TAIWAN SEMICONDUCTOR MANUFACTURING CO LTD
Form 6-K
November 08, 2010

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1934 Act Registration No. 1-14700

SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549
FORM 6-K

REPORT OF FOREIGN PRIVATE ISSUER
PURSUANT TO RULE 13a-16 OR 15d-16
OF THE SECURITIES EXCHANGE ACT OF 1934
For the month of October 2010
Taiwan Semiconductor Manufacturing Company Ltd.
(Translation of Registrant s Name Into English)
No. 8, Li-Hsin Rd. 6,
Hsinchu Science Park,
Taiwan
(Address of Principal Executive Offices)

(Indicate by check mark whether the registrant files or will file annual reports under cover of Form 20-F or Form 40-F.)

Form 20-F þ Form 40-F o

(Indicate by check mark whether the registrant by furnishing the information contained in this form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934.)

Yes o No þ

(If Yes is marked, indicated below the file number assigned to the registrant in connection with Rule 12g3-2(b): 82: ______.)

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Taiwan Semiconductor Manufacturing Company Limited
Financial Statements for the
Nine Months Ended September 30, 2010 and 2009 and
Independent Accountants Review Report

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INDEPENDENT ACCOUNTANTS REVIEW REPORT

The Board of Directors and Shareholders
Taiwan Semiconductor Manufacturing Company Limited

We have reviewed the accompanying balance sheets of Taiwan Semiconductor Manufacturing Company Limited as of September 30, 2010 and 2009, and the related statements of income and cash flows for the nine months then ended. These financial statements are the responsibility of the Company s management. Our responsibility is to issue a report on these financial statements based on our reviews.

We conducted our reviews in accordance with Statement on Auditing Standards No. 36, Review of Financial Statements, issued by the Auditing Standards Committee of the Accounting Research and Development Foundation of the Republic of China. A review consists principally of applying analytical procedures to financial data and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the Republic of China, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the financial statements referred to above for them to be in conformity with the Guidelines Governing the Preparation of Financial Reports by Securities Issuers, requirements of the Business Accounting Law and Guidelines Governing Business Accounting with respect to financial accounting standards, and accounting principles generally accepted in the Republic of China.

As discussed in Note 3 to the financial statements, effective January 1, 2009, Taiwan Semiconductor Manufacturing Company Limited adopted the newly revised Statement of Financial Accounting Standards No. 10, Accounting for Inventories.

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We have also reviewed, in accordance with Statement on Auditing Standards No. 36, the consolidated financial statements of Taiwan Semiconductor Manufacturing Company Limited and subsidiaries as of and for the nine months ended September 30, 2010 on which we have issued an unqualified review report and as of and for the nine months ended September 30, 2009 on which we have issued an unqualified review report with an explanatory paragraph relating to the adoption of the newly revised Statement of Financial Accounting Standards No. 10, Accounting for Inventories.

October 21, 2010

Notice to Readers

The accompanying financial statements are intended only to present the financial position, results of operations and cash flows in accordance with accounting principles and practices generally accepted in the Republic of China and not those of any other jurisdictions. The standards, procedures and practices to review such financial statements are those generally accepted and applied in the Republic of China.

For the convenience of readers, the accountants review report and the accompanying financial statements have been translated into English from the original Chinese version prepared and used in the Republic of China. If there is any conflict between the English version and the original Chinese version or any difference in the interpretation of the two versions, the Chinese-language accountants review report and financial statements shall prevail.

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Taiwan Semiconductor Manufacturing Company Limited
BALANCE SHEETS
SEPTEMBER 30, 2010 AND 2009
(In Thousands of New Taiwan Dollars, Except Par Value)
(Reviewed, Not Audited)

	2010		2009	
	Amount	**%**	**Amount**	**%**
ASSETS				
CURRENT ASSETS				
Cash and cash equivalents (Notes 2 and 4)	$ 90,399,569	14	$ 102,286,286	20
Financial assets at fair value through profit or loss (Notes 2, 5 and 23)	14,383		367,461	
Available-for-sale financial assets (Notes 2, 6 and 23)	4,048,549	1		
Held-to-maturity financial assets (Notes 2, 7 and 23)	5,598,471	1	8,374,389	2
Receivables from related parties (Note 24)	25,218,595	4	22,464,807	4
Notes and accounts receivable	27,263,732	4	20,825,053	4
Allowance for doubtful receivables (Notes 2 and 8)	(540,000)		(436,000)	
Allowance for sales returns and others (Notes 2 and 8)	(6,590,121)	(1)	(8,874,199)	(2)
Other receivables from related parties (Note 24)	657,787		321,499	
Other financial assets (Note 25)	282,002		903,842	
Inventories (Notes 2, 3 and 9)	23,773,530	4	17,194,184	3
Deferred income tax assets (Notes 2 and 18)	1,965,666		4,287,040	1
Prepaid expenses and other current assets	1,243,888		613,580	
Total current assets	173,336,051	27	168,327,942	32
LONG-TERM INVESTMENTS (Notes 2, 6, 7, 10, 11 and 23)				
Investments accounted for using equity method	115,519,229	18	105,085,064	20
Available-for-sale financial assets	1,036,502		1,033,473	
Held-to-maturity financial assets	1,658,671		13,278,683	3
Financial assets carried at cost	497,835		501,563	
Total long-term investments	118,712,237	18	119,898,783	23
PROPERTY, PLANT AND EQUIPMENT (Notes 2, 12 and 24)				
Cost				
Buildings	127,695,671	19	123,783,029	24
Machinery and equipment	836,615,885	129	674,274,132	129
Office equipment	11,310,109	2	10,337,123	2

	975,621,665	150	808,394,284	155
Accumulated depreciation	(685,650,928)	(105)	(610,117,838)	(117)
Advance payments and construction in progress	40,621,708	6	18,320,302	4
Net property, plant and equipment	330,592,445	51	216,596,748	42
INTANGIBLE ASSETS				
Goodwill (Note 2)	1,567,756		1,567,756	
Deferred charges, net (Notes 2 and 13)	5,608,464	1	5,453,680	1
Total intangible assets	7,176,220	1	7,021,436	1
OTHER ASSETS				
Deferred income tax assets (Notes 2 and 18)	10,200,761	2	6,973,800	1
Refundable deposits	9,059,889	1	2,754,296	1
Others (Notes 2 and 24)	437,617		487,358	
Total other assets	19,698,267	3	10,215,454	2
TOTAL	$ 649,515,220	100	$ 522,060,363	100
LIABILITIES AND SHAREHOLDERS EQUITY				
CURRENT LIABILITIES				
Short-term loans (Note 14)	$ 37,596,000	6	$	
Financial liabilities at fair value through profit or loss (Notes 2, 5 and 23)	73,530			
Accounts payable	9,645,148	1	8,297,913	1
Payables to related parties (Note 24)	3,451,537	1	2,294,155	
Income tax payable (Notes 2 and 18)	5,252,509	1	5,726,656	1
Accrued profit sharing to employees and bonus to directors (Notes 2 and 20)	8,201,440	1	8,618,411	2
Payables to contractors and equipment suppliers	26,017,941	4	15,520,005	3
Accrued expenses and other current liabilities (Notes 16 and 23)	13,471,370	2	8,675,196	2
Total current liabilities	103,709,475	16	49,132,336	9
LONG-TERM LIABILITIES				
Bonds payable (Notes 15 and 23)	4,500,000	1	4,500,000	1
Other long-term payables (Notes 16 and 23)	156,650		579,600	

Total long-term liabilities	4,656,650	1	5,079,600	1
OTHER LIABILITIES				
Accrued pension cost (Notes 2 and 17)	3,815,765		3,786,616	1
Guarantee deposits (Note 27)	809,698		1,104,704	
Deferred credits (Notes 2 and 24)			71,809	
Total other liabilities	4,625,463		4,963,129	1
Total liabilities	112,991,588	17	59,175,065	11
CAPITAL STOCK NT$10 PAR VALUE (Note 20)				
Authorized: 28,050,000 thousand shares				
Issued: 25,907,344 thousand shares in 2010				
25,900,662 thousand shares in 2009	259,073,440	40	259,006,623	50
CAPITAL SURPLUS (Notes 2 and 20)	55,634,070	9	55,439,919	10
RETAINED EARNINGS (Note 20)				
Appropriated as legal capital reserve	86,239,494	14	77,317,710	15
Appropriated as special capital reserve	1,313,047			
Unappropriated earnings	137,506,581	21	71,898,923	14
	225,059,122	35	149,216,633	29
OTHERS (Notes 2 and 23)				
Cumulative translation adjustments	(3,761,669)	(1)	(1,272,298)	
Unrealized gain on financial instruments	518,669		494,421	
	(3,243,000)	(1)	(777,877)	
Total shareholders equity	536,523,632	83	462,885,298	89
TOTAL	$ 649,515,220	100	$ 522,060,363	100

The accompanying notes are an integral part of the financial statements.
(With Deloitte & Touche review report dated October 21, 2010)

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Taiwan Semiconductor Manufacturing Company Limited
STATEMENTS OF INCOME
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2010 AND 2009
(In Thousands of New Taiwan Dollars, Except Earnings Per Share)
(Reviewed, Not Audited)

	2010		2009	
	Amount	%	Amount	%
GROSS SALES (Notes 2 and 24)	$ 308,832,522		$ 206,462,258	
SALES RETURNS AND ALLOWANCES (Notes 2 and 8)	8,715,191		9,715,735	
NET SALES	300,117,331	100	196,746,523	100
COST OF SALES (Notes 3, 9, 19 and 24)	154,784,733	52	113,516,518	58
GROSS PROFIT	145,332,598	48	83,230,005	42
UNREALIZED GROSS PROFIT FROM AFFILIATES (Note 2)	136,536		128,152	
REALIZED GROSS PROFIT	145,196,062	48	83,101,853	42
OPERATING EXPENSES (Notes 19 and 24)				
Research and development	20,084,456	6	13,686,108	7
General and administrative	8,168,276	3	7,246,047	3
Marketing	2,175,006	1	1,427,041	1
Total operating expenses	30,427,738	10	22,359,196	11
INCOME FROM OPERATIONS	114,768,324	38	60,742,657	31
NON-OPERATING INCOME AND GAINS				
Settlement income (Note 27)	6,343,524	2	494,070	
Equity in earnings of equity method investees, net (Notes 2 and 10)	4,677,062	2		
Interest income (Note 2)	555,085		938,369	1
Technical service income (Notes 24 and 27)	354,756		279,644	
Valuation gain on financial instruments, net (Notes 2, 5 and 23)	156,175		576,910	
Others (Notes 2, 23 and 24)	266,309		409,157	

Total non-operating income and gains	12,352,911	4	2,698,150	1

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Taiwan Semiconductor Manufacturing Company Limited
STATEMENTS OF INCOME
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2010 AND 2009
(In Thousands of New Taiwan Dollars, Except Earnings Per Share)
(Reviewed, Not Audited)

	2010		2009	
	Amount	%	Amount	%
NON-OPERATING EXPENSES AND LOSSES				
Casualty loss (Note 9)	$ 190,992		$	
Interest expense	142,824		108,276	
Equity in losses of equity method investees, net (Notes 2 and 10)			2,772,157	1
Foreign exchange loss, net (Note 2)			611,098	
Others (Note 2)	113,919		102,553	
Total non-operating expenses and losses	447,735		3,594,084	1
INCOME BEFORE INCOME TAX	126,673,500	42	59,846,723	31
INCOME TAX EXPENSE (Notes 2 and 18)	5,788,940	2	3,294,936	2
NET INCOME	$ 120,884,560	40	$ 56,551,787	29

	2010		2009	
	Before Income Tax	After Income Tax	Before Income Tax	After Income Tax
EARNINGS PER SHARE (NT$, Note 22)				
Basic earnings per share	$ 4.89	$ 4.67	$ 2.32	$ 2.19
Diluted earnings per share	$ 4.89	$ 4.66	$ 2.30	$ 2.18

The accompanying notes are an integral part of the financial statements.
(With Deloitte & Touche review report dated October 21, 2010)

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Taiwan Semiconductor Manufacturing Company Limited
STATEMENTS OF CASH FLOWS
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2010 AND 2009
(In Thousands of New Taiwan Dollars)
(Reviewed, Not Audited)

	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	$ 120,884,560	$ 56,551,787
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	61,013,582	55,547,956
Unrealized gross profit from affiliates	136,536	128,152
Amortization of premium/discount of financial assets	13,756	(6,248)
Gain on disposal of available-for-sale financial assets, net		(37,370)
Gain on held-to-maturity financial assets redeemed by the issuer		(16,091)
Loss on disposal of financial assets carried at cost	1,263	97
Equity in losses (earnings) of equity method investees, net	(4,677,062)	2,772,157
Cash dividends received from equity method investees	422,490	1,402,592
Gain on disposal of property, plant and equipment and other assets, net	(40,510)	(77,173)
Settlement income from receiving equity securities	(4,434,364)	
Deferred income tax	(273,785)	(1,112,168)
Changes in operating assets and liabilities:		
Decrease (increase) in:		
Financial assets and liabilities at fair value through profit or loss	240,890	(408,619)
Receivables from related parties	(2,676,822)	(10,736,603)
Notes and accounts receivable	(7,379,212)	(9,383,877)
Allowance for doubtful receivables	109,000	(746)
Allowance for sales returns and others	(1,993,511)	3,005,617
Other receivables from related parties	23,875	160,152
Other financial assets	822,070	(192,087)
Inventories	(4,943,314)	(4,386,248)
Prepaid expenses and other current assets	(339,265)	578,895
Increase (decrease) in:		
Accounts payable	456,994	4,306,139
Payables to related parties	1,412,195	1,091,805
Income tax payable	(3,508,611)	(3,496,155)
Bonuses payable to employees and directors	1,430,102	965,342
Accrued expenses and other current liabilities	(3,522,931)	641,917
Accrued pension cost	8,589	76,607
Deferred credits	(47,873)	(206,551)
Net cash provided by operating activities	153,138,642	97,169,279

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Taiwan Semiconductor Manufacturing Company Limited
STATEMENTS OF CASH FLOWS
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2010 AND 2009
(In Thousands of New Taiwan Dollars)
(Reviewed, Not Audited)

	2010	2009
CASH FLOWS FROM INVESTING ACTIVITIES		
Acquisitions of:		
Property, plant and equipment	$ (138,922,267)	$ (44,452,382)
Held-to-maturity financial assets		(9,405,409)
Investments accounted for using equity method	(8,125,980)	(262,922)
Financial assets carried at cost	(480)	(986)
Proceeds from disposal or redemption of:		
Available-for-sale financial assets		1,037,370
Held-to-maturity financial assets	14,893,000	5,418,000
Financial assets carried at cost	3,370	18,828
Property, plant and equipment and other assets	62,293	68,579
Proceeds from return of capital by investees		20,201
Increase in deferred charges	(1,177,741)	(438,308)
Increase in refundable deposits	(6,361,773)	(34,559)
Net cash used in investing activities	(139,629,578)	(48,031,588)
CASH FLOWS FROM FINANCING ACTIVITIES		
Increase in short-term loans	37,596,000	
Repayment of bonds payable		(8,000,000)
Decrease in guarantee deposits	(191,678)	(374,448)
Proceeds from exercise of employee stock options	150,760	190,995
Cash dividends	(77,708,120)	(76,876,312)
Net cash used in financing activities	(40,153,038)	(85,059,765)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(26,643,974)	(35,922,074)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	117,043,543	138,208,360
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 90,399,569	$ 102,286,286
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Interest paid	$ 171,888	$ 351,803
Income tax paid	$ 9,477,093	$ 7,770,195

INVESTING ACTIVITIES AFFECTING BOTH CASH AND NON-CASH ITEMS		
Acquisition of property, plant and equipment	$ 135,815,549	$ 52,075,005
Decrease (increase) in payables to contractors and equipment suppliers	3,229,638	(7,622,623)
Nonmonetary exchange trade-out price	(122,920)	
Cash paid	$ 138,922,267	$ 44,452,382

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Taiwan Semiconductor Manufacturing Company Limited
STATEMENTS OF CASH FLOWS
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2010 AND 2009
(In Thousands of New Taiwan Dollars)
(Reviewed, Not Audited)

	2010	2009
Disposal of property, plant and equipment and other assets	$ 620,872	$ 60,488
Decrease (increase) in other receivables from related parties	(435,659)	8,091
Nonmonetary exchange trade-out price	(122,920)	
Cash received	$ 62,293	$ 68,579
NON-CASH FINANCING ACTIVITIES		
Current portion of other long-term payables (under accrued expenses and other current liabilities)	$ 614,061	$ 775,567
Profit sharing to employees transferred to capital stock	$	$ 7,494,988

The accompanying notes are an integral part of the financial statements.
(With Deloitte & Touche review report dated October 21, 2010)

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Taiwan Semiconductor Manufacturing Company Limited
NOTES TO FINANCIAL STATEMENTS
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2010 AND 2009
(Amounts in Thousands of New Taiwan Dollars, Unless Specified Otherwise)
(Reviewed, Not Audited)

1. GENERAL

Taiwan Semiconductor Manufacturing Company Limited (the Company or TSMC), a Republic of China (R.O.C.) corporation, was incorporated on February 21, 1987. The Company is a dedicated foundry in the semiconductor industry which engages mainly in the manufacturing, selling, packaging, testing and computer-aided design of integrated circuits and other semiconductor devices and the manufacturing of masks. Beginning in 2010, the Company also engages in the researching, developing, designing, manufacturing and selling of LED lighting devices and related applications products and systems, and renewable energy and efficiency related technologies and products. On September 5, 1994, its shares were listed on the Taiwan Stock Exchange (TSE). On October 8, 1997, TSMC listed some of its shares of stock on the New York Stock Exchange (NYSE) in the form of American Depositary Shares (ADSs).

As of September 30, 2010 and 2009, the Company had 29,377 and 20,566 employees, respectively.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements are presented in conformity with the Guidelines Governing the Preparation of Financial Reports by Securities Issuers, Business Accounting Law, Guidelines Governing Business Accounting, and accounting principles generally accepted in the R.O.C.

For the convenience of readers, the accompanying financial statements have been translated into English from the original Chinese version prepared and used in the R.O.C. If there is any conflict between the English version and the original Chinese version or any difference in the interpretation of the two versions, the Chinese-language financial statements shall prevail.

Significant accounting policies are summarized as follows:

Use of Estimates

The preparation of financial statements in conformity with the aforementioned guidelines, law and principles requires management to make reasonable assumptions and estimates of matters that are inherently uncertain. The actual results may differ from management s estimates.

Classification of Current and Noncurrent Assets and Liabilities

Current assets are assets held for trading purposes and assets expected to be converted to cash, sold or consumed within one year from the balance sheet date. Current liabilities are obligations incurred for trading purposes and obligations expected to be settled within one year from the balance sheet date. Assets and liabilities that are not classified as current are noncurrent assets and liabilities, respectively.

Cash Equivalents

Repurchase agreements collateralized by government bonds acquired with maturities of less than three months from the date of purchase are classified as cash equivalents. The carrying amount approximates fair value due to their short term nature.

Financial Assets/Liabilities at Fair Value Through Profit or Loss

Derivatives that do not meet the criteria for hedge accounting are initially recognized at fair value, with transaction costs expensed as incurred. The derivatives are remeasured at fair value subsequently with changes in fair value recognized in earnings. A regular way purchase or sale of financial assets is accounted for using settlement date accounting.

Fair value is estimated using valuation techniques incorporating estimates and assumptions that are consistent with prevailing market conditions. When the fair value is positive, the derivative is recognized as a financial asset; when the fair value is negative, the derivative is recognized as a financial liability.

Available-for-sale Financial Assets

Available-for-sale financial assets are initially recognized at fair value plus transaction costs that are directly attributable to the acquisition. Changes in fair value from subsequent remeasurement are reported as a separate component of shareholders equity. The corresponding accumulated gains or losses are recognized in earnings when the financial asset is derecognized from the balance sheet. A regular way purchase or sale of financial assets is accounted for using settlement date accounting.

The fair value of overseas publicly traded stock is determined using the closing prices at the end of the period. The fair value of debt securities is determined using the average of bid and asked prices at the end of the period.

Any difference between the initial carrying amount of a debt security and the amount due at maturity is amortized using the effective interest method, with the amortization recognized in earnings.

If there is objective evidence which indicates that a financial asset is impaired, a loss is recognized. If, in a subsequent period, the amount of the impairment loss decreases, for equity securities, the previously recognized impairment loss is reversed to the extent of the decrease and recorded as an adjustment to shareholders equity; for debt securities, the amount of the decrease is recognized in earnings, provided that the decrease is clearly attributable to an event which occurred after the impairment loss was recognized.

Held-to-maturity Financial Assets

Debt securities for which the Company has a positive intention and ability to hold to maturity are categorized as held-to-maturity financial assets and are carried at amortized cost. Those financial assets are initially recognized at fair value plus transaction costs that are directly attributable to the acquisition. Gains or losses are recognized at the time of derecognition, impairment or amortization. A regular way purchase or sale of financial assets is accounted for using settlement date accounting.

If there is objective evidence which indicates that a financial asset is impaired, a loss is recognized. If, in a subsequent period, the amount of the impairment loss decreases and the decrease is clearly attributable to an event which occurred after the impairment loss was recognized, the previously recognized impairment loss is reversed to the extent of the decrease. The reversal may not result in a carrying amount that exceeds the amortized cost that would have been determined as if no impairment loss had been recognized.

Allowance for Doubtful Receivables

An allowance for doubtful receivables is provided based on a review of the collectability of receivables. The Company determines the amount of the allowance for doubtful receivables with a charge of 1% of the amount of outstanding receivables considering the account aging analysis and current trends in the credit quality of its customers.

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Revenue Recognition and Allowance for Sales Returns and Others

The Company recognizes revenue when evidence of an arrangement exists, the rewards of ownership and significant risk of the goods has been transferred to the buyer, price is fixed or determinable, and collectability is reasonably assured. Provisions for estimated sales returns and other allowances are recorded in the period the related revenue is recognized, based on historical experience, management s judgment, and any known factors that would significantly affect the allowance.

Sales prices are determined using fair value taking into account related sales discounts agreed to by the Company and its customers. Sales agreements typically provide that payment is due 30 days from invoice date for a majority of the customers and 30 to 45 days after the end of the month in which sales occur for some customers. Since the receivables from sales are collectible within one year and such transactions are frequent, fair value of the receivables is equivalent to the nominal amount of the cash to be received.

Inventories

Inventories are recorded at standard cost and adjusted to approximate weighted-average cost on the balance sheet date.

Prior to January 1, 2009, inventories were stated at the lower of cost or market value. Any write-down was made on a total-inventory basis. Market value represented replacement cost for raw materials, supplies and spare parts and net realizable value for work in process and finished goods.

As stated in Note 3, effective January 1, 2009, inventories are stated at the lower of cost or net realizable value. Inventory write-downs are made on an item-by-item basis, except where it may be appropriate to group similar or related items. Net realizable value is the estimated selling price of inventories less all estimated costs of completion and necessary selling costs.

Investments Accounted for Using Equity Method

Investments in companies wherein the Company exercises significant influence over the operating and financial policy decisions are accounted for using the equity method. The Company s share of the net income or net loss of an investee is recognized in the equity in earnings/losses of equity method investees, net account. The cost of an investment shall be analyzed and the cost of investment in excess of the fair value of identifiable net assets acquired, representing goodwill, shall not be amortized. If the fair value of identifiable net assets acquired exceeds the cost of investment, the excess shall be proportionately allocated as reductions to fair values of non-current assets (except for financial assets other than investments accounted for using the equity method and deferred income tax assets). When an indication of impairment is identified, the carrying amount of the investment is reduced, with the related impairment loss recognized in earnings.

When the Company subscribes for additional investee s shares at a percentage different from its existing ownership percentage, the resulting carrying amount of the investment in the investee differs from the amount of the Company s share of the investee s equity. The Company records such a difference as an adjustment to long-term investments with the corresponding amount charged or credited to capital surplus.

Gains or losses on sales from the Company to equity method investees are deferred in proportion to the Company s ownership percentages in the investees until such gains or losses are realized through transactions with third parties. The entire amount of the gains or losses on sales to investees over which the Company has a controlling interest is deferred until such gains or losses are realized through subsequent sales of the related products to third parties. Gains or losses on sales from equity method investees to the Company are deferred in proportion to the Company s ownership percentages in the investees until they are realized through transactions with third parties. Gains or losses on sales between equity method investees over each of which the Company has control are deferred in proportion to the Company s weighted-average ownership percentage in the investee which records gains or losses. In transactions between equity method investees over either or both of which the Company has no control, gains or losses on sales are deferred in proportion to the multiplication of the Company s weighted-average ownership percentages in the investees. Such gains or losses are recorded until they are realized through transactions with third parties.

If an investee s functional currency is a foreign currency, differences will result from the translation of the investee s financial statements into the reporting currency of the Company. Such differences are charged or credited to cumulative translation adjustments, a separate component of shareholders equity.

Financial Assets Carried at Cost

Investments for which the Company does not exercise significant influence and that do not have a quoted market price in an active market and whose fair value cannot be reliably measured, such as non-publicly traded stocks and mutual funds, are carried at their original cost. The costs of non-publicly traded stocks and mutual funds are determined using the weighted-average method. If there is objective evidence which indicates that a financial asset is impaired, a loss is recognized. A subsequent reversal of such impairment loss is not allowed.

Cash dividends are recognized as investment income upon resolution of shareholders of an investee but are accounted for as a reduction to the original cost of investment if such dividends are declared on the earnings of the investee attributable to the period prior to the purchase of the investment. Stock dividends are recorded as an increase in the number of shares held and do not affect investment income. The cost per share is recalculated based on the new total number of shares.

Property, Plant and Equipment and Assets Leased to Others

Property, plant and equipment and assets leased to others are stated at cost less accumulated depreciation. When an indication of impairment is identified, any excess of the carrying amount of an asset over its recoverable amount is recognized as a loss. If the recoverable amount increases in a subsequent period, the amount previously recognized as impairment would be reversed and recognized as a gain. However, the adjusted amount may not exceed the carrying amount that would have been determined, net of depreciation, as if no impairment loss had been recognized. Significant additions, renewals and betterments incurred during the construction period are capitalized. Maintenance and repairs are expensed as incurred.

Depreciation is computed using the straight-line method over the following estimated service lives: buildings 10 to 20 years; machinery and equipment 5 years; and office equipment 3 to 5 years.

Upon sale or disposal of property, plant and equipment and assets leased to others, the related cost and accumulated depreciation are deducted from the corresponding accounts, with any gain or loss recorded as non-operating gains or losses in the period of sale or disposal.

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Intangible Assets

Goodwill represents the excess of the consideration paid for acquisition over the fair value of identifiable net assets acquired. Goodwill is no longer amortized and instead is tested for impairment annually. If an event occurs or circumstances change which indicate that the fair value of goodwill is more likely than not below its carrying amount, an impairment loss is recognized. A subsequent reversal of such impairment loss is not allowed.

Deferred charges consist of technology license fees, software and system design costs and patent and others. The amounts are amortized over the following periods: Technology license fees the estimated life of the technology or the term of the technology transfer contract; software and system design costs 3 years; patent and others the economic life or contract period. When an indication of impairment is identified, any excess of the carrying amount of an asset over its recoverable amount is recognized as a loss. If the recoverable amount increases in a subsequent period, the previously recognized impairment loss would be reversed and recognized as a gain. However, the adjusted amount may not exceed the carrying amount that would have been determined, net of amortization, as if no impairment loss had been recognized.

Expenditures related to research activities and those related to development activities that do not meet the criteria for capitalization are charged to expense when incurred.

Pension Costs

For employees who participate in defined contribution pension plans, pension costs are recorded based on the actual contributions made to employees individual pension accounts during their service periods. For employees who participate in defined benefit pension plans, pension costs are recorded based on actuarial calculations.

Income Tax

The Company applies an inter-period allocation for its income tax whereby deferred income tax assets and liabilities are recognized for the tax effects of temporary differences and unused tax credits. Valuation allowances are provided to the extent, if any, that it is more likely than not that deferred income tax assets will not be realized. A deferred tax asset or liability is classified as current or noncurrent in accordance with the classification of its related asset or liability. However, if a deferred tax asset or liability does not relate to an asset or liability in the financial statements, then it is classified as either current or noncurrent based on the expected length of time before it is realized or settled.

Any tax credits arising from purchases of machinery, equipment and technology, research and development expenditures, personnel training expenditures, and investments in important technology-based enterprises are recognized using the flow-through method.

Adjustments of prior years tax liabilities are added to or deducted from the current period s tax provision.

Income tax on unappropriated earnings at a rate of 10% is expensed in the year of shareholder approval which is the year subsequent to the year the earnings are generated.

Stock-based Compensation

Employee stock options that were granted or modified in the period from January 1, 2004 to December 31, 2007 are accounted for by the interpretations issued by the Accounting Research and Development Foundation of the Republic of China. The Company adopted the intrinsic value method and any compensation cost determined using this method is recognized in earnings over the employee vesting period. Employee stock option plans that were granted or modified after December 31, 2007 are accounted for using fair value method in accordance with Statement of Financial Accounting Standards No. 39, Accounting for Share-based Payment. The Company did not grant or modify any employee stock options since January 1, 2008.

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Profit Sharing to Employees and Bonus to Directors

Effective January 1, 2008, the Company adopted Interpretation 2007-052, Accounting for Bonuses to Employees, Directors and Supervisors, which requires companies to record profit sharing to employees and bonus to directors as an expense rather than as an appropriation of earnings.

Foreign-currency Transactions

Foreign-currency transactions other than derivative contracts are recorded in New Taiwan dollars at the rates of exchange in effect when the transactions occur. Exchange gains or losses derived from foreign-currency transactions or monetary assets and liabilities denominated in foreign currencies are recognized in earnings.

At the balance sheet date, monetary assets and liabilities denominated in foreign currencies are revalued at prevailing exchange rates with the resulting gains or losses recognized in earnings.

3. ACCOUNTING CHANGES

Effective January 1, 2009, the Company adopted the newly revised Statement of Financial Accounting Standards (SFAS) No. 10, Accounting for Inventories. The main revisions are (1) inventories are stated at the lower of cost or net realizable value, and inventories are written down to net realizable value on an item-by-item basis except when the grouping of similar or related items is appropriate; (2) unallocated overheads are recognized as expenses in the period in which they are incurred; and (3) abnormal cost, write-downs of inventories and any reversal of write-downs are recorded as cost of sales for the period. Such changes in accounting principle did not have significant effect on the Company s financial statements for the nine months ended September 30, 2009.

4. CASH AND CASH EQUIVALENTS

	September 30	
	2010	**2009**
Cash and deposits in banks	$ 87,348,689	$ 91,703,367
Repurchase agreements collateralized by government bonds	3,050,880	10,582,919
	$ 90,399,569	$ 102,286,286

5. FINANCIAL ASSETS AND LIABILITIES AT FAIR VALUE THROUGH PROFIT OR LOSS

	September 30	
	2010	**2009**
Trading financial assets		
Forward exchange contracts	$ 3,241	$
Cross currency swap contracts	11,142	367,461
	$ 14,383	$ 367,461
Trading financial liabilities		
Forward exchange contracts	$ 73,530	$

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The Company entered into derivative contracts during the nine months ended September 30, 2010 and 2009 to manage exposures due to fluctuations of foreign exchange rates. The derivative contracts entered into by the Company did not meet the criteria for hedge accounting. Therefore, the Company did not apply hedge accounting treatment for its derivative contracts.

Outstanding forward exchange contracts consisted of the following:

	Maturity Date	Contract Amount (In Thousands)
September 30, 2010		
Sell EUR/Buy NT$	October 2010	EUR139,000/NT$5,851,568
Sell US$/Buy NT$	October 2010	US$30,000/NT$939,400

Outstanding cross currency swap contracts consisted of the following:

Maturity Date	Contract Amount (In Thousands)	Range of Interest Rates Paid	Range of Interest Rates Received
September 30, 2010			
October 2010	US$ 90,000/NT$2,830,540	0.46%	0.00%
September 30, 2009			
October 2009 to December 2009	US$ 950,000/NT$30,935,532	0.30% 1.00%	0.00% 0.61%

For the nine months ended September 30, 2010 and 2009, changes in fair value related to derivative financial instruments recognized in earnings was a net gain of NT$156,175 thousand and NT$576,910 thousand, respectively.

6. AVAILABLE-FOR-SALE FINANCIAL ASSETS

	September 30 2010	2009
Overseas publicly traded stock	$ 4,048,549	$
Corporate bonds	1,036,502	1,033,473
	5,085,051	1,033,473
Current portion	(4,048,549)	
	$ 1,036,502	$ 1,033,473

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7. HELD-TO-MATURITY FINANCIAL ASSETS

	September 30	
	2010	2009
Corporate bonds	$ 7,257,142	$ 12,748,902
Structured time deposits		6,000,000
Government bonds		2,904,170
	7,257,142	21,653,072
Current portion	(5,598,471)	(8,374,389)
	$ 1,658,671	$ 13,278,683

Structured time deposits categorized as held-to-maturity financial assets consisted of the following:

	Principal Amount	Interest Receivable	Range of Interest Rates	Maturity Date
September 30, 2009				
Callable domestic deposits	$ 6,000,000	$ 3,404	0.67%-0.95%	March 2011 to August 2011

8. ALLOWANCES FOR DOUBTFUL RECEIVABLES, SALES RETURNS AND OTHERS

Movements of the allowance for doubtful receivables were as follows:

	Nine Months Ended September 30	
	2010	2009
Balance, beginning of period	$ 431,000	$ 436,746
Provision	109,000	243,061
Write-off		(243,807)
Balance, end of period	$ 540,000	$ 436,000

Movements of the allowance for sales returns and others were as follows:

	Nine Months Ended September 30	
	2010	2009
Balance, beginning of period	$ 8,583,632	$ 5,868,582
Provision	8,715,191	9,715,735
Write-off	(10,708,702)	(6,710,118)
Balance, end of period	$ 6,590,121	$ 8,874,199

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9. INVENTORIES

	September 30	
	2010	2009
Finished goods	$ 3,007,453	$ 2,013,527
Work in process	18,087,605	13,654,961
Raw materials	1,490,972	907,655
Supplies and spare parts	1,187,500	618,041
	$ 23,773,530	$ 17,194,184

Write-down of inventories to net realizable value in the amount of NT$582,149 thousand and NT$313,175 thousand, respectively, were included in the cost of sales for the nine months ended September 30, 2010 and 2009. Inventory losses related to earthquake damage in the amount of NT$190,992 thousand were classified under non-operating expenses and losses for the nine months ended September 30, 2010.

10. INVESTMENTS ACCOUNTED FOR USING EQUITY METHOD

	September 30			
	2010		2009	
	Carrying Amount	% of Owner-ship	Carrying Amount	% of Owner-ship
TSMC Global Ltd. (TSMC Global)	$ 44,892,711	100	$ 45,492,790	100
TSMC Partners, Ltd. (TSMC Partners)	33,943,317	100	32,627,788	100
Vanguard International Semiconductor Corporation (VIS)	9,424,817	38	9,410,696	37
Systems on Silicon Manufacturing Company Pte Ltd. (SSMC)	6,890,171	39	5,899,305	39
Motech Industries Inc. (Motech)	6,533,432	20		
TSMC China Company Limited (TSMC China)	3,654,158	100	3,606,012	100
VentureTech Alliance Fund III, L.P. (VTAF III)	2,852,802	99	1,341,398	98
TSMC North America	2,827,009	100	2,686,753	100
Xintec Inc. (Xintec)	1,618,701	41	1,372,699	41
VentureTech Alliance Fund II, L.P. (VTAF II)	1,093,417	98	1,059,820	98
Global UniChip Corporation (GUC)	1,061,303	35	960,442	36
Emerging Alliance Fund, L.P. (Emerging Alliance)	320,426	99	319,571	99
TSMC Europe B.V. (TSMC Europe)	182,022	100	152,965	100
TSMC Japan Limited (TSMC Japan)	150,896	100	136,710	100
TSMC Solar Europe B.V. (TSMC Solar Europe)	25,638	100		
TSMC Solar North America, Inc. (TSMC Solar NA)	24,717	100		
TSMC Korea Limited (TSMC Korea)	20,559	100	18,115	100
TSMC Lighting North America, Inc. (TSMC Lighting NA)	3,133	100		
	$ 115,519,229		$ 105,085,064	

For the renewable energy and efficiency related businesses development, the Company established wholly-owned subsidiaries, TSMC Solar Europe, TSMC Solar NA and TSMC Lighting NA, in the third quarter of 2010.

For the nine months ended September 30, 2010, the Company increased its investment in VTAF III for the amount of NT$1,786,701 thousand, and the Company s percentage of ownership in VTAF III increased from 98% to 99%.

In February 2010, the Company subscribed to 75,316 thousand shares of Motech through a private placement for NT$6,228,661 thousand; after the subscription, the Company s percentage of ownership in Motech was 20%. Transfer of the aforementioned common shares within three years is prohibited according to the related regulations.

For the nine months ended September 30, 2010 and 2009, equity in earnings/losses of equity method investees was a net gain of NT$4,677,062 thousand and a net loss of NT$2,772,157 thousand, respectively. Related equity in earnings/losses of equity method investees were determined based on the reviewed financial statements, except those of VTAF II, Emerging Alliance, TSMC Europe, TSMC Japan and TSMC Korea for the nine months ended September 30, 2010 and those of Emerging Alliance, TSMC Europe, TSMC Japan and TSMC Korea for the nine months ended September 30, 2009. The Company believes that, had VTAF II, Emerging Alliance, TSMC Europe, TSMC Japan and TSMC Korea s financial statements been reviewed, any adjustments arising would have no material effect on the Company s financial statements.

As of September 30, 2010 and 2009, the quoted market price of publicly traded stocks in unrestricted investments accounted for using the equity method (VIS and GUC) were NT$13,789,014 thousand and NT$15,891,684 thousand, respectively.

Movements of the difference between the cost of investments and the Company s share in investees net assets allocated to depreciable assets were as follows:

	Nine Months Ended September 30	
	2010	**2009**
Balance, beginning of period	$ 1,429,118	$ 2,053,253
Additions	2,055,660	
Amortizations	(726,392)	(468,101)
Balance, end of period	$ 2,758,386	$ 1,585,152

Movements of the difference allocated to goodwill were as follows:

	Nine Months Ended September 30	
	2010	**2009**
Balance, beginning of period	$ 1,061,885	$ 1,061,885
Additions	353,680	
Balance, end of period	$ 1,415,565	$ 1,061,885

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11. FINANCIAL ASSETS CARRIED AT COST

	September 30	
	2010	2009
Non-publicly traded stocks	$ 338,584	$ 338,584
Mutual funds	159,251	162,979
	$ 497,835	$ 501,563

12. PROPERTY, PLANT AND EQUIPMENT

	Nine Months Ended September 30, 2010				
	Balance, Beginning of Period	Additions	Disposals	Reclassification	Balance, End of Period
Cost					
Buildings	$ 124,522,047	$ 3,309,121	$ (135,497)	$	$ 127,695,671
Machinery and equipment	713,426,126	124,067,387	(1,017,470)	139,842	836,615,885
Office equipment	10,781,099	1,185,072	(655,620)	(442)	11,310,109
	848,729,272	$ 128,561,580	$ (1,808,587)	$ 139,400	975,621,665
Accumulated depreciation					
Buildings	73,525,160	$ 6,012,896	$ (128,466)	$	79,409,590
Machinery and equipment	545,693,910	52,869,076	(1,017,066)	139,842	597,685,762
Office equipment	8,545,253	666,347	(655,582)	(442)	8,555,576
	627,764,323	$ 59,548,319	$ (1,801,114)	$ 139,400	685,650,928
Advance payments and construction in progress	33,786,577	$ 7,253,969	$ (418,838)	$	40,621,708
	$ 254,751,526				$ 330,592,445

	Nine Months Ended September 30, 2009				
	Balance, Beginning of Period	Additions	Disposals	Reclassification	Balance, End of Period
Cost					
Buildings	$ 114,014,588	$ 9,778,198	$ (9,823)	$ 66	$ 123,783,029
Machinery and equipment	635,008,261	40,995,876	(1,732,570)	2,565	674,274,132
Office equipment	9,748,869	738,667	(150,347)	(66)	10,337,123
	758,771,718	$ 51,512,741	$ (1,892,740)	$ 2,565	808,394,284

Accumulated depreciation					
Buildings	65,351,514	$ 6,067,051	$ (9,823)	$ 66	71,408,808
Machinery and equipment	484,046,160	47,404,997	(1,129,563)	2,565	530,324,159
Office equipment	7,849,580	685,519	(150,162)	(66)	8,384,871
	557,247,254	$ 54,157,567	$ (1,289,548)	$ 2,565	610,117,838
Advance payments and construction in progress	17,758,038	$ 562,264	$	$	18,320,302
	$ 219,282,502				$ 216,596,748

No interest was capitalized during the nine months ended September 30, 2010 and 2009.

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13. DEFERRED CHARGES, NET

	Nine Months Ended September 30, 2010			
	Balance, Beginning of Period	Additions	Amortization	Balance, End of Period
Technology license fees	$ 2,979,801	$	$ (534,476)	$ 2,445,325
Software and system design costs	1,646,973	966,623	(652,432)	1,961,164
Patent and others	1,264,911	211,118	(274,054)	1,201,975
	$ 5,891,685	$ 1,177,741	$ (1,460,962)	$ 5,608,464

	Nine Months Ended September 30, 2009			
	Balance, Beginning of Period	Additions	Amortization	Balance, End of Period
Technology license fees	$ 3,786,251	$	$ (614,959)	$ 3,171,292
Software and system design costs	1,559,857	438,308	(569,672)	1,428,493
Patent and others	1,055,353		(201,458)	853,895
	$ 6,401,461	$ 438,308	$ (1,386,089)	$ 5,453,680

14. SHORT-TERM LOANS

	September 30, 2010
Unsecured loans	
US$1,200,000 thousand, due in October 2010, and annual interest at 0.39%-0.54%	$ 37,596,000

15. BONDS PAYABLE

	September 30	
	2010	2009
Domestic unsecured bonds:		
Issued in January 2002 and repayable in January 2012, 3.00% interest payable annually	$ 4,500,000	$ 4,500,000

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16. OTHER LONG-TERM PAYABLES

The Company s long-term payables mainly resulted from license agreements for certain semiconductor-related patents. As of September 30, 2010, future payments for other long-term payables were as follows:

Year of Payment	Amount
2010 (4th quarter)	$ 363,421
2011	407,290
	770,711
Current portion (classified under accrued expenses and other current liabilities)	(614,061)
	$ 156,650

17. PENSION PLANS

The pension mechanism under the Labor Pension Act is deemed a defined contribution plan. Pursuant to the Act, the Company has made monthly contributions equal to 6% of each employee s monthly salary to employees pension accounts and recognized pension costs of NT$672,785 thousand and NT$441,429 thousand for the nine months ended September 30, 2010 and 2009, respectively.

The Company has a defined benefit plan under the Labor Standards Law that provides benefits based on an employee s length of service and average monthly salary for the six-month period prior to retirement. The Company contributes an amount equal to 2% of salaries paid each month to a pension fund (the Fund), which is administered by the Labor Pension Fund Supervisory Committee (the Committee) and deposited in the Committee s name in the Bank of Taiwan. The Company recognized pension costs of NT$177,084 thousand and NT$216,482 thousand for the nine months ended September 30, 2010 and 2009, respectively.

Movements of the Fund and accrued pension cost under the defined benefit plan were summarized as follows:

	Nine Months Ended September 30	
	2010	2009
The Fund		
Balance, beginning of period	$ 2,595,717	$ 2,389,519
Contributions	159,705	143,540
Interest	41,105	52,445
Payments	(11,050)	(37,801)
Balance, end of period	$ 2,785,477	$ 2,547,703
Accrued pension cost		
Balance, beginning of period	$ 3,807,176	$ 3,710,009
Accruals	8,589	76,607
Balance, end of period	$ 3,815,765	$ 3,786,616

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18. INCOME TAX

a. A reconciliation of income tax expense based on income before income tax at the statutory rates and income tax currently payable was as follows:

	Nine Months Ended September 30	
	2010	2009
Income tax expense based on income before income tax at statutory rate (17% and 25% for 2010 and 2009, respectively)	$ 21,534,495	$ 14,961,671
Tax effect of the following:		
Tax-exempt income	(12,295,454)	(6,678,202)
Temporary and permanent differences	(616,048)	2,854,793
Others		69,174
Additional tax at 10% on unappropriated earnings	127,489	
Income tax credits used	(3,678,333)	(5,603,718)
Income tax currently payable	$ 5,072,149	$ 5,603,718

b. Income tax expense consisted of the following:

	Nine Months Ended September 30	
	2010	2009
Income tax currently payable	$ 5,072,149	$ 5,603,718
Income tax adjustments on prior years	980,428	(1,155,113)
Other income tax adjustments	10,148	(41,501)
Net change in deferred income tax assets		
Investment tax credits	(6,965,003)	(3,159,546)
Temporary differences	65,697	143,079
Valuation allowance	6,625,521	1,904,299
Income tax expense	$ 5,788,940	$ 3,294,936

c. Net deferred income tax assets consisted of the following:

	September 30	
	2010	2009
Current deferred income tax assets		
Investment tax credits	$ 1,096,995	$ 3,442,000
Temporary differences		
Allowance for sales returns and others	566,750	757,656
Unrealized gain/loss on financial instruments	65,589	
Others	236,332	87,384

	$ 1,965,666	$ 4,287,040
Noncurrent deferred income tax assets		
Investment tax credits	$ 20,599,749	$ 13,329,764
Temporary differences		
Depreciation	1,990,080	1,740,215
Others	35,785	207,766
Valuation allowance	(12,424,853)	(8,303,945)
	$ 10,200,761	$ 6,973,800

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Effective in May 2009 and June 2010, the Article 5 of the Income Tax Law of the Republic of China was amended, in which the income tax rate of profit-seeking enterprises would be reduced from 25% to 20% and from 20% to 17%, respectively. The last amended income tax rate of 17% is retroactively applied on January 1, 2010. The Company recalculated its deferred tax assets in accordance with the new amended Article and adjusted the resulting difference as an income tax expense in 2010 and 2009, respectively.

Under Article 10 of the Statute for Industrial Innovation (SII) legislated and effective in May 2010, a profit-seeking enterprise may deduct up to 15% of its research and development expenditures from its income tax payable for the period in which these expenditures are incurred, but this deduction should not exceed 30% of the income tax payable for that period. This incentive is retroactive to January 1, 2010 and effective until December 31, 2019.

d. Integrated income tax information:

The balance of the imputation credit account as of September 30, 2010 and 2009 was NT$1,669,533 thousand and NT$214,826 thousand, respectively.

The estimated and actual creditable ratios for distribution of earnings of 2009 and 2008 were 9.85% and 9.10%, respectively.

The imputation credit allocated to shareholders is based on its balance as of the date of dividend distribution. The estimated creditable ratio may change when the actual distribution of imputation credit is made.

e. All earnings generated prior to December 31, 1997 have been appropriated.

f. As of September 30, 2010, investment tax credits consisted of the following:

Law/Statute	Item	Total Creditable Amount	Remaining Creditable Amount	Expiry Year
Statute for Upgrading Industries	Purchase of machinery and equipment	$ 3,212,913	$ 3,147,180	2012
		6,039,644	6,039,644	2013
		5,442,649	5,442,649	2014
		$ 14,695,206	$ 14,629,473	
Statute for Upgrading Industries	Research and development expenditures	$ 1,000,000	$	2010
		1,054,194		2011
		2,691,517	2,691,517	2012
		4,328,009	4,328,009	2013
		$ 9,073,720	$ 7,019,526	

Statute for Upgrading Industries	Personnel training expenditures	$	19,293	$		2011
			30,624		30,624	2012
			17,121		17,121	2013
		$	67,038	$	47,745	
Statute for Industrial Innovation	Research and development expenditures	$	1,539,113	$		2010

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g. The profits generated from the following projects are exempt from income tax for a five-year period:

	Tax-exemption Period
Construction and expansion of 2001	2006 to 2010
Construction and expansion of 2003	2007 to 2011
Construction and expansion of 2004	2008 to 2012
Construction and expansion of 2005	2010 to 2014

h. The tax authorities have examined income tax returns of the Company through 2007. All investment tax credit adjustments assessed by the tax authorities have been recognized accordingly.

19. LABOR COST, DEPRECIATION AND AMORTIZATION

	Nine Months Ended September 30, 2010		
	Classified as Cost of Sales	Classified as Operating Expenses	Total
Labor cost			
Salary and bonus	$ 17,941,777	$ 13,265,190	$ 31,206,967
Labor and health insurance	670,276	382,460	1,052,736
Pension	540,957	308,912	849,869
Meal	403,413	163,910	567,323
Welfare	161,132	95,271	256,403
Others	50,792	18,560	69,352
	$ 19,768,347	$ 14,234,303	$ 34,002,650
Depreciation	$ 55,796,317	$ 3,739,803	$ 59,536,120
Amortization	$ 933,660	$ 527,302	$ 1,460,962

	Nine Months Ended September 30, 2009		
	Classified as Cost of Sales	Classified as Operating Expenses	Total
Labor cost			
Salary and bonus	$ 11,010,069	$ 8,299,658	$ 19,309,727
Labor and health insurance	458,611	278,310	736,921
Pension	409,387	248,524	657,911
Meal	305,276	132,322	437,598
Welfare	107,465	67,310	174,775
Others	79,471	14,697	94,168

	$ 12,370,279	$ 9,040,821	$ 21,411,100
Depreciation	$ 51,354,934	$ 2,790,434	$ 54,145,368
Amortization	$ 897,733	$ 488,356	$ 1,386,089

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20. SHAREHOLDERS EQUITY

As of September 30, 2010, 1,096,448 thousand ADSs of the Company were traded on the NYSE. The number of common shares represented by the ADSs was 5,482,242 thousand (one ADS represents five common shares).

Capital surplus can only be used to offset a deficit under the Company Law. However, the capital surplus generated from donations and the excess of the issuance price over the par value of capital stock (including the stock issued for new capital, mergers, convertible bonds and the surplus from treasury stock transactions) may be appropriated as stock dividends, which are limited to a certain percentage of the Company s paid-in capital. In addition, the capital surplus from long-term investments may not be used for any purpose.

Capital surplus consisted of the following:

	September 30	
	2010	**2009**
Additional paid-in capital	$ 23,562,191	$ 23,408,710
From merger	22,805,390	22,805,390
From convertible bonds	8,893,190	8,893,190
From long-term investments	373,244	332,574
Donations	55	55
	$ 55,634,070	$ 55,439,919

The Company s Articles of Incorporation provide that, when allocating the net profits for each fiscal year, the Company shall first offset its losses in previous years and then set aside the following items accordingly:

a. Legal capital reserve at 10% of the profits left over, until the accumulated legal capital reserve equals the Company s paid-in capital;

b. Special capital reserve in accordance with relevant laws or regulations or as requested by the authorities in charge;

c. Bonus to directors and profit sharing to employees of the Company of not more than 0.3% and not less than 1% of the remainder, respectively. Directors who also serve as executive officers of the Company are not entitled to receive the bonus to directors. The Company may issue profit sharing to employee in stock of an affiliated company meeting the conditions set by the Board of Directors or, by the person duly authorized by the Board of Directors;

d. Any balance left over shall be allocated according to the resolution of the shareholders meeting.

The Company s Articles of Incorporation also provide that profits of the Company may be distributed by way of cash dividend and/or stock dividend. However, distribution of profits shall be made preferably by way of cash dividend. Distribution of profits may also be made by way of stock dividend; provided that the ratio for stock dividend shall not exceed 50% of the total distribution.

Any appropriations of the profits are subject to shareholders approval in the following year.

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The Company accrued profit sharing to employees as a charge to earnings of certain percentage of net income during the period amounted to NT$8,162,440 thousand and NT$8,556,862 thousand for the nine months ended September 2010 and 2009, respectively; bonuses to directors were accrued with an estimate based on historical experience. If the actual amounts subsequently resolved by the shareholders differ from the estimated amounts, the differences are recorded in the year of shareholders resolution as a change in accounting estimate. If profit sharing is resolved to be distributed to employees in stock, the number of shares is determined by dividing the amount of profit sharing by the closing price (after considering the effect of dividends) of the shares on the day preceding the shareholders meeting.

The Company no longer has supervisors since January 1, 2007. The required duties of supervisors are being fulfilled by the Audit Committee.

The appropriation for legal capital reserve shall be made until the reserve equals the Company s paid-in capital. The reserve may be used to offset a deficit, or be distributed as dividends and bonuses for the portion in excess of 50% of the paid-in capital if the Company has no unappropriated earnings and the reserve balance has exceeded 50% of the Company s paid-in capital. The Company Law also prescribes that, when the reserve has reached 50% of the Company s paid-in capital, up to 50% of the reserve may be transferred to capital.

A special capital reserve equivalent to the net debit balance of the other components of shareholders equity (for example, cumulative translation adjustments and unrealized loss on financial instruments, but excluding treasury stock) shall be made from unappropriated earnings pursuant to existing regulations promulgated by the Securities and Futures Bureau (SFB). Any special reserve appropriated may be reversed to the extent that the net debit balance reverses.

The appropriations of earnings for 2009 and 2008 had been approved in the shareholders meeting held on June 15, 2010 and June 10, 2009, respectively. The appropriations and dividends per share were as follows:

	Appropriation of Earnings		**Dividends Per Share (NT$)**	
	For Fiscal Year 2009	**For Fiscal Year 2008**	**For Fiscal Year 2009**	**For Fiscal Year 2008**
Legal capital reserve	$ 8,921,784	$ 9,993,317		
Special capital reserve	1,313,047	(391,857)		
Cash dividends to shareholders	77,708,120	76,876,312	$ 3.00	$ 3.00
Stock dividends to shareholders		512,509		0.02
	$ 87,942,951	$ 86,990,281		

TSMC s profit sharing to employees to be paid in cash and bonus to directors in the amounts of NT$6,691,338 thousand and NT$67,692 thousand for 2009, respectively, and profit sharing to employees to be paid in cash and in stock as well as bonus to directors in the amounts of NT$7,494,988 thousand, NT$7,494,988 thousand and NT$158,080 thousand for 2008, respectively, had been approved in the shareholders meeting held on June 15, 2010 and June 10, 2009, respectively. The profit sharing to employees in stock of 141,870 thousand shares for 2008 was determined by the closing price of the Company s common shares (after considering the effect of dividends) of the day immediately preceding the shareholders meeting, which was NT$52.83. The resolved amounts of the profit sharing to employees and bonus to directors were consistent with the resolutions of meeting of the Board of Directors held on February 9, 2010 and February 10, 2009 and same amount had been charged against earnings of 2009 and 2008, respectively.

The shareholders meeting held on June 10, 2009 also resolved to distribute stock dividends out of capital surplus, and stock dividends to shareholders as well as profit sharing to employees to be paid in stock in the amount of NT$768,763 thousand, NT$512,509 thousand and NT$7,494,988 thousand, respectively.

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The information about appropriations of profit sharing to employees and bonus to directors is available at the Market Observation Post System website.

Under the Integrated Income Tax System that became effective on January 1, 1998, the R.O.C. resident shareholders are allowed a tax credit for their proportionate share of the income tax paid by the Company on earnings generated since January 1, 1998.

21. STOCK-BASED COMPENSATION PLANS

The Company s Employee Stock Option Plans, consisting of the 2004 Plan, 2003 Plan and 2002 Plan, were approved by the SFB on January 6, 2005, October 29, 2003 and June 25, 2002, respectively. The maximum number of options authorized to be granted under the 2004 Plan, 2003 Plan and 2002 Plan was 11,000 thousand, 120,000 thousand and 100,000 thousand, respectively, with each option eligible to subscribe for one common share when exercisable. The options may be granted to qualified employees of the Company or any of its domestic or foreign subsidiaries, in which the Company s shareholding with voting rights, directly or indirectly, is more than fifty percent (50%). The options of all the plans are valid for ten years and exercisable at certain percentages subsequent to the second anniversary of the grant date. Under the terms of the plans, the options are granted at an exercise price equal to the closing price of the Company s common shares listed on the TSE on the grant date.

Options of the plans that had never been granted or had been granted but subsequently canceled had expired as of September 30, 2010.

Information about outstanding options for the nine months ended September 30, 2010 and 2009 was as follows:

	Number of Options (In Thousands)	Weighted-average Exercise Price (NT$)
Nine months ended September 30, 2010		
Balance, beginning of period	28,810	$ 32.4
Options exercised	(4,638)	32.5
Balance, end of period	24,172	32.5
Nine months ended September 30, 2009		
Balance, beginning of period	36,234	34.0
Options granted	175	34.0
Options exercised	(5,228)	36.5
Options canceled	(321)	46.5
Balance, end of period	30,860	33.5

The number of outstanding options and exercise prices have been adjusted to reflect the distribution of earnings in accordance with the plans.

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As of September 30, 2010, information about outstanding options was as follows:

Range of Exercise Price (NT$)	Number of Options (In Thousands)	Options Outstanding Weighted-average Remaining Contractual Life (Years)	Weighted-average Exercise Price (NT$)
$21.7 $30.5	18,013	2.44	$ 28.0
38.0 50.1	6,159	4.16	45.6
	24,172	2.88	32.5

As of September 30, 2010, all of the above outstanding options were exercisable.

No compensation cost was recognized under the intrinsic value method for the nine months ended September 30, 2010 and 2009. Had the Company used the fair value based method to evaluate the options using the Black-Scholes model, the assumptions at the various grant dates and pro forma results of the Company for the nine months ended September 30, 2010 and 2009 would have been as follows:

Assumptions:	
Expected dividend yield	1.00% 3.44%
Expected volatility	43.77% 46.15%
Risk free interest rate	3.07% 3.85%
Expected life	5 years

	Nine Months Ended September 30	
	2010	2009
Net income:		
Net income as reported	$ 120,884,560	$ 56,551,787
Pro forma net income	120,871,974	56,173,879
Earnings per share (EPS) after income tax (NT$):		
Basic EPS as reported	$ 4.67	$ 2.19
Pro forma basic EPS	4.67	2.18
Diluted EPS as reported	4.66	2.18
Pro forma diluted EPS	4.66	2.16

22. EARNINGS PER SHARE

EPS is computed as follows:

	Amounts (Numerator) Before Income Tax	Amounts (Numerator) After Income Tax	Number of Shares (Denominator) (In Thousands)	EPS (NT$) Before Income Tax	EPS (NT$) After Income Tax
Nine months ended September 30, 2010					

Basic EPS					
Earnings available to common shareholders	$ 126,673,500	$ 120,884,560	25,904,889	$ 4.89	$ 4.67
Effect of dilutive potential common shares			13,286		
Diluted EPS					
Earnings available to common shareholders (including effect of dilutive potential common shares)	$ 126,673,500	$ 120,884,560	25,918,175	$ 4.89	$ 4.66

(Continued)

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	Amounts (Numerator)		Number of Shares (Denominator)	EPS (NT$)	
	Before Income Tax	After Income Tax	(In Thousands)	Before Income Tax	After Income Tax
Nine months ended September 30, 2009					
Basic EPS					
Earnings available to common shareholders	$ 59,846,723	$ 56,551,787	25,813,614	$ 2.32	$ 2.19
Effect of dilutive potential common shares			166,923		
Diluted EPS					
Earnings available to common shareholders (including effect of dilutive potential common shares)	$ 59,846,723	$ 56,551,787	25,980,537	$ 2.30	$ 2.18

(Concluded)

Effective January 1, 2008, the Company adopted Interpretation 2007-052 that requires companies to record profit sharing to employees as an expense rather than as an appropriation of earnings. If the Company may settle the obligation by cash, by issuing shares, or in combination of both cash and shares, profit sharing to employees which will be settled in shares should be included in the weighted average number of shares outstanding in calculation of diluted EPS, if the shares have a dilutive effect. The number of shares is estimated by dividing the amount of profit sharing to employees in stock by the closing price (after considering the dilutive effect of dividends) of the common shares on the balance sheet date. Such dilutive effect of the potential shares needs to be included in the calculation of diluted EPS until the shares of profit sharing to employees are resolved in the shareholders meeting in the following year.

The average number of shares outstanding for EPS calculation has been considered for the effect of retroactive adjustments. This adjustment caused each of the basic and diluted after income tax EPS for the nine months ended September 30, 2009 to remain at NT$2.19 and NT$2.18 respectively.

23. DISCLOSURES FOR FINANCIAL INSTRUMENTS

a. Fair values of financial instruments were as follows:

	September 30			
	2010		2009	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Assets				
Financial assets at fair value through profit or loss	$ 14,383	$ 14,383	$ 367,461	$ 367,461
Available-for-sale financial assets	5,085,051	5,085,051	1,033,473	1,033,473
Held-to-maturity financial assets	7,257,142	7,348,294	21,653,072	21,747,720
Financial assets carried at cost	497,835		501,563	

Liabilities

Financial liabilities at fair value through profit or loss	73,530	73,530		
Bonds payable	4,500,000	4,547,696	4,500,000	4,583,826
Other long-term payable (including current portion)	770,711	770,711	1,355,167	1,355,167

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b. Methods and assumptions used in the estimation of fair values of financial instruments
   1) The aforementioned financial instruments do not include cash and cash equivalents, receivables, other financial assets, refundable deposits, short-term loans, payables and guarantee deposits. The carrying amounts of these financial instruments approximate their fair values due to their short maturities.

   2) Except for derivatives and structured time deposits, available-for-sale and held-to-maturity financial assets were based on their quoted market prices.

   3) The fair values of those derivatives and structured time deposits are determined using valuation techniques incorporating estimates and assumptions that were consistent with prevailing market conditions.

   4) Financial assets carried at cost have no quoted prices in an active market and entail an unreasonably high cost to obtain verifiable fair values. Therefore, no fair value is presented.

   5) Fair value of bonds payable was based on their quoted market price.

   6) Fair value of other long-term payables was based on the present value of expected cash flows, which approximates their carrying amount.

c. The changes in fair value of derivatives contracts which were outstanding as of September 30, 2010 and 2009 estimated using valuation techniques were recognized as a net loss of NT$59,147 thousand and a net gain of NT$367,461 thousand, respectively.

d. As of September 30, 2010 and 2009, financial assets exposed to fair value interest rate risk were NT$8,308,027 thousand and NT$23,054,006 thousand, respectively, financial liabilities exposed to fair value interest rate risk were NT$42,169,530 thousand and NT$4,500,000 thousand, respectively.

e. Movements of the unrealized gains or losses on financial instruments for the nine months ended September 30, 2010 and 2009 were as follows:

	Nine Months Ended September 30, 2010		
	From Available-for-sale Financial Assets	**Equity-method Investments**	**Total**
Balance, beginning of period	$ 46,672	$ 406,949	$ 453,621
Recognized directly in shareholders equity	(330,396)	395,444	65,048
Balance, end of period	$ (283,724)	$ 802,393	$ 518,669

	Nine Months Ended September 30, 2009		
	From Available-for-sale Financial Assets	**Equity-method Investments**	**Total**
Balance, beginning of period	$ 32,658	$ (320,000)	$ (287,342)
Recognized directly in shareholders equity	38,185	780,948	819,133
Removed from shareholders equity and recognized in earnings	(37,370)		(37,370)

Balance, end of period	$ 33,473	$ 460,948	$ 494,421

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f. Information about financial risks

1) Market risk. The derivative financial instruments categorized as financial assets/liabilities at fair value through profit or loss are mainly used to hedge the market exchange rate fluctuations of foreign-currency assets and liabilities; therefore, the market exchange rate risk of derivatives will be offset by the foreign exchange risk of these hedged items. Available-for-sale financial assets and held-to-maturity financial assets held by the Company are mainly fixed-interest-rate debt securities and overseas publicly traded stock; therefore, the fluctuations in market interest rates and market price will result in changes in fair values of these debt securities.

2) Credit risk. Credit risk represents the potential loss that would be incurred by the Company if the counter-parties or third-parties breached contracts. Financial instruments with positive fair values at the balance sheet date are evaluated for credit risk. The Company evaluated whether the financial instruments for any possible counter-party or third-parties are reputable financial institutions, business enterprises, and government agencies and accordingly, the Company believed that the Company s exposure to credit risk was not significant.

3) Liquidity risk. The Company has sufficient operating capital to meet cash needs upon settlement of derivative financial instruments and bonds payable. Therefore, the liquidity risk is low.

4) Cash flow interest rate risk. The Company mainly invests in fixed-interest-rate debt securities. Therefore, cash flows are not expected to fluctuate significantly due to changes in market interest rates.

24. RELATED PARTY TRANSACTIONS

The Company engages in business transactions with the following related parties:

a. Subsidiaries

TSMC North America
TSMC China
TSMC Europe
TSMC Japan
TSMC Korea

b. Investees

GUC (with a controlling financial interest)
Xintec (with a controlling financial interest)
VIS (accounted for using equity method)
SSMC (accounted for using equity method)
Motech (accounted for using equity method)

c. Indirect subsidiaries

WaferTech, LLC (WaferTech)
TSMC Technology, Inc. (TSMC Technology)
TSMC Design Technology Canada Inc. (TSMC Canada)

d. Indirect investee

VisEra Technology Company, Ltd. (VisEra), an indirect investee accounted for using equity method.

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e. Others

Related parties over which the Company has control or exercises significant influence but with which the Company had no material transactions.

Transactions with the aforementioned parties, other than those disclosed in other notes, are summarized as follows:

	2010		2009	
	Amount	%	Amount	%
For the nine months ended September 30				
Sales				
TSMC North America	$ 160,415,902	52	$ 111,683,024	54
Others	2,094,763	1	1,662,378	1
	$ 162,510,665	53	$ 113,345,402	55
Purchases				
TSMC China	$ 6,206,526	17	$ 2,611,248	12
WaferTech	5,958,529	17	3,872,117	18
VIS	3,643,305	10	2,433,937	11
SSMC	3,383,596	10	2,530,044	11
	$ 19,191,956	54	$ 11,447,346	52
Manufacturing expenses				
Xintec (rent and outsourcing)	$ 214,590		$	
VisEra (outsourcing)	34,434		22,550	
	$ 249,024		$ 22,550	
Marketing expenses commission				
TSMC Europe	$ 321,483	15	$ 234,892	16
TSMC Japan	196,939	9	166,109	12
TSMC China	42,140	2		
TSMC Korea	14,362		10,667	1
	$ 574,924	26	$ 411,668	29
Research and development expenses				
TSMC Technology (primarily consulting fee)	$ 425,892	2	$ 299,636	2
TSMC Canada (primarily consulting fee)	141,212	1	115,534	1

VIS (primarily rent)		8,730			1,988	
Others		38,950			39,790	
	$	614,784	3	$	456,948	3

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

(3

)

Total

$

(3

)

In addition, during the three months ended March 31, 2011, the Company amortized to interest expense $1.9 million in OCI related to the derivatives that were de-designated as hedging instruments under ASC 815, Derivatives and Hedging.

7. Income Taxes

A reconciliation of the liability for unrecognized tax benefits is as follows:

		Noncurrent tax liabilities (in thousands)
Balance at January 1, 2012	$	33,872
Additions based on current year positions		233
Additions based on prior year positions		1,491
Currency translation adjustments		641
Balance at March 31, 2012	$	36,237

The increase in the Company s liability for unrecognized tax benefits during the three months ended March 31, 2012 was primarily due to recording interest expense accruals for previously recorded unrecognized tax benefits.

The Company s effective tax rate (income taxes as a percentage of income from operations before income taxes) decreased to 37.3% for the three months ended March 31, 2012 as compared to 42.6% for the three months ended March 31, 2011. The primary reasons for the decrease are due to lower amounts of unfavorable permanent book to tax differences coupled with higher pretax income for the three months ended March 31, 2012. In addition, the Company experienced a decrease in its effective state tax rate due to a decline in the statutory income tax rate in the State of Indiana coupled with the impact of various subsidiary restructurings that were completed in the third quarter of 2011.

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8. Commitments and Contingencies

Litigation

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

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

On September 11, 2008, the Board of County Commissioners of Cherokee County, Kansas (the County) filed suit against Kansas Penn Gaming, LLC (KPG, a wholly-owned subsidiary of Penn created to pursue a development project in Cherokee County, Kansas) and the Company in the District Court of Shawnee County, Kansas. The petition alleges that KPG breached its pre-development agreement with the County when KPG withdrew its application to manage a lottery gaming facility in Cherokee County and currently seeks in excess of $50 million in damages. In connection with their petition, the County obtained an ex-parte order attaching the $25 million privilege fee (which is included in current assets) paid to the Kansas Lottery Commission in conjunction with the gaming application for the Cherokee County zone. The defendants have filed motions to dissolve and reduce the attachment. Those motions were denied. Following discovery, both parties have filed dispositive motions and the motions were argued on April 20, 2012.

9. Segment Information

The Company has aggregated its properties into three reportable segments: (i) Midwest, (ii) East/West, and (iii) Southern Plains, which is consistent with how the Company s Chief Operating Decision Maker reviews and assesses the Company s financial performance.

The Midwest reportable segment consists of the following properties: Hollywood Casino Lawrenceburg, Hollywood Casino Aurora, Hollywood Casino Joliet, and Argosy Casino Alton. It also includes the Company s Casino Rama management service contract as well as the two Ohio properties that are currently under construction, Hollywood Casino Toledo and Hollywood Casino Columbus, which are scheduled to open on, or about May 29, 2012 and early in the fourth quarter of 2012, respectively.

The East/West reportable segment consists of the following properties: Hollywood Casino at Charles Town Races, Hollywood Casino Perryville, Hollywood Casino Bangor, Hollywood Casino at Penn National Race Course, Zia Park Casino, and M Resort.

The Southern Plains reportable segment consists of the following properties: Argosy Casino Riverside, Argosy Casino Sioux City, Hollywood Casino Baton Rouge, Hollywood Casino Tunica, Hollywood Casino Bay St. Louis, and Boomtown Biloxi. It also includes the Company s 50% investment in Kansas Entertainment, which owns the Hollywood Casino at Kansas Speedway which opened in February 2012.

The Other category consists of the Company s standalone racing operations, namely Beulah Park, Raceway Park, Rosecroft Raceway, Sanford-Orlando Kennel Club, and the Company s joint venture interests in Sam Houston Race Park and Valley Race Park and Freehold Raceway. It also included the Company s joint venture interest in the Maryland Jockey Club which was sold in July 2011. If the Company is successful in obtaining gaming operations at these locations, they would be assigned to one of the Company s regional executives and reported in their respective reportable segment. The Other category also includes the Company s corporate overhead operations which does not meet the definition of an operating segment under ASC 280, Segment Reporting, and Bullwhackers.

The following tables present certain information with respect to the Company s segments. Intersegment revenues between the Company s segments were not material in any of the periods presented below.

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	Midwest	East/West (1)	Southern Plains (2) (in thousands)	Other	Total
Three months ended March 31, 2012					
Net revenues	$ 205,110	$ 370,629	$ 149,720	$ 10,600	$ 736,059
Income (loss) from operations	46,281	83,891	44,712	(32,269)	142,615
Depreciation and amortization	17,552	22,241	11,388	2,156	53,337
Gain from unconsolidated affiliates			1,678	7	1,685
Capital expenditures	101,880	10,659	3,932	3,188	119,659
Three months ended March 31, 2011					
Net revenues	213,811	288,383	155,090	9,739	667,023
Income (loss) from operations	52,676	59,738	39,509	(29,188)	122,735
Depreciation and amortization	15,644	20,567	14,664	2,283	53,158
Loss from unconsolidated affiliates			(322)	(2,032)	(2,354)
Capital expenditures	33,206	13,994	6,628	696	54,524
Balance sheet at March 31, 2012					
Total assets	1,951,980	1,244,016	1,061,173	392,794	4,649,963
Investment in and advances to unconsolidated affiliates		110	147,982	67,324	215,416
Goodwill and other intangible assets, net	924,489	226,074	394,018	55,864	1,600,445
Balance sheet at December 31, 2011					
Total assets	1,897,164	1,265,438	1,034,506	409,238	4,606,346
Investment in and advances to unconsolidated affiliates		110	107,204	66,802	174,116
Goodwill and other intangible assets, net	925,822	226,234	394,018	55,878	1,601,952

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(1) Net revenue and income from operations for the East/West segment increased by $82.2 million and $24.2 million, respectively, for the three months ended March 31, 2012, as compared to the three months ended March 31, 2011, primarily related to the acquisition of the M Resort on June 1, 2011, as well as the continued impact from the introduction of table games in July 2010 at Hollywood Casino at Charles Town Races.

(2) Gain from unconsolidated affiliates for the Southern Plains segment was impacted by the opening of Hollywood Casino at Kansas Speedway on February 3, 2012.

10. Fair Value of Financial Instruments

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

Cash and Cash Equivalents

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

Investment in Corporate Debt Securities

The fair value of the investment in corporate debt securities is estimated based on a third party broker quote. The investment in corporate debt securities is measured at fair value on a recurring basis.

Long-term Debt

The fair value of the Company s Term Loan B component of the senior secured credit facility and senior subordinated notes is estimated based on quoted prices in active markets and as such is a level 1 measurement (see Note 11). The fair value of the remainder of the Company s senior secured credit facility approximates its carrying value as it is variable rate debt. The fair value of the Company s other long-term obligations approximates its carrying value.

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

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	March 31, 2012 Carrying Amount	March 31, 2012 Fair Value	December 31, 2011 Carrying Amount	December 31, 2011 Fair Value
Financial assets:				
Cash and cash equivalents	$ 217,451	$ 217,451	$ 238,440	$ 238,440
Investment in corporate debt securities	6,720	6,720	6,790	6,790
Financial liabilities:				
Long-term debt				
Senior secured credit facility	1,701,436	1,704,093	1,714,001	1,716,720
Senior subordinated notes	325,000	363,188	325,000	353,438
Other long-term obligations	1,979	1,979	1,949	1,949

11. Fair Value Measurements

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

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

- Level 2: Inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly; these include quoted prices for similar assets or liabilities in active markets, such as interest rates and yield curves that are observable at commonly quoted intervals.

- Level 3: Unobservable inputs that reflect the reporting entity s own assumptions, as there is little, if any, related market activity.

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

The following tables set forth the assets measured at fair value on a recurring basis, by input level, in the consolidated balance sheets at March 31, 2012 and December 31, 2011 (in thousands):

	Balance Sheet Location	Quoted Prices in Active Markets for Identical Assets or Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	March 31, 2012 Total
Assets:					
	Other assets	$	$ 6,720	$	$ 6,720

Investment in corporate debt securities

	Balance Sheet Location	Quoted Prices in Active Markets for Identical Assets or Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	December 31, 2011 Total
Assets:					
Investment in corporate debt securities	Other assets	$	$ 6,790	$	$ 6,790

The valuation technique used to measure the fair value of the investment in corporate debt securities was the market approach. See Note 10 for a description of the input used in calculating the fair value measurement of investment in corporate debt securities.

There were no long-lived assets measured at fair value on a non-recurring basis during the three months ended March 31, 2012.

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12. Insurance Recoveries and Deductibles

Hollywood Casino Tunica Flood

On May 1, 2011, Hollywood Casino Tunica was forced to close as a result of flooding by the Mississippi River. Due to the flooding, access to the property was temporarily cut off and the property sustained minor damage. The property reopened on May 25, 2011.

At the time of the flood, the Company carried property insurance coverage with a flood limit of $300 million for both property damage and business interruption applicable to this event. This coverage included a $5 million property damage and two day business interruption deductible for the peril of flood.

The Company received $12.0 million in insurance proceeds related to the flood at Hollywood Casino Tunica, with $5.0 million received during the three months ended March 31, 2012. As the insurance recovery amount exceeded the net book value of assets believed to be damaged and other costs incurred as a result of the flood, the Company recorded a pre-tax gain of $3.9 million during the three months ended March 31, 2012.

13. Subsidiary Guarantors

Under the terms of the senior secured credit facility, all of Penn s subsidiaries are guarantors under the agreement, with the exception of several minor subsidiaries with total assets, excluding intercompany balances, of $241.6 million (of which $204.2 million represents investments in unconsolidated affiliates). Each of the subsidiary guarantors is 100% owned by Penn. In addition, the guarantees provided by Penn s subsidiaries under the terms of the senior secured credit facility are full and unconditional, joint and several, and Penn had no significant independent assets and no independent operations at, and for the three months ended March 31, 2012. There are no significant restrictions within the senior secured credit facility on the Company s ability to obtain funds from its subsidiaries by dividend or loan. However, in certain jurisdictions, the gaming authorities may impose restrictions pursuant to the authority granted to them with regard to Penn s ability to obtain funds from its subsidiaries.

With regard to the senior secured credit facility, the Company has not presented condensed consolidating balance sheets, condensed consolidating statements of income and condensed consolidating statements of cash flows at, and for the three months ended March 31, 2012, as Penn had no significant independent assets and no independent operations at, and for the three months ended March 31, 2012, the guarantees are full and unconditional and joint and several, and any subsidiaries of Penn other than the subsidiary guarantors are considered minor.

The Company s $325 million 8¾ senior subordinated notes are not guaranteed by the Company s subsidiaries.

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

Our Operations

We are a leading, diversified, multi-jurisdictional owner and manager of gaming and pari-mutuel properties. As of March 31, 2012, we own, manage, or have ownership interests in twenty-six facilities in the following nineteen jurisdictions: Colorado, Florida, Illinois, Indiana, Iowa, Kansas, Louisiana, Maine, Maryland, Mississippi, Missouri, Nevada, New Jersey, New Mexico, Ohio, Pennsylvania, Texas, West Virginia, and Ontario. We believe that our portfolio of assets provides us with diversified cash flow from operations.

We have made significant acquisitions in the past, and expect to continue to pursue additional acquisition and development opportunities in the future. In 1997, we began our transition from a pari-mutuel company to a diversified gaming company with the acquisition of the Charles Town property and the introduction of video lottery terminals in West Virginia. Since 1997, we have continued to expand our gaming operations through strategic acquisitions (including the acquisitions of Hollywood Casino Bay St. Louis and Boomtown Biloxi, CRC Holdings, Inc., the Bullwhackers properties, Hollywood Casino Corporation, Argosy Gaming Company, Zia Park Casino, Sanford-Orlando Kennel Club and The M Resorts LLC (the M Resort) in June 2011), greenfield projects (such as at Hollywood Casino at Penn National Race Course, Hollywood Casino Bangor and Hollywood Casino Perryville), and property expansions (such as Hollywood Casino at Charles Town Races and Hollywood Casino Lawrenceburg). Most recently, we, along with our joint venture partner, opened Hollywood Casino at Kansas Speedway on February 3, 2012, and we anticipate opening our facilities in Columbus and Toledo, Ohio in 2012.

The vast majority of our revenue is gaming revenue, derived primarily from gaming on slot machines and, to a lesser extent, table games, which is highly dependent upon the volume and spending levels of customers at our properties. Other revenues are derived from our management service fee from Casino Rama, our hotel, dining, retail, admissions, program sales, concessions and certain other ancillary activities, and our racing operations. Our racing revenue includes our share of pari-mutuel wagering on live races after payment of amounts returned as winning wagers, our share of wagering from import and export simulcasting, and our share of wagering from our off-track wagering facilities.

Key performance indicators related to gaming revenue are slot handle and table game drop (volume indicators) and win or hold percentage. Our typical property slot win percentage is in the range of 6% to 10% of slot handle, and our typical table game win percentage is in the range of 12% to 25% of table game drop.

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

We continue to expand our gaming operations through the implementation and execution of a disciplined capital expenditure program at our existing properties, the pursuit of strategic acquisitions and the development of new gaming properties, particularly in attractive regional markets. Current capital projects are ongoing at several of our new and existing properties, including our facilities under construction in Ohio. Additional information regarding our capital projects is discussed in detail in the section entitled Liquidity and Capital Resources Capital Expenditures below.

Segment Information

We have aggregated our properties into three reportable segments: (i) Midwest, (ii) East/West, and (iii) Southern Plains, which is consistent with how our Chief Operating Decision Maker reviews and assesses our financial performance.

The Midwest reportable segment consists of the following properties: Hollywood Casino Lawrenceburg, Hollywood Casino Aurora, Hollywood Casino Joliet, and Argosy Casino Alton. It also includes our Casino Rama management service contract as well as the two Ohio properties that are currently under construction, Hollywood Casino Toledo and Hollywood Casino Columbus, which are scheduled to open on, or about May 29, 2012 and early in the fourth quarter of 2012, respectively.

The East/West reportable segment consists of the following properties: Hollywood Casino at Charles Town Races, Hollywood Casino Perryville, Hollywood Casino Bangor, Hollywood Casino at Penn National Race Course, Zia Park Casino, and M Resort.

The Southern Plains reportable segment consists of the following properties: Argosy Casino Riverside, Argosy Casino Sioux City, Hollywood Casino Baton Rouge, Hollywood Casino Tunica, Hollywood Casino Bay St. Louis, and Boomtown Biloxi. It also includes our 50% investment in Kansas Entertainment, LLC (Kansas Entertainment), which owns the Hollywood Casino at Kansas Speedway which opened in February 2012.

The Other category consists of our standalone racing operations, namely Beulah Park, Raceway Park, Rosecroft Raceway, Sanford-Orlando Kennel Club, and our joint venture interests in Sam Houston Race Park and Valley Race Park and Freehold Raceway. It also included our joint venture interest in the Maryland Jockey Club which was sold in July 2011. If we are successful in obtaining gaming operations at these locations, they would be assigned to one of our regional executives and reported in their respective reportable segment. The Other category also includes our corporate overhead operations which does not meet the definition of an operating segment under Accounting Standards Codification 280, Segment Reporting, and our Bullwhackers property.

Executive Summary

Economic conditions continue to impact the overall domestic gaming industry as well as operating results. We believe that current economic conditions, including, but not limited to, high unemployment levels, low levels of consumer confidence, weakness in the housing and consumer credit markets and increased stock market volatility, have resulted in reduced levels of discretionary consumer spending compared to historical levels. However, our first quarter 2012 results compared to the corresponding period in the prior year were favorably impacted by an unusually mild winter, as well as to a lesser extent gradual strengthening in the United States economy, higher levels of consumer confidence and a significant increase in equity markets.

We believe our strengths include our relatively low leverage ratios compared to the regional casino companies that we directly compete with and the ability of our operations to generate positive cash flow. These two factors have allowed us to develop what we believe to be attractive future growth opportunities in new gaming markets. We have also made investments in joint ventures and certain racetrack operations that we believe may allow us to capitalize on additional gaming opportunities in certain states if legislation or referenda are passed that permit and/or expand gaming in these jurisdictions.

Financial Highlights:

The major factors affecting our results for the three months ended March 31, 2012, as compared to the three months ended March 31, 2011, were:

• Increases in net revenues and income from operations of $82.2 million and $24.2 million, respectively, for the three months ended March 31, 2012, as compared to the three months ended March 31, 2011, from our East/West segment. This was primarily due to the acquisition of the M Resort on June 1, 2011 and the continued impact from the introduction of table games in July 2010 at Hollywood Casino at Charles Town Races. Additionally, first quarter 2012 results for our East/West segment were favorably impacted by a mild winter.

- The opening of the new casino in Illinois in July 2011 which negatively impacted the financial results of our Midwest segment s Hollywood Casino Aurora and Hollywood Casino Joliet, which was partially offset by the expiration of the 3% surcharge in July 2011 for both of these properties.

- Income from operations at our Southern Plains segment was impacted by a pre-tax insurance gain of $3.9 million at Hollywood Casino Tunica during the three months ended March 31, 2012. Additionally, the February 3, 2012 opening of our joint venture, Hollywood Casino at Kansas Speedway, negatively impacted the results at our Argosy Riverside property.

- Excluding the recently acquired M Resort, management s continued focus on cost management contributed to improved operating margins at 12 of our 16 gaming facilities.

- Net income increased by $27.1 million for the three months ended March 31, 2012, as compared to the three months ended March 31, 2011, primarily due to the variances explained above, as well as a decrease in interest expense partially offset by an increase in income taxes.

Segment Developments:

The following are recent developments that have had or will have an impact on us by segment:

Midwest

- The Hollywood Casino Columbus project, a $400 million Hollywood-themed casino in Columbus, Ohio, inclusive of $50 million in licensing fees, is under construction with a planned casino opening of up to 3,000 slot machines, 70 table games and 30 poker

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tables, structured and surface parking, as well as food and beverage outlets and an entertainment lounge. We expect that Hollywood Casino Columbus will open early in the fourth quarter of 2012. Construction is also underway for Hollywood Casino Toledo, a $320 million Hollywood-themed casino in Toledo, Ohio, inclusive of $50 million in licensing fees, with a planned casino opening of 2,000 slot machines, 60 table games and 20 poker tables, structured and surface parking, as well as food and beverage outlets and an entertainment lounge. Hollywood Casino Toledo is anticipated to open on, or about May 29, 2012. Additionally, in June 2011, we agreed to pay an additional $110 million over ten years to the State of Ohio in return for certain clarifications from the State of Ohio with respect to various financial matters and limits on competition within the ten year time period.

- In March 2012, we announced that we had entered into a non-binding memorandum of understanding with the State of Ohio that establishes a framework for relocating our existing racetracks in Toledo and Grove City to Dayton and Austintown (located in the Mahoning Valley), respectively, where we intend to develop new integrated racing and gaming facilities, each budgeted at approximately $275 million inclusive of license and relocation fees. Pursuant to this arrangement, we would pay the state a $75 million relocation fee per facility and the Lottery Commission would retain 33.5% of video lottery terminal revenues. We remain in negotiations with the thoroughbred and harness horsemen s organizations to determine the level of their participation in the revenue streams from our investments in these two new racing and gaming facilities and are optimistic we will reach a resolution equitable to both parties. In addition, the agreement restricts any other gaming facility from being located within 50 miles of our Columbus and Toledo casinos, as well as our relocated tracks, with certain exceptions.

- On October 21, 2011, The Ohio Roundtable filed a complaint in the Court of Common Pleas in Franklin County, Ohio against a number of defendants, including the Governor, the Ohio Lottery Commission and the Ohio Casino Control Commission. The complaint alleges a variety of substantive and procedural defects relative to the approval and implementation of video lottery terminals as well as several counts dealing with the taxation of standalone casinos. We, along with the other two casinos in Ohio, have filed motions for judgment on the pleadings. Oral argument on the motions was held in April.

- In July 2011, we entered into a new interim agreement with the Ontario Lottery and Gaming Corporation (OLGC) for the operation of the Casino Rama facility through March 31, 2012, which was subsequently extended in January 2012 for an additional six months through September 30, 2012. In March 2012, the OLGC canceled its process of evaluating bids for a new five year operating contract for the facility (which included a limit on operating fees exceeding $5 million per year). Although the bid process has been canceled, there can be no assurance that the OLGC will select us to manage the property beyond September 30, 2012.

- On July 18, 2011, the tenth licensed casino in Illinois opened in the city of Des Plaines. This facility is a new source of competition for Hollywood Casino Aurora and Hollywood Casino Joliet and has had a negative impact on these properties financial results. However, the 3% surcharge Hollywood Casino Aurora and Hollywood Casino Joliet paid to subsidize local horse racing interests is no longer required with the opening of the Des Plaines facility.

- A proposed casino in Cincinnati, Ohio is anticipated to open in 2013. This new facility will have an adverse impact on Hollywood Casino Lawrenceburg.

East/West

• Hollywood Casino Bangor introduced table games on March 16, 2012 with the addition of six blackjack tables, a roulette table and seven poker tables. Table games were approved by voters in Penobscot County in November 2011.

• In our East/West segment, the developer of a proposed casino complex at the Arundel Mills mall in Anne Arundel, Maryland is targeting an opening in June 2012, with the full facility expected to be open by the end of 2012. Hollywood Casino at Charles Town Races, Hollywood Casino Perryville and Hollywood Casino at Penn National Race Course will face increased competition and their results will be negatively impacted upon the opening of this casino. In addition, the Maryland Legislature recently adjoined without taking action on a proposed gaming expansion bill which could potentially bring a sixth casino to Maryland, the latest version of which excluded our Rosecroft property as an eligible slots location, and table games to all Maryland casinos.

Southern Plains

• Kansas Entertainment opened its $391 million facility, inclusive of licensing fees, on February 3, 2012. The facility features a 95,000 square foot casino with approximately 2,000 slot machines, 52 table games and 12 poker tables, a 1,253 space parking structure, as well as a variety of dining and entertainment facilities. We and International Speedway Corporation shared equally in the cost of developing and constructing Hollywood Casino at Kansas Speedway. Our share of the project is anticipated to be approximately $145 million. The opening of this casino has and will continue to negatively impact the financial results of our Argosy Riverside property due to their close proximity to one another.

- On May 1, 2011, Hollywood Casino Tunica was forced to close as a result of flooding by the Mississippi River. Due to the flooding, access to the property was temporarily cut-off and the property sustained minor damage. The property reopened on May 25, 2011. At the time of the flood, we carried property insurance coverage with a flood limit of $300 million for both property damage and business interruption applicable to this event. This coverage included a $5 million property damage and two day business interruption deductible for the peril of flood. We received $12.0 million in insurance proceeds related to the flood at Hollywood Casino Tunica, with $5.0 million received during the three months ended March 31, 2012. As the insurance recovery amount exceeded the net book value of assets believed to be damaged and other costs incurred as a result of the flood at Hollywood Casino Tunica in the first quarter of 2012, we recorded a pre-tax gain of $3.9 million during the three months ended March 31, 2012. We continue to work with our insurance providers to settle the claims related to the flood and we anticipate additional proceeds in the second quarter of 2012.

- Each gaming license in Iowa is issued jointly to a gaming operator and a local charitable sponsor. The agreement between our gaming operator subsidiary in Iowa, Belle of Sioux City, L.P. (the Belle) and its charitable sponsor, Missouri River Historical Development, Inc. (MRHD), may expire as early as July 2012. The Belle is in the process of negotiating with MRHD to transition its current barge-based facility to a new land-based facility and to enter into a new long-term agreement with MRHD. If a new agreement cannot be reached, MRHD has indicated that it may issue a request for proposals for alternative operators for a new land-based facility and has preemptively filed a lawsuit seeking to establish its right to do so. If MRHD were to issue such a request, the Belle may contest MRHD s right to do so, may participate in the process and/or may seek an alternative charitable sponsor. Accordingly, at this time, there can be no assurance that the Belle will be able to reach an agreement with MRHD or, absent such agreement, that it will be able to partner with an alternative charitable sponsor. In the event that both MRHD and the Belle find alternative partners, it is unclear whether the Iowa Gaming and Racing Commission would issue a gaming license to one or both such groups. Further, the Belle s ability to continue its operations may also be impacted by its ability to renew or extend its existing docking lease, which expires in January 2013, or to locate a suitable site to construct a land-based facility.

- Construction on a riverboat casino and hotel in Louisiana has begun with a planned opening in the summer of 2012. The opening of this riverboat casino will have an adverse effect on the financial results of Hollywood Casino Baton Rouge. In addition, construction on a casino project in Biloxi has begun with a planned opening in the spring of 2012. The opening of this casino will have an adverse effect on the financial results of Boomtown Biloxi.

Critical Accounting Estimates

We make certain judgments and use certain estimates and assumptions when applying accounting principles in the preparation of our consolidated financial statements. The nature of the estimates and assumptions are material due to the levels of subjectivity and judgment necessary to account for highly uncertain factors or the susceptibility of such factors to change. We have identified the accounting for long-lived assets, goodwill and other intangible assets, income taxes and litigation, claims and assessments as critical accounting estimates, as they are the most important to our financial statement presentation and require difficult, subjective and complex judgments.

We believe the current assumptions and other considerations used to estimate amounts reflected in our consolidated financial statements are appropriate. However, if actual experience differs from the assumptions and other considerations used in estimating amounts reflected in our consolidated financial statements, the resulting changes could have a material adverse effect on our consolidated results of operations and, in certain situations, could have a material adverse effect on our financial condition.

For further information on our critical accounting estimates, see Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations and the notes to our audited consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2011. There has been no material change to these estimates for the three months ended March 31, 2012.

Results of Operations

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

- The fact that most of our properties operate in mature competitive markets. As a result, we expect a majority of our future growth to come from prudent acquisitions of gaming properties, jurisdictional expansions (such as the September 2010 opening of Hollywood Casino Perryville in Maryland, the February 2012 opening of a casino through a joint venture in Kansas, and the anticipated 2012 openings in Toledo and Columbus, Ohio), expansions of gaming in existing

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jurisdictions (such as the introduction of table games in July 2010 at Hollywood Casino at Charles Town Races and Hollywood Casino at Penn National Race Course, and more recently at Hollywood Casino Bangor in March 2012) and expansions/improvements of existing properties.

- The fact that a number of states are currently considering or implementing legislation to legalize or expand gaming. Such legislation presents both potential opportunities to establish new properties (for example, in Kansas where we opened a casino through a joint venture in February 2012, in Ohio where we have plans to open two casinos, one in Toledo and the other in Columbus, and in Maryland where we opened Hollywood Casino Perryville on September 27, 2010) and increased competitive threats to business at our existing properties (such as the introduction of commercial casinos in Kansas, Maryland, Ohio, and potentially Kentucky, an additional casino in Illinois which opened on July 18, 2011, gaming expansion in Baton Rouge, Louisiana, and the introduction of tavern licenses in several states).

- The actions of government bodies can affect our operations in a variety of ways. For instance, the continued pressure on governments to balance their budgets could intensify the efforts of state and local governments to raise revenues through increases in gaming taxes. In addition, government bodies may restrict, prevent or negatively impact operations in the jurisdictions in which we do business (such as the implementation of smoking bans).

- The continued demand for, and our emphasis on, slot wagering entertainment at our properties.

- The successful execution of the development and construction activities currently underway at a number of our facilities, as well as the risks associated with the costs, regulatory approval and the timing of these activities.

- The risks related to economic conditions and the effect of such conditions on consumer spending for leisure and gaming activities, which may negatively impact our operating results and our ability to access financing at favorable terms.

The results of operations for the three months ended March 31, 2012 and 2011 are summarized below:

	Three Months Ended March 31,	
	2012	2011
	(in thousands)	
Revenues:		
Gaming	$ 656,077	$ 609,111
Food, beverage and other	112,908	85,289
Management service fee	3,443	3,317
Revenues	772,428	697,717
Less promotional allowances	(36,369)	(30,694)
Net revenues	736,059	667,023
Operating expenses:		
Gaming	340,169	320,756

Food, beverage and other		87,804		68,592
General and administrative		115,997		103,476
Depreciation and amortization		53,337		53,158
Insurance recoveries, net of deductible charges		(3,863)		(1,694)
Total operating expenses		593,444		544,288
Income from operations	$	142,615	$	122,735

Certain information regarding our results of operations by segment for the three months ended March 31, 2012 and 2011 is summarized below:

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Three Months Ended March 31,	Net Revenues 2012	Net Revenues 2011	Income (loss) from Operations 2012	Income (loss) from Operations 2011
	(in thousands)			
Midwest	$ 205,110	$ 213,811	$ 46,281	$ 52,676
East/West	370,629	288,383	83,891	59,738
Southern Plains	149,720	155,090	44,712	39,509
Other	10,600	9,739	(32,269)	(29,188)
Total	$ 736,059	$ 667,023	$ 142,615	$ 122,735

Revenues

Revenues for the three months ended March 31, 2012 and 2011 were as follows (in thousands):

Three Months Ended March 31,	2012	2011	Variance	Percentage Variance
Gaming	$ 656,077	$ 609,111	$ 46,966	7.7%
Food, beverage and other	112,908	85,289	27,619	32.4%
Management service fee	3,443	3,317	126	3.8%
Revenues	772,428	697,717	74,711	10.7%
Less promotional allowances	(36,369)	(30,694)	(5,675)	(18.5)%
Net revenues	$ 736,059	$ 667,023	$ 69,036	10.3%

In our business, revenue is driven by discretionary consumer spending, which has been impacted by weakened general economic conditions such as, but not limited to, high unemployment levels, low levels of consumer confidence, weakness in the housing market and increased stock market volatility. However, first quarter 2012 results compared to the corresponding period in the prior year has benefited from an unusually mild winter, lower unemployment levels, higher levels of consumer confidence, and a significant increase in equity markets.

We have no certain mechanism for determining why consumers choose to spend more or less money at our properties from period to period and as such cannot quantify a dollar amount for each factor that impacts our customers spending behaviors. However, based on our experience, we can generally offer some insight into the factors that we believe were likely to account for such changes. In instances where we believe one factor may have had a significantly greater impact than the other factors, we have noted that as well. However, in all instances, such insights are based only on our reasonable judgment and professional experience, and no assurance can be given as to the accuracy of our judgments.

Gaming revenue

Gaming revenue increased by $47.0 million, or 7.7%, for the three months ended March 31, 2012, as compared to the three months ended March 31, 2011, primarily due to the variances explained below.

Gaming revenue for our East/West segment increased by $62.2 million, or 23.7%, for the three months ended March 31, 2012, as compared to the three months ended March 31, 2011, primarily due to the acquisition of the M Resort on June 1, 2011, an increase in gaming revenue at Hollywood Casino at Charles Town Races primarily due to the continued impact from the introduction of table games in July 2010 coupled with mild weather, and an increase in gaming revenue at Hollywood Casino Perryville primarily due to continued growth in this relatively new gaming market.

Gaming revenue for our Midwest segment decreased by $9.0 million, or 4.5%, for the three months ended March 31, 2012, as compared to the three months ended March 31, 2011, primarily due to a decrease in gaming revenue at Hollywood Casino Aurora and Hollywood Casino Joliet primarily due to increased competition with the opening of a new casino in Illinois in July 2011. In addition, the decline in gaming revenue at Hollywood Casino Joliet was impacted by increased patronage in the first quarter of 2011 as a result of the opening of the new land-based pavilion in late 2010.

Gaming revenue for our Southern Plains segment decreased by $5.7 million, or 3.9%, for the three months ended March 31, 2012, as compared to the three months ended March 31, 2011, primarily due to a decrease in gaming revenue at Argosy Casino Riverside primarily due to the opening of Hollywood Casino at Kansas Speedway joint venture in February 2012.

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Food, beverage and other revenue

Food, beverage and other revenue increased by $27.6 million, or 32.4%, for the three months ended March 31, 2012, as compared to the three months ended March 31, 2011, primarily due to the acquisition of the M Resort on June 1, 2011.

Promotional allowances

Promotional allowances increased by $5.7 million, or 18.5%, for the three months ended March 31, 2012, as compared to the three months ended March 31, 2011, primarily due to the acquisition of the M Resort on June 1, 2011.

Operating Expenses

Operating expenses for the three months ended March 31, 2012 and 2011 were as follows (in thousands):

Three Months Ended March 31,	**2012**	**2011**	**Variance**	**Percentage Variance**
Gaming	$ 340,169	$ 320,756	$ 19,413	6.1%
Food, beverage and other	87,804	68,592	19,212	28.0%
General and administrative	115,997	103,476	12,521	12.1%
Depreciation and amortization	53,337	53,158	179	0.3%
Insurance recoveries, net of deductible charges	(3,863)	(1,694)	(2,169)	(128.0)%
Total operating expenses	$ 593,444	$ 544,288	$ 49,156	9.0%

Gaming expense

Gaming expense increased by $19.4 million, or 6.1%, for the three months ended March 31, 2012, as compared to the three months ended March 31, 2011, primarily due to the variances explained below.

Gaming expense for our East/West segment increased by $29.1 million, or 18.3%, for the three months ended March 31, 2012, as compared to the three months ended March 31, 2011, primarily due to the acquisition of the M Resort on June 1, 2011 and an overall increase in gaming taxes resulting from increased taxable gaming revenue mentioned above at Hollywood Casino at Charles Town Races and Hollywood Casino Perryville.

Gaming expense for our Midwest segment decreased by $7.1 million, or 6.7%, for the three months ended March 31, 2012, as compared to the three months ended March 31, 2011, primarily due to an overall decrease in gaming taxes resulting from decreased taxable gaming revenue mentioned above for Hollywood Casino Joliet and Hollywood Casino Aurora in conjunction with the opening of the new casino in Des Plaines, Illinois, as well as the expiration of the 3% surcharge in July 2011 for both of these properties which had been required to subsidize local horse racing interests.

Gaming expense for our Southern Plains segment decreased by $2.3 million, or 4.3%, for the three months ended March 31, 2012, as compared to the three months ended March 31, 2011, primarily due to an overall decrease in gaming taxes resulting from decreased taxable gaming revenue mentioned above for Argosy Casino Riverside.

Food, beverage and other expenses

Food, beverage and other expenses increased by $19.2 million, or 28.0%, for the three months ended March 31, 2012, as compared to the three months ended March 31, 2011, primarily due to the acquisition of the M Resort on June 1, 2011.

General and administrative expenses

General and administrative expenses include expenses such as compliance, facility maintenance, utilities, property and liability insurance, surveillance and security, and certain housekeeping services, as well as all expenses for administrative departments such as accounting, purchasing, human resources, legal and internal audit. General and administrative expenses also include lobbying expenses.

General and administrative expenses increased by $12.5 million, or 12.1%, for the three months ended March 31, 2012, as compared to the three months ended March 31, 2011, primarily due to the variances explained below.

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General and administrative expenses for our East/West segment increased by $7.3 million, or 29.4%, for the three months ended March 31, 2012, as compared to the three months ended March 31, 2011, primarily due to the acquisition of the M Resort on June 1, 2011.

General and administrative expenses for Other increased by $3.5 million, or 13.2%, for the three months ended March 31, 2012, as compared to the three months ended March 31, 2011, primarily due to increased compensation costs for the first quarter of 2012 compared to the same period in the prior year to support our growing organization.

Insurance recoveries, net of deductible charges

Insurance recoveries, net of deductible charges during the three months ended March 31, 2012 were related to a pre-tax insurance gain of $3.9 million for the flood at Hollywood Casino Tunica. Insurance recoveries, net of deductible charges during the three months ended March 31, 2011 were related to a pre-tax insurance gain of $1.7 million for a fire at Hollywood Casino Joliet.

Other income (expenses)

Other income (expenses) for the three months ended March 31, 2012 and 2011 were as follows (in thousands):

Three Months Ended March 31,	**2012**	**2011**	**Variance**	**Percentage Variance**
Interest expense	$ (18,043)	$ (29,026)	$ 10,983	37.8%
Interest income	219	53	166	313.2%
Gain (loss) from unconsolidated affiliates	1,685	(2,354)	4,039	171.6%
Other	(1,003)	(1,643)	640	39.0%
Total other expenses	$ (17,142)	$ (32,970)	$ 15,828	48.0%

Interest expense

Interest expense decreased by $11.0 million, or 37.8%, for the three months ended March 31, 2012, as compared to the three months ended March 31, 2011, primarily due to the expiration of all interest rate swap contracts in 2011, redemption of our $250 million 6 ¾% senior subordinated notes in August 2011 and higher capitalized interest in the first quarter of 2012 compared to the corresponding period in the prior year, all of which were partially offset by higher interest on our senior secured credit facility entered into in July 2011 primarily due to higher interest rates and to a lesser extent higher outstanding balances. In 2011, we funded the redemption of our $250 million 6 ¾% senior subordinated notes with our revolving credit facility under the 2011 senior secured credit facility.

Gain (loss) from unconsolidated affiliates

We recorded a gain from unconsolidated affiliates of $1.7 million for the three months ended March 31, 2012, primarily due to our share of earnings from Kansas Entertainment for the three months ended March 31, 2012 due to the opening of the casino in February 2012.

We recorded a loss from unconsolidated affiliates of $2.4 million for three months ended March 31, 2011, primarily due to our share of losses in the Maryland Jockey Club for the three months ended March 31, 2011.

Other

Other decreased by $0.6 million for the three months ended March 31, 2012, as compared to the three months ended March 31, 2011, primarily due to decreased foreign currency translation losses for the three months ended March 31, 2012 compared to the corresponding period in the prior year.

Taxes

Our effective tax rate (income taxes as a percentage of income from operations before income taxes) decreased to 37.3% for the three months ended March 31, 2012 as compared to 42.6% for the three months ended March 31, 2011. The primary reasons for the decrease are due to lower amounts of unfavorable permanent book to tax differences coupled with higher pretax income for the three months ended March 31, 2012. In addition, we experienced a decrease in our effective state tax rate due to a decline in the

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statutory income tax rate in the State of Indiana coupled with the impact of various subsidiary restructurings that were completed in the third quarter of 2011.

Our projected annual effective tax rate can vary from period to period depending on, among other factors, the geographic and business mix of our earnings and the level of our tax credits. Certain of these and other factors, including our history of pre-tax earnings, are taken into account in assessing our ability to realize our net deferred tax assets.

Liquidity and Capital Resources

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

Net cash provided by operating activities totaled $122.6 million and $102.3 million for the three months ended March 31, 2012 and 2011, respectively. The increase in net cash provided by operating activities of $20.3 million for the three months ended March 31, 2012 compared to the corresponding period in the prior year is comprised primarily of an increase in cash receipts from customers of $66.7 million, a decrease in interest payments of $13.6 million, and an increase in insurance recoveries of $2.2 million, which were partially offset by an increase in cash paid to suppliers and vendors of $26.2 million, cash paid to employees of $23.4 million, and in income tax payments of $14.2 million. The increase in cash receipts collected from our customers and the increase in higher cash payments for operating expenses for the three months ended March 31, 2012 compared to the prior year was primarily due to the previously discussed growth in our East/West segment. Additionally, the increase in cash paid to employees for the three months ended March 31, 2012 compared to the prior year was primarily due to the acquisition of the M Resort on June 1, 2011.

Net cash used in investing activities totaled $132.3 million and $79.6 million for the three months ended March 31, 2012 and 2011, respectively. Net cash used in investing activities for the three months ended March 31, 2012 included expenditures for property and equipment, net of reimbursements totaling $119.7 million and investment in joint ventures of $39.6 million, both of which were partially offset by a decrease in cash in escrow of $25.7 million and proceeds from the sale of property and equipment totaling $1.3 million. The increase in net cash used in investing activities of $52.7 million for the three months ended March 31, 2012 compared to the prior year was primarily due to increased expenditures for property and equipment as a result of increased expenditures at our two facilities under construction in Ohio, as well as increased investment in joint ventures primarily due to increased funding provided to our joint venture in Kansas. This increase was partially offset by the acquisition of Rosecroft Raceway in February 2011 and a decrease in cash in escrow.

Net cash used in financing activities totaled $11.3 million and $34.6 million for the three months ended March 31, 2012 and 2011, respectively. The decrease in net cash used in financing activities for the three months ended March 31, 2012 compared to the corresponding period in the prior year was primarily due to an increase in proceeds from issuance of long-term debt.

Capital Expenditures

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

The following table summarizes our expected capital project expenditures by segment for the fiscal year ending December 31, 2012, and actual expenditures for the three months ended March 31, 2012 (excluding licensing fees). The table below should not be utilized to predict future expected capital project expenditures subsequent to 2012.

Property	**Expected for Year Ending December 31, 2012**	**Expenditures for Three Months Ended March 31, 2012 (in millions)**	**Balance to Expend in 2012**
Midwest	$ 350.1	$ 96.5	$ 253.6
East/West	2.5	0.7	1.8
Southern Plains	0.6	0.1	0.5
Other	0.7	0.5	0.2
Total	$ 353.9	$ 97.8	$ 256.1

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In November 2009, the Ohio Jobs and Growth Plan, a casino ballot proposal calling for an amendment to Ohio s Constitution to authorize casinos in the state s four largest cities, Cincinnati, Cleveland, Columbus and Toledo, was approved. Construction is underway for Hollywood Casino Toledo, a $320 million Hollywood-themed casino in Toledo, Ohio, inclusive of $50 million in licensing fees, with a planned casino opening of 2,000 slot machines, 60 table games and 20 poker tables, structured and surface parking, as well as food and beverage outlets and an entertainment lounge. The Hollywood Casino Columbus project, a $400 million Hollywood-themed casino in Columbus, Ohio, inclusive of $50 million in licensing fees, is under construction, with a planned casino opening of up to 3,000 slot machines, 70 table games and 30 poker tables, structured and surface parking, as well as food and beverage outlets and an entertainment lounge. We expect the opening of Hollywood Casino Toledo on, or about May 29, 2012 and Hollywood Casino Columbus to open early in the fourth quarter of 2012.

During the three months ended March 31, 2012, we spent approximately $21.9 million for capital maintenance expenditures, with $5.4 million at our Midwest segment, $10.0 million at our East/West segment, $3.8 million at our Southern Plains segment, and $2.7 million for Other. The majority of the capital maintenance expenditures were for slot machines and slot machine equipment.

Cash generated from operations and cash available under the revolving credit facility portion of our senior secured credit facility have funded our capital project and capital maintenance expenditures in 2012 to date.

Debt

Our senior secured credit facility had a gross outstanding balance of $1,703.1 million at March 31, 2012, consisting of $285.0 million drawn under the revolving credit facility, a $673.7 million Term Loan A facility, and a $744.4 million Term Loan B facility. Additionally, at March 31, 2012, we were contingently obligated under letters of credit issued pursuant to the senior secured credit facility with face amounts aggregating $24.5 million, resulting in $390.5 million of available borrowing capacity as of March 31, 2012 under the revolving credit facility.

Covenants

Our senior secured credit facility and $325 million 83/4% senior subordinated notes require us, among other obligations, to maintain specified financial ratios and to satisfy certain financial tests, including fixed charge coverage, interest coverage, senior leverage and total leverage ratios. In addition, our senior secured credit facility and $325 million 83/4% senior subordinated notes restrict, among other things, our ability to incur additional indebtedness, incur guarantee obligations, amend debt instruments, pay dividends, create liens on assets, make investments, engage in mergers or consolidations, and otherwise restrict corporate activities.

At March 31, 2012, we were in compliance with all required financial covenants.

Outlook

Based on our current level of operations and anticipated earnings growth, we believe that cash generated from operations and cash on hand, together with amounts available under our senior secured credit facility, will be adequate to meet our anticipated debt service requirements, capital expenditures and working capital needs for the foreseeable future. However, we cannot be certain that our business will generate sufficient cash flow from operations, that our anticipated earnings growth will be realized, or that future borrowings will be available under our senior secured credit facility or otherwise will be available to enable us to service our indebtedness, including the senior secured credit facility and the senior subordinated notes, to retire or redeem the senior subordinated notes when required or to make anticipated capital expenditures. In addition, we expect a majority of our future growth to come from acquisitions of gaming properties at reasonable valuations, greenfield projects, jurisdictional expansions and property expansion in under-penetrated markets. If we consummate significant acquisitions in the future or undertake any significant property expansions, our cash requirements may increase significantly and we may need to make additional borrowings or complete equity or debt financings to meet these requirements. Our future operating performance and our ability to service or refinance our debt will be subject to future economic conditions and to financial, business and other factors, many of which are beyond our control. See Risk Factors Risks Related to Our Capital Structure in our Annual Report on Form 10-K for the year ended December 31, 2011 for a discussion of the risk related to our capital structure.

We have historically maintained a capital structure comprising a mix of equity and debt financing. We vary our leverage to pursue opportunities in the marketplace and in an effort to maximize our enterprise value for our shareholders. We expect to meet our debt obligations as they come due through internally generated funds from operations and/or refinancing them through the debt or equity markets prior to their maturity.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The table below provides information at March 31, 2012 about our financial instruments that are sensitive to changes in interest rates. For debt obligations, the table presents notional amounts maturing during the period and the related weighted-average interest rates by maturity dates. Notional amounts are used to calculate the contractual payments to be exchanged by maturity date and the weighted-average interest rates are based on implied forward LIBOR rates at March 31, 2012.

	04/01/12 - 3/31/13	04/01/13 - 3/31/14	04/01/14 - 3/31/15	04/01/15 - 3/31/16	04/01/16 - 3/31/17	Thereafter	Total	Fair Value 3/31/12
				(in thousands)				
Long-term debt:								
Fixed rate	$	$	$	$	$	$ 325,000	$ 325,000	$ 363,188
Average interest rate						8.75%		
Other Long Term Obligations	$ 1,979	$	$	$	$	$	$ 1,979	$ 1,979
Average interest rate	6.20%							
Variable rate	$ 42,500	$ 55,625	$ 73,125	$ 77,500	$ 747,500	$ 706,875	$ 1,703,125	$ 1,704,093
Average interest rate (1)	2.63%	2.84%	3.10%	3.37%	3.51%	4.96%		

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

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Controls and Procedures

The Company s management, under the supervision and with the participation of our principal executive officer and principal financial officer, has evaluated the effectiveness of the Company s disclosure controls and procedures, as such term is defined under Rule 13a-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the Exchange Act), as of March 31, 2012, which is the end of the period covered by this Quarterly Report on Form 10-Q. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well-designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on this evaluation, our principal executive officer and principal financial officer concluded that the Company s disclosure controls and procedures were effective as of March 31, 2012 to ensure that information required to be disclosed by the Company in reports we file or submit under the Exchange Act is (i) recorded, processed, summarized, evaluated and reported, as applicable, within the time periods specified in the United States Securities and Exchange Commission s rules and forms and (ii) accumulated and communicated to the Company s management, including the Company s principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosures.

Changes in Internal Control over Financial Reporting

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

PART II. OTHER INFORMATION

ITEM 1 Legal Proceedings

Information in response to this Item is incorporated by reference to the information set forth in Note 8: Commitments and Contingencies in the Notes to the consolidated financial statements in Part I of this Quarterly Report on Form 10-Q.

ITEM 1A Risk Factors

We are not aware of any material changes to the risk factors described in the Company s Annual Report on Form 10-K for the year ended December 31, 2011.

ITEM 2 Unregistered Sales of Equity Securities and Use of Proceeds

The Company did not repurchase any common equity securities during the three months ended March 31, 2012.

ITEM 3 Defaults upon Senior Securities

Not applicable.

ITEM 4 Mine Safety Disclosures

None.

ITEM 5 Other information

Not applicable.

ITEM 6. EXHIBITS

Exhibit	**Description of Exhibit**
31.1*	CEO Certification pursuant to rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934.
31.2*	CFO Certification pursuant to rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934.

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32.1*	CEO Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2*	CFO Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101**	Interactive data files pursuant to Rule 405 of Regulation S-T: (i) the Consolidated Balance Sheets at March 31, 2012 and December 31, 2011, (ii) the Consolidated Statements of Income for the three months ended March 31, 2012 and 2011, (iii) the Consolidated Statements of Comprehensive Income for the three months ended March 31, 2012 and 2011, (iv) the Consolidated Statements of Changes in Shareholders Equity for the three months ended March 31, 2012, (v) the Consolidated Statements of Cash Flows for the three months ended March 31, 2012 and 2011 and (vi) the notes to the Consolidated Financial Statements, tagged as blocks of text.

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* Filed herewith

** Pursuant to Rule 406T of Regulation S-T, the Indenture Data Files on Exhibit 101 hereto are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities and Exchange Act of 1934, as amended, and otherwise are not subject to liability under these sections.

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SIGNATURES

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

	PENN NATIONAL GAMING, INC.	
May 3, 2012	By:	/s/ William J. Clifford William J. Clifford Senior Vice President Finance and Chief Financial Officer (Principal Financial Officer)

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