UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K

|X| ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 1996

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	23-2234473
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

Wyomissing Professional Center 825 Berkshire Blvd., Suite 203 Wyomissing, Pennsylvania	19610
(Address of principal executive offices)	Zip Code

Registrant's telephone number, including area code 610-373-2400

Securities registered pursuant to Section 12(b)of the Act:
None
Securities registered pursuant to Section 12(g) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common stock par value .01 per share	NASDAQ National Market

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 X No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. Yes No X

Aggregate market value of the voting stock held by nonaffiliates of the Registrant as of March 18, 1997 was approximately $134,012,320.

Number of Shares of Common Stock outstanding as of March 18, 1997 - 15,109,040

Documents Incorporated by Reference

Registrants Definitive Proxy Statement with respect to annual meeting of Shareholders to be held on April 30, 1997.

This Annual Report contains forward-looking statements that inherently involve risks and uncertainties. The Company's actual results could differ materially from those anticipated in these forward-looking statements as a result of certain factors, including those discussed in this Annual Report. References to "Penn National Gaming" or the "Company" include Penn National Gaming, Inc. and its subsidiaries.

PART I

ITEM 1 BUSINESS

GENERAL

Penn National Gaming, which began operations in 1972, operates the largest number of pari-mutuel wagering locations in Pennsylvania. The Company provides pari-mutuel wagering opportunities on both live and simulcast thoroughbred and harness horse races at two racetracks and seven Off-Track Wagering Facilities ("OTWs") located principally in Eastern and Central Pennsylvania. Prior to the consummation of the Acquisitions (as described below), the Company owned and operated Penn National Race Course located outside Harrisburg, Pennsylvania (the "Thoroughbred Track") and four OTWs located in Chambersburg, Lancaster, Reading and York, Pennsylvania. On November 27, 1996, the Company consummated the Pocono Downs Acquisition, and as a result acquired Pocono Downs Race Track located outside Wilkes-Barre, Pennsylvania (the "Harness Track") and two OTWs in Allentown and Erie, Pennsylvania. The Company now operates one of the two thoroughbred tracks in Pennsylvania and one of the two harness tracks in Pennsylvania. On February 13, 1997, the Company opened a seventh OTW in Williamsport, Pennsylvania. The Company intends to develop four additional OTWs that have been allocated to it under Pennsylvania law, after which it would operate a total of 11 of the 23 OTWs currently authorized in Pennsylvania.

Following the consummation of the Charles Town Acquisition on January 15, 1997, the Company operates, and has reached an agreement with its joint venture partner to hold an 89% interest in, Charles Town Races, a thoroughbred horse racing facility located in Jefferson County, West Virginia. The Charles Town Facility is approximately a 60-minute drive from Baltimore, Maryland and approximately a 70-minute drive from Washington, D.C. After refurbishment, the Company expects to reopen Charles Town Races as an entertainment complex (the "Charles Town Facility") that will feature live racing, dining, simulcast wagering and video gaming machines ("Gaming Machines"). On November 5, 1996, Jefferson County approved a referendum permitting the installation of Gaming Machines at the Charles Town Facility. Approval for the installation of 400 Gaming Machines has been applied for and is expected to be obtained from the West Virginia Lottery Commission in the Spring of 1997. The Company expects that these machines will be installed and operational in mid-1997. The installation of additional Gaming Machines at the Charles Town Facility is subject to approval by the West Virginia Lottery Commission after application and a public hearing. The Company anticipates that the Charles Town Joint Venture will apply for approval of the installation and operation of a total of 1,000 Gaming Machines within the first year after the opening of the Charles Town Facility.

The Company conducts pari-mutuel wagering at all of its locations on thoroughbred and harness races run at its own tracks ("Company Races") and on thoroughbred and harness races import simulcast from other racetracks ("import simulcasting"). The Company also simulcasts company races for wagering at other racetracks and OTWs in Pennsylvania and at other locations throughout the United States ("export simulcasting"). The Company's customers can also wager on Company Races and on races import simulcast from other racetracks through the Company's telephone account betting network ("Telebet").

INDUSTRY OVERVIEW

Pari-mutuel wagering on thoroughbred or harness racing is pooled wagering, in which a totalisator system totals the amounts wagered and adjusts the payouts to reflect the relative amounts bet on different horses and various possible outcomes. A

portion of the pooled wagers is retained by the wagering facility, a portion is paid to the applicable regulatory or taxing authorities, and a portion is distributed to the track's horsemen in the form of "purses" which encourage owners and trainers to enter their horses in that track's live races. The balance of the pooled wagers is paid out to bettors as winnings in accordance with the payoffs determined by the totalisator system. Pari-mutuel wagering is currently authorized in more than 40 states in the United States, all provinces in Canada and approximately 100 other countries around the world.

Gaming and wagering companies such as the Company that focus on pari-mutuel horse race wagering derive revenue through wagers placed at their own tracks, at their OTWs and on their own races at the tracks and OTWs of others. While some states, such as New York, operate off-track betting locations that are independent of racetracks, in other states (including Pennsylvania) racetrack ownership and operation is typically a precondition to OTW ownership and operation. A racetrack in such a state, then, is akin to an "admission ticket" to the OTW business.

Over the past several years, attendance at live racing has generally declined. Prior to the inception of OTWs, declining live racing attendance at a track translated directly into lower purses at that track. As the size of the purses declined, the quality of live racing at the track would suffer, leading in turn to further reductions in attendance. The Company believes that increased contributions to the purse pool from wagers placed at OTWs affiliated with racetracks have significantly offset the effects of declining live racing attendance on race quality, and thereby improved the marketability of many tracks' export simulcast products. Indeed, despite declining live racing attendance, total pari-mutuel wagering on horse races in the United States has remained relatively constant in recent years, increasing slightly from approximately $14.1 billion in 1992 to approximately $14.6 billion in 1995, according to the Association of Racing Commissioners International, Inc.; an increase in simulcast, inter-track, off-track and telephone wagering from approximately $7.0 billion to approximately $10.1 billion during that period has offset declining wagering at tracks on live races. Moreover, a number of states have recently begun to authorize the installation of slot machines, video lottery terminals or other gaming machines at live racing venues such as thoroughbred horse tracks, harness tracks and dog tracks. The revenue from these gaming opportunities and from the higher volume of wagers placed at these venues has not only increased total revenues for the tracks at which they are installed, but has generally further increased purse size and thereby resulted in higher quality races that can command higher simulcast revenues. Given that many pari-mutuel wagering companies, such as the Company, face the necessary precondition of conducting live racing operations as their entree into the industry, the Company believes that its opportunities for success can be maximized through OTW operations, import simulcasting and export simulcasting and the operation of Gaming Machines, to the extent permitted.

STRATEGY

The Company intends to be a leading participant in the wagering industry by capitalizing upon its horse racing expertise and its numerous wagering locations. The Company's strategy is to focus on:

Opening Additional OTWs

The Company intends to expand its operations and increase its OTW revenues by opening the four additional OTWs consistent with this strategy which it has been allocated under the Pennsylvania Race Horse Industry Reform Act (the "Pennsylvania Racing Act"). On February 13, 1997, the Company opened an additional OTW in Williamsport, Pennsylvania, and has applied for approval of and is evaluating possible sites for an OTW in Downingtown, Pennsylvania. The Company expects to move expeditiously to select appropriate locations, apply for and obtain regulatory approvals and open its three remaining allocated OTWs in Pennsylvania. In addition, the Company will consider opening OTWs in other states to the extent that market conditions and the regulatory environment may present opportunities for it to leverage its OTW operating experience. West Virginia law currently does not permit the operation of OTWs.

Developing the Charles Town Facility and Operating Gaming Machines

The Company intends to refurbish the Charles Town Facility and reopen it as an entertainment complex integrating Gaming Machines with the Company's core business strengths of live racing and simulcast wagering. The refurbishment will include

the renovation of the Charles Town Facility's thoroughbred track and barns, the remodeling of its clubhouse and dining facilities and the initial installation of 400 Gaming Machines; the cost of purchasing or leasing the Gaming Machines is not included in the $16.0 million estimated cost of the refurbishment. The installation of the initial 400 Gaming Machines and any additional Gaming Machines at the Charles Town Facility is subject to the approval of the West Virginia Lottery Commission after application and a public hearing. The Company has applied for, but has not yet obtained, approval for the installation of the initial 400 Gaming Machines and anticipates that it will apply for approval of the installation and operation of a total of 1,000 Gaming Machines within the first year after the opening of the Charles Town Facility. The Company expects that increased revenues at the Charles Town Facility from live and simulcast wagering and from Gaming Machines will result in significantly higher purse sizes and in a corresponding improvement in both the quality of live races and their marketability as an export simulcast product. In addition, the Company intends to explore opportunities to provide additional forms of entertainment at land adjacent to the Charles Town Facility to attract additional patrons.

Maintaining Quality Import Simulcasting and Increasing Export Simulcasting

The Company intends to maintain the quality of import simulcast races that it makes available for wagering by customers at its tracks and OTWs and to increase the volume of export simulcasting of Company Races for wagering at the facilities of others. The Company believes that by import simulcasting high quality races from nationally known racetracks it can increase the number of wagerers as well as the size of the average wager. Subject to applicable regulations, the Company also will seek to increase export simulcasting of races from the Thoroughbred Track and the Harness Track, and introduce export simulcasting from the refurbished Charles Town Facility, for wagering at out-of-state racetracks, OTWs, casinos and other gaming facilities, and to improve the quality of its export simulcast products by increasing purse sizes where practicable and to the fullest extent that changing laws and regulations may make possible. The Company believes that the minimal direct costs associated with export simulcasting make it a particularly desirable source of revenue.

Exploring Other Gaming Opportunities

The Company intends to continue identifying strategic opportunities in the pari-mutuel wagering and gaming industry which complement the Company's core operations and leverage its pari-mutuel management and operating strengths. The Company intends to explore other opportunities to capitalize on any changes in gaming legislation in Pennsylvania, West Virginia and other states, including legislation relating to Gaming Machines and riverboat gaming. In December 1995, the Company agreed in principle with an unrelated party to form a joint venture to develop, manage and operate pari-mutuel racing facilities in a state other than Pennsylvania or West Virginia, and will seek further such opportunities as they may present themselves. Moreover, the Company is also closely monitoring possible legislation to authorize Gaming Machines in Pennsylvania.

ACQUISITIONS

Pocono Downs Acquisition

On November 27, 1996, the Company acquired (the "Pocono Downs Acquisition") all of the capital stock of the Plains Company and all of the limited partnership interests in The Plains Company's affiliated entities (together, "Pocono Downs") for an aggregate purchase price of $48.2 million plus approximately $730,000 in acquisition-related fees and expenses. In addition, pursuant to the terms of the purchase agreement, the Company will be required to pay the sellers of Pocono Downs an additional $10.0 million if, within five years after the consummation of the Pocono Downs Acquisition, Pennsylvania authorizes any additional forms of gaming in which the Company may participate. The $10.0 million payment would be payable in annual installments of $2.0 million for five years, beginning on the date that the Company first offers such additional forms of gaming.

Pocono Downs conducts harness racing at the Harness Track located outside Wilkes-Barre, Pennsylvania, export simulcasting of Harness Track races to locations throughout the United States, pari-mutuel wagering at the Harness Track and at OTWs in Allentown and Erie, Pennsylvania on Pocono Downs races and on import simulcast races from other

racetracks and telephone account wagering on live and import simulcast races.

Charles Town Acquisition

On January 15, 1997, a joint venture (the "Charles Town Joint Venture") in which the Company will hold an 89% ownership interest, acquired (the "Charles Town Acquisition") substantially all of the assets of Charles Town Racing Limited Partnership and Charles Town Races, Inc. (together "Charles Town") relating to the Charles Town Facility for an aggregate net purchase price of approximately $16.5 million plus approximately $1.6 million in acquisition-related fees and expenses. The Charles Town Facility conducts live thoroughbred horse racing, on-site pari-mutuel wagering on live races run at the Charles Town Facility and wagering on import simulcast races. The Company expects to refurbish the Charles Town Facility as an entertainment complex that will feature live racing, dining, simulcast wagering and, in mid-1997, upon completion of the interior refurbishment, 400 Gaming Machines. The estimated cost of the refurbishment, exclusive of the cost of the purchase or lease of the Gaming Machines, is approximately $16.0 million. Pursuant to the original operating agreement governing the Charles Town Joint Venture, the Company obtained an 80% ownership interest in the Charles Town Joint Venture and was obligated to contribute 80% of the purchase price of the Charles Town Acquisition and 80% of the cost of refurbishing the Charles Town Facility. In fact, the Company contributed 100% of the purchase price of the Charles Town Acquisition and expects to contribute 100% of the cost of refurbishing the Charles Town Facility. The Company has reached an agreement with its joint venture partner, Bryant Development Company ("Bryant") pursuant to which the parties will amend the operating agreement to increase the Company's ownership interest in the Charles Town Joint Venture to 89% and decrease Bryant's interest to 11%. In addition, the amendment will provide that the entire amount the Company has contributed, and will contribute, to the Charles Town Joint Venture for the acquisition and refurbishment of the Charles Town Facility would be treated, as between the parties, as a loan to the Charles Town Joint Venture from the Company. The proposed changes in the ownership of the Charles Town Joint Venture are subject to the review of applicable West Virginia racing and lottery regulatory authorities.

The Charles Town Joint Venture acquired its option to purchase the Charles Town Facility from Bryant; Bryant, in turn, acquired the option from Showboat Operating Company ("Showboat"). Showboat retained an option (the "Showboat Option") to operate any casino at the Charles Town Facility in return for a management fee (to be negotiated at the time, based on rates payable for similar properties). Showboat has also retained a right of first refusal to purchase or lease the site of any casino at the Charles Town Facility proposed to be leased or sold and to purchase any interest proposed to be sold in any such casino (on the same terms offered by a third party or otherwise negotiated with the Charles Town Joint Venture). The rights retained by Showboat extend for a period of five years from the date that the Charles Town Joint Venture exercises its option to purchase the Charles Town Facility and expire thereafter unless legislation to permit casino gaming at the Charles Town Facility has been adopted prior to the end of the five-year period. If such legislation has been adopted prior to such time, then the rights of Showboat continue for a reasonable time (not less than 24 months) to permit completion of negotiations.

While the agreement with Showboat does not specify what activities at the Charles Town Facility would constitute operation of a casino, Showboat has agreed that the installation and operation of video lottery terminals (like the Gaming Machines the Company intends to install) at the Charles Town Facility's race track would not trigger the Showboat Option. If West Virginia law were to permit casino gaming at the Charles Town Facility and if Showboat were to exercise the Showboat Option, the Company would be required to pay a management fee to Showboat for the operation of the casino.

RACING AND WAGERING OPERATIONS

The Company's revenues are derived from: (i) wagering on Company Races at Company facilities; (ii) wagering on non-Company Races import simulcast to Company facilities; (iii) fees from wagering on export simulcasting of Company Races to non-Company wagering venues; (iv) admissions, program sales and certain other ancillary activities; and (v) food and beverage sales and concessions.

The following table summarizes certain key operating statistics for the Company's pari-mutuel operations related to the Thoroughbred Track and its OTWs for the year ended December 31:

	1996	1995	1994	1993	1992
Number of live racing days	206	204	219	238	247
Paid attendance:					
At the Thoroughbred Track	370,898	430,128	485,224	548,085	619,359
At the OTWs	678,012	621,675	363,258	251,540	166,210
Total paid attendance (1)	1,048,910	1,051,803	848,482	799,625	785,569
Wagering on Penn National races (2):					
At the Thoroughbred Track	$ 29,991,365	$ 36,833,992	$ 44,650,714	$ 53,558,980	$ 62,661,360
At the OTWs	19,895,385	19,876,199	11,572,987	10,503,690	8,246,778
Telebet	3,609,549	4,047,377	4,483,324	6,790,381	7,733,190
Simulcasts to Other PA Facilities	35,831,807	41,387,765	50,540,159	68,085,883	74,690,435
Export simulcasting	112,870,310	72,251,622	40,337,450	12,745,934	10,201,902
Total wagers on Penn National races	202,198,416	174,396,955	151,584,634	151,684,868	163,533,665
Wagering by Simulcast on Non-Penn National races (2):					
At the Thoroughbred Track	45,716,269	48,826,682	47,247,589	33,925,635	29,576,594
At the OTWs	111,151,944	89,438,659	42,730,084	23,013,876	12,582,339
Telebet	4,813,546	4,233,532	3,483,500	1,312,904	--
Total wagers on non-Penn National races	161,681,759	142,498,873	93,461,173	58,252,415	42,158,933
Total wagers on Penn National and non-Penn National races	$363,880,175	$316,895,828	$245,045,807	$209,937,283	$205,692,598
Average daily purses Penn National races	$ 62,328	$ 57,897	48,560	$ 40,834	$ 38,746
Gross margin from wagering (3):					
Wagering on Penn National races	$ 8,444,000	$ 8,513,000	$ 8,313,000	$ 8,850,000	$ 9,711,000
Wagering on non-Penn National races	19,511,000	16,121,000	9,650,000	6,496,000	4,838,000
Total gross margin from wagering	$ 27,955,000	$ 24,915,000	$ 17,963,000	$ 15,346,000	$ 14,549,000

(1) Does not reflect attendance at the Thoroughbred Track for wagering on simulcasts when live racing is not conducted, but does reflect attendance at the Reading, Chambersburg, York and Lancaster OTWs, which opened in May 1992, April 1994, March 1995, and July 1996, respectively.

(2) Wagering on certain imported stakes races is included in Wagering on Penn National races.

(3) Amounts equal total pari-mutuel revenues, less purses paid to the Thoroughbred Horsemen, taxes payable to Pennsylvania and simulcast commissions or host track fees paid to other racetracks.

The following table summarizes certain key operating statistics for the operations related to the Harness Track and its OTWs for the year ended December 31:

	1996	1995	1994	1993	1992
Number of live racing days:	135	135	143	147	149
Paid attendance:					
At the Harness Track	377,830	242,870	253,521	211,629	257,249
At the OTWs	384,935	388,858	404,192	272,237	141,108
Total paid attendance (1)	762,765	631,728	657,713	483,866	398,357
Wagering on Pocono Downs races (2):					
At the Harness Track	$12, 184,677	$ 15,672,606	$ 17,758,559	$ 18,895,856	$ 21,327,604
At the OTWs	2,322,390	2,679,733	3,469,976	2,824,718	1,311,185
Dial-a-Bet	1,656,066	--	--	--	--
Simulcasts to Other PA Facilities .	8,903,757	11,754,011	14,887,587	20,172,606	20,871,054
Export simulcasting	23,589,362	18,366,920	10,835,744	--	--
Total wagers on Pocono Downs races ...	$ 48,656,252	$ 48,473,270	$ 46,951,866	$ 41,893,180	$ 43,509,843
Wagering by Simulcast on Non-Pocono Downs races (2):					
At the Harness Track	41,005,248	42,111,065	34,221,051	27,059,965	24,536,505
At the OTWs	81,093,251	83,138,883	75,610,285	38,757,490	17,049,662
Dial-a-Bet	3,853,539	75,066	--	--	--
Total wagers on non-Pocono Downs races	$125,952,038	$125,325,014	$109,831,336	$ 65,817,455	$ 41,586,167
Total wagers on Pocono Downs and non-Pocono Downs races	$174,608,290	$173,798,284	$156,783,202	$107,710,635	$ 85,096,010
Average daily purses Pocono Downs races	$ 42,313	$ 42,314	$ 35,790	$ 26,022	$ 22,448
Gross margin from wagering (3)	$ 17,804,998	$ 17,838,231	$ 16,652,676	$ 10,918,491	$ 8,100,860

(1) Does not reflect attendance for the years 1992 thru 1995 at the Harness Track for wagering on simulcasts when live racing is not conducted, but does reflect attendance at the Erie and Allentown OTWs, which opened in May 1991 and July 1993, respectively. The Company's Consolidated results of Operations include the Harness Track and Pocono OTWs operations from November 28, 1996.

(2) Wagering on certain imported stakes races is included in Wagering on Pocono Downs races.

(3) Amounts equal total pari-mutuel revenues, less purses paid to the Harness Horsemen, taxes payable to Pennsylvania and simulcast commissions or host track fees paid to other racetracks.

The following table summarizes the Company's operations and facilities:

TRACKS

FACILITY	LOCATION	DATE OPENED/STATUS	OPERATIONS CONDUCTED
Penn National Race Course	Grantville, PA	Constructed in 1972; operated by Penn National since 1972	Live thoroughbred racing; simulcast wagering; dining; telephone account wagering
Pocono Downs Racetrack	Plains Township, PA	Constructed in 1965; operated by Penn National since November 28, 1996	Live harness racing; simulcast wagering; dining; telephone account wagering
Charles Town Races	Charles Town, WV	Constructed in 1933; acquired by Charles Town Joint Venture on January 15, 1997; to be refurbished in 1997	When reopened: live thoroughbred racing; simulcast wagering; dining; Gaming Machines (applied for)

OTWs (1)

FACILITY	LOCATION	DATE OPENED/STATUS	SIZE (SQ. FT.)	HISTORICAL COST (2)	LICENSEE
Allentown	Allentown, PA	Opened July 1993	28,500	$5,207,000	Pocono Downs
Chambersburg	Chambersburg, PA	Opened April 1994	12,500	1,500,000	Penn National
Erie	Erie, PA	Opened May 1991	22,500	3,575,000	Pocono Downs
Lancaster	Lancaster, PA	Opened July 1996	24,000	2,700,000	Penn National
Reading	Reading, PA	Opened May 1992	22,500	2,100,000	Penn National
York	York, PA	Opened March 1995	25,000	2,200,000	Penn National
Williamsport	Williamsport, PA	Opened February 1997	14,000	3,000,000 (estimated)	Penn National
Downingtown	Downingtown, PA	Proposed	20,000 (estimated)	4,000,000 (estimated)	Penn National

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(1) This table does not include three additional Pennsylvania OTWs which the Company is authorized to operate under Pennsylvania law.

(2) Consists of construction costs, equipment and, for owned properties, the cost of land and building.

Live Racing

The Company has conducted live racing at the Thoroughbred Track since 1972, and has held at least 204 days of live racing at that facility in each of the last five years. The Thoroughbred Track is one of only two thoroughbred racetracks in Pennsylvania. Although other regional racetracks offer nighttime thoroughbred racing, the Thoroughbred Track is the only racetrack in the Eastern time zone conducting year-round nighttime thoroughbred horse racing, which the Company believes increases its opportunities to export simulcast its races during periods in which other racetracks are not conducting live racing. Post time at the Thoroughbred Track is 7:30 p.m. on Wednesdays, Fridays and Saturdays, and 1:30 p.m. on Sundays and holidays.

The Pocono Downs Acquisition was consummated following the last day of racing at the Harness Track for the 1996 season. The Company expects to resume live racing at the Harness Track in April 1997 and plans to conduct 135 days of live harness racing at the facility in the 1997 season. Post time at the Harness Track is expected to be 7:30 p.m.

The Charles Town Facility is currently closed. The Company has received preliminary approval for, and plans to conduct, 159 days of thoroughbred racing at the facility in the 1997 season following the reopening of the Charles Town Facility's racetrack (currently anticipated to be in May 1997). Post time at the Charles Town Facility is expected to be 7:30 p.m. on Fridays and Saturdays and 1:30 p.m. on Wednesdays and Sundays.

Revenues from Company Races consist of the total amount wagered, less the amount paid as winning wagers. Of the amount not returned to bettors as winning wagers, a portion is paid to the state in which the track is located and the balance is divided between the Company and purses for the horsemen at that track. The Pennsylvania Racing Act specifies the maximum percentages of each dollar wagered on horse races in Pennsylvania which can be retained by the Company (prior to required payments to the Pennsylvania Horsemen and applicable taxing authorities). The percentages vary, based on the type of wager; the average percentage is approximately 20%. The balance of each dollar wagered must be paid out to the public as winning wagers. With the exception of revenues derived from wagers at the Thoroughbred Track or the Company's OTWs, the Company's revenues on each race are determined pursuant to such maximum percentage and agreements with the other racetracks and OTWs at which wagering is taking place. Amounts payable to the Pennsylvania Horsemen are determined under agreements with the Pennsylvania Horsemen and vary depending upon where the wagering is conducted and the racetrack at which such races take place. The Pennsylvania Horsemen receive their share of such wagering as race purses. The Company retains a higher percentage of wagers made at its own facilities than of wagers made at other locations. The West Virginia Racing Act provides for a similar disposition of pari-mutuel wagers placed at the Charles Town Facility, with the average percentage of wagers retained by Charles Town having also been approximately 20% (prior to required payments to the Charles Town Horsemen and to applicable West Virginia taxing authorities and other mandated beneficiary organizations).

OTW Wagering

At OTWs, as at the Company's racetracks, customers place wagers on thoroughbred and harness races simulcast from the Company's racetracks and on import simulcast races from other tracks around the country. Under the Pennsylvania Racing Act, only licensed thoroughbred and harness racing associations, such as the Company, can operate OTWs or accept customer wagers on simulcast races at Pennsylvania racetracks. Each OTW is required by the Pennsylvania Racing Act to provide various amenities, including dining and other services designed to attract a wide range of patrons. The Company operates seven of the 17 OTWs now open in Pennsylvania, located in Allentown, Chambersburg, Erie, Lancaster, Reading, York and Williamsport, Pennsylvania, and has the right (subject to applicable regulatory approvals) to open and operate an additional four Pennsylvania OTWs, which would give the Company a total of 11 of the 23 OTWs currently authorized by Pennsylvania law. Of its four additional allocated OTWs, regulatory approval has been sought for a new OTW in Downingtown, Pennsylvania. The Company expects to move expeditiously to select appropriate locations, apply for and obtain regulatory approvals and open the remaining three allocated OTWs. The Company believes that expansion through the opening of the additional Pennsylvania OTWs will increase its customer wagering base. The Company intends to open its OTWs outside of large metropolitan areas and away from the Thoroughbred Track and the Harness Track and other existing OTWs; the Company thus believes that it will be offering a new form of entertainment to the communities that it enters.

Simulcasting

The Company has been transmitting simulcasts of its races to other wagering locations and receiving simulcasts of races from other locations for wagering by its customers at Company facilities year-round for more than five years. When customers place wagers on import simulcast races, the Company receives revenue and incurs expense in substantially the same manner as it would if the race had been run at one of the Company's own tracks: of the amount not returned to bettors as winning wagers, a portion is paid to the state in which the Company wagering facility is located, a portion is paid to the race track sending the race, a portion is paid to the purse fund for the horse owners or trainers (thoroughbred or harness) of the Company's racetrack with which the wagering facility is associated, and the balance is retained by the Company. The Company believes that full card import simulcasting, in which all of the races at a non-Company track are import simulcast to a Company wagering facility, has improved the wagering opportunities for its customers and thereby increased the amount wagered at Company facilities. When the Company export simulcasts Company Races for wagering at non-Company locations, it receives a fixed percentage of the amounts wagered on that race from the location to which the simulcast is exported, while incurring minimal additional expense.

During the year ended December 31, 1996, the Company received import simulcasts from approximately 57 racetracks (including Belmont Park, Saratoga, Gulfstream Park, Santa Anita and Arlington International Racecourse) and transmitted export simulcasts of Company Races to more than 63 locations.

Pursuant to an agreement among the members of the Pennsylvania Racing Association, the Company and the two other Pennsylvania racetracks provide simulcasts of all their races to all of each other's facilities and set the commissions payable on such races. In addition, the Company has short-term agreements with various racetracks throughout the United States to import simulcast from, and export simulcast to, their facilities; these agreements include import simulcasts of major stakes races.

Wagering at the Company's facilities on import simulcasting of races from other tracks, especially from nationally-known tracks in other states, competes with wagering on Company Races. The Company believes, however, that import simulcasting of out-of-state races, including full card import simulcasting, is economically beneficial to the Company because it makes available wagering on higher quality races and thus increases the size of the average wager.

Telebet

In 1983, the Company pioneered Telebet, Pennsylvania's first telephone account wagering system. Telebet customers open an account by depositing funds with the Company at one of its locations. Account holders can then place wagers by telephone on Company Races and import simulcast races to the extent of the funds on deposit in the account; any winnings are posted to the account and are available for future wagers. In December 1995, the Harness Track instituted Dial-A-Bet, a similar telephone account betting system.

Gaming Machine Operations

On November 5, 1996, Jefferson County, West Virginia approved a referendum authorizing the installation and operation of Gaming Machines at the Charles Town Facility. As a result, the Company consummated the Charles Town Acquisition on January 15, 1997. In mid-1997, the Company intends to reopen the Charles Town Facility as an entertainment complex that will feature live racing, dining, simulcast wagering and Gaming Machines. The Charles Town Joint Venture has applied to the West Virginia Lottery Commission for approval to operate initially 400 Gaming Machines, and expects to obtain such approval in the Spring of 1997. The machines will be slot-machine-style video machines that depict spinning reels and video card games such as blackjack and poker. The Race Track Video Lottery Act specifies the maximum percentage of each dollar wagered on Gaming Machines which can be retained by the Company; the maximum statutory rate is 20%. The balance of each dollar wagered must be paid out to the public as winning wagers. Of the portion retained by the Company, a portion is paid to taxing authorities and other beneficiary organizations mandated by the State of West Virginia and a portion is paid to the Charles Town Horsemen in the form of purses. The Company anticipates that the Charles Town Joint Venture will apply for approval of the installation and operation of a total of 1,000 Gaming Machines at the Charles Town Facility within the first year after the opening of the Charles Town Facility. The installation of additional Gaming Machines at the Charles Town Facility is subject to approval by the West Virginia Lottery Commission after application and a public hearing.

Other Gaming Opportunities

In December 1995, the Company agreed in principle with an unrelated party to form a joint venture for the purpose of developing, managing and operating pari-mutuel racing facilities in a state other than Pennsylvania or West Virginia. The actual formation of the joint venture is subject to numerous contingencies including receipt of regulatory approval from that state's Horse Racing Commission. Additional investments by the Company in new or existing businesses are subject to the consent of the Company's lenders under the Credit Facility. See "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Liquidity and Capital Resources." To date, the Company has not invested a material amount in the joint venture and the joint venture has conducted no operations.

MARKETING

The Company seeks to increase wagering by broadening its customer base and increasing the wagering activity of its existing customers. To attract new customers, the Company seeks to increase the racing knowledge of its customers through its television programming, and by providing "user friendly" automated wagering systems and comfortable surroundings. The Company also seeks to attract new customers by offering various types of promotions including family fun days, premium give-away programs, contests and handicapping seminars.

Televised Racing Program

The Company's Racing Alive program is televised by satellite transmission commencing approximately one hour before post time on each live racing day at the Thoroughbred Track. The program provides color commentary on the races at the Thoroughbred Track (including wagering odds, past performance information and handicapper analysis), general education on betting and handicapping, interviews with racing personalities and featured races from other thoroughbred racetracks across the country. The Racing Alive program is shown at the Thoroughbred Track and on various cable television systems in Pennsylvania and is transmitted to all OTWs that receive Penn National Races. The Company intends to expand Racing Alive and/or to create additional televised programming to cover racing at the Harness Track and at other harness racing venues throughout the United States. The Company's satellite transmissions are encoded so that only authorized facilities can receive the program.

Automated Wagering Systems

To make wagering more "user friendly" to the novice and more efficient for the expert, the Company leases Autotote Corporation's automated wagering equipment. These wagering systems enable the customer to choose a variety of ways to place a bet through touch-screen interactive terminals and personalized portable wagering terminals, provide current odds information and enable customers to place bets and credit winning tickets to their accounts. Currently, more than 35% of all wagers at the Thoroughbred Track are processed through these self-service terminals and Telebet.

Modern Facilities

The Company provides a comfortable, upscale environment at each of its OTWs, including a full bar, a range of restaurant services and an area devoted to televised sporting events. The Company believes that its attractive facilities appeal to its current customers and to new customers, including those who have not previously visited a racetrack.

PURSES; AGREEMENTS WITH HORSEMEN

The Horsemen Agreements set forth the amounts to be paid to the Pennsylvania Horsemen as racing purses. Revenues from wagering at the Thoroughbred Track and the Harness Track, except for wagering on races simulcast from outside Pennsylvania and revenues received from export simulcasting, are divided approximately equally between the Company and the Pennsylvania Horsemen. Revenues from all other sources (all wagering at the Company's OTWs and on races simulcast from outside Pennsylvania) are shared such that the Pennsylvania Horseman generally receive between 3% and 7.5% of total wagering at the OTWs.

The Company sets the purses paid on Company Races, based on projected wagering and in accordance with the terms of the Horsemen Agreements. Because the amount of the purses is based on projections, at any given point in time the Pennsylvania Horsemen will have either been overpaid or underpaid. The agreement with the Thoroughbred Horsemen also permits the Thoroughbred Horsemen to require immediate purse adjustments should the amount of revenues to be paid to them as purses, and remaining unpaid, exceed $100,000. The amount of underpaid or overpaid purses varies from time to time, and the Company believes that further action to reduce the amount of underpaid purses will not affect its ability to increase purses in an orderly manner. In setting future purses the Company seeks, over time, to adjust for the under or over-payments, but no assurance can be given that any such adjustment will be accurate or adequate.

During the years ended December 31, 1996, 1995 and 1994, the Thoroughbred Horsemen earned an aggregate of approximately $12.3 million, $12.0 million and $10.7 million in purses, respectively. The average annual daily purses at the Thoroughbred Track during the three-year period increased from approximately $49,000 to approximately $60,000. The Company believes that the increases in daily purses have contributed to an increase in the quality of horses racing at the Thoroughbred Track. During the years ended December 31, 1996, 1995 and 1994, the Harness Horsemen earned an aggregate of approximately $5.7 million, $6.5 million and $6.0 million in purses, respectively. The average daily purses at the Harness Track during the three-year period increased from approximately $26,000 to approximately $42,300.

The Thoroughbred Horsemen Agreement was entered into in February 1996, expires in February 1999 and is subject to automatic renewal for successive one year terms unless either party gives notice of termination at least 90 days prior to the end of any such period. The Harness Horsemen Agreement was entered into in November 1994, became effective in January 1995 and expires in January 2000. Currently, there is no agreement with the Charles Town Horsemen. The Company has entered into discussions with the Charles Town Horsemen toward obtaining an agreement. The future success of the Company depends, in part, on its ability to maintain a good relationship with the Horsemen and to obtain renewal of the Horsemen Agreements and required approvals for import simulcast wagering from the Charles Town Horsemen on satisfactory terms.

COMPETITION

The Company faces significant competition for wagering dollars from other racetracks and OTWs in Pennsylvania and neighboring states (some of which also offer other forms of gaming), other gaming venues such as casinos and state-sponsored lotteries, including the Pennsylvania Lottery. The Company may also face competition in the future from new OTWs or from new racetracks. From time to time, Pennsylvania has considered legislation to permit other forms of gaming. Although Pennsylvania has not authorized any form of casino or other gaming, if additional gaming opportunities become available in or near Pennsylvania, such gaming opportunities could have a material adverse effect on the Company's business, financial condition and results of operations.

Company Races compete for wagering dollars and simulcast fees with live races and races simulcast from other racetracks both inside and outside Pennsylvania (including several in New York, New Jersey, West Virginia, Ohio, Maryland and Delaware). The Company's ability to compete successfully for wagering dollars is dependent, in part, on the quality of its live horse races. The quality of horse races at some racetracks that compete with the Company, either by live races or simulcasts, is higher than the quality of Company races. The Company believes that there has been some improvement over the last several years in the quality of the horses racing at the Thoroughbred Track, due to higher purses being paid which, in turn, has primarily resulted from the Company's increased simulcasting activities. However, increased purses may not result in a continued improvement in the quality of racing at the Thoroughbred Track or in any material improvement in the quality of racing at the Harness Track or the Charles Town Facility.

The Company's OTWs compete with the OTWs of other Pennsylvania racetracks, and new OTWs may compete with the Company's existing or proposed wagering facilities. Competition between OTWs increases as the distance between them decreases. For example, the Company believes that its Allentown OTW, which was acquired in the Pocono Downs Acquisition and which is approximately 50 miles from the Thoroughbred Track and 35 miles from the Company's Reading OTW, has drawn some patrons from the Thoroughbred Track, the Reading OTW and Telebet and that its Lancaster OTW, which is approximately 31 miles from the Thoroughbred Track and 25 miles from the Company's York OTW, has drawn some patrons from the Thoroughbred Track, the York OTW and Telebet. Moreover, the Company believes that a competitor's new OTW in King of Prussia, Pennsylvania, which is approximately 23 miles from the Reading OTW, has drawn some patrons from the Reading OTW. The opening of new OTWs in close proximity to the Company's existing or future OTWs could have a material adverse effect on the Company's business, financial condition and results of operations.

If the Company obtains approval for the installation of Gaming Machines at the Charles Town Facility, the Company's Gaming Machine operations will face competition from other Gaming Machine venues in West Virginia and in neighboring states (including Dover Downs in Dover, Delaware, Delaware Park in northern Delaware, Harrington Raceway in southern Delaware and the casinos in Atlantic City, New Jersey). Venues in Delaware and New Jersey, in addition to video gaming machines,

currently offer mechanical slot machines that feature physical spinning reels, pull-handles and the ability to both accept and pay out coins. West Virginia has not authorized, and may never approve, such mechanical slot machines. The failure to attract or retain Gaming Machine customers at the Charles Town Facility, whether arising from such competition or from other factors, could have a material adverse effect upon the Company's business, financial condition and results of operations.

EFFECT OF INCLEMENT WEATHER AND SEASONALITY

Because horse racing is conducted outdoors, variable weather conditions contribute to the seasonality of the Company's business. Weather conditions, particularly during the winter months, may cause races to be canceled or may curtail attendance. Because a substantial portion of the Company's Thoroughbred Track and Harness Track expenses are fixed, the loss of scheduled racing days could have a material adverse effect on the Company's business, financial condition and results of operations.

The severe winter weather in 1996 resulted in the closure of the Company's OTW facilities for two days in January 1996. Because of the Company's growing dependence upon OTW operations, severe weather that causes the Company's OTWs to close could have a material adverse effect upon the Company's business, financial condition and results of operations.

Attendance and wagering at the Company's facilities have been favorably affected by special racing events which stimulate interest in horse racing, such as the Triple Crown races in May and June and the Breeders' Cup in autumn. As a result, the Company's revenues and net income have been greatest in the second and third quarters of the year, and lowest in the first and fourth quarters of the year. See "Management's Discussion and Analysis of Financial Condition and Results of Operations --Effect of Inclement Weather and Seasonality."

REGULATION AND TAXATION

General

The Company is authorized to conduct thoroughbred racing and harness racing in Pennsylvania under the Pennsylvania Racing Act. The Company is also authorized, under the Pennsylvania Racing Act and the Federal Interstate Horseracing Act of 1978 (the "Federal Horseracing Act"), to conduct import simulcast wagering. The Company is also subject to the provisions of the Horse and Dog Racing Act (the "West Virginia Racing Act") which governs the conduct of horseracing in West Virginia, and the State Lottery Act and the Race Track Video Lottery Act (the "West Virginia Gaming Machine Acts") which governs the operation of Gaming Machines in West Virginia. The Company's live racing, pari-mutuel wagering and Gaming Machine operations are contingent upon the continued governmental approval of such operations as forms of legalized gaming. The West Virginia State Lottery Commission is subject to review every six years. The next review date is July 1, 1998. All of the Company's current and proposed operations are subject to extensive regulations and could be subjected at any time to additional or more restrictive regulations, or banned entirely.

Sunset Provisions in Gaming Machine Legislation

The Company has applied for approval to install and operate Gaming Machines at the refurbished Charles Town Facility pursuant to the West Virginia Gaming Machine Acts. The Race Track Video Lottery Act was adopted in 1994, and was set to terminate on June 30, 1997 unless extended or reenacted. In March 1997 the West Virginia Legislature terminated this Sunset Provision, thus eliminating the need to further extend the Gaming Machine Act.

Pennsylvania Racing Regulations

The Company's horse racing operations at the Thoroughbred Track and the Harness Track are subject to extensive regulation under the Pennsylvania Racing Act, which established the Pennsylvania Racing Commissions. The Pennsylvania Racing Commissions are responsible for, among other things, (i) granting permission annually to maintain racing licenses and schedule race meets, (ii) approving, after a public hearing, the opening of additional OTWs, (iii) approving simulcasting activities, (iv) licensing all officers, directors, racing officials and certain other employees of the Company and (v) approving all contracts entered into by the Company affecting racing, pari-mutuel wagering and OTW operations.

As in most states, the regulations and oversight applicable to the Company's operations in Pennsylvania are intended primarily to safeguard the legitimacy of the sport and its freedom from inappropriate or criminal influences. The Pennsylvania Racing Commissions have broad authority to regulate in the best interests of racing and may, to that end, disapprove the involvement of certain personnel in the Company's operations, deny approval of certain acquisitions following their consummation or withhold permission for a proposed OTW site for a variety of reasons, including community opposition. For example, the Pennsylvania State Thoroughbred Racing Commission withheld approval for the Company's initial site for its Lancaster OTW, but the Company applied and was ultimately approved for another site in Lancaster, which opened in July 1996. The Pennsylvania legislature also has reserved the right to revoke the power of the Pennsylvania Racing Commissions to approve additional OTWs and could, at any time, terminate pari-mutuel wagering as a form of legalized gaming in Pennsylvania or subject such wagering to additional restrictive regulation; such termination would, and any further restrictions could, have a material adverse effect upon the Company's business, financial condition and results of operations.

The Company may not be able to obtain all necessary approvals for the operation or expansion of its business. Even if all such approvals are obtained, the regulatory process could delay implementation of the Company's plans to open additional OTWs. The Company has had continued permission from the Pennsylvania State Horse Racing Commission to conduct live racing at the Thoroughbred Track since it commenced operations in 1972, and has obtained permission from the Pennsylvania State Harness Racing Commission to conduct live racing at the Harness Track beginning with the 1997 season. Currently, the Company has approval from the Pennsylvania Racing Commissions to operate seven OTWs and the right, under the Pennsylvania Racing Act, to operate four additional OTWs, subject to approval by the Pennsylvania Racing Commissions. A Commission may refuse to grant permission to open additional OTWs or to continue to operate existing facilities. The failure to obtain required regulatory approvals would have a material adverse effect upon the Company's business, financial condition and results of operations.

The Pennsylvania Racing Act provides that no corporation licensed to conduct thoroughbred racing shall be licensed to conduct harness racing and that no corporation licensed to conduct harness racing shall be licensed to conduct thoroughbred racing. The Company's harness and thoroughbred licenses are held by separate corporations, each of which is a wholly owned subsidiary of the Company. Moreover, the Pennsylvania State Harness Racing Commission has reissued the Pocono Downs harness racing license and has found, in connection with the reissuance, that it is not "inconsistent with the best interests, convenience or necessity or with the best interests of racing generally," that a subsidiary of the Company beneficially owns Pocono Downs. The Company thus believes that the arrangement under which it holds both a harness and a thoroughbred license complies with applicable regulations.

West Virginia Racing and Gaming Regulation

The Company's operations at the Charles Town Facility are subject to regulation by the West Virginia Racing Commission under the West Virginia Racing Act, and by the West Virginia Lottery Commission under the West Virginia Gaming Machine Acts. The powers and responsibilities of the West Virginia Racing Commission under the West Virginia Racing Act are substantially similar in scope and effect to those of the Pennsylvania Racing Commissions and extend to the approval and/or oversight of all aspects of racing and pari-mutuel wagering operations. The Charles Town Joint Venture has applied to the West Virginia Racing Commission for a license to conduct racing and pari-mutuel wagering at the Charles Town Facility. The West Virginia Racing Commission has issued this license, subject to its review and approval of the documents pursuant to which the Charles Town Acquisition was consummated and financing therefor was obtained and to its review and approval of any changes in the ownership of the Charles Town Joint Venture, among other conditions. The Charles Town Joint Venture has also applied to the West Virginia Lottery Commission for approval to install and operate 400 Gaming Machines at the refurbished Charles Town Facility; this approval has not yet been granted. The Company anticipates, but cannot assure, that it will obtain approval for the installation and operation of the 400 Gaming Machines in the Spring of 1997. The Charles Town Joint Venture may not receive or retain all of the regulatory approvals necessary from time to time to conduct racing and pari-mutuel wagering operations at the Charles Town Facility. The failure to receive or retain a delay in receiving such approvals could cause the reduction or suspension of racing and pari-mutuel wagering, as well as of Gaming Machine operations, at the Charles Town Facility and have a material adverse effect upon the Company's business, financial condition and results of operations.

The installation and operation of Gaming Machines at the Charles Town Facility are subject to the provisions of the West Virginia

Gaming Machine Act and the regulatory authority of the West Virginia Lottery Commission. Pursuant to the West Virginia Gaming Machine Act and regulatory approval currently being sought by the Company thereunder, the Company plans, following the completion of the interior refurbishment of the Charles Town Facility in mid-1997, to install initially 400 Gaming Machines at the Charles Town Facility. The installation of additional Gaming Machines at the Charles Town Facility is subject to approval by the West Virginia Lottery Commission after application and a public hearing. The Company anticipates that the Charles Town Joint Venture will apply for approval of the installation and operation of a total of 1,000 Gaming Machines at the Charles Town Facility within the first year after the opening of the Charles Town Facility. The West Virginia Lottery Commission may not approve the installation of the initial or any additional Gaming Machines, however, or may not do so in a timely manner, or may ultimately approve the installation of a smaller number of Gaming Machines than requested.

Moreover, the West Virginia Gaming Machine Act requires that the operator of the Charles Town Facility enter into a written agreement with the Charles Town Horsemen in order to conduct Gaming Machine operations. The West Virginia Gaming Machine Act also requires that the Charles Town Joint Venture enter into a written agreement with the pari-mutuel clerks in order to operate Gaming Machines. In March 1997 the Charles Town Joint Venture entered into written agreements with the Charles Town Horsemen, the West Virginia Breeders Association and the pari-mutual clerks. The Agreements provide that the net terminal income from the Gaming Machines shall be distributed in accordance with the provisions of Section 29-22A-10(c) of the Race Track Video Lottery Act. The agreements expire on June 30, 1998.

State and Federal Simulcast Regulation

Both the Federal Horseracing Act and the Pennsylvania Racing Act require that the Company have a written agreement with the Thoroughbred Horsemen and with the Harness Horsemen in order to simulcast races. The Company has entered into the Horsemen Agreements, and in accordance therewith has agreed upon the allocations of the Company's revenues from import simulcast wagering to the purse funds for the Thoroughbred Track and the Harness Track. Because the Company cannot conduct import simulcast wagering in the absence of the Horsemen Agreements, the termination or non-renewal of either Horsemen Agreement could have a material adverse effect on the Company's business, financial condition and results of operations.

The Federal Horseracing Act requires that the operator of the Charles Town Facility obtain the approval of the Charles Town Horsemen before import simulcast wagering can be conducted there. While such approval has been obtained by Charles Town in the past, there is no written agreement with the Charles Town Horsemen providing for such approval in the future. The Company has entered into discussions with the Charles Town Horsemen toward obtaining an agreement evidencing such approval. The failure to obtain such approval could have a material adverse effect on the Company's business, financial condition and results of operations.

Taxation

The Company believes that the prospect of significant additional revenue is one of the primary reasons that jurisdictions permit legalized gaming. As a result, gaming companies are typically subject to significant taxes and fees in addition to normal federal and state income taxes, and such taxes and fees are subject to increase at any time. The Company pays substantial taxes and fees with respect to its operations. From time to time, federal legislators and officials have proposed changes in tax laws, or in the administration of such laws, affecting the gaming industry. It is not possible to determine with certainty the likelihood of changes in tax laws or in the administration of such laws. Such changes, if adopted, could have a material adverse effect on the Company's business, financial condition and results of operations.

Compliance with Other Laws

The Company and its OTWs are also subject to a variety of other rules and regulations, including zoning, construction and land-use laws and regulations in Pennsylvania and West Virginia governing the serving of alcoholic beverages. Currently, Pennsylvania laws and regulations permit the construction of off-track wagering facilities, but may affect the selection of a particular OTW site because of parking, traffic flow and other similar considerations, any of which may serve to delay the opening of future OTWs in Pennsylvania. By contrast, West Virginia law does not permit the operation of OTWs. The Company derives a significant portion of its other revenues from the sale of alcoholic beverages to patrons of its facilities. Any interruption

or termination of the Company's existing ability to serve alcoholic beverages would have a material adverse effect on the Company's business, financial condition and results of operations.

Restrictions on Share Ownership and Transfer

The Pennsylvania Racing Act requires that any shareholder proposing to transfer beneficial ownership of 5% or more of the Company's shares file an affidavit with the Company setting forth certain information about the proposed transfer and transferee, a copy of which the Company is required to furnish to the Pennsylvania Racing Commission. The certificates representing the Company shares owned by 5% beneficial shareholders are required to bear certain legends prescribed by the Pennsylvania Racing Act. In addition, under the Pennsylvania Racing Act, the Pennsylvania Racing Commission has the authority to order a 5% beneficial shareholder of the Company to dispose of his Common Stock of the Company if it determines that continued ownership would be inconsistent with the public interest, convenience or necessity or the best interest of racing generally. The West Virginia Gaming Machine Act provides that a transfer of more than 5% of the voting stock of a corporation which controls the license may only be to persons who have met the licensing requirements of the West Virginia Gaming Machine Act or which transfer has been pre-approved by the West Virginia Lottery Commission. Any transfer that does not comply with this requirement voids the license. See "Description of Capital Stock -- Certain Restrictions on Share Ownership and Transfer."

ITEM 2 PROPERTIES

Thoroughbred Track

The Thoroughbred Track is located on approximately 225 acres approximately 15 miles northeast of Harrisburg, 100 miles west of Philadelphia and 200 miles east of Pittsburgh. There is a total population of approximately 1.4 million persons within a radius of approximately 35 miles around the Thoroughbred Track and approximately 2.2 million persons within a 50-mile radius. The property includes a one mile all-weather thoroughbred racetrack and a 7/8-mile turf track. The property also includes approximately 400 acres surrounding the Thoroughbred Track which are available for future expansion or development.

The Thoroughbred Track's main building is the grandstand/clubhouse, which is completely enclosed and heated and, at the clubhouse level, fully air-conditioned. The building has a capacity of approximately 15,000 persons with seating for approximately 9,000, including 1,400 clubhouse dining seats. Several other dining facilities and numerous food and beverage stands are situated throughout the facility. Television sets for viewing live racing and simulcasts are located throughout the facility. The pari-mutuel wagering areas are divided between those available for on-track wagering and those available for simulcast wagering.

The Thoroughbred Track includes stables for approximately 1,250 horses, a blacksmith shop, veterinarians' quarters, jockeys' quarters, a paddock building, living quarters for grooms, a cafeteria and recreational building in the back stretch area and water and sewage treatment plants. Parking facilities for approximately 6,500 vehicles adjoin the Thoroughbred Track.

Harness Track

The Harness Track is located on approximately 400 acres in Plains Township, outside Wilkes-Barre, Pennsylvania. There is a total population of approximately 785,000 persons within a radius of approximately 35 miles around the Harness Track and approximately 1.5 million persons within a 50-mile radius. The property includes a 5/8-mile all-weather, lighted harness track. The Harness Track's main buildings are the grandstand and the clubhouse. The clubhouse is completely enclosed and heated and fully air-conditioned. The grandstand has enclosed, heated and air-conditioned seating for approximately 500 persons and permanent open-air stadium-style seating for approximately 2,500 persons. The clubhouse is a tiered dining and wagering facility that seats approximately 1,000 persons. The clubhouse dining area seats 500 persons. Television sets for viewing live racing and simulcasts are located throughout the facility along with pari-mutuel wagering areas.

A two-story 14,000 square foot building which houses the Pocono Downs offices is located on the property. The Harness Track

also includes stables for approximately 950 horses, five paddock stables, quarters for grooms, two blacksmith shops and a cafeteria for the Harness Horsemen. Parking facilities for approximately 5,000 vehicles adjoin the track.

As a result of the Pocono Downs Acquisition, the Company owns a solid waste landfill (the "Landfill") located outside Wilkes-Barre, Pennsylvania. The Landfill is on a parcel of land adjacent to the Harness Track. The Landfill was operated by the East Side Landfill Authority (the "Landfill Authority") from 1970 until 1982, disposed of municipal waste on behalf of four municipalities. The Landfill is currently subject to a closure order issued by the Pennsylvania Department of Environmental Resources. According to the Company's environmental consulting firm, the Landfill closure is substantially complete. To date, the municipalities obligated to implement the closure order pursuant to the Settlement Agreement, have been fulfilling their obligations. However, there can be no assurance that the municipalities will continue to meet their obligations under the Settlement Agreement or that the terms of the Settlement Agreement will not be amended in the future. In addition, the Company may be liable for future claims with respect to the Landfill under the Comprehensive Environmental Response Compensation and Liability Act and analogous state laws. The Company may incur expenses in connection with the Landfill in the future, which expenses may not be reimbursed by the municipalities. Any such expenses could have a material adverse effect on the Company's business, financial condition and results of operations.

Charles Town Facility

The Charles Town Facility is located on a portion of a 250-acre parcel in Charles Town, West Virginia, which is approximately a 60-minute drive from Baltimore, Maryland and a 70-minute drive from Washington, D.C. There is a total population of approximately 3.1 million persons within a 50-mile radius and approximately 9.0 million persons within a 100-mile radius of the Charles Town Facility. The property includes a 3/4-mile thoroughbred racetrack. The Charles Town Facility's main building is the grandstand/clubhouse, which is completely enclosed and heated. The clubhouse dining room has seating for 600. Additional food and beverage areas are situated throughout the facility. The property surrounding the Charles Town Facility, including the site of the former Shenandoah Downs Racetrack, is available for future expansion or development. In addition, the Company has a right of first refusal for an additional 250 acres that are adjacent to the Charles Town Facility.

The Charles Town Facility also includes stables, an indoor paddock, ample parking and water and sewage treatment facilities.

OTWs

The Company's OTWs provide areas for viewing import simulcasts and televised sporting events, placing pari-mutuel wagers and dining. The facilities also provide convenient parking.

The Company's current OTW properties are described in the following chart:

LOCATION	OWNED OR LEASED
Allentown	Owned
Chambersburg	Leased
Erie	Owned
Lancaster	Leased
Reading	Leased
York	Leased
Williamsport	Owned

The Company has an agreement to purchase land for its proposed Downingtown OTW facility. The agreement is subject to numerous contingencies including approval from the Pennsylvania State Horse Racing Commission. On March 26, 1996, the Company submitted an application to the Pennsylvania State Horse Racing Commission which was amended on December 31, 1996, for approval of the Downingtown OTW facility. The Pennsylvania State Horse Racing Commission has scheduled a public hearing on April 7, 1997.

Other Property and Equipment

The Company currently leases 2,100 square feet of office space in an office building in Wyomissing, Pennsylvania for the Company's executive offices. The lease is for a five-year term expiring April 2000 with an annual minimum rental of $23,320. The office building is owned by an affiliate of Peter M. Carlino.

The Company considers its properties adequate for its present purposes. In addition to the anticipated openings of the Williamsport and Downingtown OTWs, the Company intends to open three additional OTWs for which sites have not been selected. The Company believes, but cannot assure, that suitable sites will be available on satisfactory terms.

EMPLOYEES AND LABOR RELATIONS

At March 18, 1997, the Company had 1,183 permanent employees, of whom 389 were full-time and 794 part-time. Of the total 1,183 employees, 476 were employed at the Thoroughbred Track, 191 were employed at the Harness Track and 516 were employed at the Company's OTWs. Employees of the Company who work in the admissions department and pari-mutuels department at the Thoroughbred Track, the Harness Track and the OTWs are represented under collective bargaining agreements between the Company and Sports Arena Employees' Union Local 137. The agreements extend until October 3, 1999 for track employees and until May 20, 1998 for OTW employees. The Company believes that its relations with its employees are satisfactory.

During the 1996 racing season at the Charles Town Facility, there were approximately 113 full-time and 215 part-time employees. Charles Town employees who work as pari-mutuel clerks were represented under a collective bargaining agreement between Charles Town and the West Virginia Union of Mutuel Clerks, Local No. 553. The agreement expired December 31, 1996, and was extended one year until December 31, 1997.

ITEM 3 LEGAL PROCEEDINGS

On December 11, 1996, GTECH commenced an action in the United States District Court for the Northern District of West Virginia against Charles Town, the Company, Penn National Gaming of West Virginia, Inc. (a wholly-owned subsidiary of the Company) and Bryant. The complaint filed by GTECH alleges that Charles Town and AmTote were parties to the October 20, 1994 AmTote Agreement, pursuant to which AmTote was granted an exclusive right to install and operate a "video lottery system" at the Charles Town Facility. When the AmTote Agreement was executed, AmTote was a subsidiary of GTECH; GTECH has since divested itself of AmTote, but is purportedly the assignee of certain of AmTote's rights under the AmTote Agreement pursuant to an assignment and assumption agreement dated February 22, 1996. The complaint seeks (i) preliminary and permanent injunctive relief enjoining Charles Town, Bryant, the Company and its subsidiary from consummating the Charles Town Acquisition or any similar transaction unless the purchasing party explicitly accepts and assumes the AmTote Agreement, (ii) a declaratory judgment that the AmTote Agreement is valid and binding, that GTECH has the right to be the exclusive installer, operator, provider and servicer of a video lottery system at the Charles Town Facility, and that any party buying the stock or assets of Charles Town must accept and assume the AmTote Agreement and recognize such rights of GTECH thereunder, (iii) compensatory damages, (iv) legal fees and costs and (v) such other further legal and equitable relief as the court deems just and appropriate. On December 23, 1996, the court denied GTECH's motion preliminarily to enjoin the Company from consummating the Charles Town Acquisition unless it accepted and assumed the AmTote Agreement. The court noted that GTECH may pursue its claim for damages and, if warranted, pursue other injunctive relief in the future. The Company consummated the Charles Town Acquisition on January 15, 1997, at which time Charles Town assigned to the Charles Town Joint Venture all legally valid and binding obligations, if any, under the AmTote Agreement. In addition, the Company has agreed to indemnify Charles Town for any damages Charles Town may suffer as a result of a claim that Charles Town failed to fulfill its obligations under the AmTote Agreement. On January 13, 1997, Charles Town filed a motion to dismiss GTECH's complaint. As of March 18, 1997, the court had not yet ruled on this motion. The Company believes the allegations of the complaint to be without merit and intends to contest the action vigorously.

ITEM 4 SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None

PART II

ITEM 5 MARKET FOR THE REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

The Company's Common Stock is quoted on The NASDAQ National Market under the symbol "PENN." The following table sets forth for the periods indicated the high and low sales prices per share of the Company's Common Stock as reported on The NASDAQ National Market since the date on which the Common Stock commenced trading.

	HIGH	LOW
1994		
Second Quarter (May 25 through June 30, 1994).....	$3.458	$2.333
Third Quarter.....	3.167	2.396
Fourth Quarter.....	2.667	2.083
1995		
First Quarter.....	2.917	2.250
Second Quarter.....	5.125	2.500
Third Quarter.....	6.833	4.417
Fourth Quarter.....	6.458	4.167
1996		
First Quarter.....	6.000	4.292
Second Quarter.....	14.500	5.875
Third Quarter.....	15.625	9.000
Fourth Quarter.....	21.375	13.750

The closing sale price per share of Common Stock on The NASDAQ National Market on March 18, 1997, was $16.00. As of March 18, 1997, there were 402 holders of record of Common Stock.

DIVIDEND POLICY

Since the Company's initial public offering of Common Stock in May 1994, the Company has not paid any cash dividends on its Common Stock. The Company intends to retain all of its earnings to finance the development of the Company's business, and thus, does not anticipate paying cash dividends on its Common Stock for the foreseeable future. Payment of any cash dividends in the future will be at the discretion of the Company's Board of Directors and will depend upon, among other things, future earnings, operations, capital requirements, the general financial condition of the Company and general business conditions. Moreover, the Credit Facility prohibits the Company from authorizing, declaring or paying any dividends until the Company's commitments under the Credit Facility have been terminated and all amounts outstanding thereunder have been repaid. In addition, future bank financing may prohibit the payment of dividends under certain conditions.

ITEM 6 SELECTED CONSOLIDATED FINANCIAL DATA

The following selected consolidated financial data of the Company for the years ended December 31, 1996, 1995, 1994, 1993 and 1992, except for Other Data, are derived from financial statements that have been audited by BDO Seidman, LLP independent certified public accountants, adjusted as described in the notes below. The selected consolidated financial data should be read in conjunction with the Consolidated Financial Statements, and Notes related thereto, "Management's Discussion and Analysis of Financial Condition and Results of Operations" and other financial information included herein. All shares and earnings per share have been adjusted for the three-for-two and two-for-one stock splits declared and paid in 1996.

	Year Ended December 31,				
	1996	1995	1994	1993(1)	1992(1)
	(In thousands, except share and per share data)				
Income Statement Data:					
Pari-mutuel revenues					
Penn National races	$18,727	$21,376	$23,428	$29,224	$31,967
Import simulcasting	32,992	27,254	16,968	9,162	5,764
Export simulcasting	3,347	2,142	1,187	383	306
Admissions, programs and other racing revenues	4,379	3,704	2,563	2,485	2,502
Concession revenues	3,389	3,200	1,885	1,410	1,285
Total revenues	62,834	57,676	46,031	42,664	41,824
Operating expenses					
Purses, stakes and trophies	12,874	12,091	10,674	9,719	9,581
Direct salaries, payroll taxes and employee benefits	8,669	7,699	6,707	6,394	5,939
Simulcast expenses	9,215	9,084	8,892	10,136	10,403
Pari-mutuel taxes	5,356	4,963	4,054	3,568	3,504
Other direct meeting expenses	9,583	8,214	6,375	6,046	5,835
OTW concession expenses	2,451	2,221	1,231	806	541
Management fees paid to related entity	--	--	345	1,208	1,366
Other operating expenses	5,226	5,149	3,329	2,331	2,354
Total operating expenses	53,374	49,421	41,607	40,208	39,523
Income from operations	9,460	8,255	4,424	2,456	2,301
Other income (expenses)					
Interest income (expense), net	(156)	198	(340)	(962)	(917)
Other	--	10	15	6	56
Total other income (expenses)	(156)	208	(325)	(956)	(861)
Income before income taxes and extraordinary item	9,304	8,463	4,099	1,500	1,440
Taxes on income	3,794	3,467	1,381	42	150
Income before extraordinary item	5,510	4,996	2,718	1,458	1,290
Extraordinary item	--	--	115	--	--
Net income	$ 5,510	$4,996	$2,603	$1,458	$1,290
Net income per share	$ .39	$ .38			
Supplemental Pro Forma Net Income Statement Data (2):					
Supplemental pro forma net income			$2,724	$1,819	
Supplemental pro forma net income per share			$ 0.22	$ 0.15	
Weighted average number of common shares outstanding	14,020,000	13,104,000	12,663,000	12,249,000(3)	

SELECTED CONSOLIDATED FINANCIAL DATA - (Continued)

	Year Ended December 31,				
	1996	1995	1994	1993 (1)	1992 (1)
	(In thousands, except attendance data)				
Other Data: (Unaudited)					
Total paid attendance (4)	1,088,621	1,051,803	848,482	799,625	785,569
Pari-mutuel wagering					
Penn National races	$ 89,327	$102,145	$111,248	$138,939	$153,332
Import simulcasting	170,814	142,499	93,461	58,252	42,159
Export simulcasting	112,871	72,252	40,337	12,746	10,202
Total pari-mutuel wagering	$373,012	$316,896	$245,046	$209,937	$205,693
Gross profit from wagering (5)	$ 27,955	$ 24,915	$ 7,963	$ 15,346	$ 14,549

	December 31,				
	1996	1995	1994	1993	1992
Balance Sheet Data:	(In thousands)				
Cash	$ 5,634	$ 7,514	$ 5,502	$ 1,002	$ 937
Working capital (deficiency)	(509)	4,134	2,074	(4,549)	(4,700)
Total assets	96,723	27,532	21,873	18,373	18,071
Total debt	47,517	390	516	10,422	11,716
Shareholders' equity	27,881	20,802	15,627	3,418	2,516

(1) The Consolidated Financial Statements of the Company include entities which, prior to a reorganization which occurred in 1994 shortly before the Company's initial public offering (the "Reorganization"), were affiliated through common ownership and control.

(2) Supplemental pro forma amounts for the years ended December 31, 1994 and 1993 reflect (i) the elimination of $345,000 and $1,208,000, respectively, in management fees paid to a related entity, (ii) the inclusion of $133,000 and $320,000, respectively, in executive compensation, (iii) the elimination of $413,000 and $946,000 , respectively, of interest expenses on Company debt which was repaid with the proceeds of the initial public offering in 1994, (iv) the elimination of $198,000 and $0, respectively, of loss on early extinguishment of debt, and (v) a provision for income taxes of $377,000 and $701,000, respectively, as if the S corporations and partnerships comprising part of the Company prior to the Reorganization in 1994 had been taxed as C corporations. There were no supplemental pro forma adjustments for any subsequent periods.

(3) Based on 8,400,000 shares of Common Stock outstanding before the initial public offering in May 1994, plus 4,500,000 shares sold by the Company in the initial public offering.

(4) Does not reflect attendance at the Thoroughbred Track for wagering on simulcasts when live racing is not conducted, but does reflect attendance at the Reading, Chambersburg, York and Lancaster OTWs, which opened in May 1992, April 1994, March 1995 and July 1996, respectively.

(5) Amounts equal total pari-mutuel revenues, less purses paid to Horsemen, taxes payable to Pennsylvania, and simulcast commissions or host track fees paid to other racetracks.

ITEM 7 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

GENERAL

Penn National's pari-mutuel revenues are comprised of (i) wagering on Penn National races at the Thoroughbred and Harness Tracks, Penn National's OTWs, other Pennsylvania racetracks and OTWs and through Telebet, as well as wagering at the Thoroughbred and Harness Tracks on certain stakes races run at out-of-state racetracks (referred to in the Company's financial statements as "pari-mutuel revenues from Penn National races"), (ii) wagering on full cards of import simulcast races at the Thoroughbred and Harness Tracks, Penn National's OTWs and through Telebet (referred to in the Company's financial statements as "pari-mutuel revenues from import simulcasting") and (iii) fees from wagering on export simulcasting Penn National races at out-of-state locations (referred to in the Company's financial statements as "pari-mutuel revenues from export simulcasting"). Penn National's other revenues are comprised of admissions, program sales and certain other ancillary activities and food and beverage sales and concessions. All revenues and expenses derived from the Harness Track and from the Pocono OTWs are only included from the date of the Pocono Downs Acquisition (November 28, 1996).

The amount of revenue to Penn National from a wager depends upon where the race is run and where the wagering takes place. Pari-mutuel revenues from Penn National races and import simulcasting of out-of-state races consist of the total amount wagered, less the amount paid as winning wagers. Pari-mutuel revenues from wagering at the Thoroughbred and Harness Tracks or Penn National's OTWs on import simulcasting from other Pennsylvania racetracks consists of the total amount wagered, less the amounts paid as winning wagers, amounts payable to the host racetrack and pari-mutuel taxes to Pennsylvania. Pari-mutuel revenues from export simulcasting consists of amounts payable to Penn National by the out-of-state racetracks with respect to wagering on live races at the Thoroughbred and Harness Tracks.

Operating expenses include purses payable to the horsemen, commissions to other racetracks with respect to wagering at their facilities on races at the Thoroughbred and Harness Tracks, pari-mutuel taxes on Penn National races and export simulcasting and other direct and indirect operating expenses.

The Pennsylvania Race Horse Industry Reform Act specifies the maximum percentages of each dollar wagered on horse races in Pennsylvania which may be retained by Penn National (prior to required payments to the horsemen and applicable taxing authorities). The percentages vary, based on the type of wager; however, the average percentage is approximately 20%. The balance of each dollar wagered must be paid out as winning wagers. With the exception of revenues derived from wagers at the Thoroughbred and Harness Tracks or the Penn National OTWs, Penn National's revenues on each race are determined pursuant to such maximum percentage and agreements with the other racetracks and OTWs at which wagering is taking place. Amounts payable to the horsemen are determined under agreements with the horsemen and vary depending upon where the wagering is conducted and the racetrack at which such races take place. The horsemen receive their share of such wagering as race purses. Penn National retains a higher percentage of wagers made at its own facilities than of wagers made at other locations. See "Business -- Purses; Agreements with Horsemen."

RESULTS OF OPERATIONS

The following table sets forth certain data from the Consolidated Statements of Income of the Company as a percentage of total revenues:

	Year Ended December 31,		
	1996	1995	1994
Revenues			
Pari-mutuel revenues			
Penn National races	29.8%	37.1%	50.9%
Import simulcasting	52.5	47.3	36.9
Export simulcasting	5.3	3.7	2.6
Admissions, programs and other racing revenues	7.0	6.4	5.5
Concession revenues	5.4	5.5	4.1
Total revenues	100.0	100.0	100.0
Operating expenses			
Purses, stakes and trophies	20.5	21.0	23.2
Direct salaries, payroll taxes and employee benefits	13.8	13.3	14.6
Simulcast expenses	14.7	15.8	19.3
Pari-mutuel taxes	8.5	8.6	8.8
Other direct meeting expenses	15.3	14.2	13.8
OTW concession expenses	3.9	3.9	2.7
Management fees paid to related entity	--	--	0.8
Other operating expenses	8.3	8.9	7.2
Total operating expenses	84.9	85.7	90.4
Income from operations	15.1	14.3	9.6
Other income (expenses)			
Interest income (expense), net	(0.2)	0.4	(0.7)
Other	--	--	--
	--	--	--
Total other income (expenses)	(0.2)	0.4	(0.7)
Income before income taxes and extraordinary item	14.9	14.7	8.9
Net income	8.8	8.7	5.7

Year Ended December 31, 1996 Compared to Year Ended December 31, 1995

Total revenues increased by approximately $5.1 million or 8.9% from $57.7 million in 1995 to $62.8 million in 1996. The increase was attributable to an increase in import and export simulcasting revenues, offset in part by a decrease in pari-mutuel revenues on Penn National races. The increases in pari-mutuel revenue from import simulcasting, admissions, programs and other racing revenues and concession revenue were due primarily to operating the York OTW facility for twelve months in 1996 compared to nine months in 1995, the opening of the Lancaster OTW facility in July of 1996, and the additional revenue from

the Pocono Downs Acquisition since November 28, 1996. The increase in export simulcasting revenue of $1.2 million or 56.3% from $2.1 million to $3.3 million resulted from the marketing of Penn National races to additional out-of-state locations. The decrease in pari-mutuel revenues on Penn National races was due to increased import simulcasting revenue form wagering on other racetracks at Company facilities and inclement winter weather conditions throughout the state of Pennsylvania during the first quarter. For the year, Penn National was scheduled to run 217 live race days but canceled eleven in the first quarter due to weather. In 1995, Penn National ran 204 live race days and had six cancellations.

Total operating expenses increased by approximately $4.0 million or 8.0% from $49.4 million in 1995 to $53.4 million in 1996. The increase in operating expenses resulted from a full year of operations for the York OTW compared to nine months in 1995, six months of operating expenses for the new Lancaster OTW, one month of operating expenses at Pocono Downs and the expansion of the corporate staff and office facility at Wyomissing in June of 1995.

Income from operations increased by approximately $1.2 million or 14.6% from $8.3 million in 1995 to $9.5 million in 1996 due to the factors described above.

The Company had other operating expenses of $156,000 in 1996 compared to other operating income of $208,000 in 1995, primarily as a result of increased interest expense. The increase in interest expense is due to the company incurring bank debt of $47 million on November 27, 1996 for the purchase of Pocono Downs.

Net income increased 10.3% or $514,000 from $5.0 million in 1995 to $5.5 million in 1996 reflecting the factors described above. Income tax expense increased from $3.5 million to $3.8 million due to the increase in income for the year.

Year Ended December 31, 1995 Compared to Year Ended December 31, 1994

Total revenues increased by approximately $11.6 million or 25.3% from $46.0 million to $57.7 million in 1995. This increase was primarily attributable to an increase in import and export simulcasting revenues, admissions, programs and other racing revenues and concession revenues. The increase in revenues resulted from a full year of operations at the Chambersburg OTW compared to eight months of operations in 1994, the opening of the York OTW in March 1995, and an increase of approximately $955,000 or 80.5% from $1.2 million to $2.1 million in export simulcasting revenues due to Penn National races being broadcast to additional out-of-state locations. The decrease in pari-mutuel revenues from live races at the Thoroughbred Track was due to the decrease in the number of live race days from 219 race days in 1994 to 204 race days in 1995.

Total operating expenses increased by approximately $7.8 million or 18.8% from $41.6 million to $49.4 million in 1995. The increase in operating expenses resulted from a full year of operations at the Chambersburg OTW, the opening of the York OTW and the expansion of the corporate staff and office facility in Wyomissing. The decrease in management fees was a result of the management fees being discontinued when Penn National completed its initial public offering in 1994.

Income from operations increased by approximately $3.8 million or 86.6% from $4.4 million to $8.3 million due to the factors described above.

Total other income (expense) increased by approximately $533,000 due to the investment of available cash reserves and the decrease in interest expense as a result of repayment of all bank debt with the proceeds of Penn National's initial public offering in May 1994.

Net income increased by approximately $2.4 million or 91.9% from $2.6 million to $5.0 million reflecting the factors described above. Income tax expenses increased from $1.4 million to $3.5 million due to the increased income for the year.

LIQUIDITY AND CAPITAL RESOURCES

Historically, Penn National's primary sources of liquidity and capital resources have been cash flow from operations and borrowings from banks and related parties. During the year ended December 31, 1996, Penn National's cash position decreased by approximately $1.9 million from $7.5 million at December 31, 1995 to $5.6 million at December 31, 1996, as a result of expenditures for improvements and equipment at the Thoroughbred Track, construction of the Lancaster OTW, the start of construction of the Williamsport OTW and prepaid acquisition costs in connection with the Pocono Downs and Charles Town Acquisitions.

Net cash provided from operating activities totaled approximately $8.0 million for the year ended December 31, 1996, of which $7.2 million came from net income and non-cash expenses, which was offset by other operating activity items.

Cash flows used in investing activities for the year ended December 31, 1996 totaled approximately $55.8 million. Capital expenditures totaled $7.0 million for improvements and equipment at the Thoroughbred Track, the construction of the Lancaster OTW and the start of construction of the Williamsport OTW. Prepaid acquisition costs totaled $1.6 million for the Charles Town Acquisition. The acquisition of Pocono Downs totaled $48.2 million.

Cash flows from financing activities for the year ended December 31, 1996 totaled approximately $1.6 million from the exercise of options and warrants and the issuance of 410,290 shares of Common Stock and $47 million in proceeds from long-term debt.

At December 31, 1996, the Company was contingently obligated under letters of credit with face amounts aggregating $1,436,000. The $1,436,000 consisted of $1,336,000 relating to the horsemens' account balances and $100,000 for Pennsylvania pari-mutuel taxes.

In November 1996, the Company entered into an agreement with a bank group which provides an aggregate of $75 million of credit facilities ("Credit Facility Agreement"). Simultaneously with the closing of the Credit Facility Agreement, the Company repaid amounts outstanding under its old facility and replaced it. The credit facilities consist of two term loan facilities of $47 million and $23 million (together, the "Term Loans") which were used for the Pocono Downs and Charles Town acquisitions, respectively, and which will be used for a portion of the cost of refurbishment of the Charles Town Facility, and a revolving credit facility of $5 million (together, the "Loans"). The credit facilities mature in November 2001. The Loans are secured by substantially all of the assets of the Company. The Credit Facility Agreement provides for certain covenants, including those of a financial nature.

Funding of the first $47 million Term Loan facility took place on November 27, 1996 in conjunction with the Pocono Downs acquisition. On January 15, 1997, the Charles Town Acquisition was consummated and, in accordance with the terms of the Credit Facility Agreement, the second $23 million Term Loan was made available for utilization by the Company. The Company borrowed $16.5 million of the $23 million Term Loan on January 15, 1997.

The $5 million revolving credit facility (the "Revolving Facility") includes a $2 million sublimit for standby letters of credit for periods of up to twelve months. Up to $3 million of the Revolving Facility was made available on November 27, 1996. The remaining $2 million was made available upon completion of the Charles Town Acquisition on January 15, 1997.

At the Company's option, the Loans may be maintained from time to time as Base Rate Loans, which shall bear interest at the highest of: (1) 1/2 of 1% in excess of the federal reserve reported certificate of deposit rate, (2) the rate that the bank group announces from time to time as its prime lending rate and (3) 1/2 of 1% in excess of the federal funds rate plus an applicable margin of up to 2%. The Loans may also be maintained as Reserve Adjusted Eurodollar Loans, which bear interest at a rate tied to a eurodollar rate plus an applicable margin of up to 3%.

Mandatory repayments of the Term Loans and the Revolving Facility are required in an amount equal to a percentage of the net cash proceeds from any issuance or incurrence of equity or funded debt by the Company, that percentage to be dependent upon the then outstanding balances of the Term Loans and the Revolving Facility and the Company's leverage ratio; however, the Credit Facility Agreement, as amended, permitted the Company to retain up to the first $8 million of proceeds from an offering of the Company's equity securities. As a result of the Company's offering, the Company retained $4 million of such proceeds. Mandatory repayments of varying percentages are also required in the event of either asset sales in excess of stipulated amounts or defined excess cash flow.

In February 1997, the Company completed a second public offering which generated proceeds of approximately $23 million after payment of commissions and other offering expenses. The Company used $19 million of the proceeds to repay a portion of the company's bank debt. The remaining amount of approximately $4 million will be used to finance the refurbishment of the Charles Town facility.

During 1997, the Company anticipates capital expenditures of approximately $4.0 million to construct the Downingtown OTW, approximately $3.0 million to complete the Williamsport OTW, approximately $4.0 million towards the construction of two additional OTWs and approximately $1.0 million for miscellaneous capital expenditures and improvements. Under the Credit Facility, the Company is permitted to make capital expenditures (not including the refurbishment of the Charles Town Facility or the cost of Gaming Machines) of $12.0 million in 1997, $4.0 million in 1998 and $2.0 million in 1999 and thereafter. The Company anticipates expending approximately $16.0 million on the refurbishment of the Charles Town Facility (excluding the cost of Gaming Machines).

In December 1995, the Company agreed in principle to form a joint venture to develop, manage and operate pari-mutuel racing facilities in a state other than Pennsylvania or West Virginia. The actual formation of the joint venture is subject to numerous contingencies, including receipt of regulatory approval from that state's Horse Racing Commission and approval of the Company's lenders. The Company intends to fund, if successful, the joint venture's operations through additional borrowings and the Company's working capital.

On February 26, 1996, construction began on the Lancaster OTW. The construction costs totaled approximately $2.7 million and were funded from the Company's cash reserves. The Lancaster OTW opened July 11, 1996.

On May 13, 1996, the Company loaned $400,000 to an unrelated company in Downingtown in connection with an option to acquire land upon which the Company may construct an OTW. The loan bears interest at a rate of 10% per annum and matures on May 13, 1997.

The Company currently estimates that the net proceeds of the offering, together with cash generated from operations and borrowings under the Credit Facility, will be sufficient to finance its current operations, potential obligations relating to the Acquisitions and planned capital expenditure requirements at least through 1997. There can be no assurance, however, that the Company will not be required to seek additional capital at an earlier date. The Company may, from time to time, seek additional funding through public or private financing, including equity financing. There can be no assurance that adequate funding will be available as needed or, if available, on terms acceptable to the Company. If additional funds are raised by issuing equity securities, existing shareholders may experience dilution.

EFFECT OF INCLEMENT WEATHER AND SEASONALITY

Because horse racing is conducted outdoors, variable weather contributes to the seasonality of the Company's business. Weather conditions, particularly during the winter months, may cause races to be canceled or may curtail attendance. During the year ended December 31, 1995, the Company lost six scheduled racing days due to weather conditions and during the year ended December 31, 1996, the Company lost eleven scheduled racing days due to weather conditions. Over the previous five years, the Company lost an average of four days per year due to inclement weather. Because a substantial portion of the Company's Thoroughbred Track and Harness Track expenses are fixed, the loss of scheduled racing days could have a material adverse effect on the Company's business, financial condition and results of operations.

The severe winter weather in 1996 also resulted in the closure of the Company's OTW facilities for two days in January 1996. Although weather conditions reduced attendance at OTWs, the reduction in attendance at OTWs on days when both the Thoroughbred Track and the OTWs were open was proportionately less than the reduction in attendance at the Thoroughbred Track. Because of the Company's growing dependence upon OTW operations, severe weather that causes the Company's OTWs to close could have a material adverse effect on the Company's business, financial condition and results of operations.

Attendance and wagering at the Company's facilities have been favorably affected by special racing events which stimulate interest in horse racing, such as the Triple Crown races in May and June and the Breeders' Cup in autumn. As a result, the Company's revenues and net income have been greatest in the second and third quarters of the year and lowest in the first and fourth quarters of the year.

OTHER MATTERS

During 1995, the Financial Accounting Standards Board ("FASB") adopted Statement of Financial Accounting Standards No. 121 ("SFAS 121"), "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of." The Company adopted the provisions of SFAS 121 during the year ended December 31, 1995. SFAS 121 establishes accounting standards for the impairment of long-lived assets, certain identifiable intangibles and goodwill related to those assets to be held and used and for long-lived assets and certain identifiable intangibles to be disposed of.

The Company reviews the carrying values of its long-lived and identifiable intangible assets for possible impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. Any long-lived assets held for disposal are reported at the lower of their carrying amounts or fair value less cost to sell.

During 1995, the FASB also adopted Statement of Financial Accounting Standards No. 123 ("SFAS 123"), "Accounting for Stock-Based Compensation," which has recognition provisions that establish a fair value based method of accounting for stock-based employee compensation plans and established fair value as the measurement basis for transactions in which an entity acquires goods or services from nonemployees in exchange for equity instruments. SFAS 123 also has certain disclosure provisions. Adoption of the recognition provisions of SFAS 123 with regard to these transactions with nonemployees was required for all such transactions entered into after December 15, 1995 and the Company adopted these provisions as required. The recognition provision with regard to the fair value based method of accounting for stock-based employee compensation plans is optional. Accounting Principles Board Opinion No. 25 "Accounting for Stock Issued to Employers" ("APB 25") uses what is referred to as an intrinsic value based method of accounting. The Company has decided to continue to apply APB 25, for its stock-based employee compensation arrangements. Accordingly, no compensation cost has been recognized. In accordance with SFAS 123, the Company disclosed the effects of employee stock options issued for the years ended December 31, 1996 and 1995.

On March 3, 1997, the FASB issued Statement of Financial Accounting Standards No. 128, "Earnings per Share" ("SFAS 128"). This pronouncement is effective for financial statements issued for periods ending after December 15, 1997 and provides a different method of calculating earnings per share than is currently used in accordance with APB 15, "Earning per Share". SFAS 128 provides for the calculation of "Basic" and "Diluted" earnings per share. Basic earnings per share includes no dilution and is calculated by dividing net income by the common shares outstanding for the period. Diluted earnings per share reflects the potential dilution of securities that could share in the earnings of an entity, similar to fully diluted earnings per share. The Company does not feel that the adoption of SFAS 128 will have a material effect in 1997.

ITEM 8 FINANCIAL STATEMENTS AND SUPPLEMENTAL DATA

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Report of Independent Certified Public Accountants

Penn National Gaming, Inc.
and Subsidiaries
Wyomissing, Pennsylvania

We have audited the accompanying consolidated balance sheets of Penn National Gaming, Inc. and Subsidiaries as of December 31, 1996 and 1995, and the related consolidated statements of income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 1996. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Penn National Gaming, Inc. and Subsidiaries at December 31, 1996 and 1995, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1996 in conformity with generally accepted accounting principles.

/s/ BDO SEIDMAN, LLP

BDO SEIDMAN, LLP

Philadelphia, Pennsylvania
February 25, 1997

Penn National Gaming, Inc. and Subsidiaries
Consolidated Balance Sheets
(In Thousands, Except Per Share and Share Data)

	December 31,	
	1996	1995
Assets		
Current assets		
Cash	$ 5,634	$ 7,514
Accounts receivable	4,293	1,618
Prepaid expenses and other current assets	1,552	600
Deferred income taxes	90	104
Total current assets	11,569	9,836
Property, plant and equipment, at cost		
Land and improvements	15,728	3,336
Building and improvements	30,484	8,651
Furniture, fixtures and equipment	8,937	4,696
Transportation equipment	366	309
Leasehold improvements	6,680	4,363
Leased equipment under capitalized lease	1,626	824
Construction in progress	2,926	255
	66,747	22,434
Less accumulated depreciation and amortization	8,029	6,728
Net property, plant and equipment	58,718	15,706
Other assets		
Excess of cost over fair market value of net assets acquired (net of accumulated amortization of $811 and $713, respectively)	21,885	1,898
Prepaid acquisition costs	1,764	--
Deferred financing costs	2,416	--
Miscellaneous	371	92
Total other assets	26,436	1,990
	$96,723	$27,532

See accompanying summary of significant accounting policies and notes to consolidated financial statements.

Penn National Gaming, Inc. and Subsidiaries
Consolidated Balance Sheets
(In Thousands, Except Per Share and Share Data)

	December 31,	
	1996	1995
Liabilities and Shareholders' Equity		
Current liabilities		
Current maturities of long-term debt and capital lease obligations	$ 1,563	$ 250
Accounts payable	5,066	1,395
Purses due horsemen	1,421	1,293
Uncashed pari-mutuel tickets	1,336	704
Accrued expenses	1,880	702
Customer deposits	420	315
Income taxes	--	797
Taxes, other than income taxes	392	246
Total current liabilities	12,078	5,702
Long-term liabilities		
Long-term debt and capital lease obligations, net of current maturities	45,954	140
Deferred income taxes	10,810	888
Total long-term liabilities	56,764	1,028
Commitments and contingencies		
Shareholders' equity		
Preferred stock, $.01 par value Authorized 1,000,000 shares Issued none	--	--
Common stock, $.01 par value Authorized 20,000,000 shares Issued and outstanding 13,355,290 and 12,945,000, respectively	134	43
Additional paid-in capital	14,299	12,821
Retained earnings	13,448	7,938
Total shareholders' equity	27,881	20,802
	$96,723	$27,532

See accompanying summary of significant accounting policies and notes to consolidated financial statements.

Penn National Gaming, Inc. and Subsidiaries
Consolidated Statements of Income
(In Thousands, Except Per Share Data)

	Year ended December 31,		
	1996	1995	1994
Revenues			
Pari-mutuel revenues			
Penn National races	$18,727	$21,376	$23,428
Import simulcasting	32,992	27,254	16,968
Export simulcasting	3,347	2,142	1,187
Admissions, programs and other racing revenues	4,379	3,704	2,563
Concession revenues	3,389	3,200	1,885
Total revenues	62,834	57,676	46,031
Operating expenses			
Purses, stakes and trophies	12,874	12,091	10,674
Direct salaries, payroll taxes and employee benefits	8,669	7,699	6,707
Simulcast expenses	9,215	9,084	8,892
Pari-mutuel taxes	5,356	4,963	4,054
Other direct meeting expenses	9,583	8,214	6,375
Off-track wagering concession expenses	2,451	2,221	1,231
Management fees paid to related party	--	--	345
Other operating expenses	5,226	5,149	3,329
Total operating expenses	53,374	49,421	41,607
Income from operations	9,460	8,255	4,424
Other income (expenses)			
Interest (expense)	(506)	(71)	(465)
Interest income	350	269	125
Other	--	10	15
Total other income (expense)	(156)	208	(325)

Penn National Gaming, Inc. and Subsidiaries
Consolidated Statements of Income
(In Thousands, Except Per Share Data)

	Year ended December 31,		
	1996	1995	1994
Income before income taxes and extraordinary item	$ 9,304	$ 8,463	$ 4,099
Taxes on income	3,794	3,467	1,381
Income before extraordinary item	5,510	4,996	2,718
Extraordinary item			
Loss on early extinguishment of debt, net of income taxes of $83	--	--	115
Net income	$ 5,510	$ 4,996	$ 2,603
Net income per share	$ .39	$ .38	
Supplemental pro forma			
Historical net income before taxes on income			$ 4,099
Supplemental pro forma adjustments			625
Supplemental pro forma income before taxes on income			4,724
Supplemental pro forma taxes on income			2,000
Supplemental pro forma net income			$ 2,724
Supplemental pro forma net income per share			$ .22
Weighted average common shares outstanding	14,020	13,104	12,663

See accompanying summary of significant accounting policies and notes to consolidated financial statements.

Penn National Gaming, Inc. and Subsidiaries
Consolidated Statements of Shareholders' Equity
(In Thousands, Except Share Data)

	Common Stock		Additional Paid-In	Retained	
	Shares	Amount	Capital	Earnings	Total
Balance, January 1, 1994	8,400,000	$ 28	$ 2	$ 3,388	$ 3,418
Deferred income taxes of S corporations and partnerships	--	--	(302)	--	(302)
Distributions to stockholders	--	--	--	(3,049)	(3,049)
Issuance of common stock	4,500,000	15	12,942	--	12,957
Net income for the year ended December 31, 1994	--	--	--	2,603	2,603
Balance, December 31, 1994	12,900,000	43	12,642	2,942	15,627
Issuance of common stock	45,000	--	179	--	179
Net income for the year ended December 31, 1995	--	--	--	4,996	4,996
Balance, December 31, 1995	12,945,000	43	12,821	7,938	20,802
Issuance of common stock	410,290	4	1,565	--	1,569
Stock splits	--	87	(87)	--	--
Net income for the year ended December 31, 1996	--	--	--	5,510	5,510
Balance, December 31, 1996	13,355,290	$ 134	$ 14,299	$ 13,448	$ 27,881

See accompanying summary of significant accounting policies and notes to consolidated financial statements.

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

	Year ended December 31,		
	1996	1995	1994
Cash flows from operating activities			
Net income	$ 5,510	$ 4,996	$ 2,603
Adjustments to reconcile net income to net cash provided by operating activities			
Depreciation and amortization	1,433	881	699
Extraordinary loss related to early extinguishment of debt, before income tax benefit	--	--	198
Deferred income taxes	228	20	493
Decrease (increase) in			
Accounts receivable	(1,870)	(362)	(309)
Prepaid expenses and other current assets	871	(158)	(60)
Miscellaneous other assets	(255)	5	(56)
Increase (decrease) in			
Accounts payable	1,288	(15)	(228)
Purses due horsemen	(248)	297	85
Uncashed pari-mutuel tickets	632	184	(12)
Accrued expenses	1,092	(376)	196
Customer deposits	105	16	(10)
Taxes other than income taxes	146	239	(147)
Income taxes	(985)	190	607
Net cash provided by operating activities	7,947	5,917	4,059
Cash flows from investing activities			
Expenditures for property and equipment	(6,995)	(3,958)	(2,852)
(Increase) in advances to related parties	--	--	(3,688)
(Increase) in prepaid acquisition costs	(1,514)	--	--
Acquisition of business, net of cash acquired	(47,320)	--	--
Net cash (used in) provided by investing activities	(55,829)	(3,958)	836

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

	Year ended December 31,		
	1996	1995	1994
Cash flows from financing activities			
Proceeds from sale of common stock	$ 1,569	$ 179	$12,957
Principal payments on notes payable, banks	--	--	(1,289)
Proceeds from notes payable, related party	--	--	178
Principal payments on notes payable, related party	--	--	(361)
Proceeds of long-term debt	47,000	--	800
Principal payments on long-term debt and capitalized lease obligations	(123)	(126)	(9,433)
Increase in unamortized financing cost	(2,444)	--	(182)
Distributions to shareholders	--	--	(3,049)
(Decrease) in advances from related parties	--	--	(16)
Net cash provided by (used in) financing activities	46,002	53	(395)
Net (decrease) increase in cash	(1,880)	2,012	4,500
Cash, at beginning of year	7,514	5,502	1,002
Cash, at end of year	$ 5,634	$7,514	$ 5,502

See accompanying summary of significant accounting policies and notes to consolidated financial statements.

1. Summary of Significant Accounting Policies

Principles of Consolidation and Reorganization

The consolidated financial statements include the following entities of Penn National Gaming, Inc. prior to the reorganization, as described below, and which were affiliated through common ownership and control.

Mountainview Thoroughbred Racing Association ("Mountainview")
Pennsylvania National Turf Club, Inc. ("Turf Club")
PNRC Reading, Inc. (An S Corporation)
PNRC Chambersburg, Inc. (An S Corporation)
PNRC Limited Partnership
Carlino Family Partnership
Penn National Gaming, Inc.,
formerly called PNRC Corp. (An S Corporation)

The consolidated financial statements for the periods prior to the reorganization have been prepared as if the entities had operated as a single consolidated group assuming that the reorganization had taken place. After the reorganization and the current year's business acquisition (see Note 2), the consolidated financial statements include the accounts of Penn National Gaming, Inc. and its wholly owned subsidiaries (collectively referred to as the "Company"). All significant intercompany accounts and transactions have been eliminated in consolidation.

Reorganization

The Company completed an initial public offering on May 25, 1994 by selling 4,500,000 shares of its common stock.

On April 11, 1994, the Company entered into an agreement and plan of reorganization, pursuant to which, on May 24, 1994: (1) Penn National Gaming, Inc. ("Parent") acquired all of the outstanding stock of Mountainview, Turf Club, PNRC Reading, Inc. and PNRC Chambersburg, Inc., (2) Penn National Gaming, Inc. acquired the limited partners' interests in PNRC Limited Partnership and all of the partnership interests in Carlino Family Partnership, and these partnerships were liquidated into the Company. In exchange for the stock and assets acquired in the transactions, the Company issued 8,400,000 shares of its common stock. Pursuant to the reorganization, Turf Club, Mountainview, PNRC Reading, Inc. and PNRC Chambersburg, Inc. became wholly-owned subsidiaries of the Parent. Subsequent to the

reorganization, the Company merged PNRC Reading, Inc. and PNRC Chambersburg, Inc. into Mountainview in accordance with a statutory merger, leaving Turf Club and Mountainview as the only subsidiaries of the Company.

The transaction was treated similar to a pooling of interests and the exchange of stock and partnership interests was a tax-free exchange.

Description of Business

The Company, which began operations in 1972, provides pari-mutuel wagering opportunities on both live and simulcast thoroughbred and harness horse races at two racetracks and six off-track wagering facilities ("OTWs") located principally in Eastern and Central Pennsylvania. Prior to the consummation of the acquisition of Pocono Downs (see Note 2), the Company owned and operated Penn National Race Course located outside Harrisburg, Pennsylvania (the "Thoroughbred Track"), and four OTWs in Chambersburg, Lancaster, Reading and York, Pennsylvania. On November 27, 1996, the Company consummated the Pocono Downs Acquisition, and as a result acquired Pocono Downs Racetrack, located near Wilkes-Barre, Pennsylvania (the "Harness Track"), and OTWs in Allentown and Erie, Pennsylvania.

On January 15, 1997, a joint venture, in which the Company has reached an agreement to hold an 89% interest, acquired substantially all of the assets relating to Charles Town Races, a thoroughbred racing facility in Jefferson County, West Virginia (see Note 2). The Company expects to refurbish the Charles Town facility as an entertainment complex that will feature gaming machines, live racing, dining and simulcast wagering.

The Company conducts wagering at its tracks and its OTWs on thoroughbred and harness races which it runs at its tracks and on thoroughbred and harness races simulcast from other racetracks. The Company also simulcasts its races for wagering at other racetracks and OTWs, including all Pennsylvania racetracks and OTWs and locations outside Pennsylvania. Wagering on Company races and races simulcast from other racetracks also occurs through the Company's telephone account betting network.

Glossary of Terminology

The following is a listing of terminology used throughout the financial statements:

The Company's Racetracks	--	The Thoroughbred Track in Grantville, Pennsylvania and the Harness Track near Wilkes-Barre, Pennsylvania (See Note 2)
OTW	--	Off-track wagering location.
Pari-mutuel wagering	--	All wagering at the Company's racetracks and OTWs and all wagering on Penn National races at other racetracks and their OTWs.
Telebet	--	Telephone account wagering.
Totalisator Services	--	Computer services provided to the Company by Autotote Enterprises, Inc. for processing pari-mutuel betting odds and wagering proceeds.

Pari-mutuel Revenues:

Penn National Races	--	The Company's share of pari-mutuel wagering on races at the Company's racetracks within Pennsylvania and certain stakes races from racetracks outside of Pennsylvania after payment of the amount returned as winning wagers.
Import Simulcasting	--	Company's share of wagering at the Company's racetracks and OTWs and by Telebet on full cards of races simulcast from other racetracks.
Export Simulcasting	--	Company's share of wagering at out-of-state locations on Penn National Races.

A summary of pari-mutuel wagering for the periods indicated is as follows:

	Year Ended December 31,		
	1996	1995	1994
	(In Thousands)		
Pari-mutuel wagering in Pennsylvania on Penn National races	$ 89,327	$102,145	$111,248
Pari-mutuel wagering on simulcasting			
Import simulcasting from other Pennsylvania race tracks	24,780	29,159	28,622
Import simulcasting from out of Pennsylvania race tracks	146,034	113,340	64,839
Export simulcasting to out of Pennsylvania wagering facilities	112,871	72,252	40,337
	283,685	214,751	133,798
Total pari-mutuel wagering	$373,012	$316,896	$245,046

Racing Meet

The Company's racing seasons for the years ended December 31, 1996, 1995 and 1994 totaled 206, 204 and 219 live race days, respectively.

Depreciation and Amortization

Depreciation of property and equipment and amortization of leasehold improvements are computed by the straight-line method at rates adequate to allocate the cost of the applicable assets over their estimated useful lives. Depreciation and amortization for the years ended December 31, 1996, 1995 and 1994 amounted to $1,301,000, $814,000 and $612,000, respectively.

The excess of cost over fair value of net assets acquired is being amortized on the straight-line method over a forty year period. Amortization expense for 1996, 1995 and 1994 amounted to $98,000, $67,000 and $67,000, respectively. The Company evaluates the recoverability of the goodwill quarterly, or more frequently whenever events and circumstances warrant revised estimates, and considers whether the goodwill should be completely or partially written off or the amortization period accelerated.

The Company adopted the provisions of Statement of Financial Accounting Standards No. 121 ("SFAS 121") "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of" during the year ended December 31, 1995. SFAS 121 establishes accounting standards for the impairment of long-lived assets, certain identifiable intangibles and goodwill related to those assets to be held and used and for long-lived assets and certain identifiable intangibles to be disposed of. The Company reviews the carrying values of its long-lived and identifiable intangible assets for possible impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable based on undiscounted estimated future operating cash flows. As of December 31, 1996, the Company has determined that no impairment has occurred.

Income Taxes

Prior to the reorganization, certain entities included within these financial statements were partnerships and "S" corporations. Therefore, no provision had been made for income taxes since such taxes, if any, were the liabilities of the individual partners and shareholders.

The Company has adopted the provisions of Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes" ("SFAS 109"). SFAS 109 requires a company to recognize deferred tax liabilities and assets for the expected future tax consequences of events that have been recognized in a

company's financial statements or tax returns. Under this method, deferred tax liabilities and assets are determined based on the difference between the financial statement carrying amounts and tax bases of assets and liabilities using enacted tax rates in effect in the years in which the differences are expected to reverse.

Cash and Cash Equivalents

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

Net Income Per Common Share

Net income and supplemental pro forma net income per share are calculated by dividing net income or supplemental pro forma net income by the weighted average number of common stock outstanding (see Note 8) adjusted by the dilutive effect of common stock equivalents, which consist of stock options (using the treasury stock method) and warrants. All net income per share calculations reflect all stock splits (see Note 10).

Deferred Financing Costs

Deferred financing costs, which were incurred by the Company in connection with the new credit facility (see Note 3), are charged to operations as additional interest expense over the life of the underlying indebtedness using the interest method adjusted to give effect to any early repayments.

Concentration of Credit Risk

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

The Company's policy is to limit the amount of credit exposure to any one financial institution and place investments with financial institutions evaluated as being creditworthy, or in short-term (less than seven days) money market and tax free bond funds which are exposed to minimal interest rate and credit risk. At December 31, 1996 and 1995, the Company had bank deposits which exceeded federally insured limits by approximately $499,000, and $248,000 respectively, and money market and tax free bond funds of approximately $2,553,000 and $6,400,000, respectively. Concentration of credit risk, with respect to accounts receivable, is limited due to the Company's credit evaluation process. The Company does not require collateral from its customers. The Company's customer base consists principally of other race tracks and OTWs. Historically, the Company has not incurred any significant credit related losses.

Fair Value of Financial Instruments

As of December 31, 1996 and 1995, the following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practical to estimate:

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

Long-Term Debt and Capital Lease Obligations: The fair value of the Company's long-term debt and capital lease obligations is estimated based on the quoted market prices for the same or similar issues or on the current rates offered to the Company for debt of the same remaining maturities. The carrying amount approximates fair value since the Company's interest rates approximate current interest rates.

Prepaid Acquisition Costs

Prepaid acquisition costs, which were incurred by the Company substantially in connection with the Charles Town Acquisition (see Note 2), will be included in the purchase price of the Charles Town Acquisition and allocated to the appropriate assets.

Use of Estimates

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

2. Acquisitions

Pocono Downs Acquisition

On November 27, 1996, the Company purchased all of the capital stock of The Plains Company and the limited partnership interests in The Plains Company's affiliated entities (together, "Pocono Downs") for an aggregate purchase price of $48.2 million plus acquisition-related fees and expenses of $730,000 (the "Pocono Downs Acquisition"). Pocono Downs conducts live harness racing at the harness racetrack located near Wilkes-Barre, Pennsylvania (the "Harness Track"), export simulcasting of Harness Track races to locations throughout the United States, pari-mutuel wagering at the Harness Track and at OTWs in Allentown and Erie, Pennsylvania on Pocono Downs races and on import simulcast races from other racetracks, and telephone account wagering on live and import simulcast races.

The Pocono Downs Acquisition was accounted for using the purchase method of accounting. Accordingly, a portion of the purchase price was allocated to the net assets acquired based on their estimated fair values. In accordance with SFAS 109, the Company recorded an additional increase to goodwill of approximately $9.7 million and a corresponding increase to a deferred tax liability, representing the difference between the financial and tax bases of certain assets acquired.

The results of operations of Pocono Downs have been included in the Company's consolidated financial statements since the effective date of the acquisition. The balance of the purchase price was recorded as cost over net assets acquired as goodwill, approximately $10.4 million, and is being amortized over forty years on a straight-line basis. The Company used its credit facility (see Note 3) and cash of Pocono Downs to fund the acquisition.

The following unaudited pro forma financial information for the Company gives effect to the Pocono Downs Acquisition as if it had taken place at the beginning of the fiscal year for each of the periods presented:

	Year ended December 31,	
	1996	1995
	(In Thousands, Except Per Share Data)	
Revenues	$93,849	$91,530
Net income	6,306	6,546
Net income per share	.45	.50
Shares used in computation	14,020	13,104

The pro forma consolidated results do not purport to be indicative of results that would have occurred had the acquisition been in effect for the periods presented, nor do they purport to be indicative of the results that will be obtained in the future.

In addition, pursuant to the terms of the purchase agreement, the Company will be required to pay the sellers of Pocono Downs an additional $10 million if, within five years after the consummation of the Pocono Downs Acquisition, Pennsylvania authorizes any additional form of gaming in which the Company may participate. The $10 million payment would be payable in annual installments of $2 million for five years, beginning on the date that the Company first offers such additional form of gaming.

Charles Town Acquisition

On February 26, 1996, the Company entered into a joint venture agreement (the "Charles Town Joint Venture") with Bryant Development Company ("Bryant"), the holder of an option to purchase substantially all of the assets of Charles Town Racing Limited Partnership and Charles Town Races, Inc. (together, "Charles Town") relating to the Charles Town Race Track and Shenandoah Downs (together, the "Charles Town Facility") in Jefferson County, West Virginia. In connection with the Charles Town Joint Venture

agreement, Bryant assigned the option to the Charles Town Joint Venture. In November 1996, the Charles Town Joint Venture and Charles Town entered into an amended and restated option agreement. On November 5, 1996, Jefferson County, West Virginia approved a referendum permitting installation of gaming machines at the Charles Town Facility. On January 15, 1997, the Charles Town Joint Venture acquired substantially all of the assets of Charles Town (the "Charles Town Acquisition") for approximately $16.5 million plus acquisition-related fees and expenses of approximately $1.6 million. Pursuant to the original operating agreement governing the Charles Town Joint Venture, the Company held an 80% ownership interest in the Charles Town Joint Venture and was obligated to contribute 80% of the purchase price of the Charles Town Acquisition and 80% of the cost of refurbishing the Charles Town Facility. In fact, the Company contributed 100% of the purchase price of the Charles Town Acquisition and expects to contribute 100% of the cost of refurbishing the Charles Town Facility. The Company has reached an agreement with Bryant, pursuant to which the parties have agreed to amend the operating agreement to increase the Company's ownership interest to 89% and decrease Bryant's ownership interest to 11%. In addition, the amendment will provide that the entire amount the Company has contributed, and will contribute, to the Charles Town Joint Venture for the acquisition and refurbish ment of the Charles Town Facility would be treated, as between the parties, as a loan to the Charles Town Joint Venture from the Company. The proposed changes in the ownership of the Charles Town Venture are subject to the review of applicable West Virginia racing and regulatory authorities. The Charles Town Acquisition was accounted for using the purchase method of accounting. Accordingly, a portion of the purchase price was allocated to the net assets acquired based on their estimated fair values.

The Charles Town Joint Venture has developed plans for the refurbishment of the Charles Town Facility as an entertainment complex that will feature live racing, dining, simulcast wagering and the installation of gaming machines; the estimated cost of the refurbishment is approximately $16 million exclusive of the costs of gaming machines.

Effective June 4, 1996, the Charles Town Joint Venture entered into a Loan and Security Agreement with Charles Town. The Loan and Security Agreement provided for a working capital line of credit in the amount of $1,250,000 and a requisite reduction of the purchase price under the option, by $1.60 for each dollar borrowed under that line. Upon consummation of the Charles Town Acquisition, Charles Town Races, Inc. repaid the loan.

3. Long-Term Debt and Capital Lease Obligations

	December 31,	
	1996	1995
	(In Thousands)	
Long-Term Debt		
Term loans payable to a bank group in quarterly installments with interest at 8.625% at December 31, 1996 and floating rates through 2001. The term loans are collateralized by substantially all of the Company's assets (see additional information below under Credit Facilities).	$47,000	$ --
Notes are payable to former minority shareholders of Pennsylvania National Turf Club, Inc. upon demand.	130	132
Note payable to Bryant Development Co., Charles Town Joint Venture partner. The note is due April 1, 1998 and accrues interest at 8%.	250	--
Capital lease obligations	137	258
	47,517	390
Less current maturities	1,563	250
	$45,954	$ 140

Credit Facilities

At December 31, 1996, the Company was contingently obligated under letters of credit with face amounts aggregating $1,436,000. The $1,436,000 consisted of $1,336,000 relating to the horsemens' account balances and $100,000 for Pennsylvania pari-mutuel taxes.

In November 1996, the Company entered into an agreement with a bank group which provides an aggregate of $75 million of credit facilities ("Credit Facility Agreement"). Simultaneously with the closing of the Credit Facility Agreement, the Company repaid amounts outstanding under its old facility and replaced it. The credit facilities consist of two term loan facilities of $47 million and $23 million (together, the "Term Loans") which were used for the Pocono Downs and Charles Town acquisitions, respectively, and which will be used for a portion of the cost of refurbishment of the Charles Town Facility, and a revolving credit facility of $5 million (together, the "Loans"). The credit facilities mature in November 2001. The Loans are secured by substantially all of the assets of the Company. The Credit Facility Agreement provides for certain covenants, including those of a financial nature.

Funding of the first $47 million Term Loan facility took place on November 27, 1996 in conjunction with the Pocono Downs acquisition. On January 15, 1997, the Charles Town Acquisition was consummated and, in accordance with the terms of the Credit Facility Agreement, the second $23 million Term Loan was made available for utilization by the Company. The Company borrowed $16.5 million of the $23 million Term Loan on January 15, 1997.

The $5 million revolving credit facility (the "Revolving Facility") includes a $2 million sublimit for standby letters of credit for periods of up to twelve months. Up to $3 million of the Revolving Facility was made available on November 27, 1996. The remaining $2 million was made available upon completion of the Charles Town Acquisition on January 15, 1997.

At the Company's option, the Loans may be maintained from time to time as Base Rate Loans, which shall bear interest at the highest of: (1) 1/2 of 1% in excess of the federal reserve reported certificate of deposit rate, (2) the rate that the bank group announces from time to time as its prime lending rate and (3) 1/2 of 1% in excess of the federal funds rate plus an applicable margin of up to 2%. The Loans may also be maintained as Reserve Adjusted Eurodollar Loans, which bear interest at a rate tied to a eurodollar rate plus an applicable margin of up to 3%.

Mandatory repayments of the Term Loans and the Revolving Facility are required in an amount equal to a percentage of the net cash proceeds from any issuance or incurrence of equity or funded debt by the Company, that percentage to be dependent upon the then outstanding balances of the Term Loans and the Revolving Facility and the Company's leverage ratio; however, the Credit Facility Agreement, as amended, permitted the Company to retain up to the first $8 million of proceeds from an offering of the Company's equity securities. Mandatory repayments of varying percentages are also required in the event of either asset sales in excess of stipulated amounts or defined excess cash flow.

Commencing on December 31, 1997 according to the Credit Facility Agreement, the Term Loans will amortize on a quarterly basis with payments thereunder to be split proportionately between the two Term Loans in annual aggregate amounts as follows (assuming the Term Loans are fully drawn):

Year	Amount
1997	$2,000,000
1998	8,000,000
1999	20,000,000
2000	20,000,000
2001	20,000,000

The following is a schedule of future minimum lease payments under capitalized leases and repayment of long-term debt, as of December 31, 1996:

December 31,	Capitalized Leases	Term Loans and Notes Payable	Total
		(In Thousands)	
1997	$ 90	$ 1,473	$ 1,563
1998	51	5,621	5,672
1999	10	13,429	13,439
2000	--	13,429	13,429
2001	--	13,428	13,428
Total minimum payments	151	47,380	47,531
Less interest discount amount	14	--	14
Total present value of net minimum lease payments and total notes payable	137	47,380	47,517
Current portion	90	1,473	1,563
Total non-current portion	$ 47	$45,907	$45,954

On February 18, 1997, the Company completed a secondary public offering of 1,725,000 shares of common stock and used $19 million of the $23 million proceeds therefrom to reduce the then outstanding Term Loan amounts (see Note 10).

4. Related Party Transactions

Management fees of $345,000 were paid in 1994 to a related company.

In August 1994, the Company signed a consulting agreement with its former Chairman expiring in August 1999 at an annual payment of $125,000.

5. Customer Deposits

Customer deposits represent amounts held by the Company for telephone wagering.

6. Commitments and Contingencies

The Company is liable for Totalisator Services and equipment under two five-year agreements expiring in 1998. The agreements provide for annual payments based on a specified percentage of the total amount wagered at the Company's race tracks, with minimum annual payments of $500,000.

On July 11, 1996, the Company opened its Lancaster OTW facility. The Company entered into a ten year lease agreement for the 24,050 square feet facility, which provides for minimum annual lease payments of $192,400 in years one through five and $211,640 in years six through ten.

The Company is also liable under numerous operating leases for automobiles, other equipment and buildings, which expire through 2004. Total rental expense under these agreements was $1,001,000, $672,000 and $636,000 for the years ended December 31, 1996, 1995 and 1994, respectively.

The future lease commitments relating to non-cancelable operating leases, as of December 31, 1996 are as follows:

December 31,	(In Thousands)
1997	$1,010
1998	886
1999	616
2000	615
2001	624
Thereafter	2,267
	$6,018

In March 1996, the Company took an assignment of an agreement to purchase land for its proposed Downingtown OTW facility. The agreement, which provides for a purchase price of $1,696,000, is subject to numerous contingencies including approval from the Pennsylvania State Horse Racing Commission.

On April 12, 1994, the Company entered into employment agreements with its Chairman and Chief Financial Officer at annual base salaries of $225,000 and $95,000, respectively. The agreements became effective June 1, 1994 and, as amended, terminate on June 30, 1999. Each agreement prohibits the employee from competing with the Company during its term and for one year thereafter, and requires a death benefit payment by the Company equal to 50% of the employee's annual salary in effect at the time of his death.

On June 1, 1995, the Company entered into an employment agreement with its President and Chief Operating Officer at an annual base salary of $210,000. The agreement terminates on June 12, 1998. The agreement prohibits the employee from competing with the Company during its term and for two years thereafter, and requires a death benefit payment by the Company equal to 50% of the employee's annual salary in effect at the time of his death.

Under the agreement between the Company and its former president, the former president received options to purchase 150,000 shares of common stock at $3.33 per share expiring May 31, 2000.

Effective January 1, 1990, the Company adopted a profit sharing plan under the provisions of Section 401(k) of the Internal Revenue Code covering all eligible employees who are not members of a bargaining unit. The Company's contributions are set at 50% of employees' elective salary deferrals which may be made up to a maximum of 6% of employee compensation. The Company made contributions to the plan of approximately $89,000, $70,000 and $60,000 for the years ended December 31, 1996, 1995 and 1994, respectively. Additionally, the Company has an employee retirement plan under Section 401(k) of the Internal Revenue Code covering Pocono Downs employees. The Company has no obligation to contribute to this plan. The Company may make discretionary contributions based on percentages of employee elective deferrals.

In December 1995, the Company agreed in principal with an unrelated party to form a joint venture for the purpose of developing, managing and operating pari-mutuel racing facilities in a state other than Pennsylvania or West Virginia. The joint venture is subject to numerous contingencies, including receipt of regulatory approvals from that state's horse racing commission.

On December 11, 1996, GTECH Corporation ("GTECH") commenced an action in the United States District Court for the Northern District of West Virginia against Charles Town, the Company, Penn National Gaming of West Virginia, Inc., a wholly owned subsidiary of the Company, and Bryant. The complaint filed by GTECH alleges that Charles Town and AmTote International, Inc. ("AmTote") were parties to an October 20, 1994 agreement (the "AmTote Agreement"), pursuant to which AmTote was allegedly granted an exclusive right to install and operate a "video lottery system" at the Charles Town Facility. When the AmTote Agreement was entered into, AmTote was a subsidiary of GTECH; GTECH has since divested itself of AmTote, but is purportedly the assignee of certain of AmTote's rights under the AmTote Agreement pursuant to an assignment and assumption agreement dated February 22, 1996. The complaint seeks (i) preliminary and permanent injunctive relief enjoining Charles Town, Bryant, the Company and its subsidiary from consummating the Charles Town Acquisition or any similar transaction unless the purchasing party explicitly accepts and assumes the AmTote Agreement, (ii) a declaratory judgment that the AmTote Agreement is valid and binding, that GTECH has the right to be the exclusive installer, operator, provider and servicer of a video lottery system at the Charles Town Facility and that any party buying the stock or assets of Charles Town must accept and assume the AmTote Agreement and recognize such rights of GTECH thereunder, (iii) compensatory damages, (iv) legal fees and costs and (v) such other further legal and equitable relief as the court deems just and appropriate. On December 23, 1996, the court denied GTECH's motion to preliminarily enjoin the Company from consummating the Charles Town Acquisition unless it accepts and assumes the AmTote Agreement. The court noted that GTECH may pursue its claim for damages and, if warranted, pursue other injunctive relief in the future. The Company consummated the Charles Town Acquisition on January 15, 1997. On January 13, 1997, Charles Town filed a motion to dismiss GTECH's complaint. As of March 17, 1997, the court has not yet ruled on this motion. The Company believes the allegations of the complaint to be without merit and intends to contest the action vigorously.

7. Income Taxes

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

	Year ended December 31,		
	1996	1995	1994
	(In Thousands)		
Current tax expense			
Federal	$2,686	$2,605	$ 511
State	880	842	377
Total current	3,566	3,447	888
Deferred tax expense			
Federal	178	15	485
State	50	5	8
Total deferred	228	20	493
Total provision	$3,794	$3,467	$1,381

Deferred tax assets and liabilities are comprised of the following:

	December 31,	
	1996	1995
	(In Thousands)	
Deferred tax assets		
Reserve for debit balances of horsemens' accounts, bad debts and litigation	$ 90	$104
Deferred tax liabilities		
Property, plant and equipment	$10,810	$888

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

	December 31,		
	1996	1995	1994
		(In Thousands)	
Percent of Pretax Income			
Federal tax rate	34.0%	34.0%	34.0%
Increase in taxes resulting from State and local income taxes, net of federal tax benefit	6.6	6.7	6.2
Permanent difference relating to amortization of goodwill	.2	.3	.6
Entities previously taxed as S Corporations and Partnerships	--	--	(9.2)
Other	--	--	2.1
	40.8%	41.0%	33.7%

8. Supplemental Pro Forma Net Income Per Share

The supplemental pro forma amount for the year ended December 31, 1994 reflects: (i) the elimination of $345,000 in management fees paid to a related entity; (ii) the inclusion of $133,000 in executive compensation; (iii) the elimination of $413,000 of interest expenses on Company debt which was repaid with the proceeds of the initial public offering, and (iv) a provision for income taxes of $377,000 as if the S corporations and partnerships comprising part of the Company had been taxed as a C corporation. There were no supplemental pro forma adjustments for any subsequent periods.

Supplemental pro forma net income per share is based on the weighted average number of shares of common stock outstanding, plus the number of shares the Company would have needed to sell to fund the retirement of debt and the number of shares the Company would have needed to sell to fund $1,190,000 of distributions of undistributed S corporation earnings.

9. Supplemental Disclosures of Cash Flow Information

Cash paid during the year for interest was $506,000, $71,000 and $535,000 in 1996, 1995 and 1994, respectively.

Cash paid during the year for income taxes was $2,490,000, $2,839,000 and $250,000 in 1996, 1995 and 1994, respectively.

Non-cash investing and financing activities were as follows:

The Company purchased Pocono Downs for an aggregate purchase price of $47,320,000, net of cash acquired. In conjunction with the acquisition, liabilities were assumed as follows:

Fair value of assets acquired	$53,150,000
Cash paid for the capital stock and the limited partnership interests	47,320,000
Liabilities assumed	$ 5,830,000

During 1994, capital lease obligations of $199,000 were incurred to lease new equipment.

During 1996, the Company issued a $250,000 long-term note payable for the incurrence of prepaid Charles Town Acquisition costs.

10. Shareholders' Equity

Common Stock

On June 3, 1994, the Company completed its initial public offering. The proceeds, net of expenses, amounted to $12,957,000 for 4,500,000 shares of common stock issued. The offering price per share was $3.33.

On February 18, 1997, the Company completed a secondary public offering of 1,725,000 shares of its common stock. The net proceeds of $23 million were used to reduce $19 million of the Term Loan amounts outstanding under the $75 million credit facility with the balance of the proceeds to be used to finance a portion of the cost of the refurbishment of the Charles Town Races facility (see Note 2 for Acquisitions).

Stock Options and Warrants

In April 1994, the Company's Board of Directors and shareholders adopted and approved the Stock Option Plan ("Plan"). The Plan permits the grant of options to purchase up to 1,290,000 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 the 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 Plan provides for the granting of both incentive stock options intended to qualify under Section 422 of the Internal Revenue Code of 1986, and non-qualified stock options which do not so qualify. Unless the Plan is terminated earlier by the Board of Directors, the Plan will terminate in April 2004.

Stock options that expire between May 26, 2001 and October 23, 2006 have been granted to officers and directors to purchase Common Stock at prices ranging from $3.33 to $17.63 per share.

All options were granted at market prices. The following table contains information on stock options issued under the Plan for the three year period ended December 31, 1996:

	Option Shares	Exercise Price Range Per Share	Weighted Average Price
Outstanding at January 1, 1994	--	$ --	$ --
Granted	765,000	3.33	3.33
Cancelled	(300,000)	3.33	3.33
Outstanding at December 31, 1994	465,000	3.33	3.33
Granted	345,000	3.33 to 5.58	5.51
Outstanding at December 31, 1995	810,000	3.33 to 5.58	3.82
Granted	280,000	5.63 to 17.63	12.99
Exercised	(110,250)	3.33	3.33
Outstanding at December 31, 1996	979,750	3.33 to 17.63	9.10

In addition, 300,000 common stock options were issued outside the plan on October 23, 1996. These options were issued at $17.63 per share and are exercisable through October 23, 2006.

	Option Shares	Exercise Price Range Per Share	Weighted Average Price
Exercisable at year-end			
1994	150,000	$ 3.33	$ 3.33
1995	270,000	3.33 to 5.58	3.33
1996	337,250	3.33 to 17.63	3.71

	1994 Plan
Available for future grant	
1994	825,000
1995	480,000
1996	200,000

The following table summarizes information about stock options outstanding at December 31, 1996:

	Ranges		Total
Range of exercise prices	$ 3.33 to 5.50	$ 5.58 to 17.63	$ 3.33 to 17.63
Outstanding options			
Number outstanding at December 31, 1996	669,750	310,000	979,750
Weighted average remaining contractual life (years)	6.04	7.97	6.96
Weighted average exercise price	$ 3.81	$ 14.91	$ 9.10
Exercisable options			
Number outstanding at December 31, 1996	329,750	7,500	337,250
Weighted average exercise price	$ 3.66	$ 5.58	$ 3.71

Warrants outstanding have been granted to the Company's underwriters and certain officers and directors to purchase Common Stock at prices ranging from $3.33 to $4.00 per share which expire on June 2, 1999 and May 31, 2000. During 1995, the Company cancelled 300,000 warrants which were granted to a former officer of the Company at a price of $3.33 per share and were to expire on May 31, 2000. The 300,000 cancelled warrants were replaced with 300,000 shares of common stock purchase options at an exercise price of $3.33 per share. A summary of the warrant transactions follows:

	Warrant Shares	Exercise Price Range Per Share	Weighted Average Price
Warrants outstanding at January 1, 1994	--	$ --	$ --
Warrants granted	690,000	3.33 to 4.00	3.85
Warrants outstanding at December 31, 1994	690,000	3.33 to 4.00	3.85
Warrants cancelled	(150,000)	3.33	3.33
Warrants exercised	(45,000)	4.00	4.00
Warrants outstanding at December 31, 1995	495,000	4.00	4.00
Warrants exercised	(300,000)	4.00	4.00
Warrants outstanding at December 31, 1996	195,000	4.00	4.00

During 1995, the FASB adopted Statement of Financial Accounting Standards No. 123 ("SFAS 123"), "Accounting for Stock-Based Compensation", which has recognition provisions that establish a fair value based method of accounting for stock-based employee compensation plans and established fair value as the measurement basis for transactions in which an entity acquires goods or services from nonemployees in exchange for equity instruments. SFAS 123 also has certain disclosure provisions. Adoption of the recognition provisions of SFAS 123 with regard to these transactions with nonemployees was required for all such transactions entered into after December 15, 1995, and the Company adopted these provisions as required. The recognition provision with regard to the fair value based method of accounting for stock-based employee compensation plans is optional. Accounting Principles Board Opinion No. 25 "Accounting for Stock Issued to Employers" ("APB 25") uses what is referred to as an intrinsic value based method of accounting. The Company has decided to continue to apply APB 25 for its stock-based employee compensation arrangements. Accordingly, no compensation cost has been recognized. Had compensation cost for the Company's employee stock option plan been determined based on the fair value at the grant date for awards under the plan consistent with the method of SFAS 123, the Company's net income and net income per share would have been reduced to the pro forma amounts indicated below:

	Year ended December 31,	
	1996	1995
Net income		
As reported	$5,510,000	$4,996,000
Pro forma	5,020,000	4,984,000
Net income per share		
As reported	$.39	$.38
Pro forma	.36	.38

Stock Splits

The Board of Directors authorized a three-for-two stock split on April 18, 1996 on its Common Stock to shareholders of record on May 3, 1996 which was paid on May 23, 1996. On November 13, 1996, the Board of Directors authorized a two-for-one stock split on its Common Stock to be paid on December 20, 1996 to shareholders of record on November 22, 1996. In addition, authorized shares of Common Stock were increased from 10,000,000 to 20,000,000. All references in the financial statements to number of shares, net income per share amounts and market prices of the Company's Common Stock have been retroactively restated to reflect the increased number of Common Stock shares outstanding.

11. Loss from Retirement of Debt

In 1994, the Company recorded an extraordinary loss of $115,000 after taxes for the early retirement of debt. The extraordinary loss consists primarily of the write-off of deferred finance costs associated with the retired notes, and legal and bank fees relating to the early extinguishment of the debt.

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

Not Applicable

PART III

ITEM 10 DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

The information required by Item 10 is incorporated by reference from the Company's definitive proxy statement with respect to the Company's Annual Meeting of Shareholders to be held on April 30, 1997. Such proxy statement shall be filed pursuant to Regulation 14A promulgated under the Securities Exchange Act of 1934, as amended, within 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K.

ITEM 11 EXECUTIVE COMPENSATION

The information required by Item 11 is incorporated by reference from the Company's definitive proxy statement with respect to the Company's Annual Meeting of Shareholders to be held on April 30, 1997. Such proxy statement shall be filed pursuant to Regulation 14A promulgated under the Securities Exchange Act of 1934, as amended, within 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K.

ITEM 12 SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The information required by Item 12 is incorporated by reference from the Company's definitive proxy statement with respect to the Company's Annual Meeting of Shareholders to be held on April 30, 1997. Such proxy statement shall be filed pursuant to Regulation 14A promulgated under the Securities Exchange Act of 1934, as amended, within 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K.

ITEM 13 CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information required by Item 13 is incorporated by reference from the Company's definitive proxy statement with respect to the Company's Annual Meeting of Shareholders to be held on April 30, 1997. Such proxy statement shall be filed pursuant to Regulation 14A promulgated under the Securities Exchange Act of 1934, as amended, within 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K.

PART IV

ITEM 14 EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

(A) (1) The Financial Statements included in the Index to Part II, Item 8, are filed as part of this Report

(2) List of Exhibits

EXHIBIT NOS.	DESCRIPTION OF EXHIBIT
1	Form of Underwriting Agreement among the Company, Fahnestock & Co. Inc. and Brenner Securities Corporation (Incorporated by reference to the Company's registration statement on Form S-1, File #33-77758, dated May 26, 1994.)
1.1	Form of Underwriting Agreement among the Company, Saloman Brothers Inc., Gerard Klauer, Mattison & Company Inc. and Jefferies & Company, Inc. (Incorporated by reference to the Company's registration statement on Form S-3, File #333-18861, dated February 11, 1997)
2.1	Agreement and Plan of Reorganization dated April 11, 1994 among the Registrant, Carlino Family Partnership, Carlino Financial Corporation and the shareholders and general partners of the entities now comprising Penn National Gaming, Inc. (Incorporated by reference to the Company's registration statement on Form S-1, File #33-77758, dated May 26, 1994.)
2.1.1	Amendment to Agreement and Plan of Reorganization dated April 26, 1994 among the Registrant, Carlino Family Partnership, Carlino Financial Corporation and the shareholders and general partners of the entities now comprising Penn National Gaming, Inc. (Incorporated by reference to the Company's registration statement on Form S-1, File #33-77758, dated May 26, 1994.)
2.2	Agreement and Plan of Reorganization dated April 11, 1994 between the Registrant and Thomas J. Gorman. (Incorporated by reference to the Company's registration statement on Form S-1, File #33-77758, dated May 26, 1994.)
2.2.1	Amendment to Agreement and Plan of Reorganization dated April 26, 1994 between the Registrant and Thomas J. Gorman. (Incorporated by reference to the Company's registration statement on Form S-1, File #33-77758, dated May 26, 1994.)
2.3	Closing Agreement dated January 15, 1997 among Charles Town Races, Inc., Charles Town Racing Limited Partnership, and PNGI Charles Town Gaming Limited Liability Company. (Incorporated by reference to the Company's Form 8-K, File #0-24206, dated January 30, 1997.)

2.4 Amended and Restated Operating Agreement dated as of December 31, 1996 among Penn National Gaming of West Virginia, Inc., Bryant Development Company and PNGI Charles Town Gaming Limited Liability Company. (Incorporated by reference to the Company's Form 8-K, File #0-24206, dated January 30, 1997.)

2.5 Letter dated January 14, 1997 from Peter M. Carlino to James A. Reeder (Incorporated by reference to the Company's Form 8-K, File #0-24206, dated January 30, 1997.)

2.6 First Amendment and Consent dated as of January 7, 1997 among the Company, Bankers Trust Company as Agent, CoreStates Bank, N.A. as Co-Agent, and certain banks party to the Credit Agreement dated as of November 27, 1996 (Incorporated by reference to the Company's Form 8-K, File #0-24206, dated January 30, 1997.)

2.7 Amended and Restated Option Agreement dated as of February 17, 1995 among Charles Town Races, Inc., Charles Town Racing Limited Partnership, and PNGI Charles Town Gaming Limited Liability Company (Incorporated by reference to Exhibit 2.1 of the Company's Form 8-K, File #0-24206, dated January 30, 1997.)

2.8 Transfer, Assignment and Assumption Agreement and Bill of Sale dated January 15, 1997 among Charles Town Races, Inc., Charles Town Racing Limited Partnership, and PNGI Charles Town Gaming Limited Liability Company (Incorporated by reference to Exhibit 2.2 of the Company's Form 8-K, File #0-24206, dated January 30, 1997.)

3.1 Amended and Restated Articles of Incorporation of Registrant, Incorporated with the Pennsylvania Department of State on April 12, 1994. (Incorporated by reference to the Company's registration statement on Form S-1, File #33-77758, dated May 26, 1994.)

3.2 By-laws of Registrant (Incorporated by reference to the Company's registration statement on Form S-1, File #33-77758, dated May 26, 1994.)

5.2 Loan and Security agreement dated May 8, 1996 between the Company and Charles Town Races, Inc. (Incorporated by reference to of the Company's Form 8-K, File #0-24206, dated June 12, 1996.)

5.3 Security agreement dated May 8, 1996 between the Company and Charles Town Racing Limited Partnership. (Incorporated by reference to Exhibit 5.1 of the Company's Form 8-K, File #0-24206, dated June 12, 1996.)

5.4 Stock Pledge agreement dated May 8, 1996 between the Company and Charles Town Racing Limited Partnership. (Incorporated by reference to the Company's Form 8-K, File #0-24206, dated June 12, 1996.)

5.5 Limited Recourse Guaranty agreement dated May 8, 1996 between the Company and Charles Town Racing Limited Partnership. (Incorporated by reference to the Company's Form 8-K, File #0-24206, dated June 12, 1996.)

5.6 Cooperation agreement dated April 30, 1996 between the Company and Charles Town Races, Inc. and Charles Town Racing Limited Partnership. (Incorporated by reference to Exhibit 5.1 of the Company's Form 8-K, File #0-24206, dated June 12, 1996.)

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 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 Employment Agreement dated April 12, 1994 between the Registrant and Peter M. Carlino. (Incorporated by reference to the Company's registration statement on Form S-1, File #33-77758, dated May 26, 1994.)

10.3 Credit Agreement, dated as of November 27, 1996, among Penn National Gaming, Inc., various banks, CoreStates Bank, N.A., as Co-Agent and Bankers Trust Company, as Agent. (Incorporated by reference to Exhibit 10.1 of the Company's Form 8-K, File #0-24206, dated December 12, 1996.)

10.4 Employment Agreement dated April 12, 1994 between the Registrant and Robert S. Ippolito. (Incorporated by reference to the Company's registration statement on Form S-1, File #33-77758, dated May 26, 1994.)

10.5 Agreement dated February 15, 1993 among Mountainview Thoroughbred Racing Association, Pennsylvania National Turf Club, Inc., and Pennsylvania Division, Horsemen's Benevolent and Protection Association, Inc. (Incorporated by reference to the Company's registration statement on Form S-1, File #33-77758, dated May 26, 1994.)

10.6 Agreement dated October 3, 1990 between Pennsylvania National Turf Club, Inc., Mountainview Thoroughbred Racing Association and Sports Arena Employees' Union Local No. 137 (Penn National Race Track). (Incorporated by reference to the Company's registration statement on Form S-1, File #33-77758, dated May 26, 1994.)

10.7 Agreement dated May 20, 1992 between Mountainview Thoroughbred Racing Association and Pennsylvania National Turf Club, Inc. and Sports Arena Employees' Union Local 137 (non-primary locations). (Incorporated by reference to the Company's registration statement on Form S-1, File #33-77758, dated May 26, 1994.)

10.8 Consolidation of PRA Agreement dated May 18, 1992 and PRA Amendment dated February 9, 1993 among all members of the Pennsylvania Racing Association. (Incorporated by reference to the Company's registration statement on Form S-1, File #33-77758, dated May 26, 1994.)

10.11 Lease dated March 7, 1991 between Shelbourne Associates and PNRC Limited Partnership. (Incorporated by reference to the Company's registration statement on Form S-1, File #33-77758, dated May 26, 1994.)

10.13 Lease dated June 30, 1993 between John E. Kyner, Jr. and Sandra R. Kyner, and PNRC Chambersburg, Inc. (Incorporated by reference to the Company's registration statement on Form S-1, File #33-77758, dated May 26, 1994.)

10.17 Totalisator Agreement dated February 9, 1993 between Mountainview Thoroughbred Racing Association, Pennsylvania National Turf Club, Inc. and Autotote Systems, Inc. (Incorporated by reference to the Company's registration statement on Form S-1, File #33-77758, dated May 26, 1994.)

10.18 Assignment and Assumption of Concession Agreement dated December 30, 1982 between Mountainview Thoroughbred Racing Association, Carlino Family Partnership, PNRC Limited Partnership, Pennsylvania National Turf Club, Inc., and Harry M. Stevens, Inc. of Penn. (Incorporated by reference to the Company's registration statement on Form S-1, File #33-77758, dated May 26, 1994.)

10.18.1 Concession Agreement dated December 2, 1971 between Pennsylvania National Turf Club, Inc. and Harry M. Stevens, Inc. of Penn and amendment thereto dated October 1, 1973. (Incorporated by reference to the Company's registration statement on Form S-1, File #33-77758, dated May 26, 1994.)

10.19 Agreement dated December 8, 1991 between Televiev Racing Patrol, Inc. and Pennsylvania National Turf Club, Inc. (Incorporated by reference to the Company's registration statement on Form S-1, File #33-77758, dated May 26, 1994.)

10.34 Warrant Agreement between the Registrant and Fahnestock & Co. Inc. (Incorporated by reference to the Company's registration statement on Form S-1, File #33-77758, dated May 26, 1994.)

10.38 Consulting Agreement dated August 29, 1994, between the Company and Peter D. Carlino. (Incorporated by reference to the Company's Form 10-K File #0-24206 dated March 23, 1995.)

10.39 Lease dated July 7, 1994, between North Mall Associates and the Company for the York OTW. (Incorporated by reference to the Company's Form 10-K file #0-24206 dated March 23, 1995.)

10.41 Lease dated March 31, 1995 between Wyomissing Professional Center III, LP and the Company for the Wyomissing Corporate Office. (Incorporated by reference to the Company's Form 10-K file #0-24206 dated March 20, 1996.)

10.42 Employment agreement dated June 1, 1995 between the Company and William J. Bork. (Incorporated by reference to the Company's Form 10-K file #0-24206 dated March 20, 1996.)

10.43 Lease dated July 17, 1995 between E. Lampeter Associates and Pennsylvania National Turf Club, Inc. for the Lancaster OTW, as amended. (Incorporated by reference to the Company's Form 10-K file #0-24206 dated March 20, 1996.)

10.44 Agreement dated September 1, 1995 between Mountainview Thoroughbred Racing Association and Pennsylvania National Turf Club, Inc. And Sports Arena Employees' Union Local 137 (non-primary location). (Incorporated by reference to the Company's Form 10-K file #0-24206 dated March 20, 1996.)

10.45 Agreement dated December 27, 1995 between Pennsylvania National Turf Club, Inc. And Televiev Racing Patrols, Inc. Incorporated by reference to the Company's Form 10-K file #0-24206 dated March 20, 1996.)

10.47 Agreement dated February 15, 1996 among Mountainview Thoroughbred Racing Association, Pennsylvania National Turf Club, Inc. and Pennsylvania Division, Horsemen's Benevolent and Protection Association, Inc. (Incorporated by reference to the Company's Form 10-K file #0-24206 dated March 20, 1996.)

10.48 Agreement dated February 16, 1996 between Pennsylvania National Turf Club, Inc. And Crown Investment Trust. (Incorporated by reference to the Company's Form 10-K file #0-24206 dated March 20, 1996.)

10.49 General Contractor agreement dated February 26, 1996 between Pennsylvania National Turf Club, Inc. And Warfel Construction Company. (Incorporated by reference to the Company's Form 10-K file #0-24206 dated March 20, 1996.)

10.50 Formation agreement dated February 26, 1996 between the Company and Bryant Development Company. (Incorporated by reference to the Company's Form 10-K file #0-24206 dated March 20, 1996.)

10.51 Assignment of agreement of sale dated March 6, 1996 between the Company and Montgomery Realty Growth Fund, Inc. (Incorporated by reference to the Company's Form 10-Q file #0-24206, dated May 14, 1996.)

10.52 General contractor agreement dated August 7, 1996, between Pennsylvania National Turf Club, Inc. And Warfel Construction Company. (Incorporated by reference to the Company's Form 10-Q file #0-24206, dated August 14, 1996.)

10.53 Agreement dated September 24, 1996 between the Company and Fred V. Schubert to purchase land for the Company's Downingtown OTW. (Incorporated by reference to the Company's Form 10-Q file #0-24206, dated November 13, 1996.)

10.54 Purchase Agreement dated September 13, 1996 between the Company and the Estate of Joseph B. Banks for the purchase of Pocono Downs Race Track and two related OTW facilities. (Incorporated by reference to the Company's Form 10-Q file #0-24206, dated November 13, 1996.)

10.55 Loan Commitment Letter dated October 15, 1996 between the Company and Bankers Trust Company. (Incorporated by reference to the Company's Form 10-Q file #0-24206, dated November 13, 1996.)

10.56 Amended and restated option agreement dated as of February 17, 1995 between the PNGI Charles Town Gaming Limited Liability Company (The joint venture) and Charles Town Racing Limited Partnership and Charles Town Races, Inc. (Incorporated by reference to the Company's Form 10-Q file #0-24206, dated November 13, 1996.)

10.57 General Contractor Agreement dated December 23, 1996, between PNGI Charles Town Gaming Limited Liability Company and Warfel Construction Company.

10.58 Agreement dated March 19, 1997, between PNGI Charles Town Gaming Limited Liability Company and The Charles Town HBPA, Inc.

10.59 Agreement dated March 21, 1997, between PNGI Charles Town Gaming Limited Liability Company and The West Virginia Thoroughbred Breeders Association.

10.60 Agreement between PNGI Charles Town Gaming Limited Liability Company and The West Virginia Union of Mutuels Clerks, Local 533, Service Employees International Union, AFL-CIO.

21 Subsidiaries of the Registrant.

23.1 Consent of BDO Seidman, LLP. (Incorporated by reference to the Company's registration statement on Form S-3, File #333-18861, dated February 11, 1997.)

23.2 Consent of Robert Rossi & Co. (Incorporated by reference to the Company's registration statement on Form S-3, File #333-18861, dated February 11, 1997.)

23.3 Consent of Leonard J. Miller & Associates, Chartered. (Incorporated by reference to the Company's registration statement on Form S-3, File #333-18861, dated February 11, 1997.)

23.4 Consent of Morgan, Lewis & Bockius LLP. (Incorporated by reference to the Company's registration statement on Form S-3, File #333-18861, dated February 11, 1997.)

23.5 Consent of Leonard J. Miller & Associates, Chartered (Incorporated by reference to the Company's Form 8-K/A File #0-24206, dated March 25, 1997.)

24.1 Powers of Attorney. (Incorporated by reference to the Company's registration statement on Form S-3, File #333-18861, dated February 11, 1997.)

27 Financial Data Schedule.

99 Press release of Penn National Gaming Inc., issued January 20, 1995. (Incorporated by reference to the Company's Form 8-K, File #0-24206, dated January 21, 1997.)

(B) Reports on Form 8-K

The Company filed the following Form 8-K during the fourth quarter 1996:

On December 12, 1996, the Company filed Form 8-K which reflected the completion, on November 27, 1996, of the purchase of Pocono Downs Racetrack and the completion of a $75 million credit facility with various banks.

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

Dated: March 27, 1997

Pursuant to the requirements of the Securities 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	Chief Executive Officer and Director (Principal Executive Officer)	March 27, 1997
\s\ William J. Bork William J. Bork	Chief Operating Officer and Director (Principal Operating Officer)	March 27, 1997
\s\ Robert S. Ippolito Robert S. Ippolito	Chief Financial Officer (Principal Financial Officer)	March 27, 1997
\s\ Harold Cramer Harold Cramer	Director	March 27, 1997
\s\ David A. Handler David A. Handler	Director	March 27, 1997
\s\ Robert P. Levy Robert P. Levy	Director	March 27, 1997
\s\ John M. Jacquemin John M. Jacquemin	Director	March 27, 1997

EXHIBIT INDEX

Exhibit Nos.	Description of Exhibits	Page No.
10.57	General Contractor Agreement dated December 23, 1996, between PNGI Charles Town Gaming Limited Liability Company and Warfel Construction Company.	76 - 94
10.58	Agreement dated March 19, 1997, between PNGI Charles Town Gaming Limited Liability Company and The Charles Town HBPA, Inc.	95 - 97
10.59	Agreement dated March 21, 1997, between PNGI Charles Town Gaming Limited Liability Company and The West Virginia Thoroughbred Breeders Association.	98 - 100
10.60	Agreement between PNGI Charles Town Gaming Limited Liability Company and The West Virginia Union of Mutuels Clerks, Local 533, Service Employees International Union, AFL-CIO.	101 - 102
21	Subsidiaries of Registrant.	103
27	Financial Data Schedule.	104

AIA Document A121/CMc and AGC Document 565
Standard Form of Agreement Between Owner
and Construction Manager
where the Construction Manager is also
THE CONSTRUCTOR
1991 EDITION

THIS DOCUMENT HAS IMPORTANT LEGAL CONSEQUENCES. CONSULTATION WITH AN ATTORNEY IS ENCOURAGED WITH RESPECT TO ITS COMPLETION OR MODIFICATION.

The 1987 Edition of AIA Document A201, General Conditions of the Contract for Construction, is referred to herein. This Agreement requires modification if other general conditions are utilized.

AGREEMENT

made as of the day of December In the year of Nineteen Hundred and Ninety-Six
(In words, indicate day, month and year)
BETWEEN the Owner:
(Name and address)

PNGI Charles Town Gaming Limited Liability Company
825 Berkshire Boulevard
Suite 203
Wyomissing, PA 19610

and the Construction Manager:
(Name and address)

Warfel Construction Company
812 North Prince Street
P. O. Box 4488
Lancaster, PA 17604

The Project is:
(Name, address and brief description)

Renovations to Charles Town Race Track
Charles Town, West Virginia

The Architect is:
(Name and address)

Architectural Concepts
StoneBank Professional Center
Suite 200
967 East Swedesford Road
Exton, PA 19341

The Owner and Construction Manager agree as set forth below.

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ARTICLE 1

GENERAL PROVISIONS

1.1 RELATIONSHIP OF PARTIES

The Construction Manager accepts the relationship of trust and confidence established with the Owner by this Agreement, and covenants with the Owner to furnish the Construction Manager's reasonable skill and judgment and to cooperate with the Architect in furthering the interests of the Owner. The Construction Manager shall furnish construction administration and management services and use the Construction Manager's best efforts to perform the Project in an expeditious and economical manner consistent with the interests of the Owner. The Owner shall endeavor to promote harmony and cooperation among the Owner, Architect, Construction Manager and other persons or entities employed by the Owner for the Project.

1.2 GENERAL CONDITIONS

For the Construction Phase, the General Conditions of the Contract shall be the 1987 Edition of AIA Document A201, General Conditions of the Contract for Construction, which is incorporated herein by reference. For the Preconstruction Phase, or in the event that the Preconstruction and Construction Phases proceed concurrently, AIA Document A201 shall apply to the Preconstruction Phase only as specifically provided in this Agreement. The term "Contractor" as used in AIA Document A201 shall mean the Construction Manager.

ARTICLE 2

CONSTRUCTION MANAGER'S RESPONSIBILITIES

The construction Manager shall perform the services described in this Article. The services to be provided under Paragraphs 2.1 and 2.2 constitute the Preconstruction Phase services. If the Owner and Construction Manager agree, after consultation with the Architect, the Construction Phase may commence before the Preconstruction Phase is completed, in which case both phases shall proceed concurrently.

2.1 PRECONSTRUCTION PHASE

2.1.1 PRELIMINARY EVALUATION

The Construction Manager shall provide a preliminary evaluation of the Owner's program and Project budget requirements, each in terms of the other.

2.1.2 CONSULTATION

The Construction Manager with the Architect shall jointly schedule and attend regular meetings with the Owner and Architect. The Construction Manager shall consult with the Owner and Architect regarding site use and improvements, and the selection of materials, building systems and equipment. The Construction Manager shall provide recommendations on construction feasibility; actions designed to minimize adverse effects of labor or material shortages; time requirements for procurement, installation and construction completion; and factors related to construction cost including estimates of alternative designs or materials, preliminary budgets and possible economies.

2.1.3 PRELIMINARY PROJECT SCHEDULE

When Project requirements described in Subparagraph 3.1.1 have been sufficiently identified, the Construction Manager shall prepare, and periodically update, a preliminary Project schedule for the Architect's review and the Owner's approval. The Construction Manager shall obtain the Architect's approval of the portion of the preliminary Project schedule relating to the performance of the Architect's services. The Construction Manager shall coordinate and integrate the preliminary Project schedule with the services and activities of the Owner, Architect and Construction Manager. As design proceeds, the preliminary Project schedule shall be updated to indicate proposed activity sequences and durations, milestone dates for receipt and approval of pertinent information, submittal of a Guaranteed Maximum Price proposal, preparation and processing of shop drawings and samples, delivery of materials or equipment requiring long-lead time procurement, Owner's occupancy requirements showing portions of the Project having occupancy priority, and proposed date of Substantial Completion. If preliminary Project schedule updates indicate that previously approved schedules may not be met, the Construction Manager shall make appropriate recommendations to the Owner and Architect.

2.1.4 PHASED CONSTRUCTION

The Construction Manager shall make recommendations to the Owner and Architect regarding the phased issuance of Drawings and Specifications to facilitate phased construction of the Work, if such phased construction is appropriate for the Project, taking into consideration such factors as economies, time of performance, availability of labor and materials, and provisions for temporary facilities.

2.1.5 PRELIMINARY COST ESTIMATES

2.1.5.1 When the Owner has sufficiently identified the Project requirements and the Architect has prepared other basic design criteria, the Construction Manager shall prepare, for the review of the Architect and approval of the Owner, a preliminary cost estimate utilizing area, volume or similar conceptual estimating techniques.

2.1.5.2 When Schematic Design Documents have been prepared by the Architect and approved by the Owner, the Construction Manager shall prepare for the review of the Architect and approval of the Owner, a more detailed estimate with supporting data. During the preparation of the Design Development Documents, the Construction Manager shall update and refine this estimate at appropriate intervals agreed to by the Owner, Architect and Construction Manager.

2.1.5.3 When Design Development Documents have been prepared by the Architect and approved by the Owner, the Construction Manager shall prepare a detailed estimate with supporting data for review by the Architect and approval by the Owner. During the preparation of the Construction Documents, the Construction Manager shall update and refine this estimate at appropriate intervals agreed to by the Owner, Architect and Construction Manager.

2.1.5.4 If any estimate submitted to the Owner exceeds previously approved estimates or the Owner's budget, the Construction Manager shall make appropriate recommendations to the Owner and Architect.

2.1.6 SUBCONTRACTORS AND SUPPLIERS

The Construction Manager shall seek to develop subcontractor interest in the Project and shall furnish to the Owner and Architect for their information a list of possible subcontractors, including suppliers who are to furnish materials or equipment fabricated to a special design, from whom proposals will be requested for each principal portion of the Work. The Architect will promptly reply in writing to the Construction Manager if the Architect or Owner know of any objection to such subcontractor or supplier. The receipt of such list shall not require the Owner or Architect to investigate the qualifications of proposed subcontractors or suppliers, nor shall it waive the right of the Owner or Architect later to object to or reject any proposed subcontractor or supplier.

2.1.7 LONG-LEAD TIME ITEMS

The Construction Manager shall recommend to the Owner and Architect a schedule for procurement of long-lead time items which will constitute part of the Work as required to meet the Project schedule. If such long-lead time items are procured by the Owner, they shall be procured on terms and conditions acceptable to the Construction Manager. Upon the Owner's acceptance of the Construction Manager's Guaranteed Maximum Price proposal, all contracts for such items shall be assigned by the Owner to the Construction Manager, who shall accept responsibility for such items as if procured by the Construction Manager. The Construction Manager shall expedite the delivery of long-lead time items.

2.1.8 EXTENT OF RESPONSIBILITY

The Construction Manager does not warrant or guarantee estimates and schedules except as may be included as part of the Guaranteed Maximum Price. The recommendations and advice of the Construction Manager concerning design alternatives shall be subject to the review and approval of the Owner and the Owner's professional consultants. It is not the Construction Manager's responsibility to ascertain that the Drawings and Specifications are in accordance with applicable laws, statutes, ordinances, building codes, rules and regulations. However, if the Construction Manager recognizes that portions of the Drawings and Specifications are at variance therewith, the Construction Manager shall promptly notify the Architect and Owner in writing.

2.1.9 EQUAL EMPLOYMENT OPPORTUNITY AND AFFIRMATIVE ACTION

The Construction Manager shall comply with applicable laws, regulations and special requirements of the Contract Documents regarding equal employment opportunity and affirmative action programs.

2.3 CONSTRUCTION PHASE

2.3.1 GENERAL

2.3.1.1 The Construction Phase shall commence upon

(2) the Owner's first authorization to the Construction Manager to:

(a) award a subcontract, or
(b) undertake construction Work with the Construction Manager's own forces or
(c) issue a purchase order for materials or equipment required for the Work.

2.3.2 ADMINISTRATION

2.3.2.1 Those portions of the Work that the Construction Manager does not customarily perform with the Construction Manager's own personnel shall be performed under subcontracts or by other appropriate agreements with the Construction Manager. The Construction Manager shall obtain bids from Subcontractors and from suppliers of materials or equipment fabricated to a special design for the Work from the list previously reviewed and, after analyzing such bids, shall deliver such bids to the Owner and Architect. The Owner shall then determine with the advice of the Construction Manager and subject to the reasonable objection of the Architect, which bids will be accepted. The Owner may designate specific persons or entities from whom the Construction Manager shall obtain bids; however, if the Guaranteed Maximum Price has been established, the Owner may not prohibit the Construction Manager from obtaining bids from other qualified bidders. The Construction Manager shall not be required to contract with anyone to whom the Construction Manager has reasonable objection.

2.3.2.2 If the Guaranteed Maximum Price has been established and a specific bidder among those whose bids are delivered by the Construction Manager to the Owner and Architect (1) is recommended to the Owner by the Construction Manager; (2) is qualified to perform that portion of the Work; (3) has submitted a bid which conforms to the requirements of the Contract Documents without reservations or exceptions, but the Owner requires that another bid be accepted, then the Construction Manager may require that a change in the Work be issued to adjust the Contract Time and the Guaranteed Maximum Price by the difference between the bid of the person or entity recommended to the Owner by the Construction Manager and the amount of the subcontract or other agreement actually signed with the person or entity designated by the Owner.

2.3.2.3 Subcontracts and agreements with suppliers furnishing materials or equipment fabricated to a special design shall conform to the payment provisions of Subparagraphs 7.1.8 and 7.1.9 and shall not be awarded on the basis of cost plus a fee without the prior consent of the Owner.

2.3.2.4 The Construction Manager shall schedule and conduct meetings at which the Owner, Architect, Construction Manager and appropriate Subcontractors can discuss the status of the Work. The Construction Manager shall prepare and promptly distribute meeting minutes.

2.3.2.5 Promptly after the Owner's acceptance of the Guaranteed Maximum Price proposal, the Construction Manager shall prepare a schedule in accordance with Paragraph 3.10 of AIA Document A201, including the Owner's occupancy requirements.

2.3.2.6 The Construction Manager shall provide monthly written reports to the Owner and Architect on the progress of the entire Work. The Construction Manager shall maintain a daily log containing a record of weather, Subcontractors working on the site, number of workers, Work accomplished, problems encountered and other similar relevant data as the Owner may reasonably require. The log shall be available to the Owner and Architect.

2.3.2.7 The Construction Manager shall develop a system of cost control for the Work, including regular monitoring of actual costs for activities in progress and estimates for uncompleted tasks and proposed changes. The Construction Manager shall identify variances between actual and estimated costs and report the variances to the Owner and Architect at regular intervals.

2.4 PROFESSIONAL SERVICES

The Construction Manager shall not be required to provide professional services which constitute the practice of architecture or engineering, unless such services are specifically required by the Contract Documents for a portion of the Work or unless the Construction Manager has specifically agreed in writing to provide such services. In such event, the Construction Manager shall cause such services to be performed by appropriately licensed professionals.

2.5 UNSAFE MATERIALS

In addition to the provisions of Paragraph 10.1 in AIA Document A201, if reasonable precautions will be inadequate to prevent foreseeable bodily injury or death to persons resulting from a material or substance encountered but not created on the site by the Construction Manager, the Construction Manager shall, upon recognizing the condition, immediately stop work in the affected area and report the condition to the Owner and Architect in writing. The Owner, Construction Manager and Architect shall then proceed in the same manner described in Subparagraph 10.1 .2 of AIA Document A201. The Owner shall be responsible for obtaining the services of a licensed laboratory to verify the presence or absence of the material or substance reported by the Construction Manager and, in the event such material or substance is found to be present, to verify that it has been rendered harmless. Unless otherwise required by the Contract Documents, the Owner shall furnish in writing to the

Construction Manager and Architect the names and qualifications of persons or entities who are to perform tests verifying the presence or absence of such material or substance or who are to perform the task of removal or safe containment of such material or substance. The Construction Manager and Architect will promptly reply to the Owner in writing stating whether or not either has reasonable objection to the persons or entities proposed by the Owner. If either the Construction Manager or Architect has an objection to a person or entity proposed by the Owner, the Owner shall propose another to whom the Construction Manager and Architect have no reasonable objection.

ARTICLE 3

OWNER'S RESPONSIBILITIES

3.1 INFORMATION AND SERVICES

3.1.1 The Owner shall provide full information in a timely manner regarding the requirements of the Project, including a program which sets forth the Owner's objectives, constraints and criteria, including space requirements and relationships, flexibility and expandability requirements, special equipment and systems, and site requirements.

3.1.2 The Owner, upon written request from the Construction Manager, shall furnish evidence of Project financing prior to the start of the Construction Phase and from time to time thereafter as the Construction Manager may request. Furnishing of such evidence shall be a condition precedent to commencement or continuation of the Work.

3.1.3 The Owner shall establish and update an overall budget for the Project, based on consultation with the Construction Manager and Architect, which shall include contingencies for changes in the Work and other costs which are the responsibility of the Owner.

3.1.4 STRUCTURAL AND ENVIRONMENTAL TESTS, SURVEYS AND REPORTS

In the Preconstruction Phase, the Owner shall furnish the following with reasonable promptness and at the Owner's expense, and the Construction Manager shall be entitled to rely upon the accuracy of any such information, reports, surveys, drawings and tests described in Clauses 3.1.4.1 through 3.1.4.4, except to the extent that the Construction Manager knows of any inaccuracy:

3.1.4.1 Reports, surveys, drawings and tests concerning the conditions of the site which are required by law.

3.1.4.2 Surveys describing physical characteristics, legal limitations and utility locations for the site of the Project, and a written legal description of the site. The surveys and legal information shall include, as applicable, grades and lines of streets, alleys, pavements and adjoining property and structures; adjacent drainage; rights-of-way, restrictions, easements, encroachments, zoning, deed restrictions, boundaries and contours of the site; locations, dimensions and necessary data pertaining to existing buildings, other improvements and trees; and information concerning available utility services and lines, both public and private, above and below grade, including inverts and depths. All information on the survey shall be referenced to a project benchmark.

3.1.4.3 The services of geotechnical engineers when such services are requested by the Construction Manager. Such services may include but are not limited to test borings, test pits, determinations of soil bearing values, percolation tests, evaluations of hazardous materials, ground corrosion and resistivity tests, including necessary operations for anticipating subsoil conditions, with reports and appropriate professional recommendations.

3.1.4.4 Structural, mechanical, chemical, air and water pollution tests, tests for hazardous materials, and other laboratory and environmental tests, inspections and reports which are required by law.

3.1.4.5 The services of other consultants when such services are reasonably required by the scope of the Project and are requested by the Construction Manager.

3.2 OWNER'S DESIGNATED REPRESENTATIVE

The Owner shall designate in writing a representative who shall have express authority to bind the Owner with respect to all matters requiring the Owner's approval or authorization. This representative shall have the authority to make decisions on behalf of the Owner concerning estimates and schedules, construction budgets, and changes in the Work, and shall render such decisions promptly and furnish information expeditiously, so as to avoid unreasonable delay in the services or Work of the Construction Manager.

3.3 ARCHITECT

The Owner shall retain an Architect to provide the Basic Services, including normal structural, mechanical and electrical engineering services, other than cost estimating services, described in the edition of AIA Document B141 current as of the date of this Agreement. The Owner shall authorize and cause the Architect to provide those

Additional Services described in AIA Document B141 requested by the Construction Manager which must necessarily be provided by the Architect for the Preconstruction and Construction Phases of the Work. Such services shall be provided in accordance with time schedules agreed to by the Owner, Architect and Construction Manager. Upon request of the Construction Manager, the Owner shall furnish to the Construction Manager a copy of the Owner's Agreement with the Architect, from which compensation provisions may be deleted.

3.4 LEGAL REQUIREMENTS

The Owner shall determine and advise the Architect and Construction Manager of any special legal requirements relating specifically to the Project which differ from those generally applicable to construction in the jurisdiction of the Project. The Owner shall furnish such legal services as are necessary to provide the information and services required under Paragraph 3.1.

ARTICLE 4

COMPENSATION AND PAYMENTS FOR PRECONSTRUCTION PHASE SERVICES

The Owner shall compensate and make payments to the Construction Manager for Preconstruction Phase services as follows:

4.1 COMPENSATION

4.1.1 For the services described in Paragraphs 2.1 and 2.2 the Construction Manager's compensation shall be calculated as follows:

(State basis of compensation, whether a stipulated sum, multiple of Direct Personnel Expense, actual cost, etc. Include a statement of reimbursable cost items as applicable)

Compensation based on a multiple of 2 times Direct Personnel Expenses (as defined in 4.1.3) of Construction Manager's personnel, plus the following reimbursable costs item: long distance telephone, fax transmission, consultants, design services, reproduction costs, travel expenses, computer time for scheduling. Time spent on the project by the Principal-in-Charge is not reimbursable.

4.1.3 If compensation is based on a multiple of Direct Personnel Expense, Direct Personnel Expense is defined as the direct salaries of the Construction Manager's personnel engaged in the Project and the portion of the cost of their mandatory and customary contributions and benefits related thereto, such as employment taxes and other statutory employee benefits, insurance, sick leave, holidays, vacations, pensions and similar contributions and benefits.

4.2 PAYMENTS

4.2.1 Payments shall be made monthly following presentation of the Construction Manager's invoice and, where applicable, shall be in proportion to services performed.

4.2.2 Payments are due and payable fifteen (15) days from the date the Construction Manager's invoice is received by the Owner. Amounts unpaid after the date on which payment is due shall bear interest at the rate entered below, or in the absence thereof, at the legal rate prevailing from time to time at the place where the Project is located.

4.2.3 The sum of the Preconstruction Compensation (4.1.1) is guaranteed not to exceed ONE HUNDRED FORTY THOUSAND DOLLARS ($140,000.00).

the location (Usury law's and requirements under the Federal Truth and Lending Act, similar state and local consumer credit laws and other regulations at the Owner's and Construction Manager's principal places of business of the Project and elsewhere may affect the validity of this provision. Legal advice should be obtained with respect to deletions or modifications. and also regarding requirements such as written disclosures or waivers.)

ARTICLE 5

COMPENSATION FOR CONSTRUCTION PHASE SERVICES

The Owner shall compensate the Construction Manager for Construction Phase services as follows:

5.1 COMPENSATION

5.1.1 For the Construction Manager's performance of the Work as described in Paragraph 2.3, the Owner shall pay the Construction Manager in current funds the Contract Sum consisting of the Cost of the Work as defined in Article 6 and the Construction Manager's Fee determined as follows:

(State a lump sum, percentage of actual Cost of the Work or other provision for determining the Construction Manager's Fee, and explain how the Construction Manager's Fee is to be adjusted for changes in the Work.)

The Construction Manager's Fee shall be based upon three and one-half percent (3 1/2%) of the Cost of the Work.

5.2 GUARANTEED MAXIMUM PRICE

No Guaranteed Maximum Price will be developed.

5.3 CHANGES IN THE WORK

5.3.2 In calculating adjustments to subcontracts (except those awarded with the Owner's prior consent on the basis of cost plus a fee), the terms "cost" and "fee" as used in Clause 7.333 of AIA Document A201 and the terms "costs" and "a reasonable allowance for overhead and profit" as used in Subparagraph 7.3.6 of AIA Document A201 shall have the meanings assigned to them in that document and shall not be modified by this Article 5. Adjustments to subcontracts awarded with the Owner's prior consent on the basis of cost plus a fee shall be calculated in accordance with the terms of those subcontracts.

5.3.3 In calculating adjustments to the Contract, the terms "cost" and "costs" as used in the above-referenced provisions of AIA Document A201 shall mean the Cost of the Work as defined in Article 6 of this Agreement and the terms "and a reasonable allowance for overhead and profit" shall mean the Construction Manager's Fee as defined in Subparagraph 5.1.1 of this Agreement.

5.3.4 If no specific provision is made in Subparagraph 5.1.1 for adjustment of the Construction Manager's Fee in the case of changes in the Work, or if the extent of such changes is such, in the aggregate, that application of the adjustment provisions of Subparagraph 5.1.1 will cause substantial inequity to the Owner or Construction Manager, the Construction Manager's Fee shall be equitably adjusted on the basis of the fee established for the original Work.

ARTICLE 6

COST OF THE WORK FOR CONSTRUCTION PHASE

6.1 COSTS TO BE REIMBURSED

6.1.1 The term "Cost of the Work" shall mean costs necessarily incurred by the Construction Manager in the proper performance of the Work. Such costs shall be at rates not higher than those customarily paid at the place of the Project except with prior consent of the Owner. The Cost of the Work shall include only the items set forth in this Article 6.

6.1.2 LABOR COSTS

.1 Wages of construction workers directly employed by the Construction Manager to perform the construction of the Work at the site or, with the Owner's agreement, at off-site workshops.

.2 Wages or salaries of the Construction Manager's supervisory and administrative personnel when stationed at the site with the Owner's agreement for that portion of their time spent working on this project at whatever location.

(it is intended that the wages or salaries of certain personnel stationed at the Construction Manager's principal office or offices other than the site office shall be included in the Cost of the Work, such personnel shall be identified below:)

.3 Wages and salaries of the Construction Manager's supervisory or administrative personnel engaged, at factories, workshops or on the road, in expediting the production or transportation of materials or equipment required for the Work, but only for that portion of their time required for the Work.

.4 Costs paid or incurred by the Construction Manager for taxes, insurance, contributions, assessments and benefits required by law or collective bargaining agreements, and, for personnel not covered by such agreements, customary benefits such as sick leave, medical and health benefits, holidays, vacations and pensions, provided that such costs are based on wages and salaries included in the Cost of the Work under Clauses 6.1,2.1 through 6.1.2.3. Such costs shall not exceed 48% of such wages and salaries.

6.1.3 SUBCONTRACT COSTS

Payments made by the Construction Manager to Subcontractors in accordance with the requirements of the subcontracts.

6.1.4 COSTS OF MATERIALS AND EQUIPMENT INCORPORATED IN THE COMPLETED CONSTRUCTION

.1 Costs, including transportation, of materials and equipment incorporated or to be incorporated in the completed construction.

.2 Costs of materials described in the preceding Clause 6.1.4.1 in excess of those actually installed but required to provide reasonable allowance for waste and for spoilage. Unused excess materials, if any, shall be handed over to the Owner at the completion or the Work or, at the Owner's option, shall be sold by the Construction Manager; amounts realized, if any, from such sales shall be credited to the Owner as a deduction from the Cost of the Work.

6.1.5 COSTS OF OTHER MATERIALS AND EQUIPMENT, TEMPORARY FACILITIES AND RELATED ITEMS

.1 Costs, including transportation, installation, maintenance, dismantling and removal of materials, supplies, temporary facilities, machinery., equipment, and hand tools not customarily owned by the construction workers, which are provided by the Construction Manager at the site and fully consumed in the performance of the Work; and cost less salvage value on such items if not fully consumed, whether sold to others or retained by the Construction Manager. Cost for items previously used by the Construction Manager shall mean fair market value.

.2 Rental charges for temporary facilities, machinery, equipment, and hand tools not customarily owned by the construction workers, which are provided by the Construction Manager at the site, whether rented from the Construction Manager or others, and costs of transportation, installation, minor repairs and replacements, dismantling and removal thereof. Rates and quantities of equipment rented shall be subject to the Owner's prior approval.

.3 Costs of removal of debris from the site.

.4 Reproduction costs, costs of telegrams, facsimile transmissions and long-distance telephone calls, postage and express delivery charges, telephone service at the site and reasonable petty cash expenses of the site office.

.5 That portion of the reasonable travel and subsistence expenses of the Construction Manager's personnel incurred while traveling in discharge of duties connected with the Work.

6.1.6 MISCELLANEOUS COSTS

.1 That portion directly attributable to this Contract of premiums for insurance and bonds.

(If charges for self insurance are to be included, specify the basis of reimbursement.)

.2 Sales, use or similar taxes imposed by a governmental authority which are related to the Work and for which the Construction Manager is liable.

.3 Fees and assessments for the building permit and for other permits, licenses and inspections for which the Construction Manager is required by the Contract Documents to pay.

.4 Fees of testing laboratories for tests required by the Contract Documents, except those related to nonconforming Work other than that for which payment is permitted by Clause 6.1.8.2.

.5 Royalties and license fees paid for the use of a particular design. process or product required by the Contract Documents; the cost of defending suits or claims for infringement of patent or other intellectual property rights

arising from such requirement by the Contract Documents; payments made in accordance with legal judgments against the Construction Manager resulting from such suits or claims and payments of settlements made with the Owner's consent; provided, however, that such costs of legal defenses, judgments and settlements shall not be included in the calculation of the Construction Manager's Fee or the Guaranteed Maximum Price and provided that such royalties, fees and costs are not excluded by the last sentence of Subparagraph 3.17.1 of AIA Document A201 or other provisions of the Contract Documents.

.6 Data processing costs related to the Work.

.7 Deposits lost for causes other than the Construction Manager's negligence or failure to fulfill a specific responsibility to the Owner set forth in this Agreement.

.8 Legal, mediation and arbitration costs, other than those arising from disputes between the Owner and Construction Manager, reasonably incurred by the Construction Manager in the performance of the Work and with the Owner's written permission, which permission shall not be unreasonably withheld.

.9 Expenses incurred in accordance with the Construction Manager's standard personnel policy for relocation and temporary living allowances of personnel required for the Work, in case it is necessary to relocate such personnel from distant locations.

6.1.7 OTHER COSTS

.1 Other costs incurred in the performance of the Work if and to the extent approved in advance in writing by the Owner.

6.1.8 EMERGENCIES AND REPAIRS TO DAMAGED OR NONCONFORMING WORK

The Cost of the Work shall also include costs described in Subparagraph 6.1.1 which are incurred by the Construction Manager:

.1 In taking action to prevent threatened damage, injury or loss in case of an emergency affecting the safety of persons and property, as provided in paragraph 10.3 or AIA Document A201.

.2 In repairing or correcting damaged or nonconforming Work executed by the Construction Manager or the Construction Manager's Subcontractors or suppliers, provided that such damaged or nonconforming Work was not caused by the negligence or failure to fulfill a specific responsibility to the Owner set forth in this Agreement of the Construction Manager or the Construction Manager's foremen, engineers or superintendents, or other supervisory administrative or managerial personnel of the Construction Manager, or the failure of the Construction Manager's personnel to supervise adequately the Work of the Subcontractors or suppliers, and only to the extent that the cost of repair or correction is not recoverable by the Construction Manager from insurance, Subcontractors or suppliers.

6.1.9 The costs described in Subparagraphs 6.1.1 through 6.1.8 shall be included in the Cost of the Work notwithstanding any provision of AIA Document A201 or other Conditions of the Contract which may require the Construction Manager to pay such costs, unless such costs are excluded by the provisions of Paragraph 6.2

6.2 COSTS NOT TO BE REIMBURSED

6.2.1 The Cost of the Work shall not include:

.1 Salaries and other compensation of the Construction Manager's personnel stationed at the Construction Manager's principal office or offices other than the site office, except as specifically provided in Clauses 6.1.2.2 and 6.1.2.3.

.2 Expenses of the Construction Manager's principal office and offices other than the site office except as specifically provided in Paragraph 6.1.

.3 Overhead and general expenses, except as may be expressly included in Paragraph 6.1.

.4 The Construction Manager's capital expenses, including interest on the Construction Manager's capital employed for the Work.

.5 Rental costs of machinery and equipment, except as specifically, provided in Subparagraph 6.1.5.2.

.6 Except as provided in Clause 6.1.8.2, costs due to the negligence of the Construction Manager or to the failure of the construction Manager to fulfill a specific responsibility to the Owner set forth in this Agreement.

.7 Costs incurred in the performance of Preconstruction Phase Services.

.8 Except as provided in Clause 6.1.7.1, any cost not specifically and expressly described in Paragraph 6.1.

6.3 DISCOUNTS, REBATES AND REFUNDS

6.3.1 Cash discounts obtained on payments made by the Construction Manager shall accrue to the Owner if (l) before making the payment, the Construction Manager included them in an Application for Payment and received payment therefor from the Owner, or (2) the Owner has deposited funds with the Construction Manager with which to make payments; otherwise, cash discounts shall accrue to the Construction Manager. Trade discounts, rebates, refunds and amounts received from sales of surplus materials and equipment shall accrue to the Owner, and the Construction Manager shall make provisions so that they can be secured.

6.3.2 Amounts which accrue to the Owner in accordance with the provisions of Subparagraph 6.3.1 shall be credited to the Owner as a deduction from the Cost of the Work.

6.4 ACCOUNTING RECORDS

6.4.1 The Construction Manager shall keep full and detailed accounts and exercise such controls as may be necessary for proper financial management under this Contract; the accounting and control systems shall be satisfactory to the Owner. The Owner and the Owner's accountants shall be afforded access to the Construction Manager's records, books, correspondence, instructions, drawings, receipts, subcontracts, purchase orders, vouchers, memoranda and other data relating to this Project, and the Construction Manager shall preserve these for a period of three years after final payment, or for such longer period as may be required by law

ARTICLE 7

CONSTRUCTION PHASE

7.1 PROGRESS PAYMENTS

7.1.1 Based upon Applications for Payment submitted to the Architect by the Construction Manager and Certificates for Payment issued by the Architect, the Owner shall make progress payments on account of the Contract Sum to the Construction Manager as provided below and elsewhere in the Contract Documents.

7.1.2 The period covered by' each Application for Payment shall be one calendar month ending on the last day of the month, or as follows:

7.1.3 Provided an Application for Payment is received by the Architect not later than the 26th day of a month, the Owner shall make payment to the Construction Manager not later than the 10th day of the month. If an Application for Payment is received by the Architect after the application date fixed above, payment shall be made by the Owner not later than fourteen days after the Architect receives the Application for Payment.

7.1.4 With each Application for Payment, the Construction Manager shall submit payrolls, petty cash accounts, receipted invoices or invoices with check vouchers attached, and any other evidence required by the Owner or Architect to demonstrate that cash disbursements already made by the Construction Manager on account of the Cost of the Work equal or exceed (1) progress payments already received by the Construction Manager; less (2) that portion of those payments attributable to the Construction Manager's Fee; plus (3) payrolls covered by the present Application for Payment.

7.1.5 Each Application for Payment shall be based upon the most recent schedule of values submitted by the Construction Manager in accordance with the Contract Documents. The schedule of Values shall allocate the entire Guaranteed Maximum Price amount the various portions of the Work, except that the Construction Manager's Fee shall be shown as a single separate item. The schedule of values shall be prepared in such form and supported by such data to substantiate its accuracy as the Architect may require. This schedule, unless objected to by the Architect, shall be used as a basis for reviewing the Construction Manager's Applications for Payment.

7.1.6 Applications for Payment shall show the percentage completion of each portion of the Work as of the end of the period covered by the Application for Payment. The percentage completion shall be the lesser of (1) the percentage of that portion of the Work which has actually been completed or (2) the percentage obtained by dividing (a) the expense which has actually been incurred by the Construction Manager on account of that portion of the Work for which the Construction Manager has made or intends to make actual payment prior to the next Application for Payment by (b) the share of the Guaranteed Maximum Price allocated to that portion of the Work in the schedule of values.

7.1.7 Subject to other provisions of the Contract Documents, the amount of each progress payment shall be computed as follows:

.1 Take that portion of the Guaranteed Maximum Price properly allocable to completed Work as determined by multiplying the percentage completion of each portion of the Work by the share of the Guaranteed Maximum Price allocated to that portion of the Work in the schedule of values. Pending final determination of cost to the Owner of changes in the Work, amounts not in dispute may be included as provided in Subparagraph 7.3.7 of AIA Document A201, even though the Guaranteed Maximum Price has not yet been adjusted by Change Order.

.2 Add that portion of the Guaranteed Maximum Price properly allocable to materials and equipment delivered and suitably stored at the site for subsequent incorporation in the Work or, if approved in advance by the Owner, suitably stored off the site at a location agreed upon in writing.

.3 Add the Construction Manager's Fee, less retainage of five percent (5%). The Construction Manager's Fee shall be computed upon the Cost of the Work described in the two preceding Clauses at the rate stated in Subparagraph 5.1.1 or if the Construction Manager's Fee is stated as a fixed sum in that Subparagraph, shall be an amount which bears the same ratio to that fixed-sum Fee as the Cost of the Work the two preceding Clauses bears to a reasonable estimate of the probable Cost of the Work upon its completion.

.4 Subtract the aggregate of previous payments made by the Owner.

.5 Subtract the shortfall, if any indicated by the Construction Manager in the documentation required by Subparagraph 7.1.4 to substantiate prior Applications for Payment or resulting from errors subsequently discovered By the Owner's accountants in such documentation.

.6 Subtract amounts, if any, for which the Architect has withheld or nullified a Certificate for Payment as provided in Paragraph 9.5 of AIA Document AIA. Document A201.

7.1.8 Except with the Owner's prior approval, payments to subcontractors shall be subject to retention of not less than five percent (5%). The Owner and the Construction Manager shall agree upon a mutually acceptable procedure for review and approval of payments and retention for subcontracts.

7.1.9 Except with the Owner's prior approval, the Construction Manager shall not make advance payments to suppliers for materials or equipment which have not been delivered and stored at the site.

7.1.10 In taking action on the Construction Manager's Applications for Payment, the Architect shall be entitled to reply on the accuracy and completeness of the information furnished by the Construction Manager and shall not be deemed to represent that the Architect has made a detailed examination, audit or arithmetic verification of the documentation submitted in accordance with Subparagraph 7.1.4 or other supporting data that the Architect has made exhaustive or continuous on-site inspections or that the Architect has made examinations to ascertain how or for what purposes the Construction Manager has used amounts previously paid on account of the Contract. Such examinations, audits and verifications, if required by the Owner, will be performed by the Owner's accountants acting in the sole interest of the Owner.

*7.2 FINAL PAYMENT

7.2.1 Final payment shall be made by the Owner to the Construction Manager when (1) the Contract has been fully performed by the Construction Manager except for the Construction Manager's responsibility to correct nonconforming Work, as provided in Subparagraph 12.2.2 of AIA. Document A201 and to satisfy other requirements, if any, which necessarily survive final payment; (2) a final application for Payment and a final accounting for the Cost of the Work have been submitted by the Construction Manager and reviewed by the Owner's accountants and (3) a final Certificate for Payment has then been issued by the Architect; such final payment shall be made by the Owner not more than 30 days after the issuance of the Architect's final Certificate for Payment, or as follows:

o 7.1.:1.1 When construction of the Work is 50% complete and the progress of the Work is satisfactory to the Owner, the retainage referred to in subparagraph 7.1.7.3 and 7.1.8 shall be reduced to 2 1/2%.

7.2.2 The amount of the final payment shall be calculated as follows:

.1 Take the sum of the Cost of the Work substantiated by the Construction Manager's final accounting and the Construction Manager's Fee; but not more than the Guaranteed Maximum Price.

.2 Subtract amounts, if any, for which the Architect withholds, in whole or in part, a final Certificate for Payment as provided in Subparagraph 9.5.1 of AIA. Document A201 or other provisions of the Contract Documents.

.3 Subtract the aggregate of previous payments made by the Owner.

If the aggregate of previous payments made by the Owner exceeds the amount due the Construction Manager shall reimburse the difference to the Owner.

7.2.3 The Owner's accountants will review and report in writing on the Construction Manager's final accounting within 30 days after delivery of the final accounting to the Architect by the Construction Manager. Based upon such Cost of the work as the Owner's accountants report to be substantiated by the Construction Manager's final accounting, and provided the other conditions of Subparagraph 7.2.1 have been met, the Architect will, within seven days after receipt of the written report of the Owner's accountants, either issue to the Owner a final Certificate for Payment with a copy to the Construction Manager, or notify the Construction Manager and Owner in writing of the Architect's reasons for withholding a certificate as provided in Subparagraph 9.5.1 of AIA Document A201. The time periods stated in this Paragraph 7.2 supersede those stated in Subparagraph 9.4.1 of AIA. Document A201.

7.2.4 If the Owner's accountants report the Cost of the work as substantiated by the Construction Manager's final accounting to be less than claimed by the Construction Manager, the Construction Manager shall be entitled to proceed in accordance with Article 9 without a further decision of the Architect. Unless agreed to otherwise, a demand for mediation or arbitration of the disputed amount shall be made by the Construction Manager within 60 days after the Construction Manager's receipt of a copy of the Architect's final Certificate for Payment. Failure to make such demand within this 60-day period shall result in the substantiated amount reported by the Owner's accountants becoming binding on the Construction Manager. Pending a final resolution of the disputed amount, the Owner shall pay the Construction Manager the amount certified in the Architect's final Certificate for Payment.

7.2.5 If, subsequent to final payment and at the Owner's request, the Construction Manager incurs costs described in Paragraph 6.1 and not excluded by Paragraph 6.2 (1) to correct nonconforming Work, or (2) arising from the resolution of disputes, the Owner shall reimburse the

Construction Manager such costs and the Construction Manager's Fee, if any, related thereto on the same basis as if such costs had been incurred prior to final payment, but not in excess of the Guaranteed Maximum Price. If the Construction Manager has participated in savings, the amount of such savings shall be recalculated and appropriate credit given to the Owner in determining the net amount to be paid by the Owner to the Construction Manager.

ARTICLE 8
INSURANCE AND BONDS

8.1 INSURANCE REQUIRED OF THE CONSTRUCTION MANAGER

During both phases of the Project, the Construction Manager shall purchase and maintain insurance as set forth in Paragraph 11.1 of AIA. Document A201. Such insurance shall be written for not less than the following limits, or greater if required by law:

8.1.1 Workers' Compensation and Employers' Liability meeting statutory limits mandated by State and Federal laws. If (l) limits in excess of those required by statute are to be provided or (2) the employer is not statutorily bound to obtain such insurance coverage or (3) additional coverages are required, additional coverages and limits for such insurance shall be as follows:

8.1.2 Commercial General Liability including coverage for Premises-Operations, Independent Contractors' Protective, Products-Completed Operations, Contractual Liability, Personal Injury, and Broad Form Property Damage (including coverage for Explosion, Collapse and Underground hazards):

$ 1,000,000	Each Occurrence
$ 1,000,000	General Aggregate
$ 1,000,000	Personal and Advertising Injury
$ 1,000,000	Products-Completed Operations Aggregate

.1 The policy shall be endorsed to have the General Aggregate apply to this Project only.

.2 Products and Completed Operations insurance shall be maintained for a minimum period of at least ( ) year(s) after either 90 days following Substantial Completion or final payment, whichever is earlier.

.3 The Contractual Liability insurance shall include coverage sufficient to meet the obligations in AIA. Document A201 under Paragraph 3.18.

8.1.3 Automobile Liability (owned, non-owned and hired vehicles) for bodily injury and property damage: $ 1,000,000 Each Accident

8.1.4 Other coverage:
(If Umbrella Excess Liability coverage is required over the primary insurance or retention, insert the coverage limits. Commercial General Liability and Automobile Liability limits may be attained by individual policies or by a combination of primary policies and Umbrella and/or Excess Liability policies.)

Excess Liability Coverage	$ 10,000,000 per occurrence

8.2 INSURANCE REQUIRED OF THE OWNER

During both phases of the Project, the Owner shall purchase and maintain liability and property insurance, including waivers of subrogation, as set forth in Paragraphs 11.2 and 11.3 of AIA. Document A201. Such insurance shall be written for not less than the following limits, or greater if required by law:

8.2.1 Property Insurance: $ 1,000 Deductible Per Occurrence

Limit shall be full amount of contract $ 1,000 Aggregate Deductible

8.2.2 Boiler and Machinery insurance with a limit of:
(If not a blanket policy, list the objects to be insured.)

8.3 PERFORMANCE BOND AND PAYMENT BOND

8.3.1 The Construction Manager shall not (Insert "Shall" or '"shall not ") furnish bonds covering faithful performance of the Contract and payment of obligations arising thereunder. Bonds may be obtained through the Construction Manager's usual source and the cost thereof shall be included in the Cost of the Work. The amount of each bond shall be equal to percent (%) of the Contract Sum.

8.3.2 The Construction Manager shall deliver the required bonds to the Owner at least three days before the commencement of any Work at the Project site.

ARTICLE 9

MISCELLANEOUS PROVISIONS

9.1

DISPUTE RESOLUTION FOR THE PRECONSTRUCTION PHASE

9.1.1 Claims, disputes or other matters in question between the parties to this Agreement which arise prior to the commencement of the Construction Phase or which relate solely to the Preconstruction Phase services of the Construction Manager or to the Owner's obligations to the Construction Manager during the Preconstruction Phase, shall be resolved by mediation or by arbitration.

9.1.2 Any mediation conducted pursuant to this Paragraph 9.1 shall be held in accordance with the Construction Industry Mediation Rules of the American Arbitration Association currently in effect, unless the parties mutually agree otherwise. Demand for mediation shall be filed in writing with the other party to this Agreement and with the American Arbitration Association. Any demand for mediation shall be made within a reasonable time after the claim, dispute or other matter in question has arisen. In no event shall the demand for mediation be made after the date when institution of legal or equitable proceedings based upon such claim, dispute or other matter in question would be barred by the applicable statute of limitations.

9.13 Any claim, dispute or other matter in question not resolved by mediation shall be decided by arbitration in accordance with the Construction Industry Arbitration Rules of the American Arbitration Association currently in effect unless the parties mutually agree otherwise.

9.1.4 Demand for arbitration shall be filed in writing with the other party to this Agreement and with the American Arbitration Association. A demand for arbitration may be made concurrently with a demand for mediation and shall be made within a reasonable time after the claim, dispute or other matter in question has arisen. In no event shall the demand for arbitration be made after the date when institution of legal or equitable proceedings based upon such claim, dispute or other matter in question would be barred by the applicable statute of limitations.

9.1.5 No arbitration arising out of or relating to the Contract Documents shall include, by consolidation or joinder or in any other manner, the Architect, the Architect's employees or consultants, except by written consent containing specific reference to the Agreement and signed by the Architect, Owner, Construction Manager and any other person or entity sought to be joined. No arbitration shall include, by consolidation or joinder or in any other manner, parties other than the Owner, Construction Manager, a separate contractor as described in

Article 6 of AIA Document A201 and other persons substantially involved in a common question of fact or law whose presence is required if complete relief is to be accorded in arbitration. No person or entity other than the Owner or Construction Manager or a separate contractor as described in Article 6 of AIA Document A201 shall be included as an original third party or additional third party to an arbitration whose interest or responsibility is insubstantial. Consent to arbitration involving an additional person or entity shall not constitute agreement to arbitration of a dispute not described in such consent or with a person or entity not named or described therein. The foregoing agreement to arbitrate and other agreements to arbitrate with an additional person or entity duly consented to by parties to this Agreement shall be specifically enforceable under applicable law in any court having jurisdiction thereof.

9.1.6 The award rendered by the arbitrator or arbitrators shall be final, and judgment may be entered upon it in accordance with applicable law in any court having jurisdiction thereof.

9.2 DISPUTE RESOLUTION FOR THE CONSTRUCTION PHASE

9.2.1 Any other claim, dispute or other matter in question arising out of or related to this Agreement or breach thereof shall be settled in accordance with Article 4 of AIA Document A201, except that in addition to and prior to arbitration, the parties shall endeavor to settle disputes by mediation in accordance with the Construction Industry Mediation Rules of the American Arbitration Association currently in effect unless the parties mutually agree otherwise. Any mediation arising under this Paragraph shall be conducted in accordance with the provisions of Subparagraphs 9.1.2 and 9.1.3.

9.3 OTHER PROVISIONS

9.3.1 Unless otherwise noted, the terms used in this Agreement shall have the same meaning as those in the 1987 Edition of AIA Document A201, General Conditions of the Contract for Construction.

9.3.2 EXTENT OF CONTRACT

This Contract, which includes this Agreement and the other documents incorporated herein by reference, represents the entire and integrated agreement between the Owner and Construction Manager and supersedes all prior negotiations, representations or agreements, either written or oral. This Agreement may be amended only by written instrument signed by both the Owner and Construction Manager. If anything in any document incorporated into this Agreement is inconsistent with this Agreement, this Agreement shall govern.

9.3.3 OWNERSHIP AND USE OF DOCUMENTS

The Drawings, Specifications and other documents prepared by the Architect, and copies thereof furnished to the Construction Manager, are for use solely with respect to this Project. They are not to be used by the Construction Manager, Subcontractors, Sub-subcontractors or suppliers on other projects, or for additions to this Project outside the scope of the Work, without the specific written consent of the Owner and Architect. The Construction Manager, Subcontractors, Sub-subcontractors and suppliers are granted a limited license to use and reproduce applicable portions of the Drawings, Specifications and other documents prepared by the Architect appropriate to and for use in the execution of their Work under the Contract Documents.

9.3.4 GOVERNING LAW

The Contract shall be governed by the law of the place where the Project is located.

9.3.5 ASSIGNMENT

The Owner and Construction Manager respectively bind themselves, their partners, successors, assigns and legal representatives to the other party hereto and to partners, successors, assigns and legal representatives of such other party in respect to covenants, agreements and obligations contained in the Contract Documents. Neither party to the Contract shall assign the Contract as a whole without written consent of the other. If either party attempts to make such an assignment without such consent, that party shall nevertheless remain legally responsible for all obligations under the Contract.

ARTICLE 10
TERMINATION OR SUSPENSION

10.1 TERMINATION PRIOR TO ESTABLISHING GUARANTEED MAXIMUM PRICE

10.1.1 Prior to execution by both parties of Amendment No. l establishing the Guaranteed Maximum Price, the Owner may terminate this Contract at any time without cause, and the Construction Manager may terminate this Contact for any of the reasons described in Subparagraph 14.1.1 of AIA Document A201.

10.1.2 If the Owner or Construction Manager terminates this Contract pursuant to this Paragraph 10.1 prior to commencement of the Construction Phase, the Construction Manager shall be equitably compensated for Preconstruction Phase services performed prior to receipt of notice of termination; provided, however, that the compensation for such services shall not exceed the compensation set forth in Subparagraph 4.1.1.

10.1.3 If the Owner or Construction Manager terminates this Contract pursuant to this Paragraph 10.1 after commencement of the Construction Phase, the Construction Manager shall, in addition to the compensation provided in Subparagraph 10.1.2, be paid an amount calculated as follows:

.1 Take the Cost of the Work incurred by the Construction Manager.

.2 Add the Construction Manager's Fee computed upon the Cost of the Work to the date of termination at the rate stated in Paragraph 5.1 or, if the Construction Manager's Fee is stated as a fixed sum in that Paragraph, an amount which bears the same ratio to that fixed sum Fee as the Cost of Work at the time of termination bears to a reasonable estimate of the probable Cost of the Work upon its completion.

.3 Subtract the aggregate of previous payments made by the Owner on account of the Construction Phase.

The Owner shall also pay the Construction Manager fair compensation, either by purchase or rental at the election of the Owner, for any equipment owned by the Construction Manager which the Owner elects to retain and which is not otherwise included in the Cost of the Work under Clause 10.1.3.1. To the extent that the Owner elects to take legal assignment of subcontracts and purchase orders (including rental agreements), the Construction Manager shall, as a condition of receiving the payments referred to in this Article 10, execute and deliver all such papers and take all such steps, including the legal assignment of such subcontracts and other contractual rights of the Construction Manager, as the Owner may require for the purpose of fully vesting in the Owner the rights and benefits of the Construction Manager under such subcontracts or purchase orders.

Subcontracts, purchase orders and rental agreements entered into by the Construction Manager with the Owner's written approval prior to the execution of Amendment No. 1 shall contain provisions permitting assignment to the Owner as described above. If the Owner accepts such assignment, the Owner shall reimburse or indemnify the Construction Manager with respect to all costs arising under the subcontract, purchase order or rental agreement except those which would not have been reimbursable as Cost of the Work if the contract had not been terminated. If the Owner elects not to accept the assignment of any subcontract, purchase order or rental agreement which would have constituted a Cost of the Work had this agreement not been terminated, the Construction Manager shall terminate such subcontract, purchase order or rental agreement and the Owner shall pay the Construction Manager the costs necessarily incurred by the Construction Manager by reason of such termination.

10.2 TERMINATION SUBSEQUENT TO ESTABLISHING GUARANTEED MAXIMUM PRICE

Subsequent to execution by both parties of Amendment No. 1, the Contract may be terminated as provided in Article 14 of AIA Document A201.

10.2.1 In the event of such termination by the Owner, the amount payable to the Construction Manager pursuant to Subparagraph 14.1.2 of AIA Document A201 shall not exceed the amount the Construction Manager would have been entitled to receive pursuant to Subparagraphs 10.1.2 and 10.1 of this Agreement.

10.2.2 In the event of such termination by the Construction Manager, the amount to be paid to the Construction Manager under Subparagraph 14.1.2 of AIA Document A201 shall not exceed the amount the Construction Manager would be entitled to receive under Subparagraphs 10.1.2 or 10.1.3 above, except that the Construction Manager's Fee shall be calculated as if the Work had been fully completed by the Construction Manager, including a reasonable estimate of the Cost of the Work for Work not actually completed.

10.3 SUSPENSION

The Work may be suspended by the Owner as provided in Article 14 of AIA Document A201; in such case, the Guaranteed Maximum Price, if established, shall be increased as provided in Subparagraph 14.3.2 of AIA Document A201 except that the term "cost of performance of the Contract" in that Subparagraph shall be understood to mean the Cost of the Work and the term "profit" shall be understood to mean the Construction Manager's Fee as described in Subparagraphs 5.1.1 and 5.3.4 of this Agreement.

ARTICLE 11

OTHER CONDITIONS AND SERVICES

11.1

The total cost of the Construction Manager's general conditions as listed on Exhibit A attached shall not exceed 3 1/4% (three and one-quarter percent) of the final contract cost.

11.2

Should the Construction Phase extend beyond seven months through no fault of the Construction Manager, the Construction Manager shall be entitled to additional reimbursement for general conditions as listed on Exhibit A and not to exceed $46,000 per month.

11.3

In accordance with Paragraph 2.4, the Construction Manager shall secure the design of the Mechanical, Electrical, and Plumbing Systems as part of the pre-construction services.

This Agreement entered into as of the day and year first written above.

OWNER:	PNGI Charles Town Gaming Limited Liability Company	CONSTRUCTION MANAGER: Warfel Construction Company
By:	/s/ Peter M. Carlino	/s/ T. W. Peters, Pres
Date:	December 17, 1996	December 23, 1996
ATTEST:	/s/ Susan Montgomery	Witness: /s/ Carol A. Burkholder

The Charles Town H.B.P.A., Inc.
P.O. Box 581
Charles Town, WV 25414

March 19, 1997

West Virginia Lottery Commission
Mr. Richard Boyle
312 MacCorkle Avenue, S.E.
P.O. Box 2067
Charleston, WV 25327

Dear Mr. Boyle:

This letter constitutes a Letter Agreement by and between PNGI Charles Town Gaming Limited Liability Company, a West Virginia Limited Liability Company, and The Charles Town H.B.P.A., Inc., a West Virginia Corporation, that the net terminal income from Video Lottery Terminals operated by PNGI Charles Town Gaming Limited Liability Company at Charles Town Racetrack shall be distributed in accordance with the provisions of Section 29-22A-10(c) of the Race Track Video Lottery Act, as such statutory provision shall be in effect on the date of execution of this Letter Agreement, or as hereinafter amended from time to time by the West Virginia Legislature, either at any regular or special session.

This Letter Agreement is binding upon the signatories thereof for a period from the date of its execution through June 30, 1997, and for a period of one (1) year from July 1, 1997 through June 30, 1998, inclusive, and shall become binding and effective upon the date of final execution by all of the parties thereto, and shall not be amended, revised, extended, or superceded, either by the actions of the parties, inaction, or default or inability to negotiate the statutorily mandated annual renewal of the Letter Agreement by the signatories hereto, without the execution in writing of an Agreement by all of the signatories hereto.

The undersigned, Jay Fortney, is President/General Manager of PNGI Charles Town Gaming Limited Liability Company, a West Virginia Limited Liability Company, and has the authority to bind the Limited Liability Company.

The undersigned, Raymond J. Funkhouser, II, is President of The Charles Town H.B.P.A., Inc., a West Virginia Corporation, and has the authority to bind the members of that Corporation.

Witness the following signatures and seals as of the 20th day of March, 1997.

PNGI CHARLES TOWN GAMING
LIMITED LIABILITY COMPANY,
A West Virginia Limited Liability Company

By: /s/ Jay Fortney

Jay Fortney, its President and
General Manager

CHARLES TOWN H.B.P.A., INC.,
a West Virginia Corporation

By: /s/ Raymond J. Funkhouser,II
---
it's President

STATE OF WEST VIRGINIA

COUNTY OF JEFFERSON, to-wit:

I, Charlotte L. Burner , a notary public for the County/City and State aforesaid, certify that JAY FORTNEY, whose name is signed to the foregoing as President and General Manager of PNGI CHARLES TOWN GAMING LIMITED LIABILITY COMPANY, a West Virginia Limited Liability Company, dated the 20th day of March , 1997 acknowledged the same on behalf of the Limited Liability Company as its General Manager and President before me in the County/City aforesaid.

Given under my hand and official seal this 20th day of March, 1997.

/s/ Charlotte L. Burner

Notary Public

My commission expires on November 27, 2001

STATE OF WEST VIRGINIA

COUNTY OF JEFFERSON, to-wit:

I, Patricia M. Evans, a notary public for the County/City and State aforesaid, certify that RAYMOND J. FUNKHOUSER, II, whose name is signed to the foregoing as President of THE CHARLES TOWN H.B.P.A., INC., a West Virginia Corporation, dated the 20th Day of March , 1997 acknowledged the same on behalf of the Corporation as its President before me in the County/City aforesaid.

Given under my hand and official seal this 20th day of March, 1997.

/s/ Patricia M. Evans

Notary Public

My commission expires on September 18, 2006

The West Virginia Thoroughbred Breeders Association
Post Office Box 626
Charles Town, WV 25414

March 21, 1997

West Virginia Lottery Commission
Mr. Richard Boyle
312 MacCorkle Avenue, S.E.
P.O. Box 2067
Charleston, WV 25327

Dear Mr. Boyle:

This letter constitutes a Letter Agreement by and between PNGI Charles Town Gaming Limited Liability Company, a West Virginia Limited Liability, and The West Virginia Thoroughbred Breeders Association, a West Virginia Association, that the net terminal income from Video Lottery Terminals operated by PNGI Charles Town Gaming Limited Liability Company at Charles Town Racetrack shall be distributed in accordance with the provisions of Section 29-22A-10(c) of the Race Track Video Lottery Act, as such statutory provision shall be in effect on the date of execution of this Letter Agreement, or as hereinafter amended from time to time by the West Virginia Legislature, either at any regular or special session.

This Letter Agreement is binding upon the signatories thereof for a period from the date of its execution through June 30, 1997, and for a period of one (1) year from July 1, 1997 through June 30, 1998, inclusive, and shall become binding and effective upon the date of final execution by all of the parties thereto, and shall not be amended, revised, extended, or superceded, either by the actions of the parties, inaction, or default or inability to negotiate the statutorily mandated annual renewal of the Letter Agreement by the signatories hereto, without the execution in writing of an Agreement by all of the signatories hereto.

The undersigned, Jay Fortney, is President/General Manager of PNGI Charles Town Gaming Limited Liability Company, a West Virginia Limited Liability Company, and has the authority to bind the Limited Liability Company.

The undersigned, Keith B. Berkeley, D.V.M., is President of The West Virginia Thoroughbred Breeders Association, a West Virginia Association, and has the authority to bind the members of that Association.

Witness the following signatures and seals as of the 24th day of March, 1997.

PNGI CHARLES TOWN GAMING
LIMITED LIABILITY COMPANY,
A West Virginia Limited Liability Company

By: /s/ Jay Fortney

Jay Fortney, its President and
General Manager

THE WEST VIRGINIA THOROUGHBRED
BREEDERS ASSOCIATION, a West Virginia
Association

By: /s/ Keith B. Berkeley, D.V.M.

Keith B. Berkeley, D.V.M.
its President

STATE OF WEST VIRGINIA

COUNTY OF JEFFERSON, to-wit:

I, Charlotte L. Burner , a notary public for the County/City and State aforesaid, certify that JAY FORTNEY, whose name is signed to the foregoing as President and General Manager of PNGI CHARLES TOWN GAMING LIMITED LIABILITY COMPANY, a West Virginia Limited Liability Company, dated the 24th day of March, 1997 acknowledged the same on behalf of the Limited Liability Company as its General Manager and President before me in the County/City aforesaid.

Given under my hand and official seal this 24th day of March, 1997.

/s/ Charlotte L. Burner

Notary Public

My commission expires on November 27, 2001.

STATE OF WEST VIRGINIA

COUNTY OF JEFFERSON, to-wit:

I, Charlotte L. Burner , a notary public for the County/City and State aforesaid, certify that KEITH B. BERKELEY, D.V.M., whose name is signed to the foregoing as President of THE WEST VIRGINIA THOROUGHBRED BREEDERS ASSOCIATION, dated the 24th Day of March , 1997 acknowledged the same on behalf of the Association as its President before me in the County/City aforesaid.

Given under my hand and official seal this 24th day of March, 1997.

/s/ Charlotte L. Burner

Notary Public

My commission expires on November 27, 2001.

Charles Town Races
Post Office Box 551 Charles Town, West Virginia 25414
o 304-725-7001 Fax 304-725-6979

January 1997

West Virginia Lottery Commission
Mr. Richard Boyle
312 MacCorkle Avenue S.E.
P.O. Box 2067
Charleston, WV 25327

Dear Mr. Boyle:

This will confirm our agreement that the proceeds from Video Lottery Terminals operated at Charles Town Races shall be distributed in accordance with Section 29-22A-10 of the West Virginia Race Track Video Lottery Act.

Sincerely,

/s/ Jay Fortney

Jay Fortney
President/General Manager
Charles Town Races

cc: Lois J. Graham

Charles Town Races
Post Office Box 551 Charles Town, West Virginia 25414
o 304-725-7001 Fax 304-725-6979

(1) The undersigned is the representative of a majority of the horse owners and trainers at Charles Town Races.

(2) The undersigned is the representative of a majority of the pari-mutuel clerks at Charles Town Races.

(3) The undersigned is the representative of a majority of the breeders at Charles Town Races.

(2) West Virginia Union of Mutuels Clerks, Local 553, service Employees International Union, AFL-CIO.

By /s/ Joseph G. Farrie — 1/15/97

Joseph Farrie, Active President — Date

By /s/ Faye D'Angelo — 1/15/97

Faye D'Angelo, President Elect (Effective January 28, 1997) — Date

PNGI Charles Town Gaming Limited Liability Company

By: /s/ Jay Fortney — 3/24/97

Jay Fortney, President/General Manager — Date

Exhibit # 21 Subsidiaries of the Registrant

Mountainview Thoroughbred Racing Association
Pennsylvania National Turf Club, Inc.
Penn National Speedway, Inc.
Sterling Aviation, Inc.
Penn National Holding Company
Penn National Gaming Of West Virginia, Inc.
Penn National Gaming Of Indiana, Inc.
PNGI Pocono, Inc.
The Plains Company
Pocono Downs, Inc.
Northeast Concessions, Inc.
Audio Video Concepts, Inc.
Backside, Inc.
The Downs Off-Track Wagering, Inc.
Mill Creek Land, Inc.
PNGI Charles Town Gaming, Limited Liability Company (80% owned)

5
1,000

YEAR
DEC-31-1996
DEC-01-1996
DEC-31-1996
5,634
0
4,293
0
0
11,569
66,747
8,029
96,723
12,078
0
0
0
0
134
27,747
96,723
62,834
62,834
48,148
48,148
5,226
0
506
9,304
3,794
5,510
0
0
0
5,510
.39
.39