a period equal to the greater of (1) the number of months remaining in the Employment Term or (2) 36 months (the "Severance Period").

(ii) Executive shall continue to receive the health benefits coverage in effect on the effective date of termination (or as the same may be changed from time to time for Peer Executives) for Executive and, if any, Executive's spouse and dependents for the Severance Period. At the option of the Company, the Company may elect to pay Executive cash in lieu of such coverage in an amount equal to Executive's after-tax cost of obtaining generally comparable coverage for such period.

(iii) Executive shall continue to serve as a non-officer employee of the Company during the Severance Period and, as such, all options granted to Executive shall continue vesting for such period.

(c) Payments. Cash Payments due under this Section 3.4 shall be made as follows: 75% shall be made within 15 days of the effective date of termination and the balance shall be made in accordance with the payroll practices in effect on the date of termination, unless, at the Company's sole option, the Company elects to make all such payments in a single lump sum. Except as otherwise provided in this Section 3.4, Section 8 or Section 9, no other payments or benefits shall be due under this Agreement to Executive.

3.5. Notice of Termination. Any termination of Executive's employment shall be communicated by a written notice of termination delivered within the time period specified in this Section 3. The notice of termination shall (i) indicate the specific termination provision in this Agreement relied upon, (ii) briefly summarize the facts and circumstances deemed to provide a basis for a termination of employment and the applicable provision hereof, and (iii) specify the termination date in accordance with the requirements of this Agreement.

4. No Conflicts of Interest. Executive agrees that throughout the period of Executive's employment hereunder or otherwise, Executive will not perform any activities or services, or accept other employment that would materially interfere with or present a conflict of interest concerning Executive's employment with the Company. Executive agrees and acknowledges that Executive's employment by the Company is conditioned upon Executive adhering

to and complying with the business practices and requirements of ethical conduct set forth in writing from time to time by the Company in its employee manual or similar publication. Executive represents and warrants that no other contract, agreement or understanding to which Executive is a party or may be subject will be violated by the execution of this Agreement by Executive.

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5. Confidentiality. Executive recognizes and acknowledges that Executive will have access to certain confidential information of the Company and that such information constitutes valuable, special and unique property of the Company (including, but not limited to, information such as business strategies, identity of acquisition or growth targets, marketing plans, customer lists, and other business related information for the Company's customers). Executive agrees that Executive will not, for any reason or purpose whatsoever, during or after the term of employment, disclose any of such confidential information to any party, and that Executive will keep inviolate and secret all confidential information or knowledge which Executive has access to by virtue of Executive's employment with the Company, except as otherwise may be necessary in the ordinary course of performing Executive's duties with the Company.

6. Non-Competition.

(a) As used herein, the term "Restriction Period" shall mean a period equal to the greater of (i) the remainder of the Employment Term in effect on the effective date of termination and (ii) the Severance Period, if applicable; provided, however, that, if on or before the Trigger Date, Executive has been terminated for one of the reasons contemplated by Section 3.4(b), Executive may elect to terminate the Restriction Period at any time following the first anniversary of the effective date of termination by delivering written notice to the Company that Executive has made such election and that, in consideration therefore, is waiving the right to receive any continued payments under Section 3.4(b).

(b) During Executive's employment by the Company and for the duration of the Restriction Period thereafter, Executive shall not, except with the prior written consent of the Company, directly or indirectly, own, manage, operate, join, control, finance or participate in the ownership, management, operation, control or financing of, or be connected as an officer, director, employee, partner, principal, agent, representative, consultant or otherwise with, or use or permit Executive's name to be used in connection with, any business or enterprise which owns or operates a gaming or pari-mutuel facility located within 150 miles of any gaming or pari-mutuel facility owned or operated by the Company or any of its affiliates.

(c) The foregoing restrictions shall not be construed to prohibit Executive's ownership of less than 5% of any class of securities of any corporation which is engaged in any of the foregoing businesses and has a class of securities registered pursuant to the Securities Exchange Act of 1934, provided that such ownership represents a passive investment and that neither Executive nor any group of persons including Executive in any way, either directly or indirectly, manages or exercises control of any such corporation, guarantees any of its financial obligations, otherwise takes any part in its business, other than exercising Executive's rights as a shareholder, or seeks to do any of the foregoing.

(d) Executive acknowledges that the covenants contained in Sections 5 through 7 hereof are reasonable and necessary to protect the legitimate interests of the Company and its affiliates and, in particular, that the duration and geographic scope of such covenants are reasonable given the nature of this Agreement and the position that Executive will hold within the Company. Executive further agrees to disclose the existence and terms of such covenants to any employer that Executive works for during the Restriction Period.

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7. Non-Solicitation. During Executive's employment by the Company and for a period equal to the greater of the Restriction Period or one year after the effective date of termination, Executive will not, except with the prior written consent of the Company, (i) directly or indirectly, solicit or hire, or encourage the solicitation or hiring of, any person who is, or was within a six month period prior to such solicitation or hiring, an executive or management employee of the Company or any of its affiliates for any position as an employee, independent contractor, consultant or otherwise or (ii) divert or attempt to divert any existing business of the Company or any of its affiliates.

8. Change of Control.

8.1. Consideration

(a) Change of Control. In the event of a Change of Control (as defined below), Executive shall be entitled to receive a cash payment in an amount equal to the product of three times the sum of (i) the highest annual rate of Base Salary in effect for Executive during the 24-month period immediately preceding the effective date of the Change in Control (the "Trigger Date") and (ii) the highest amount of annual cash bonus compensation paid to Executive in respect of either the first or second full calendar year immediately preceding the Trigger Date.

(b) Restrictive Provisions. As consideration for the foregoing payments, Executive agrees not to challenge the enforceability of any of the restrictions contained in Sections 5, 6 or 7 of this Agreement upon or after the occurrence of a Change of Control. Executive and Company acknowledge that, as additional consideration for the change of control payments, Executive has also agreed to limit Executive's ability to opt out of the Restriction Period in Section 6(a) to periods prior to the Trigger Date.

8.2. Payment Terms. This change of control payment shall be made in two lump sum payments as follows: (i) 75% to Executive on the Trigger Date; and (ii) 25% into a mutually acceptable escrow account on the Trigger Date, payable to Executive on the 90th day following the Trigger Date. Notwithstanding any of the foregoing to the contrary, the payment contemplated by clause (ii) shall be paid immediately upon the occurrence of any of the following: (a) Executive's employment is terminated by the Company; or (b) Executive terminates employment for Good Reason (as defined below).

8.3. Certain Other Terms. In the event payments are being made to Executive under this Section 8, no payments shall be due under Section 3.4(b)(i) of this Agreement with respect to any termination of Executive's employment following a Change of Control. At the option of the Company, the Company may require Executive to execute the release attached hereto as Exhibit A; provided, however, that this requirement shall not in any way alter the timing of the payments to be made under Section 8.2. The provisions of this Section 8 shall continue to apply to Executive if, during the 24-month period immediately preceding the Trigger Date, the Company terminates Executive's employment without Cause or due to a total disability or the



8.4. Defined Terms.

(a) Change of Control. The occurrence of one or more of the following events: (i) any sale, lease, exchange or other transfer (in one transaction or a series of related transactions) of all or substantially all of the assets of the Company; (ii) the election of two (2) or more persons to the Board who do not constitute Continuing Directors; or (iii) the ownership or acquisition by any Person or Group of the power, directly or indirectly, to vote or direct the voting of securities having more than forty percent (40%) of the ordinary voting power for the election of directors of the Company.

(b) Good Reason. The occurrence of any of the following events that the Company fails to cure within 10 days after receiving written notice thereof from Executive: (i) assignment to Executive of any duties inconsistent in any material respect with Executive's position (including status, offices, titles and reporting requirements), authority, duties or responsibilities or inconsistent with Executive's legal or fiduciary obligations; (ii) any reduction in Executive's compensation or substantial reduction in Executive's benefits taken as a whole; (iii) any travel requirements materially greater than Executive's travel requirements prior to the Change of Control; or (iv) breach of any material term of this Agreement by the Company.

(c) Continuing Directors. Any person who, as of the date of determination, either (i) was a member of the Board as of the date of this Agreement or (ii) was nominated for election or elected to the Board with the affirmative vote of a majority of directors comprising the Board or, if applicable, the Nominating Committee of the Board, who were Continuing Directors immediately prior to such nomination or election.

(d) Group. Any group of related Persons for purposes of Section 13(d) of the Securities Exchange Act of 1934, as amended.

(e) Person. Any individual, partnership, joint venture, trust, corporation, limited liability entity, unincorporated organization or other entity (including a governmental entity).

9. Certain Tax Matters.

9.1. Generally. In the event Executive becomes entitled to receive the payments (the "Severance Payments") provided under Section 3 or Section 8 hereof or under any other plan or arrangement providing for payments under circumstances similar to those contemplated by such sections, and if any of the Severance Payments will be subject to the tax (the "Excise Tax") imposed by Section 4999 of the Internal Revenue Code of 1986, as amended (the "Code"), the Company shall pay to Executive at the time specified for such payments, an additional amount (the "Gross-Up Payment") such that the net amount retained by Executive shall be equal to the amount of the Severance Payments after deducting normal and ordinary taxes but not deducting (a) the Excise Tax and (b) any federal, state and local income tax and Excise Tax payable on the payment provided for by this Section 9.

9.2. Illustration. For example, if the Severance Payments are \$1,000,000 and if Executive is subject to the Excise Tax, then the Gross-Up Payment will be such that Executive will retain an amount of \$1,000,000 less only any normal and ordinary taxes on such amount.

The Excise Tax and federal, state and local taxes and any Excise Tax on the payment provided by this Section 9 will not be deemed normal and ordinary taxes.

9.3. Certain Terms. For purposes of determining whether any of the Severance Payments will be subject to the Excise Tax and the amount of such Excise Tax, the following will apply:

(a) Any other payments or benefits received or to be received by Executive in connection with a Change in Control of the Company or Executive's termination of employment (whether pursuant to the terms of this Agreement or any other plan, arrangement or agreement with the Company shall be treated as "parachute payments" within the meaning of Section 280G(b)(2) of the Code, and all "excess parachute payments" within the meaning of Section 280G(b)(1) shall be treated as subject to the Excise Tax, unless in the opinion of tax counsel selected by the Company's Compensation Committee and acceptable to Executive, such other payments or benefits (in whole or in part) do not constitute parachute payments, or such excess parachute payments (in whole or in part) represent reasonable compensation for services actually rendered within the meaning of Section 280G(b)(4) of the Code in excess of the base amount within the meaning of Section 280G(b)(3) of the Code, or are otherwise not subject to the Excise Tax;

(b) The amount of the Severance Payments which shall be treated as subject to the Excise Tax shall be equal to the lesser of (y) the total amount of the Severance Payments or (z) the amount of excess parachute payments within the meaning of Section 280G(b)(1) (after applying clause (a), above); and

(c) The value of any non-cash benefits or any deferred payment or benefit shall be determined by the Company's independent auditors in accordance with proposed, temporary or final regulations under Sections 280G(d)(3) and (4) of the Code or, in the absence of such regulations, in accordance with the principles of Section 280G(d)(3) and (4) of the Code. For purposes of determining the amount of the Gross-Up Payment, Executive shall be deemed to pay Federal income taxes at the highest marginal rate of federal income taxation in the calendar year in which the Gross-Up Payment is to be made and state and local income taxes at the highest marginal rate of taxation in the state and locality of Executive on the Trigger Date, net of the maximum reduction in Federal income taxes which could be obtained from deduction of such state and local taxes. In the event that the amount of Excise Tax attributable to Severance Payments is subsequently determined to be less than the amount taken into account hereunder at the time of determination then, subject to applicable law, appropriate adjustments will be made with respect to the payments hereunder.

9.4. Fees and Expenses. The Company shall reimburse Executive for all reasonable legal fees and expenses incurred by Executive in connection with any tax audit or proceeding to the extent attributable to the application of Section 4999 of the Code or any regulations pertaining thereto to any payment or benefit provided hereunder.

10. Document Surrender. Upon the termination of Executive's employment for any reason, Executive shall immediately surrender and deliver to the Company all documents, correspondence and any other information, of any type whatsoever, from the Company or any of

its agents, servants, employees, suppliers, and existing or potential customers, that came into Executive's possession by any means whatsoever, during the course of employment.

11. Governing Law. This Agreement shall be governed by and construed in accordance with the internal laws (and not the law of conflicts) of the Commonwealth of Pennsylvania.

12. Jurisdiction. The parties hereby irrevocably consent to the jurisdiction of the courts of the Commonwealth of Pennsylvania for all purposes in connection with any action or proceeding which arises out of or relates to this Agreement and agree that any action instituted under this Agreement shall be commenced, prosecuted and continued only in the state or federal courts having jurisdiction for matters arising in Wyomissing, Pennsylvania, which shall be the exclusive and only proper forum for adjudicating such a claim.

13. Notices. All notices and other communications required or permitted under this Agreement or necessary or convenient in connection herewith shall be in writing and shall be deemed to have been given when hand delivered, delivered by guaranteed next-day delivery or sent by facsimile (with confirmation of transmission) or shall be deemed given on the third business day when mailed by registered or certified mail, as follows (provided that notice of change of address shall be deemed given only when received):

If to the Company, to:

Penn National Gaming, Inc.  
825 Berkshire Boulevard, Suite 200  
Wyomissing, PA 19610  
Fax: (610) 376-2842

Attention: President

If to Executive, to:

Peter M. Carlino  
c/o Penn National Gaming, Inc.  
825 Berkshire Boulevard, Suite 200  
Wyomissing, PA 19610  
Fax: (610) 376-2842

or to such other names or addresses as the Company or Executive, as the case may be, shall designate by notice to each other person entitled to receive notices in the manner specified in this Section.

14. Contents of Agreement; Amendment and Assignment.

14.1. This Agreement sets forth the entire understanding between the parties hereto with respect to the subject matter hereof and supersedes all prior or contemporaneous agreements or understandings with respect to thereto, including without limitation, the Initial Agreement which is hereby terminated. This Agreement cannot be changed, modified, extended, waived or terminated except upon a written instrument signed by the party against which it is to be enforced.

14.2. Executive may not assign any of his rights or obligations under this Agreement. The Company may assign its rights and obligations under this Agreement to any successor to all or substantially all of its assets or business by means of liquidation, dissolution, merger, consolidation, transfer of assets or otherwise.

15. Severability. If any provision of this Agreement or application thereof to anyone or under any circumstances is adjudicated to be invalid or unenforceable in any jurisdiction, such invalidity or unenforceability shall not affect any other provision or application of this Agreement which can be given effect without the invalid or unenforceable provision or application and shall not invalidate or render unenforceable such provision or application in any other jurisdiction. If any provision is held void, invalid or unenforceable with respect to particular circumstances, it shall nevertheless remain in full force and effect in all other circumstances. In addition, if any court determines that any part of Sections 5, 6 or 7 hereof is unenforceable because of its duration, geographical scope or otherwise, such court will have the power to modify such provision and, in its modified form, such provision will then be enforceable.

16. Remedies.

16.1. No remedy conferred upon a party by this Agreement is intended to be exclusive of any other remedy, and each and every such remedy shall be cumulative and shall be in addition to any other remedy given under this Agreement or now or hereafter existing at law or in equity.

16.2. No delay or omission by a party in exercising any right, remedy or power under this Agreement or existing at law or in equity shall be construed as a waiver thereof, and any such right, remedy or power may be exercised by such party from time to time and as often as may be deemed expedient or necessary by such party in its sole discretion.

16.3. Executive acknowledges that money damages would not be a sufficient remedy for any breach of this Agreement by Executive and that the Company shall be entitled to specific performance and injunctive relief as remedies for any such breach, in addition to all other remedies available at law or equity to the Company.

17. Construction. This Agreement is the result of thoughtful negotiations and reflects an arms' length bargain between two sophisticated parties, each represented by counsel. The parties agree that, if this Agreement requires interpretation, neither party should be considered "the drafter" nor be entitled to any presumption that ambiguities are to be resolved in his or her favor.

18. Beneficiaries/References. Executive shall be entitled, to the extent permitted under any applicable law, to select and change a beneficiary or beneficiaries to receive any compensation or benefit payable under this Agreement following Executive's death by giving the Company written notice thereof. In the event of Executive's death or a judicial determination of Executive's incompetence, reference in this Agreement to Executive shall be deemed, where appropriate, to refer to Executive's beneficiary, estate or other legal representative.

19. Withholding. All payments under this Agreement shall be made subject to applicable tax withholding, and the Company shall withhold from any payments under this Agreement all federal, state and local taxes, as the Company is required to withhold pursuant to any law or governmental rule or regulation. Except as specifically provided otherwise in this Agreement, Executive shall bear all expense of, and be solely responsible for, all federal, state and local taxes due with respect to any payment received under this Agreement.

20. Regulatory Compliance. The terms and provisions hereof shall be conditioned on and subject to compliance with all laws, rules, and regulations of all jurisdictions, or agencies, boards or commissions thereof, having regulatory jurisdiction over the employment or activities of Executive hereunder.

IN WITNESS WHEREOF, the undersigned, intending to be legally bound, have executed this Agreement as of the date first above written.

PENN NATIONAL GAMING, INC.

By: /s/ Robert S. Ippolito

Name:

Robert  
Ippolito

Title: Vice President, Secretary &  
Treasurer

EXECUTIVE

/s/ Peter M. Carlino

Peter M. Carlino

**EMPLOYMENT AGREEMENT**

This EMPLOYMENT AGREEMENT (the "Agreement") is entered into as of this 26<sup>th</sup> day of May, 2004 (the "Commencement Date") by and between Penn National Gaming, Inc., a Pennsylvania corporation (the "Company"), and Kevin G. DeSanctis, an individual residing in Pennsylvania ("Executive").

WHEREAS, Executive and the Company are party to a certain Employment Agreement, dated as of February 15, 2001 (as amended from time to time, the "Initial Agreement") which, by agreement among the parties has been extended pending completion of this Agreement; and

WHEREAS, the parties now desire to terminate the Initial Agreement and to enter into a new agreement reflecting, among other things, certain additional covenants and consideration exchanged by the parties, all as more specifically set forth herein.

NOW, THEREFORE, the parties hereto, intending to be legally bound, hereby agree as follows:

1. **Employment.** The Company hereby agrees to employ Executive and Executive hereby accepts such employment, in accordance with the terms, conditions and provisions hereinafter set forth.

1.1. **Duties and Responsibilities.** Executive shall serve as President and Chief Operating Officer of the Company. Executive shall perform all duties and accept all responsibilities incident to such position as may be reasonably assigned to him by the Chief Executive Officer and the Board of Directors of the Company (the "Board"). Executive's principal place of employment shall be in Wyomissing, Pennsylvania.

1.2. **Term.** The term of this Agreement shall begin on the date hereof and shall terminate at the close of business on the third anniversary of the Commencement Date (the "Initial Term"), unless earlier terminated in accordance with Section 3 hereof. This Agreement shall automatically renew for additional three-year periods (each, a "Renewal Term" and, together with the Initial Term, the "Employment Term") unless either party has delivered written notice of non-renewal at least 60 days prior to the start of a Renewal Term or unless earlier terminated in accordance with Section 3 hereof.

1.3. **Extent of Service.** Executive agrees to use Executive's best efforts to carry out Executive's duties and responsibilities and, consistent with the other provisions of this Agreement, to devote substantially all of Executive's business time, attention and energy thereto. The foregoing shall not be construed as preventing Executive from serving on the board of philanthropic organizations, or providing oversight with respect to his personal investments, so long as such service does not materially interfere with Executive's duties hereunder.

2. **Compensation.** For all services rendered by Executive to the Company, the Company shall compensate Executive as set forth below.

2.1. **Base Salary.** The Company shall pay Executive a base salary ("Base Salary"), commencing on the Commencement Date, at the annual rate of seven hundred twenty-eight

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thousand (\$728,000), payable in installments at such times as the Company customarily pays its other senior executives ("Peer Executives"). Executive's performance and Base Salary shall be reviewed annually. Any increase in Base Salary or other compensation shall be made at the discretion of the compensation committee of the Board (the "Compensation Committee").

2.2. **Cash Bonuses.** Executive shall participate in the Company's incentive compensation plan for senior management as such may be adopted, amended and approved, from time to time, by the Compensation Committee.

2.3. **Equity Compensation.** The Company may grant to Executive options or other equity compensation pursuant to, and subject to the terms and conditions of, the then current equity compensation plan of Penn National Gaming, Inc. The Compensation Committee shall set the amount and terms of such options or other equity compensation.

2.4. **Other Benefits.** Executive shall be entitled to participate in all other employee benefit plans and programs, including, without limitation, health, vacation, retirement, deferred compensation or SERP, made available to other Peer Executives, as such plans and programs may be in effect from time to time and subject to the eligibility requirements of the each plan. Nothing in this Agreement shall prevent the Company from amending or terminating any retirement, welfare or other employee benefit plans or programs from time to time, as the Company deems appropriate.

2.5. **Vacation, Sick Leave and Holidays.** Executive shall be entitled in each calendar year to four (4) weeks of paid vacation time. Each vacation shall be taken by Executive at such time or times as agreed upon by the Company and Executive, and any portion of Executive's allowable vacation time not used during the calendar year shall be subject to the Company's payroll policies regarding carryover vacation. Executive shall be entitled to holiday and sick leave in accordance with the Company's holiday and other pay for time not worked policies.

2.6. **Reimbursement of Expenses.** Executive shall be provided with reimbursement of reasonable expenses related to Executive's employment by the Company on a basis no less favorable than that authorized from time to time for Peer Executives.

2.7. **Automobile.** During the term of this Agreement, the Company shall provide Executive with an automobile of such make and model consistent with the Company's policy for its provision of automobiles to Peer Executives. The Company shall reimburse Executive for all expenses arising from or related to the maintenance, repair and daily operation of such automobile in carrying out Executive's duties hereunder, including but not limited to, fuel, service and insurance costs, provided that Executive presents vouchers evidencing such expenses as required by the Company.

2.8. **Perquisites.** The Company shall maintain life insurance on the life of Executive in the amount of \$5,000,000, to the extent it can be issued at standard rates, and Executive may name the beneficiary of such policy.

3. **Termination.** Executive's employment may be terminated prior to the end of the Employment Term in accordance with, and subject to the terms and conditions, set forth below.

3.1. Termination by the Company.

(a) Without Cause. The Company may terminate Executive at any time without Cause (as such term is defined in subsection (b) below) upon delivery of written notice to Executive, which notice shall set forth the effective date of such termination.

(b) With Cause. The Company may terminate Executive at any time for Cause effective immediately upon delivery of written notice to Executive. As used herein, the term "Cause" shall mean:

- (i) Executive shall have been convicted of a felony or any misdemeanor involving allegations of fraud, theft, perjury or conspiracy;
- (ii) Executive is found disqualified or not suitable to hold a casino or other gaming license by a governmental gaming authority in any jurisdiction where Executive is required to be found qualified, suitable or licensed;
- (iii) Executive materially breaches any material Company policy or any material term hereof, including, without limitation, Sections 4 through 7 and, in each case, fails to cure such breach within 15 days after receipt of written notice thereof; or
- (iv) Executive misappropriates corporate funds as determined in good faith by the Board.

3.2. Termination by the Executive. Executive may voluntarily terminate employment for any reason effective upon 60 days' prior written notice to the Company, unless the Company waives such notice requirement (in which case the Company shall notify Executive in writing as to the effective date of termination). The Company and Executive, however, recognize and agree that they mutually agreed upon the term of this Agreement and that Executive is expected to complete fully the Employment Term.

3.3. Termination for Death or Disability. In the event of the death or total disability of Executive, this Agreement shall terminate effective as of the date of Executive's death or total disability. The term "total disability" shall have the definition set forth in the Company's Long Term Disability Insurance Policy in effect at the time of such determination.

3.4. Payments Due Upon Termination.

(a) Generally. Upon any termination described in Sections 3.1, 3.2 or 3.3 above, Executive shall be entitled to receive any amounts due for Base Salary earned or expenses incurred through the effective date of termination and any benefits accrued or earned on or prior to such date in accordance with the terms of any applicable benefit plans and programs.

(b) Certain Circumstances. In the event the Company terminates Executive's employment without Cause or due to a total disability or in the event that the Company elects not to renew this Agreement, and subject to Executive executing the release attached hereto as Exhibit A, Executive shall be entitled to receive the following in lieu of any other severance:

(i) Executive shall receive a payment equal to Executive's monthly Base Salary at the highest rate in effect for Executive during the 24-month period immediately preceding the effective date of termination and Executive's monthly bonus value (determined by dividing the highest amount of annual cash bonus compensation paid to Executive in respect of either the first or second full calendar year immediately preceding the effective date of termination by twelve) for a period equal to the greater of (1) the number of months remaining in the Employment Term or (2) 24 months (the "Severance Period").

(ii) Executive shall continue to receive the health benefits coverage in effect on the effective date of termination (or as the same may be changed from time to time for Peer Executives) for Executive and, if any, Executive's spouse and dependents for the Severance Period. At the option of the Company, the Company may elect to pay Executive cash in lieu of such coverage in an amount equal to Executive's after-tax cost of obtaining generally comparable coverage for such period.

(iii) Executive shall continue to serve as a non-officer employee of the Company during the Severance Period and, as such, all options granted to Executive shall continue vesting for such period.

(c) Payments. Cash Payments due under this Section 3.4 shall be made as follows: 75% shall be made within 15 days of the effective date of termination and the balance shall be made in accordance with the payroll practices in effect on the date of termination, unless, at the Company's sole option, the Company elects to make all such payments in a single lump sum. Except as otherwise provided in this Section 3.4, Section 8 or Section 9, no other payments or benefits shall be due under this Agreement to Executive.

3.5. Notice of Termination. Any termination of Executive's employment shall be communicated by a written notice of termination delivered within the time period specified in this Section 3. The notice of termination shall (i) indicate the specific termination provision in this Agreement relied upon, (ii) briefly summarize the facts and circumstances deemed to provide a basis for a termination of employment and the applicable provision hereof, and (iii) specify the termination date in accordance with the requirements of this Agreement.

4. No Conflicts of Interest. Executive agrees that throughout the period of Executive's employment hereunder or otherwise, Executive will not perform any activities or services, or accept other employment that would materially interfere with or present a conflict of interest concerning Executive's employment with the Company. Executive agrees and acknowledges that Executive's employment by the Company is conditioned upon Executive adhering to and complying with the business practices and requirements of ethical conduct set forth in writing from time to time by the Company in its employee

manual or similar publication. Executive represents and warrants that no other contract, agreement or understanding to which Executive is a party or may be subject will be violated by the execution of this Agreement by Executive.

5. Confidentiality. Executive recognizes and acknowledges that Executive will have access to certain confidential information of the Company and that such information constitutes valuable, special and unique property of the Company (including, but not limited to, information

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such as business strategies, identity of acquisition or growth targets, marketing plans, customer lists, and other business related information for the Company's customers). Executive agrees that Executive will not, for any reason or purpose whatsoever, during or after the term of employment, disclose any of such confidential information to any party, and that Executive will keep inviolate and secret all confidential information or knowledge which Executive has access to by virtue of Executive's employment with the Company, except as otherwise may be necessary in the ordinary course of performing Executive's duties with the Company.

6. Non-Competition.

(a) As used herein, the term "Restriction Period" shall mean a period equal to the greater of (i) the remainder of the Employment Term in effect on the effective date of termination and (ii) the Severance Period, if applicable; provided, however, that, if on or before the Trigger Date, Executive has been terminated for one of the reasons contemplated by Section 3.4(b), Executive may elect to terminate the Restriction Period at any time following the first anniversary of the effective date of termination by delivering written notice to the Company that Executive has made such election and that, in consideration therefore, is waiving the right to receive any continued payments under Section 3.4(b).

(b) During Executive's employment by the Company and for the duration of the Restriction Period thereafter, Executive shall not, except with the prior written consent of the Company, directly or indirectly, own, manage, operate, join, control, finance or participate in the ownership, management, operation, control or financing of, or be connected as an officer, director, employee, partner, principal, agent, representative, consultant or otherwise with, or use or permit Executive's name to be used in connection with, any business or enterprise which owns or operates a gaming or pari-mutuel facility located within 150 miles of any gaming or pari-mutuel facility owned or operated by the Company or any of its affiliates.

(c) The foregoing restrictions shall not be construed to prohibit Executive's ownership of less than 5% of any class of securities of any corporation which is engaged in any of the foregoing businesses and has a class of securities registered pursuant to the Securities Exchange Act of 1934, provided that such ownership represents a passive investment and that neither Executive nor any group of persons including Executive in any way, either directly or indirectly, manages or exercises control of any such corporation, guarantees any of its financial obligations, otherwise takes any part in its business, other than exercising Executive's rights as a shareholder, or seeks to do any of the foregoing.

(d) Executive acknowledges that the covenants contained in Sections 5 through 7 hereof are reasonable and necessary to protect the legitimate interests of the Company and its affiliates and, in particular, that the duration and geographic scope of such covenants are reasonable given the nature of this Agreement and the position that Executive will hold within the Company. Executive further agrees to disclose the existence and terms of such covenants to any employer that Executive works for during the Restriction Period.

7. Non-Solicitation. During Executive's employment by the Company and for a period equal to the greater of the Restriction Period or one year after the effective date of termination, Executive will not, except with the prior written consent of the Company, (i) directly or

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indirectly, solicit or hire, or encourage the solicitation or hiring of, any person who is, or was within a six month period prior to such solicitation or hiring, an executive or management employee of the Company or any of its affiliates for any position as an employee, independent contractor, consultant or otherwise or (ii) divert or attempt to divert any existing business of the Company or any of its affiliates.

8. Change of Control.

8.1. Consideration

(a) Change of Control. In the event of a Change of Control (as defined below), Executive shall be entitled to receive a cash payment in an amount equal to the product of three times the sum of (i) the highest annual rate of Base Salary in effect for Executive during the 24-month period immediately preceding the effective date of the Change in Control (the "Trigger Date") and (ii) the highest amount of annual cash bonus compensation paid to Executive in respect of either the first or second full calendar year immediately preceding the Trigger Date.

(b) Restrictive Provisions. As consideration for the foregoing payments, Executive agrees not to challenge the enforceability of any of the restrictions contained in Sections 5, 6 or 7 of this Agreement upon or after the occurrence of a Change of Control. Executive and Company acknowledge that, as additional consideration for the change of control payments, Executive has also agreed to limit Executive's ability to opt out of the Restriction Period in Section 6(a) to periods prior to the Trigger Date.

8.2. Payment Terms. This change of control payment shall be made in two lump sum payments as follows: (i) 75% to Executive on the Trigger Date; and (ii) 25% into a mutually acceptable escrow account on the Trigger Date, payable to Executive on the 90<sup>th</sup> day following the Trigger Date. Notwithstanding any of the foregoing to the contrary, the payment contemplated by clause (ii) shall be paid immediately upon the occurrence of any of the following: (a) Executive's employment is terminated by the Company; or (b) Executive terminates employment for Good Reason (as defined below).

8.3. Certain Other Terms. In the event payments are being made to Executive under this Section 8, no payments shall be due under Section 3.4(b)(i) of this Agreement with respect to any termination of Executive's employment following a Change of Control. At the option of the Company, the Company may require Executive to execute the release attached hereto as Exhibit A; provided, however, that this requirement shall not in any way alter the timing of the payments to be made under Section 8.2. The provisions of this Section 8 shall continue to apply to Executive if, during the 24-month period immediately preceding the Trigger Date, the Company terminates Executive's employment without Cause or due to a total disability or the

8.4. Defined Terms.

(a) Change of Control. The occurrence of one or more of the following events: (i) any sale, lease, exchange or other transfer (in one transaction or a series of related transactions) of all or substantially all of the assets of the Company; (ii) the election of two (2) or more persons to the Board who do not constitute Continuing Directors; or (iii) the ownership or acquisition by any Person or Group of the power, directly or indirectly, to vote or direct the voting of securities having more than forty percent (40%) of the ordinary voting power for the election of directors of the Company.

(b) Good Reason. The occurrence of any of the following events that the Company fails to cure within 10 days after receiving written notice thereof from Executive: (i) assignment to Executive of any duties inconsistent in any material respect with Executive's position (including status, offices, titles and reporting requirements), authority, duties or responsibilities or inconsistent with Executive's legal or fiduciary obligations; (ii) any reduction in Executive's compensation or substantial reduction in Executive's benefits taken as a whole; (iii) any travel requirements materially greater than Executive's travel requirements prior to the Change of Control; or (iv) breach of any material term of this Agreement by the Company.

(c) Continuing Directors. Any person who, as of the date of determination, either (i) was a member of the Board as of the date of this Agreement or (ii) was nominated for election or elected to the Board with the affirmative vote of a majority of directors comprising the Board or, if applicable, the Nominating Committee of the Board, who were Continuing Directors immediately prior to such nomination or election.

(d) Group. Any group of related Persons for purposes of Section 13(d) of the Securities Exchange Act of 1934, as amended.

(e) Person. Any individual, partnership, joint venture, trust, corporation, limited liability entity, unincorporated organization or other entity (including a governmental entity).

9. Certain Tax Matters.

9.1. Generally. In the event Executive becomes entitled to receive the payments (the "Severance Payments") provided under Section 3 or Section 8 hereof or under any other plan or arrangement providing for payments under circumstances similar to those contemplated by such sections, and if any of the Severance Payments will be subject to the tax (the "Excise Tax") imposed by Section 4999 of the Internal Revenue Code of 1986, as amended (the "Code"), the Company shall pay to Executive at the time specified for such payments, an additional amount (the "Gross-Up Payment") such that the net amount retained by Executive shall be equal to the amount of the Severance Payments after deducting normal and ordinary taxes but not deducting (a) the Excise Tax and (b) any federal, state and local income tax and Excise Tax payable on the payment provided for by this Section 9.

9.2. Illustration. For example, if the Severance Payments are \$1,000,000 and if Executive is subject to the Excise Tax, then the Gross-Up Payment will be such that Executive will retain an amount of \$1,000,000 less only any normal and ordinary taxes on such amount.

The Excise Tax and federal, state and local taxes and any Excise Tax on the payment provided by this Section 9 will not be deemed normal and ordinary taxes.

9.3. Certain Terms. For purposes of determining whether any of the Severance Payments will be subject to the Excise Tax and the amount of such Excise Tax, the following will apply:

(a) Any other payments or benefits received or to be received by Executive in connection with a Change in Control of the Company or Executive's termination of employment (whether pursuant to the terms of this Agreement or any other plan, arrangement or agreement with the Company shall be treated as "parachute payments" within the meaning of Section 280G(b)(2) of the Code, and all "excess parachute payments" within the meaning of Section 280G(b)(1) shall be treated as subject to the Excise Tax, unless in the opinion of tax counsel selected by the Company's Compensation Committee and acceptable to Executive, such other payments or benefits (in whole or in part) do not constitute parachute payments, or such excess parachute payments (in whole or in part) represent reasonable compensation for services actually rendered within the meaning of Section 280G(b)(4) of the Code in excess of the base amount within the meaning of Section 280G(b)(3) of the Code, or are otherwise not subject to the Excise Tax;

(b) The amount of the Severance Payments which shall be treated as subject to the Excise Tax shall be equal to the lesser of (y) the total amount of the Severance Payments or (z) the amount of excess parachute payments within the meaning of Section 280G(b)(1) (after applying clause (a), above); and

(c) The value of any non-cash benefits or any deferred payment or benefit shall be determined by the Company's independent auditors in accordance with proposed, temporary or final regulations under Sections 280G(d)(3) and (4) of the Code or, in the absence of such regulations, in accordance with the principles of Section 280G(d)(3) and (4) of the Code. For purposes of determining the amount of the Gross-Up Payment, Executive shall be deemed to pay Federal income taxes at the highest marginal rate of federal income taxation in the calendar year in which the Gross-Up Payment is to be made and state and local income taxes at the highest marginal rate of taxation in the state and locality of Executive on the Trigger Date, net of the maximum reduction in Federal income taxes which could be obtained from deduction of such state and local taxes. In the event that the amount of Excise Tax attributable to Severance Payments is subsequently determined to be less than the amount taken into account hereunder at the time of determination then, subject to applicable law, appropriate adjustments will be made with respect to the payments hereunder.

9.4. Fees and Expenses. The Company shall reimburse Executive for all reasonable legal fees and expenses incurred by Executive in connection with any tax audit or proceeding to the extent attributable to the application of Section 4999 of the Code or any regulations pertaining thereto to any payment or benefit provided hereunder.

10. Document Surrender. Upon the termination of Executive's employment for any reason, Executive shall immediately surrender and deliver to the Company all documents, correspondence and any other information, of any type whatsoever, from the Company or any of

its agents, servants, employees, suppliers, and existing or potential customers, that came into Executive's possession by any means whatsoever, during the course of employment.

11. Governing Law. This Agreement shall be governed by and construed in accordance with the internal laws (and not the law of conflicts) of the Commonwealth of Pennsylvania.

12. Jurisdiction. The parties hereby irrevocably consent to the jurisdiction of the courts of the Commonwealth of Pennsylvania for all purposes in connection with any action or proceeding which arises out of or relates to this Agreement and agree that any action instituted under this Agreement shall be commenced, prosecuted and continued only in the state or federal courts having jurisdiction for matters arising in Wyomissing, Pennsylvania, which shall be the exclusive and only proper forum for adjudicating such a claim.

13. Notices. All notices and other communications required or permitted under this Agreement or necessary or convenient in connection herewith shall be in writing and shall be deemed to have been given when hand delivered, delivered by guaranteed next-day delivery or sent by facsimile (with confirmation of transmission) or shall be deemed given on the third business day when mailed by registered or certified mail, as follows (provided that notice of change of address shall be deemed given only when received):

If to the Company, to:

Penn National Gaming, Inc.  
825 Berkshire Boulevard, Suite 200  
Wyomissing, PA 19610  
Fax: (610) 376-2842

Attention: Chairman

If to Executive, to:

Kevin G. DeSanctis  
c/o Penn National Gaming, Inc.  
825 Berkshire Boulevard, Suite 200  
Wyomissing, PA 19610  
Fax: (610) 376-2842

or to such other names or addresses as the Company or Executive, as the case may be, shall designate by notice to each other person entitled to receive notices in the manner specified in this Section.

14. Contents of Agreement; Amendment and Assignment.

14.1. This Agreement sets forth the entire understanding between the parties hereto with respect to the subject matter hereof and supersedes all prior or contemporaneous agreements or understandings with respect to thereto, including without limitation, the Initial Agreement which is hereby terminated. This Agreement cannot be changed, modified, extended, waived or

terminated except upon a written instrument signed by the party against which it is to be enforced.

14.2. Executive may not assign any of his rights or obligations under this Agreement. The Company may assign its rights and obligations under this Agreement to any successor to all or substantially all of its assets or business by means of liquidation, dissolution, merger, consolidation, transfer of assets or otherwise.

15. Severability. If any provision of this Agreement or application thereof to anyone or under any circumstances is adjudicated to be invalid or unenforceable in any jurisdiction, such invalidity or unenforceability shall not affect any other provision or application of this Agreement which can be given effect without the invalid or unenforceable provision or application and shall not invalidate or render unenforceable such provision or application in any other jurisdiction. If any provision is held void, invalid or unenforceable with respect to particular circumstances, it shall nevertheless remain in full force and effect in all other circumstances. In addition, if any court determines that any part of Sections 5, 6 or 7 hereof is unenforceable because of its duration, geographical scope or otherwise, such court will have the power to modify such provision and, in its modified form, such provision will then be enforceable.

16. Remedies.

16.1. No remedy conferred upon a party by this Agreement is intended to be exclusive of any other remedy, and each and every such remedy shall be cumulative and shall be in addition to any other remedy given under this Agreement or now or hereafter existing at law or in equity.

16.2. No delay or omission by a party in exercising any right, remedy or power under this Agreement or existing at law or in equity shall be construed as a waiver thereof, and any such right, remedy or power may be exercised by such party from time to time and as often as may be deemed expedient or necessary by such party in its sole discretion.



16.3. Executive acknowledges that money damages would not be a sufficient remedy for any breach of this Agreement by Executive and that the Company shall be entitled to specific performance and injunctive relief as remedies for any such breach, in addition to all other remedies available at law or equity to the Company.

17. Construction. This Agreement is the result of thoughtful negotiations and reflects an arms' length bargain between two sophisticated parties, each represented by counsel. The parties agree that, if this Agreement requires interpretation, neither party should be considered "the drafter" nor be entitled to any presumption that ambiguities are to be resolved in his or her favor.

18. Beneficiaries/References. Executive shall be entitled, to the extent permitted under any applicable law, to select and change a beneficiary or beneficiaries to receive any compensation or benefit payable under this Agreement following Executive's death by giving the Company written notice thereof. In the event of Executive's death or a judicial determination of Executive's incompetence, reference in this Agreement to Executive shall be deemed, where appropriate, to refer to Executive's beneficiary, estate or other legal representative.

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19. Withholding. All payments under this Agreement shall be made subject to applicable tax withholding, and the Company shall withhold from any payments under this Agreement all federal, state and local taxes, as the Company is required to withhold pursuant to any law or governmental rule or regulation. Except as specifically provided otherwise in this Agreement, Executive shall bear all expense of, and be solely responsible for, all federal, state and local taxes due with respect to any payment received under this Agreement.

20. Regulatory Compliance. The terms and provisions hereof shall be conditioned on and subject to compliance with all laws, rules, and regulations of all jurisdictions, or agencies, boards or commissions thereof, having regulatory jurisdiction over the employment or activities of Executive hereunder.

IN WITNESS WHEREOF, the undersigned, intending to be legally bound, have executed this Agreement as of the date first above written.

PENN NATIONAL GAMING, INC.

By: /s/ Peter M. Carlino  
Name: Peter M. Carlino  
Title: Chairman and Chief Executive  
Officer

EXECUTIVE

/s/ Kevin DeSanctis  
Kevin G. DeSanctis

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**AGREEMENT**

For good and valuable consideration, the **LIVE RACING AGREEMENT** (the "Agreement") effective March 23, 1999 through January 1, 2004 by and among **PENN NATIONAL TURF CLUB, INC.**, **MOUNTAINVIEW THOROUGHBRED RACING ASSOCIATION**, the **PENNSYLVANIA HORSEMEN'S BENEVOLENT AND PROTECTIVE ASSOCIATION, INC.** ("Horsemen"), and all of its terms and conditions are hereby extended by the mutual consent of all parties through 11:59 p.m. on 8/31/04. In the interim, the parties further agree to discuss in good faith the structure, quantity and repayment terms for a proposed advance of purse money to the Horsemen, as well as all other items pertaining to a new Live Racing Agreement.

To indicate their acceptance of this extension of the Agreement, the duly authorized agents of the parties have executed below.

**PENNSYLVANIA NATIONAL TURF CLUB, INC.**

By: /s/ Richard T. Schnaars  
 Name: Richard T. Schnaars  
 Title: Vice Pres./Gen. Mgr.  
 Dated: 7/30/04

**MOUNTAINVIEW THOROUGHBRED RACING ASSOCIATION**

By: /s/ Richard T. Schnaars  
 Name: Richard T. Schnaars  
 Title: Vice Pres./Gen. Mgr.  
 Dated: 7/30/04

**PENNSYLVANIA HORSEMEN'S BENEVOLENT AND PROTECTIVE ASSOCIATION, INC.**

By: /s/ John J. Wanes  
 Name: John J. Wanes  
 Title: President  
 Dated: \_\_\_\_\_

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**AMENDMENT NO. 1 TO  
CREDIT AGREEMENT**

This AMENDMENT NO. 1 (this "Amendment") dated as of June 9, 2004, to the CREDIT AGREEMENT dated as of March 3, 2003, as amended and restated as of December 5, 2003 (the "Credit Agreement") among PENN NATIONAL GAMING, INC. as Borrower; the Subsidiary Guarantors party hereto; the Lenders party hereto; BEAR, STEARNS & CO. INC. and MERRILL LYNCH, PIERCE, FENNER & SMITH INCORPORATED, as original joint lead arrangers and original joint bookrunners (in such capacities, together with their successors in such capacities, "Original Lead Arrangers"); MERRILL LYNCH, PIERCE, FENNER & SMITH INCORPORATED, as syndication agent (in such capacity, together with its successors in such capacity, "Syndication Agent"); BEAR, STEARNS & CO. INC., as sole lead arranger and sole bookrunner in connection with the Term D Loan Facility and the amendment and restatement of the original credit agreement (the "New Lead Arranger"; together with the Original Lead Arrangers, the "Lead Arrangers"); BEAR STEARNS CORPORATE LENDING INC., as swingline lender ("Swingline Lender"), as administrative agent (in such capacity, together with its successors in such capacity, "Administrative Agent") and as collateral agent (in such capacity, together with its successors in such capacity, "Collateral Agent"); and SOCIETE GENERALE and CREDIT LYONNAIS NEW YORK BRANCH, as joint documentation agents (in such capacities, together with their successors in such capacities, "Documentation Agents"). Capitalized terms used and not otherwise defined herein shall have the meanings assigned to them in the Credit Agreement.

RECITALS:

WHEREAS, Borrower requests that certain modifications be made to Sections 2.09, 10.04 and 10.08 of the Credit Agreement.

WHEREAS, pursuant to Section 13.04 of the Credit Agreement, the consent of the Majority Lenders is necessary to effect this Amendment.

NOW, THEREFORE, in consideration of the foregoing, and for other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto hereby agree as follows:

AGREEMENT:

SECTION 1. Amendments.

(a) Section 1.01 of the Credit Agreement shall be amended to include the following definition:

**"Bangor Historic Track Facility"** shall mean the Gaming Facility known as "Bangor Raceway" located in Bangor, Maine.

(b) The first sentence of Section 2.09(b)(iii) of the Credit Agreement is amended to read in its entirety as follows:

"In addition to the foregoing, and *provided* that the Consolidated **Senior** Leverage Ratio is less than 2.25 to 1.00, Borrower shall have the right to elect to make a *pro rata* offer to prepay the Term D Facility Loans then outstanding and apply any amounts not accepted for such prepayment to repurchase Permitted Subordinated Indebtedness and/or Borrower Outstanding Bonds in accordance with Section 10.10(v)."

(c) Section 10.04(p) of the Credit Agreement is amended to delete the following language:

"no more than \$50.0 million of which shall be from the incurrence of Indebtedness, no more than \$50.0 million of which shall be from an Equity Issuance (exclusive of the fees and expenses incurred in connection with the issuance of such Indebtedness or such Equity Issuance)."

(d) Section 10.08(d)(ii) of the Credit Agreement is amended so that clause (A) thereof reads as follows:

"(A) (x) \$90.0 million at the Charles Town Facility *less* Expansion Capital Expenditures totaling \$25.9 million previously incurred since March 3, 2003; *provided, however,* that any Expansion Capital Expenditure at the Charles Town Facility shall not extend past December 31, 2006 and (y) \$75.0 million at the Bangor Historic Track Facility *provided, however,* that any Expansion Capital Expenditure at the Bangor Historic Track Facility shall not extend past December 31, 2005,"

(e) Section 10.10(a)(v) of the Credit Agreement is amended to read in its entirety as follows:

"so long as the Consolidated **Senior** Leverage Ratio is less than 2.25 to 1.00, payment of or repurchase, redemption, retirement, acquisition or cancellation of Borrower's and its Restricted Subsidiaries' Permitted Subordinated Indebtedness and/or Borrower Outstanding Bonds with all or any portion of the amounts by which Borrower offered to prepay the Term D Facility Loans then outstanding in accordance with Section 2.09(b)(iii) but that were declined in accordance with such Section 2.09(b)(iii);"

SECTION 2. Representations and Warranties. The Credit Parties hereby affirm and restate the representations and warranties made by it in the Credit Agreement and confirm that all such representations and warranties are true and correct in all material respects as of the date hereof, after giving effect to the effectiveness of this Amendment, except to the extent that any such representation and warranty specifically relates to an earlier date.

SECTION 3. Miscellaneous.

(a) This Amendment relates only to the specific matters covered herein and shall not constitute a consent to or waiver or modification of any other provision, term or condition of the Credit Agreement.



By:           /s/ Kevin DeSanctis            
Name: Kevin DeSanctis  
Title: President

DEL'S-SEAWAY SHRIMP & OYSTER  
COMPANY, INC.,

By:           /s/ Kevin DeSanctis            
Name: Kevin DeSanctis  
Title: President

PNGI CHARLES TOWN GAMING LIMITED  
LIABILITY COMPANY

By: PENN NATIONAL GAMING OF WEST VIRGINIA,  
INC.,  
Managing Member

By:           /s/ Robert S. Ippolito            
Name: Robert S. Ippolito  
Title: Secretary and Treasurer

PNGI CHARLES TOWN FOOD & BEVERAGE LIMITED  
LIABILITY COMPANY

By:           /s Richard Moore            
Name: Richard Moore  
Title: Manager

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PENN NATIONAL GSFR, LLC

By: PENN NATIONAL GAMING, INC.,  
Sole Member and Manager

By:           /s/ Robert S. Ippolito            
Name: Robert S. Ippolito  
Title: Vice President, Secretary and  
Treasurer

PENN NATIONAL SPEEDWAY, INC.

By:           /s/ Richard J. Carlino            
Name: Richard J. Carlino  
Title: Chief Executive Officer

W-B DOWNS, INC.

By:           /s/ William J. Clifford            
Name: William J. Clifford  
Title: President

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WILKES BARRE DOWNS, INC.

By:           /s/ William J. Clifford            
Name: William J. Clifford  
Title: President

By: /S/ Robert S. Ippolito  
Name: Robert S. Ippolito  
Title: Treasurer

On behalf of the Subsidiary Guarantors listed below:

BSL, INC.  
BTN, INC.  
CHC CASINOS CORP.  
CRC HOLDINGS, INC.  
THE DOWNS RACING, INC.  
EBETUSA.COM, INC.  
HOLLYWOOD CASINO CORPORATION  
HOLLYWOOD MANAGEMENT, INC.  
HWCC DEVELOPMENT CORPORATION  
HWCC-HOLDINGS, INC.  
HWCC-GOLF COURSE PARTNERS, INC.  
HWCC-TRANSPORTATION, INC.  
HWCC-TUNICA, INC.  
LOUISIANA CASINO CRUISES, INC.  
MILL CREEK LAND, INC.  
MOUNTAINVIEW THOROUGHBRED  
RACING ASSOCIATION  
NORTHEAST CONCESSIONS, INC.  
PNGI POCONO, INC.  
PENN BULLPEN, INC.  
PENN BULLWHACKERS, INC.  
PENN MILLSITE, INC.  
PENN NATIONAL GAMING OF  
WEST VIRGINIA, INC.  
PENN NATIONAL HOLDING COMPANY  
PENN SILVER HAWK, INC.  
PENNSYLVANIA NATIONAL TURF  
CLUB, INC.  
STERLING AVIATION, INC.

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BEAR, STEARNS & CO. INC.,  
as Original Joint Lead Arranger and Original Joint  
Bookrunner

By: /s/ Keith C. Barnish  
Name: Keith C. Barnish  
Title: Senior Managing Director

BEAR, STEARNS & CO. INC.,  
as Sole Lead Arranger and Sole Bookrunner for the  
Term D Loan Facility and the Amendment and  
Restatement

By: /s/ Keith C. Barnish  
Name: Keith C. Barnish  
Title: Senior Managing Director

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MERRILL LYNCH, PIERCE, FENNER & SMITH  
INCORPORATED,  
as Original Joint Lead Arranger, Original Joint  
Bookrunner and Syndication Agent

By: /s/ Michael E. O'Brien  
Name: Michael E. O'Brien  
Title: Director

Address for Notices:

Merrill Lynch, Pierce Fenner & Smith  
Incorporated  
4 World Financial Center  
250 Vesey Street  
New York, New York 10080  
Attention: Michael O'Brien

Telecopier No.: (212) 449-4877  
Telephone No.: (212) 449-0948

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BEAR STEARNS CORPORATE LENDING INC.,  
as Administrative Agent, Swingline Lender,  
and Collateral Agent

By: /s/ Victor Bulzacchelli  
Name: Victor Bulzacchelli  
Title: Vice President

Address for Notices:

Bear Stearns Corporate Lending Inc.  
383 Madison Avenue  
New York, New York 10179  
Attention: Stephen O'Keefe

Telecopier No.: (212) 272-9184  
Telephone No.: (212) 272-9430

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SOCIETE GENERALE,  
as Joint Documentation Agent

By: /s/ Carina T. Huynh  
Name: Carina T. Huynh  
Title: Vice President

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CALYON NEW YORK BRANCH,  
as Joint Documentation Agent

By: /s/ Attila Coach  
Name: Attila Coach  
Title: Managing Director

By: /s/ Frank Herrera  
Name: F. Frank Herrera  
Title: Director

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**CERTIFICATION PURSUANT TO RULE 13a-14(a) AND 15d-14(a) OF  
THE SECURITIES EXCHANGE ACT OF 1934**

I, Peter M. Carlino, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Penn National Gaming, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (c) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 9, 2004

/s/ Peter M. Carlino

Peter M. Carlino

Chairman and Chief Executive Officer

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**CERTIFICATION PURSUANT TO RULE 13a-14(a) AND 15d-14(a) OF  
THE SECURITIES EXCHANGE ACT OF 1934**

I, William J. Clifford, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Penn National Gaming, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
  - (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (c) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 9, 2004

/s/ William J. Clifford  
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William J. Clifford  
Senior Vice President-Finance and  
Chief Financial Officer

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**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Penn National Gaming, Inc. (the "Company") on Form 10-Q for the quarter ended June 30, 2004 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Peter M. Carlino, Chairman and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, to the best of my knowledge, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

By: /s/ Peter M. Carlino  
Peter M. Carlino  
Chairman and Chief Executive Officer  
August 9, 2004

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**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Penn National Gaming, Inc. (the "Company") on Form 10-Q for the quarter ended June 30, 2004 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, William J. Clifford, Senior Vice President-Finance and Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, to the best of my knowledge, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

By: /s/ William J. Clifford  
William J. Clifford  
Senior Vice President-Finance and  
Chief Financial Officer  
August 9, 2004

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