
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2004

OR

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

For the transition period from _____ to _____

Commission file number: 0-24206

PENN NATIONAL GAMING, INC.

(Exact name of registrant as specified in its charter)

Pennsylvania
(State or other jurisdiction of
incorporation or organization)

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

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

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

Not Applicable

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

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

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

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

Title	Outstanding as of May 5, 2004
Common Stock, par value \$.01 per share	40,059,700

This report contains information that are not statements of historical fact, but merely reflect our intent, belief or expectations regarding the anticipated effect of events, circumstances and trends. Such statements should be considered forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Although we believe that our expectations are based on reasonable assumptions within the bounds of our knowledge of our business and operations, there can be no assurance that actual results will not differ materially from our expectations. Meaningful factors which could cause actual results to differ from expectations include, but are not limited to, risks related to the following: the passage of state, federal or local legislation that would expand, restrict, further tax or prevent gaming operations in the jurisdictions in which we do business; the activities of our competitors; increases in our effective rate of taxation at any of our properties or at the corporate level; successful completion of capital projects at our gaming and pari-mutuel facilities; the existence of attractive acquisition candidates and the costs and risks involved in the pursuit of those acquisitions; our ability to maintain regulatory approvals for our existing businesses and to receive regulatory approvals for our new businesses; the maintenance of agreements with our horsemen and pari-mutuel clerks; our dependence on key personnel; the impact of terrorism and other international hostilities; the availability and cost of financing; and other factors as discussed in our other filings with the United States Securities and Exchange Commission. We do not intend to update publicly any forward-looking statements except as required by law.

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

<u>PART I. FINANCIAL INFORMATION</u>	4
<u>ITEM 1. FINANCIAL STATEMENTS</u>	4
<u>Penn National Gaming, Inc. and Subsidiaries Consolidated Balance Sheets</u>	<u>4</u>
<u>December 31, 2003 and March 31, 2004 (unaudited)</u>	
<u>Penn National Gaming, Inc. and Subsidiaries Consolidated Statements of Income</u>	<u>5</u>
<u>(unaudited)</u>	
<u>Three months Ended March 31, 2003 and 2004</u>	
<u>Penn National Gaming, Inc. and Subsidiaries Consolidated Statements of Shareholders' Equity and Comprehensive Income (unaudited)</u>	<u>6</u>
<u>Three months Ended March 31, 2004</u>	
<u>Penn National Gaming, Inc. and Subsidiaries Consolidated Statements of Cash Flows</u>	<u>7</u>
<u>(Unaudited)</u>	
<u>Three months Ended March 31, 2003 and 2004</u>	
<u>Notes to Consolidated Financial Statements</u>	<u>8</u>
<u>ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>	16
<u>ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>	24
<u>ITEM 4. CONTROLS AND PROCEDURES</u>	24
<u>PART II. OTHER INFORMATION</u>	25
<u>ITEM 1. LEGAL PROCEEDINGS</u>	25
<u>ITEM 3. DEFAULTS UPON SENIOR SECURITIES</u>	25
<u>ITEM 5. OTHER INFORMATION</u>	25
<u>ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K</u>	26

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

	<u>December 31, 2003</u>	<u>March 31, 2004</u> <u>(unaudited)</u>
Current assets:		
Cash and cash equivalents	\$ 106,969	\$ 118,361
Receivables	28,304	30,346
Prepaid income taxes	7,593	6,434
Prepaid expenses and other current assets	29,592	29,861
Deferred income taxes	17,285	17,477
Total current assets	<u>189,743</u>	<u>202,479</u>
Net property and equipment, at cost	<u>740,507</u>	<u>734,107</u>
Other assets:		
Investment in and advances to unconsolidated affiliate	17,187	14,535
Excess of cost over fair market value of net assets acquired	603,470	604,982
Management service contract (net of amortization of \$6,719 and \$7,347, respectively)	19,027	18,399
Deferred financing costs, net	28,214	27,388
Miscellaneous	11,451	20,891
Total other assets	<u>679,349</u>	<u>686,195</u>
	<u>\$ 1,609,599</u>	<u>\$ 1,622,781</u>
Liabilities and Shareholders' Equity		
Current liabilities:		
Current maturities of long-term debt	\$ 124,979	\$ 124,736
Accounts payable	28,155	21,331
Accrued Liabilities:		
Expenses	46,117	51,383
Interest	36,516	38,446
Salaries and wages	29,925	23,125
Gaming, pari-mutuel, property and other taxes	11,624	20,948
Income taxes payable	—	7,397
Other current liabilities	9,722	13,308
Total current liabilities	<u>287,038</u>	<u>300,674</u>
Long term liabilities:		
Long-term debt, net of current maturities	984,489	963,429
Deferred income taxes	27,791	28,850
Other liabilities	403	434

Total long-term liabilities	1,012,683	992,713
Commitments and contingencies		
Shareholders' equity:		
Preferred stock, \$.01 par value, 1,000,000 shares authorized, none issued	—	¾
Common stock, \$.01 par value, 200,000,000 shares authorized; shares issued 40,621,350 and 40,839,350, respectively	409	411
Treasury stock, at cost 849,400 shares	(2,379)	(2,379)
Additional paid-in capital	162,442	165,372
Retained earnings	148,055	165,842
Accumulated other comprehensive income	1,351	148
Total shareholders' equity	<u>309,878</u>	<u>329,394</u>
	<u>\$ 1,609,599</u>	<u>\$ 1,622,781</u>

See accompanying notes to consolidated financial statements.

4

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

	Three Months Ended March 31,	
	2003	2004
Revenues		
Gaming	\$ 183,984	\$ 283,808
Racing	24,843	24,640
Management service fee	2,699	3,458
Food, beverage and other revenue	25,345	41,120
Gross revenues	236,871	353,026
Less: Promotional allowances.	(11,737)	(22,255)
Net revenues	<u>225,134</u>	<u>330,771</u>
Operating Expenses		
Gaming	101,895	154,777
Racing	18,408	18,233
Food, beverage and other expenses	17,134	28,785
General and administrative	36,065	55,416
Depreciation and amortization	12,829	19,266
Total operating expenses	<u>186,331</u>	<u>276,477</u>
Income from operations	<u>38,803</u>	<u>54,294</u>
Other income (expenses)		
Interest expense	(16,352)	(25,698)
Interest income	434	389
Earnings from joint venture	588	460
Other	(104)	(1,078)
Loss on change in fair values of interest rate swaps	(527)	—
Loss on early extinguishment of debt	(1,310)	—
Total other expenses	<u>(17,271)</u>	<u>(25,927)</u>
Income before income taxes	21,532	28,367
Taxes on income	8,345	10,580
Net income	<u>\$ 13,187</u>	<u>\$ 17,787</u>
Per share data		
Basic net income	\$.34	\$.45
Diluted net income	\$.33	\$.43
Weighted shares outstanding		
Basic	39,219	39,859
Diluted	40,280	41,112

See accompanying notes to consolidated financial statements.

5

Penn National Gaming, Inc. and Subsidiaries
Consolidated Statements of Shareholders' Equity and Comprehensive Income

(Unaudited)
(In thousands, except share data)

	Common Stock		Treasury Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total	Comprehensive Income
	Shares	Amount						
Balance, December 31, 2003	40,621,350	\$ 409	\$ (2,379)	\$ 162,442	\$ 148,055	\$ 1,351	\$ 309,878	\$ —
Exercise of stock options including tax benefit of \$1,707	218,000	2	—	2,930	—	—	2,932	—
Change in fair value of interest rate swap contracts, net of income tax benefit of \$766	—	—	—	—	—	(1,191)	(1,191)	(1,191)
Amortization of interest rate swap agreement, net of income taxes of \$23	—	—	—	—	—	39	39	—
Foreign currency translation adjustment	—	—	—	—	—	(51)	(51)	(51)
Net income for the period	—	—	—	—	17,787	—	17,787	17,787
Balance, March 31, 2004	<u>40,839,350</u>	<u>\$ 411</u>	<u>\$ (2,379)</u>	<u>\$ 165,372</u>	<u>\$ 165,842</u>	<u>\$ 148</u>	<u>\$ 329,394</u>	<u>\$ 16,545</u>

See accompanying notes to consolidated financial statements.

6

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

	Three Months Ended March 31,	
	2003	2004
Cash flows from operating activities		
Net income	\$ 13,187	\$ 17,787
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	12,829	19,266
Amortization of deferred financing costs charged to interest expense	707	1,360
Amortization of the unrealized loss on interest rate swap contracts charged to interest expense	373	39
Loss on disposal of fixed assets	830	679
Earnings from joint venture	(588)	(460)
Loss relating to early extinguishment of debt	1,310	—
Deferred income taxes	2,319	867
Tax benefit from stock options exercised	342	1,707
Loss on change in value of interest rate swap contracts	527	¾
Decrease (increase), net of businesses acquired in:		
Receivables	2,219	(2,773)
Prepaid expenses and other current assets	(11,462)	(4,329)
Prepaid income taxes	6,415	1,159
Miscellaneous other assets	10,096	(6,119)
Increase (decrease), net of businesses acquired in:		
Accounts payable	21,649	(6,824)
Accrued liabilities	(9,384)	(756)
Gaming, pari-mutuel, property and other taxes	2,760	9,321
Income taxes payable	5,678	7,400
Other current and non-current liabilities	(1,010)	3,617
Net cash provided by operating activities	<u>58,797</u>	<u>41,941</u>
Cash flows from investing activities		
Expenditures for property and equipment	(9,950)	(13,107)
Payments to terminate interest rate swap contract	(1,902)	¾
Proceeds from sale of property and equipment	62	105
Acquisition of business, net of cash acquired	(264,081)	¾
Cash in escrow	(401,612)	¾
Distributions from joint venture	¾	3,112
Net cash (used in) investing activities	<u>(677,483)</u>	<u>(9,890)</u>
Cash flows from financing activities		
Proceeds from exercise of options	321	1,229
Proceeds from credit facility	700,000	¾
Principal payments on long-term debt	¾	(21,303)
(Increase) in unamortized financing cost	(18,829)	(534)
Net cash provided by (used in) financing activities	<u>681,492</u>	<u>(20,608)</u>
Effect of exchange rate fluctuations on cash	125	(51)
Net increase in cash and cash equivalents	62,931	11,392
Cash and cash equivalents, at beginning of period	55,121	106,969
Cash and cash equivalents, at end of period	<u>\$ 118,052</u>	<u>\$ 118,361</u>

Notes to Consolidated Financial Statements

1. Basis of Presentation

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

In the opinion of management, all adjustments (consisting of normal recurring accruals) have been made that are necessary to present fairly the financial position of the Company as of March 31, 2004 and the results of its operations for the three month periods ended March 31, 2003 and 2004. The results of operations experienced for the three month period ended March 31, 2004 are not necessarily indicative of the results to be experienced for the fiscal year ending December 31, 2004.

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

2. Revenue Recognition

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

	Three Months Ended March 31,	
	2003	2004
	(In thousands)	
Rooms	\$ 1,334	\$ 3,010
Food and beverage	9,474	16,423
Other	929	2,822
Total promotional allowances	<u>\$ 11,737</u>	<u>\$ 22,255</u>

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

	Three Months Ended March 31,	
	2003	2004
	(In thousands)	
Rooms	\$ 1,063	\$ 2,465
Food and beverage	6,314	12,572
Other	690	1,471
Total cost of complimentary services	<u>\$ 8,067</u>	<u>\$ 16,508</u>

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

Revenues from the management service contract the Company has with Casino Rama (the "Casino Rama Management Contract") are recognized as those services are performed.

3. Earnings Per Share

The weighted average number of shares of common stock and common stock equivalents used in the computation of basic and diluted earnings per share are set forth in the table below. For the three month periods ended March 31, 2003 and 2004, the effect of all outstanding stock options have been included in the calculation of diluted earnings per share.

	Three Months Ended March 31,	
	2003	2004
	(In thousands)	
Weighted average number of shares outstanding-Basic earnings per share	39,219	39,859
Dilutive effect of stock options	1,061	1,253
Weighted average number of shares outstanding-Diluted earnings per share	<u>40,280</u>	<u>41,112</u>

4. Stock-Based Compensation

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

The Company accounts for the plan under the recognition and measurement principles of APB 25 and related Interpretations. No stock-based employee compensation cost is reflected in net income for options granted since all options granted under the plan had an exercise price equal to the fair market value of the underlying common stock on the date of grant. However, there are situations that may occur, such as the accelerated vesting of options that require a current charge to income. The following table illustrates the affect on net income and earnings per share if the Company had applied the fair value recognition provisions of Financial Accounting Standards Board Statement No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123") as amended by Statement of Financial Accounting Standards No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure" ("SFAS 148"), to stock-based employee compensation.

9

	Three Months Ended March 31,	
	2003	2004
	(In thousands)	
Net income, as reported	\$ 13,187	\$ 17,787
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects	¾	¾
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(571)	(781)
Pro forma net income	<u>\$ 12,616</u>	<u>\$ 17,006</u>
Earnings per share:		
Basic-as reported	\$.34	\$.45
Basic-pro forma	\$.32	\$.43
Diluted-as reported	\$.33	\$.43
Diluted-pro forma	\$.31	\$.41

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

Three months ended March 31,	2003	2004
Risk-free interest rate	3.0%	3.0%
Volatility	50.0%	31.0%
Dividend yield	0.0%	0.0%
Expected life (years)	5	6

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

5. Certain Risks and Uncertainties

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

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

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

10

6. Property and Equipment

Property and equipment consist of the following:

	December 31, 2003	March 31, 2004
	(In thousands)	
Land and improvements	\$ 123,660	\$ 128,756
Building and improvements	530,845	531,817
Furniture, fixtures, and equipment	216,503	221,018
Transportation equipment	1,246	1,369
Leasehold improvements	14,495	14,533
Construction in progress	6,093	5,901
Total property and equipment	<u>892,842</u>	<u>903,394</u>

Less: accumulated depreciation and amortization	152,335	169,287
Property and equipment, net	<u>\$ 740,507</u>	<u>\$ 734,107</u>

Interest capitalized in connection with major construction projects was \$.3 million and \$0 for the year ended December 31, 2003 and for the three months ended March 31, 2004, respectively. Depreciation and amortization expense, for property and equipment, totaled \$12.2 million and \$18.6 million for the three months ended March 31, 2003 and 2004, respectively.

7. Supplemental Disclosures of Cash Flow Information

	Three Months Ended March 31,	
	2003	2004
	(In thousands)	
Cash payments of interest	\$ 23,493	\$ 24,317
Cash payments of income taxes	\$ —	\$ —
<i>Acquisitions: Hollywood Casino Corporation Acquisition</i>		
Cash Paid	\$ 397,948	\$ —
Fair value of assets acquired, including cash acquired of \$133,867 in 2003	\$ 976,245	\$ —
Fair value of liabilities assumed	\$ 578,297	\$ —

11

8. Long-term Debt

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

	December 31, 2003	March 31, 2004
Senior secured credit facility. This credit facility is secured by substantially all of the assets of the Company.	\$ 399,700	\$ 378,700
\$200 million 11 1/8% senior subordinated notes. These notes are general unsecured obligations of the Company.	200,000	200,000
\$175 million 8 7/8% senior subordinated notes. These notes are general unsecured obligations of the Company.	175,000	175,000
\$200 million 6 7/8% senior subordinated notes. These notes are general unsecured obligations of the Company.	200,000	200,000
<i>Hollywood Casino Shreveport non-recourse debt</i>		
13% Shreveport First Mortgage Notes	150,000	150,000
13% Shreveport Senior Secured Notes, including bond premium of \$686 and \$623, respectively	39,686	39,623
Less: Bond valuation allowance	(70,348)	(70,348)
Capital leases	15,423	15,190
Other notes payable	7	—
	<u>1,109,468</u>	<u>1,088,165</u>
Less: current maturities	124,979	124,736
	<u>\$ 984,489</u>	<u>\$ 963,429</u>

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

2004 (9 months)	\$ 123,518
2005	5,591
2006	5,709
2007	370,346
2008	202,288
2009	2,015
Thereafter	378,698
Total minimum payments	<u>\$ 1,088,165</u>

At March 31, 2004, the Company was contingently obligated under letters of credit issued pursuant to the senior secured credit facility with face amounts aggregating \$7.8 million.

The senior secured credit facility requires the Company, among other obligations, to maintain specified financial ratios and satisfy certain financial tests, including interest coverage and total leverage ratios. In addition, the senior secured credit facility restricts, among other things, the Company's ability to incur additional indebtedness, incur guarantee obligations, amend debt instruments, pay dividends, create liens on assets, make investments, make acquisitions, engage in mergers or consolidations, make capital expenditures, or engage in certain transactions with subsidiaries and affiliates and otherwise restrict corporate activities. The terms of the senior subordinated notes contain similar restrictions. At March 31, 2004, the Company was in compliance with all required financial covenants.

9. Segment Information

The Company currently operates in two segments: gaming and racing. The accounting policies for each segment are the same as those described in the "Summary of Significant Accounting Policies" section of the Company's Annual Report on Form 10-K for the year ended December 31, 2003.

12

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

As of and for the three months ended March 31, 2004				
	Gaming	Racing	Eliminations	Total
Revenue	\$ 308,576	\$ 22,511	\$ (316)(2)	\$ 330,771
Income from operations	52,422	1,872	—	54,294
Depreciation and Amortization	18,484	782	—	19,266
Total Assets	2,720,753	100,959	(1,198,931)(3)	1,622,781

As of and for the three months ended March 31, 2003				
	Gaming(1)	Racing	Eliminations	Total
Revenue	\$ 202,079	\$ 23,402	\$ (347)(2)	\$ 225,134
Income from operations	36,523	2,280	—	38,803
Depreciation and Amortization	11,987	842	—	12,829
Total Assets	3,183,971	99,211	(1,223,835)(3)	2,059,347

(1) Reflects results of Hollywood Casino since the March 3, 2003 acquisition, which the Company accounts for as of March 1, 2003.

(2) Primarily reflects intercompany transactions related to import/export simulcasting.

(3) Primarily reflects elimination of intercompany investments, receivables and payables.

10. Litigation

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

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

In August 2002, the lessor of the property on which Casino Rouge conducts a significant portion of its dockside operations filed a lawsuit against the Company in the 19th Judicial District Court for the Parish of East Baton Rouge, Louisiana seeking a declaratory judgment that the plaintiff is entitled to terminate the lease and/or void the Company's option to renew the lease due to certain alleged defaults by the Company or its predecessors-in-interest. The term of the Company's lease expired in January 2004 and the Company exercised its automatic right to renew for an additional five year term (which, as previously noted is being contested by the landlord). In September 2003 the court granted the Company a partial motion for summary judgment. In February 2004, the Company filed another motion for partial judgment on most of the remaining issues. A hearing date has been set for July 2004. Further litigation on the remaining issues is anticipated.

In October 2002, in response to the Company's plans to relocate the river barge underlying the Boomtown Biloxi casino to an adjacent property, the lessor of the property on which the Boomtown Biloxi casino conducts a portion of its dockside operations, filed a lawsuit against the Company in the U.S. District Court for the Southern District of Mississippi seeking a declaratory judgment that (i) the Company must use the leased premises for a gaming use or, in the alternative, (ii) after the move, the Company will remain obligated to make the revenue based rent payments to plaintiff set forth in the lease. The plaintiff filed this suit immediately after the Mississippi Gaming Commission approved the Company's request to relocate the barge. Since such approval, the Mississippi

Department of Marine Resources and the U.S. Army Corps of Engineers have also approved our plan to relocate the barge. The Company filed a motion for summary judgment in October 2003 and the plaintiff filed its own motion for summary judgment in January 2004. In March 2004, the trial court ruled in favor of the Company on all counts. The plaintiff has filed a motion for reconsideration, which has not yet been ruled on by the trial court.

In October 2003, the Company and one of its subsidiaries brought a declaratory action for coverage against Lexington Insurance Company and National Union Fire Insurance of Pittsburgh, Pennsylvania ("National Union") in the Circuit Court of Jefferson County, West Virginia ("the West Virginia Action"). The case involves a dispute over coverage for punitive damage awards for claims arising in West Virginia. Subsequent to the filing of the West Virginia action, National Union brought an action against the Company and several of its subsidiaries in the Court of Common Pleas of Berks County, Pennsylvania denying coverage for punitive damage awards for claims arising in West Virginia. The Company has resolved the underlying cases in West Virginia in which punitive damages have been plead, paid out the settlement amounts in the first quarter of 2004 (which amounts are included in miscellaneous assets) and is seeking reimbursement for the settlement amounts in the West Virginia action.

11. Subsidiary Guarantors

Under the terms of the senior secured credit facility, all of the Company's domestic subsidiaries except for Onward Development, LLC, an inactive subsidiary, Tennessee Downs, Inc., an inactive subsidiary, HWCC-Louisiana, Inc., HWCC-Shreveport, Inc. HCS I, Inc, HCS II Inc., HCS-Golf Course, LLC, Hollywood Casino Shreveport and Shreveport Capital Corporation and their respective subsidiaries, if any, ("Subsidiary Non-Guarantors"), are guarantors under the agreement. Summarized financial information as of and for the three months ended March 31, 2004 and 2003 for Penn, the Subsidiary Guarantors and Subsidiary Non-guarantors is as follows:

	Penn	Subsidiary Guarantors	Subsidiary Non-Guarantors	Eliminations	Consolidated
As of March 31, 2004					
Condensed Consolidating Balance Sheet (In thousands)					

Current assets	\$ 36,097	\$ 119,671	\$ 45,789	\$ 922	\$ 202,479
Net property and equipment, at cost	4,503	621,020	108,584	—	734,107
Other assets	1,177,868	712,056	(3,876)	(1,199,853)	686,195
Total	\$ 1,218,468	\$ 1,452,747	\$ 150,497	\$ (1,198,931)	\$ 1,622,781
Current liabilities	\$ 43,415	\$ 78,634	\$ 174,732	\$ 3,893	\$ 300,674
Long-term liabilities	960,431	1,201,742	435	(1,169,895)	992,713
Shareholder's equity	214,622	172,371	(24,670)	(32,929)	329,394
Total	\$ 1,218,468	\$ 1,452,747	\$ 150,497	\$ (1,198,931)	\$ 1,622,781

Three months ended March 31, 2004

Condensed Consolidating Statement of Income (In thousands)

Total revenues	\$ —	\$ 290,726	\$ 40,361	\$ (316)	\$ 330,771
Total operating expenses	6,191	231,641	38,961	(316)	276,477
Income (loss) from operations	(6,191)	59,085	1,400	—	54,294
Other income (expense)	9,937	(28,738)	(7,126)	—	(25,927)
Income (loss) before income taxes	3,746	30,347	(5,726)	—	28,367
Taxes on income (loss)	3,007	7,530	43	—	10,580
Net income (loss)	\$ 739	\$ 22,817	\$ (5,769)	\$ —	\$ 17,787

14

	Penn	Subsidiary Guarantors	Subsidiary Non-Guarantors	Eliminations	Consolidated
<i>Three months ended March 31, 2004</i>					
<i>Condensed Consolidating Statement of Cash Flows (In thousands)</i>					
Net cash provided by operating activities	\$ 6,421	\$ 31,488	\$ 4,032	\$ —	\$ 41,941
Net cash used in investing activities	24,449	(34,072)	(267)	—	(9,890)
Net cash provided by (used in) financing activities	(20,303)	103	(408)	—	(20,608)
Effect of exchange rate fluctuations on cash	—	(105)	54	—	(51)
Net increase (decrease) in cash and cash equivalents	10,567	(2,586)	3,411	—	11,392
Cash and cash equivalents at beginning of period	11,212	68,819	26,938	—	106,969
Cash and cash equivalents at end of period	\$ 21,779	\$ 66,233	\$ 30,349	\$ —	\$ 118,361

As of December 31, 2003

Condensed Consolidating Balance Sheet (In thousands)

Current assets	\$ 1,153,015	\$ 124,220	\$ 46,231	\$ (1,133,723)	\$ 189,743
Net property and equipment, at cost	1,793	627,970	110,744	—	740,507
Other assets	70,634	679,152	1,150	(71,587)	679,349
Total	\$ 1,225,442	\$ 1,431,342	\$ 158,125	\$ (1,205,310)	\$ 1,609,599
Current liabilities	\$ 55,944	\$ 64,489	\$ 162,708	\$ 3,897	\$ 287,038
Long-term liabilities	976,012	1,207,221	5,734	(1,176,284)	1,012,683
Shareholder's equity	193,486	159,632	(10,317)	(32,923)	309,878
Total	\$ 1,225,442	\$ 1,431,342	\$ 158,125	\$ (1,205,310)	\$ 1,609,599

Three months ended March 31, 2003

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

Total revenues	\$ —	\$ 210,072	\$ 15,409	\$ (347)	\$ 225,134
Total operating expenses	4,598	168,892	13,188	(347)	186,331
Income (loss) from operations	(4,598)	41,180	2,221	—	38,803
Other income (expense)	9,926	(24,547)	(2,650)	—	(17,271)
Income (loss) before income taxes (benefit)	5,328	16,633	(429)	—	21,532
Taxes (benefit) on income (loss)	2,224	6,292	(171)	—	8,345
Net income (loss)	\$ 3,104	\$ 10,341	\$ (258)	\$ —	\$ 13,187

15

	Penn	Subsidiary Guarantors	Subsidiary Non-Guarantors	Eliminations	Consolidated
<i>Three months ended March 31, 2003</i>					
<i>Condensed Consolidating Statement of Cash Flows (In thousands)</i>					
Net cash provided by operating activities	\$ 12,582	\$ 42,814	\$ 3,401	\$ —	\$ 58,797
Net cash provided by (used in) investing activities	(690,953)	13,534	(64)	—	(677,483)
Net cash provided by (used in) financing activities	681,492	115	(115)	—	681,492
Effect of exchange rate fluctuations on cash	125	—	—	—	125
Net increase in cash and cash equivalents	3,246	56,463	3,222	—	62,931
Cash and cash equivalents at beginning of period	3,339	38,430	13,352	—	55,121

Cash and cash equivalents at end of period	\$	6,585	\$	94,893	\$	16,574	\$	—	\$	118,052
--	----	-------	----	--------	----	--------	----	---	----	---------

12. Unaudited Pro Forma Financial Information

Unaudited pro forma financial information for the three months ended March 31, 2003 and 2004, as though the Hollywood Casino acquisition had occurred on January 1, 2003, is as follows:

	Three Months Ended	
	March 31,	
	2003	2004
	(In thousands)	
Revenues	\$ 306,457	\$ 330,771
Net income	\$ 16,987	\$ 17,787
Net income per common share		
Basic	\$.43	\$.45
Diluted	\$.42	\$.43
Weighted shares outstanding		
Basic	39,219	39,859
Diluted	40,280	41,112

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

Our Operations

We are a leading, diversified, multi-jurisdictional owner and operator of gaming properties, as well as horse racetracks and associated off-track wagering facilities, or OTWs. We own or operate nine gaming properties located in Colorado, Illinois, Louisiana, Mississippi, Ontario and West Virginia that are focused primarily on serving customers within driving distance of the properties. We also own two racetracks and eleven OTWs in Pennsylvania, one racetrack in West Virginia, and through a joint venture, own and operate a racetrack in New Jersey. We operate in two segments, gaming and pari-mutuel operations, and derive substantially all of our revenues from such operations. We believe that our portfolio of assets provides us with a diversified cash flow from operations.

16

We intend to continue to expand our gaming operations through the implementation of a disciplined capital expenditure program at our existing properties and the continued pursuit of strategic acquisitions of gaming properties particularly in attractive regional markets.

Gaming revenues are derived primarily from gaming on slot machines and table games. Pari-mutuel revenues are derived from wagering on our live races, wagering on import simulcasts at our racetracks and OTWs and through telephone account wagering, and fees from wagering on export simulcasting our races at out-of-state locations. Other revenues are derived from hotel, dining, retail, admissions, program sales, concessions and certain other ancillary activities.

Key performance indicators related to revenues are:

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

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

Results of Operations

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

- The continued emphasis on slot revenue at our properties, which revenue is the consistently profitable segment of the gaming industry.
- The continued expansion and revenue gains at our Charles Town Entertainment Complex.
- Recent economic conditions could intensify the efforts of state and local governments to raise revenues through increases in gaming taxes, as illustrated by our experience in Illinois in 2003.
- A number of states are currently considering legislation to legalize or expand gaming. Such legislation presents both potential opportunities to establish new properties (for instance in Pennsylvania and Maine) and potential competitive threats to business at our existing properties (such as Maryland and Texas). The timing and occurrence of these events remain uncertain. Legalized gaming from casinos located on Native American lands could also have a significant competitive effect.

17

The results of operations by property level for the three months ended March 31, 2003 and 2004 are summarized below (in thousands):

	Revenues(1)		Income from operations	
	2003	2004	2003	2004
Charles Town Entertainment Complex	\$ 70,483	\$ 94,052	\$ 15,192	\$ 20,272
Hollywood Casino Aurora (2)	24,791	58,869	6,571	14,608
Casino Rouge	29,070	28,455	7,518	7,301
Casino Magic-Bay St. Louis	26,665	28,601	3,491	3,853
Hollywood Casino Tunica (2)	10,548	30,888	1,640	5,215
Boomtown Biloxi	18,917	19,595	3,011	2,951
Hollywood Casino Shreveport (2)	12,710	36,901	1,988	1,390
Bullwhackers	6,198	7,758	194	810
Casino Rama Management Contract	2,699	3,458	2,494	3,200
Pennsylvania Racing Operations	23,400	22,510	2,051	1,613
Corporate eliminations (3)	(347)	(316)	—	—
Corporate overhead	—	—	(5,347)	(6,919)
Total	\$ 225,134	\$ 330,771	\$ 38,803	\$ 54,294

- (1) Net revenues are net of promotional allowances.
(2) Reflects results since March 3, 2003 acquisition.
(3) Primarily reflects intracompany transactions related to import/export simulcast wagering.

Revenues

Revenues for the three month period ended March 31, 2004 increased by \$105.6 million, or 46.9%, to \$330.7 million from \$225.1 million in 2003. The three new Hollywood Casino properties contributed \$78.6 million of the increase in revenue. The increase for the Hollywood Casino properties was a result of comparing a three month period of operations in 2004 to a one month period of operations in 2003. For the properties we owned prior to the acquisition of the Hollywood Casino properties, revenues increased by \$27.0 million, or 15.3%. Revenues at the Charles Town Entertainment Complex increased by \$23.6 million, or 33.4%, over the same period from last year due to the opening of an additional 38,000 square feet of gaming space with 700 new slot machines in July of 2003. At Casino-Magic-Bay St. Louis revenues increased by \$1.9 million. The primary driver in the revenue increase was a higher occupancy rate at the 291-room Bay Tower Hotel and Conference Center. The occupancy rate for the three months ended March 31, 2004 was 87.3% compared to 72.6% in 2003 and was the result of a marketing program that focused on better utilization of the hotel and increased play on the gaming floor. Revenues at Bullwhackers increased by \$1.5 million, or 25.2%, due to the introduction of penny machines that were part of the facility renovations completed in 2003 and a more aggressive marketing program that is focused on the "locals" market.

Operating Expenses

Operating expenses for the three month period ended March 31, 2004 increased by \$90.1 million, or 48.4%, to \$276.4 million from \$186.3 million in 2003. The three new Hollywood Casino properties were responsible for \$67.6 million of the increase in operating expenses. The increase was a result of comparing a three month period of operations in 2004 to a one month period of operations in 2003. For the properties we owned prior to the acquisition of the Hollywood Casino properties, expenses increased by \$22.5 million, or 15.1%. At the Charles Town Entertainment Complex expenses increased by \$18.5 million, or 33.4%, over the same period from last year due to the opening of an additional 38,000 square feet of gaming space with 700 new slot machines in July of 2003. At Casino Magic—Bay St. Louis expenses increased by \$1.6 million and included higher gaming taxes and slot machine participation fees that increased with revenues, additional hotel expenses that increased with occupancy rates and higher marketing expenses for entertainment and players' club promotions. Expenses at

Bullwhackers increased by \$.9 million, or 15.7%, primarily as a result of the higher gaming taxes associated with higher revenues and increased marketing expenses for advertising and players' club promotions.

Corporate overhead expenses increased by \$1.6 million for the three months ended March 31, 2004 as compared to 2003. We continue to incur expenses for lobbying and site development expenses in connection with Pennsylvania slot legislation and Maine slot legislation. Other corporate expenses such as payroll and employee benefits, legal, outside services and travel have increased as a result of the Hollywood Casino acquisition in March of 2003. Notably, our corporate overhead as a percentage of our net revenues has decreased to 2.1% in 2004 compared to 2.4% in 2003.

Depreciation and amortization expense increased by \$6.4 million to \$19.2 million in 2003 from \$12.8 million in 2002. The addition of the Hollywood Casino properties increased depreciation and amortization expense by \$4.6 million. The remaining increase of \$1.8 million was primarily a result of the expansion at Charles Town for additional gaming space and the parking structure and the purchase of new slot machines at many of our properties.

Income from operations

Operating income increased by \$15.5 million, or 39.9%, to \$54.3 million for the three months ended March 31, 2004 from \$38.8 million in 2003. The primary drivers, as discussed above, in the growth of income from operations were the three Hollywood Casino properties, which accounted for \$11.0 million of the increase, and Charles Town, which accounted for \$5.1 million.

Other income (expense)

Other income (expense) summary (in thousands):

Three Months Ended March 31,	2003	2004
Other income (expense):		

Interest expense	\$ (16,352)	\$ (25,698)
Interest income	434	389
Earnings from joint venture	588	460
Other	(104)	(1,078)
Loss on change in fair values of interest rate swaps	(527)	—
Loss on early extinguishment of debt	(1,310)	—
Total other expense	<u>\$ (17,271)</u>	<u>\$ (25,927)</u>

Interest expense increased by \$9.3 million for the three months ended March 31, 2004 compared to 2003 as a result of borrowing an additional \$700 million for the acquisition of Hollywood Casino Corporation and the interest expense associated with the Hollywood Casino Shreveport notes. During the first quarter of 2004, we made principal payments of \$21.3 million on our senior secured credit facility, including an accelerated payment of \$20 million on March 31, 2004. Subject to the availability of attractive acquisition or project opportunities, we expect to continue to accelerate our principal payments as free cash flow allows.

During the first quarter of 2004, we incurred other non-recurring expenses of \$1.1 million. These expenses are primarily attributable to costs for debt negotiations relative to, and the proposed sale of, Hollywood Casino Shreveport.

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.

19

Net cash provided by operating activities was \$40.7 million for the three months ended March 31, 2004. This consisted of net income of \$17.8 million, non-cash reconciling items of \$23.4 million and net decreases in current liability accounts along with net decreases in current asset accounts of \$5 million, net of assets and liabilities acquired in the Hollywood Casino Corporation acquisition.

Cash flows used in investing activities totaled \$9.9 million for the three months ended March 31, 2004. Expenditures for property, plant, and equipment totaled \$13.1 million and included \$2.0 million at Charles Town for the Phase III expansion project, \$3.5 million for a land purchase at Boomtown and \$7.6 million in maintenance capital expenditures including new slot machines. We also received a \$3.1 million cash distribution from our New Jersey joint venture.

Cash used in financing activities was \$20.6 million for the three months ended March 31, 2004. Principal payments on long-term debt included \$21.3 million in payments under our credit facility. Net proceeds from the exercise of stock options totaled \$1.2 million.

Outlook

Based on our current level of operations, and anticipated revenue growth, we believe that cash generated from operations and amounts available under our credit facility will be adequate to meet our anticipated debt service requirements, capital expenditures and working capital needs for the foreseeable future. We cannot assure you, however, that our business will generate sufficient cash flow from operations, that our anticipated revenue growth will be realized, or that future borrowings will be available under our credit facility or otherwise will be available to enable us to service our indebtedness, including the credit facility and the notes, to retire or redeem the notes when required or to make anticipated capital expenditures. In addition, if we consummate significant acquisitions in the future, our cash requirements may increase significantly. We may need to refinance all or a portion of our debt on or before maturity. Our future operating performance and our ability to service or refinance our debt will be subject to future economic conditions and to financial, business and other factors, many of which are beyond our control.

Capital Expenditures

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

Property	Budget for Year Ended December 31, 2004	Expenditures Through March 31, 2004	Balance to Expend
Charles Town Entertainment Complex	\$ 34,200	\$ 2,034	\$ 32,166
Boomtown Biloxi	5,460	3,481	1,979
Totals	<u>\$ 39,660</u>	<u>\$ 5,515</u>	<u>\$ 34,145</u>

The Charles Town Entertainment Complex has started the design work for Phase III of the facility expansion. Phase III includes the expansion of the parking garage by approximately 1,050 spaces, adding an additional 300 slot machines and related equipment and infrastructure improvements, including a loading dock, dry storage area, offices and a maintenance shop. The parking garage should be completed by the third quarter of 2004 and the new gaming area should be open by the fourth quarter of 2004. At Boomtown Biloxi, we signed an option to purchase approximately 4 acres of land adjacent to our Boomtown Biloxi property in January 2002. This purchase was completed in January 2004 at a cost of \$3.7 million and is part of our 2004 budget. We expect to use the land for additional parking and to develop the property in the event that we move the casino barge. The decision to move the casino barge is contingent upon the outcome of the lawsuit filed by our landlord that goes to

20

trial in 2004. Moving the casino barge is estimated to cost approximately \$20.0 million. Due to the ongoing litigation with our landlord at the Boomtown Biloxi property, we have elected not to budget for any additional project-related capital expenditures in 2004 other than the acquisition of the land. In the event that this dispute can be resolved, we may elect to revisit the decision.

During 2003, we began expanding our corporate offices to provide additional workstations and office space for our employees. The first part of this project was completed in the second quarter of 2003. Additional office space expansion is planned for 2004.

During the quarter, we spent approximately \$7.6 million for maintenance capital expenditures at our properties.

For 2004, we expect to spend approximately \$53.7 million for maintenance capital expenditures at our properties. Of this total, approximately \$11.1 million will be spent on slot machines and ticket-in, ticket-out slot technology at our facilities in states where the new technology is approved.

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

Senior Secured Credit Facility

At March 31, 2004, we had an outstanding balance of \$378.7 million on the Term Loan D facility and \$92.2 million available to borrow under the revolving credit facility after giving effect to outstanding letters of credit of \$7.8 million. The weighted average interest rate on the Term D facility is 3.63% at March 31, 2004, excluding swaps and deferred finance fees.

Covenants

Our senior secured credit facility requires us, among other obligations, to maintain specified financial ratios and satisfy certain financial tests, including interest coverage and total leverage ratios. In addition, our senior secured credit facility restricts, among other things, our ability to incur additional indebtedness, incur guarantee obligations, amend debt instruments, pay dividends, create liens on assets, make investments, make acquisitions, engage in mergers or consolidations, make capital expenditures, or engage in certain transactions with subsidiaries and affiliates and otherwise restrict corporate activities. The terms of our senior subordinated notes contain similar restrictions. At March 31, 2004, we were in compliance with all required financial covenants.

Commitments and Contingencies

—Contractual Cash Obligations

The following table presents our contractual cash obligations as of March 31, 2004:

	Payments Due By Period				2009 and After
	Total	2004	2005 - 2006 (In thousands)	2007 - 2008	
Senior secured credit facility(1)	\$ 378,700	\$ 2,847	\$ 7,594	\$ 368,259	\$ —
11 1/8% senior subordinated notes due 2008(2)					
Principal	200,000	—	—	200,000	—
Interest	89,000	11,125	44,500	33,375	—
8 7/8% senior subordinated notes due 2010(3)					
Principal	175,000	—	—	—	175,000
Interest	93,188	7,766	31,063	31,062	23,297
6 7/8% senior subordinated notes due 2011(4)					
Principal	200,000	—	—	—	200,000
Interest	109,885	13,635	27,500	27,500	41,250
13% Hollywood Casino Shreveport notes(5)					
Principal	189,000	189,000	—	—	—
Interest	18,468	18,468	—	—	—
Purchase obligations	14,242	10,062	3,172	975	33
Construction commitments	10,085	10,085	—	—	—
Capital Leases	15,190	1,392	3,695	4,375	5,728
Operating Leases	23,947	6,156	6,416	3,287	8,088
Total	\$ 1,516,705	\$ 270,536	\$ 123,940	\$ 668,833	\$ 453,396

(1) As of March 31, 2004 there was no indebtedness outstanding under the credit facility and there was approximately \$92.2 million available for borrowing under the revolving credit portion of the credit facility.

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

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

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

(5) The \$150.0 million aggregate principal amount of 13% senior secured notes matures August 1, 2006 and the \$39.0 million aggregate principal amount of 13% first mortgage notes matures August 1, 2006. Interest payments of approximately \$12.3 million are due on the notes each August 1 and February 1 until August 1, 2006. The Hollywood Casino Shreveport notes are non-recourse to us and our subsidiaries (other than HCS, Shreveport Capital Corporation, HCS I, Inc., HCS II, Inc. and HWCC-Louisiana, Inc.). The Hollywood Casino Shreveport notes have been in default under the terms of their respective note indentures since May 2003, and accordingly are classified as current obligations at March 31, 2004.

—Other Commercial Commitments

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

	Total Amounts Committed	Amount of Commitment Expiration Per Period			
		2004	2005 – 2006 (in thousands)	2007 2008	2009 and After
Revolving Credit Facility(1)	\$ —	\$ —	\$ —	\$ —	\$ —
Letters of Credit(1)	7,809	7,809	—	—	—
Guarantees of New Jersey Joint Venture Obligations(2)	8,625	8,625	—	—	—
Total	\$ 16,434	\$ 16,434	\$ —	\$ —	\$ —

- (1) The available balance under the revolving portion of the \$100 million senior secured credit facility is diminished by outstanding letters of credit.
- (2) In connection with our 50% ownership interest in Pennwood Racing, Inc., our joint venture in New Jersey, we have entered into a debt service maintenance agreement with Pennwood's lender to guarantee up to 50% of Pennwood's \$17.2 million term loan. Our obligation as of March 31, 2004 under this guarantee is approximately \$8.6 million.

—Interest Rate Swap Agreements

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

Hollywood Casino Shreveport Notes

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

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

On February 3, 2004, our indirect subsidiary, HCS I, Inc., the managing general partner of Hollywood Casino Shreveport general partnership, or HCS, announced that its Board of Directors has initiated a process that it hopes will result in the sale or other disposition of the riverboat casino/hotel complex of HCS located in Shreveport, Louisiana. The announcement followed action by the Board authorizing HCS's financial advisor, Libra Securities LLC, to begin contacting potential acquirers. The Board also authorized the creation of an independent committee to oversee the sale process. The Board created the independent committee in case we seek to participate as a bidder in the sale process. The Board took action after consultation with an ad hoc committee of holders of the Hollywood Casino Shreveport notes. Although no formal agreement has been reached with the ad hoc committee regarding the sale process, HCS anticipates that it will consult with the ad hoc committee

throughout the process. There can be no assurance that the process will result in the sale or other disposition of the riverboat casino/hotel complex or that, if it does, the sale proceeds will be adequate to pay the Hollywood Casino Shreveport notes in full. Further, the holders of the Hollywood Casino Shreveport notes might pursue all rights and remedies that they may have under the indentures as a result of the event of default. Any such action on the part of the note holders may prompt HCS to seek the protection of the bankruptcy laws or other similar remedies. HCS currently anticipates that any transaction would be effected through a federal bankruptcy proceeding. HCS did not make the August 1, 2003 and the February 1, 2004 interest payments, aggregating \$24.6 million, due on the Hollywood Casino Shreveport notes. The Hollywood Casino Shreveport notes have been in default under the terms of their respective note indentures since May 2003, and accordingly are classified as current obligations at March 31, 2004.

Accounting Pronouncements Issued or Adopted in 2004

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

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

On December 20, 2000, we entered into an interest rate swap with a notional amount of \$100 million and a termination date of December 22, 2003. Under this agreement, we pay a fixed rate of 5.835% against a variable interest rate based on the 90-day LIBOR rate. On August 3, 2001, we entered into an interest rate swap with a notional amount of \$36 million with a termination date of June 30, 2004. Under this agreement, we paid a fixed rate of 4.8125% against a variable interest rate based on the 90-day LIBOR rate. On March 3, 2003, we terminated our \$36 million notional amount interest rate swap originally scheduled to expire in June 2004. We paid \$1.9 million to terminate the swap agreement.

We have a policy designed to manage interest rate risk associated with our current and anticipated future borrowings. This policy enables us to use any combination of interest rate swaps, futures, options, caps and similar instruments. To the extent we employ such financial instruments pursuant to this

policy, they are accounted for as hedging instruments. In order to qualify for hedge accounting, the underlying hedged item must expose us to risks associated with market fluctuations and the financial instrument used must be designated as a hedge and must reduce our exposure to the market in fluctuations throughout the hedge period. If these criteria are not met, a change in the market value of the financial instrument is recognized as a gain or loss in the period of change. Interest paid or received pursuant to the financial instrument is included as interest expense in the period.

On March 27, 2003, we entered into forward interest rate swap agreements with a total notional amount of \$375.0 million in accordance with the terms of the \$800 million senior secured credit facility. There are three two-year swap contracts totaling \$175 million with an effective date of March 27, 2003 and a termination date of March 27, 2005. Under these contracts, we pay a fixed rate of 1.92% against a variable rate based on the 90-day LIBOR rate. We also entered into three three-year swap contracts totaling \$200 million with a termination date of March 27, 2006. Under these contracts, we pay a fixed rate of 2.48% to 2.49% against a variable rate based on the 90-day LIBOR rate. The difference between amounts received and amounts paid under such agreements, as well as any costs or fees, is recorded as reduction of, or addition to, interest expense as incurred over the life of the swap or similar financial instrument. At March 31, 2004, the 90-day LIBOR rate was 1.14%.

ITEM 4. CONTROLS AND PROCEDURES

Our management, under the supervision and with the participation of the principal executive officer and principal financial officer, have evaluated the effectiveness of our controls and procedures related to our reporting and disclosure obligations as of March 31, 2004, which is the end of the period covered by this Quarterly Report on Form 10-Q. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in

24

evaluating the cost-benefit relationship of possible controls and procedures. Based on that evaluation, the principal executive officer and principal financial officer have concluded that these disclosure controls and procedures are sufficient to provide that (a) material information relating to us, including our consolidated subsidiaries, is made known to these officers by other employees of us and our consolidated subsidiaries, particularly material information related to the period for which this periodic report is being prepared; and (b) this information is recorded, processed, summarized, evaluated and reported, as applicable, within the time periods specified in the rules and forms of the Securities and Exchange Commission.

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

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

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

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

The Hollywood Casino Shreveport notes are non-recourse to Penn and its subsidiaries (other than Hollywood Casino Shreveport, Shreveport Capital Corporation, HCS I, Inc., HCS II, Inc. and HWCC-Louisiana, Inc.) and are secured by substantially all of the assets of the casino, and the partnership interests held by HCS I, Inc. and HCS II, Inc. and the stock held by HWCC-Louisiana, Inc.

ITEM 5. OTHER INFORMATION

Recent Developments

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

Development activity in Maine

In April 2004, in the litigation brought by certain special interest groups challenging the grant of the conditional racing license to Bangor Historic Track, Inc., the trial court dismissed the petitioners' appeals from the Maine Harness Racing Commission decision granting a conditional license. No appeal

of the court's decision has been taken and the time to file such appeals has expired. There is still pending before the trial court an independent count requesting declaratory judgment regarding the initial gaming legislation adopted in Maine; however that legislation has since been repealed and replaced. It is unclear at this time whether the plaintiffs intend to pursue this count.

In May 2004, the governor of Maine signed into law a bill providing for increased taxation and additional regulation of slot machine gaming as well as for the creation of a gambling control board. The law takes effect on July 29, 2004. Nomination and appointment of the members of the new gambling control board is currently expected to be completed by the close of the third quarter of 2004. The governor also signed an executive order creating a gambling advisory council that is tasked with immediately commencing work on the creation and implementation of the State's regulatory structure.

While we are preparing to move forward with this project, no assurance can be given that we will be able to complete this project or the transaction contemplated by the purchase agreement relating to this project. There remain several conditions and contingencies regarding the consummation of the purchase transaction, and both the regulatory and legislative environments continue to remain subject to uncertainty, including, without limitation, the process of adopting rules and regulations necessary to allow for the issuance of gaming related licenses.

Hollywood Casino Shreveport

In May 2004, our indirect subsidiary, HCS I, Inc., the managing general partner of Hollywood Casino Shreveport general partnership, or HCS, distributed formal requests for bids from certain qualified bidders recommended by its independent financial advisor. There can be no assurance that the process will result in the sale or other disposition of the riverboat casino/hotel complex or that, if it does, the sale proceeds will be adequate to pay the HCS notes in full. HCS currently anticipates that any transaction would be effected through a federal bankruptcy proceeding.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

<u>Exhibit</u>	<u>Description of Exhibit</u>
10.1	Agreement, effective January 15, 2004, between The Downs Racing, Inc. and the Pennsylvania Harness Horsemen's Association, Inc.
10.2	Amendment dated March 30, 2004 to Live Racing Agreement dated March 23, 2003 among Penn National Turf Club, Inc., Mountainview Thoroughbred Racing Association and the Pennsylvania Horsemen's Benevolent and Protective Association, Inc.
31.1	CEO Certification pursuant to rule 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934
31.2	CFO Certification pursuant to rule 13a-14(a) and 15d-14(a) of the Securities Exchange Act of 1934
32.1	CEO Certification pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of The Sarbanes-Oxley Act of 2002
32.2	CFO Certification pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of The Sarbanes-Oxley Act of 2002

(b) Reports on Form 8-K

<u>Report</u>	<u>Item(s) No.</u>	<u>Date of Report</u>	<u>Date Filed or Furnished</u>
Form 8-K	5, 7 and 12	February 3, 2003	Filed February 6, 2004

SIGNATURES

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

PENN NATIONAL GAMING, INC.

By:

May 10, 2004

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

AGREEMENT BETWEEN THE DOWNS RACING, INC. AND PENNSYLVANIA HARNESS HORSEMEN'S ASSOCIATION, INC.

THIS AGREEMENT is made and entered into on the 15 day of **March, 2004**, by and between The Downs Racing, Inc. situate at RT 315, Wilkes-Barre, Pa. (hereinafter called "The Downs") and The Pennsylvania Harness Horsemen's Association, Inc., a Pennsylvania Corporation (hereinafter called "PHHA") and,

WITNESSETH THAT: WHEREAS, The Downs is licensed to conduct and is engaged in the business of conducting harness racing meetings, simulcasting and account wagering of races to and from other locations, at, to and from The Downs, and

WHEREAS, PHHA's membership consists of owners, trainers, and drivers of harness horses participating in harness race meetings at The Downs and elsewhere in the United States and Canada, and PHHA has been organized and exists for the purpose of promoting the sport of harness racing; improving the lot of owners, trainers, drivers, breeders and grooms of harness racing horses participating in race meetings; establishing health, welfare and insurance programs for drivers, trainers and grooms of harness racing horses; negotiating with harness racing tracks on behalf of owners, trainers, drivers and grooms of harness racing horses; and generally rendering assistance to them whenever and wherever possible; and

WHEREAS, the parties hereto believe that the amount of pari-mutuel wagering at The Downs is the best basis upon which to fix the financial arrangements between the parties, and

WHEREAS, the parties have agreed that all existing agreements shall remain in full force and effect until the effective date of this agreement (**January 15, 2004** - 12:01 AM).

NOW, THEREFORE, in consideration of the promises and covenants contained herein, it is agreed as follows:

1. TERM OF AGREEMENT

The provisions of this Agreement shall apply to and govern every harness racing meeting, and all simulcasting, and account wagering conducted at, from or to The Downs from 12:00 AM on **January 15, 2004** (Effective Date) through 12:00 AM **January 15, 2005**.

2. PURSE DISTRIBUTION

A. The parties hereto have agreed that The Downs shall pay to the PHHA horsemen's account a fixed percentage of 4.3% (for the term through **January 15, 2004 through January 15, 2005**) of total system handle. Total system handle shall mean all **PARI-MUTUEL** wagering conducted at the primary location, all non-primary locations, all telephone-

ACCOUNT WAGERING AND ALL INTERACTIVE ACCOUNT wagering.

(1) Interactive Wagering - All interactive wagering conducted via an authorized personal computer connection to The Downs (eBetUSA or its equivalent) will **NOT BE HANDLED SEPARATELY FROM THE TOTAL SYSTEM HANDLED.**

B. AGREEMENT FOR PHHA EXPENSES AND PERCENTAGES

- (1) During the Term of this Agreement, The Downs shall pay to the PHHA the sum of Four Hundred Twenty Thousand Dollars (\$420,000) to be used for the purposes described in paragraph 5 below.
- (2) Each Contract Year, the balance of the amounts determined under paragraph 2A, after deducting the amounts payable under (1) above, shall be paid in racing purses.
- (3) The amount due to the PHHA annually shall be accrued at the rate of Thirty Five Thousand Dollars (\$35,000) per month every Contract year. Payment shall be made in equal monthly payments to the PHHA to be used for purposes described in paragraph 5 below. At the written request of the PHHA, The Downs shall make direct payments for insurance or for other purposes allowed under paragraph 5 below, or shall make direct payment to the PHHA up to any amount payable to the PHHA. However, the total amount paid out in any Contract Year to or on behalf of the PHHA for purposes described in paragraph 5 below may EXCEED Four Hundred Twenty Thousand Dollars (\$420,000).
- (4) **A MAXIMUM OF THREE (3)** percent of the total overnight purse payments in each Contract Year may be paid out in racing purses for early and late closing events and stake event.

C. INTERSTATE SIMULCASTING

- (1) In addition to the amounts otherwise provided for in this Agreement, The Downs shall distribute in racing purses of total handle during each Contract Year throughout the Term of this **Agreement, 1.1%** in fees earned by The Downs for live programs simulcast to wagering locations outside Pennsylvania (export signal).
- (2) It is also specifically understood and agreed that if the host track (e.g., the track from which the live racing is being broadcast) requires written agreement or permission from PHHA for receipt of a simulcast for any race(s), then PHHA will automatically and

immediately provide its written agreement and/or permission (whichever is required) on the forms required. The PHHA's granting of such agreement or permission or its prompt execution of the forms supplied to it, as referenced above, will not be unreasonably withheld or delayed. If The Downs believes that PHHA has unreasonably withheld or delayed such agreement or permission or execution, then it shall have the right to initiate an immediate expedited arbitration to resolve such dispute.

D. INTRASTATE SIMULCASTING

In addition to the amount(s) otherwise provided for in Paragraph 2, The Downs shall distribute in racing purses the following amounts based upon handle on racing conducted within Pennsylvania and simulcast to Primary Locations within Pennsylvania.

- (1) Two and one-half (2 1/2%) percent of the total handle on The Downs live races simulcast to the Primary Location of another Pennsylvania Racetrack shall be distributed, throughout the entire Term of this Agreement.

E. NON-PRIMARY LOCATIONS

The percentage to be applied to the purses from wagering at other Pennsylvania Horse Racing Association Non-Primary Locations is as provided by applicable Pennsylvania statute. All revenue from sections 2A, 2A1, C1, D1, and E shall be paid to the horsemen's purse account on a daily basis.

3. MINIMUM PURSES/MAXIMUM PURSES

- A. During the Term of this Agreement the minimum purse payable by The Downs for any pari-mutuel betting race shall be One Thousand Two Hundred Dollars (\$1,200.00) unless circumstances warrant a change which shall be mutually agreeable to both parties.
- B. During the Term of this Agreement, the maximum purse payable by The Downs for any overnight pari-mutuel race from the purse account created by this Agreement shall be Ten Thousand Dollars (\$10,000.00) unless circumstances warrant a change which shall be mutually agreeable to both parties.

4. RACING SCHEDULE

- A. The Downs will schedule a minimum of one hundred twenty-five (125) race days and one thousand five hundred twelve (1,512) live overnight races at The Downs during each race season during the Term of this Agreement, subject however to conditions beyond its control. **Additional**

3

race days beyond one hundred twenty five (125) and additional races beyond one thousand five hundred and twelve (1,512) may be allowed only with the consent of PHHA.

- B. The Downs management will prepare a weekly schedule showing the number of live races and simulcast races to be presented each day during a given week. That schedule will be presented to the PHHA at least two weeks prior to the first racing day of the scheduled week. If the live overnight races do not fill, then this will be considered a condition beyond the control of The Downs and the minimum number of 1,512 live overnight races will be reduced by the number of races not filled.

5. ARRANGEMENTS WITH PHHA

- A. As per Paragraph 2(B)(3) of this Agreement said amounts shall be used for:
 - (1) To defray PHHA's operating expenses;
 - (2) To pay PHHA's dues to any national organization of horsemen to which it belongs;
 - (3) To pay premiums for a group health and medical insurance policy for drivers, trainers and grooms;
 - (4) To pay premiums for any accident and disability insurance policy which covers trainers and drivers that are involved in accidents while training or racing;
 - (5) To cover the cost for marketing and promotional items.
- B. The Downs shall provide an office for the use of the PHHA representative on its racing grounds,
- C. Representatives of The Downs and PHHA will be available to consult with each other at reasonable convenient times concerning any matters pertaining to the operation of race meetings of The Downs or the provisions of this Agreement. Specifically, representatives of The Downs and PHHA shall meet before each racing season and throughout the same on a bi-weekly basis whenever possible to discuss and agree on racing dates, purse structures and races offered on the condition sheet and qualifying standards.

6. STALL ASSIGNMENTS

Nothing in this Agreement shall be deemed to limit or restrict in any manner the absolute discretion of The Downs to assign stalls to owners and trainers whether or not members of PHHA, except that stall space shall not be denied by reason of

membership in, or activity on behalf of, PHHA or duly constituted horsemen's committees, or as otherwise prohibited or restricted by law.

7. RACING APPLICATION

Each owner and/or trainer having horses racing at The Downs shall be required to complete a racing application that details the complete inventory of horses in that owner's or trainer's racing stable. Such form may be required to be updated on a monthly basis.

8. PENNSYLVANIA-OWNED AND/OR SIREN RACES OR HORSES WHO HAVE RACED A NUMBER OF TIMES AT THE MEET

A. At the request of PHHA, The Downs shall offer on each weekly *condition sheet Pennsylvania*-Owned and/or Sired Races or races for horses that have started a certain number of times at the meet per live race week during the Term of this Agreement. The number of those races **SHALL BE FOURTEEN (14) PER WEEK**. "Pennsylvania-Owned Races" when used above means races restricted to horses which are (a) wholly owned and declared by Pennsylvania resident(s) or (b) wholly owned by Pennsylvania resident(s) and declared by a Pennsylvania resident lessee of the horse. "Pennsylvania-Sired Races": Pennsylvania Harness Racing Commission Regulations/definitions shall govern.

"Pennsylvania Residence" shall be established by presentation, on request of The Downs and/or PHHA representative, (a) a valid Pennsylvania Vehicle Registration and a valid Pennsylvania Driver's License or (b) Pennsylvania State Income Tax Return showing permanent domicile in Pennsylvania for the previous two (2) years.

9. PHHA INSURANCE PROGRAM

A. PHHA hereby agrees to provide, at its expense, on track insurance to cover trainers and drivers participating in training and racing activities at The Downs. The coverage will be \$200,000 accident medical, \$25,000 accidental death and dismemberment, and \$250 weekly disability with a maximum of 104 weeks.

10. CONTROLLING LAW AND REGULATIONS: ARBITRATION

A. The interpretation of the provision of this Agreement shall be governed by the laws of Pennsylvania.

B. The performance and operation of this Agreement during the entire term hereof, shall be subject in all respects to the provisions of the Pennsylvania Race Horse Industry Reform Act, all the Commonwealth's rules and regulations, and subject to the approval of the Pennsylvania State Harness Racing Commission.

C. This is the entire agreement between the parties. Any modification or amendment to this Agreement must be in writing and signed by the parties or their duly authorized representatives.

D. Any and all disputes between the parties hereto arising out of or relating to this Agreement or any breach thereof shall be resolved by arbitration to be held in Wilkes-Barre, Pennsylvania, in accordance with the Rules of the American Arbitration Association then in effect. Any award rendered by the arbitrator(s) may be entered in any court having jurisdiction thereof. The costs of such arbitration shall be borne equally by the parties hereof.

11. ASSIGNMENT, TRANSFER, ADOPTION OF AGREEMENT

Any assignment of all the rights and obligations of The Downs or transfer or adoption of this Agreement shall require PHHA's consent and upon such assignment, transfer or adoption, such assignee or transferee shall be substituted as a party to this Agreement.

12. NINE HORSE FIELDS

Nine horse or larger fields may be permitted in any overnight, early or late closer or stake race only with the permission of the PHHA. There will be no nine horse fields for maidens or non-winners of two (2) pari-mutuel races life, unless approved by the PHHA. All two year olds will be limited to eight in a field unless approved by the PHHA.

13. NEW INCOME SOURCES

If The Downs becomes aware of a new source of wagering or simulcasting income not addressed in this Agreement, The Downs will notify the PHHA of such income source and PHHA will enter negotiations concerning such income. In the event legislation is passed to allow slot machines at the Pennsylvania Race tracks and exercising its rights under paragraph 6 above, The Downs shall take into consideration when assigning stalls the history of each applicant racing at The Downs. In exercising such considerations all things being approximately equal, The Downs shall use best efforts to assign stalls and to allow applicants to continue with the number of stalls substantially consistent with the average over the previous 3 years.

14. The parties will negotiate in good faith and mutually agree to establish a formula concerning the assignment of stalls.

IN WITNESS WHEREOF, with the intentions of being legally bound, the parties by their respective chief officers who are authorized and empowered to bind the respective parties, have caused this Agreement to be duly executed as of this 15 day of March, 2004.

THE DOWNS, INC.

PENNSYLVANIA HARNESS HORSEMEN'S
ASSOCIATION, INC.

BY: /s/ Richard Orbann

BY: /s/ Earl E. Beal, Jr.
PRESIDENT

BY: _____
SECRETARY

BY: _____
SECRETARY

(CORPORATE SEAL)

(CORPORATE SEAL)

ATTEST: /s/ Camilla Grube

ATTEST: /s/ Ronald P. Battoni

AGREEMENT

For good and valuable consideration, the LIVE RACING AGREEMENT (the "Agreement") effective March 23, 1999 through January 1, 2004 by and among PENN NATIONAL TURF CLUB, INC., MOUNTAINVIEW THOROUGHBRED RACING ASSOCIATION, the PENNSYLVANIA HORSEMEN'S BENEVOLENT AND PROTECTIVE ASSOCIATION, INC., and all of its terms and conditions are hereby extended by the mutual consent of all parties through 11:59 p.m. on 5/31/04.

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

PENNSYLVANIA NATIONAL TURF
CLUB, INC.

By: /s/ Richard T. Schnaars
Name: Richard T. Schnaars
Title: Vice Pres./Gen. Mgr.
Dated: 3/30/04

MOUNTAINVIEW THOROUGHBRED
RACING ASSOCIATION

By: /s/ Richard T. Schnaars
Name: Richard T. Schnaars
Title: Vice Pres./Gen. Mgr.
Dated: 3/30/04

PENNSYLVANIA HORSEMEN'S
BENEVOLENT AND PROTECTIVE
ASSOCIATION, INC.

By: /s/ John J. Wanes
Name: John J. Wanes
Title: President
Dated: 3/30/04

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

I, Peter M. Carlino, certify that:

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

Date: May 10, 2004

/s/ Peter M. Carlino
Peter M. Carlino
Chairman and Chief Executive Officer

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

I, William J. Clifford, certify that:

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

Date May 10, 2004

/s/ William J. Clifford

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

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

In connection with the Quarterly Report of Penn National Gaming, Inc. (the "Company") on Form 10-Q for the quarter ended March 31, 2004 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Peter M. Carlino, Chairman and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, to the best of my knowledge, that:

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

By: /s/ Peter M. Carlino

Peter M. Carlino
Chairman and Chief Executive Officer
May 10, 2004

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

In connection with the Quarterly Report of Penn National Gaming, Inc. (the "Company") on Form 10-Q for the quarter ended March 31, 2004 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, William J. Clifford, Senior Vice President-Finance and Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, to the best of my knowledge, that:

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

By: /s/ William J. Clifford
William J. Clifford
Senior Vice President-Finance and
Chief Financial Officer
May 10, 2004
