INFOSPACE INC
Form 10-Q
August 04, 2006
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended June 30, 2006

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: 0-25131

INFOSPACE, INC.

(Exact name of registrant as specified in its charter)

Delaware **(State or other jurisdiction of** **incorporation or organization)**	**91-1718107** **(I.R.S. Employer** **Identification No.)**
601 108th Avenue NE, Suite 1200 **Bellevue, Washington** **(Address of principal executive offices)**	**98004** **(Zip Code)**

Registrant s telephone number, including area code: (425) 201-6100

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. x Yes ¨ No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check One):

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨

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

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

Class	Outstanding at August 1, 2006
Common Stock, Par Value $.0001	31,321,968

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Item 1. Financial Statements

INFOSPACE, INC.

UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS

(amounts in thousands, except share data)

	June 30, 2006	December 31, 2005
ASSETS		
Current assets:		
Cash and cash equivalents	$ 182,701	$ 153,013
Short-term investments, available-for-sale	222,612	222,360
Accounts receivable, net of allowance of $1,252 and $1,507	64,555	71,661
Other receivables	3,564	3,972
Prepaid expenses and other current assets	10,397	12,639
Total current assets	483,829	463,645
Property and equipment, net	28,512	26,889
Long-term investments, available-for-sale	1,712	
Goodwill	171,948	176,979
Other intangible assets, net	36,761	44,080
Deferred tax assets, net	22,235	25,000
Other long-term assets	9,101	6,786
Total assets	$ 754,098	$ 743,379
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 9,391	$ 11,585
Accrued expenses and other current liabilities	52,818	51,917
Short-term deferred revenue	2,991	2,474
Total current liabilities	65,200	65,976
Long-term liabilities:		
Other liabilities and deferred revenue	1,722	2,011
Deferred tax liabilities	5,390	10,421
Total long-term liabilities	7,112	12,432
Total liabilities	72,312	78,408
Commitments and contingencies (Note 4)		
Stockholders equity:		
Common stock, par value $.0001 authorized, 900,000,000 shares; issued and outstanding, 31,272,287 and 31,018,795 shares	3	3
Additional paid-in capital	1,697,365	1,684,974
Accumulated deficit	(1,016,501)	(1,020,525)
Accumulated other comprehensive income	919	519
Total stockholders equity	681,786	664,971
Total liabilities and stockholders equity	$ 754,098	$ 743,379

See accompanying notes to unaudited Condensed Consolidated Financial Statements.

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INFOSPACE, INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(amounts in thousands, except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	**2005**	**2006**	**2005**
Revenues	$ 95,846	$ 83,181	$ 186,120	$ 170,203
Operating expenses:				
Content and distribution	46,121	34,864	87,733	69,694
Systems and network operations	7,880	4,899	14,988	9,312
Product development	12,467	7,596	21,775	14,967
Sales and marketing	12,567	7,030	22,130	14,902
General and administrative	12,547	9,729	26,633	20,334
Depreciation	3,457	1,941	6,774	3,715
Amortization of intangible assets	3,611	3,763	7,319	7,846
Total operating expenses	98,650	69,822	187,352	140,770
Operating income (loss)	(2,804)	13,359	(1,232)	29,433
Gain on equity investments, net		154		154
Other income, net	4,723	2,838	8,595	82,992
Income before income taxes	1,919	16,351	7,363	112,579
Provision for income taxes	(900)	(65)	(3,339)	(2,394)
Net income	$ 1,019	$ 16,286	$ 4,024	$ 110,185
Earnings per share Basic	$ 0.03	$ 0.49	$ 0.13	$ 3.33
Earnings per share Diluted	$ 0.03	$ 0.44	$ 0.12	$ 2.98
Weighted average shares outstanding used in computing basic net income per share	31,239	33,108	31,162	33,081
Weighted average shares outstanding used in computing diluted net income per share	32,931	36,720	32,925	37,024
Other comprehensive income:				
Net income	$ 1,019	$ 16,286	$ 4,024	$ 110,185
Foreign currency translation adjustment	153	(282)	227	(580)
Net unrealized gain (loss) on investments	(86)	293	173	(15)
Other comprehensive income	$ 1,086	$ 16,297	$ 4,424	$ 109,590

See accompanying notes to unaudited Condensed Consolidated Financial Statements.

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INFOSPACE, INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(amounts in thousands)

	Six Months Ended June 30, 2006	2005
Operating activities:		
Net income	$ 4,024	$ 110,185
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	14,093	11,561
Stock-based compensation expense	8,744	
Deferred income taxes	2,765	(992)
Bad debt expense	67	318
Net gain on equity investment		(154)
Other	11	(90)
Cash provided (used) by changes in operating assets and liabilities, net of effects of acquisitions:		
Accounts receivable	7,039	(5,038)
Other receivables	408	15,153
Prepaid expenses and other current assets	2,242	(2,380)
Other long-term assets	(2,315)	(1,699)
Accounts payable	(1,701)	(2,463)
Accrued expenses and other current and long-term liabilities	2,524	(743)
Deferred revenue	119	(2,021)
Net cash provided by operating activities	38,020	121,637
Investing activities:		
Business acquisition		(26,364)
Purchases of property and equipment	(10,082)	(8,057)
Proceeds from the sale of assets and equity investments	33	194
Proceeds from sales and maturities of investments	231,263	106,232
Purchases of investments	(233,053)	(117,018)
Net cash used by investing activities	(11,839)	(45,013)
Financing activities:		
Common stock repurchases		(10,101)
Proceeds from exercise of stock options	2,564	6,798
Proceeds from issuance of stock through employee stock purchase plan	943	766
Net cash provided (used) by financing activities	3,507	(2,537)
Net increase in cash and cash equivalents	29,688	74,087
Cash and cash equivalents:		
Beginning of period	153,013	85,245
End of period	$ 182,701	$ 159,332

See accompanying notes to unaudited Condensed Consolidated Financial Statements.

INFOSPACE, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. The Company and Basis of Presentation

InfoSpace, Inc. (the Company or InfoSpace) is a provider and publisher of mobile content, products and services assisting consumers with finding information, personalization and entertainment on the mobile phone. The Company also uses its technology, including metasearch, to power its branded Web sites and provide private-label online search and directory services to its distribution partners.

The accompanying unaudited Condensed Consolidated Financial Statements include all adjustments, consisting of normal recurring adjustments that, in the opinion of management, are necessary to present fairly the financial information set forth herein. Certain information and note disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) have been condensed or omitted pursuant to the rules and regulations of the U.S. Securities and Exchange Commission (the SEC). Results of operations for the three and six months ended June 30, 2006 are not necessarily indicative of future financial results. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual amounts may differ, perhaps materially, from these financial estimates.

Investors should read these interim financial statements and related notes in conjunction with the audited financial statements and related notes included in the Company s Annual Report on Form 10-K for the year ended December 31, 2005.

2. Stock-Based Compensation

On January 1, 2006, the Company adopted Statement of Financial Accounting Standard (SFAS) No. 123(R), *Share-Based Payment*, which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors including stock option grants and purchases of stock made pursuant to the Company s 1998 Employee Stock Purchase Plan (the ESPP) based on estimated fair values. SFAS No. 123(R) supersedes the Company s previous accounting under Accounting Principles Board Opinion (APB) No. 25, *Accounting for Stock Issued to Employees*. In March 2005, the SEC issued Staff Accounting Bulletin (SAB) No. 107, and the Company has applied SAB No. 107 s provisions in its adoption of SFAS No. 123(R).

The Company adopted SFAS No. 123(R) using the modified prospective transition method, which requires the application of the accounting standard as of January 1, 2006. In accordance with the modified prospective transition method, the Company s unaudited Condensed Consolidated Financial Statements for the three and six months ended June 30, 2005 have not been restated to reflect, and do not include, the impact of SFAS No. 123(R).

SFAS No. 123(R) requires companies to estimate the fair value of share-based payment awards on the date of grant using an option-pricing model. The value of the award s portion that is ultimately expected to vest is recognized as expense over the requisite service periods in the accompanying unaudited Condensed Consolidated Financial Statements for the three and six months ended June 30, 2006. Prior to the adoption of SFAS No. 123(R), the Company accounted for share-based awards to employees and directors using the intrinsic value method in accordance with APB No. 25 as allowed under SFAS No. 123, *Accounting for Stock-Based Compensation*. Under the intrinsic value method, share-based compensation expense was only recognized by the Company if the exercise price of the grant was less than the fair market value of the underlying stock at the date of grant. No stock-based compensation expense was recorded by the Company in 2005.

As of June 30, 2006, total unrecognized share-based compensation cost related to unvested stock options was $38.8 million, which is expected to be recognized over a weighted average period of approximately 15 months. The Company has included the following amounts for share-based compensation cost, including the cost related to the ESPP, in the accompanying unaudited Condensed Consolidated Statement of Income for the three and six months ended June 30, 2006, respectively (amounts in thousands):

	Three Months Ended June 30, 2006	Six Months Ended June 30, 2006
Systems and network operations	$ 464	$ 654
Product development	714	1,129
Sales and marketing	1,509	2,551
General and administrative	1,948	4,410
Total	$ 4,635	$ 8,744

Share-based compensation expense recognized during the three and six months ended June 30, 2006 include (1) compensation expense for awards granted prior to, but not yet fully vested as of, January 1, 2006, and (2) compensation expense for the share-based payment awards granted subsequent to December 31, 2005, based on the grant date fair values estimated in accordance with the provisions of SFAS No. 123 and SFAS No. 123(R), respectively. The Company has historically disclosed and currently recognizes share based compensation expense using the accelerated multiple option approach as described in the Financial Accounting Standards Board (FASB) Interpretation (FIN) 28, *Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans an interpretation of APB Opinions No. 15 and 25*. SFAS No. 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. In the Company s pro forma disclosures required under SFAS No. 123 for the periods prior to 2006, the Company accounted for forfeitures as they occurred. The Company has historically and continues to estimate the fair value of share based awards using the Black-Scholes-Merton (Black-Scholes) option-pricing model.

Stock Incentive Plans

1996 Plan: During 2006 and 2005, the Company granted options to purchase common stock under the Restated 1996 Flexible Stock Incentive Program (the 1996 Plan). Options granted from the 1996 Plan typically vest over two, three or four years, a ratable portion vesting one year from the date of grant and ratably thereafter on a semi-annual basis, and expire seven years from the date of grant. Shares underlying options available under the 1996 Plan increase annually on the first day of January by an amount equal to the lesser of (A) five percent of the Company s outstanding shares at the end of the Company s preceding fiscal year, or (B) an amount determined by the Board of Directors. The 1996 Plan limits the number of shares of common stock that may be granted to any one individual pursuant to stock options in any fiscal year of the Company to 800,000 shares, plus an additional 800,000 shares in connection with his or her initial employment with the Company, which grant shall not count against the limit. If an option is surrendered or for any other reason ceases to be exercisable in whole or in part, the shares which were subject to the option but on which the option has not been exercised shall continue to be available under the 1996 Plan.

2001 Plan: In February 2001, the Company implemented the 2001 Nonstatutory Stock Option Plan (the 2001 Plan), under which nonqualified stock options to purchase common stock or shares of restricted stock may be granted to employees. Under the 2001 Plan, 2.5 million shares of common stock are authorized for grant of options or issuance of restricted stock. Options granted under the 2001 Plan before 2006 expire ten years from the date of the grant and vest over two years, with 50% vesting ratably on a monthly basis for the first 24 months and the remaining 50% balance vesting at the end of the two-year period. Options from the 2001 Plan granted during 2006 typically vest over two or three years, a ratable portion vesting one year from the date of grant and ratably thereafter on a semi-annual basis, and expire seven years from the date of grant.

Switchboard Plan: In conjunction with the acquisition of Switchboard Incorporated, the Company initiated the InfoSpace, Inc. Switchboard Incorporated Stock Incentive Plan (the Switchboard Plan), a plan under which incentive options and nonqualified stock options to purchase common stock may be granted to employees of InfoSpace, Inc. Under this plan, options to purchase 480,826 shares of the Company s common stock were reserved for grants. Options under the Switchboard Plan expire six years from the date of the grant. Options under this plan generally vest over four years, 25% one year from date of grant and ratably thereafter on a monthly basis.

Other plans: In addition to the plans described above, the Company has several option plans assumed through acquisitions by InfoSpace and Go2Net, Inc. Options granted under these plans typically vest over a four-year period, 25% one year from the date of grant and ratably thereafter

on a quarterly basis and expire six or ten years from the date of grant.

ESPP: The Company adopted the ESPP in August 1998. The ESPP is intended to qualify under Section 423 of the Code and permits eligible employees of the Company and its subsidiaries to purchase common stock through payroll deductions of up to 15% of their compensation. The ESPP was implemented with six-month offering periods that begin on each February 1

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and August 1. The price of common stock purchased under the ESPP is the lesser of 85% of the fair market value on the first day of an offering period and 85% of the fair market value on the last day of an offering period. The ESPP does not have a fixed expiration date, but may be terminated by the Company s Board of Directors at any time.

A summary of the general terms of options to purchase common stock previously granted under these plans, including options outstanding and available for grant at June 30, 2006, is as follows:

	1996 Plan	2001 Plan	Switchboard Plan	Other Plans
Requisite service period in years	4 or less	3 or less	4	4
Vesting	1st year cliff then ratably thereafter	1st year cliff then ratably thereafter, or 50% ratably over service period then 50% cliff at end of service period	1st year cliff then ratably thereafter	1st year cliff then ratably thereafter
Life in years	7 or 10	7 or 10	6	6 or 10
Options outstanding at 6/30/06	8,812,723	1,188,224	317,400	9,620
Options available for grant at 6/30/06	786,786	618,332	139,551	

Share-Based Compensation Cost under SFAS No. 123

Prior to January 1, 2006, the Company disclosed compensation cost in accordance with SFAS No. 123. The provisions of SFAS No. 123 require the Company to disclose the assumptions used in calculating the fair value pro forma expense. Had compensation expense for the plans been determined based on the fair value of the options at the grant dates for awards under the plans consistent with SFAS No. 123, the Company s net income for the three and six months ended June 30, 2005 would have been as follows (amounts in thousands, except per share data):

	Three Months Ended June 30, 2005	Six Months Ended June 30, 2005
Net income as reported	$ 16,286	$ 110,185
Stock-based compensation, as reported		
Total stock-based compensation determined under fair value based method for all awards	(8,429)	(16,257)
Pro forma net income	$ 7,857	$ 93,928
Basic net income per share, as reported	$ 0.49	$ 3.33
Diluted net income per share, as reported	$ 0.44	$ 2.98
Basic net income per share, SFAS No. 123 adjusted	$ 0.24	$ 2.84
Diluted net income per share, SFAS No. 123 adjusted	$ 0.22	$ 2.61

Pro forma disclosures for the three and six months ended June 30, 2006 are not presented because stock-based compensation is recognized in the unaudited Condensed Consolidated Statement of Income.

To estimate compensation expense which would have been recognized under SFAS No. 123 for the three and six months ended June 30, 2005 and the compensation cost that was recognized under SFAS No. 123(R) for the three and six months ended June 30, 2006, the Company uses the Black-Scholes option-pricing model with the following weighted-average assumptions for equity awards granted:

	Employee Stock Option Plans				Employee Stock Purchase Plan	
	Three Months Ended June 30,		Six Months Ended June 30,		Three and Six Months Ended June 30,	
	2006	2005	2006	2005	2006	2005
Risk-free interest rate	4.78%	3.85%	4.70%	3.86%	4.13%	2.77%
Expected dividend yield	0%	0%	0%	0%	0%	0%
Volatility	61%	66%	63%	66%	35%	58%
Expected life	2.6 years	3.5 years	2.7 years	3.5 years	6 months	6 months

The risk-free interest rate is based on the implied yield available on U.S. Treasury issues with an equivalent remaining term. The Company has not paid dividends in the past and does not plan to pay any dividends in the future. The expected volatility is based on historical volatility of the Company s stock for the related vesting period. The expected life of the equity award is based on historical experience.

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Activity and pricing information regarding all options to purchase shares of common stock are summarized as follows:

	Options	Weighted Average Exercise Price
Outstanding December 31, 2005	8,035,342	$ 29.40
Granted	895,000	25.35
Forfeited	(191,872)	37.24
Exercised	(97,609)	12.86
Outstanding March 31, 2006	8,640,861	$ 28.99
Granted	2,268,650	24.00
Forfeited	(472,650)	27.96
Exercised	(108,894)	12.03
Outstanding June 30, 2006	10,327,967	$ 28.12
Options exercisable, June 30, 2006	5,566,859	$ 31.89

During the three and six months ended June 30, 2006, the total intrinsic value of options exercised to purchase common stock was $1.5 million and $2.6 million, respectively, and the weighted average fair value of options to purchase common stock that were granted was $9.94 per share and $10.44 per share, respectively.

During the three and six months ended June 30, 2006, financing cash generated from share-based compensation arrangements amounted to $1.3 million and $2.6 million, respectively, for the purchase of shares upon exercise of options. During the six months ended June 30, 2006, financing cash generated for the purchase of shares through the ESPP amounted to $943,000. The Company issues new shares upon exercise of options to purchase common stock or purchase through the ESPP.

Additional information regarding options outstanding for all plans as of June 30, 2006, is as follows:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual Life (yrs.)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
$0.25 14.29	1,218,178	5.58	$ 10.08	980,918	$ 9.57
$14.31 21.98	1,267,000	4.89	17.60	702,049	15.71
$22.02 25.75	3,760,225	6.15	24.19	601,513	24.16
$25.80 34.88	1,244,053	5.83	29.54	443,868	32.43
$36.56 675.00	2,838,511	4.71	45.15	2,838,511	45.15
Total	10,327,967		$ 28.15	5,566,859	$ 31.89
Aggregate intrinsic value (in thousands)	$ 21,887			$ 17,745	
Weighted average remaining contractual life		5.49		4.79	

The aggregate intrinsic value in the table above is based on the Company s closing stock price of $22.67 per share as of June 30, 2006, which amount would have been received by the optionees had all options been exercised on that date.

Employee Stock Purchase Plan

The Company adopted the ESPP in August 1998. There were 46,989 and 23,706 shares issued for the ESPP periods that ended in the six months ended June 30, 2006 and 2005, respectively.

3. Net Income Per Share

Basic net income per share is computed using the weighted average number of common shares outstanding during the period. Diluted net income per share is computed using the weighted average number of common and potentially dilutive shares outstanding during the period. Potentially dilutive shares consist of the incremental common shares issuable upon the exercise of outstanding stock options and warrants using the treasury stock method. Potentially dilutive shares are excluded from the computation of earnings per share if their effect is antidilutive.

The treasury stock method calculates the dilutive effect for only those stock options and warrants whose exercise price is less than the average stock price during the period presented. The number of dilutive stock options and warrants and the

number of antidilutive stock options and warrants excluded from the calculation of weighted average dilutive common shares outstanding for the three and six months ended June 30, 2006 and 2005 are shown below.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Weighted average common shares outstanding, basic	31,238,796	33,107,847	31,161,521	33,080,962
Dilutive stock options and warrants	1,692,302	3,612,203	1,763,189	3,942,893
Weighted average common shares outstanding, diluted	32,931,098	36,720,050	32,924,710	37,023,855
Stock options and warrants excluded as antidilutive	5,208,390	3,597,223	4,720,885	2,009,761

4. Commitments and Contingencies

The following are the Company s contractual commitments associated with our operating lease obligations (in thousands):

	Remainder of 2006	2007	2008	2009	2010	Thereafter	Total
Operating lease commitments, net of sublease income	$ 3,585	$ 7,454	$ 5,222	$ 7,144	$ 6,981	$ 11,032	$ 41,418

As of June 30, 2006, the Company has pledged $4.3 million as collateral for standby letters of credit and bank guaranties for certain of its property leases, which is included in Other long-term assets.

Litigation

On June 6, 2003, a complaint entitled Enger v. Richards, filed in the Superior Court of the State of Washington (King County), was amended to add the Company and Naveen Jain, its former chairman and chief executive officer, as defendants. The action alleged various claims in connection with the sale of Yellow Pages on the Internet, LLC to the Company in May 1997. In December 2003, the plaintiff voluntarily dismissed the Company from this action. In January 2004, defendant John Richards, a former Company employee, asserted a third-party claim for indemnification against the Company, which purports to seek reimbursement for his legal fees as well as any judgment. In January 2005, the plaintiff, Jain and the Company settled all of their respective claims including Jain s claim for indemnification against the Company and any potential claims that Enger could bring against the Company. The settlement was paid entirely by the Company s insurance. Richards claim for indemnification was not a part of the settlement agreement. On March 16, 2005, the trial court entered a judgment in Richards favor. Enger is appealing that judgment. The Company believes it has meritorious defenses to Richards claim for indemnification, but litigation is inherently uncertain and the Company may not prevail in this matter.

On March 26, 2004, a complaint entitled Alexander Hutton Capital, L.L.C. v. John Richards, Naveen Jain, et al., was filed in the Superior Court of the State of Washington (King County). Plaintiff did not name the Company as a defendant. As in the Enger v. Richards case (above) to which it is related, this action alleges various claims in connection with the sale of Yellow Pages on the Internet, LLC to the Company in May 1997. In July 2004, Richards asserted a third party claim for indemnification against the Company, which purports to seek reimbursement for his legal fees as well as any judgment. In February 2005, the plaintiff, the Jains and the Company settled their respective claims, including the Jains claim for indemnification against the Company and any potential claims that Hutton could bring against the Company. The settlement was paid entirely by the Company s insurance. On July 22, 2005, the Court granted Richards motion to dismiss his claim for indemnification without prejudice. By order dated July 20, 2006, the Court found Richards liable to plaintiff for fraud and breach of fiduciary duty in the amount of $3,029,443 and stated that the Court has reserved for other non-party Yellow Pages on the Internet, LLC members, including Enger (see related Enger v. Richards case above), an additional $4,525,279 that the Court found Richards received through his fraud. Richards has indicated his intention to appeal the Court s decision. The Company believes that it has meritorious defenses to any potential claim of indemnification by Richards and that the Court s findings of intentional misconduct for fraud and breach of fiduciary duty by Richards, in addition to other findings, bar any potential claim for indemnification against the Company. However, litigation is inherently uncertain and the Company may not prevail in this matter.

Certain shareholders of Authorize.Net Corporation, a former subsidiary acquired through the Company s merger with Go2Net, Inc., filed a lawsuit in May 2000 in Utah State Court to reallocate the consideration received in the acquisition of Authorize.Net by Go2Net. The plaintiffs made claims under the Utah Uniform Securities Act as well as various common law claims. The plaintiffs subsequently amended the complaint, recaptioned as Patrick O Keefe II, et al. v. David Heaps, et al., asserting claims against Authorize.Net, Go2Net and InfoSpace, and Authorize.Net asserted counterclaims against the plaintiffs. Two former officers of Authorize.Net also asserted cross-claims for indemnification and contribution against Authorize.Net. The Utah Court entered orders dismissing with prejudice all of plaintiffs claims against Authorize.Net, Go2Net and InfoSpace, and certain other of plaintiffs claims; the plaintiffs appealed the court s decision. On April 28, 2006, the parties entered into a settlement agreement that resolved all remaining claims between the parties and the plaintiffs appeal. The Utah Court approved and dismissed the case with prejudice by order dated May 18, 2006.

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Other

From time to time the Company is subject to various other legal proceedings or claims that arise in the ordinary course of business. Additionally, the Company is subject to income taxes in the U.S. and several foreign jurisdictions and, in the ordinary course of business, there are transactions and calculations where the ultimate tax determination is uncertain. Although the Company cannot predict the outcome of these matters with certainty, the Company s management does not believe that the disposition of these ordinary course matters will have a material adverse effect on the Company s financial position, results of operations or cash flows.

In the ordinary course of business, the Company may provide indemnifications of varying scope and terms to customers, vendors, partners and other parties. The Company has agreed to hold certain parties harmless against losses arising from a breach of representations or covenants, or other claims made against certain parties. It is not possible to determine the maximum potential amount under these indemnification agreements due to the conditional nature of the Company s obligations and the unique facts and circumstances involved in each particular agreement. Accordingly, the Company has not recorded a liability related to indemnification provisions.

In addition, the Company periodically enters into agreements that require minimum performance commitments. The Company s management believes that the likelihood is remote that any such arrangements will have a significant adverse effect on our financial position, results of operations or liquidity. Accordingly, the Company has not recorded a liability related to these contingencies.

5. Goodwill

The following table provides information about activity in goodwill by reporting unit for the period from January 1, 2006 to June 30, 2006 (in thousands):

	Mobile	Online	Total
Goodwill as of December 31, 2005	$ 36,933	$ 140,046	$ 176,979
Adjustments for deferred taxes associated with IOMO Limited acquisition	(1,683)		(1,683)
Adjustments for deferred taxes associated with elkware GmbH acquisition	(3,348)		(3,348)
Goodwill as of June 30, 2006	$ 31,902	$ 140,046	$ 171,948

During the six months ended June 30, 2006, the Company elected to include the taxable income of two of its foreign subsidiaries, IOMO Limited and InfoSpace GmbH (formerly elkware GmbH), in the calculation of its income subject to U.S. taxation. As a result, the Company recorded a reduction of the goodwill associated with the acquisitions of those subsidiaries, consistent with the provisions of SFAS No. 109, *Accounting for Income Taxes*.

6. Other Income, net

Other income, net for the three and six months ended June 30, 2006 and 2005, consists of the following (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Interest income	$ 4,827	$ 2,865	$ 8,777	$ 4,648
Gain on litigation settlement				79,297
Foreign currency exchange gain (loss)	20	(86)	(10)	(1,020)
Other items, net	(124)	59	(172)	67
Other income, net	$ 4,723	$ 2,838	$ 8,595	$ 82,992

On March 25, 2005, the Company received proceeds of $83.2 million from the settlement of several outstanding litigation matters. The Company recognized a gain of $79.3 million during the six months ended June 30, 2005, comprised of the settlement proceeds and interest of $83.2 million, less $3.9 million in legal fees. In addition, the Company recognized $2.0 million in income taxes related to the settlement, which is included in Provision for income taxes in the six months ended June 30, 2005.

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7. Segment Disclosures

SFAS No. 131*, Disclosures about Segments of an Enterprise and Related Information*, establishes standards for the way that companies report information about operating segments. It also establishes standards for related disclosures about products and services, geographic areas, and major customers.

In January 2006, the Company realigned its operations to a functional organization structure and combined the functional operations of its two separate business units, Mobile and Search & Directory, to leverage its search and directory technology to its mobile products, services and distribution channels. This resulted in a change in the way it presents financial information to its chief operating decision maker, reflecting how management measures operating performance. The Company presents revenues consistent with the historical presentation, Mobile and Online (formerly referred to as Search & Directory) and, additionally, presents segment content and distribution costs and segment gross profit, which is revenues less content and distribution costs for each of the two segments. Content and distribution costs consist principally of costs related to royalty and license fees related to the Company s Mobile products for items such as ringtones, graphics and games, and other content or data licenses, and revenue sharing arrangements with the Company s Online distribution partners as well as certain content and data licenses. Additionally, the Company does not allocate systems and network operations expenses, product development expenses, sales and marketing expenses, general and administrative expenses, depreciation, amortization of intangible assets, income taxes or other income to the reportable segments. For each segment, the historical financial results for 2005 are presented in a manner consistent with the Company s new measures for reportable segments information. The revised financial information for the new segment reporting is not indicative of how the Company operated or managed its business in the past and is different than the segment results previously presented.

Information on reportable segments currently presented to the Company s chief operating decision maker and a reconciliation to consolidated net income for the three and six months ended June 30, 2006 and 2005 are presented below (in thousands). The Company does not account for, and does not report to management, its assets or capital expenditures by segment.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Mobile				
Revenue	$ 45,473	$ 37,091	$ 89,617	$ 76,144
Content and distribution costs	27,999	17,821	53,336	35,243
Gross profit	17,474	19,270	36,281	40,901
Gross profit margin	38.4%	52.0%	40.5%	53.7%
Online				
Revenue	50,373	46,090	96,503	94,059
Content and distribution costs	18,122	17,043	34,397	34,451
Gross profit	32,251	29,047	62,106	59,608
Gross profit margin	64.0%	63.0%	64.4%	63.4%
Total				
Total segment revenues	95,846	83,181	186,120	170,203
Total segment content and distribution costs	46,121	34,864	87,733	69,694
Total segment gross profit	49,725	48,317	98,387	100,509
Total segment gross profit margin	51.9%	58.1%	52.9%	59.1%
Corporate				
Operating expenses	40,826	29,254	76,782	59,515
Stock-based compensation expense	4,635		8,744	
Depreciation	3,457	1,941	6,774	3,715
Amortization of intangible assets	3,611	3,763	7,319	7,846
Gain on investments, net		(154)		(154)
Other income, net	(4,723)	(2,838)	(8,595)	(82,992)
Provision for income taxes	900	65	3,339	2,394
	48,706	32,031	94,363	(9,676)

Net Income	$ 1,019	$ 16,286	$ 4,024	$ 110,185

8. Stock Repurchase Plan

On May 30, 2006, the Company s Board of Directors approved a stock repurchase plan whereby the Company is authorized to purchase up to $100 million of its common stock during the succeeding twelve month period. Repurchased

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shares will be retired and resume the status of authorized but unissued shares of common stock. Under the previous repurchase plan authorized on May 13, 2005, which expired May 12, 2006, the Company purchased 2,633,002 shares in open-market transactions during 2005 at a total cost, exclusive of purchase and administrative costs, of $70.2 million, at an average price of $26.66 per share. The Company s stock repurchases for the three and six months ended June 30, 2006 and 2005, are presented below (in thousands, except per share data):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Purchase of shares, exclusive of purchase and administrative costs	$	$ 11,078	$	$ 11,078
Shares purchased		336		336
Average price per share		$ 32.97		$ 32.97

9. Recent Accounting Pronouncements

In June 2006, the FASB issued FIN No. 48, *Accounting for Uncertainty in Income Taxes*. FIN No. 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN No. 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN No. 48 is effective for the Company s first fiscal year beginning after December 15, 2006. The Company expects to adopt FIN No. 48 on January 1, 2007 and does not expect FIN No. 48 will have a material effect on the Company s financial position, cash flows, or results of operations.

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

You should read the following discussion and analysis in conjunction with our unaudited Condensed Consolidated Financial Statements and Notes thereto included elsewhere in this report and our annual report on Form 10-K for the year ended December 31, 2005. In addition to historical information, the following discussion contains certain forward-looking statements that involve known and unknown risks and uncertainties, such as statements of our plans, objectives, expectations and intentions. You should read the cautionary statements made in this report as being applicable to all related forward-looking statements wherever they appear in this report. Our actual results could differ materially from those discussed in the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed below and in Item 1A. of Part II, Risk Factors. , and in our reports filed with the Securities and Exchange Commission. You should not place undue reliance on these forward-looking statements, which reflect only our opinion as of the date of this report.

Overview

InfoSpace, Inc. (InfoSpace , Our or We) is a provider and publisher of mobile content, products and services that assist consumers with finding information, personalization and entertainment on the mobile phone. We also use our metasearch technology to power our own branded Web sites and provide private-label online search and directory services to distribution partners. We were founded in 1996 and are incorporated in the state of Delaware. Our principal corporate office is located in Bellevue, Washington. We also have facilities in Los Angeles and San Mateo, California; Westborough, Massachusetts; Woking and Eastleigh, United Kingdom; Papendrecht, The Netherlands; and Hamburg, Germany. Our common stock is listed on the newly designated NASDAQ Global Select Market under the symbol INSP.

In early 2006, we realigned our operations to a functional organization structure, resulting in the elimination of the separate business units, to expand our mobile media offerings, leverage online search and directory technology and applications for mobile devices, and expand our distribution channels. We plan to leverage our intellectual capital and core competencies to increase our focus on mobile applications, products, and services. As part of this plan, we changed our segment reporting to better reflect the performance of our company. Given this change in our organizational structure, for each segment the historical financial results for the first two quarters of 2005, as well as the first two quarters of 2006, are presented in a manner consistent with our new reporting segments. The revised financial information for the new segment reporting was prepared for comparative purposes and may not be indicative of how we operated or managed our business in the past and is different than the segment results previously presented.

Our Mobile business provides media products and content to mobile operators and portal and infrastructure services that enable mobile operators to deliver content and programming across multiple devices to their subscribers. Through our products, content and service offerings, our mobile operator partners are able to aggregate, configure and customize the services they offer under their own brand and deliver them to their subscribers. We also provide media products and content directly to consumers through our online branded Web site, Moviso.com.

Our Online business provides search and directory services which enable Internet users to locate information, merchants, individuals and products online. We offer search and directory services through our branded Web sites, Dogpile.com, Switchboard.com, InfoSpace.com, Webcrawler.com and MetaCrawler.com, as well as through the Web properties of distribution partners. Partner versions of our search and directory services are generally private-labeled and delivered with each distribution partner s unique requirements.

Company Internet Site and Availability of SEC Filings

Our corporate Internet site is located at www.infospaceinc.com. We make available on that site our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K from 2003 through the current period, as well as any amendments to those filings, and other filings we make electronically with the U.S. Securities and Exchange Commission (the SEC). The filings can be found in the Investor Relations section of our site and are available free of charge. Information on our Internet site is not part of this Form 10-Q. In addition, the SEC maintains an Internet site at www.sec.gov that contains reports, proxy and information statements, and other information regarding us and other issuers that file electronically with the SEC.

Overview of Second Quarter 2006 Operating Results

The following is an overview of our operating results for the three months ended June 30, 2006. A more detailed discussion , comparing our operating results for the three and six months ended June 30, 2006 and 2005, is included under the heading Historical Results of Operations in this Management s Discussion and Analysis of Financial Condition and Results of Operations.

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Revenues for the three months ended June 30, 2006 increased to $95.8 million from $83.2 million in the three months ended June 30, 2005. Revenues from our Mobile business increased to $45.5 million in the second quarter of 2006 from $37.1 million in the second quarter of 2005, primarily attributable to an increase in sales of our media download products, such as ringtones and graphics. Revenues from our Online business increased to $50.4 million in the second quarter of 2006 from $46.1 million in the second quarter of 2005. This increase was primarily due to greater revenue per paid search. During the second quarter of 2006, over 60% of our search revenues came from our search distribution partners.

Content and distribution costs for the three months ended June 30, 2006 increased to $46.1 million from $34.9 million in the three months ended June 30, 2005. Total segment gross profit, comprised of revenues net of content and distribution costs, increased to $49.7 million for the three months ended June 30, 2006 from $48.3 million for the second quarter of 2005. Segment gross profit for our Mobile segment decreased to $17.5 million in the second quarter of 2006 from $19.3 million in the second quarter of 2005, primarily attributable to the loss of a service agreement at the end of 2005 and an increase in content costs associated with our media downloads. Mobile content costs, as a percentage of revenue, increased at a greater rate as a result of an increase in content costs and the shift of the mix of products and services we provided. In particular, sales of our labeltone or true tone (MP3-like quality) ringtones, that have a greater cost as a percentage of revenue than our other media download products, represented a larger share of our Mobile revenues. Segment gross profit from our Online business increased to $32.3 million in the second quarter of 2006 from $29.0 million in the second quarter of 2005, due to increases in revenue per paid search, primarily from our own branded Web sites.

Other operating expenses for the three months ended June 30, 2006 were $52.5 million, an increase of $17.6 million from $35.0 million in the three months ended June 30, 2005. Other operating expenses include expenses related to systems and network operations, product development, sales and marketing, general and administrative, depreciation and amortization of intangible assets. The increase from the three months ended June 30, 2005 was primarily attributable to spending on certain business initiatives, general growth in our operations, and the effect of expensing stock options and other equity based awards as required under Statement of Financial Accounting Standard (SFAS) No. 123(R), *Share-Based Payment*, which we adopted on January 1, 2006. Increased operating costs related to our initiatives and growth in our business primarily relate to increases in personnel costs, including salaries, benefits and other employee costs, and costs of temporary help from contractors to augment our staffing needs, as well as increases in marketing and promotional costs and depreciation expense.

Net income for the three months ended June 30, 2006 was $1.0 million compared to net income of $16.3 million in the three months ended June 30, 2005. The decrease was primarily attributable to increases in operating expenses in 2006 as noted above. Additionally, we provided for income taxes at a rate of approximately 47% in the second quarter of 2006, as compared to less than 1% in the second quarter of 2005.

Critical Accounting Policies and Estimates

Management s Discussion and Analysis of Financial Condition and Results of Operations, as well as disclosures included elsewhere in this Form 10-Q, are based upon our unaudited Condensed Consolidated Financial Statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingencies.

The SEC has defined a company s most critical accounting policies as the ones that are the most important to the portrayal of the company s financial condition and results of operations, and which require the company to make its most difficult and subjective judgments, often as a result of the need to make estimates of matters that are inherently uncertain. On an ongoing basis, we evaluate the estimates used, including those related to impairment of goodwill and other intangible assets, useful lives of other intangible assets and property and equipment, contingencies, stock-based compensation and certain other operating expenses, the fair value of assets and liabilities acquired in our business combinations, and whether to provide a valuation allowance for some or all of our deferred tax assets. We base our estimates on historical experience, current conditions and various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources as well as identifying and assessing our accounting treatment with respect to commitments and contingencies. Actual results may differ significantly from these estimates under different assumptions, judgments or conditions. We believe the following critical accounting policies involve the more significant judgments and estimates used in the preparation of our consolidated financial statements. We also have other key accounting policies, which involve the use of estimates, judgments and assumptions that are significant to understanding our results. For additional information see Item 8 of Part II Financial Statements and Supplementary Data Note 1: Summary of Significant Accounting Policies of our Annual Report on Form 10-K.

Revenue Recognition

Our revenues are derived from products and services delivered to our customers across our two segments, Mobile and Online. In general, we recognize revenues in the period in which the services are performed, products are delivered or the transaction occurs. In certain arrangements, we record deferred revenue for amounts received from customers in advance of the performance of services or upon execution of an agreement and recognize revenues ratably over the term of the agreement or expected customer life. We generally record revenue on a gross basis in accordance with Emerging Issues Task Force Issue No. 99-19, *Reporting Revenue Gross as a Principal versus Net as an Agent*. For distribution partner arrangements in our Online business, we record revenue on a gross basis and the corresponding revenue sharing payments as a content and distribution expense. For mobile operator customers in which we license the content, we record revenue on a gross basis and the corresponding licensing expense as a content and distribution expense. In the event the mobile operator customer directly licenses the content, we record as revenue the service fees we earn.

Income Taxes

We account for income taxes under the asset and liability method, under which deferred tax assets, including net operating loss carryforwards, and liabilities are determined based on temporary differences between the book and tax basis of assets and liabilities. We periodically evaluate the likelihood of the realization of deferred tax assets, and reduce the carrying amount of the deferred tax assets by a valuation allowance to the extent we believe a portion will not be realized. We consider many factors when assessing the likelihood of future realization of our deferred tax assets, including our recent cumulative earnings experience by taxing jurisdiction, expectations of future taxable income, the carryforward periods available to us for tax reporting purposes, and other relevant factors. The range of possible judgments relating to the valuation of our deferred tax assets is wide.

At December 31, 2005, based on the weight of available evidence, we determined that it was more likely than not that a portion of our deferred tax asset would be realized and, at December 31, 2005, our deferred tax asset, net of the valuation allowance, was $25.0 million. This amount was based on total deferred assets of $425.8 million, primarily comprised of $379.7 million of accumulated net operating loss carryforwards, net of a $400.8 million valuation allowance. Significant judgment is required in making this assessment, and it is very difficult to predict when, if ever, our assessment may conclude that the remaining portion of our deferred tax assets is realizable.

Accounting for Goodwill and Certain Other Intangible Assets

SFAS No. 142, *Goodwill and Other Intangible Assets*, requires that goodwill be tested for impairment at the reporting unit level (operating segment or one level below an operating segment) on an annual basis and between annual tests in certain circumstances. Application of the goodwill impairment test requires judgment, including the identification of reporting units, assigning assets and liabilities to reporting units, assigning goodwill to reporting units, and determining the fair value of each reporting unit. Significant judgments required to estimate the fair value of reporting units include estimating future cash flows, determining appropriate discount rates and other assumptions. Changes in these estimates and assumptions could materially affect the determination of fair value for each reporting unit. As of June 30, 2006, we had $171.9 million of goodwill on our balance sheet relating to our Mobile and Online reporting units.

Business Combinations

Business combinations accounted for under the purchase method of accounting require management to estimate the fair value of the assets acquired and liabilities assumed. The allocation of the purchase price is based on the estimated fair value of assets and liabilities acquired and may be subject to adjustments during the year following the date of acquisition related to a change in the fair value of the assets and liabilities assumed.

Allowances for Sales and Doubtful Accounts

Our management must make estimates of potential future sales allowances related to current period revenues for our products and services. We analyze historical adjustments, current economic trends and changes in customer demand and acceptance of our products when evaluating the adequacy of the sales allowances. Estimates must be made and used in connection with establishing the sales allowance in any accounting period.

The allowance for doubtful accounts is a management estimate that considers actual facts and circumstances of individual customers and other debtors, such as financial condition and historical payment trends. We evaluate the adequacy of the allowance utilizing a combination of specific identification of potentially problematic accounts and identification of accounts that have exceeded payment terms.

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Contingencies

We are subject to various legal proceedings and claims, the outcomes of which are subject to significant uncertainty. SFAS No. 5, *Accounting for Contingencies*, requires that an estimated loss from a loss contingency should be accrued by a charge to income if it is probable that an asset has been impaired or a liability has been incurred and the amount of the loss can be reasonably estimated. Disclosure of a contingency is required if there is at least a reasonable possibility that a loss has been incurred. We evaluate, among other factors, the degree of probability of an unfavorable outcome and the ability to make a reasonable estimate of the amount of loss. Changes in these factors could materially impact our financial position or our results of operations. See Note 4 to our unaudited Condensed Consolidated Financial Statements for further information regarding contingencies.

Historical Results of Operations

For the six months ended June 30, 2006, our net income was $4.0 million. While we have achieved profitability for twelve consecutive quarters, including the three months ended June 30, 2006, and for the years ended December 31, 2004 and 2005, prior to 2004, we had incurred annual losses since our inception and, as of June 30, 2006, had an accumulated deficit of $1.0 billion.

In light of the rapidly evolving nature of our business and overall market conditions, we believe that period-to-period comparisons of our revenues and operating expenses are not necessarily meaningful, and you should not rely upon them as indications of our future performance.

Results of Operations for the Three and Six Months Ended June 30, 2006 and 2005

Revenues. Revenues are derived from deploying our services and products to customers. Under many of our agreements, we earn revenue from a combination of our products and services delivered to a range of customers. Revenues for the three and six months ended June 30, 2006 and 2005 are presented below (amounts in thousands):

	Three Months Ended June 30,		Change from	Six Months Ended June 30,		Change from
Revenues	**2006**	**2005**	**2005**	**2006**	**2005**	**2005**
Mobile	$ 45,473	$ 37,091	$ 8,382	$ 89,617	$ 76,144	$ 13,473
Online	50,373	46,090	4,283	96,503	94,059	2,444
Total	$ 95,846	$ 83,181	$ 12,665	$ 186,120	$ 170,203	$ 15,917

The increase in revenue for our Mobile products and services for the three and six months ended June 30, 2006 as compared to the three and six months ended June 30, 2005, is primarily due to increased revenues from the sales of our media download products, primarily sales of our labeltone or true tone (MP3-like quality) ringtones, which comprised approximately 67% of our Mobile revenues for the three months ended June 30, 2006 as compared to approximately 62% for the three months ended March 31, 2006. Partially offsetting the increase in revenue for Mobile products and services is the loss of a service agreement at the end of 2005.

The increase in revenue for Online products and services for the three and six months ended June 30, 2006 as compared to the three and six months ended June 30, 2005, is primarily due the growth in our online search services, in particular, greater revenue per paid search, and, to a lesser extent, directory revenues related to a contract we entered into in June 2005. These increases are partially offset by a decline in revenue due to one of our top ten customers, Verizon, not renewing certain key provisions of our subscription agreement for yellow pages listings in June 2005. During the three and six months ended June 30, 2006 and 2005, over 60% of our search distribution revenues came from our search distribution partners.

Seasonality

Our Online services are historically affected by seasonal fluctuations in Internet usage, which generally declines in the summer months. Our Mobile business may also be subject to seasonality based on the timing of consumer product cycles and other factors, such as the timing of new mobile phone sales.

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Content and Distribution Expenses. Content and distribution expenses consist principally of costs related to royalty and license fees related to our Mobile products for items such as ringtones, graphics and games, and other content or data licenses, and revenue sharing arrangements with our Online distribution partners, as well as online content and data licenses. Content and distribution expenses in total dollars (in thousands) and as a percent of total revenues for the three and six months ended June 30, 2006 and 2005 are presented below:

	Three Months Ended June 30,		Change from	Six Months Ended June 30,		Change from
Content and Distribution Expense	**2006**	**2005**	**2005**	**2006**	**2005**	**2005**
Mobile	$ 27,999	$ 17,821	$ 10,178	$ 53,336	$ 35,243	$ 18,093
Percent of Mobile Revenue	61.6%	48.0%	13.6%	59.5%	46.3%	13.2%
Online	18,122	17,043	1,079	34,397	34,451	(54)
Percent of Online Revenue	36.0%	37.0%	(1.0)%	35.6%	36.6%	(1.0)%
Total	$ 46,121	$ 34,864	$ 11,257	$ 87,733	$ 69,694	$ 18,039
Percent of Total Revenue	48.1%	41.9%	6.2%	47.1%	40.9%	6.2%

Content and distribution expenses increased by $11.3 million to $46.1 million for the three months ended June 30, 2006, as compared to $34.9 million for the three months ended June 30, 2005. The absolute dollar and cost as a percent of revenues increase for the three months ended June 30, 2006 as compared to the three months ended June 30, 2005, was primarily attributable to revenue growth from sales of our content and media products to our Mobile customers, in particular, sales of our labeltone or true tone (MP3-like quality) ringtones, for which our costs as a percentage of revenues are greater than our other media download products. Content and distribution costs related to our Online products and services increased in absolute dollars, primarily due to an increase in revenue shared with our distribution partners. We anticipate that our content and distribution costs will continue to increase in absolute dollars if revenues from sales of our content and media products to our Mobile customers continue to increase or if revenues increase through growth from existing arrangements with our Online distribution partners or we add new Online distribution partners. In addition, our content license and royalty fees have increased as a percent of Mobile revenue as a result of content price increases, variation in carrier demand for our products and the change in mix of our product sales. If the trend continues to shift towards sales of higher cost media download content and products or if Online revenue generated from our distribution partners increases at a greater rate than revenues generated from our own branded Web sites, content and distribution costs as a percent of revenue will continue to increase.

Content and distribution expenses increased by $18.0 million to $87.7 million for the six months ended June 30, 2006, as compared to $69.7 million for the six months ended June 30, 2005. The absolute dollar and cost as a percent of revenues increase for the six months ended June 30, 2006 as compared to the six months ended June 30, 2005, was primarily attributable to revenue growth from sales of our content and media products to our Mobile customers, in particular, sales of our labeltone or true tone (MP3-like quality) ringtones, for which our costs as a percentage of revenues are greater than our other media download products.

Systems and Network Operations Expenses. Systems and network operations consists of expenses associated with the delivery, maintenance and support of our products, services and infrastructure, including personnel expenses, which include salaries, stock-based compensation, benefits and other employee related costs, and temporary help and contractors to augment our staffing, and communication costs and equipment repair and maintenance. Systems and network operations expenses in total dollars (in thousands) and as a percent of total revenues for the three and six months ended June 30, 2006 and 2005 are presented below:

	Three Months Ended June 30,		Change from	Six Months Ended June 30,		Change from
	2006	**2005**	**2005**	**2006**	**2005**	**2005**
Systems and Network Operations	$ 7,880	$ 4,899	$ 2,981	$ 14,988	$ 9,312	$ 5,676
Percent of Revenue	8.2%	5.9%	2.3%	8.1%	5.5%	2.6%

Systems and network operations expenses increased by $3.0 million and $5.7 million to $7.9 million and $15.0 million for the three and six months ended June 30, 2006, respectively, as compared to $4.9 million and $9.3 million for the three and six months ended June 30, 2005, respectively. The absolute dollar increase for the three and six months ended June 30, 2006 as compared to the three and six months ended June 30, 2005 was primarily attributable to an increase of $1.8 million and $3.7 million, respectively, in personnel expenses, contractors to augment our staffing, and temporary help, which was the result of additional headcount due to growth in our business, and an increase in software license fees and maintenance costs and communication costs of $1.1 million and $1.8 million, respectively.

Product Development Expenses. Product development expenses consist principally of personnel expenses, which include salaries, stock-based compensation, benefits and other employee related costs, and temporary help and contractors to augment

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our staffing, for research, development, support and ongoing enhancements of our products and services. Product development expenses in total dollars (in thousands) and as a percent of total revenues for the three and six months ended June 30, 2006 and 2005 are presented below:

	Three Months Ended June 30,		Change from	Six Months Ended June 30,		Change from
	2006	2005	2005	2006	2005	2005
Product Development Expenses	$ 12,467	$ 7,596	$ 4,871	$ 21,775	$ 14,967	$ 6,808
Percent of Revenue	13.0%	9.1%	3.9%	11.7%	8.8%	2.9%

Product development expenses increased by $4.9 million and $6.8 million to $12.5 million and $21.8 million for the three and six months ended June 30, 2006, respectively, as compared to $7.6 million and $15.0 million for the three and six months ended June 30, 2005, respectively. The absolute dollar increase for the three and six months ended June 30, 2006 as compared to the three months ended June 30, 2005 was primarily attributable to an increase of $5.1 million and $7.3 million, respectively, in personnel related expenses and contractors to augment our staffing, as we continued to invest in the development and enhancement of our products and services. This increase was partially offset by reductions in professional service fees.

Product development costs may not be consistent with revenue trends as they represent key costs to develop and enhance our product offerings. We believe that investments in technology and new products are necessary to remain competitive, and we anticipate that product development expenses will increase in absolute dollars as we continue to invest in our products and services.

Sales and Marketing Expenses. Sales and marketing expenses consist principally of personnel costs, which include salaries, stock-based compensation, benefits and other employee related costs, and temporary help and contractors to augment our staffing, and advertising, market research and promotion expenses. Sales and marketing expenses in total dollars (in thousands) and as a percent of total revenues for the three and six months ended June 30, 2006 and 2005 are presented below:

	Three Months Ended June 30,		Change from	Six Months Ended June 30,		Change from
	2006	2005	2005	2006	2005	2005
Sales and Marketing Expenses	$ 12,567	$ 7,030	$ 5,537	$ 22,130	$ 14,902	$ 7,228
Percent of Revenue	13.1%	8.5%	4.6%	11.9%	8.8%	3.1%

Sales and marketing expenses increased by $5.5 million to $12.6 million for the three months ended June 30, 2006 as compared to $7.0 million for the three months ended June 30, 2005. The absolute dollar increase for the three months ended June 30, 2006 as compared to the three months ended June 30, 2005 was primarily attributable to an increase in personnel related expenses, temporary help and contractors to augment our staffing totaling $4.0 million and an increase of $1.3 million in marketing and promotional expense.

Sales and marketing expenses increased by $7.2 million to $22.1 million for the six months ended June 30, 2006 as compared to $14.9 million for the six months ended June 30, 2005. The absolute dollar increase for the six months ended June 30, 2006 as compared to the six months ended June 30, 2005 was primarily attributable to an increase in personnel related expenses totaling $5.1 million and an increase of $1.9 million in marketing and promotional expense.

Sales and marketing expenses may increase in absolute dollars as we continue to invest in marketing initiatives and sales promotions and expand our products, services and distribution channels, including our branded Web site, Moviso.com, where we provide media products and content directly to consumers.

General and Administrative Expenses. General and administrative expenses consist primarily of personnel expenses, which include salaries, stock-based compensation, benefits and other employee related costs, professional service fees, which include legal fees, audit fees, SEC compliance costs, which include costs related to compliance with the Sarbanes-Oxley Act of 2002, occupancy and general office expenses, and general business development and management expenses. General and administrative expenses in total dollars (in thousands) and as a percent of total revenues for the three and six months ended June 30, 2006 and 2005 are presented below:

	Three Months Ended June 30,		Change from	Six Months Ended June 30,		Change from
	2006	2005	2005	2006	2005	2005
General and Administrative Expenses	$ 12,547	$ 9,729	$ 2,818	$ 26,633	$ 20,334	$ 6,299
Percent of Revenue	13.1%	11.7%	1.4%	14.3%	11.9%	2.4%

General and administrative expenses increased by $2.8 million to $12.5 million for the three months ended June 30, 2006 as compared to $9.7 million for the three months ended June 30, 2005. The absolute dollar increase for the three months

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ended June 30, 2006 as compared to the three months ended June 30, 2005 was primarily attributable to stock-based compensation expense of $1.9 million and an increase in personnel related expenses and contractors to augment staffing, totaling $884,000.

General and administrative expenses increased by $6.3 million to $26.6 million for the six months ended June 30, 2006 as compared to $20.3 million for the six months ended June 30, 2005. The absolute dollar increase for the six months ended June 30, 2006 as compared to the six months ended June 30, 2005 was primarily attributable to stock-based compensation expense of $4.4 million, an increase in personnel related expenses and contractors to augment staffing, totaling $1.4 million, and a $750,000 charge related to certain litigation settlements.

Depreciation. Depreciation of property and equipment includes depreciation of network servers and data center equipment, computers, software, office equipment and fixtures, and leasehold improvements. Depreciation of property and equipment totaled $3.5 million and $6.8 million for the three and six months ended June 30, 2006, respectively, compared to $1.9 million and $3.7 million for the three and six months ended June 30, 2005, respectively. Depreciation expense increased primarily as a result of property and equipment recently placed in service related to our redundant data center.

Amortization of Intangible Assets. Amortization of definite-lived intangible assets includes amortization of core technology, customer and content relationships, customer lists and other intangible assets. Amortization of other intangible assets totaled $3.6 million and $7.3 million during the three and six months ended June 30, 2006, respectively, compared to $3.8 million and $7.8 million during the three and six months ended June 30, 2005, respectively. The decrease from the three and six months ended June 30, 2005 to the three and six months ended June 30, 2006 is primarily attributable to intangible assets that reached the end of their estimated useful lives and were accordingly fully amortized. The expected future amortization of intangible assets at June 30, 2006 is $5.9 million for the remainder of 2006, $7.5 million in 2007, $4.7 million in 2008, and $3.1 million in 2009.

Other Income, Net. Other income, net, primarily consists of interest income, gain from litigation settlements and foreign currency gain (loss).

		Three Months Ended June 30,			**Change from**	**Six Months Ended June 30,**		**Change from**
		2006	**2005**		**2005**	**2006**	**2005**	**2005**
Interest income		$ 4,827	$ 2,865	&nbD VALIGN="BOTTOM" style="font-family:times;">	$ 2,206,500	$ 2,227,944		
	Management service fee	14,787	16,725		17,273			
	Food, beverage and other	339,235	334,206		320,520			
Gross revenues		2,512,050	2,557,431		2,565,737			
	Less promotional allowances	(142,775)	(134,378)		(128,944)			
Net revenues		2,369,275	2,423,053		2,436,793			
Operating expenses:								
	Gaming	1,161,510	1,181,870		1,180,437			
	Food, beverage and other	266,351	257,653		240,912			
	General and administrative	403,136	415,093		369,720			
	Impairment losses	532,377	481,333					
	Empress Casino Hotel	6,063						

fire			
Depreciation and amortization	194,436	173,545	147,915
Total operating expenses	2,563,873	2,509,494	1,938,984
(Loss) income from operations	$ (194,598)	$ (86,441)	$ 497,809

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The results of operations by property for the years ended December 31, 2009, 2008 and 2007 are summarized below:

	Net Revenues			Income (loss) from Operations		
Year Ended December 31,	**2009**	**2008**	**2007**	**2009(4)**	**2008(5)**	**2007**
			(in thousands)			
Charles Town Entertainment Complex	$ 455,350	$ 477,032	$ 500,800	$ 103,356	$ 114,726	$ 127,277
Hollywood Casino Lawrenceburg	422,015	432,082	478,719	(431,754)	(96,094)	142,690
Hollywood Casino at Penn National Race Course(1)	292,670	224,935	48,488	14,394	11,530	(9,451)
Hollywood Casino Aurora	184,776	198,693	251,877	49,607	13,009	73,914
Empress Casino Hotel	107,058	168,663	225,794	9,511	(63,922)	38,821
Argosy Casino Riverside	193,785	186,132	174,426	53,760	48,526	42,388
Hollywood Casino Baton Rouge	122,994	131,013	135,869	39,336	43,829	47,417
Argosy Casino Alton	78,230	84,040	119,166	12,980	(301)	29,709
Hollywood Casino Tunica	92,896	88,540	103,858	14,627	14,363	19,536
Hollywood Casino Bay St. Louis	95,060	101,997	96,622	5,506	6,025	4,850
Argosy Casino Sioux City	53,927	54,774	54,417	15,065	14,634	13,259
Boomtown Biloxi	73,881	75,701	86,159	7,870	9,753	12,979
Hollywood Slots Hotel and Raceway	67,176	55,780	46,689	(2,072)	(79,922)	9,523
Bullwhackers	19,658	22,128	28,882	(1,108)	(16,922)	1,149
Black Gold Casino at Zia Park(2)	81,743	90,255	58,572	22,063	27,755	16,702
Casino Rama management service contract	14,787	16,725	17,273	13,395	15,183	15,899
Raceway Park	6,963	7,549	7,814	(1,206)	(1,368)	(1,119)
Sanford-Orlando Kennel Club(3)	6,306	7,014	1,368	(641)	(725)	(3)
Earnings from Pennwood Racing, Inc.						
Corporate overhead				(119,287)	(146,520)	(87,731)
Total	$ 2,369,275	$ 2,423,053	$ 2,436,793	$ (194,598)	$ (86,441)	$ 497,809

(1) Hollywood Casino at Penn National Race Course includes the results of our Pennsylvania casino that opened on February 12, 2008, as well as the Penn National Race Course and four OTWs.

(2) Reflects results since the April 16, 2007 acquisition effective date.

(3) Reflects results since the October 17, 2007 acquisition effective date.

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

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(5)
As a result of a decline in our share price, an overall reduction in industry valuations, and property operating performance in the then-current economic environment, we recorded a pre-tax impairment charge of $481.3 million during the year ended December 31, 2008, as we determined that a portion of the value of our goodwill, indefinite-life intangible assets and long-lived assets was impaired. The pre-tax impairment charge by property was as follows: Hollywood Casino Lawrenceburg, $214.1 million; Hollywood Casino Aurora, $43.7 million; Empress Casino Hotel, $94.4 million; Argosy Casino Alton, $14.1 million; Bullwhackers, $14.2 million; Hollywood Slots Hotel and Raceway, $82.7 million; and Corporate overhead, $18.1 million.

Revenues

Revenues for the years ended December 31, 2009, 2008 and 2007 are as follows (in thousands):

Year ended December 31,	2009	2008	Variance	Percentage Variance
Gaming	$ 2,158,028	$ 2,206,500	$ (48,472)	(2.2)%
Management service fee	14,787	16,725	(1,938)	(11.6)%
Food, beverage and other	339,235	334,206	5,029	1.5%
Gross revenues	2,512,050	2,557,431	(45,381)	(1.8)%
Less promotional allowances	(142,775)	(134,378)	(8,397)	6.2%
Net revenues	$ 2,369,275	$ 2,423,053	$ (53,778)	(2.2)%

Year ended December 31,	2008	2007	Variance	Percentage Variance
Gaming	$ 2,206,500	$ 2,227,944	$ (21,444)	(1.0)%
Management service fee	16,725	17,273	(548)	(3.2)%
Food, beverage and other	334,206	320,520	13,686	4.3%
Gross revenues	2,557,431	2,565,737	(8,306)	(0.3)%
Less promotional allowances	(134,378)	(128,944)	(5,434)	4.2%
Net revenues	$ 2,423,053	$ 2,436,793	$ (13,740)	(0.6)%

Gaming revenue

2009 Compared with 2008

Gaming revenue decreased by $48.5 million, or 2.2%, to $2,158.0 million in 2009, primarily due to decreases at several of our properties, which were partially offset by increases at Hollywood Casino at Penn National Race Course, Hollywood Slots Hotel and Raceway, and Argosy Casino Riverside.

Gaming revenue at Empress Casino Hotel decreased by $58.7 million in 2009, primarily due to the property being closed from March 20, 2009 until June 25, 2009 due to a fire and decreases in consumer spending on gaming activities caused by current economic conditions.

Gaming revenue at Charles Town Entertainment Complex decreased by $21.9 million in 2009, primarily due to decreases in consumer spending on gaming activities caused by current economic conditions as well as competitive pressures.

Gaming revenue at Hollywood Casino Aurora decreased by $14.0 million in 2009, primarily due to decreases in consumer spending on gaming activities caused by current economic conditions and new competitive pressures.

Gaming revenue at Hollywood Casino Lawrenceburg decreased by $11.4 million in 2009, primarily due to new competitive pressures, the reduced capacity of, and subsequent temporary closure of, the casino as part of the transition to the new casino riverboat, and decreases in consumer spending on

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gaming activities caused by current economic conditions, all of which were partially offset by an increase due to the opening of the new casino riverboat in late June 2009.

Gaming revenue at Hollywood Casino Baton Rouge decreased by $8.1 million in 2009, primarily due to decreases in consumer spending on gaming activities caused by current economic conditions.

Gaming revenue at Black Gold Casino at Zia Park decreased by $7.7 million in 2009, primarily due to decreases in consumer spending on gaming activities caused by current economic conditions.

Gaming revenue at Argosy Casino Alton decreased by $5.5 million in 2009, primarily due to decreases in consumer spending on gaming activities caused by current economic conditions as well as competitive pressures, including the repeal of the $500 loss limit in neighboring Missouri in November 2008.

Gaming revenue at Hollywood Casino Bay St. Louis decreased by $5.3 million in 2009, primarily due to decreases in consumer spending on gaming activities caused by current economic conditions as well as competitive pressures.

Gaming revenue at Hollywood Casino at Penn National Race Course increased by $67.1 million in 2009, primarily due to the continued impact of the opening of the casino on February 12, 2008 and the continued growth from a new gaming market.

Gaming revenue at Hollywood Slots Hotel and Raceway increased by $8.6 million in 2009, primarily due to the continued impact of the opening of the permanent facility on July 1, 2008.

Gaming revenue at Argosy Casino Riverside increased by $8.1 million in 2009, primarily due to the repeal of the $500 loss limit in Missouri in November 2008 and continued successful marketing efforts.

2008 Compared with 2007

Gaming revenue decreased by $21.4 million, or 1.0%, to $2,206.5 million in 2008, primarily due to decreases at several of our properties, which were partially offset by increases due to the opening of the casino at Hollywood Casino at Penn National Race Course, the acquisition of Black Gold Casino at Zia Park, the impact of the hotel and successful marketing efforts at Argosy Casino Riverside, and the opening of the permanent facility at Hollywood Slots Hotel and Raceway.

Gaming revenue at Empress Casino Hotel decreased by $55.8 million in 2008, primarily due to decreases in consumer spending on gaming activities caused by then-current economic conditions, the impact of the Illinois smoking ban that became effective on January 1, 2008, an increase in cash back from promotional points programs, and competitive pressures.

Gaming revenue at Hollywood Casino Aurora decreased by $52.1 million in 2008, primarily due to decreases in consumer spending on gaming activities caused by then-current economic conditions, new competitive pressures and the impact of the Illinois smoking ban that became effective on January 1, 2008.

Gaming revenue at Hollywood Casino Lawrenceburg decreased by $43.7 million in 2008, primarily due to decreases in consumer spending on gaming activities caused by then-current economic conditions as well as new competitive pressures.

Gaming revenue at Argosy Casino Alton decreased by $34.0 million in 2008, primarily due to new competition in the market and the impact of the Illinois smoking ban that became effective on January 1, 2008.

Gaming revenue at Charles Town Entertainment Complex decreased by $22.5 million in 2008, primarily due to decreases in consumer spending on gaming activities caused by then-current economic conditions as well as competitive pressures.

Gaming revenue at Hollywood Casino Tunica decreased by $14.2 million in 2008, primarily due to decreases in consumer spending on gaming activities caused by then-current economic conditions.

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Gaming revenue at Boomtown Biloxi decreased by $9.4 million in 2008, primarily due to continued competitive pressures, decreases in consumer spending on gaming activities caused by then-current economic conditions and the impact of Hurricane Gustav and Hurricane Ike.

Gaming revenue at Bullwhackers decreased by $6.7 million in 2008, primarily due to decreases in consumer spending on gaming activities caused by then-current economic conditions, continued competitive pressures and the impact of the Colorado smoking ban that became effective on January 1, 2008.

Gaming revenue at Hollywood Casino at Penn National Race Course, which opened its casino on February 12, 2008, was $170.5 million in 2008.

Gaming revenue at Black Gold Casino at Zia Park increased by $29.6 million in 2008, primarily due to the acquisition of the property in mid-April 2007, as well as favorable regional economic conditions and successful marketing efforts.

Gaming revenue at Argosy Casino Riverside increased by $8.7 million in 2008, primarily due to the impact of its hotel and successful marketing efforts.

Gaming revenue at Hollywood Slots Hotel and Raceway increased by $7.2 million in 2008, primarily due to the opening of the permanent facility on July 1, 2008.

Food, beverage and other revenue

2009 Compared with 2008

Food, beverage and other revenue increased by $5.0 million, or 1.5%, to $339.2 million in 2009, primarily due to increases at several of our properties, which were partially offset by a decrease at Empress Casino Hotel.

Food, beverage and other revenue at Hollywood Slots Hotel and Raceway increased by $5.1 million in 2009, primarily due to increased promotional efforts and the continued impact of the opening of the permanent facility on July 1, 2008.

Food, beverage and other revenue at Hollywood Casino Tunica increased by $3.9 million in 2009, primarily due to new food and beverage promotions.

Food, beverage and other revenue at Charles Town Entertainment Complex increased by $3.1 million in 2009, primarily due to the opening of its hotel to the public in September 2008.

Food, beverage and other revenue at Boomtown Biloxi increased by $1.3 million in 2009, primarily due to expanded marketing efforts, including new food and beverage promotions.

Food, beverage and other revenue at Empress Casino Hotel decreased by $6.9 million in 2009, as the property was closed from March 20, 2009 until June 25, 2009 due to a fire.

2008 Compared with 2007

Food, beverage and other revenue increased by $13.7 million, or 4.3%, to $334.2 million in 2008, primarily due to the opening of the casino at Hollywood Casino at Penn National Race Course, the acquisition of Sanford-Orlando Kennel Club, the impact of the hotel at Argosy Casino Riverside, and the opening of the permanent facility at Hollywood Slots Hotel and Raceway, all of which were partially offset by decreases at Argosy Casino Alton, Hollywood Casino Tunica, Empress Casino Hotel and Hollywood Casino Aurora.

Food, beverage and other revenue at Hollywood Casino at Penn National Race Course increased by $8.7 million in 2008, as the casino opened on February 12, 2008.

Food, beverage and other revenue at Sanford-Orlando Kennel Club, which we acquired in mid-October 2007, increased by $5.6 million in 2008.

Food, beverage and other revenue at Argosy Casino Riverside increased by $5.2 million in 2008, primarily due to the impact of its hotel.

Food, beverage and other revenue at Hollywood Slots Hotel and Raceway increased by $2.7 million in 2008, primarily due to the opening of the permanent facility on July 1, 2008.

Food, beverage and other revenue at Argosy Casino Alton decreased by $2.4 million in 2008, primarily due to new competition in the region and the impact of the Illinois smoking ban that became effective on January 1, 2008.

Food, beverage and other revenue at Hollywood Casino Tunica decreased by $2.4 million in 2008, primarily due to decreases in consumer spending on gaming activities caused by then-current economic conditions.

Food, beverage and other revenue at Empress Casino Hotel decreased by $1.7 million in 2008, primarily due to the impact of the Illinois smoking ban that became effective on January 1, 2008.

Food, beverage and other revenue at Hollywood Casino Aurora decreased by $1.5 million in 2008, primarily due to decreases in consumer spending on gaming activities caused by then-current economic conditions, new competitive pressures and the impact of the Illinois smoking ban that became effective on January 1, 2008.

Promotional allowances

2009 Compared with 2008

Promotional allowances increased by $8.4 million, or 6.2%, to $142.8 million in 2009, primarily due to increases at several of our properties, which were partially offset by a decrease at Empress Casino Hotel.

Promotional allowances at Hollywood Casino Tunica increased by $4.3 million in 2009, primarily due to new food and beverage and hotel promotions.

Promotional allowances at Charles Town Entertainment Complex increased by $2.9 million in 2009, primarily due to increased marketing efforts and the opening of its hotel to the public in September 2008.

Promotional allowances at Hollywood Slots Hotel and Raceway increased by $2.2 million in 2009, primarily due to increased promotional efforts and the continued impact of the opening of the permanent facility on July 1, 2008.

Promotional allowances at Boomtown Biloxi increased by $1.7 million in 2009, primarily due to expanded marketing efforts.

Promotional allowances at Empress Casino Hotel decreased by $3.9 million in 2009, as the property was closed from March 20, 2009 until June 25, 2009 due to a fire.

2008 Compared with 2007

Promotional allowances increased by $5.4 million, or 4.2%, to $134.4 million in 2008, primarily due to the opening of the casino at Hollywood Casino at Penn National Race Course and the impact of the hotel and gaming revenue growth at Argosy Casino Riverside.

Promotional allowances at Hollywood Casino at Penn National Race Course increased by $2.7 million in 2008, as the casino opened on February 12, 2008.

Promotional allowances at Argosy Casino Riverside increased by $2.1 million in 2008, primarily due to the impact of its hotel and gaming revenue growth.

Operating Expenses

Operating expenses for the years ended December 31, 2009, 2008 and 2007 are as follows (in thousands):

Year ended December 31,	2009	2008	Variance	Percentage Variance
Gaming	$ 1,161,510	$ 1,181,870	$ (20,360)	(1.7)%
Food, beverage and other	266,351	257,653	8,698	3.4%
General and administrative	403,136	415,093	(11,957)	(2.9)%
Impairment losses	532,377	481,333	51,044	10.6%
Empress Casino Hotel fire	6,063		6,063	100.0%
Depreciation and amortization	194,436	173,545	20,891	12.0%
Total operating expenses	$ 2,563,873	$ 2,509,494	$ 54,379	2.2%

Year ended December 31,	2008	2007	Variance	Percentage Variance
Gaming	$ 1,181,870	$ 1,180,437	$ 1,433	0.1%
Food, beverage and other	257,653	240,912	16,741	6.9%
General and administrative	415,093	369,720	45,373	12.3%
Impairment losses	481,333		481,333	100.0%
Depreciation and amortization	173,545	147,915	25,630	17.3%
Total operating expenses	$ 2,509,494	$ 1,938,984	$ 570,510	29.4%

Gaming expense

2009 Compared with 2008

Gaming expense decreased by $20.4 million, or 1.7%, to $1,161.5 million in 2009, primarily due to decreases at several of our properties, which were partially offset by increases at Hollywood Casino at Penn National Race Course, Hollywood Slots Hotel and Raceway, and Argosy Casino Riverside.

Gaming expense at Empress Casino Hotel decreased by $36.1 million in 2009, primarily due to a decrease in gaming taxes resulting from lower gaming revenue, lower marketing expenses and the property being closed from March 20, 2009 until June 25, 2009 due to a fire, all of which were partially offset by an increase in incremental tax as a result of the expiration of the 3% tax surcharge from May 26, 2008 through December 14, 2008.

Gaming expense at Charles Town Entertainment Complex decreased by $11.8 million in 2009, primarily due to a decrease in gaming taxes resulting from lower gaming revenue.

Gaming expense at Hollywood Casino Aurora decreased by $7.0 million in 2009, primarily due to a decrease in gaming taxes resulting from lower gaming revenue, which was partially offset by an increase in incremental tax as a result of the expiration of the 3% tax surcharge from May 26, 2008 through December 14, 2008.

Gaming expense at Hollywood Casino Lawrenceburg decreased by $4.2 million in 2009, primarily due to a decrease in gaming taxes resulting from lower gaming revenue and lower payroll costs, both of which were partially offset by increased marketing expenses.

Gaming expense at Argosy Casino Alton decreased by $3.7 million in 2009, primarily due to a decrease in gaming taxes resulting from lower gaming revenue.

Gaming expense at Black Gold Casino at Zia Park decreased by $3.2 million in 2009, primarily due to a decrease in gaming taxes resulting from lower gaming revenue.

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Gaming expense at Hollywood Casino Bay St. Louis decreased by $3.1 million in 2009, primarily due to a decrease in gaming taxes resulting from lower gaming revenue and reduced marketing expenses.

Gaming expense at Hollywood Casino at Penn National Race Course increased by $41.7 million in 2009, primarily due to an increase in gaming taxes resulting from higher gaming revenue and an increase in regulatory fees.

Gaming expense at Hollywood Slots Hotel and Raceway increased by $5.4 million in 2009, primarily due to the continued impact of the opening of the permanent facility on July 1, 2008.

Gaming expense at Argosy Casino Riverside increased by $3.7 million in 2009, primarily due to an increase in gaming taxes resulting from higher gaming revenue due to the repeal of the $500 loss limit in Missouri and an increase in the tax rate on adjusted gross receipts in November 2008.

2008 Compared with 2007

Gaming expense increased by $1.4 million, or 0.1%, to $1,181.9 million in 2008, primarily due to the opening of the casino at Hollywood Casino at Penn National Race Course, the acquisition of Black Gold Casino at Zia Park, and the opening of the permanent facility at Hollywood Slots Hotel and Raceway, all of which were partially offset by decreases at several of our properties.

Gaming expense at Hollywood Casino at Penn National Race Course, which opened its casino on February 12, 2008, was $118.6 million in 2008.

Gaming expense at Black Gold Casino at Zia Park increased by $15.4 million in 2008, primarily due to the acquisition of the property in mid-April 2007, as well as an increase in gaming taxes resulting from higher gaming revenue.

Gaming expense at Hollywood Slots Hotel and Raceway increased by $4.5 million in 2008, primarily due to the opening of the permanent facility on July 1, 2008.

Gaming expense at Empress Casino Hotel decreased by $45.6 million in 2008, primarily due to a decrease in gaming taxes resulting from lower gaming revenue, the expiration of the 3% tax surcharge from May 26, 2008 through December 14, 2008, decreased marketing expenses and lower payroll costs.

Gaming expense at Hollywood Casino Aurora decreased by $34.0 million in 2008, primarily due to a decrease in gaming taxes resulting from lower gaming revenue, the expiration of the 3% tax surcharge from May 26, 2008 through December 14, 2008, decreased marketing expenses and lower payroll costs.

Gaming expense at Hollywood Casino Lawrenceburg decreased by $19.5 million in 2008, primarily due to a decrease in gaming taxes resulting from lower gaming revenue, decrease in the fee paid to the City of Lawrenceburg resulting from lower adjusted gross receipts, and lower payroll costs, all of which were partially offset by an increase in marketing expense.

Gaming expense at Argosy Casino Alton decreased by $15.2 million in 2008, primarily due to a decrease in gaming taxes resulting from lower gaming revenue.

Gaming expense at Charles Town Entertainment Complex decreased by $11.0 million in 2008, primarily due to a decrease in gaming taxes resulting from lower gaming revenue.

Gaming expense at Hollywood Casino Tunica decreased by $5.9 million in 2008, primarily due to a decrease in gaming taxes resulting from lower gaming revenue, decreased marketing expenses and lower payroll costs.

Gaming expense at Boomtown Biloxi decreased by $3.5 million in 2008, primarily due to a decrease in gaming taxes resulting from lower gaming revenue.

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Food, beverage and other expense

2009 Compared to 2008

Food, beverage and other expense increased by $8.7 million, or 3.4%, to $266.4 million in 2009, primarily due to increases at several of our properties, which were partially offset by a decrease at Empress Casino Hotel.

Food, beverage and other expense at Hollywood Casino at Penn National Race Course increased by $4.9 million in 2009, primarily due to the opening of a buffet in October 2008, the opening of a specialty restaurant in December 2008, and the continued impact of the opening of the casino on February 12, 2008.

Food, beverage and other expense at Hollywood Casino Tunica increased by $2.9 million in 2009, primarily due to an increase in the volume of food and beverages resulting from higher food and beverage revenue.

Food, beverage and other expense at Argosy Casino Riverside increased by $1.6 million in 2009, primarily due to increased benefit costs.

Food, beverage and other expense at Boomtown Biloxi increased by $1.5 million in 2009, primarily due to an increase in the volume of food and beverages resulting from higher food and beverage revenue.

Food, beverage and other expense at Hollywood Slots Hotel and Raceway increased by $1.3 million in 2009, primarily due to the continued impact of the opening of the permanent facility on July 1, 2008.

Food, beverage and other expense at Empress Casino Hotel decreased by $3.6 million in 2009, as the property was closed from March 20, 2009 until June 25, 2009 due to a fire.

2008 Compared with 2007

Food, beverage and other expense increased by $16.7 million, or 6.9%, to $257.7 million in 2008, primarily due to the acquisition of Sanford-Orlando Kennel Club, the opening of the permanent facility at Hollywood Slots Hotel and Raceway, the opening of the casino at Hollywood Casino at Penn National Race Course, and the impact of the hotel at Argosy Casino Riverside, all of which were partially offset by a decrease at Hollywood Casino Tunica.

Food, beverage and other expense at Sanford-Orlando Kennel Club, which we acquired in mid-October 2007, increased by $5.7 million in 2008.

Food, beverage and other expense at Hollywood Slots Hotel and Raceway increased by $4.7 million in 2008, primarily due to the opening of the permanent facility on July 1, 2008.

Food, beverage and other expense at Hollywood Casino at Penn National Race Course increased by $4.5 million in 2008, as the casino opened on February 12, 2008.

Food, beverage and other expense at Argosy Casino Riverside increased by $1.5 million in 2008, primarily due to the impact of its hotel.

Food, beverage and other expense at Hollywood Casino Tunica decreased by $2.0 million in 2008, primarily due to a decrease in the cost of food and beverages resulting from lower food and beverage revenue, as well as lower payroll costs.

General and administrative expense

General and administrative expense at the properties includes expenses such as compliance, facility maintenance, utilities, property and liability insurance, surveillance and security, and certain housekeeping, as well as all expenses for administrative departments such as accounting, purchasing,

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human resources, legal and internal audit. General and administrative expense also includes lobbying expenses.

2009 Compared with 2008

General and administrative expense decreased by $12.0 million, or 2.9%, to $403.1 million in 2009, primarily due to decreases in corporate overhead expense and at Empress Casino Hotel, both of which were partially offset by an increase at Hollywood Casino at Penn National Race Course.

Corporate overhead expense decreased by $9.6 million in 2009, primarily due to decreased lobbying expenses, which was partially offset by the expensing of equity-based compensation awards having increased by $1.5 million for the year ended December 31, 2009, primarily due to the timing of the 2008 stock option grant and the extension of the expiration date for previous stock option grants by up to three years in December 2008, increased payroll costs, and increased costs for legal, consulting and other fees related to the pursuit of potential opportunities.

General and administrative expense at Empress Casino Hotel decreased by $4.2 million in 2009, as the property was closed from March 20, 2009 until June 25, 2009 due to a fire.

General and administrative expense at Hollywood Casino at Penn National Race Course increased by $5.0 million in 2009, primarily due to increased payroll costs and an increase in real estate taxes due to the property reassessments that were effective in April 2009.

2008 Compared with 2007

General and administrative expense increased by $45.4 million, or 12.3%, to $415.1 million in 2008, primarily due to an increase in corporate overhead expense and the opening of the casino at Hollywood Casino at Penn National Race Course, both of which were partially offset by a decrease at Argosy Casino Alton.

Corporate overhead expense increased by $38.7 million in 2008, primarily due to increased lobbying expenses, for efforts primarily in Ohio, Maryland and Maine, and separation payments to Leonard DeAngelo, both of which were partially offset by no EBITDA-based bonuses being paid to corporate employees in 2008.

General and administrative expense at Hollywood Casino at Penn National Race Course increased by $11.2 million in 2008, as the casino opened on February 12, 2008.

General and administrative expense at Argosy Casino Alton decreased by $4.2 million in 2008, primarily due to cost reduction measures.

Impairment losses

2009

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

2008

As a result of a decline in our share price, an overall reduction in industry valuations, and property operating performance in the then-current economic environment, we recorded a pre-tax impairment charge of $481.3 million ($392.6 million, net of taxes) during the year ended December 31, 2008, as we

determined that a portion of the value of our goodwill, indefinite-life intangible assets and long-lived assets was impaired. The impairment charge by property was as follows: Hollywood Casino Lawrenceburg, $214.1 million pre-tax ($189.3 million, net of taxes); Hollywood Casino Aurora, $43.7 million pre-tax and net of taxes; Empress Casino Hotel, $94.4 million pre-tax ($60.4 million, net of taxes); Argosy Casino Alton, $14.1 million pre-tax and net of taxes; Bullwhackers, $14.2 million pre-tax ($9.1 million, net of taxes); Hollywood Slots Hotel and Raceway, $82.7 million pre-tax ($64.0 million, net of taxes); and Corporate overhead, $18.1 million pre-tax ($12.0 million, net of taxes).

Empress Casino Hotel fire

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

Depreciation and amortization expense

2009 Compared to 2008

Depreciation and amortization expense increased by $20.9 million, or 12.0%, to $194.4 million in 2009, primarily due to increases at Hollywood Casino at Penn National Race Course, Hollywood Casino Lawrenceburg, and Hollywood Slots Hotel and Raceway, all of which were partially offset by decreases at Argosy Casino Riverside, Empress Casino Hotel, and corporate overhead.

Depreciation and amortization expense at Hollywood Casino at Penn National Race Course increased by $13.3 million in 2009, primarily due to incremental depreciation expense being recorded during the year ended December 31, 2009 and the continued impact of the opening of the casino on February 12, 2008.

Depreciation and amortization expense at Hollywood Casino Lawrenceburg increased by $9.9 million in 2009, primarily due to the opening of the new casino riverboat in late June 2009.

Depreciation and amortization expense at Hollywood Slots Hotel and Raceway increased by $5.9 million in 2009, primarily due to the continued impact of the opening of the permanent facility on July 1, 2008.

Depreciation and amortization expense at Argosy Casino Riverside decreased by $3.2 million in 2009, primarily due to a large volume of equipment related to the casino expansion completed in December 2003 now being fully depreciated.

Depreciation and amortization expense at Empress Casino Hotel decreased by $2.8 million in 2009, as the property was closed from March 20, 2009 until June 25, 2009 due to a fire.

Depreciation and amortization expense for corporate overhead decreased by $0.9 million in 2009, primarily due to certain intangible assets now being fully amortized.

2008 Compared with 2007

Depreciation and amortization expense increased by $25.6 million, or 17.3%, to $173.5 million in 2008, primarily due to the opening of the casino at Hollywood Casino at Penn National Race Course and the opening of the permanent facility at Hollywood Slots Hotel and Raceway.

Depreciation and amortization expense at Hollywood Casino at Penn National Race Course increased by $21.2 million in 2008, as the casino opened on February 12, 2008.

Depreciation and amortization expense at Hollywood Slots Hotel and Raceway increased by $3.8 million in 2008, primarily due to the opening of the permanent facility on July 1, 2008.

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Other income (expenses)

Other income (expenses) for the years ended December 31, 2009, 2008 and 2007 are as follows (in thousands):

Year ended December 31,	2009	2008	Variance	Percentage Variance
Interest expense	$ (134,984)	$ (169,827)	$ 34,843	20.5%
Interest income	6,522	8,362	(1,840)	(22.0)%
Loss from joint venture	(1,121)	(1,526)	405	26.5%
Merger termination settlement fees, net of related expenses		195,426	(195,426)	(100.0)%
Loss on early extinguishment of debt	(4,793)		(4,793)	(100.0)%
Other	1,093	6,421	(5,328)	(83.0)%
Total other (expenses) income	$ (133,283)	$ 38,856	$ (172,139)	(443.0)%

Year ended December 31,	2008	2007	Variance	Percentage Variance
Interest expense	$ (169,827)	$ (198,059)	$ 28,232	14.3%
Interest income	8,362	4,016	4,346	108.2%
Loss from joint venture	(1,526)	(99)	(1,427)	(1,441.4)%
Merger termination settlement fees, net of related expenses	195,426		195,426	100.0%
Other	6,421	(11,427)	17,848	156.2%
Total other income (expenses)	$ 38,856	$ (205,569)	$ 244,425	118.9%

Interest expense

Interest expense decreased by $34.8 million, or 20.5%, to $135.0 million in 2009, primarily due to lower outstanding balances and lower interest rates on our senior secured credit facility, which was partially offset by increased interest expense resulting from interest rate swaps due to the drop in variable rates, lower capitalized interest during the year ended December 31, 2009 and incremental interest expense due to the issuance of the $325 million 8$^{3}/_{4}$% senior subordinated notes in August 2009.

Interest expense decreased by $28.2 million, or 14.3%, to $169.8 million in 2008, primarily due to lower outstanding balances and lower interest rates on our senior secured credit facility, which was partially offset by increased interest expense resulting from payments related to interest rate swaps in 2008.

Interest income

Interest income increased by $4.3 million, or 108.2%, to $8.4 million in 2008, primarily due to interest earned on the investment in corporate securities in 2008, as well as the original issue discount amortization.

Merger termination settlement fees, net of related expenses

Merger termination settlement fees, net of related expenses, include the Cash Termination Fee of $225 million, partially offset by $29.6 million in costs incurred for the termination of the Merger.

Loss on early extinguishment of debt

We recorded a $4.8 million loss on early extinguishment of debt during the year ended December 31, 2009, as a result of the repayment of all outstanding borrowings under the Term Loan A

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Facility of the senior secured credit facility and the redemption of our $200 million 6$^{7}/_{8}$% senior subordinated notes. As a result of these payments, we recorded a loss on early extinguishment of debt of $4.8 million for the write-off of deferred financing fees related to the Term Loan A Facility and the $200 million 6$^{7}/_{8}$% senior subordinated notes.

Other

Other decreased by $5.3 million, or 83.0%, to $1.1 million in 2009, primarily due to foreign currency translation losses that were recorded during the year ended December 31, 2009, which was partially offset by the gain on the sale of the investment in corporate debt securities.

Other increased by $17.8 million, or 156.2%, to $6.4 million in 2008, primarily due to foreign currency translation gains that were recorded during the year ended December 31, 2008, which was partially offset by the write-off of costs incurred to procure licenses to manage gaming facilities in Kansas.

Taxes

The decrease in our effective tax rate (income taxes as a percentage of income from operations before taxes) to 18.4% for the year ended December 31, 2009, as compared to 222.2% for the year ended December 31, 2008, is primarily as a result of lower earnings, a change in the geographic mix of earnings and benefits related to favorable resolutions of certain tax settlements, all of which were partially offset by an increase in the rate due to the non-deductible portion of our goodwill impairment charges.

The increase in our effective tax rate to 222.2% for the year ended December 31, 2008, as compared to 45.2% for the year ended December 31, 2007, is primarily a result of the nondeductible portion of the impairment loss related to goodwill and nondeductible lobbying expenses.

Our effective income tax rate can vary from period to period depending on, among other factors, the geographic and business mix of our earnings and the level of our tax credits. Certain of these and other factors, including our history of pre-tax earnings, are taken into account in assessing our ability to realize our net deferred tax assets. We expect our effective tax rate to normalize for the year ending December 31, 2010.

Liquidity and Capital Resources

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

Net cash provided by operating activities was $338.2 million, $420.5 million and $431.2 million for the years ended December 31, 2009, 2008 and 2007, respectively. Net cash provided by operating activities for the year ended December 31, 2009 included non-cash reconciling items, such as depreciation, amortization, the charge for stock compensation, the loss relating to the early extinguishment of debt, the Empress Casino Hotel fire insurance loss, the gain on sale of investment in corporate debt securities, and impairment losses, of $623.0 million, partially offset by net loss including noncontrolling interests of $267.4 million and net changes in asset and liability accounts of $17.4 million.

Net cash used in investing activities totaled $262.7 million, $391.5 million and $611.6 million for the years ended December 31, 2009, 2008 and 2007, respectively. Net cash used in investing activities for the year ended December 31, 2009 included expenditures for property and equipment and license fees totaling $289.6 million and $9.0 million, respectively, investment in Kansas Entertainment of $12.9 million, increase in cash in escrow of $25.0 million, all of which were partially offset by proceeds from the sale of property and equipment, the sale of investment in corporate debt securities and insurance proceeds received as a result of the Empress Casino Hotel fire totaling $2.6 million, $50.6 million and $20.6 million, respectively.

Net cash (used in) provided by financing activities totaled ($108.8) million, $542.9 million and $186.3 million for the years ended December 31, 2009, 2008 and 2007, respectively. Net cash used in financing activities for the year ended December 31, 2009 included principal payments on long-term debt and payments on insurance financing totaling $879.2 million and $16.8 million, respectively, and an increase in deferred financing fees of $22.9 million. All of these were partially offset by proceeds from the exercise of stock options totaling $5.4 million, the tax benefit from stock options exercised totaling $2.4 million, contributions from noncontrolling interests of $1.9 million, and proceeds from the issuance of long-term debt and insurance financing of $784.9 million and $15.5 million, respectively.

On July 3, 2008, we entered into an agreement with certain affiliates of Fortress and Centerbridge, terminating the Merger Agreement. In connection with the termination of the Merger Agreement, we agreed to receive a total of $1.475 billion, consisting of the Cash Termination Fee and the Investment. On October 30, 2008, we closed the sale of the Investment and issued 12,500 shares of our Preferred Stock.

We used a portion of the net proceeds from the Investment and the after-tax proceeds of the Cash Termination Fee for the repayment of some of our existing debt, repurchases of our Common Stock, lobbying expenses for efforts in Ohio and investment in corporate debt securities, with the remainder being invested primarily in short-term securities. The repurchase of up to $200 million of our Common Stock over the twenty-four month period ending July 2010 was authorized by our Board of Directors in July 2008. During the year ended December 31, 2009, we did not repurchase any shares of our Common Stock. During the year ended December 31, 2008, we repurchased 8,934,984 shares of our Common Stock in open market transactions for approximately $152.6 million, at an average price of $17.05.

Capital Expenditures

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

The following table summarizes our capital project expenditures by property for the year ended December 31, 2009:

Property	Actual(1) (in millions)
Hollywood Casino Lawrenceburg	$ 124.6
Empress Casino Hotel	50.8
Hollywood Casino Perryville	19.2
Hollywood Casino at Penn National Race Course	4.7
Hollywood Casino Toledo	2.5
Hollywood Slots Hotel and Raceway	0.6
Other	6.6
Total	$ 209.0

(1) Excludes licensing fees

The Hollywood-themed expansion at Lawrenceburg includes the addition of 1,500 parking spaces and 1,168 gaming positions, as well as enhanced amenities and a floor layout that will better facilitate customer flow. The garage and pedestrian walkway opened in May 2008 and the gaming facility opened in June 2009. Meeting space for Hollywood Casino Lawrenceburg partially opened in December 2009 and will be completed in the first quarter of 2010, a new steakhouse/lounge is scheduled for completion

in the second quarter of 2010, and a new mid-priced restaurant is scheduled for completion in the third quarter of 2010.

At Empress Casino Hotel, we started the facility enhancements in late 2008. On March 20, 2009, Empress Casino Hotel, which was undergoing a $55 million renovation, was closed following a fire that started in the land-based pavilion at the facility. All customers and employees were successfully evacuated, and the fire was contained on the land-side of the property before it could spread to the adjacent casino barge. On June 25, 2009, the casino barge was reopened with temporary land-based facilities, and we began construction of a new land-based pavilion. Construction on a new 1,100 space parking garage was completed in the first quarter of 2010. The permanent land-based pavilion is expected to be completed by the fourth quarter of 2010 and upgrades to the gaming vessel and other areas are expected to be completed by the first quarter of 2011.

In Cecil County, Maryland, following our selection by the Maryland Video Lottery Facility Location Commission to develop and manage a video lottery terminal facility, we exercised our option and completed the purchase of approximately 36 acres of land located in Perryville, Maryland, and commenced construction of a $97.5 million Hollywood-themed facility, inclusive of licensing fees of $9.0 million. The new facility will feature 75,000 square feet of gaming space, 1,500 video lottery terminals, food and beverage offerings, and parking for over 1,600 vehicles. The facility is expected to open to the public in late 2010.

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

In November 2009, the "Ohio Jobs and Growth Plan," a casino ballot proposal calling for an amendment to Ohio's Constitution to authorize casinos in the state's four largest cities, Cincinnati, Cleveland, Columbus and Toledo, was approved. Plans are currently being developed for a $300 million Hollywood-themed casino in Toledo, Ohio, inclusive of $50 million in licensing fees, and a $400 million Hollywood-themed casino in Columbus, Ohio, inclusive of $50 million in licensing fees. Hollywood Casino Toledo is expected to feature a 125,000 square foot casino, up to 3,000 slot machines, 80 table games and 20 poker tables, a 2,500 parking space garage, as well as food and beverage outlets and an entertainment lounge. Hollywood Casino Columbus is expected to feature a 180,000 square foot casino, up to 4,000 slot machines, 100 table games and 25 poker tables, a 4,000 parking space garage, as well as food and beverage outlets and an entertainment lounge. Hollywood Casino Toledo and Hollywood Casino Columbus are estimated to be completed in the second half of 2012.

In February 2010, Kansas Entertainment received the final approval under the Kansas Expanded Lottery Act, along with its gaming license from the Kansas Racing and Gaming Commission, to proceed with the development of a Hollywood-themed destination facility overlooking Turn 2 at Kansas Speedway. In December 2009, Kansas Entertainment was selected by the Kansas Lottery Gaming Facility Review Board to develop and operate a facility in the North East Gaming Zone in Wyandotte County, Kansas. Kansas Entertainment will begin construction of the facility in the second half of 2010 with a planned opening in early 2012. The $410 million Hollywood-themed destination facility, inclusive of licensing fees, is expected to feature a 100,000 square foot casino with capacity for 2,300 slot machines, 61 table games and 25 poker tables, a 1,500 parking structure, as well as a variety of dining and entertainment amenities. We and International Speedway Corporation will share equally the cost of developing and constructing the proposed facility. We estimate that our share of the project will be approximately $155 million.

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

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During the year ended December 31, 2009, we spent approximately $80.6 million for capital maintenance expenditures at our properties. The majority of the capital maintenance expenditures were for slot machines and slot machine equipment.

Cash generated from operations and cash available under the revolver portion of our senior secured credit facility have funded our capital project and capital maintenance expenditures in 2009.

The following table summarizes our expected capital project expenditures by property for the year ended December 31, 2010, as well as the projects in their entirety (including licensing fees):

Property	Project Total for 2010	Our Share of Project Total for 2010	Project Total	Our Share of Project Total
		(in millions)		
Hollywood Casino Lawrenceburg	$ 12.3	$ 12.3	$ 13.5	$ 13.5
Empress Casino Hotel(1)	63.3	63.3	81.0	81.0
Charles Town Entertainment Complex	38.6	38.6	40.0	40.0
Hollywood Casino at Penn National Race Course	24.7	24.7	25.0	25.0
Hollywood Casino Perryville	67.2	67.2	98.0	98.0
Hollywood Casino Columbus	105.0	94.5	400.0	360.0
Hollywood Casino Toledo	80.0	72.0	300.0	270.0
Wyandotte County, Kansas	50.0	25.0	410.0	155.0
Other	17.2	17.2	26.3	26.3
Total	$ 458.3	$ 414.8	$ 1,393.8	$ 1,068.8

(1) Net of amounts received from insurance proceeds.

Debt

Senior Secured Credit Facility

The senior secured credit facility historically consisted of three credit facilities comprised of a $750 million revolving credit facility with a maturity date of October 3, 2010, a $325 million Term Loan A Facility with a maturity date of October 3, 2011 and a $1.65 billion Term Loan B Facility with a maturity date of October 3, 2012. In September 2009, we amended our senior secured credit facility, in order to increase the borrowing capacity and to extend the term under the revolving credit facility portion of the senior secured credit facility. Under the new revolving credit facility, two tranches were created, one for those participants who agreed to extend and one for those that did not extend. Tranche A Revolving Loans consist of available borrowings of $359.4 million, which are due on the original maturity date of October 3, 2010, and Tranche B Revolving Loans consist of available borrowings of $640.6 million, which are due on July 3, 2012, for a total borrowing capacity of $1 billion.

In August 2009, we repaid $40 million of borrowings under the Term Loan A Facility, $70 million of borrowings under the Term Loan B Facility, and all outstanding borrowings under the revolving credit facility at the time, using a portion of the proceeds from the offering of $325 million 8 3/4% senior subordinated notes. In addition, in September 2009, we repaid all of the remaining outstanding borrowings under the Term Loan A Facility, using drawings under the new revolving credit facility.

As of December 31, 2009, $237.5 million was drawn under the revolving credit facility and $1,518.1 million was outstanding under the Term Loan B Facility, for a total of $1,755.6 million. As of December 31, 2008, $123.7 million was drawn under the revolving credit facility, $239.7 million was outstanding under the Term Loan A Facility, and $1,596.4 million was outstanding under the Term Loan B Facility, for a total of $1,959.8 million.

We recorded a $2.4 million loss on early extinguishment of debt during the year ended December 31, 2009 for the write-off of deferred financing fees related to the Term Loan A Facility.

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During the year ended December 31, 2009, our senior secured credit facility amount outstanding decreased by $204.2 million, primarily due to the August 2009 repayment of $40 million of borrowings under the Term Loan A Facility, $70 million of borrowings under the Term Loan B Facility, and all outstanding borrowings under the revolving credit facility at the time, using a portion of the proceeds from the offering of $325 million 8 3/4% senior subordinated notes. These repayments were partially offset by drawings under the revolving credit facility, primarily to repay $105.5 million outstanding aggregate principal amount of the 6 7/8% senior subordinated notes.

The senior secured credit facility is secured by substantially all of the assets of Penn and its restricted subsidiaries.

Redemption of 6 7/8% Senior Subordinated Notes

In August 2009, we called for the redemption of our $200 million 6 7/8% senior subordinated notes. The redemption price was $1,000 per $1,000 principal amount, plus accrued and unpaid interest, which was paid in September 2009. Approximately $94.5 million aggregate principal amount of the 6 7/8% senior subordinated notes were validly tendered and paid. In October 2009, we called for the redemption of all of the $105.5 million outstanding aggregate principal amount of our 6 7/8% senior subordinated notes. The redemption price was $1,000 per $1,000 principal amount, plus accrued and unpaid interest. In December 2009, we repaid all of the $105.5 million outstanding aggregate principal amount of our 6 7/8% senior subordinated notes. We funded the $94.5 million redemption from a portion of the proceeds from the offering of $325 million 8 3/4% senior subordinated notes and available cash and funded the $105.5 million redemption using drawings under the revolving credit facility.

We recorded a $2.4 million loss on early extinguishment of debt during the year ended December 31, 2009 for the write-off of the deferred financing fees related to the $200 million 6 7/8% senior subordinated notes.

6 3/4% Senior Subordinated Notes

On March 9, 2005, we completed an offering of $250 million 6 3/4% senior subordinated notes that mature on March 1, 2015. Interest on the $250 million 6 3/4% senior subordinated notes is payable on March 1 and September 1 of each year, beginning September 1, 2005. The $250 million 6 3/4% senior subordinated notes are general unsecured obligations and are not guaranteed by our subsidiaries. The $250 million 6 3/4% senior subordinated notes were issued in a private placement pursuant to an exemption from the registration requirements of the Securities Act of 1933, as amended. Effective March 2010, we may redeem all or part of the $250 million 6 3/4% senior subordinated notes at certain specified redemption prices.

8 3/4% Senior Subordinated Notes

In August 2009, we completed an offering of $325 million 8 3/4% senior subordinated notes that mature on August 15, 2019. Interest on the $325 million 8 3/4% senior subordinated notes is payable on February 15 and August 15 of each year, beginning February 15, 2010. The $325 million 8 3/4% senior subordinated notes are general unsecured obligations and are not guaranteed by our subsidiaries. The $325 million 8 3/4% senior subordinated notes were issued in a private placement pursuant to an exemption from the registration requirements of the Securities Act of 1933, as amended.

A portion of the proceeds from the offering were used to repay $40 million of borrowings under the Term Loan A Facility, $70 million of borrowings under the Term Loan B Facility, and all outstanding borrowings under the revolving credit facility at the time. The remainder of the proceeds, plus available cash, was used to pay the validly-tendered principal amounts of the $200 million 6 7/8% senior subordinated notes.

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Other Long-Term Obligations

On October 15, 2004, we announced the sale of The Downs Racing, Inc. and its subsidiaries to the Mohegan Tribal Gaming Authority ("MTGA"). Under the terms of the agreement, the MTGA acquired The Downs Racing, Inc. and its subsidiaries, including Pocono Downs (a standardbred horse racing facility located on 400 acres in Wilkes-Barre, Pennsylvania) and five Pennsylvania OTWs located in Carbondale, East Stroudsburg, Erie, Hazelton and the Lehigh Valley (Allentown). The sale agreement also provided the MTGA with certain post-closing termination rights in the event of certain materially adverse legislative or regulatory events. In January 2005, we received $280 million from the MTGA, and transferred the operations of The Downs Racing, Inc. and its subsidiaries to the MTGA. The sale was not considered final for accounting purposes until the third quarter of 2006, as the MTGA had certain post-closing termination rights that remained outstanding. On August 7, 2006, we entered into the Second Amendment to the Purchase Agreement and Release of Claims with the MTGA pertaining to the October 14, 2004 Purchase Agreement (the "Purchase Agreement"), and agreed to pay the MTGA an aggregate of $30 million over five years, beginning on the first anniversary of the commencement of slot operations at Mohegan Sun at Pocono Downs, in exchange for the MTGA's agreement to release various claims it raised against us under the Purchase Agreement and the MTGA's surrender of all post-closing termination rights it might have had under the Purchase Agreement. We recorded the present value of the $30 million liability within debt, as the amount due to the MTGA was payable over five years. In March 2009, we entered into the Third Amendment to the Purchase Agreement, in which the remaining payments due under the Purchase Agreement were accelerated and reduced. Under the Third Amendment to the Purchase Agreement, in exchange for the accelerated payment, which was paid to the MTGA in March 2009, all remaining obligations under the Purchase Agreement were deemed to be satisfied and, as result, we recorded a $1.3 million gain during the year ended December 31, 2009, which is included in other income within the consolidated statements of operations.

Covenants

Our senior secured credit facility, $325 million $8^{3}/_{4}\%$ and $250 million $6^{3}/_{4}\%$ senior subordinated notes require us, among other obligations, to maintain specified financial ratios and to satisfy certain financial tests, including fixed charge coverage, senior leverage and total leverage ratios. In addition, our senior secured credit facility, $325 million $8^{3}/_{4}\%$ and $250 million $6^{3}/_{4}\%$ senior subordinated notes restrict, among other things, our ability to incur additional indebtedness, incur guarantee obligations, amend debt instruments, pay dividends, create liens on assets, make investments, make acquisitions, engage in mergers or consolidations, make capital expenditures, or engage in certain transactions with subsidiaries and affiliates and otherwise restricts corporate activities.

During the year ended December 31, 2008, we placed some of the funds received from the issuance of our Preferred Stock into unrestricted subsidiaries, in order to allow for maximum flexibility in the deployment of the funds. The funds and activity maintained within the unrestricted subsidiaries are excluded from our covenant calculations.

At December 31, 2009, we were in compliance with all required financial covenants.

Outlook

Based on our current level of operations, and anticipated revenue growth, we believe that cash generated from operations and from the Investment, together with amounts available under our senior secured credit facility, will be adequate to meet our anticipated debt service requirements, capital expenditures and working capital needs for the foreseeable future. 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 senior secured credit facility or otherwise will be available to enable us to service our indebtedness, including the senior secured credit facility and the senior subordinated notes, to retire or redeem the senior subordinated notes when

required or to make anticipated capital expenditures. In addition, we expect a majority of our future growth to come from acquisitions of gaming properties at reasonable valuations, greenfield projects, jurisdictional expansions and property expansion in under-penetrated markets. If we consummate significant acquisitions in the future or undertake any significant property expansions, our cash requirements may increase significantly and we may need to make additional borrowings or complete equity or debt financings to meet these requirements. 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. See "Risk Factors Risks Related to Our Capital Structure" of this Annual Report on Form 10-K for a discussion of the risk related to our capital structure.

Commitments and Contingencies

Contractual Cash Obligations

At December 31, 2009, there was $237.5 million indebtedness outstanding under the revolving credit portion of our senior secured credit facility and approximately $734.7 million available for borrowing. The following table presents our contractual cash obligations at December 31, 2009:

	Payments Due By Period				
	Total	**2010**	**2011 - 2012**	**2013 - 2014**	**2015 and After**
			(in thousands)		
Senior secured credit facility					
Principal	$ 1,755,602	$ 85,019	$ 1,670,583	$	$
Interest	183,709	85,248	98,461		
6 3/4% senior subordinated notes					
Principal	250,000				250,000
Interest	92,813	16,875	33,750	33,750	8,438
8 3/4% senior subordinated notes					
Principal	325,000				325,000
Interest	284,454	28,516	56,875	56,875	142,188
Purchase obligations	25,957	17,807	4,294	2,595	1,261
Capital expenditure commitments	53,102	53,102			
Capital leases	4,175	1,052	1,203	171	1,749
Operating leases	63,948	7,006	12,152	8,462	36,328
Other liabilities reflected in the Company's consolidated balance sheets(1)	12,904	12,904			
Total	$ 3,051,664	$ 307,529	$ 1,877,318	$ 101,853	$ 764,964

(1) Does not include any liability for unrecognized tax benefits, as the Company cannot make a reasonably reliable estimate of the period of cash settlement with the respective taxing authority.

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Other Commercial Commitments

The following table presents our material commercial commitments as of December 31, 2009 for the following future periods:

	Total Amounts Committed	2010	2011 2012	2013 2014	2015 and After
			(in thousands)		
Letters of Credit(1)	$ 27,865	$ 27,865	$	$	$
Guarantees of New Jersey Joint Venture Obligations(2)	4,365	1,000	2,000	1,365	
Total	$ 32,230	$ 28,865	$ 2,000	$ 1,365	$

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

(2) In connection with our 50% ownership interest in Pennwood Racing, Inc. ("Pennwood"), our joint venture in New Jersey, we entered into a debt service maintenance agreement with Pennwood's lender to guarantee up to 50% of Pennwood's $8.7 million term loan. Our obligation at December 31, 2009 under this guarantee was approximately $4.4 million.

Interest Rate Swap Agreements

See Item 7A, "Quantitative and Qualitative Disclosures About Market Risk" below.

New Accounting Pronouncements

In January 2010, the FASB issued guidance to improve disclosures about fair value measurements. The guidance provides amendments to require new disclosures regarding transfers in and out of Levels 1 and 2 of the fair value measurement hierarchy, and activity in Level 3, and to clarify existing disclosures regarding the level of disaggregation, inputs and valuation techniques. The guidance is effective for interim and annual reporting periods beginning after December 15, 2009, except for the new disclosures regarding purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements, which are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. We adopted the guidance, except for the new disclosures regarding purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements, as of January 1, 2010, as required. We do not expect that the January 1, 2010 adoption of the guidance will have a material impact on our consolidated financial statements. We are currently determining the impact of the new disclosures regarding purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements on our consolidated financial statements.

In January 2010, the FASB issued guidance to address implementation issues related to the changes in ownership provisions in ASC 810, "Consolidation," ("ASC 810"). The guidance clarifies the scope of the decrease in ownership provisions in ASC 810 and expands the disclosures about the deconsolidation of a subsidiary or derecognition of a group of assets within the scope of ASC 810. As we previously adopted ASC 810, the guidance is effective beginning in the first interim or annual reporting period ending on or after December 15, 2009, and should be applied retrospectively to the first period that ASC 810 was adopted by us. We adopted the guidance as of December 31, 2009, as required. This guidance did not have a material impact on our consolidated financial statements.

In September 2009, the FASB issued guidance concerning fair value measurements of investments in certain entities that calculate net asset value per share (or its equivalent). The guidance creates a practical expedient to measure the fair value of an investment that is within the scope of the guidance on the basis of the net asset value per share of the investment (or its equivalent) determined as of the reporting entity's measurement date. Therefore, the guidance allows certain attributes of the

investment, which in the past may have indicated that it was necessary to make adjustments to the net asset value per share (or its equivalent) to estimate the fair value of the investment, to not be considered if the practical expedient is used. Additional disclosures are also required under the guidance. The guidance is effective for interim and annual periods ending after December 15, 2009, with early application permitted. We adopted the guidance as of December 31, 2009, as required. This guidance did not have a material impact on our consolidated financial statements.

In August 2009, the FASB issued guidance on the measurement of liabilities at fair value. The guidance provides clarification in measuring the fair value of liabilities. The guidance is effective for the first reporting period (including interim periods) beginning after issuance. We adopted the guidance as of October 1, 2009, as required. This guidance did not have a material impact on our consolidated financial statements.

In June 2009, the FASB issued the ASC. The ASC became the source of authoritative accounting principles recognized by the FASB to be applied by nongovernmental entities in the preparation of financial statements in conformity with generally accepted accounting principles ("GAAP"). The ASC eliminates the previous United States GAAP hierarchy and establishes one level of authoritative GAAP. All other literature is considered non-authoritative. The ASC is effective for most financial statements issued for interim and annual periods ending after September 15, 2009. We adopted the ASC as of September 30, 2009, as required. The adoption of the ASC did not have an impact on our consolidated financial statements.

In June 2009, the FASB issued amended guidance for variable interest entities. The objective of the amended guidance is to improve financial reporting by enterprises involved with variable interest entities and to provide more relevant and reliable information to users of financial statements. The amended guidance is effective as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter. Earlier application is prohibited. We adopted the amended guidance as of January 1, 2010, as required. We do not expect that the adoption of the amended guidance will have a material impact on our consolidated financial statements.

In May 2009, the FASB issued guidance on subsequent events. The guidance establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. In addition, under the guidance, an entity is required to disclose the date through which subsequent events have been evaluated, as well as whether that date is the date the financial statements were issued or the date the financial statements were available to be issued. The guidance does not apply to subsequent events or transactions that are within the scope of other applicable GAAP that provide different guidance on the accounting treatment for subsequent events or transactions. The guidance is effective for interim or annual financial periods ending after June 15, 2009, and shall be applied prospectively. We adopted the guidance as of June 30, 2009, as required. The adoption of the guidance did not have a material impact on our consolidated financial statements. In February 2010, the FASB issued amended guidance on subsequent events. The amended guidance removes the requirement for United States Securities and Exchange Commission filers to disclose the date through which subsequent events have been evaluated. The amended guidance is effective upon issuance, except for the use of the issued date for conduit debt obligors. We adopted the amended guidance upon issuance, as required. The adoption of the amended guidance did not have a material impact on our consolidated financial statements.

In April 2009, the FASB issued additional requirements regarding disclosures about the fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. The new requirements are effective for interim reporting periods ending after June 15, 2009. We adopted the additional requirements as of June 30, 2009, as required. The adoption of the new requirements did not have a material impact on our consolidated financial statements.

In April 2009, the FASB issued guidance on the recognition and presentation of other-than-temporary impairments. The guidance amends the other-than-temporary impairment

guidance for debt securities to make the guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments on debt and equity securities in the financial statements. The guidance does not amend existing recognition and measurement guidance related to other-than-temporary impairments of equity securities. The guidance is effective for interim and annual reporting periods ending after June 15, 2009. We adopted the guidance as of June 30, 2009, as required. The adoption of the guidance did not have a material impact on our consolidated financial statements.

In April 2009, the FASB issued guidance on determining fair value when the volume and level of activity for the asset or liability have significantly decreased and on identifying transactions that are not orderly. The guidance is effective for interim and annual reporting periods ending after June 15, 2009, and shall be applied prospectively. We adopted the guidance as of June 30, 2009, as required. The adoption of the guidance did not have a material impact on our consolidated financial statements.

In April 2009, the FASB issued guidance regarding the accounting for assets acquired and liabilities assumed in a business combination that arise from contingencies. The guidance addresses application issues on initial recognition and measurement, subsequent measurement and accounting, and disclosure of assets and liabilities arising from contingencies in a business combination. The guidance is effective for all assets acquired or liabilities assumed arising from contingencies in business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. We adopted the guidance as of January 1, 2009, as required. We expect that the adoption of the guidance will have an impact on our consolidated financial statements, in the event that we acquire companies in the future.

In April 2008, the FASB issued guidance regarding the determination of the useful life of intangible assets. The guidance amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset. The guidance is effective for financial statements issued for fiscal years and interim periods beginning after December 15, 2008. Early adoption is prohibited. We adopted the guidance as of January 1, 2009, as required. The adoption of the guidance did not have a material impact on our consolidated financial statements.

In March 2008, the FASB issued guidance regarding the disclosure of derivative instruments and hedging activities. The guidance requires enhanced disclosures about an entity's derivative and hedging activities. Specifically, entities are required to provide enhanced disclosures about: a) how and why an entity uses derivative instruments; b) how derivative instruments and related hedged items are accounted; and c) how derivative instruments and related hedged items affect an entity's financial position, financial performance and cash flows. The guidance is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. The guidance encourages, but does not require, comparative disclosures for earlier periods at initial adoption. We adopted the guidance as of January 1, 2009, as required. The adoption of the guidance did not have a material impact on our consolidated financial statements.

In December 2007, the FASB issued amended guidance on business combinations. The intention of the amended guidance is to improve reporting by creating greater consistency in the accounting and financial reporting of business combinations. The amended guidance requires that the acquiring entity in a business combination recognize all (and only) the assets and liabilities assumed in the transaction, establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed, and requires the acquirer to disclose to investors and other users all of the information that they need to evaluate and understand the nature and financial effect of the business combination. In addition, the amended guidance modifies the accounting for transaction and restructuring costs. The amended guidance is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. We adopted the amended guidance as of January 1, 2009, as required. We expect

that the adoption of the amended guidance will have an impact on our consolidated financial statements, in the event that we acquire companies in the future.

In September 2006, the FASB issued guidance on fair value measurements. The guidance defines fair value, establishes a framework for measuring fair value, and expands the disclosure requirements about fair value measurements. In February 2008, the FASB amended the guidance so as to exclude from its scope certain accounting pronouncements that address fair value measurements associated with leases and to delay the effective date of the guidance to fiscal years beginning after November 15, 2008 for nonfinancial assets and nonfinancial liabilities that are not recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). In October 2008, the FASB issued additional guidance that provides clarification on the application of the guidance on fair value measurements in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. We adopted the guidance on fair value measurements, as amended, and on a prospective basis, as of January 1, 2008. The January 1, 2008 adoption did not have a material impact on our consolidated financial statements. We adopted the guidance on fair value measurements, as amended, and on a prospective basis, as of January 1, 2009 to nonfinancial assets and nonfinancial liabilities that are not recognized or disclosed at fair value in the financial statements on a recurring basis. The January 1, 2009 adoption did not have a material impact on our consolidated financial statements.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The table below provides information at December 31, 2009 about our financial instruments that are sensitive to changes in interest rates, including debt obligations and interest rate swaps. For debt obligations, the table presents notional amounts maturing during the year and the related weighted-average interest rates at year-end. For interest rate swaps, the table presents notional amounts and weighted-average interest rates outstanding at each year-end. Notional amounts are used to calculate the contractual payments to be exchanged under the contract and the weighted-average variable rates are based on implied forward rates in the yield curve at December 31, 2009.

	2010	2011	2012	2013	2014	Thereafter	Total	Fair Value 12/31/09
				(in thousands)				
Long-term debt:								
Fixed rate	$	$	$	$	$	$ 575,000	$ 575,000	$ 572,375
Average interest rate						7.88%		
Variable rate	$ 85,019	$ 354,875	$ 1,315,708	$	$	$	$ 1,755,602	$ 1,755,602
Average interest rate(1)	3.25%	4.58%	5.09%					
Leases	$ 1,052	$ 1,126	$ 77	$ 82	$ 89	$ 1,749	$ 4,175	$ 4,175
Average interest rate	5.68%	5.67%	7.72%	7.72%	7.72%	7.72%		
Interest rate derivatives:								
Interest rate swaps								
Variable to fixed(2)	$ 1,240,000	$	$	$	$	$	N/A	$ (43,925)
Average pay rate	2.58%						N/A	
Average receive rate(3)	2.00%						N/A	

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

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

(3) Estimated rate, reflective of forward LIBOR.

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

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Report of Independent Registered Public Accounting Firm

Board of Directors
Penn National Gaming, Inc. and subsidiaries

We have audited the accompanying consolidated balance sheets of Penn National Gaming, Inc. and subsidiaries as of December 31, 2009 and 2008, and the related consolidated statements of operations, changes in shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2009. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Penn National Gaming, Inc. and subsidiaries at December 31, 2009 and 2008, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2009, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Penn National Gaming, Inc. and subsidiaries' internal control over financial reporting as of December 31, 2009, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 26, 2010 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Philadelphia, Pennsylvania
February 26, 2010

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

	December 31, 2009	December 31, 2008
Assets		
Current assets		
Cash and cash equivalents	$ 713,118	$ 746,278
Receivables, net of allowance for doubtful accounts of $3,548 and $3,797 at December 31, 2009 and 2008, respectively	46,672	43,574
Insurance receivable	33,494	
Prepaid expenses and other current assets	121,545	95,386
Deferred income taxes	23,619	21,065
Total current assets	938,448	906,303
Property and equipment, net	1,837,504	1,812,131
Other assets		
Investment in and advances to unconsolidated affiliates	26,305	14,419
Goodwill	1,379,961	1,598,571
Other intangible assets	376,954	693,764
Deferred financing fees, net of accumulated amortization of $39,703 and $38,914 at December 31, 2009 and 2008, respectively	40,889	34,910
Other assets	112,555	129,578
Total other assets	1,936,664	2,471,242
Total assets	$ 4,712,616	$ 5,189,676
Liabilities		
Current liabilities		
Current maturities of long-term debt	$ 86,071	$ 105,281
Accounts payable	19,850	35,540
Accrued expenses	110,108	106,769
Accrued interest	61,786	80,190
Accrued salaries and wages	65,608	55,380
Gaming, pari-mutuel, property, and other taxes	38,943	44,503
Insurance financing	6,752	8,093
Other current liabilities	41,138	34,730
Total current liabilities	430,256	470,486
Long-term liabilities		
Long-term debt, net of current maturities	2,248,706	2,324,899
Deferred income taxes	127,107	265,610
Noncurrent tax liabilities	46,702	68,632
Other noncurrent liabilities	7,769	2,776
Total long-term liabilities	2,430,284	2,661,917
Shareholders' equity		
Penn National Gaming, Inc. and subsidiaries shareholders' equity:		
Preferred stock ($.01 par value, 1,000,000 shares authorized, 12,500 issued and outstanding at December 31, 2009 and 2008)		

Common stock ($.01 par value, 200,000,000 shares authorized, 78,972,256 and 78,148,488 shares issued at December 31, 2009 and 2008, respectively)	786	782
Additional paid-in capital	1,480,476	1,442,829
Retained earnings	397,407	662,355
Accumulated other comprehensive loss	(26,028)	(48,693)
Total Penn National Gaming, Inc. and subsidiaries shareholders' equity	1,852,641	2,057,273
Noncontrolling interests	(565)	
Total shareholders' equity	1,852,076	2,057,273
Total liabilities and shareholders' equity	$ 4,712,616	$ 5,189,676

See accompanying notes to the consolidated financial statements.

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

Year ended December 31,	2009	2008	2007
Revenues			
Gaming	$ 2,158,028	$ 2,206,500	$ 2,227,944
Management service fee	14,787	16,725	17,273
Food, beverage and other	339,235	334,206	320,520
Gross revenues	2,512,050	2,557,431	2,565,737
Less promotional allowances	(142,775)	(134,378)	(128,944)
Net revenues	2,369,275	2,423,053	2,436,793
Operating expenses			
Gaming	1,161,510	1,181,870	1,180,437
Food, beverage and other	266,351	257,653	240,912
General and administrative	403,136	415,093	369,720
Impairment losses	532,377	481,333	
Empress Casino Hotel fire	6,063		
Depreciation and amortization	194,436	173,545	147,915
Total operating expenses	2,563,873	2,509,494	1,938,984
(Loss) income from operations	(194,598)	(86,441)	497,809
Other income (expenses)			
Interest expense	(134,984)	(169,827)	(198,059)
Interest income	6,522	8,362	4,016
Loss from joint venture	(1,121)	(1,526)	(99)
Merger termination settlement fees, net of related expenses		195,426	
Loss on early extinguishment of debt	(4,793)		
Other	1,093	6,421	(11,427)
Total other (expenses) income	(133,283)	38,856	(205,569)
(Loss) income from operations before income taxes	(327,881)	(47,585)	292,240
Taxes on income	(60,468)	105,738	132,187
Net (loss) income including noncontrolling interests	(267,413)	(153,323)	160,053
Less: Net loss attributable to noncontrolling interests	(2,465)		
Net (loss) income attributable to the shareholders of Penn National Gaming, Inc. and subsidiaries	$ (264,948)	$ (153,323)	$ 160,053
(Loss) earnings per common share attributable to the shareholders of Penn National Gaming, Inc. and subsidiaries:			
Basic (loss) earnings per common share	$ (3.39)	$ (1.81)	$ 1.87
Diluted (loss) earnings per common share	$ (3.39)	$ (1.81)	$ 1.81

See accompanying notes to the consolidated financial statements.

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

	Penn National Gaming Inc. shareholders										
	Preferred Stock		Common Stock								
	Shares	Amount	Shares	Amount	Treasury Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Noncontrolling Interests	Total Shareholders' Equity	Comprehensive (Loss) Income
Balance, December 31, 2006		$	86,814,999	$ 868	$ (2,379)	$ 251,943	$ 667,557	$ 3,174	$	$ 921,163	
Stock option activity, including tax benefit of $20,460			1,824,071	19		68,851				68,870	$
Restricted stock			(60,000)			1,966				1,966	
Change in fair value of interest rate swap contracts, net of income taxes of $11,203								(19,728)		(19,728)	(19,728)
Foreign currency translation adjustment								570		570	570
Cumulative effect of adoption of ASC 740							(11,932)			(11,932)	
Net income							160,053			160,053	160,053
Balance, December 31, 2007			88,579,070	887	(2,379)	322,760	815,678	(15,984)		1,120,962	140,895
Issuance of Preferred Stock	12,500					1,246,400				1,246,400	
Stock option activity, including tax benefit of $1,060			203,202	2		26,305				26,307	
Share activity			(10,633,784)	(107)	2,379	(154,633)				(152,361)	
Restricted stock						1,997				1,997	
Change in fair value of interest rate swap contracts, net of income taxes of $13,072								(23,216)		(23,216)	(23,216)
Change in fair value of corporate debt securities								(8,008)		(8,008)	(8,008)
Foreign currency translation adjustment								(1,485)		(1,485)	(1,485)
Net loss							(153,323)			(153,323)	(153,323)
Balance, December 31, 2008	12,500		78,148,488	782		1,442,829	662,355	(48,693)		2,057,273	(186,032)
Stock option activity, including tax benefit of $2,388			491,078	4		35,173				35,177	
Restricted stock			332,690			2,474				2,474	
Change in fair value of interest rate swap contracts, net of income taxes of $8,150								14,586		14,586	14,586
Change in fair value of corporate debt securities								6,843		6,843	6,843
Foreign currency translation adjustment								1,236		1,236	1,236
Contributions from noncontrolling interests									1,900	1,900	
Net loss							(264,948)		(2,465)	(267,413)	(267,413)
Balance, December 31, 2009	12,500	$	78,972,256	$ 786	$	$ 1,480,476	$ 397,407	$ (26,028)	$ (565)	$ 1,852,076	$ (244,748)

See accompanying notes to the consolidated financial statements.

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

Year ended December 31,	2009	2008	2007
Operating activities			
Net (loss) income including noncontrolling interests	$ (267,413)	$ (153,323)	$ 160,053
Adjustments to reconcile net (loss) income including noncontrolling interests to net			
cash provided by operating activities:			
Depreciation and amortization	194,436	173,545	147,915
Amortization of items charged to interest expense	12,255	12,625	13,011
Amortization of items charged to interest income	(1,522)	(912)	
Loss on sale of fixed assets	332	1,610	1,637
Loss from joint venture	1,121	1,526	99
Loss on early extinguishment of debt	4,793		
Empress Casino Hotel fire	5,186		
Gain on accelerated payment of other long-term obligations	(1,305)		
Gain on sale of investment in corporate debt securities	(6,598)		
Deferred income taxes	(146,408)	(91,098)	18,265
Charge for stock compensation	28,360	26,857	25,465
Impairment losses	532,377	481,333	
(Increase) decrease, net of businesses acquired			
Accounts receivable	(16,091)	12,853	(2,168)
Insurance receivable			100,000
Prepaid expenses and other current assets	(13,160)	(27,722)	924
Other assets	(8,138)	25,747	(7,159)
(Decrease) increase, net of businesses acquired			
Accounts payable	(5,292)	(350)	(22,234)
Accrued expenses	4,837	(12,045)	(12,436)
Accrued interest	4,332	(12,729)	(1,594)
Accrued salaries and wages	10,228	1,231	(6,003)
Gaming, pari-mutuel, property and other taxes	(5,560)	882	(4,629)
Income taxes		(6,794)	(3,584)
Other current and noncurrent liabilities	11,401	1,014	9,470
Other noncurrent tax liabilities	75	(13,787)	14,187
Net cash provided by operating activities	338,246	420,463	431,219
Investing activities			
Expenditures for property and equipment	(289,551)	(344,894)	(361,155)
Proceeds from sale of property and equipment	2,628	1,066	15,020
Investment in corporate debt securities		(47,286)	
Proceeds from sale of investment in corporate debt securities	50,602		
Proceeds from Empress Casino Hotel fire	20,593		
Investment in Kansas Entertainment	(12,895)		
Increase in cash in escrow	(25,036)		
Acquisition of businesses and licenses, net of cash acquired	(9,000)	(384)	(265,482)
Net cash used in investing activities	(262,659)	(391,498)	(611,617)
Financing activities			
Proceeds from exercise of options	5,431	2,397	24,911
Repurchases of common stock		(152,361)	
Proceeds from issuance of long-term debt	784,929	447,833	426,065
Principal payments on long-term debt	(879,193)	(993,966)	(282,360)
Proceeds from issuance of preferred stock, net of related expenses		1,246,400	
Proceeds from insurance financing	15,454	22,255	29,009
Payments on insurance financing	(16,795)	(30,677)	(31,830)

Contributions from noncontrolling interests	1,900		
Increase in deferred financing fees	(22,861)		
Tax benefit from stock options exercised	2,388	1,060	20,460
Net cash (used in) provided by financing activities	(108,747)	542,941	186,255
Net (decrease) increase in cash and cash equivalents	(33,160)	571,906	5,857
Cash and cash equivalents at beginning of year	746,278	174,372	168,515
Cash and cash equivalents at end of year	$ 713,118	$ 746,278	$ 174,372
Supplemental disclosure			
Interest expense paid	$ 124,992	$ 183,264	$ 199,425
Income taxes paid	$ 109,200	$ 190,287	$ 88,546

See accompanying notes to the consolidated financial statements.

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

1. Business and Basis of Presentation

Penn National Gaming, Inc. ("Penn") and subsidiaries (collectively, the "Company") is a diversified, multi-jurisdictional owner and manager of gaming and pari-mutuel properties. Penn is the successor to several businesses that have operated as Penn National Race Course since 1972. Penn was incorporated in Pennsylvania in 1982 as PNRC Corp. and adopted its current name in 1994, when the Company became a public company. In 1997, the Company began its transition from a pari-mutuel company to a diversified gaming company with the acquisition of the Charles Town property and the introduction of video lottery terminals in West Virginia. Since 1997, the Company has continued to expand its gaming operations through strategic acquisitions (including the acquisitions of Hollywood Casino Bay St. Louis and Boomtown Biloxi, CRC Holdings, Inc., the Bullwhackers properties, Hollywood Casino Corporation, Argosy Gaming Company ("Argosy"), Black Gold Casino at Zia Park, and Sanford-Orlando Kennel Club), greenfield projects (such as at Hollywood Casino at Penn National Race Course and Hollywood Slots Hotel and Raceway) and property expansions (such as at Charles Town Entertainment Complex and Hollywood Casino Lawrenceburg).

The Company currently owns or manages nineteen facilities in fifteen jurisdictions, including Colorado, Florida, Illinois, Indiana, Iowa, Louisiana, Maine, Mississippi, Missouri, New Jersey, New Mexico, Ohio, Pennsylvania, West Virginia, and Ontario.

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

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

2. Principles of Consolidation

The consolidated financial statements include the accounts of Penn and its subsidiaries, including wholly-owned subsidiaries and subsidiaries with a noncontrolling interest. Investment in and advances to unconsolidated affiliates that are 50% owned are accounted for under the equity method. All significant intercompany accounts and transactions have been eliminated in consolidation.

3. Merger Announcement and Termination

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

On July 3, 2008, the Company entered into an agreement with certain affiliates of Fortress and Centerbridge, terminating the Merger Agreement. In connection with the termination of the Merger Agreement, the Company agreed to receive a total of $1.475 billion, consisting of a nonrefundable $225 million cash termination fee (the "Cash Termination Fee") and a $1.25 billion, zero coupon, preferred equity investment (the "Investment"). On October 30, 2008, the Company closed the sale of

the Investment and issued 12,500 shares of Series B Redeemable Preferred Stock (the "Preferred Stock").

The Company used a portion of the net proceeds from the Investment and the after-tax proceeds of the Cash Termination Fee for the repayment of some of its existing debt, repurchases of its Common Stock, lobbying expenses for efforts in Ohio and investment in corporate debt securities, with the remainder being invested primarily in short-term securities. The repurchase of up to $200 million of the Company's Common Stock over the twenty-four month period ending July 2010 was authorized by the Company's Board of Directors in July 2008. During the year ended December 31, 2009, the Company did not repurchase any shares of its Common Stock. During the year ended December 31, 2008, the Company repurchased 8,934,984 shares of its Common Stock in open market transactions for approximately $152.6 million, at an average price of $17.05.

On December 26, 2007, the Company entered into a Change in Control Payment Acknowledgement and Agreement (the "Acknowledgement and Agreement") with certain members of its management team. Pursuant to the Acknowledgement and Agreement, a portion of the payment due on a change in control to such executives was accelerated and paid on or before December 31, 2007. The Acknowledgement and Agreements were entered into as part of actions taken to reduce the amount of "gross-up" payments pertaining to federal excise taxes that may have otherwise been owed to such executives under the terms of their existing employment agreements in connection with the change in control payments due upon the consummation of the Merger. The accelerated change in control payments were subject to a clawback right in the event the Merger was terminated pursuant to the terms of the Merger Agreement or the closing of the Merger otherwise failed to occur or if the executive's employment with the Company was terminated prior to the effective date of the Merger under circumstances where the executive was not entitled to receive the remainder of his change in control payment under the terms of his employment agreement. In July 2008, the Company exercised its clawback right for the accelerated change in control payments in accordance with the Acknowledgement and Agreement, and advised the affected executives of the amounts to be repaid and the due date. Each executive has repaid to the Company all after-tax cash received by such executive and filed all returns and other instruments necessary to effect the refund of all applicable taxes. Further, each executive has assigned his right to such tax refunds to the Company.

4. Summary of Significant Accounting Policies

Cash and Cash Equivalents

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

Concentration of Credit Risk

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

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

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

The Company's receivables of $46.7 million and $43.6 million at December 31, 2009 and 2008, respectively, primarily consist of $12.9 million and $10.8 million, respectively, due from the West Virginia Lottery for gaming revenue settlements and capital reinvestment projects at the Charles Town

Entertainment Complex, and $11.7 million and $11.4 million, respectively, for reimbursement of expenses paid on behalf of Casino Rama.

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

Fair Value of Financial Instruments

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

Cash and Cash Equivalents

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

Investment in Corporate Debt Securities

The fair value of the investment in corporate debt securities is estimated based on quoted prices in active markets for identical investments. The investment in corporate debt securities is measured at fair value on a recurring basis.

Long-term Debt

The fair value of the Company's senior secured credit facility approximates its carrying value, as it is variable-rate debt. The fair value of the Company's senior subordinated notes is estimated based on quoted prices in active markets for identical instruments. The fair value of the Company's other long-term obligations and capital leases approximates its carrying value.

Interest Rate Swap Contracts

The fair value of the Company's interest rate swap contracts is measured as the present value of all expected future cash flows based on the LIBOR-based swap yield curve as of the date of the valuation, subject to a credit adjustment to the LIBOR-based yield curve's implied discount rates. The credit adjustment reflects the Company's best estimate as to the Company's credit quality at December 31, 2009. The interest rate swap contracts are measured at fair value on a recurring basis.

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

	2009		2008	
December 31,	**Carrying Amount**	**Fair Value**	**Carrying Amount**	**Fair Value**
Financial assets:				
Cash and cash equivalents	$ 713,118	$ 713,118	$ 746,278	$ 746,278
Investment in corporate debt securities	4,550	4,550	40,190	40,190
Financial liabilities:				
Long-term debt				
Senior secured credit facility	1,755,602	1,755,602	1,959,784	1,959,784
Senior subordinated notes and other long-term obligations	575,000	572,375	464,201	389,201
Capital leases	4,175	4,175	6,195	6,195
Interest rate swap contracts	43,925	43,925	63,185	63,185

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

Property and Equipment

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

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

Land improvements	5 to 15 years
Building and improvements	25 to 40 years
Furniture, fixtures, and equipment	3 to 7 years

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

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

The Company reviews the carrying values of its property and equipment for possible impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable based on undiscounted estimated future cash flows expected to result from its use and eventual disposition. The factors considered by the Company in performing this assessment include current operating results, trends and prospects, as well as the effect of obsolescence, demand, competition and other economic factors. In estimating expected future cash flows for determining whether an asset is impaired, assets are grouped at the individual property level. In assessing the recoverability of the carrying value of property and equipment, the Company must make assumptions regarding future cash flows and other factors. If these estimates or the related assumptions change in the future, the Company may be required to record an impairment loss for these assets. Such an impairment loss would be recognized as a non-cash component of operating income.

Goodwill and Other Intangible Assets

At December 31, 2009, the Company had $1,380.0 million in goodwill and $377.0 million in other intangible assets within its consolidated balance sheet, representing 29.3% and 8.0% of total assets, respectively, resulting from the Company's acquisition of other businesses and payment for gaming licenses and racing permits. Two issues arise with respect to these assets that require significant management estimates and judgment: (i) the valuation in connection with the initial purchase price allocation; and (ii) the ongoing evaluation for impairment.

In connection with the Company's acquisitions, valuations are completed to determine the allocation of the purchase prices. The factors considered in the valuations include data gathered as a result of the Company's due diligence in connection with the acquisitions, projections for future operations, and data obtained from third-party valuation specialists as deemed appropriate. Goodwill is tested annually, or more frequently if indicators of impairment exist, for impairment by comparing the fair value of the reporting units to their carrying amount. If the carrying amount of a reporting unit exceeds its fair value, an impairment test is performed to determine the implied value of goodwill for that reporting unit. If the implied value is less than the carrying amount for that reporting unit, an impairment loss is recognized for that reporting unit. In accordance with Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 350, "Intangibles-Goodwill and Other," the Company considers its gaming license, racing permit and trademark intangible assets as

indefinite-life intangible assets that do not require amortization. Rather, these intangible assets are tested annually, or more frequently if indicators of impairment exist, for impairment by comparing the fair value of the recorded assets to their carrying amount. If the carrying amounts of the gaming license, racing permit and trademark intangible assets exceed their fair value, an impairment loss is recognized. The evaluation of goodwill and indefinite-life intangible assets requires the use of estimates about future operating results of each reporting unit to determine their estimated fair value. The Company uses a market approach model, which includes the use of EBITDA (earnings before interest, taxes, charges for stock compensation, depreciation and amortization, gain or loss on disposal of assets, and certain other income and expenses, and inclusive of loss from joint venture) multiples, as the Company believes that EBITDA is a widely-used measure of performance in the gaming industry and as the Company uses EBITDA as the primary measurement of the operating performance of its properties (including the evaluation of operating personnel). In addition, the Company believes that an EBITDA multiple is the principal basis for the valuation of gaming companies. Changes in the estimated EBITDA multiple or forecasted operations can materially affect these estimates. Once an impairment of goodwill or other indefinite-life intangible assets has been recorded, it cannot be reversed. Because the Company's goodwill and indefinite-life intangible assets are not amortized, there may be volatility in reported income because impairment losses, if any, are likely to occur irregularly and in varying amounts. Intangible assets that have a definite-life, including the management service contract for Casino Rama, are amortized on a straight-line basis over their estimated useful lives or related service contract. The Company reviews the carrying value of its intangible assets that have a definite-life for possible impairment whenever events or changes in circumstances indicate that their carrying value may not be recoverable. If the carrying amount of the intangible assets that have a definite-life exceed their fair value, an impairment loss is recognized.

Deferred Financing Fees

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

Comprehensive Income

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

Income Taxes

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

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

ASC 740 also creates a single model to address uncertainty in tax positions, and clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements by

prescribing the minimum recognition threshold a tax position is required to meet before being recognized in an enterprise's financial statements. It also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. The liability for unrecognized tax benefits is included in noncurrent tax liabilities within the consolidated balance sheet at December 31, 2009.

Accounting for Derivatives and Hedging Activities

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

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

Currently, the Company has a number of interest rate swap contracts in place. These contracts serve to mitigate income volatility for a portion of its variable-rate funding. Swap contract coverage extends out through 2011. In effect, these swap contracts synthetically convert the portion of variable-rate debt being hedged to the equivalent of fixed-rate funding. Under the terms of the swap contracts, the Company receives cash flows from the swap contract counterparties to offset the benchmark interest rate component of variable interest payments on the hedged financings, in exchange for paying cash flows based on the swap contracts' fixed rates. These two respective obligations are net-settled, periodically. The Company accounts for these swap contracts as cash flow hedges, which requires determining a division of hedge results deemed effective and deemed ineffective. However, most of the Company's hedges were designed in such a way so as to perfectly offset specifically-defined interest payments, such that no ineffectiveness has occurred nor would any ineffectiveness occur, as long as the forecasted cash flows of the designated hedged items and the associated swap contracts remain unchanged.

The fair value of the Company's interest rate swap contracts is measured as the present value of all expected future cash flows based on the LIBOR-based swap yield curve as of the date of the valuation, subject to a credit adjustment to the LIBOR-based yield curve's implied discount rates. The credit adjustment reflects the Company's best estimate as to the Company's credit quality at December 31, 2009.

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

Under cash flow hedge accounting, derivatives are included in the consolidated balance sheets as assets or liabilities at fair value. The interest rate swap contract liabilities are included in accrued interest within the consolidated balance sheets at December 31, 2009 and 2008.

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During the year ended December 31, 2009, the Company had certain derivative instruments that were not designated to qualify for hedge accounting. The periodic change in the mark-to-market of these derivative instruments is recorded in current period earnings.

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

Revenue Recognition and Promotional Allowances

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

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

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

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

The retail value of accommodations, food and beverage, and other services furnished to guests without charge is included in gross revenues and then deducted as promotional allowances. The estimated cost of providing such promotional allowances is primarily included in food, beverage and other expense. The amounts included in promotional allowances for the years ended December 31, 2009, 2008 and 2007 are as follows:

Year ended December 31,	2009	2008	2007
		(in thousands)	
Rooms	$ 23,316	$ 17,750	$ 15,518
Food and beverage	108,473	103,038	101,040
Other	10,986	13,590	12,386
Total promotional allowances	$ 142,775	$ 134,378	$ 128,944

The estimated cost of providing such complimentary services for the years ended December 31, 2009, 2008 and 2007 are as follows:

Year ended December 31,	2009	2008	2007
		(in thousands)	
Rooms	$ 9,406	$ 7,280	$ 6,538
Food and beverage	77,444	73,565	71,922
Other	6,590	6,034	5,471
Total cost of complimentary services	$ 93,440	$ 86,879	$ 83,931

Earnings Per Share

The Company calculates earnings per share ("EPS") in accordance with ASC 260, "Earnings Per Share" ("ASC 260"). Basic EPS is computed by dividing net income applicable to common stock,

excluding net income attributable to noncontrolling interests, by the weighted-average number of common shares outstanding during the period. Diluted EPS reflects the additional dilution for all potentially-dilutive securities such as stock options.

In the fourth quarter of 2008, the Company issued 12,500 shares of the Company's Preferred Stock, which the Company determined qualified as a participating security as defined in ASC 260. Under ASC 260, a security is considered a participating security if the security may participate in undistributed earnings with common stock, whether that participation is conditioned upon the occurrence of a specified event or not. In accordance with ASC 260, a company is required to use the two-class method when computing EPS when a company has a security that qualifies as a "participating security." The two-class method is an earnings allocation formula that determines EPS for each class of common stock and participating security according to dividends declared (or accumulated) and participation rights in undistributed earnings. A participating security is included in the computation of basic EPS using the two-class method. Under the two-class method, basic EPS for the Company's Common Stock is computed by dividing net income applicable to common stock attributable to the shareholders of Penn National Gaming, Inc. and subsidiaries by the weighted-average common shares outstanding during the period. Diluted EPS for the Company's Common Stock is computed using the more dilutive of the two-class method or the if-converted method.

However, since the Company reported a loss from operations for the years ended December 31, 2009 and 2008, it was required by ASC 260 to use basic weighted-average common shares outstanding, rather than diluted weighted-average common shares outstanding, when calculating diluted EPS for the years ended December 31, 2009 and 2008. In addition, since the Company reported a loss from operations for the years ended December 31, 2009 and 2008, the Preferred Stock was not deemed to be a participating security for the years ended December 31, 2009 and 2008, pursuant to ASC 260. The basic weighted-average common shares outstanding for the years ended December 31, 2009 and 2008 were 78,121,571 and 84,535,877, respectively.

The following table reconciles the weighted-average common shares outstanding used in the calculation of basic EPS to the weighted-average common shares outstanding used in the calculation of diluted EPS for the year ended December 31, 2007:

Year ended December 31,	**2007**
	(in thousands)
Determination of shares:	
Weighted-average common shares outstanding	85,578
Assumed conversion of dilutive stock options	2,806
Diluted weighted-average common shares outstanding	88,384

Options to purchase 9,966,125 and 8,804,578 shares were outstanding during the years ended December 31, 2009 and 2008, respectively, but were not included in the computation of diluted EPS because they are antidilutive since the Company reported a loss from operations for the years ended December 31, 2009 and 2008. Options to purchase 1,395,610 shares were outstanding during the year ended December 31, 2007, but were not included in the computation of diluted EPS because they are antidilutive.

The repurchase of up to $200 million of the Company's Common Stock over the twenty-four month period ending July 2010 was authorized by the Company's Board of Directors in July 2008. During the year ended December 31, 2009, the Company did not repurchase any shares of its Common Stock. During the year ended December 31, 2008, the Company repurchased 8,934,984 shares of its Common Stock in open market transactions for approximately $152.6 million, at an average price of $17.05.

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Stock-Based Compensation

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

The fair value for stock options was estimated at the date of grant using the Black-Scholes option-pricing model, which requires management to make certain assumptions. The risk-free interest rate was based on the United States ("U.S.") Treasury spot rate with a remaining term equal to the expected life assumed at the date of grant. Expected volatility was estimated based on the historical volatility of the Company's stock price over a period of 5.32 years, in order to match the expected life of the options at the grant date. There is no expected dividend yield since the Company has not paid any cash dividends on its Common Stock since its initial public offering in May 1994 and since the Company intends to retain all of its earnings to finance the development of its business for the foreseeable future. The weighted-average expected life was based on the contractual term of the stock option and expected employee exercise dates, which was based on the historical and expected exercise behavior of the Company's employees. Forfeitures are estimated at the date of grant based on historical experience. The following are the weighted-average assumptions used in the Black-Scholes option-pricing model at December 31, 2009, 2008 and 2007:

Year ended December 31,	2009	2008	2007
Risk-free interest rate	2.80%	1.61%	4.24%
Expected volatility	49.68%	45.56%	37.68%
Dividend yield			
Weighted-average expected life (years)	5.32	5.36	4.73
Forfeiture rate	5.00%	4.00%	4.00%

Segment Information

In accordance with ASC 280, "Segment Reporting" ("ASC 280"), the Company views each property as an operating segment, and aggregates all of its properties into one reportable segment, as the Company believes that they are economically similar, offer similar types of products and services, cater to the same types of customers and are similarly regulated.

Statements of Cash Flows

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

Acquisitions

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

Certain Risks and Uncertainties

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

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

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

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

5. New Accounting Pronouncements

In January 2010, the FASB issued guidance to improve disclosures about fair value measurements. The guidance provides amendments to require new disclosures regarding transfers in and out of Levels 1 and 2 of the fair value measurement hierarchy, and activity in Level 3, and to clarify existing disclosures regarding the level of disaggregation, inputs and valuation techniques. The guidance is effective for interim and annual reporting periods beginning after December 15, 2009, except for the new disclosures regarding purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements, which are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. The Company adopted the guidance, except for the new disclosures regarding purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements, as of January 1, 2010, as required. The Company does not expect that the January 1, 2010 adoption of the guidance will have a material impact on its consolidated financial statements. The Company is currently determining the impact of the new disclosures regarding purchases, sales, issuances, and settlements in the roll forward of activity in Level 3 fair value measurements on its consolidated financial statements.

In January 2010, the FASB issued guidance to address implementation issues related to the changes in ownership provisions in ASC 810, "Consolidation," ("ASC 810"). The guidance clarifies the scope of the decrease in ownership provisions in ASC 810 and expands the disclosures about the deconsolidation of a subsidiary or derecognition of a group of assets within the scope of ASC 810. As the Company previously adopted ASC 810, the guidance is effective beginning in the first interim or annual reporting period ending on or after December 15, 2009, and should be applied retrospectively to the first period that ASC 810 was adopted by the Company. The Company adopted the guidance as of December 31, 2009, as required. This guidance did not have a material impact on the Company's consolidated financial statements.

In September 2009, the FASB issued guidance concerning fair value measurements of investments in certain entities that calculate net asset value per share (or its equivalent). The guidance creates a practical expedient to measure the fair value of an investment that is within the scope of the guidance on the basis of the net asset value per share of the investment (or its equivalent) determined as of the reporting entity's measurement date. Therefore, the guidance allows certain attributes of the investment, which in the past may have indicated that it was necessary to make adjustments to the net asset value per share (or its equivalent) to estimate the fair value of the investment, to not be considered if the practical expedient is used. Additional disclosures are also required under the guidance. The guidance is effective for interim and annual periods ending after December 15, 2009, with early application permitted. The Company adopted the guidance as of December 31, 2009, as required. This guidance did not have a material impact on the Company's consolidated financial statements.

In August 2009, the FASB issued guidance on the measurement of liabilities at fair value. The guidance provides clarification in measuring the fair value of liabilities. The guidance is effective for the first reporting period (including interim periods) beginning after issuance. The Company adopted the guidance as of October 1, 2009, as required. This guidance did not have a material impact on the Company's consolidated financial statements.

In June 2009, the FASB issued the ASC. The ASC became the source of authoritative accounting principles recognized by the FASB to be applied by nongovernmental entities in the preparation of financial statements in conformity with GAAP. The ASC eliminates the previous U.S. GAAP hierarchy

and establishes one level of authoritative GAAP. All other literature is considered non-authoritative. The ASC is effective for most financial statements issued for interim and annual periods ending after September 15, 2009. The Company adopted the ASC as of September 30, 2009, as required. The adoption of the ASC did not have an impact on the Company's consolidated financial statements.

In June 2009, the FASB issued amended guidance for variable interest entities. The objective of the amended guidance is to improve financial reporting by enterprises involved with variable interest entities and to provide more relevant and reliable information to users of financial statements. The amended guidance is effective as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter. Earlier application is prohibited. The Company adopted the amended guidance as of January 1, 2010, as required. The Company does not expect that the adoption of the amended guidance will have a material impact on its consolidated financial statements.

In May 2009, the FASB issued guidance on subsequent events. The guidance establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. In addition, under the guidance, an entity is required to disclose the date through which subsequent events have been evaluated, as well as whether that date is the date the financial statements were issued or the date the financial statements were available to be issued. The guidance does not apply to subsequent events or transactions that are within the scope of other applicable GAAP that provide different guidance on the accounting treatment for subsequent events or transactions. The guidance is effective for interim or annual financial periods ending after June 15, 2009, and shall be applied prospectively. The Company adopted the guidance as of June 30, 2009, as required. The adoption of the guidance did not have a material impact on the Company's consolidated financial statements. In February 2010, the FASB issued amended guidance on subsequent events. The amended guidance removes the requirement for U.S. Securities and Exchange Commission filers to disclose the date through which subsequent events have been evaluated. The amended guidance is effective upon issuance, except for the use of the issued date for conduit debt obligors. The Company adopted the amended guidance upon issuance, as required. The adoption of the amended guidance did not have a material impact on the Company's consolidated financial statements.

In April 2009, the FASB issued additional requirements regarding disclosures about the fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. The new requirements are effective for interim reporting periods ending after June 15, 2009. The Company adopted the additional requirements as of June 30, 2009, as required. The adoption of the new requirements did not have a material impact on the Company's consolidated financial statements.

In April 2009, the FASB issued guidance on the recognition and presentation of other-than-temporary impairments. The guidance amends the other-than-temporary impairment guidance for debt securities to make the guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments on debt and equity securities in the financial statements. The guidance does not amend existing recognition and measurement guidance related to other-than-temporary impairments of equity securities. The guidance is effective for interim and annual reporting periods ending after June 15, 2009. The Company adopted the guidance as of June 30, 2009, as required. The adoption of the guidance did not have a material impact on the Company's consolidated financial statements.

In April 2009, the FASB issued guidance on determining fair value when the volume and level of activity for the asset or liability have significantly decreased and on identifying transactions that are not orderly. The guidance is effective for interim and annual reporting periods ending after June 15, 2009, and shall be applied prospectively. The Company adopted the guidance as of June 30, 2009, as required. The adoption of the guidance did not have a material impact on the Company's consolidated financial statements.

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In April 2009, the FASB issued guidance regarding the accounting for assets acquired and liabilities assumed in a business combination that arise from contingencies. The guidance addresses application issues on initial recognition and measurement, subsequent measurement and accounting, and disclosure of assets and liabilities arising from contingencies in a business combination. The guidance is effective for all assets acquired or liabilities assumed arising from contingencies in business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The Company adopted the guidance as of January 1, 2009, as required. The Company expects that the adoption of the guidance will have an impact on its consolidated financial statements, in the event that the Company acquires companies in the future.

In April 2008, the FASB issued guidance regarding the determination of the useful life of intangible assets. The guidance amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset. The guidance is effective for financial statements issued for fiscal years and interim periods beginning after December 15, 2008. Early adoption is prohibited. The Company adopted the guidance as of January 1, 2009, as required. The adoption of the guidance did not have a material impact on the Company's consolidated financial statements.

In March 2008, the FASB issued guidance regarding the disclosure of derivative instruments and hedging activities. The guidance requires enhanced disclosures about an entity's derivative and hedging activities. Specifically, entities are required to provide enhanced disclosures about: a) how and why an entity uses derivative instruments; b) how derivative instruments and related hedged items are accounted; and c) how derivative instruments and related hedged items affect an entity's financial position, financial performance and cash flows. The guidance is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. The guidance encourages, but does not require, comparative disclosures for earlier periods at initial adoption. The Company adopted the guidance as of January 1, 2009, as required. The adoption of the guidance did not have a material impact on the Company's consolidated financial statements.

In December 2007, the FASB issued amended guidance on business combinations. The intention of the amended guidance is to improve reporting by creating greater consistency in the accounting and financial reporting of business combinations. The amended guidance requires that the acquiring entity in a business combination recognize all (and only) the assets and liabilities assumed in the transaction, establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed, and requires the acquirer to disclose to investors and other users all of the information that they need to evaluate and understand the nature and financial effect of the business combination. In addition, the amended guidance modifies the accounting for transaction and restructuring costs. The amended guidance is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The Company adopted the amended guidance as of January 1, 2009, as required. The Company expects that the adoption of the amended guidance will have an impact on its consolidated financial statements, in the event that the Company acquires companies in the future.

In September 2006, the FASB issued guidance on fair value measurements. The guidance defines fair value, establishes a framework for measuring fair value, and expands the disclosure requirements about fair value measurements. In February 2008, the FASB amended the guidance so as to exclude from its scope certain accounting pronouncements that address fair value measurements associated with leases and to delay the effective date of the guidance to fiscal years beginning after November 15, 2008 for nonfinancial assets and nonfinancial liabilities that are not recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). In October 2008, the FASB issued additional guidance that provides clarification on the application of the guidance on fair value measurements in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. The Company adopted the guidance on fair value measurements, as amended, and on a prospective basis,

as of January 1, 2008. The January 1, 2008 adoption did not have a material impact on the Company's consolidated financial statements. The Company adopted the guidance on fair value measurements, as amended, and on a prospective basis, as of January 1, 2009 to nonfinancial assets and nonfinancial liabilities that are not recognized or disclosed at fair value in the financial statements on a recurring basis. The January 1, 2009 adoption did not have a material impact on the Company's consolidated financial statements.

6. Acquisitions

Sanford-Orlando Kennel Club

On October 17, 2007, pursuant to the Asset Purchase Agreement dated July 5, 2007, the Company completed the purchase of Sanford-Orlando Kennel Club in Longwood, Florida from Sanford-Orlando Kennel Club, Inc. and Collins and Collins. In connection with the purchase, the Company also secured a right of first refusal with respect to a majority stake in the Sarasota Kennel Club in Sarasota, Florida. The purchase price for the Sanford-Orlando Kennel Club provides for additional consideration to be paid by the Company based upon certain future regulatory developments. Located on approximately 26 acres in Longwood, Florida, the Sanford-Orlando Kennel Club features year-round greyhound racing, a simulcast wagering facility, a clubhouse lounge and two dining areas. The Company accounted for the acquisition in accordance with ASC 805. The results of the Sanford-Orlando Kennel Club have been included in the Company's consolidated financial statements since the acquisition date.

Black Gold Casino at Zia Park

On April 16, 2007, pursuant to the Asset Purchase Agreement dated November 7, 2006 among Zia Partners, LLC ("Zia"), Zia Park LLC (the "Buyer"), a wholly-owned subsidiary of Penn, and (solely with respect to specified sections thereof which relate to the Company's guarantee of the Buyer's payment and performance) Penn, the Buyer completed the acquisition of Black Gold Casino at Zia Park and all related assets of Zia. Penn funded this purchase with additional borrowings under its existing revolving credit facility. The Company accounted for the acquisition in accordance with ASC 805. As a result of the acquisition, goodwill of $144.2 million and other intangible assets of $2.9 million are included within the consolidated balance sheet at December 31, 2009. The results of the Black Gold Casino at Zia Park have been included in the Company's consolidated financial statements since the acquisition date.

7. Investment In and Advances to Unconsolidated Affiliates

On September 10, 2009, the Company announced that it had entered into an agreement, subject to local and regulatory approvals and certain other closing conditions, with principals of The Cordish Company ("Cordish"), the managing member of Kansas Entertainment, LLC ("Kansas Entertainment"), wherein the Company agreed to acquire Cordish's 50% interest in Kansas Entertainment and to assume their role as managing member.

As a result of the agreement with Cordish, the Company joined Kansas Speedway Development Corporation, a wholly-owned subsidiary of International Speedway Corporation (which owns the other 50% of Kansas Entertainment) in its application with the Kansas Lottery Commission to develop and operate a facility in the North East Gaming Zone in Wyandotte County, Kansas. The Company and International Speedway Corporation will share equally the cost of developing and constructing the proposed facility, and intend to jointly seek third party financing for the project.

On December 1, 2009, Kansas Entertainment was selected by the Kansas Lottery Gaming Facility Review Board to develop and operate a facility in the North East Gaming Zone in Wyandotte County, Kansas.

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In February 2010, Kansas Entertainment received the final approval under the Kansas Expanded Lottery Act, along with its gaming license from the Kansas Racing and Gaming Commission, to proceed with the development of the facility.

On September 14, 2009, as a result of the agreement with Cordish, the Company withdrew its license application with the Kansas Lottery Commission to be considered as a Lottery Gaming Facility Manager at another site in Wyandotte County.

The Company's investment in Kansas Entertainment, which consists of the Company's portion of the privilege fee paid to the Kansas Lottery Commission in conjunction with its application and its portion of capital expenditures spent to develop the proposed facility, is accounted for under the equity method and is included in investment in and advances to unconsolidated affiliates within the consolidated balance sheet at December 31, 2009.

In accordance with the agreement, $25.0 million was placed in escrow until certain conditions in the agreement with Cordish are satisfied. This amount is included in other assets within the consolidated balance sheet at December 31, 2009.

8. Property and Equipment

Property and equipment, net, consists of the following:

December 31,	2009	2008
	(in thousands)	
Land and improvements	$ 239,933	$ 216,834
Building and improvements	1,433,611	1,298,513
Furniture, fixtures, and equipment	849,071	692,851
Leasehold improvements	17,204	17,128
Construction in progress	47,299	183,056
Total property and equipment	2,587,118	2,408,382
Less accumulated depreciation	(749,614)	(596,251)
Property and equipment, net	$ 1,837,504	$ 1,812,131

Depreciation expense, for property and equipment, totaled $187.8 million, $165.9 million and $140.3 million in 2009, 2008, and 2007, respectively. Interest capitalized in connection with major construction projects was $7.0 million, $13.8 million and $14.6 million in 2009, 2008 and 2007, respectively.

During the year ended December 31, 2009, the Company recorded a pre-tax impairment charge for the replaced Lawrenceburg vessel of $11.9 million ($7.1 million, net of taxes) in conjunction with the opening of the new casino riverboat at Hollywood Casino Lawrenceburg. During the year ended December 31, 2008, the Company recorded a pre-tax impairment charge of $15.1 million ($10.0 million, net of taxes), as it determined that a portion of the value of its long-lived assets, primarily at its Bullwhackers property, was impaired.

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9. Goodwill and Other Intangible Assets

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

Balance at January 1, 2008:	
Goodwill	$ 2,047,661
Accumulated goodwill impairment losses	(34,522)
Goodwill, net	$ 2,013,139
Goodwill acquired during the year	
Goodwill impairment losses	(397,220)
Other	(17,348)
Balance at December 31, 2008:	
Goodwill	$ 2,030,313
Accumulated goodwill impairment losses	(431,742)
Goodwill, net	$ 1,598,571
Goodwill acquired during the year	
Goodwill impairment losses	(213,260)
Other	(5,350)
Balance at December 31, 2009:	
Goodwill	$ 2,024,963
Accumulated goodwill impairment losses	(645,002)
Goodwill, net	$ 1,379,961

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

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

During the year ended December 31, 2008, goodwill decreased by $414.6 million, primarily due to the Company recording a pre-tax impairment charge of $397.2 million ($338.5 million, net of taxes), as a portion of the value of the goodwill associated with the original purchase of Empress Casino Hotel, Hollywood Casino Lawrenceburg, Hollywood Casino Aurora and Argosy Casino Alton, and all of the goodwill associated with the original purchase of Hollywood Slots Hotel and Raceway, was impaired.

The table below presents the gross carrying value, accumulated amortization, and net book value of each major class of intangible asset at December 31, 2009 and 2008:

	2009			2008		
December 31,	Gross Carrying Value	Accumulated Amortization	Net Book Value	Gross Carrying Value	Accumulated Amortization	Net Book Value
			(in thousands)			
Indefinite-life intangible assets	$ 368,886	$	$ 368,886	$ 679,054	$	$ 679,054
Other intangible assets	49,396	41,328	8,068	49,396	34,686	14,710
Total	$ 418,282	$ 41,328	$ 376,954	$ 728,450	$ 34,686	$ 693,764

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Indefinite-life intangible assets consist mainly of gaming licenses and trademark intangible assets from the acquisition of Argosy and the placement of slot machines at Hollywood Casino at Penn National Race Course.

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

During the year ended December 31, 2008, indefinite-life intangible assets decreased by $76.1 million, primarily as the Company recorded a pre-tax impairment charge of $69.0 million ($44.1 million, net of taxes), as a portion of the value of the indefinite-life intangible assets associated with the original purchase of Argosy, and all of the indefinite-life intangible assets associated with the original purchase of Hollywood Slots Hotel and Raceway, was impaired.

The Company's intangible asset amortization expense was $6.6 million, $7.7 million and $7.6 million for the years ended December 31, 2009, 2008 and 2007, respectively.

The following table presents expected intangible asset amortization expense based on existing intangible assets at December 31, 2009 (in thousands):

2010	$	5,773
2011		2,096
2012		199
Total	$	8,068

10. Investment in Corporate Securities

During the year ended December 31, 2008, the Company made a $47.3 million investment in the corporate debt securities of other gaming companies. The investment, which the Company is treating as available-for-sale securities, is included in other assets within the consolidated balance sheets at December 31, 2009 and 2008. During the years ended December 31, 2009 and 2008, the Company recorded a $6.8 million unrealized gain and an $8.0 million unrealized loss, respectively, in OCI for this investment. The change in the fair value also reflects the original issue discount amortization, which was $1.5 million and $0.9 million for the years ended December 31, 2009 and 2008, respectively.

During the year ended December 31, 2009, the Company sold $42.2 million of this investment and recorded a $6.6 million gain, which is included in other income within the consolidated statements of operations.

The following is a schedule of the contractual maturities of the Company's investment in corporate securities at December 31, 2009 (in thousands):

2010	$	
2011		
2012		4,550
Total	$	4,550

11. Long-term Debt

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

December 31,	2009	2008
	(in thousands)	
Senior secured credit facility	$ 1,755,602	$ 1,959,784
$200 million 6⁷/₈% senior subordinated notes		200,000
$250 million 6³/₄% senior subordinated notes	250,000	250,000
$325 million 8³/₄% senior subordinated notes	325,000	
Other long-term obligations		14,201
Capital leases	4,175	6,195
	2,334,777	2,430,180
Less current maturities of long-term debt	(86,071)	(105,281)
	$ 2,248,706	$ 2,324,899

The following is a schedule of future minimum repayments of long-term debt as of December 31, 2009 (in thousands):

2010	$ 86,071
2011	356,001
2012	1,315,785
2013	82
2014	89
Thereafter	576,749
Total minimum payments	$ 2,334,777

At December 31, 2009, the Company was contingently obligated under letters of credit issued pursuant to the senior secured credit facility with face amounts aggregating $27.9 million.

Senior Secured Credit Facility

The senior secured credit facility historically consisted of three credit facilities comprised of a $750 million revolving credit facility with a maturity date of October 3, 2010, a $325 million Term Loan A Facility with a maturity date of October 3, 2011 and a $1.65 billion Term Loan B Facility with a maturity date of October 3, 2012. In September 2009, the Company amended its senior secured credit facility, in order to increase the borrowing capacity and to extend the term under the revolving credit facility portion of the senior secured credit facility. Under the new revolving credit facility, two tranches were created, one for those participants who agreed to extend and one for those that did not extend. Tranche A Revolving Loans consist of available borrowings of $359.4 million, which are due on the original maturity date of October 3, 2010, and Tranche B Revolving Loans consist of available borrowings of $640.6 million, which are due on July 3, 2012, for a total borrowing capacity of $1 billion.

In August 2009, the Company repaid $40 million of borrowings under the Term Loan A Facility, $70 million of borrowings under the Term Loan B Facility, and all outstanding borrowings under the revolving credit facility at the time, using a portion of the proceeds from the offering of $325 million 8³/₄% senior subordinated notes. In addition, in September 2009, the Company repaid all of the remaining outstanding borrowings under the Term Loan A Facility, using drawings under the new revolving credit facility.

As of December 31, 2009, $237.5 million was drawn under the revolving credit facility and $1,518.1 million was outstanding under the Term Loan B Facility, for a total of $1,755.6 million. As of December 31, 2008, $123.7 million was drawn under the revolving credit facility, $239.7 million was

outstanding under the Term Loan A Facility, and $1,596.4 million was outstanding under the Term Loan B Facility, for a total of $1,959.8 million.

The Company recorded a $2.4 million loss on early extinguishment of debt during the year ended December 31, 2009 for the write-off of deferred financing fees related to the Term Loan A Facility.

During the year ended December 31, 2009, the Company's senior secured credit facility amount outstanding decreased by $204.2 million, primarily due to the August 2009 repayment of $40 million of borrowings under the Term Loan A Facility, $70 million of borrowings under the Term Loan B Facility, and all outstanding borrowings under the revolving credit facility at the time, using a portion of the proceeds from the offering of $325 million $8^{3}/_{4}$% senior subordinated notes. These repayments were partially offset by drawings under the revolving credit facility, primarily to repay $105.5 million outstanding aggregate principal amount of the $6^{7}/_{8}$% senior subordinated notes.

The senior secured credit facility is secured by substantially all of the assets of Penn and its restricted subsidiaries.

Interest Rate Swap Contracts

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

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

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

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

In addition, during the year ended December 31, 2009, the Company amortized $15.9 million in OCI related to the derivatives that were de-designated as hedging instruments under ASC 815, "Derivatives and Hedging."

In the coming twelve months, the Company anticipates that approximately a $35.3 million loss will be reclassified from OCI to earnings, as part of interest expense. As this amount represents effective hedge results, a comparable offsetting amount of incrementally lower interest expense will be realized in connection with the variable funding being hedged.

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The following table sets forth the fair value of the interest rate swap contract liabilities included in accrued interest within the consolidated balance sheets at December 31, 2009 and 2008:

	December 31, 2009		December 31, 2008	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
		(in thousands)		
Derivatives designated as hedging instruments				
Interest rate swap contracts	Accrued interest	$ 23,485	Accrued interest	$ 63,185
Total derivatives designated as hedging instruments		$ 23,485		$ 63,185
Derivatives not designated as hedging instruments				
Interest rate swap contracts	Accrued interest	$ 20,440	Accrued interest	$
Total derivatives not designated as hedging instruments		$ 20,440		$
Total derivatives		$ 43,925		$ 63,185

Redemption of 6$^7/_8$% Senior Subordinated Notes

In August 2009, the Company called for the redemption of its $200 million 6$^7/_8$% senior subordinated notes. The redemption price was $1,000 per $1,000 principal amount, plus accrued and unpaid interest, which was paid in September 2009. Approximately $94.5 million aggregate principal amount of the 6$^7/_8$% senior subordinated notes were validly tendered and paid. In October 2009, the Company called for the redemption of all of the $105.5 million outstanding aggregate principal amount of its 6$^7/_8$% senior subordinated notes. The redemption price was $1,000 per $1,000 principal amount, plus accrued and unpaid interest. In December 2009, the Company repaid all of the $105.5 million outstanding aggregate principal amount of its 6$^7/_8$% senior subordinated notes. The Company funded the $94.5 million redemption from a portion of the proceeds from the offering of $325 million 8$^3/_4$% senior subordinated notes and available cash and funded the $105.5 million redemption using drawings under the revolving credit facility.

The Company recorded a $2.4 million loss on early extinguishment of debt during the year ended December 31, 2009 for the write-off of the deferred financing fees related to the $200 million 6$^7/_8$% senior subordinated notes.

6$^3/_4$% Senior Subordinated Notes

On March 9, 2005, the Company completed an offering of $250 million 6$^3/_4$% senior subordinated notes that mature on March 1, 2015. Interest on the $250 million 6$^3/_4$% senior subordinated notes is payable on March 1 and September 1 of each year, beginning September 1, 2005. The $250 million 6$^3/_4$% senior subordinated notes are general unsecured obligations and are not guaranteed by the Company's subsidiaries. The $250 million 6$^3/_4$% senior subordinated notes were issued in a private placement pursuant to an exemption from the registration requirements of the Securities Act of 1933, as amended. Effective March 2010, the Company may redeem all or part of the $250 million 6$^3/_4$% senior subordinated notes at certain specified redemption prices.

8$^3/_4$% Senior Subordinated Notes

In August 2009, the Company completed an offering of $325 million 8$^3/_4$% senior subordinated notes that mature on August 15, 2019. Interest on the $325 million 8$^3/_4$% senior subordinated notes is payable on February 15 and August 15 of each year, beginning February 15, 2010. The $325 million

$8^{3}/_{4}\%$ senior subordinated notes are general unsecured obligations and are not guaranteed by the Company's subsidiaries. The $325 million $8^{3}/_{4}\%$ senior subordinated notes were issued in a private placement pursuant to an exemption from the registration requirements of the Securities Act of 1933, as amended.

A portion of the proceeds from the offering were used to repay $40 million of borrowings under the Term Loan A Facility, $70 million of borrowings under the Term Loan B Facility, and all outstanding borrowings under the revolving credit facility at the time. The remainder of the proceeds, plus available cash, was used to pay the validly-tendered principal amounts of the $200 million $6^{7}/_{8}\%$ senior subordinated notes.

Other Long-Term Obligations

On October 15, 2004, the Company announced the sale of The Downs Racing, Inc. and its subsidiaries to the Mohegan Tribal Gaming Authority ("MTGA"). Under the terms of the agreement, the MTGA acquired The Downs Racing, Inc. and its subsidiaries, including Pocono Downs (a standardbred horse racing facility located on 400 acres in Wilkes-Barre, Pennsylvania) and five Pennsylvania OTWs located in Carbondale, East Stroudsburg, Erie, Hazelton and the Lehigh Valley (Allentown). The sale agreement also provided the MTGA with certain post-closing termination rights in the event of certain materially adverse legislative or regulatory events. In January 2005, the Company received $280 million from the MTGA, and transferred the operations of The Downs Racing, Inc. and its subsidiaries to the MTGA. The sale was not considered final for accounting purposes until the third quarter of 2006, as the MTGA had certain post-closing termination rights that remained outstanding. On August 7, 2006, the Company entered into the Second Amendment to the Purchase Agreement and Release of Claims ("Amendment and Release") with the MTGA pertaining to the October 14, 2004 Purchase Agreement (the "Purchase Agreement"), and agreed to pay the MTGA an aggregate of $30 million over five years, beginning on the first anniversary of the commencement of slot operations at Mohegan Sun at Pocono Downs, in exchange for the MTGA's agreement to release various claims it raised against the Company under the Purchase Agreement and the MTGA's surrender of all post-closing termination rights it might have had under the Purchase Agreement. The Company recorded the present value of the $30 million liability within debt, as the amount due to the MTGA was payable over five years. In March 2009, the Company entered into the Third Amendment to the Purchase Agreement, in which the remaining payments due under the Purchase Agreement were accelerated and reduced. Under the Third Amendment to the Purchase Agreement, in exchange for the accelerated payment, which was paid to the MTGA in March 2009, all remaining obligations under the Purchase Agreement were deemed to be satisfied and, as a result, the Company recorded a $1.3 million gain during the year ended December 31, 2009, which is included in other income within the consolidated statements of operations.

Covenants

The Company's senior secured credit facility, $325 million $8^{3}/_{4}\%$ and $250 million $6^{3}/_{4}\%$ senior subordinated notes require it, among other obligations, to maintain specified financial ratios and to satisfy certain financial tests, including fixed charge coverage, senior leverage and total leverage ratios. In addition, the Company's senior secured credit facility, $325 million $8^{3}/_{4}\%$ and $250 million $6^{3}/_{4}\%$ senior subordinated notes restrict, among other things, the Company's ability to incur additional indebtedness, incur guarantee obligations, amend debt instruments, pay dividends, create liens on assets, make investments, make acquisitions, engage in mergers or consolidations, make capital expenditures, or engage in certain transactions with subsidiaries and affiliates and otherwise restricts corporate activities.

During the year ended December 31, 2008, the Company placed some of the funds received from the issuance of its Preferred Stock into unrestricted subsidiaries, in order to allow for maximum

flexibility in the deployment of the funds. The funds and activity maintained within the unrestricted subsidiaries are excluded from the Company's covenant calculations.

At December 31, 2009, the Company was in compliance with all required financial covenants.

12. Commitments and Contingencies

Litigation

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

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

In conjunction with the Company's acquisition of Argosy Gaming Company in 2005, and subsequent disposition of the Argosy Casino Baton Rouge property, the Company became responsible for litigation initiated in 1997 related to the Baton Rouge casino license formerly owned by Argosy. On November 26, 1997, Capitol House filed an amended petition in the Nineteenth Judicial District Court for East Baton Rouge Parish, State of Louisiana, amending its previously filed but unserved suit against Richard Perryman, the person selected by the Louisiana Gaming Division to evaluate and rank the applicants seeking a gaming license for East Baton Rouge Parish, and adding state law claims against Jazz Enterprises, Inc., the former Jazz Enterprises, Inc. shareholders, Argosy, Argosy of Louisiana, Inc. and Catfish Queen Partnership in Commendam, d/b/a the Belle of Baton Rouge Casino. This suit alleged that these parties violated the Louisiana Unfair Trade Practices Act in connection with obtaining the gaming license that was issued to Jazz Enterprises, Inc./Catfish Queen Partnership in Commendam. The plaintiff, an applicant for a gaming license whose application was denied by the Louisiana Gaming Division, sought to prove that the gaming license was invalidly issued and to recover lost profits that the plaintiff contended it could have earned if the gaming license had been issued to the plaintiff. On October 2, 2006, the Company prevailed on a partial summary judgment motion which limited plaintiff's damages to its out-of-pocket costs in seeking its gaming license, thereby eliminating any recovery for potential lost gaming profits. On February 6, 2007, the jury returned a verdict of $3.8 million (exclusive of statutory interest and attorneys' fees) against Jazz Enterprises, Inc. and Argosy. After ruling on post-trial motions, on September 27, 2007, the trial court entered a judgment in the amount of $1.4 million, plus attorneys' fees, costs and interest. The Company has the right to seek indemnification from two of the former Jazz Enterprises, Inc. shareholders for any liability suffered as a result of such cause of action, however, there can be no assurance that the former Jazz Enterprises, Inc. shareholders will have assets sufficient to satisfy any claim in excess of Argosy's recoupment rights. The Company established an appropriate reserve and bonded the judgment pending its appeal. Both the plaintiff and the Company appealed the judgment to the First Circuit Court of Appeals in Louisiana. On August 31, 2009, the appellate court reversed the trial court's decision and dismissed the case against Argosy in its entirety. Capitol House has requested that the Louisiana Supreme Court take its appeal of the dismissal and that request is currently pending.

The Illinois Legislature passed into law House Bill 1918, effective May 26, 2006, which singled out four of the nine Illinois casinos, including the Company's Empress Casino Hotel and Hollywood Casino

Aurora, for a 3% tax surcharge to subsidize local horse racing interests. On May 30, 2006, Empress Casino Hotel and Hollywood Casino Aurora joined with the two other riverboats affected by the law, Harrah's Joliet and the Grand Victoria Casino in Elgin (collectively, the "Four Casinos"), and filed suit in the Circuit Court of the Twelfth Judicial District in Will County, Illinois (the "Court"), asking the Court to declare the law unconstitutional. Empress Casino Hotel and Hollywood Casino Aurora began paying the 3% tax surcharge into a protest fund which accrues interest during the pendency of the lawsuit. In two orders dated March 29, 2007 and April 20, 2007, the Court declared the law unconstitutional under the Uniformity Clause of the Illinois Constitution and enjoined the collection of this tax surcharge. The State of Illinois requested, and was granted, a stay of this ruling. As a result, Empress Casino Hotel and Hollywood Casino Aurora continued paying the 3% tax surcharge into the protest fund until May 25, 2008, when the 3% tax surcharge expired. The State of Illinois appealed the ruling to the Illinois Supreme Court. On June 5, 2008, the Illinois Supreme Court reversed the trial court's ruling and issued a decision upholding the constitutionality of the 3% tax surcharge. On January 21, 2009, the Four Casinos filed a petition for certiorari, requesting the U.S. Supreme Court to hear the case. Seven amicus curiae briefs supporting the plaintiffs' request were also filed. On June 8, 2009, the U.S. Supreme Court decided not to hear the case. On June 10, 2009, the Four Casinos filed a petition with the Court to open the judgment based on new evidence that came to light during the investigation of former Illinois Governor Rod Blagojevich that the 2006 law was procured by corruption. On August 17, 2009, the Court dismissed the Four Casinos' petition to reopen the case, and the Four Casinos have decided not to pursue an appeal of the dismissal.

On December 15, 2008, former Illinois Governor Rod Blagojevich signed Public Act No. 95-1008 requiring the Four Casinos to continue paying the 3% tax surcharge to subsidize Illinois horse racing interests. On January 8, 2009, the Four Casinos filed suit in the Court, asking it to declare the law unconstitutional. The 3% tax surcharge being paid pursuant to Public Act No. 95-1008 is paid into a protest fund where it accrues interest. The defendants have filed a motion to dismiss, which was granted on August 17, 2009. The Four Casinos have appealed the dismissal and have filed a motion to keep the funds in the protest fund while the appeal is being litigated. The accumulated funds will be returned to Empress Casino Hotel and Hollywood Casino Aurora if they ultimately prevail in the lawsuit.

On June 12, 2009, the Four Casinos filed a lawsuit in Illinois Federal Court naming former Illinois Governor Rod Blagojevich, his campaign fund, racetrack owner John Johnston, and his two racetracks as defendants alleging a civil conspiracy in violation of the Racketeer Influenced and Corrupt Organizations Act, 18 U.S.C. §1962(c),(d) ("RICO"), based on an illegal scheme to secure the enactment of the 3% tax surcharge legislation in exchange for the payment of money by Johnston and entities controlled by him. The Four Casinos also seek to impose a constructive trust over all funds paid under the tax surcharge, and therefore all of the Illinois racetracks are named as parties to the lawsuit. The defendants in the RICO case filed motions to dismiss. On December 7, 2009, the district court denied the motion to dismiss the RICO count, but it granted the motion to dismiss the constructive trust count, stating that it did not have jurisdiction in this case to impose the constructive trust. The Four Casinos have appealed this dismissal to the Seventh Circuit Court of Appeals. The appellate court has ordered that any monies disbursed to the tracks be maintained until the appeal has been decided.

In August 2007, a complaint was filed on behalf of a putative class of public shareholders of the Company, and derivatively on behalf of the Company, in the Court of Common Pleas of Berks County, Pennsylvania (the "Complaint"). The Complaint names the Company's Board of Directors as defendants and the Company as a nominal defendant. The Complaint alleges, among other things, that the Board of Directors breached their fiduciary duties by agreeing to the proposed transaction with Fortress and Centerbridge for inadequate consideration, that certain members of the Board of Directors have conflicts with regard to the Merger, and that the Company and its Board of Directors have failed to disclose certain material information with regard to the Merger. The Complaint seeks, among other things, a court order determining that the action is properly maintained as a class action

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and a derivative action enjoining the Company and its Board of Directors from consummating the proposed Merger, and awarding the payment of attorneys' fees and expenses. The Company and the plaintiff had reached a tentative settlement, contingent upon consummation of the transaction with Fortress and Centerbridge, in which the Company agreed to pay certain attorneys' fees and to make certain disclosures regarding the events leading up to the transaction with Fortress and Centerbridge in the proxy statement sent to shareholders in November 2007. The case was terminated by the court for inactivity on September 7, 2009, and no payments were made.

On July 16, 2008, the Company was served with a purported class action lawsuit brought by plaintiffs seeking to represent a class of shareholders who purchased shares of the Company's Common Stock between March 20, 2008 and July 2, 2008. The lawsuit alleges that the Company's disclosure practices relative to the proposed transaction with Fortress and Centerbridge and the eventual termination of that transaction were misleading and deficient in violation of the Securities Exchange Act of 1934. The complaint, which seeks class certification and unspecified damages, was filed in federal court in Maryland. The complaint was amended, among other things, to add three new named plaintiffs and to name Peter M. Carlino, Chairman and Chief Executive Officer, and William J. Clifford, Senior Vice President and Chief Financial Officer, as additional defendants. The Company filed a motion to dismiss the complaint in November 2008, and the court granted the motion and dismissed the complaint with prejudice. The plaintiffs filed a motion for reconsideration, which was denied on October 21, 2009. The plaintiffs have appealed the decision and the parties are in the process of filing appellate briefs.

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

On September 23, 2008, KPG filed an action against HV Properties of Kansas, LLC ("HV") in the U.S. District Court for the District of Kansas seeking a declaratory judgment from the U.S. District Court finding that KPG has no further obligations to HV under a Real Estate Sale Contract (the "Contract") that KPG and HV entered into on September 6, 2007, and that KPG properly terminated this Contract under the terms of the Repurchase Agreement entered into between the parties effective September 28, 2007. HV filed a counterclaim claiming KPG breached the Contract, and seeks $37.5 million in damages. On October 7, 2008, HV filed suit against the Company claiming the Company is liable to HV for KPG's alleged breach based on a Guaranty Agreement signed by the Company. Both cases were consolidated. The Company filed a motion to dismiss HV's claims, which was denied on May 6, 2009. Discovery has concluded and dispositive motions are currently being briefed by both sides.

Operating Lease Commitments

The Company is liable under numerous operating leases for airplanes, automobiles, land for the property on which some of its casinos operate, other equipment and buildings, which expire at various dates through 2093. Total rental expense under these agreements was $31.5 million, $30.7 million and $29.6 million for the years ended December 31, 2009, 2008, and 2007, respectively.

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

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

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

The future minimum lease commitments relating to the base lease rent portion of noncancelable operating leases at December 31, 2009 are as follows (in thousands):

Year ending December 31,	
2010	$ 7,006
2011	6,672
2012	5,480
2013	4,639
2014	3,823
Thereafter	36,328
Total	$ 63,948

Capital Expenditure Commitments

At December 31, 2009, the Company was contractually committed to spend approximately $53.1 million in capital expenditures for projects in progress.

Employee Benefit Plans

The Company maintains a profit-sharing plan under the provisions of Section 401(k) of the Internal Revenue Code of 1986, as amended, which covers all eligible employees. The plan enables participating employees to defer a portion of their salary in a retirement fund to be administered by the Company. The Company makes a discretionary match contribution of 50% of employees' elective salary deferrals, up to a maximum of 6% of eligible employee compensation.

The Company also has a defined contribution plan, the Charles Town Races Future Service Retirement Plan, covering substantially all of its union employees at the Charles Town Entertainment Complex. The Company makes annual contributions to this plan for the eligible union employees and to the Penn National Gaming, Inc. 401(k) Plan for the eligible non-union employees for an amount equal to the amount accrued for retirement expense, which is calculated as 0.25% of the daily mutual handle and 1.0% up to a base of the net video lottery revenues and, after the base is met, it reverts to 0.5%.

The Company maintains a non-qualified deferred compensation plan that covers most management and other highly-compensated employees. This plan was effective March 1, 2001. The plan allows the participants to defer, on a pre-tax basis, a portion of their base annual salary and bonus, and earn tax-deferred earnings on these deferrals. The plan also provides for matching Company contributions that vest over a five-year period. The Company has established a Trust, and transfers to the Trust, on a periodic basis, an amount necessary to provide for its respective future liabilities with respect to

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participant deferral and Company contribution amounts. The Company's matching contributions in 2009, 2008 and 2007 were $1.5 million, $1.7 million and $2.2 million, respectively.

Agreements with Horsemen and Pari-Mutuel Clerks

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

At the Charles Town Entertainment Complex, the Company has an agreement with the Charles Town Horsemen with an initial term expiring on December 31, 2011, and an agreement with the breeders that expires on June 30, 2010. The pari-mutuel clerks at Charles Town are represented under a collective bargaining agreement with the West Virginia Division of Mutuel Clerks, which expires on December 31, 2010.

The Company's agreement with the Pennsylvania Thoroughbred Horsemen at Penn National Race Course expires on September 30, 2011. The Company has a collective bargaining agreement with Local 137 of the Sports Arena Employees (AFL-CIO) at Penn National Race Course with respect to pari-mutuel clerks, admissions and Telebet personnel which expires on December 31, 2011. The Company also has an agreement in place with the Sports Arena Employees Local 137 (AFL-CIO) with respect to pari-mutuel clerks and admission personnel at the Company's OTWs, which expired on September 30, 2009 and has been extended pending continuing negotiations.

The Company's agreement with the Maine Harness Horsemen Association at Bangor Raceway expires on December 31, 2011.

The Company's agreement with the Ohio Harness Horsemen Association expires on December 31, 2012.

Pennwood Racing, Inc. also has an agreement in effect with the horsemen at Freehold Raceway, which expires on December 31, 2011.

Throughout the Argosy properties, the Seafarers Entertainment and Allied Trade Union represents approximately one thousand eight hundred of the Company's employees. At the Empress Casino Hotel, the Hotel Employees and Restaurant Employees Union ("UNITE/HERE") Local 1 represents approximately three hundred employees under a collective bargaining agreement which expires on March 31, 2011. At certain of the Company's Argosy properties, the Seafarer International Union of North America, Atlantic, Gulf, Lakes and Inland Waters District/NMU, AFL-CIO, the International Brotherhood of Electrical Workers, the Security Police and Fire Professionals of America, the American Maritime Officers Union, the International Brotherhood of Electrical Workers Local 176, and UNITE/HERE Local 10 represent certain of the Company's employees. The Company has collective bargaining agreements with these unions that expire at various times between July 2010 and October 2015. None of these unions individually represent more than fifty of the Company's employees.

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

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New Jersey Joint Venture

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

In 1999, the Company made an $11.3 million loan to the joint venture and an equity investment of $0.3 million. In 2008, the balance of the loan was increased by $0.5 million to $11.8 million to substitute a payment of interest on the loan. The loan is evidenced by a subordinated secured note, which is included in investment in and advances to unconsolidated affiliates within the consolidated balance sheets. The $11.3 million portion of the note bears interest at prime plus 2.25% or a minimum of 10.00% (at December 31, 2009, the interest rate was 10.00%). The $0.5 million portion of the note bears interest at the lesser of prime plus 2.00% or the 30-day LIBOR plus 3.00% (at December 31, 2009, the interest rate was 3.23%). The Company has recorded interest income within the consolidated statements of operations of $1.2 million, $1.2 million and $1.2 million for the years ended December 31, 2009, 2008 and 2007, respectively.

The joint venture, through Freehold Racing Association, was part of a multi-employer pension plan. For collectively bargained, multi-employer pension plans, contributions were made in accordance with negotiated labor contracts and generally were based on days worked. With the passage of the Multi-Employer Pension Plan Amendments Act of 1980, the joint venture may, under certain circumstances, become subject to liabilities in excess of contributions made under collective bargaining agreements. Generally, these liabilities are contingent upon the termination, withdrawal, or partial withdrawal from the plans. In June 2006, Freehold Racing Association withdrew from the multi-employer pension plan, and thereby became subject to payment of a withdrawal liability to the multi-employer pension plan. In January 2008, Freehold Racing Association was informed that the multi-employer pension plan experienced a mass withdrawal termination as of December 25, 2007. In November 2009, Freehold Racing Association received notice and demand for payment of the reallocation component of the joint venture withdrawal liability. The reallocation liability was calculated to be $5.1 million as of the date of withdrawal. Freehold Racing Association's obligation will continue until 2055 or such time that it is notified that the obligation has been satisfied. At December 31, 2009, the joint venture withdrawal liability was approximately $5.0 million for Freehold Racing Association.

The Company and Greenwood entered into a Debt Service Maintenance Agreement with a bank in which each joint venture partner has guaranteed up to 50% of a $23.0 million term loan to the joint venture. The Debt Service Maintenance Agreement remains in effect for the life of the loan and was due to expire on September 30, 2009. In 2008, the joint venture borrowed an additional $1.75 million and the maturity date of the term loan was extended to September 30, 2013. In 2009, certain terms and conditions of the agreement were amended, including the interest rates to be applied and the payment schedule. At December 31, 2009, the outstanding balance on the loan to the joint venture amounted to $8.7 million, of which the Company's obligation under its guarantee of the term loan was limited to approximately $4.4 million. The Company's investment in the joint venture is accounted for under the equity method. The original investment was recorded at cost and has been adjusted by the Company's share of income (loss) of the joint venture and distributions received. The Company's 50% share of the income (loss) of the joint venture is included in other income (expenses) within the consolidated statements of operations.

13. Income Taxes

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

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

Year ended December 31,	2009	2008
	(in thousands)	
Deferred tax assets:		
Stock-based compensation expense	$ 26,499	$ 17,510
Accrued expenses	26,092	21,973
Deferred tax assets resulting from unrecognized tax benefits	11,682	12,751
State net operating losses	7,404	6,622
Accumulated other comprehensive loss	14,916	21,929
Gross deferred tax assets	86,593	80,785
Less valuation allowance	(4,268)	(3,860)
Net deferred tax assets	82,325	76,925
Deferred tax liabilities:		
Property, plant and equipment	(86,334)	(86,342)
Intangibles	(99,479)	(235,128)
Net deferred tax liabilities	(185,813)	(321,470)
Net:	$ (103,488)	$ (244,545)
Reflected on consolidated balance sheets:		
Current deferred tax assets, net	$ 23,619	$ 21,065
Noncurrent deferred tax liabilities, net	(127,107)	(265,610)
Net deferred taxes	$ (103,488)	$ (244,545)

For income tax reporting, the Company has state net operating loss carryforwards aggregating approximately $157.3 million available to reduce future state income taxes primarily for the Commonwealth of Pennsylvania and the State of Mississippi as of December 31, 2009. The tax benefit associated with these net operating loss carryforwards is approximately $7.4 million. Due to state tax statutes on annual net operating loss utilization limits, the availability of gaming tax credits, and income and loss projections in the applicable jurisdictions, a $3.9 million valuation allowance has been recorded to reflect the net operating losses which are not presently expected to be realized. In addition, a $0.4 million valuation has been recorded to reflect the income tax effect of unrealized capital loss carryforwards of the Company which are not presently expected to be realized. If not used, substantially all the carryforwards will expire at various dates from December 31, 2010 to December 31, 2029. In the event that the valuation allowance is ultimately unnecessary, the majority would be treated as a reduction of tax expense.

In addition, certain subsidiaries have accumulated state net operating loss carryforwards aggregating approximately $650.5 million for which no benefit has been recorded as they are attributable to uncertain tax positions. The unrecognized tax benefits as of December 31, 2009 attributable to these net operating losses was approximately $42.1 million. Due to the uncertain tax position, these net operating losses are not included as components of deferred tax assets as of December 31, 2009. In the event of any benefit from realization of these net operating losses, $8.6 million would be treated as an increase to equity, and the remainder would be treated as a reduction of tax expense. If not used, substantially all the carryforwards will expire at various dates from December 31, 2010 to December 31, 2029.

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The provision for income taxes charged to operations was as follows:

Year ended December 31,	2009	2008	2007
		(in thousands)	
Current tax expense			
Federal	$ 65,941	$ 157,043	$ 75,959
State	20,232	35,461	28,536
Foreign	(233)	4,332	9,427
Total current	85,940	196,836	113,922
Deferred tax (benefit) expense			
Federal	(112,072)	(78,895)	16,223
State	(34,336)	(12,203)	2,042
Total deferred	(146,408)	(91,098)	18,265
Total provision	$ (60,468)	$ 105,738	$ 132,187

The following table reconciles the statutory federal income tax rate to the actual effective income tax rate for 2009, 2008 and 2007:

Year ended December 31,	2009	2008	2007
Percent of pretax income			
Federal taxes	35.0%	35.0%	35.0%
State and local income taxes	3.3%	(32.0)%	6.8%
Permanent differences	(20.5)%	(217.9)%	2.6%
Foreign	0.4%	(7.5)%	1.2%
Other miscellaneous items	0.2%	0.2%	(0.4)%
	18.4%	(222.2)%	45.2%

Year ended December 31,	2009	2008	2007
		(in thousands)	
Amount based upon pretax income			
Federal taxes	$ (114,758)	$ (16,655)	$ 102,284
State and local income taxes	(10,671)	15,229	19,953
Permanent differences	67,166	103,707	7,460
Foreign	(1,291)	3,587	3,453
Other miscellaneous items	(914)	(130)	(963)
	$ (60,468)	$ 105,738	$ 132,187

The Company adopted the provisions of ASC 740 on January 1, 2007. As a result of the implementation of ASC 740, the Company recognized a liability for unrecognized tax benefits of approximately $11.9 million, which was accounted for as a reduction to the January 1, 2007 retained earnings balance. The liability for unrecognized tax benefits is included in noncurrent tax liabilities within the consolidated balance sheet at December 31, 2009 and 2008.

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

	Noncurrent tax liabilities
	(in thousands)
Balance at January 1, 2008	$ 82,849
Additions based on current year tax positions	10,702
Additions based on prior year tax positions	2,105
Decreases due to settlements and/or reduction in liabilities	(6,984)
Currency translation adjustments	(20,040)
Balance at December 31, 2008	68,632
Additions based on current year tax positions	4,614
Additions based on prior year tax positions	9,333
Decreases due to settlements and/or reduction in liabilities	(45,848)
Currency translation adjustments	9,971
Balance at December 31, 2009	$ 46,702

Included in the liability for unrecognized tax benefits at December 31, 2009 and 2008 were $9.5 million and $31.7 million, respectively, of tax positions that are indemnified by a third party. The indemnification stems from a transaction the Company completed in 2001 with The Continental Companies and CHC International, Inc. (the "Seller") whereby the Company acquired Casino Rouge in Baton Rouge, Louisiana and the management contract for Casino Rama in Orillia, Ontario, Canada. As part of the acquisition, Continental and the Company entered into an Indemnification Agreement whereby Continental indemnified the Company for any tax liabilities to arise subsequent to the acquisition for taxation years which Continental was the owner. The Canada Revenue Agency ("CRA") proposed a reassessment of CHC Canada in respect to its 1996 through 2000 taxation years. The Company and Seller disagreed with the CRA's position, and the matter was placed in Competent Authority in 2004.

On May 20, 2009, the Company was notified by the Competent Authority Services Division of the CRA that the CRA and the U.S. Competent Authority ("IRS") negotiated a settlement regarding the years under assessment from the CRA 1996 through 2000 taxation years. According to the terms of the agreement, the CRA had agreed to reduce their original disallowance of management fees charged by the Company's indirect U.S. subsidiary CRC Holdings, Inc. to CHC Casinos Canada, Limited from CND$54,472,752 to CND$13,556,919 in exchange for the IRS granting relief by allowing CRC Holdings-US to decrease its income by $9,130,658 (US$) (or $13,556,919 (CND$)) and repay the $9,130,658 (US$) to CHC Casinos Canada Limited free of any U.S. withholding taxes.

On November 27, 2009, the Company received from the CRA Notice of Reassessment ("Notice") for the taxation years covered under the Component Authority settlement. In accordance with the terms of the Notice, the Company paid CND$8,466,363.09 on December 16, 2009. Based upon the calculations within the Notice, the Company recalculated its pre-acquisition liability/indemnification receivable and decreased its liability/indemnification receivable. As of December 31, 2009, the Company is currently working with Continental to be reimbursed in accordance with the Indemnification Agreement. Once payment is received by the Company, it will reverse the federal portion of the indemnification receivable. For the years after 2001, where the Company has no indemnification, it has included in the liability for unrecognized tax benefits $22.0 million of tax reserves, including $12.6 million of accrued interest and penalties.

Included in the liability for unrecognized tax benefits at December 31, 2009 and 2008 were $10.0 million and ($20.0) million, respectively, of currency translation adjustments for foreign currency tax positions.

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Included in the liability for unrecognized tax benefits at December 31, 2009 and 2008 were $37.2 million and $36.6 million, respectively, of tax positions that, if reversed, would affect the effective tax rate.

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

During the years ended December 31, 2009 and 2008, the Company recognized approximately $2.7 million and $2.5 million, respectively, of interest and penalties, net of deferred taxes. In addition, due to settlements and/or reductions in previously recorded liabilities on uncertain tax positions, the Company had reductions in previously accrued interest and penalties of $1.6 million, net of deferred taxes. The Company has accrued approximately $25.9 million (gross) for the payment of interest and penalties at December 31, 2009. These accruals were included in noncurrent tax liabilities within the consolidated balance sheet at December 31, 2009.

The Company is currently in various stages of the examination and appeal process in connection with our open audits. Generally, it is difficult to determine when these examinations will be closed, but the Company reasonably expects that its ASC 740 liabilities will not significantly change over the next twelve months.

As of December 31, 2009, the Company is subject to U.S. Federal income tax examinations for the tax years 2006, 2007 and 2008. In addition, the Company is subject to state and local income tax examinations for various tax years in the taxing jurisdictions in which the Company operates.

14. Shareholders' Equity

Shareholder Rights Plan

On May 20, 1998, the Board of Directors of the Company authorized and declared a dividend distribution of one preferred stock purchase right (the "Right" or "Rights") for each outstanding share of the Company's Common Stock, par value $.01 per share, payable to shareholders of record at the close of business on March 19, 1999. In addition, a Right was issued for each share of the Company's Common Stock issued after March 19, 1999 and prior to the Rights' expiration. Each Right entitled the registered holder to purchase from the Company one one-hundredth of a share (a "Preferred Stock Fraction") of the Company's Series A Preferred Stock (or another series of preferred stock with substantially similar terms), or a combination of securities and assets of equivalent value, at a purchase price of $10.00 per Preferred Stock Fraction, subject to adjustment. The description and terms of the Rights were set forth in a Rights Agreement (the "Rights Agreement") dated March 2, 1999, and amended on June 15, 2007, between the Company and Continental Stock Transfer and Trust Company as Rights Agent. The Rights Agreement and the associated Rights expired on March 18, 2009.

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

On July 3, 2008, the Company entered into an agreement with certain affiliates of Fortress and Centerbridge, terminating the Merger Agreement. In connection with the termination of the Merger Agreement, the Company agreed to receive a total of $1.475 billion, consisting of the Cash Termination Fee and the Investment. On October 30, 2008, the Company closed the sale of the Investment and issued 12,500 shares of Preferred Stock.

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

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to authorize (i) special dividends to security holders of the Company; (ii) issuance by the Company of equity securities senior to or on a parity with the Investment; (iii) stock repurchases, including but not limited to, by means of a tender offer which is funded by an asset sale outside the ordinary course (other than repurchases in the open market and repurchases by tender offer at not greater than a 20% premium); and (iv) certain other amendments to the terms of the Investment. The Investment has an aggregate liquidation preference equal to $1.25 billion, the aggregate purchase price paid for the Investment shares (the "Purchase Price"), subject to certain adjustments. In addition, the Investment terms provide that the Investment participates in any dividends paid on the Common Stock. To the extent that the Company pays a special dividend, such special dividend will reduce the amount to be paid to the holders of the Investment upon a liquidation or redemption.

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

The redemption price to be paid to the holders of the Investment on June 30, 2015 is equal to the Purchase Price, subject to increase or decrease in the event that the average trading price of the Common Stock (measured over the 20 consecutive trading days prior to May 26, 2015) is greater than $67 per share or less than $45 per share, respectively. There is no coupon payable with respect to the Investment. The Company shall redeem all of the Investment for cash, provided the Company may elect on or prior to June 1, 2015 to pay all or part of the redemption price in shares of the Common Stock. At December 31, 2009, the redemption price was $755.3 million (27.8 million shares of Common Stock if the Company elected to redeem through the issuance of Common Stock).

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

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

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

Pursuant to the Investor Rights Agreement, the Investment holders may not directly or indirectly sell, transfer, pledge, encumber, assign or otherwise dispose of any portion of any Investment shares to any person without the prior written consent of the Company prior to July 21, 2009. However, the Investment holders may sell, transfer, pledge, encumber, assign or otherwise dispose of their Investment shares prior to July 21, 2009 if such transaction is made: (i) to an affiliate of any such Investment holder which agrees to be bound by the terms of the Investor Rights Agreement; (ii) with the prior written consent of the Company's Board of Directors, to a person pursuant to a tender or exchange offer for Investment shares or Common Stock by such person or a merger, consolidation or reorganization of the Company with such person; (iii) if the Company acknowledges in writing that it is unable to pay its debts, commences a voluntary case in bankruptcy or a voluntary petition seeking reorganization or makes an assignment for the benefit of creditors; or (iv) if the Company consents to the entry of an order for relief against it seeking liquidation, reorganization or a creditor's arrangement of the Company.

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

15. Noncontrolling Interests

In November 2009, the Company entered into an agreement with Lakes Entertainment, Inc. ("Lakes"), permitting Lakes to invest in up to a 10% equity interest in each of the Company's proposed facilities in Columbus and Toledo, Ohio. During the year ended December 31, 2009, Lakes contributed $1.9 million to the Company towards the proposed facilities, and its portion of the net loss for the proposed facilities was $2.5 million. The noncontrolling interest is included in shareholders' equity within the consolidated balance sheet at December 31, 2009, stated separately from the Company's shareholders' equity.

16. Stock-Based Compensation

In April 1994, the Company's Board of Directors and shareholders adopted and approved the 1994 Stock Option Plan (the "1994 Plan"). The 1994 Plan permitted the grant of options to purchase up to 12,000,000 shares of Common Stock, subject to antidilution adjustments, at a price per share no less than 100% of the fair market value of the Common Stock on the date an option is granted with respect to incentive stock options only. The price would be no less than 110% of fair market value in the case of an incentive stock option granted to any individual who owns more than 10% of the total combined voting power of all classes of outstanding stock. The 1994 Plan provided for the granting of both incentive stock options intended to qualify under Section 422 of the Internal Revenue Code of 1986, as amended, and nonqualified stock options, which do not so qualify. The options granted prior to the 2003 Plan remain outstanding.

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

On August 20, 2008, the Company's Board of Directors adopted and approved the 2008 Long Term Incentive Compensation Plan (the "2008 Plan"). On November 12, 2008, the Company's shareholders approved the 2008 Plan. The 2008 Plan permits the Company to issue stock options (incentive and/or non-qualified), stock appreciation rights, restricted stock, phantom stock units and other equity and cash awards to employees. Non-employee directors are eligible to receive all such awards, other than incentive stock options. The aggregate number of shares of Common Stock that may be issued under the 2008 Plan shall not exceed 6,900,000. Awards of stock options and stock appreciation rights will be counted against the 6,900,000 limit as one share of Common Stock for each share granted. However each share awarded in the form of restricted stock, phantom stock units or any other full value stock award will be counted as issuing 2.16 shares of Common Stock for purposes of determining the number of shares available for issuance under the plan. At December 31, 2009, there were 4,401,889 options available for future grants under the 2008 Plan.

Stock options that expire between February 12, 2010 and September 11, 2018 have been granted to officers, directors and employees to purchase Common Stock at prices ranging from $7.75 to $61.82 per share. All options were granted at the fair market value of the Common Stock on the date the options were granted.

The following table contains information on stock options issued under the plans for the three-year period ended December 31, 2009:

	Number of Option Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in thousands)
Outstanding at December 31, 2006	8,110,601	$ 21.87	4.97	$ 160,225
Granted	1,458,750	42.21		
Exercised	(1,824,071)	13.66		
Canceled	(495,375)	28.44		
Outstanding at December 31, 2007	7,249,905	$ 27.58	4.87	$ 231,837
Granted	1,834,000	29.56		
Exercised	(203,202)	11.80		
Canceled	(76,125)	37.00		
Outstanding at December 31, 2008	8,804,578	$ 28.27	6.30	$ 17,677
Granted	1,849,375	22.32		
Exercised	(491,078)	11.06		
Canceled	(196,750)	32.27		
Outstanding at December 31, 2009	9,966,125	$ 27.83	5.67	$ 33,038

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Included in the above are Common Stock options that were issued in 2003 to the Company's Chairman outside of the 1994 Plan and the 2003 Plan. These options were issued at $7.95 per share, and are exercisable through February 6, 2013. At December 31, 2009 and 2008, the number of these Common Stock options that were outstanding was 23,750. On December 31, 2008, the Company modified the expiration date of certain of its stock options from the seventh anniversary of the date of grant to the tenth anniversary of the date of grant. This modification resulted in additional compensation costs related to stock-based compensation of $2.3 million pre-tax ($1.6 million after-tax) for the year ended December 31, 2008.

The weighted-average grant-date fair value of options granted during the years ended December 31, 2009, 2008 and 2007 were $8.91, $10.57 and $16.08, respectively.

	Number of Option Shares	Weighted-Average Exercise Price
Exercisable at December 31,		
2009	5,872,151	$ 27.41
2008	4,608,441	23.60
2007	3,080,480	19.74

The aggregate intrinsic value of stock options exercised during the years ended December 31, 2009, 2008 and 2007 was $8.4 million, $4.1 million and $74.6 million, respectively.

At December 31, 2009, there were 5,872,151 shares that were exercisable, with a weighted-average exercise price of $27.41, a weighted-average remaining contractual term of 4.82 years, and an aggregate intrinsic value of $22.3 million.

The following table summarizes information about stock options outstanding at December 31, 2009:

	Exercise Price Range			Total
	$7.75 to $29.22	$29.34 to $38.42	$38.43 to $61.82	$7.75 to $61.82
Outstanding options				
Number outstanding	5,273,461	3,332,915	1,359,749	9,966,125
Weighted-average remaining contractual life (years)	4.49	7.01	6.99	5.67
Weighted-average exercise price	$ 21.80	$ 31.53	$ 42.10	$ 27.83
Exercisable options				
Number outstanding	3,483,336	1,680,540	708,275	5,872,151
Weighted-average exercise price	$ 22.01	$ 32.40	$ 42.07	$ 27.41

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The following table contains information on restricted stock awards issued under the plans for the three-year period ended December 31, 2009:

	Number of Award Shares
Outstanding at December 31, 2006	160,000
Awarded	280,000
Released	
Canceled	(60,000)
Outstanding at December 31, 2007	380,000
Awarded	
Released	
Canceled	
Outstanding at December 31, 2008	380,000
Awarded	332,690
Released	(160,000)
Canceled	
Outstanding at December 31, 2009	552,690

Compensation costs related to stock-based compensation for the years ended December 31, 2009, 2008, and 2007 totaled $28.4 million pre-tax ($20.9 million after-tax), $26.9 million pre-tax ($19.8 million after-tax), and $25.5 million pre-tax ($18.6 million after-tax), respectively, and are included within the consolidated statements of operations under general and administrative expense.

At December 31, 2009 and December 31, 2008, the total compensation cost related to nonvested awards not yet recognized equaled $39.5 million and $67.0 million, respectively, including $31.2 million and $63.9 million for stock options, respectively, and $8.3 million and $3.1 million for restricted stock, respectively. This cost is expected to be recognized over the remaining vesting periods, which will not exceed five years.

17. Segment Information

In accordance with ASC 280, the Company views each property as an operating segment, and aggregates all of its properties into one reportable segment, as the Company believes that they are economically similar, offer similar types of products and services, cater to the same types of customers and are similarly regulated.

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18. Summarized Quarterly Data (Unaudited)

The following table summarizes the quarterly results of operations for the years ended December 31, 2009 and 2008:

	Fiscal Quarter			
	First	Second	Third	Fourth
	(in thousands, except per share data)			
2009				
Net revenues	$ 612,226	$ 580,817	$ 620,426	$ 555,806
Income (loss) from operations	100,835	76,705	87,404	(459,542)
Net income (loss) attributable to the shareholders of Penn National Gaming, Inc. and subsidiaries	40,661	28,480	21,351	(355,440)
Earnings (loss) per common share attributable to the shareholders of Penn National Gaming, Inc. and shareholders:				
Basic earnings (loss) per common share	0.42	0.29	0.22	(4.54)
Diluted earnings (loss) per common share	0.38	0.27	0.20	(4.54)
2008				
Net revenues	$ 613,494	$ 620,586	$ 617,887	$ 571,086
Income (loss) from operations	118,559	113,591	96,377	(414,968)
Net income (loss) attributable to the shareholders of Penn National Gaming, Inc. and subsidiaries	40,736	37,023	147,491	(378,573)
Earnings (loss) per common share attributable to the shareholders of Penn National Gaming, Inc. and shareholders:				
Basic earnings (loss) per common share	0.47	0.43	1.72	(4.77)
Diluted earnings (loss) per common share	0.46	0.42	1.69	(4.77)

In conjunction with the opening of the new casino riverboat at Hollywood Casino Lawrenceburg, the Company recorded a pre-tax impairment charge for the replaced Lawrenceburg vessel of $11.7 million ($6.8 million, net of taxes) during the second quarter of 2009. In addition, as a result of the anticipated impact of gaming expansion in Ohio, the Company recorded a pre-tax impairment charge of $520.5 million ($368.8 million, net of taxes) during the fourth quarter of 2009, as the Company determined that a portion of the value of the goodwill and indefinite-life intangible assets associated with the original purchase of Hollywood Casino Lawrenceburg was impaired.

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

19. Related Party Transactions

Executive Office Lease

The Company currently leases 42,348 square feet of executive office and warehouse space for buildings in Wyomissing, Pennsylvania from affiliates of its Chairman and Chief Executive Officer. Rent

expense for the years ended December 31, 2009, 2008 and 2007 amounted to $0.9 million, $0.8 million and $0.7 million, respectively. The leases for the office space expire in March 2012, May 2012 and May 2013, and the lease for the warehouse space expires in July 2010. The future minimum lease commitments relating to these leases at December 31, 2009 equaled $2.2 million. The Company also paid $0.7 million and $3.7 million in construction costs to these same affiliates for the years ended December 31, 2008 and 2007, respectively.

20. Subsidiary Guarantors

Under the terms of the senior secured credit facility, most of Penn's subsidiaries are guarantors under the agreement. Each of the subsidiary guarantors is 100% owned by Penn. In addition, the guarantees provided by such subsidiaries under the terms of the senior secured credit facility are full and unconditional, joint and several. There are no significant restrictions within the senior secured credit facility on the Company's ability to obtain funds from its subsidiaries by dividend or loan. However, in certain jurisdictions, the gaming authorities may impose restrictions pursuant to the authority granted to them with regard to Penn's ability to obtain funds from its subsidiaries.

With regard to the senior secured credit facility, the Company has not presented condensed consolidating balance sheets, condensed consolidating statements of operations and condensed consolidating statements of cash flows at, and for the year ended, December 31, 2007, as Penn had no significant independent assets and no independent operations at, and for the year ended, December 31, 2007. However, during the year ended December 31, 2008, the Company placed some of the funds received from the issuance of its Preferred Stock into unrestricted subsidiaries, in order to allow for maximum flexibility in the deployment of the funds and this resulted in significant independent assets. Summarized financial information for the years ended December 31, 2009 and 2008 for Penn, the subsidiary guarantors of the senior secured credit facility and the subsidiary non-guarantors is presented below.

Under the terms of the $200 million $6^7/_8$% senior subordinated notes, most of Penn's subsidiaries are guarantors under the agreement. Each of the subsidiary guarantors is 100% owned by Penn. In addition, the guarantees provided by such subsidiaries under the terms of the $200 million $6^7/_8$% senior subordinated notes are full and unconditional, joint and several. There are no significant restrictions within the $200 million $6^7/_8$% senior subordinated notes on the Company's ability to obtain funds from its subsidiaries by dividend or loan. However, in certain jurisdictions, the gaming authorities may impose restrictions pursuant to the authority granted to them with regard to Penn's ability to obtain funds from its subsidiaries.

With regard to the $200 million $6^7/_8$% senior subordinated notes, the Company has not presented condensed consolidating balance sheets, condensed consolidating statements of operations and condensed consolidating statements of cash flows at, and for the year ended, December 31, 2007, as Penn had no significant independent assets and no independent operations at, and for the year ended, December 31, 2007. However, during the year ended December 31, 2008, the Company placed some of the funds received from the issuance of its Preferred Stock into unrestricted subsidiaries, in order to allow for maximum flexibility in the deployment of the funds and this resulted in significant independent assets. Summarized financial information for the year ended December 31, 2008 for Penn, the subsidiary guarantors of the $200 million $6^7/_8$% senior subordinated notes and the subsidiary non-guarantors is presented below. Summarized financial information for the year ended December 31, 2009 is not reported because, during the year ended December 31, 2009, the Company repaid all of the outstanding aggregate principal amount of its $200 million $6^7/_8$% senior subordinated notes.

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

	Penn	Subsidiary Guarantors	Subsidiary Non-Guarantors	Eliminations	Consolidated
			(in thousands)		
Senior Secured Credit Facility					
At December 31, 2009					
Condensed Consolidating Balance Sheet					
Total current assets	$ 69,290	$ 243,073	$ 586,140	$ 39,945	$ 938,448
Property and equipment, net	23,273	1,774,157	40,074		1,837,504
Total other assets	4,037,883	5,109,436	248,058	(7,458,713)	1,936,664
Total assets	$ 4,130,446	$ 7,126,666	$ 874,272	$ (7,418,768)	$ 4,712,616
Total current liabilities	$ 83,294	$ 285,926	$ 21,106	$ 39,930	$ 430,256
Total long-term liabilities	2,194,508	3,221,642	61,739	(3,047,605)	2,430,284
Total shareholders' equity	1,852,644	3,619,098	791,427	(4,411,093)	1,852,076
Total liabilities and shareholders' equity	$ 4,130,446	$ 7,126,666	$ 874,272	$ (7,418,768)	$ 4,712,616
Year Ended December 31, 2009					
Condensed Consolidating Statement of Operations					
Net revenues	$	$ 2,339,014	$ 30,261	$	$ 2,369,275
Total operating expenses	83,823	2,424,420	55,630		2,563,873
Loss from operations	(83,823)	(85,406)	(25,369)		(194,598)
Other income (expenses)	66,227	(211,391)	11,881		(133,283)
Loss from operations before income taxes	(17,596)	(296,797)	(13,488)		(327,881)
Taxes on income	(40,838)	(24,896)	5,266		(60,468)
Net income (loss) including noncontrolling interests	23,242	(271,901)	(18,754)		(267,413)
Less: Net loss attributable to noncontrolling interests			(2,465)		(2,465)
Net income (loss) attributable to the shareholders of Penn National Gaming, Inc. and subsidiaries	$ 23,242	$ (271,901)	$ (16,289)	$	$ (264,948)
Year Ended December 31, 2009					
Condensed Consolidating Statement of Cash Flows					
Net cash provided by (used in) operating activities	$ 101,367	$ 241,677	$ (4,798)	$	$ 338,246
Net cash used in investing activities	(1,877)	(236,242)	(24,540)		(262,659)
Net cash used in financing activities	(95,565)	(2,020)	(11,162)		(108,747)
Net increase (decrease) in cash and cash equivalents	3,925	3,415	(40,500)		(33,160)
Cash and cash equivalents at beginning of year	2,460	142,104	601,714		746,278
Cash and cash equivalents at end of year	$ 6,385	$ 145,519	$ 561,214	$	$ 713,118
Senior Secured Credit Facility					
At December 31, 2008					
Condensed Consolidating Balance Sheet					
Total current assets	$ 40,598	$ 235,862	$ 614,787	$ 15,056	$ 906,303
Property and equipment, net	17,707	1,781,982	12,442		1,812,131
Total other assets	4,351,845	2,351,302	262,923	(4,494,828)	2,471,242
Total assets	$ 4,410,150	$ 4,369,146	$ 890,152	$ (4,479,772)	$ 5,189,676
Total current liabilities	$ 105,147	$ 332,812	$ 17,468	$ 15,059	$ 470,486
Total long-term liabilities	2,247,736	3,667,014	97,151	(3,349,984)	2,661,917
Total shareholders' equity	2,057,267	369,320	775,533	(1,144,847)	2,057,273

Total liabilities and shareholders' equity	$	4,410,150	$	4,369,146	$	890,152	$	(4,479,772)	$	5,189,676

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	Penn	Subsidiary Guarantors	Subsidiary Non-Guarantors	Eliminations	Consolidated
			(in thousands)		
Year Ended December 31, 2008					
Condensed Consolidating Statement of Operations					
Net revenues	$	$ 2,387,358	$ 35,695	$	$ 2,423,053
Total operating expenses	94,925	2,352,864	61,705		2,509,494
(Loss) income from operations	(94,925)	34,494	(26,010)		(86,441)
Other income (expenses)	239,920	(198,845)	(2,219)		38,856
Income (loss) from operations before income taxes	144,995	(164,351)	(28,229)		(47,585)
Taxes on income	38,851	66,563	324		105,738
Net income (loss)	$ 106,144	$ (230,914)	$ (28,553)	$	$ (153,323)
Year Ended December 31, 2008					
Condensed Consolidating Statement of Cash Flows					
Net cash (used in) provided by operating activities	$ (544,759)	$ 360,012	$ 605,210	$	$ 420,463
Net cash used in investing activities	(2,085)	(388,361)	(1,052)		(391,498)
Net cash provided by (used in) financing activities	552,233	(2,292)	(7,000)		542,941
Net increase (decrease) in cash and cash equivalents	5,389	(30,641)	597,158		571,906
Cash and cash equivalents at beginning of year	(2,929)	172,745	4,556		174,372
Cash and cash equivalents at end of year	$ 2,460	$ 142,104	$ 601,714	$	$ 746,278
$200 million 6 7/8% Senior Subordinated Notes					
At December 31, 2008					
Condensed Consolidating Balance Sheet					
Total current assets	$ 40,598	$ 236,431	$ 614,218	$ 15,056	$ 906,303
Property and equipment, net	17,707	1,794,424			1,812,131
Total other assets	4,351,845	2,460,021	154,204	(4,494,828)	2,471,242
Total assets	$ 4,410,150	$ 4,490,876	$ 768,422	$ (4,479,772)	$ 5,189,676
Total current liabilities	$ 105,147	$ 338,765	$ 11,515	$ 15,059	$ 470,486
Total long-term liabilities	2,247,736	3,681,006	83,159	(3,349,984)	2,661,917
Total shareholders' equity	2,057,267	471,105	673,748	(1,144,847)	2,057,273
Total liabilities and shareholders' equity	$ 4,410,150	$ 4,490,876	$ 768,422	$ (4,479,772)	$ 5,189,676
Year Ended December 31, 2008					
Condensed Consolidating Statement of Operations					
Net revenues	$	$ 2,406,328	$ 16,725	$	$ 2,423,053
Total operating expenses	94,925	2,376,103	38,466		2,509,494
(Loss) income from operations	(94,925)	30,225	(21,741)		(86,441)
Other income (expenses)	239,920	(201,134)	70		38,856
Income (loss) from operations before income taxes	144,995	(170,909)	(21,671)		(47,585)
Taxes on income	38,851	66,102	785		105,738

Net income (loss)	$ 106,144	$ (237,011)	$ (22,456)	$		$ (153,323)
Year Ended December 31, 2008						
Condensed Consolidating Statement of Cash Flows						
Net cash (used in) provided by operating activities	$ (544,759)	$ 367,455	$ 597,767	$		$ 420,463
Net cash used in investing activities	(2,085)	(389,413)				(391,498)
Net cash provided by (used in) financing activities	552,233	(9,292)				542,941
Net increase (decrease) in cash and cash equivalents	5,389	(31,250)	597,767			571,906
Cash and cash equivalents at beginning of year	(2,929)	173,684	3,617			174,372
Cash and cash equivalents at end of year	$ 2,460	$ 142,434	$ 601,384	$		$ 746,278

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21. Fair Value Measurements

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

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

Level 2: Inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly; these include quoted prices for similar assets or liabilities in active markets and quoted prices for identical or similar assets or liabilities in markets that are not active.

Level 3: Unobservable inputs that reflect the reporting entity's own assumptions.

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

The following tables set forth the assets and liabilities measured at fair value on a recurring basis, by input level, in the consolidated balance sheet at December 31, 2009 and 2008 (in thousands):

	Balance Sheet Location	Quoted Prices in Active Markets for Identical Assets or Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	December 31, 2009 Total
Assets:					
Investment in corporate debt securities	Other assets	$ 4,550	$	$	$ 4,550
Liabilities:					
Interest rate swap contracts	Accrued interest		43,925		43,925

	Balance Sheet Location	Quoted Prices in Active Markets for Identical Assets or Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	December 31, 2008 Total
Assets:					
Investment in corporate debt securities	Other assets	$ 40,190	$	$	$ 40,190
Liabilities:					
Interest rate swap contracts	Accrued interest		63,185		63,185

The valuation technique used to measure the fair value of the investment in corporate debt securities and interest rate swap contracts was the market approach.

In conjunction with the opening of the new casino riverboat at Hollywood Casino Lawrenceburg, the Company recorded a pre-tax impairment charge for the replaced Lawrenceburg vessel of $11.9 million ($7.1 million, net of taxes) during the year ended December 31, 2009. In addition, as a result of the anticipated impact of gaming expansion in Ohio, the Company recorded a pre-tax impairment charge of $520.5 million ($368.8 million, net of taxes) during the year ended December 31, 2009, as the Company determined that a portion of the value

of goodwill and indefinite-life intangible assets associated with the original purchase of Hollywood Casino Lawrenceburg was impaired.

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The following table sets forth the assets and liabilities measured at fair value on a nonrecurring basis, by input level, in the consolidated balance sheet at December 31, 2009 (in thousands):

	Balance Sheet Location	Quoted Prices in Active Markets for Identical Assets or Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	December 31, 2009 Total	Total Reduction in Fair Value Recorded at December 31, 2009
Assets:						
Goodwill	Goodwill	$	$	$ 1,379,961	$ 1,379,961	$ (213,260)
Indefinite-life intangible assets	Other intangible assets			368,886	368,886	(307,228)
Long-lived assets	Other assets		6,750		6,750	(11,889)
						$ (532,377)

The valuation technique used to measure the fair value of goodwill, indefinite-life intangible assets and long-lived assets was the market approach. See Note 4 to the Consolidated Financial Statements for a description of the inputs and the information used to develop the inputs in calculating the fair value measurements of goodwill, indefinite-life intangible assets and long-lived assets.

22. Empress Casino Hotel Fire

On March 20, 2009, the Company's Empress Casino Hotel, which was undergoing a $55 million renovation, was closed following a fire that started in the land-based pavilion at the facility. All customers and employees were successfully evacuated, and the fire was contained on the land-side of the property before it could spread to the adjacent casino barge. On June 25, 2009, the casino barge was reopened with temporary land-based facilities, and the Company began construction of a new land-based pavilion.

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

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

The $33.5 million insurance receivable recorded at December 31, 2009 was limited to the net book value of assets believed to be damaged, destroyed or abandoned and other costs incurred during the year ended December 31, 2009 as a result of the fire at Empress Casino Hotel that are expected to be recovered via the insurance claim. During the year ended December 31, 2009, the Company received $20.6 million in insurance proceeds related to the fire at Empress Casino Hotel.

23. Discontinued Operations Sale of The Downs Racing, Inc. and Subsidiaries

On October 15, 2004, the Company announced the sale of The Downs Racing, Inc. and its subsidiaries to the MTGA. Under the terms of the agreement, the MTGA acquired The Downs Racing, Inc. and its subsidiaries, including Pocono Downs (a standardbred horse racing facility located on 400 acres in Wilkes-Barre, Pennsylvania) and five Pennsylvania OTWs located in Carbondale, East Stroudsburg, Erie, Hazelton and the Lehigh Valley (Allentown). The sale agreement also provided the

MTGA with certain post-closing termination rights in the event of certain materially adverse legislative or regulatory events. In January 2005, the Company received $280 million from the MTGA, and transferred the operations of The Downs Racing, Inc. and its subsidiaries to the MTGA. The sale was not considered final for accounting purposes until the third quarter of 2006, as the MTGA had certain post-closing termination rights that remained outstanding. On August 7, 2006, the Company entered into the Amendment and Release with the MTGA pertaining to the Purchase Agreement, and agreed to pay the MTGA an aggregate of $30 million over five years, beginning on the first anniversary of the commencement of slot operations at Mohegan Sun at Pocono Downs, in exchange for the MTGA's agreement to release various claims it raised against the Company under the Purchase Agreement and the MTGA's surrender of all post-closing termination rights it might have had under the Purchase Agreement. The Company recorded the present value of the $30 million liability within debt, as the amount due to the MTGA was payable over five years. In March 2009, the Company entered into the Third Amendment to the Purchase Agreement, in which the remaining payments due under the Purchase Agreement were accelerated and reduced. Under the Third Amendment to the Purchase Agreement, in exchange for the accelerated payment, which was paid to the MTGA in March 2009, all remaining obligations under the Purchase Agreement were deemed to be satisfied and, as a result, the Company recorded a $1.3 million gain during the year ended December 31, 2009, which is included in other income within the consolidated statements of operations.

24. Subsequent Events

The Company evaluated all subsequent events through the date that the consolidated financial statements were issued. No material subsequent events have occurred since December 31, 2009 that required recognition or disclosure in the consolidated financial statements.

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

None

ITEM 9A. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

We carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)). Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered in this report, our disclosure controls and procedures were effective to ensure that information required to be disclosed in reports filed under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the required time periods and is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control Over Financial Reporting

There have been no changes in our internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) that occurred during the fiscal quarter ended December 31, 2009, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Management's Report on Internal Control Over Financial Reporting

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

Our management assessed the effectiveness of our internal control over financial reporting, and concluded that it was effective as of December 31, 2009. In making this assessment, we used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in *Internal Control Integrated Framework*.

The effectiveness of the Company's internal control over financial reporting as of December 31, 2009 has been audited by Ernst & Young LLP, an independent registered public accounting firm, as stated in their report below.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors
Penn National Gaming, Inc. and subsidiaries

We have audited Penn National Gaming, Inc. and subsidiaries' internal control over financial reporting as of December 31, 2009, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Penn National Gaming, Inc. and subsidiaries' management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Annual Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

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

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

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

In our opinion, Penn National Gaming, Inc. and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2009, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Penn National Gaming, Inc. and subsidiaries as of December 31, 2009 and 2008, and the related consolidated statements of operations, changes in shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2009 and our report dated February 26, 2010 expressed an unqualified opinion thereon.

/s/ Ernst & Young LLP

Philadelphia, Pennsylvania
February 26, 2010

ITEM 9B. OTHER INFORMATION

None

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by this item concerning directors is hereby incorporated by reference to the Company's definitive proxy statement for its 2010 Annual Meeting of Shareholders (the "2010 Proxy Statement"), to be filed with the U.S. Securities and Exchange Commission within 120 days after December 31, 2009, pursuant to Regulation 14A under the Securities Act. Information required by this item concerning executive officers is included in Part I of this Annual Report on Form 10-K.

ITEM 11. EXECUTIVE COMPENSATION

The information called for in this item is hereby incorporated by reference to the 2010 Proxy Statement.

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

The information called for in this item is hereby incorporated by reference to the 2010 Proxy Statement.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE

The information called for in this item is hereby incorporated by reference to the 2010 Proxy Statement.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information called for in this item is hereby incorporated by reference to the 2010 Proxy Statement.

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PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

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

Report of Independent Registered Public Accounting Firm

Consolidated Balance Sheets as of December 31, 2009 and 2008

Consolidated Statements of Operations for the years ended December 31, 2009, 2008 and 2007

Consolidated Statements of Changes in Shareholders' Equity for the years ended December 31, 2009, 2008 and 2007

Consolidated Statements of Cash Flows for the years ended December 31, 2009, 2008 and 2007

All other schedules are omitted because they are not applicable, or not required, or because the required information is included in the Consolidated Financial Statements or notes thereto.

3. Exhibits, Including Those Incorporated by Reference.

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

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

PENN NATIONAL GAMING, INC.

By: /s/ PETER M. CARLINO

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

Dated: February 26, 2010

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

Signature	Title	Date
/s/ PETER M. CARLINO Peter M. Carlino	Chairman of the Board, Chief Executive Officer and Director (Principal Executive Officer)	February 26, 2010
/s/ WILLIAM J. CLIFFORD William J. Clifford	Senior Vice President Finance and Chief Financial Officer (Principal Financial Officer)	February 26, 2010
/s/ DESIREE A. BURKE Desiree A. Burke	Vice President and Chief Accounting Officer (Principal Accounting Officer)	February 26, 2010
/s/ HAROLD CRAMER Harold Cramer	Director	February 26, 2010
/s/ WESLEY R. EDENS Wesley R. Edens	Director	February 26, 2010
/s/ DAVID A. HANDLER David A. Handler	Director	February 26, 2010
/s/ JOHN M. JACQUEMIN John M. Jacquemin	Director	February 26, 2010
/s/ ROBERT P. LEVY Robert P. Levy	Director	February 26, 2010
/s/ BARBARA Z. SHATTUCK Barbara Z. Shattuck	Director	February 26, 2010

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EXHIBIT INDEX

Exhibit	Description of Exhibit
2.1	Agreement and Plan of Merger, dated as of August 7, 2002, by and among Hollywood Casino Corporation, Penn National Gaming, Inc. and P Acquisition Corp. (Incorporated by reference to Exhibit 2.1 to the Company's current report on Form 8-K, dated August 7, 2002).
2.2	Purchase Agreement by and among PNGI Pocono Corp., PNGI, LLC, and the Mohegan Tribal Gaming Authority, dated October 14, 2004. (Incorporated by reference to Exhibit 2.1 to the Company's current report on Form 8-K, filed October 20, 2004).
2.2(a)	Amendment No. 1 to Purchase Agreement, dated as of January 7, 2005, by and among PNGI Pocono Corp., PNGI, LLC, and The Mohegan Tribal Gaming Authority. (Incorporated by reference to Exhibit 2.1 to the Company's quarterly report on Form 10-Q for the quarter ended June 30, 2006).
2.2(b)	Second Amendment to Purchase Agreement and Release of Claims, dated as of August 7, 2006, between PNGI Pocono Inc. and The Mohegan Tribal Gaming Authority, and joined in by Penn National Gaming, Inc. (Incorporated by reference to Exhibit 2.2 to the Company's quarterly report on Form 10-Q for the quarter ended June 30, 2006).
2.2(c)	Third Amendment to Purchase Agreement and Release of Claims, dated as of March 10, 2009, between PNGI Pocono Corp., PNGI, LLC and The Mohegan Tribal Gaming Authority (Incorporated by reference to Exhibit 2.2(c) to the Company's quarterly report on Form 10-Q for the quarter ended March 31, 2009).
2.3	Agreement and Plan of Merger, dated as of November 3, 2004, among Penn National Gaming, Inc., Argosy Gaming Company and Thoroughbred Acquisition Corp. (Incorporated by reference to Exhibit 2.1 to the Company's current report on Form 8-K, filed November 5, 2004).
2.4	Agreement to Execute Securities Purchase Agreement, dated June 20, 2005, among Penn National Gaming, Inc., CP Baton Rouge Casino, L.L.C. and Columbia Sussex Corporation. (Incorporated by reference to Exhibit 10.1 to the Company's current report on Form 8-K, filed June 22, 2005).
2.4(a)	Letter agreement, dated October 3, 2005, among Penn National Gaming, Inc., CP Baton Rouge Casino, L.L.C., Columbia Sussex Corporation and Wimar Tahoe Corporation amending Agreement to Execute Securities Purchase Agreement. (Incorporated by reference to Exhibit 10.3 to the Company's current report on Form 8-K, filed October 4, 2005).
2.5	Securities Purchase Agreement, dated October 3, 2005, among Argosy Gaming Company, Wimar Tahoe Corporation and CP Baton Rouge Casino, L.L.C. (Incorporated by reference to Exhibit 10.2 to the Company's current report on Form 8-K, filed October 4, 2005).
2.6	Asset Purchase Agreement, dated as of November 7, 2006, by and among Zia Partners, LLC, Zia Park, LLC and (solely with respect to Section 2.6 and Articles VI and XII thereof) Penn National Gaming, Inc. (Incorporated by reference to Exhibit 10.1 to the Company's current report on Form 8-K, filed November 9, 2006).
2.6(a)	First Amendment to Asset Purchase Agreement, dated as of April 13, 2007, by and among Zia Partners, LLC, Zia Park LLC and Penn National Gaming, Inc. (Incorporated by reference to Exhibit 2.2 to the Company's current report on Form 8-K filed on April 18, 2007).
2.6(b)	Second Amendment to Asset Purchase Agreement, dated as of April 16, 2007, by and among Zia Partners, LLC, Zia Park LLC and Penn National Gaming, Inc. (Incorporated by reference to Exhibit 2.3 to the Company's current report on Form 8-K filed on April 18, 2007).

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Exhibit	Description of Exhibit
2.7	Agreement and Plan of Merger, dated as of June 15, 2007, by and among Penn National Gaming, Inc., PNG Acquisition Company Inc. and PNG Merger Sub Inc. (Incorporated by reference to Exhibit 2.1 to the Company's current report on Form 8-K filed on June 15, 2007).
2.8	Asset Purchase Agreement, dated as of November 16, 2009, by and among Fontainebleau Las Vegas Holdings, LLC, Fontainebleau Las Vegas, LLC, Fontainebleau Las Vegas Capital Corp., Fontainebleau Las Vegas Retail Parent, LLC, Fontainebleau Las Vegas Retail Mezzanine, LLC, Fontainebleau Las Vegas Retail, LLC and Nevada Gaming Ventures, Inc. (Incorporated by reference to Exhibit 99.1 to the Company's current report on Form 8-K, filed on November 17, 2009)
3.1	Amended and Restated Articles of Incorporation of Penn National Gaming, Inc., filed with the Pennsylvania Department of State on October 15, 1996. (Incorporated by reference to Exhibit 3.1 to the Company's registration statement on Form S-3, File #333-63780, dated June 25, 2001).
3.2	Articles of Amendment to the Amended and Restated Articles of Incorporation of Penn National Gaming, Inc., filed with the Pennsylvania Department of State on November 13, 1996. (Incorporated by reference to Exhibit 3.2 to the Company's registration statement on Form S-3, File #333-63780, dated June 25, 2001).
3.3	Statement with respect to shares of Series A Preferred Stock of Penn National Gaming, Inc., filed with the Pennsylvania Department of State on March 16, 1999. (Incorporated by reference to Exhibit 3.3 to the Company's registration statement on Form S-3, File #333-63780, dated June 25, 2001).
3.4	Articles of Amendment to the Amended and Restated Articles of Incorporation of Penn National Gaming, Inc., filed with the Pennsylvania Department of State on July 23, 2001. (Incorporated by reference to Exhibit 3.4 to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2001).
3.5	Articles of Amendment to the Amended and Restated Articles of Incorporation of Penn National Gaming, Inc., filed with the Pennsylvania Department of State on December 28, 2007. (Incorporated by reference to Exhibit 3.1 to the Company's current report on Form 8-K, filed on January 2, 2008).
3.6	Second Amended and Restated Bylaws of Penn National Gaming, Inc. (Incorporated by reference to Exhibit 3.1 to the Company's current report on Form 8-K filed on November 18, 2008).
3.7	Statement with Respect to Shares of Series B Redeemable Preferred Stock of Penn National Gaming, Inc., filed with the Pennsylvania Department of State on July 9, 2008. (Incorporated by reference to Exhibit 4.1 to the Company's current report on Form 8-K filed on July 9, 2008).
4.1	Specimen copy of Common Stock Certificate (Incorporated by reference to Exhibit 3.6 to the Company's quarterly report on Form 10-Q for the quarter ended June 30, 2003).
4.2	Indenture dated as of December 4, 2003 by and among Penn National Gaming, Inc., certain guarantors and U.S. Bank National Association relating to the $6^7/_8$% Senior Subordinated Notes due 2011 (Incorporated by reference to Exhibit 4.12 to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2003).
4.3	Form of Penn National Gaming, Inc. $6^7/_8$% Senior Subordinated Note due 2011. (Included as Exhibit A to Exhibit 4.12 to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2003).
4.4	Form of Supplemental Indenture to be Delivered by Subsequent Guarantors by and among Penn National Gaming, Inc., certain guarantors and U.S. Bank National Association relating to the $6^7/_8$% Senior Subordinated Notes due 2011. (Included as Exhibit F to Exhibit 4.12 to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2003).

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Exhibit	Description of Exhibit
4.5	Indenture dated as of March 9, 2005 by and among Penn National Gaming, Inc. and Wells Fargo Bank, National Association relating to the $6^{3}/_{4}$% Senior Subordinated Notes due 2015. (Incorporated by reference to Exhibit 10.1 to the Company's current report on Form 8-K, filed March 15, 2005).
4.5(a)	First Supplemental Indenture dated as of July 5, 2005 between Penn National Gaming, Inc. and Wells Fargo Bank, National Association relating to the $6^{3}/_{4}$% Senior Subordinated Notes due 2015. (Incorporated by reference to Exhibit 10.37 to the Company's registration statement on Form S-4, filed July 7, 2005 (File #333-125274)).
4.6	Form of Penn National Gaming, Inc. $6^{3}/_{4}$% Senior Subordinated Note due 2015. (Included as Exhibit A to Exhibit 4.6).
4.7	Specimen copy of Series B Redeemable Preferred Stock Certificate. (Incorporated by reference to Exhibit 4.8 to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2008).
4.8	Investor Rights Agreement, dated as of July 3, 2008, by and among Penn National Gaming, Inc., FIF V PFD LLC, Centerbridge Capital Partners, L.P., DB Investment Partners, Inc. and Wachovia Investment Holdings, LLC. (Incorporated by reference to Exhibit 4.2 to the Company's current report on Form 8-K filed on July 9, 2008).
4.9	Indenture, dated as of August 14, 2009, between Penn National Gaming, Inc. and Wells Fargo Bank, National Association, as trustee, relating to the $8^{3}/_{4}$% Senior Subordinated Notes due 2019 (Incorporated by reference to Exhibit 4.1 to the Company's current report on Form 8-K, filed on August 14, 2009).
9.1	Form of Trust Agreement of Peter D. Carlino, Peter M. Carlino, Richard J. Carlino, David E. Carlino, Susan F. Harrington, Anne de Lourdes Irwin, Robert M. Carlino, Stephen P. Carlino and Rosina E. Carlino Gilbert. (Incorporated by reference to the Company's registration statement on Form S-1, File #33-77758, dated May 26, 1994).
10.1#	Penn National Gaming, Inc. 1994 Stock Option Plan. (Incorporated by reference to the Company's registration statement on Form S-1, File #33-77758, dated May 26, 1994).
10.2#	Penn National Gaming, Inc. 2003 Long Term Incentive Compensation Plan. (Incorporated by reference to Appendix A of the Company's Proxy Statement dated April 22, 2003 filed pursuant to Section 14(a) of the Securities Exchange Act of 1934, as amended).
10.2(a)#	Form of Non-Qualified Stock Option Certificate for the Penn National Gaming, Inc. 2003 Long Term Incentive Compensation Plan. (Incorporated by reference to Exhibit 10.2(a) to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2005).
10.2(b)#	Form of Incentive Stock Option Certificate for the Penn National Gaming, Inc. 2003 Long Term Incentive Compensation Plan. (Incorporated by reference to Exhibit 10.2(b) to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2005).
10.2(c)#	Form of Restricted Stock Award for the Penn National Gaming, Inc. 2003 Long Term Incentive Compensation Plan. (Incorporated by reference to Exhibit 10.2(c) to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2005).
10.3#	Employment Agreement dated December 31, 2008 between Penn National Gaming, Inc. and Peter M. Carlino. (Incorporated by reference to Exhibit 10.3 to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2008).
10.4#	Employment Agreement dated December 31, 2008 between Penn National Gaming, Inc. and William Clifford. (Incorporated by reference to Exhibit 10.4 to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2008).
10.5#	Employment Agreement dated December 31, 2008 between Penn National Gaming, Inc. and Jordan B. Savitch. (Incorporated by reference to Exhibit 10.5 to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2008).

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Exhibit	Description of Exhibit
10.6#	Separation Agreement and General Release in the form attached as Exhibit A to the Employment Agreement dated July 31, 2006 between Penn National Gaming, Inc. and Leonard DeAngelo. (Incorporated by reference to Exhibit 10.1 to the Company's current report on Form 8-K, filed on August 2, 2006).
10.7#	Employment Agreement dated December 31, 2008 between Penn National Gaming, Inc. and Robert S. Ippolito. (Incorporated by reference to Exhibit 10.7 to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2008).
10.8	Form of Change in Control Payment Acknowledgement and Agreement between Penn National Gaming, Inc. and Certain Executive Officers of Penn National Gaming, Inc. (Incorporated by reference to Exhibit 10.1 the Company's current report on Form 8-K, filed on January 2, 2008).
10.8(a)	Schedule of executive officers entering into Change in Control Payment Acknowledgement and Agreement. (Incorporated by reference to Exhibit 10.8(a) to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2007).
10.9	Consulting Agreement dated August 29, 1994, between Penn National Gaming, Inc. and Peter D. Carlino. (Incorporated by reference to the Company's annual report on Form 10-K for the fiscal year ended December 31, 1994).
10.10	Amended and Restated Lease dated April 5, 2005 between Wyomissing Professional Center III, LP and Penn National Gaming, Inc. for portion of the Wyomissing Corporate Office. (Incorporated by reference to Exhibit 10.1 to the Company's current report on Form 8-K, filed on April 8, 2005).
10.11	Lease dated January 25, 2002 between Wyomissing Professional Center II, LP and Penn National Gaming, Inc. for portion of the Wyomissing Corporate Office. (Incorporated by reference to Exhibit 10.12 to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2004).
10.11(a)	Commencement Agreement, dated May 21, 2002, in connection with Lease dated January 25, 2002 Wyomissing Professional Center II, LP and Penn National Gaming, Inc. for portion of the Wyomissing Corporate Office. (Incorporated by reference to Exhibit 10.12(a) to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2004).
10.11(b)	First Lease Amendment, dated December 4, 2002, to Lease dated January 25, 2002 Wyomissing Professional Center II, LP and Penn National Gaming, Inc. for portion of the Wyomissing Corporate Office. (Incorporated by reference to Exhibit 10.12(b) to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2004).
10.12	Lease dated April 5, 2005 between Wyomissing Professional Center, Inc. and Penn National Gaming, Inc. for portion of the Wyomissing Corporate Office. (Incorporated by reference to Exhibit 10.2 to the Company's current report on Form 8-K filed on April 8, 2005).
10.13	Lease dated August 22, 2003 between The Corporate Campus at Spring Ridge 1250, L.P. and Penn National Gaming, Inc. for portion of the Wyomissing Corporate Office. (Incorporated by reference to Exhibit 10.13 to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2004).
10.14	Agreement dated April 7, 2006 by and between PNGI Charles Town Gaming Limited Liability Company and the West Virginia Union of Mutuel Clerks, Local 553, Service Employees International Union, AFL CIO. (Incorporated by reference to exhibit 10.1 to the Company's current report on Form 8-K, filed on April 24, 2006).
10.15	Agreement dated February 20, 2009 between PNGI Charles Town Gaming Limited Liability Company and Charles Town HBPA, Inc. (Incorporated by reference to Exhibit 10.16 to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2008).

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Exhibit	Description of Exhibit
10.16	Credit Agreement, dated October 3, 2005 by and among Penn National Gaming, Inc., the subsidiary guarantors party thereto, Deutsche Bank Securities Inc., Goldman Sachs Credit Partners L.P. and Lehman Brothers Inc., as Joint Lead Arrangers and Joint Bookrunners, Goldman Sachs Credit Partners L.P. and Lehman Commercial Paper Inc., as Co-Syndication Agents, Deutsche Bank Trust Company Americas, as Swingline Lender, Administrative Agent and as Collateral Agent, and Calyon New York Branch, Wells Fargo Bank, National Association and Bank of Scotland, as Co-Documentation Agents, and the lenders party thereto. (Incorporated by reference to Exhibit 10.1 to the Company's current report on Form 8-K, filed October 4, 2005).
10.16(a)	Amendment, dated September 18, 2006, to the Credit Agreement by and among Penn National Gaming, Inc., the subsidiary guarantors party thereto, Deutsche Bank Securities Inc., Goldman Sachs Credit Partners L.P. and Lehman Brothers Inc., as Joint Lead Arrangers and Joint Bookrunners, Goldman Sachs Credit Partners L.P. and Lehman Commercial Paper Inc., as Co-Syndication Agents, Deutsche Bank Trust Company Americas, as Swingline Lender, Administrative Agent and as Collateral Agent, and Calyon New York Branch, Wells Fargo Bank, National Association and Bank of Scotland, as Co-Documentation Agents, and the lenders party thereto. (Incorporated by reference to Exhibit 10.1 to the Company's current report on Form 8-K, filed on September 21, 2006).
10.16(b)	Second Amendment to Credit Agreement, dated as of September 23, 2009, among Penn National Gaming, Inc., certain of its subsidiaries, Deutsche Bank Securities Inc., Wells Fargo Securities, LLC, Banc of America Securities LLC and RBS Securities Inc., as co-lead arrangers and co-book running managers, Wells Fargo Bank, National Association and Bank of America, N.A., as syndication agents, the lenders party thereto, Deutsche Bank Trust Company Americas, as Swingline Lender, Administrative Agent and Collateral Agent under the Credit Agreement (as defined therein), and Wachovia Bank National Association, as L/C Lender under the Credit Agreement. (Incorporated by reference to Exhibit 10.1 to the Company's current report on Form 8-K, filed on September 25, 2009).
10.17	Ground Lease dated as of October 11, 1993 between R.M. Leatherman and Hugh M. Mageveney, III, as Landlord, and SRCT, as Tenant. (Incorporated by reference to Exhibit 10.4 of HWCC-Tunica, Inc.'s registration statement on Form S-1, File #33-82182, dated August 1, 1994).
10.18	Letter Agreement dated as of October 11, 1993 between R.M. Leatherman and Hugh M. Mageveney, III, as Landlord, and SRCT, as Tenant (relating to Ground Lease). (Incorporated by reference to Exhibit 10.5 of HWCC-Tunica, Inc.'s registration statement on Form S-1, File #33-82182, dated August 1, 1994).
10.19	Assignment of Lease and Assumption Agreement dated as of May 31, 1994 between SRCT and STP (relating to Ground Lease). (Incorporated by reference to Exhibit 10.7 of HWCC-Tunica, Inc.'s registration statement on Form S-1, File #33-82182, dated August 1, 1994).
10.20#	Penn National Gaming, Inc. Nonqualified Stock Option granted to Peter M. Carlino, dated February 6, 2003. (Incorporated by reference to Exhibit 10.26 to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2003).
10.21	Ground Lease, dated March 23, 2007, between Skrmetta MS, LLC as Landlord and BTN, Inc., a wholly-owned subsidiary of Penn National Gaming, Inc., as Tenant. (Incorporated by reference to Exhibit 10.2 to the Company's quarterly report on Form 10-Q for the quarter ended March 31, 2007).
10.22	Penn-Argosy Merger Approval Agreement between the Illinois Gaming Board and Penn National Gaming, Inc., effective September 29, 2005. (Incorporated by reference to Exhibit 10.2 to the Company's quarterly report on Form 10-Q for the quarter ended September 30, 2005).

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Exhibit	Description of Exhibit
10.22(a)	First Amendment to the September 29, 2005 Penn-Argosy Merger Approval Agreement, dated April 25, 2006, between Penn National Gaming, Inc. and the Illinois Gaming Board. (Incorporated by reference to Exhibit 10.1 to the Company's quarterly report on Form 10-Q for the quarter ended March 31, 2006).
10.23	Riverboat Gaming Development Agreement between the City of Lawrenceburg, Indiana and Indiana Gaming Company, L.P. dated as of April 13, 1994, as amended by Amendment Number One to Riverboat Development Agreement between the City of Lawrenceburg, Indiana and Indiana Gaming Company L.P., dated as of December 28, 1995 (Incorporated by reference to Argosy Gaming Company's annual report on Form 10-K for the fiscal year ended December 31, 1995).
10.23(a)	Second Amendment to Riverboat Gaming Development Agreement Between City of Lawrenceburg, Indiana, and the Indiana Gaming Company, L.P. dated August 20, 1996. (Incorporated by reference to Exhibit 10.23(a) to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2005).
10.23(b)	Third Amendment to Riverboat Gaming Development Agreement Between City of Lawrenceburg, Indiana, and the Indiana Gaming Company, L.P. dated June 24, 2004. (Incorporated by reference to Exhibit 10.2 of Argosy Gaming Company's quarterly report on Form 10-Q for the quarter ended September 30, 2004).
10.24#	Compensatory Arrangements with Certain Executive Officers. (Incorporated by reference to Exhibit 10.26 to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2007)
10.25#	Penn National Gaming, Inc. Deferred Compensation Plan, as amended. (Incorporated by reference to Exhibit 10.27 to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2006).
10.26#	Description of Penn National Gaming, Inc. Annual Incentive Plan. (Incorporated by reference to Exhibit 10.1 to the Company's current report on Form 8-K, filed on June 12, 2007).
10.27#	Employment Agreement by and between Penn National Gaming, Inc. and Tim Wilmott dated December 31, 2008. (Incorporated by reference to Exhibit 10.1 to the Company's current report on Form 8-K, filed on January 7, 2009).
10.28	Stock Purchase Agreement, dated as of July 3, 2008, by and among Penn National Gaming, Inc., FIF V PFD LLC, Centerbridge Capital Partners, L.P., DB Investment Partners, Inc. and Wachovia Investment Holdings, LLC. (Incorporated by reference to Exhibit 10.1 to the Company's current report on Form 8-K filed on July 9, 2008).
10.29	Termination and Settlement Agreement, dated as of July 3, 2008, by and among Penn National Gaming, Inc., PNG Acquisition Company Inc., PNG Merger Sub Inc., PNG Holdings LLC, FIG PNG Holdings LLC, Fortress Investment Fund V (Fund A) L.P., Fortress Investment Fund V (Fund D) L.P., Fortress Investment Fund V (Fund E) L.P., Fortress Investment Fund V (Fund B) L.P., Fortress Investment Fund V (Fund C) L.P., Fortress Investment Fund V (Fund F) L.P., CB PNG Holdings LLC, Centerbridge Capital Partners, L.P., Centerbridge Capital Partners Strategic, L.P., Centerbridge Capital Partners SBS, L.P., DB Investment Partners, Inc., Wachovia Investment Holdings, LLC, Deutsche Bank Securities Inc., Deutsche Bank AG New York Branch, Wachovia Capital Markets, LLC, Wachovia Bank, National Association and Wachovia Investment Holdings, LLC. (Incorporated by reference to Exhibit 10.2 to the Company's current report on Form 8-K filed on July 9, 2008).
10.30#	Penn National Gaming, Inc. 2008 Long Term Incentive Compensation Plan. (Incorporated by reference to Exhibit 10.32 to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2008).

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Exhibit	Description of Exhibit
10.31	Form of Non-Qualified Stock Option Certificate for the Penn National Gaming, Inc. 2008 Long Term Incentive Compensation Plan. (Incorporated by reference to Exhibit 10.33 to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2008).
10.32*	Form of Restricted Stock Award for the Penn National Gaming, Inc. 2008 Long Term Incentive Compensation Plan.
10.33#	Employment Agreement by and between Penn National Gaming, Inc. and John Finamore dated December 31, 2008. (Incorporated by reference to Exhibit 10.35 to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2008).
10.34	Registration Rights Agreement, dated as of August 14, 2009, among Penn National Gaming, Inc. and Deutsche Bank Securities Inc., Wells Fargo Securities, LLC, Banc of America Securities LLC and RBS Securities Inc., each for itself and on behalf of each of the other initial purchasers (Incorporated by reference to Exhibit 10.1 to the Company's current report on Form 8-K, filed on August 14, 2009).
10.35	Debtor-In-Possession Credit Agreement, dated as of November 16, 2009, among Fontainebleau Las Vegas Holdings, LLC, Fontainebleau Las Vegas, LLC, Fontainebleau Las Vegas Capital Corp., the Lenders party thereto and Nevada Gaming Ventures, Inc. (Incorporated by reference to Exhibit 99.2 to the Company's current report on Form 8-K/A, filed on November 18, 2009)
14.1	Penn National Gaming, Inc. Code of Business Conduct. (Incorporated by reference to Exhibit 14.1 to the Company's current report on Form 8-K, filed on April 24, 2006).
21.1*	Subsidiaries of the Registrant.
23.1*	Consent of Ernst & Young LLP, Independent Registered Public Accounting Firm.
31.1*	CEO Certification pursuant to rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934.
31.2*	CFO Certification pursuant to rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934.
32.1*	CEO Certification pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of The Sarbanes-Oxley Act of 2002.
32.2*	CFO Certification pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of The Sarbanes-Oxley Act of 2002.
99.1*	Description of Governmental Regulation.

Compensation plans and arrangements for executives and others.

* Filed herewith.