



GREAT CANADIAN GAMING CORPORATION

AUDITORS' REPORT  
AND  
CONSOLIDATED FINANCIAL STATEMENTS

For the Year Ended December 31, 2005

*(Expressed in thousands, except for share and per share information)*

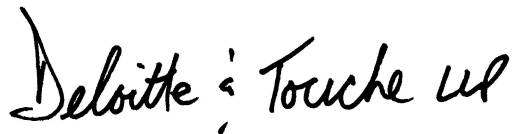
## Auditors' Report

To the Shareholders of  
Great Canadian Gaming Corporation

We have audited the consolidated balance sheets of Great Canadian Gaming Corporation as at December 31, 2005 and 2004 and the consolidated statements of income, shareholders' equity and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2005 and 2004 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.



Chartered Accountants  
Vancouver, British Columbia

March 10, 2006 (except for Note 25 which is as at March 28, 2006)

# GREAT CANADIAN GAMING CORPORATION

## Consolidated Balance Sheets

(In thousands, except for share and per share information)

As at December 31,

		2005		2004	
				Note 2(d)	
<b>ASSETS</b>					
CURRENT					
Cash and cash equivalents	Note 4	\$ 69,812	\$		38,946
Restricted cash	Note 4	6,598			4,187
Accounts receivable		13,098			6,040
Due from Provincial Gaming Corporations, current	Note 5	35,353			15,000
Promissory notes receivable, current	Note 9	1,329			1,639
Income taxes receivable		4,533			-
Future income taxes	Note 11	1,875			-
Prepays, deposits, and other assets		7,708			3,201
		<b>140,306</b>			69,013
Due from Provincial Gaming Corporations	Note 5	253,485			102,065
Property, plant and equipment	Note 6	283,071			125,352
Promissory notes receivable and other assets	Note 9	8,544			17,318
Intangible assets	Note 7	195,767			28,629
Goodwill	Note 8	37,497			20,038
		<b>\$ 918,670</b>	\$		362,415
<b>LIABILITIES</b>					
CURRENT					
Gaming revenues payable		\$ 10,030	\$		6,272
Accounts payable and accrued liabilities		56,854			33,044
Income taxes payable		3,694			1,797
Long-term debt, current	Note 10	3,252			860
		<b>73,830</b>			41,973
Long-term debt	Note 10	438,279			154,000
Future income taxes	Note 11	82,123			11,536
Deferred credit and other liabilities		5,385			-
Non-controlling interests		733			836
		<b>600,350</b>			208,345
<b>SHAREHOLDERS' EQUITY</b>					
Share capital and other equity	Note 12	247,727			101,801
Cumulative foreign currency translation		(7,163)			(5,908)
Retained earnings		77,756			58,177
		<b>318,320</b>			154,070
		<b>\$ 918,670</b>	\$		362,415
Contingencies and litigation	Note 21				
Commitments	Note 22				
Subsequent events	Note 25				

See Accompanying Notes to the Consolidated Financial Statements

# GREAT CANADIAN GAMING CORPORATION

## Consolidated Statements of Income

(In thousands, except for share and per share information)  
For years ended December 31,

		2005	2004
			Note 2(d)
REVENUES	Note 14	<b>\$ 278,104</b>	\$ 175,670
EXPENSES			
Human resources		<b>140,975</b>	87,761
General & administration		<b>21,872</b>	10,735
Operating supplies		<b>20,004</b>	7,691
Occupancy costs		<b>16,568</b>	8,516
Marketing and promotion		<b>13,322</b>	5,387
Amortization		<b>12,788</b>	4,825
Stock-based compensation	Note 12	<b>5,312</b>	2,209
		<b>230,841</b>	127,124
INCOME BEFORE UNDERNOTED ITEMS		<b>47,263</b>	48,546
Restructuring costs	Note 23	-	5,557
Termination of legal proceedings	Note 21	-	2,275
INCOME FROM OPERATIONS		<b>47,263</b>	40,714
Gain (loss) on investments and properties	Note 15	<b>(8,200)</b>	1,874
Interest and financing, net		<b>(9,368)</b>	(2,201)
Accretive income	Note 5	<b>7,548</b>	1,365
Foreign exchange gain		<b>200</b>	340
INCOME BEFORE INCOME TAXES		<b>37,443</b>	42,092
Income taxes	Note 11	<b>16,671</b>	14,967
INCOME BEFORE NON-CONTROLLING INTEREST		<b>20,772</b>	27,125
Non-controlling interests		<b>1,193</b>	400
NET INCOME		<b>\$ 19,579</b>	\$ 26,725
EARNINGS PER COMMON SHARE	Note 13		
Basic		<b>\$ 0.26</b>	\$ 0.41
Diluted		<b>\$ 0.25</b>	\$ 0.38
WEIGHTED AVERAGE NUMBER OF COMMON SHARES	Note 13		
Basic		<b>76,626,504</b>	65,913,320
Diluted		<b>78,402,986</b>	70,652,768

See Accompanying Notes to the Consolidated Financial Statements

**GREAT CANADIAN GAMING CORPORATION**  
**Consolidated Statements of Shareholders' Equity**

(In thousands, except for share and per share information)

	Common Shares		Additional	Share Capital	Cumulative	Retained	Shareholders'
	Number	Amount	Paid-up Capital And Other Equity	And Other Equity	Foreign Currency Translation Adjustments	Earnings	Equity
			Amount	Amount			
At December 31, 2003	61,834,343	\$ 59,219	\$ 7,390	\$ 66,609	\$ (3,447)	\$ 31,452	\$ 94,614
Exercise of incentive stock options	4,542,936	15,221	(4,612)	10,609	-	-	10,609
Private placement	250,000	1,547	-	1,547	-	-	1,547
Exercise of warrants	3,362,410	21,325	(498)	20,827	-	-	20,827
Stock based compensation	-	-	2,209	2,209	-	-	2,209
Effect of foreign currency translation	-	-	-	-	(2,461)	-	(2,461)
Net income	-	-	-	-	-	26,725	26,725
At December 31, 2004	69,989,689	\$ 97,312	\$ 4,489	\$ 101,801	\$ (5,908)	\$ 58,177	\$ 154,070
Exercise of incentive stock options	981,327	\$ 4,973	\$ (1,907)	\$ 3,066	\$ -	\$ -	\$ 3,066
Treasury offering	3,750,000	60,069	-	60,069	-	-	60,069
Issuance of common shares, upon exercise of special warrants	3,703,704	72,709	-	72,709	-	-	72,709
Stock based compensation	-	-	5,312	5,312	-	-	5,312
Exercise of warrants	1,025,000	4,770	-	4,770	-	-	4,770
Effect of foreign currency translation	-	-	-	-	(1,255)	-	(1,255)
Net income	-	-	-	-	-	19,579	19,579
At December 31, 2005	79,449,720	\$ 239,833	\$ 7,894	\$ 247,727	\$ (7,163)	\$ 77,756	\$ 318,320

# GREAT CANADIAN GAMING CORPORATION

## Consolidated Statements of Cash Flows

For years ended December 31,  
(In thousands, except for share and per share information)

	2005	2004
<b>Cash Flows from Operating Activities</b>		
Net income	\$ 19,579	\$ 26,725
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization	12,788	4,825
Non-cash restructuring costs	-	558
Gain from disposal of land	(274)	-
Accretive income	(7,548)	(1,365)
Loss (gain) on disposal of investments	999	(1,975)
Impairment of investments	7,913	300
Stock-based compensation	5,312	2,209
FDIF qualified operating expenses, net of discount	(4,932)	(7,312)
Other activities	4,044	1,719
Future income taxes	(616)	450
Changes in non-cash operating working capital	1,146	3,509
Net cash provided by operating activities	38,411	29,643
<b>Cash Flows from Financing Activities</b>		
Proceeds from long-term debt	419,252	222,451
Repayment of long-term debt	(177,346)	(110,352)
Deferred financing costs	(4,449)	(2,846)
Bond forward	1,731	-
Common shares issued for cash, net of issuance costs	138,137	32,983
Net cash provided by financing activities	377,325	142,236
<b>Cash Flows from Investing Activities</b>		
Restricted cash	909	(4,187)
Investment in and advances to equity investees	(1,056)	(251)
Funds received from Provincial Gaming Corporations	22,600	12,455
Purchase of property, plant and equipment, net of related accounts payable	(194,329)	(137,581)
Proceeds from disposal of property, plant and equipment	5,947	-
Consolidation of cash of Georgian Downs	1,286	-
Acquisitions, net of cash acquired	(182,104)	(36,633)
River Rock prepaid lease	(9,262)	-
Promissory notes and advances receivable, net	(28,568)	511
Net cash used in investing activities	(384,577)	(165,686)
Effect of foreign exchange on cash and cash equivalents	(293)	(1,440)
<b>Net Cash Inflow</b>	<b>30,866</b>	<b>4,753</b>
<b>Cash and cash equivalents, Beginning of Year</b>	<b>38,946</b>	<b>34,193</b>
<b>Cash and cash equivalents, End of Year</b>	<b>\$ 69,812</b>	<b>\$ 38,946</b>
<b>Supplemental Disclosure</b>		
Interest received	\$ 2,424	\$ 1,008
Interest paid	\$ 16,054	\$ 3,651
Income taxes paid	\$ 18,634	\$ 14,160
<b>Non-Cash Investing and Financing Activities</b>		
Conversion of promissory note to preferred shares	Note 9 \$ 6,917	\$ -
FDIF allocated to assets	Note 5 \$ 117,003	\$ 95,538

See Accompanying Notes to the Consolidated Financial Statements

**GREAT CANADIAN GAMING CORPORATION**  
**Notes to the Consolidated Financial Statements**

For the years ended December 31, 2005 and 2004  
(Expressed in thousands, except for share and per share information)

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**1. NATURE OF BUSINESS**

Great Canadian Gaming Corporation (the "Company"), is a multi-jurisdictional gaming and entertainment operator with operations in British Columbia ("BC"), Ontario ("ON"), and Nova Scotia ("NS"), Canada, and Washington State, United States of America ("Washington"). The Company operates thirteen casinos, a thoroughbred racetrack, four standardbred racetracks, a community gaming centre, a hotel, a theatre and numerous associated food and beverage and entertainment facilities.

**2. SIGNIFICANT ACCOUNTING POLICIES**

These consolidated financial statements are presented in accordance with Canadian generally accepted accounting principles and reflect the following significant accounting policies:

*a) Principles of consolidation*

These consolidated financial statements include the accounts of the Company, its subsidiaries and on a proportionate basis, the accounts of its joint ventures. Subsidiaries include variable interest entities. Variable interest entities are entities subject to control by the Company on a basis other than by ownership of voting interests where a majority of an entity's expected losses, expected residual returns, or both are effectively assumed by the Company.

Significant inter-company balances and transactions with subsidiaries and the proportionate share of inter-company balances and transactions with joint ventures are eliminated upon consolidation.

**GREAT CANADIAN GAMING CORPORATION**  
**Notes to the Consolidated Financial Statements**

For the years ended December 31, 2005 and 2004  
(Expressed in thousands, except for share and per share information)

**2. SIGNIFICANT ACCOUNTING POLICIES (Continued)**

*b) Operating entities*

The Company's operating entities are:

Entity	Abbreviation	Ownership interest % as at December 31, 2005	Ownership interest % as at December 31, 2004
Flamboro Downs Holdings Limited	Flamboro Downs	100%	-
Georgian Downs Limited	Georgian Downs	100% <sup>(1)</sup>	-
Great American Gaming Corporation	GAGC	100%	100%
Great Canadian Casinos Inc.	GCC	100%	100%
Great Canadian Entertainment Centres Ltd.	GCEC	100%	100%
Hastings Entertainment Inc.	HEI	100%	100%
Jack O'Clubs Gaming Hall Ltd.	Jack O'Clubs	67%	67%
Mayfield Consulting Canada Inc.	Mayfield	<sup>(2)</sup>	<sup>(2)</sup>
Metropolitan Entertainment Group	MEG	100%	-
Orangeville Raceway Limited	Orangeville	100%	-
TBC Teletheatre B.C.	TBC	50% <sup>(3)</sup>	25% <sup>(3)</sup>

<sup>(1)</sup> The Company accounted for the investment in and the operating results of Georgian Downs using the equity method from July 2, 2005 to September 30, 2005 since the Company had significant influence over its operations but was awaiting regulatory approval of the acquisition (Note 3(b)). Georgian Downs' operating results are consolidated from October 1, 2005.

<sup>(2)</sup> Mayfield and certain associated companies of Mayfield (hereinafter called Mayfield) have been contracted by the Company to provide food and beverage, and hotel management services in certain locations. Under the terms of the various management services contracts, the Company is the primary beneficiary of Mayfield, even though the Company has no share ownership in Mayfield, as the Company bears the principal risks and rewards of Mayfield's operations. Mayfield is consolidated from the inception date of each applicable management services contract as a variable interest entity. The Mayfield companies that are consolidated provide services only to the Company.

<sup>(3)</sup> On March 18, 2005, the Company increased its ownership interest in TBC to 50% and effectively controlled it from that date (Note 3(e)). TBC's operating results are consolidated from March 18, 2005.

*c) Uncertainty in management estimates*

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the reporting period. Estimates are used for, but not limited to, the net present value of amounts due from Provincial Gaming Corporations ("PGCs"), fair value of net assets acquired in business combinations, impairment of goodwill, impairment of long-lived assets, amortization of property, plant and equipment, stock-based compensation, income taxes and contingencies. Actual results may differ from those estimates.

**GREAT CANADIAN GAMING CORPORATION**  
**Notes to the Consolidated Financial Statements**

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**2. SIGNIFICANT ACCOUNTING POLICIES (Continued)**

*d) Comparative figures*

Certain of the prior year's comparative figures have been reclassified to conform to the current year's presentation. Specifically, for the year ended December 31, 2004:

- i) Revenues have been decreased by \$1,365 and accretive income has been increased by \$1,365 to separately disclose accretive income;
- ii) Revenues have been decreased by \$1,480 and marketing and promotions have been decreased by \$1,480 to present revenues net of promotional allowances;
- iii) General and administration expenses have been increased by \$10,735, human resources have been decreased by \$1,600, operating supplies have been decreased by \$5,240, occupancy costs have been decreased by \$1,336, and marketing and promotions have been decreased by \$2,559 to separately disclose general and administration expenses; and
- iv) Cash and cash equivalents have been decreased by \$4,187 and restricted cash has been increased by \$4,187 to separately disclose restricted cash.

*e) Cash and cash equivalents*

Cash and cash equivalents include cash and liquid investments with a maturity of three months or less.

*f) Restricted cash*

Cash is considered restricted when it is subject to contingent rights of a third party.

*g) Facility Development Improvement Fund*

For each BC casino location, the Company has entered into a casino operational services agreement ("COSA") with the British Columbia Lottery Corporation ("BCLC"). Each COSA includes a provision for reimbursement of certain of the Company's qualifying capital and operating expenditures under the Facility Development Improvement Fund ("FDIF"). Under new COSAs with BCLC, the FDIF concept has been renamed as the Facilities Development Commission ("FDC").

The Company accounts for the FDIF as a form of government assistance and records the assistance when the conditions surrounding the assistance are satisfied, as a reduction to the original expenditure. Recently, the majority of the FDIF relates to capital expenditures made by the Company on its expansion activities at the River Rock Casino Resort, Boulevard Casino and Fraser Downs Racetrack & Casino. In certain circumstances, FDIF is provided towards operating expenditures.

When the expenditures are approved by BCLC for reimbursement under FDIF, the Company reflects that approval by reducing the costs of the related asset or operating expense and establishing a receivable from BCLC for the reimbursement. Once

**GREAT CANADIAN GAMING CORPORATION**  
**Notes to the Consolidated Financial Statements**

For the years ended December 31, 2005 and 2004  
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**2. SIGNIFICANT ACCOUNTING POLICIES (Continued)**

*g) Facility Development Improvement Fund (Continued)*

approved, the amount to be collected in any one period from BCLC is based on certain percentages of the win from gaming activities of that period. Currently, these reimbursement percentages range from 3% to 7% of the win from gaming activities.

The FDIF receivable is non-interest bearing and is discounted using a discount rate management believes to be the market rate of interest for a similar instrument with similar terms and conditions. In addition, management estimates the amount of and timing of future reimbursements from BCLC based on current and planned scope of operations. Management estimates that the total receivable amount from BCLC will be collected over a period of approximately sixteen years.

The discounted FDIF receivable increases by the amount of the imputed discount over its estimated collection term. In the consolidated statement of income, this increase is recorded as "Accretive Income". If the amount or timing of future reimbursements or the scope of operations differs significantly from management estimates, the actual values of the FDIF receivable and accretive income could differ from the amounts reflected in the consolidated financial statements.

*h) Marketing fees to BCLC*

The Company contributes between 0.5% and 0.75% of the gaming win in four of its BC casinos to BCLC as prepayment for marketing programs. The Company records the contribution to BCLC as a prepaid expense and expenses the prepayment based on confirmation of expenditures made by BCLC from this fund.

In the event of and to the extent that the amounts contributed are not expended on marketing programs within the defined periods, the Company will be entitled to repayment of the contribution.

*i) Capital reserve account*

The Amended and Restated Operating Contract ("AROC") with the Nova Scotia Gaming Corporation ("NSGC") includes a provision for reimbursement of certain of the Company's qualifying expenditures under the Capital Reserve Account ("CRA").

Reimbursement of qualifying expenditures is received from the CRA, or if there is insufficient balance in the CRA, is recorded as a receivable from NSGC and recorded as a reduction in the historical cost of the related expenditures at the time approval is given by NSGC.

The replacement assets acquired using CRA funds are the property of the Company until the end of the AROC, at which time, the assets revert to NSGC.

**GREAT CANADIAN GAMING CORPORATION**  
**Notes to the Consolidated Financial Statements**

For the years ended December 31, 2005 and 2004  
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**2. SIGNIFICANT ACCOUNTING POLICIES (Continued)**

*j) Investments*

The Company accounts for its investments in companies over which it has significant influence on the equity basis of accounting whereby the investments are initially recorded at cost and adjusted for the Company's share of income or losses of the investee companies.

Investments in companies which are not subject to significant influence are accounted for using the cost method whereby the investments are recorded at cost and earnings are recognized to the extent received or receivable.

When there is a loss in the value of an investment that is other than a temporary decline, the investment is written down to estimated realizable value.

*k) Property, plant and equipment*

Property, plant and equipment are recorded at cost less accumulated amortization. Qualified property, plant and equipment are recorded at cost less the fair value of the FDIF or CRA receivable and accumulated amortization. Amortization is expensed on a straight-line basis from the month the asset is put in use over the estimated useful lives of the assets at the following rates:

Land	not amortized
Buildings	20 to 40 years
Aircraft	20 years
Equipment	1 to 5 years
Enterprise Resource Planning systems	5 years
Leasehold improvements	over related lease term

During the construction period of gaming and ancillary facilities, the Company capitalizes construction and overhead costs, including interest, directly attributable to the construction project. The costs of construction of the Company's gaming and ancillary facilities are classified as properties under development. When the property or portion thereof is substantially complete and ready for use, costs cease to be capitalized and are amortized over the asset's estimated useful life.

During the year, the Company changed its estimates of the usage of its property, plant and equipment to more accurately reflect the economic benefit of the asset. This change has been applied prospectively.

**GREAT CANADIAN GAMING CORPORATION**  
**Notes to the Consolidated Financial Statements**

For the years ended December 31, 2005 and 2004  
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**2. SIGNIFICANT ACCOUNTING POLICIES (Continued)**

*l) Intangible assets*

The Company's finite-lived intangible assets consist primarily of electronic gaming rights, operational service agreements, siteholder agreements and horseracing licences. Intangible assets are amortized over the estimated useful life ranging from five to twenty years. Judgment is used to estimate an intangible asset's useful life and is based on an analysis of all pertinent factors, including expected use of the intangible asset, contractual provisions that enable renewal or extension of the intangible asset's legal or contractual life without substantial cost, and renewal history. Changes in the estimate of an intangible asset's useful life are treated as a change in accounting estimate and are applied prospectively.

Intangible assets are tested for impairment consistent with the method described for long-lived assets below. The intangible assets impairment test had no impact on the Company's results for the years ended December 31, 2005 and 2004.

*m) Goodwill*

Goodwill represents the excess of the purchase price of acquired companies over the estimated fair value of the tangible and intangible net assets acquired. Goodwill is tested for impairment at least annually and whenever events or circumstances indicate that its carrying value may not be fully recoverable. The excess of the carrying value amount over the fair value of goodwill, if any, is charged to operations in the period the impairment occurred. The goodwill impairment test had no impact on the Company's results for the years ended December 31, 2005 and 2004.

*n) Impairment of long-lived assets*

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. An impairment loss is recognized when the carrying value of a long-lived asset intended for use exceeds the sum of the undiscounted cash flows expected from its use and eventual disposition. The impairment loss is measured as the excess of the carrying value of the asset over its fair value. The long-lived assets impairment test had no impact on the Company's results for the years ended December 31, 2005 and 2004.

*o) Deferred financing costs*

Deferred financing costs relate to the costs associated with securing the long-term financing and credit facility. These costs are being amortized on a straight-line basis over the term of the related debt and credit facility.

**GREAT CANADIAN GAMING CORPORATION**  
**Notes to the Consolidated Financial Statements**

For the years ended December 31, 2005 and 2004  
(Expressed in thousands, except for share and per share information)

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**2. SIGNIFICANT ACCOUNTING POLICIES (Continued)**

*p) Hedges*

The Company utilizes derivative financial instruments in the management of its interest rate exposures. The Company formally documents all relationships between hedging instruments and hedged items, as well as its risk management objectives and strategies for undertaking various hedge transactions. The Company also assesses, both at the hedge's inception and on an ongoing basis, whether the derivatives used in hedging transactions are effective in offsetting changes in fair values or cash flows of hedged items.

*q) Translation of foreign operations and foreign currency transactions*

The Company's financial statements are presented in Canadian dollars. The Company's non-Canadian operations are translated into Canadian dollars using the current rate method. Under this method, assets and liabilities are translated into Canadian dollars using the exchange rate in effect on the balance sheet date. Revenue and expenses are translated at average exchange rates prevailing during the year. The resulting translation gains and losses arising from re-measurement are included as a separate component of shareholders' equity.

Transactions completed in foreign currencies are translated into Canadian dollars at the rates prevailing at the time of the transactions. Amounts payable and receivable in foreign currencies are reflected in the financial statements at the exchange rate prevailing at the balance sheet date with the resulting gain or loss included in the statement of income in the year which it occurs.

*r) Stock-based compensation*

The Company applies the fair value method of accounting for all stock option awards. Under this method, the Company recognizes compensation expense for stock options awarded based on the fair value of the options at the later of the date of grant or the date of shareholder approval of the grant using the Black-Scholes model. Stock-based compensation expense includes the impact of future stock option forfeitures, which have not been material to date. The fair value of the options is expensed over the expected life of the options.

*s) Revenue recognition*

The Company recognizes the net win from gaming activities (the difference between gaming wins and losses), including table games, slot machines and bingo games, as gaming revenues. Gaming revenues are net of commissions paid to BCLC, taxes paid to Washington State, commissions paid to NSGC, and accruals for anticipated payouts of progressive slot machine jackpots and certain progressive table games. Slot machine commissions are recorded as revenue when the amounts are earned from the Ontario Lottery Gaming Commission ("OLGC").

**GREAT CANADIAN GAMING CORPORATION**  
**Notes to the Consolidated Financial Statements**

For the years ended December 31, 2005 and 2004  
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**2. SIGNIFICANT ACCOUNTING POLICIES (Continued)**

*s) Revenue recognition (Continued)*

The Company recognizes wagering revenue from racetracks net of amounts returned as winning wagers, provincial and federal taxes, and purses for wagering. Wagering revenue also includes the net amount of the host track share of wagering on races simulcast to other associations.

Hotel, food and beverage, entertainment and other operating revenues are recognized as goods are delivered and services are performed.

Revenues are recognized net of promotional allowances, primarily food and beverage. The retail value of food and beverage furnished to guests without charge is included in gross revenue and then deducted as promotional allowances before arriving at net revenues.

*t) Income taxes*

The Company follows the liability method of accounting for income taxes. Under this method, current income taxes are recognized for the estimated tax payable for the current year. Future income taxes relate to the expected future tax consequences of differences between the carrying amount of balance sheet items and their corresponding tax values. Future income tax assets, if any, are recognized only to the extent that, in the opinion of management, it is more likely than not that the future income tax assets will be realized. Future income tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of the enactment or substantive enactment.

*u) Earnings per common share*

Basic earnings per common share are calculated using the weighted average number of common shares outstanding during the period. Diluted earnings per common share are presented using the treasury stock method and are calculated by dividing net earnings applicable to common shares by the sum of the weighted average number of common shares outstanding and all additional common shares that would have been outstanding if potentially dilutive common shares had been issued.

**3. ACQUISITIONS**

Acquisitions are accounted for using the purchase method, whereby the purchase price is allocated to the fair value of assets and liabilities at the acquisition date, and the results of operations are included in the consolidated financial statements from the date of acquisition. To the extent that certain acquisition agreements provide for contingent consideration based on future financial performance, these payments, if any, will be treated as additional costs of the purchase.

The Company has adjusted its purchase price allocations based on assistance from independent valuers. The results of the valuations have been applied prospectively in these financial statements.

**GREAT CANADIAN GAMING CORPORATION**  
**Notes to the Consolidated Financial Statements**

For the years ended December 31, 2005 and 2004  
(Expressed in thousands, except for share and per share information)

**3. ACQUISITIONS (Continued)**

**Significant 2005 Acquisitions**

<b>Company</b>	<b>Flamboro Downs</b>	<b>Georgian Downs</b>	<b>MEG</b>	<b>Orangeville</b>	<b>Weinlager</b>	<b>Total</b>
<b>Operations</b>	Racetrack <sup>(1)</sup>	Racetrack <sup>(1)</sup>	Casino	Racetrack & Casino	Food & Beverage	
<b>Acquisition date</b>	19-Oct-05	2-Jul-05	31-May-05	18-Mar-05	10-Jan-05	
<b>% Ownership acquired</b>	100%	100%	100%	100%	50%	
<b>% Ownership achieved</b>	100%	100%	100%	100%	100%	
Cash	33,761	25,842	93,117	40,000	1,225	193,945
Working capital adjustment	681	281	-	-	-	962
Acquisition costs	1,190	1,255	1,875	305	103	4,728
<b>Total purchase price</b>	<b>35,632</b>	<b>27,378</b>	<b>94,992</b>	<b>40,305</b>	<b>1,328</b>	<b>199,635</b>
Cash and cash equivalents	506	1,358	8,207	3,603	(143)	13,531
Restricted cash	3,320	-	-	-	-	3,320
Net working capital	(3,153)	(339)	(7,079)	(3,726)	298	(13,999)
Due from PGCs	-	-	50,856	14,670	-	65,526
Property, plant and equipment	22,199	22,524	24,205	20,266	812	90,006
Intangible assets	69,000	37,000	34,881	30,000	-	170,881
Goodwill	15,433	854	-	-	1,427	17,714
Long-term debt	(44,194)	(279)	-	(6,099)	-	(50,572)
Due to the Company	-	(22,308)	-	-	(691)	(22,999)
Other liabilities	-	-	-	(1,392)	(375)	(1,767)
Future income taxes	(27,479)	(11,432)	(16,078)	(17,017)	-	(72,006)
<b>Net assets acquired</b>	<b>35,632</b>	<b>27,378</b>	<b>94,992</b>	<b>40,305</b>	<b>1,328</b>	<b>199,635</b>

<sup>(1)</sup> Each of Flamboro Downs and Georgian Downs has a siteholder agreement with OLGC to host slot machines at its premises.

**Significant 2004 Acquisitions**

<b>Company</b>	<b>HEI</b>	<b>Vetter</b>	<b>Evergreen &amp; LLCs</b>	<b>Pair O' Dice</b>	<b>Total</b>
<b>Operations</b>	Racetrack	Bingo hall	Casino	Casino	
<b>Acquisition date</b>	8-Apr & 8-Nov-04	1-Oct-04	2-Jul-04	1-Jan-04	
<b>% Ownership acquired</b>	100%	100%	20% to 50%	10%	
<b>% Ownership achieved</b>	100%	100%	100%	100%	
Cash	31,609	2,000	1,801	195	35,605
Note payable	-	-	667	-	667
Acquisition costs	95	77	62	20	254
<b>Total purchase price</b>	<b>31,704</b>	<b>2,077</b>	<b>2,530</b>	<b>215</b>	<b>36,526</b>
Cash and cash equivalents	2,761	158	898	76	3,893
Net working capital	(2,084)	42	(92)	(588)	(2,722)
Property, plant and equipment	6,986	40	4,586	137	11,749
Intangible assets	28,485	-	-	-	28,485
Goodwill	9,930	2,037	3,305	590	15,862
Long-term debt	(4,228)	-	(2,144)	-	(6,372)
Due to the Company	-	(200)	(4,023)	-	(4,223)
Future income taxes	(10,146)	-	-	-	(10,146)
<b>Net assets acquired</b>	<b>31,704</b>	<b>2,077</b>	<b>2,530</b>	<b>215</b>	<b>36,526</b>

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**3. ACQUISITIONS (Continued)**

*a) Flamboro Downs*

On October 19, 2005, the Company completed the purchase of the outstanding common shares of Flamboro Downs. Flamboro Downs operates a standardbred racetrack and is a siteholder for slot machines operated by OLGC in Flamborough, Ontario.

*b) Georgian Downs*

On July 2, 2005, Great Canadian Gaming (Ontario) Ltd. ("GCGO") acquired all of the outstanding shares of Georgian Downs as a bare trustee for the Company until regulatory approval was received. Georgian Downs, located in Innisfil, Ontario, is an operator of a standardbred racing facility and a siteholder for slot machines operated by the OLGC.

On September 30, 2005, after obtaining the required regulatory approvals, the bare trustee arrangement was cancelled and the Company received legal title to all of the outstanding shares of GCGO. The Company has consolidated Georgian Downs' financial position as at September 30, 2005. For the period from July 2, 2005 to September 30, 2005, the Company included the operating results of Georgian Downs under the equity method, which is included in gain (loss) on investments and properties, as the Company had significant influence.

As part of the Georgian Downs acquisition, the Company is committed to future trailing payments as disclosed in Note 22(c).

*c) Metropolitan Entertainment Group*

On May 31, 2005, the Company completed the purchase of the partnership interests of MEG, a Nova Scotia partnership which owned Casino Nova Scotia Halifax and Casino Nova Scotia Sydney. At acquisition, Company initiated its MEG integration plan to improve operations and reduce costs. As a result, the Company included \$2,364 of accrued liabilities related to the restructuring, primarily severance, as part of the identifiable liabilities acquired. As at December 31, 2005, \$178 of this restructuring accrual remains in accounts payable and accrued liabilities.

*d) Orangeville Raceway Limited*

On March 18, 2005, the Company completed the purchase of the outstanding common shares of Orangeville. Orangeville owns and operates two standardbred racing facilities in BC: Fraser Downs Racetrack & Casino in Surrey ("Fraser Downs"), and Sandown Park in North Saanich ("Sandown"). As part of the Orangeville acquisition, the Company is committed to future trailing payments as disclosed in Note 22(c).

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**3. ACQUISITIONS (Continued)**

*d) Orangeville Raceway Limited (Continued)*

The net of the amounts assigned to assets acquired and liabilities assumed exceeded the cost of the purchase ("excess" – sometimes referred to as "negative goodwill"). The Company has included in other liabilities a provision for the contingent consideration equivalent to the lesser of the maximum amount of the contingent consideration and the excess.

*e) TBC Teletheatre B.C.*

As a result of the acquisition of Orangeville, the Company increased its existing 25% interest in TBC (acquired through the acquisition of HEI and previously accounted for using the equity method) to 50% and has consolidated TBC's financial position, operating results and cash flows from March 18, 2005.

TBC's principal business activity is the operation of teletheatre, telephone and internet wagering facilities in BC, which broadcast horseracing from Hastings Racecourse, Fraser Downs and other racetracks in Canada and throughout the world.

*f) Weinlager & Amici Caffè (Coquitlam) Ltd. and Weinlager & Amici Caffè (Victoria) Ltd.*

On January 10, 2005, the Company purchased the remaining 50% interest in Weinlager & Amici Caffè (Coquitlam) Ltd. and Weinlager & Amici Caffè (Victoria) Ltd. (collectively "Weinlager"). Weinlager owns the food and beverage assets at the Company's Coquitlam, Holiday Inn, Nanaimo and View Royal casinos.

*g) Vetter Management Services Ltd.*

On October 1, 2004, the Company purchased the outstanding common shares of Vetter Management Service Ltd. ("Vetter"). Vetter operated a bingo hall in Dawson Creek, BC under the name Bear Mountain Bingo. The Company has expanded the operation to include slot machines under the new operating name "Bear Mountain Community Gaming Centre". As part of the Vetter acquisition, the Company is committed to future trailing payments as disclosed in Note 22(c).

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**3. ACQUISITIONS (Continued)**

*h) Evergreen and Grand Central Properties*

On July 2, 2004, the Company acquired the remaining interest in Evergreen Entertainment Corporation ("Evergreen") for cash consideration of US\$350 (CAD\$467), and the remaining interests in Grand Central Properties Algona, LLC ("GCP Algona"), Grand Central Properties Everett, LLC ("GCP Everett"), Grand Central Properties Tukwila, LLC ("GCP Tukwila"), and Grand Central Properties Tacoma, LLC ("GCP Tacoma") (collectively "LLCs") for consideration of US\$1,500 (CAD\$2,001), consisting of US\$1,000 (CAD\$1,334) in cash and US\$500 (CAD\$667) in a non-interest bearing note paid in full on November 1, 2004. The transaction resulted in the Company owning 100% of Evergreen and LLCs.

Evergreen operates Grand Central Casinos in Tukwila and Lakewood in Washington State, US. The LLCs own the land and building of the Tukwila and Lakewood casinos. The LLCs also owned two vacant properties initially acquired for casino development purposes in Algona and Everett, which were sold in 2005.

*i) O'Aces LLC*

On June 4, 2004, the Company purchased the remaining 20% non-controlling interest in O'Aces LLC ("O'Aces") for cash consideration of one US dollar. O'Aces operates a Great American Casino in Kent, Washington. The transaction gave the Company 100% ownership in O'Aces. As part of the acquisition agreement, the Company agreed to make future contingent payments as disclosed in Note 22(c).

*j) Hastings Entertainment Inc.*

As part of a two-step purchase during the year, the Company acquired all of the outstanding common shares of HEI on November 8, 2004. HEI owns and operates the Hastings Racecourse in Vancouver, BC, which features live thoroughbred racing, simulcasts of national and international horseracing, exclusive local rights to operate tele-theatres, and a wide array of food and beverage operations.

*k) Pair O' Dice Investment LLC*

On January 1, 2004, the Company purchased the remaining 10% interest in Pair O'Dice Investment LLC ("Pair O'Dice). Pair O'Dice owns and operates Great American Casino in Everett, Washington.

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**4. CASH AND CASH EQUIVALENTS, AND RESTRICTED CASH**

Cash and cash equivalents excludes cash floats of \$16,125 (2004 - \$11,900) provided by BCLC for use in BC casino operations. Since these cash floats are owned by BCLC, they are not reflected in the Company's cash and cash equivalents balances. The Company has issued letters of credit in favour of BCLC as security for these amounts.

Restricted cash is composed primarily of \$4,898 related to payments for construction projects (2004 - \$4,187) and \$1,335 held for capital expenditures that require approval from OLG (2004 - nil).

**5. DUE FROM PROVINCIAL GAMING CORPORATIONS**

Due from PGCs includes the discounted FDIF due from BCLC, and operator's capital investment ("OCI") and mandatory deferrals ("MD") due from NSGC:

As at December 31, 2005			
	BCLC	NSGC	Total
<b>Total</b>	\$ 244,878	\$ 43,960	\$ 288,838
<b>Less: current portion</b>	20,000	15,353	35,353
	\$ 224,878	\$ 28,607	\$ 253,485

As at December 31, 2004			
	BCLC	NSGC	Total
Total	\$ 117,065	\$ -	\$ 117,065
Less: current portion	15,000	-	15,000
	\$ 102,065	\$ -	\$ 102,065

*a) Facilities Development Improvement Fund due from BCLC*

	2005	2004
FDIF receivable, beginning of year	\$ 117,065	\$ 25,305
FDIF receivable from acquisition of Orangeville Note 3	14,670	-
Qualified assets approved by BCLC	194,282	121,101
Qualified expenditures approved by BCLC	6,303	7,312
FDIF reimbursement received	(16,340)	(12,455)
	315,980	141,263
Imputed discount applied	(78,650)	(25,563)
Accretive income	7,548	1,365
	\$ 244,878	\$ 117,065

**GREAT CANADIAN GAMING CORPORATION**  
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**5. DUE FROM PROVINCIAL GAMING CORPORATIONS (Continued)**

*a) Facilities Development Improvement Fund due from BCLC (Continued)*

The long-term portion of FDIF receivable was discounted over a period of approximately sixteen years at a discount rate ranging from 4% to 4.7% per annum.

*b) Operator's Capital Investment and Mandatory Deferral due from NSGC*

	2005	2004
OCI and MD receivables, beginning of year	\$ -	\$ -
OCI and MD receivables from acquisition of MEG	50,856	-
OCI premium amortization	(947)	-
OCI and MD principal repayment received	(6,260)	-
	<b>43,649</b>	-
Interest receivable	311	-
	<b>\$ 43,960</b>	-

On July 1, 2005, the Company entered into an Amended and Restated Operating Contract ("AROC") with NSGC to operate the two Nova Scotia casinos. The Company is entitled to the repayment of MEG's initial capital investment in building the casinos through the OCI and MD.

The OCI and MD receivables accrue interest on the outstanding balance at 12% and prime plus 1% per annum, respectively. Since the OCI receivable accrues interest at a rate higher than the rate which management believes to be the market rate of interest for a similar instrument with similar terms and conditions at the time, the OCI receivable balance acquired at acquisition includes a premium. The premium on the OCI receivable is amortized over the term of the OCI to result in an effective interest rate of approximately 2.91%.

The OCI is repaid in monthly instalments of \$1,094 to April 2007, and the MD is repaid in monthly instalments of \$100 to April 2007, monthly instalments of \$900 from May 2007 to April 2009, and \$200 in May 2009.

Interest payments received on the OCI and MD and the amortization of the premium on OCI are recorded as interest income.

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**6. PROPERTY, PLANT AND EQUIPMENT**

December 31, 2005					
	Original Cost	Less: FDIF Qualified	Adjusted Cost	Accum- ulated Amort- ization	Net Book Value
Land	\$ 29,501	\$ 11,402	\$ 18,099	\$ -	\$ 18,099
Buildings	399,778	188,909	210,869	5,346	205,523
Properties under development	19,387	5,051	14,336	-	14,336
Aircraft	6,859	-	6,859	115	6,744
Equipment	55,007	26,395	28,612	11,906	16,706
Enterprise Resource Planning systems	5,138	-	5,138	2,660	2,478
Equipment under capital lease	1,295	-	1,295	465	830
Leasehold interests	17,958	14,543	3,415	29	3,386
Leasehold improvements	35,499	17,850	17,649	2,680	14,969
	<b>\$ 570,422</b>	<b>\$ 264,150</b>	<b>\$ 306,272</b>	<b>\$ 23,201</b>	<b>\$ 283,071</b>

December 31, 2004					
	Original Cost	Less: FDIF Qualified	Adjusted Cost	Accum- ulated Amort- ization	Net Book Value
Land	\$ 22,306	\$ 11,402	\$ 10,904	\$ -	\$ 10,904
Buildings	147,253	98,819	48,434	1,694	46,740
Properties under development	51,011	1,136	49,875	-	49,875
Equipment	26,886	12,199	14,687	7,959	6,728
Enterprise Resource Planning systems	4,244	-	4,244	1,742	2,502
Equipment under capital lease	9,268	7,980	1,288	659	629
Leasehold interests	8,614	7,959	655	-	655
Leasehold improvements	16,837	7,666	9,171	1,852	7,319
	<b>\$ 286,419</b>	<b>\$ 147,161</b>	<b>\$ 139,258</b>	<b>\$ 13,906</b>	<b>\$ 125,352</b>

Equipment under capital lease without any further lease obligation has been reclassified to equipment.

As at December 31, 2005, included in land are properties held for sale in Washington of \$Nil (2004 - \$3,428).

See Note 10 for interest and financing costs capitalized to property, plant and equipment.

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**7. INTANGIBLE ASSETS**

	December 31, 2005	December 31, 2004
Cost	\$ 200,011	\$ 29,140
Accumulated amortization	(4,244)	(511)
	<b>\$ 195,767</b>	<b>\$ 28,629</b>

As described in Note 3, the Company's business acquisitions during the year included \$170,881 (2004 - \$28,485) of intangible assets. Intangible assets are amortized over their estimated useful lives, primarily 20 years, resulting in amortization expense of \$3,740 for the year ended December 31, 2005 (2004 - \$482).

**8. GOODWILL**

		2005	2004
Balance, beginning of year		\$ 20,038	\$ 5,029
Acquisitions	Note 3	17,714	15,862
Foreign exchange translation		(255)	(853)
Balance, end of year		<b>\$ 37,497</b>	<b>\$ 20,038</b>

**9. PROMISSORY NOTES RECEIVABLE AND OTHER ASSETS**

	December 31, 2005	December 31, 2004
Creation Casinos Inc. ("Creation")		
Common shares, net of writedown of \$90 (2004 - \$Nil)	\$ -	\$ 90
Class A Preference Shares, net of writedown of \$7,400 (2004 - \$Nil)	-	-
Promissory note receivable	-	6,816
Queen of Diamonds		
Common shares	-	382
Promissory note receivable, net of writedown of \$400 (2004 - \$Nil)	1,000	-
Deferred financing costs, net of amortization of \$759 (2004 - \$59)	6,438	2,787
Deposit on acquisition of Orangeville	-	4,000
Other	2,435	4,882
	<b>\$ 9,873</b>	<b>\$ 18,957</b>
Less: current portion	1,329	1,639
	<b>\$ 8,544</b>	<b>\$ 17,318</b>

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**9. OTHER ASSETS (Continued)**

*a) Queen of Diamonds*

On July 15, 2005, the Company disposed of its interest in Queen of Diamonds Cruises (VCC) Limited and Queen of Diamonds Cruises Ltd. The Company recorded a loss of \$999. As part of the disposal, the Company acquired a non-interest bearing promissory note receivable of \$1,400 from Queen of Diamonds Cruises (VCC) Limited. The promissory note receivable is repayable on demand and secured by a limited recourse pledge of the proceeds from the sale of the vessel, M.V. Queen of Diamonds, owned by Queen of Diamonds Cruises Ltd. As at December 31, 2005, based on an assessment of the security, the Company has recorded a write-down of \$400 on the promissory note, which is included in gain (loss) on investments and properties for the year ended December 31, 2005.

*b) Creation Casinos Inc.*

On December 31, 2004, the Company sold the majority of its common shares held in Creation for cash consideration of \$2,250 to certain individuals, including a party related to a director and shareholder of the Company, and a director of Creation who is also part of the senior management of the Company. The transaction resulted in a gain of \$1,975 which decreased the Company's 38% equity interest to 9%. Certain directors of the Company also own shares of Creation.

On June 15, 2005, the Company converted \$6,816 in promissory notes receivable, \$101 in accrued interest, and \$483 in capital lease obligation guaranteed by the Company into 74,000 Class A Preference Shares, Series One of Creation (the "Preference Shares"). The Preference Shares have a par value of \$100 per share, are non-voting, and carry the right to receive non-cumulative annual dividends of \$3.00 per share commencing after December 31, 2005, for each fiscal year in which Creation realizes positive net income at least equivalent to 3% of the par value of the Preference Shares outstanding at the end of such year. The Preference Shares contain a provision for mandatory redemption to the extent of 25% of net operating cash flow and are otherwise redeemable at the discretion of Creation. As a pre-condition of the conversion to preference shares, Creation was required to raise equity capital of approximately \$3,000, which it completed on May 24, 2005.

On February 27, 2006, Creation announced that it ceased operations of its only operating asset, a casino in Lithuania, pending the outcome of a previously announced arbitration proceeding. As a result, the Company has fully written down the carrying values of its investment in Creation's common shares of \$90 and preference shares of \$7,400. As a result, the carrying values of these assets are \$Nil as at December 31, 2005 and \$7,490 is included in gain (loss) on investments and properties in the consolidated statement of income. Notwithstanding the full write-down recorded, the Company will pursue all commercially reasonable means to recover its investment in Creation.

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**10. LONG-TERM DEBT**

	<b>December 31, 2005</b>	December 31, 2004
Series A Senior Secured Notes	\$ 150,000	\$ 150,000
Series B Senior Secured Notes	150,000	-
Credit Facility	93,000	-
Flamboro Promissory Note	44,194	-
HEI Promissory Note	3,889	4,339
Obligations under capital leases and other debt	448	521
	<b>\$ 441,531</b>	<b>\$ 154,860</b>
Less: current portion	3,252	860
	<b>\$ 438,279</b>	<b>\$ 154,000</b>

The maturity of long-term debt for years subsequent to December 31, 2005 is as follows:

2006	\$ 3,252
2007	135,275
2008	20,610
2009	20,566
2010	20,597
Thereafter	241,231
	<b>\$ 441,531</b>

On July 21, 2005, the Company issued 5.50% \$150,000 Series B Senior Secured Notes ("Series B Notes"). The Series B Notes pay interest semi-annually on January 21 and July 21 of each year, commencing January 21, 2006. The Series B Notes mature on July 21, 2015. The Series B Notes rank pari passu with both the Company's Series A Notes and \$200,000 Credit Facility. The proceeds from the Series B Notes were used to reduce the amounts outstanding under the Credit Facility, which was used to fund acquisitions, and for general working capital purposes.

On June 27, 2005, in advance of and in conjunction with the closing of the issuance of the Series B Notes, the Company entered into a bond forward transaction, based on the ten-year Government of Canada bond yield rate, to hedge the interest rate associated with the issuance of the Series B Notes. The bond forward resulted in a cash receipt of \$1,731 on July 21, 2005, which is deferred and included in deferred credit and other liabilities and is amortized to reduce the coupon rate of interest over the ten-year term of the Series B Notes. The bond forward transaction reduced the effective interest rate on the Series B Notes from 5.50% to 5.38%.

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**10. LONG-TERM DEBT (Continued)**

On September 29, 2004, the Company issued 5.74% \$150,000 Series A Senior Secured Notes ("Series A Notes"). The Series A Notes pay interest semi-annually on March 29 and September 29 of each year, commencing March 29, 2005. The Series A Notes mature on September 29, 2014, with semi-annual instalments of principal commencing March 29, 2008 in the amount of \$10,000 each to and including March 29, 2012, and semi-annual instalments of principal commencing September 29, 2012 in the amount of \$12,000 each until the maturity date at September 29, 2014. The proceeds from the Series A Notes were used to repay amounts outstanding under previous loans of the Company.

Provided that no default has occurred and is continuing, the Series A Notes and Series B Notes (collectively the "Notes") are redeemable by the Company at its option in whole at any time or in part from time to time on not more than 60 days' and not less than 30 days' notice at a price equal to the outstanding principal amount plus accrued and unpaid interest plus a prepayment amount.

The Credit Facility has a limit of \$200,000, bears interest at either the Toronto-Dominion Bank's Canadian prime rate or a spread over the banker's acceptance rate, and is subject to annual renewals. The current expiry is on September 27, 2007.

The Notes and Credit Facility are guaranteed by the Company and its principal subsidiaries. The Notes are direct secured obligations of the Company and secured equally and rateably with the indebtedness of the Company pursuant to the Credit Facility. The Notes and Credit Facility require the Company to be in compliance with financial covenants, and contain limitations on the Company's ability to make investments in non-core businesses, incur additional senior indebtedness or sell core assets. See subsequent events (Note 25).

The Flamboro Promissory Note acquired as part of the acquisition of Flamboro Downs bears interest between 6% and 7% per annum depending on the Government of Canada Bond yield rate, requires a principal payment of \$2,500 on June 30, 2006 and a lump sum payment of \$41,694 on June 30, 2007, and is secured by certain assets of Flamboro Downs.

The HEI Promissory Note acquired as part of the acquisition of HEI bears interest at 6% per annum, is repayable in quarterly instalments of principal and interest of \$175 until December 31, 2012, and is secured by a general security agreement with a first charge against all of HEI's assets.

During the year ended December 31, 2005, interest and financing costs of \$9,368 (2004 - \$2,201) are net of interest income of \$2,601 (2004 - \$1,249), capitalized interest on construction of \$5,570 (2004 - \$1,571) and interest and financing costs recovered through the FDIF of \$20 (2004 - \$1,354). Capitalized interest on construction was subsequently reduced by FDIF recoveries of \$3,107 (2004 - \$1,490).

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**11. INCOME TAXES**

The Company's income tax expense is as follows:

	<b>2005</b>	2004
Current tax expense	\$ 17,287	\$ 14,517
Future tax expense	<b>(616)</b>	450
	<b>\$ 16,671</b>	<b>\$ 14,967</b>

	<b>2005</b>	2004
Canadian basic statutory tax rate	<b>35.25%</b>	35.62%
Expected income tax provision for the current year	\$ 13,198	\$ 14,993
Effect of change in tax rates on future income taxes	<b>(1,213)</b>	-
Non-deductible capital losses	<b>3,113</b>	-
Non-deductible stock-based compensation	<b>1,848</b>	785
Other	<b>(275)</b>	(811)
	<b>\$ 16,671</b>	<b>\$ 14,967</b>

Temporary differences and carry-forwards which give rise to future income tax assets and liabilities as at December 31 are as follows:

	<b>2005</b>	2004
Future income tax assets		
Tax loss carry-forwards, net of allowance	\$ 6,070	\$ 1,694
Property, plant and equipment	<b>82,401</b>	36,579
Other	<b>3,443</b>	2,103
	<b>\$ 91,914</b>	<b>\$ 40,376</b>
Future income tax liabilities		
Due from PGCs	\$ 100,323	\$ 41,688
Intangible assets	<b>70,483</b>	10,146
Other	<b>1,356</b>	78
	<b>\$ 172,162</b>	<b>\$ 51,912</b>
Future income tax liabilities, net	\$ 80,248	\$ 11,536
Less: current portion	<b>(1,875)</b>	-
Long-term future income tax liabilities, net	<b>\$ 82,123</b>	<b>\$ 11,536</b>

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**11. INCOME TAXES (Continued)**

The Company has non-capital loss carry-forwards for tax purposes of approximately \$18,000 available to reduce future years' income for tax purposes. The loss carry-forwards expire in varying amounts and in varying years to 2015.

**12. SHARE CAPITAL**

*a) Common shares*

On June 9, 2005, the Company's common shares were subdivided on a five-for-two split basis. All references to the number of common shares and per share amounts have been retroactively restated to reflect this subdivision.

As at December 31, 2005 and 2004, the Company is authorized to issue an unlimited number of common shares with no par value.

*b) Treasury offering of common shares*

On January 13, 2005, the Company completed an offering of 3,750,000 common shares at \$16.60 per share for gross proceeds of \$62,250. The cost of the offering, net of future income taxes, reduced the gross proceeds by \$2,181.

*c) Private placement of Special Warrants*

On August 3, 2005, the Company completed a placement of 3,703,704 special warrants (the "Special Warrants") at a price of \$20.25 per Special Warrant for gross proceeds of \$75,000. The cost of the placement, net of future income taxes, reduced the gross proceeds by \$2,291. On September 8, 2005, the 3,703,704 Special Warrants were converted into common shares.

*d) Private placement*

On January 16, 2004, the Company completed a private placement of 250,000 units at a price of \$6.60 per unit with a director of the Company. Each unit was comprised of one common share and one share purchase warrant which was convertible into one common share at an exercise price of \$6.68 per common share up to July 16, 2005. The net proceeds received on the private placement were \$1,547.

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**12. SHARE CAPITAL**

- e) *Stock-based compensation plans*
- i) *Stock option plans*

At the Annual General Meeting held on June 15, 2005, the Company adopted a new stock option plan to conform to the TSX Company Manual amendments made effective January 1, 2005, and transferred all outstanding stock options under the 1999 and 2003 plans to the new 2005 Stock Option Plan (the "2005 Plan"). Under the 2005 Plan, the maximum number of stock options reserved for issuance is limited to 10% of the common shares issued and outstanding from time to time. As at December 31, 2005, 1,920,722 common shares remain available for granting.

Under the 2005 Plan, no one individual may receive stock options in excess of 5% of the issued and outstanding common shares of the Company. Stock options granted from January 1, 2004 vest over three years and expire five years from the date of grant.

Stock options under the 2005 Plan are as follows:

	<b>2005</b>		<b>2004</b>	
	<b>Options</b>	<b>Weighted-Average Exercise Price</b>	<b>Options</b>	<b>Weighted-Average Exercise Price</b>
Outstanding at beginning of year	<b>4,005,564</b>	<b>\$ 7.10</b>	6,373,500	\$ 2.39
Granted	<b>2,731,250</b>	<b>18.16</b>	2,175,000	10.96
Cancelled/Expired	<b>(131,250)</b>	<b>11.09</b>	-	-
Exercised	<b>(981,327)</b>	<b>3.13</b>	(4,542,936)	2.34
Outstanding at end of year	<b>5,624,237</b>	<b>\$13.07</b>	4,005,564	\$ 7.10

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**12. SHARE CAPITAL (Continued)**

- e) *Stock-based compensation plans (Continued)*  
i) *Stock option plans (Continued)*

Exercise Price	Number Outstanding	Options Outstanding December 31, 2005		Options Exercisable December 31, 2005	
		Weighted-Average Contractual Life	Weighted-Average Exercise Price	Number Exercisable	Weighted-Average Exercise Price
\$0.90 - \$4.08	746,775	1.2 years	\$ 1.96	746,775	\$ 1.96
\$6.74 - \$9.04	741,525	3.1 years	8.36	741,525	8.36
\$11.60	1,187,812	3.5 years	11.60	487,812	11.60
\$12.79 - \$13.94	320,000	3.9 years	13.00	96,040	12.87
\$17.37 - \$17.99	1,721,875	4.2 years	17.96	259,375	17.96
\$18.47 - \$20.47	906,250	4.4 years	18.73	143,750	18.64
	<b>5,624,237</b>	<b>3.5 years</b>	<b>\$ 13.07</b>	<b>2,475,277</b>	<b>\$ 8.85</b>

The fair values of stock options granted were determined using the Black-Scholes option pricing model with the following assumptions: no dividends are to be paid; expected volatility of 41% to 43% (2004 – 31% to 32%); risk-free interest rates of 2.8% to 3.6% (2004 – 2.7% to 3.2%); and expected lives of three years (2004 – three to five years).

During the year ended December 31, 2005, the total compensation expense related to the fair value of stock options was \$5,312 (2004 - \$2,209), of which \$5,288 (2004 - \$2,135) was to employees and directors and \$24 (2004 - \$74) was to consultants.

- ii) *Employee share purchase plan*

Eligible employees of the Company may elect to participate in the Employee Share Purchase Plan (the “Share Purchase Plan”) by contributing up to 5% of their gross pay with the Company matching 25% of the contributions. As at December 31, 2005, 203,184 (2004 – 186,505) common shares were held under the Share Purchase Plan and 31% of employees participated in the Plan (2004 – 23%).

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**12. SHARE CAPITAL (Continued)**

*f) Warrants*

	Equivalent Number of Common Shares	Weighted-Average Exercise Price
Outstanding as at January 1, 2004	4,300,000	\$5.73
Granted	250,000	6.68
Exercised	(3,362,410)	6.24
Outstanding and exercisable as at December 31, 2004	1,187,590	\$ 4.50
<b>Exercised</b>	<b>(1,025,000)</b>	<b>4.65</b>
<b>Expired/Cancelled</b>	<b>(162,590)</b>	<b>3.50</b>
<b>Outstanding and exercisable as at December 31, 2005</b>	<b>-</b>	<b>\$ -</b>

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**13. EARNINGS PER COMMON SHARE**

The following table sets forth the computation of basic and diluted earnings per common share:

	<b>2005</b>	2004
Net income, as reported (A)	\$ <b>19,579</b>	\$ 26,725
Weighted average number of common shares outstanding (B)	<b>76,626,504</b>	65,913,320
Dilutive adjustments for stock options	<b>1,556,144</b>	3,028,770
Dilutive adjustment for warrants	<b>220,338</b>	1,710,678
Diluted weighted average number of common shares (C)	<b>78,402,986</b>	70,652,768
Earnings per common share		
Basic (A / B)	\$ <b>0.26</b>	\$ 0.41
Diluted (A / C)	\$ <b>0.25</b>	\$ 0.38

**14. REVENUES**

	<b>2005</b>	2004
Gross table win	\$ <b>229,485</b>	\$ 202,605
Gross slot win	<b>373,091</b>	236,222
Gross racetrack	<b>87,743</b>	21,888
Food and beverage	<b>37,917</b>	11,472
Hotel revenues	<b>2,165</b>	-
Other gaming revenues	<b>1,698</b>	790
	<b>732,099</b>	472,977
Less: Gaming and other commissions and taxes	<b>(387,111)</b>	(285,909)
Racetrack purses	<b>(65,142)</b>	(12,986)
	<b>279,846</b>	174,082
ATM revenues	<b>3,458</b>	1,875
Other	<b>1,443</b>	1,193
	\$ <b>284,747</b>	\$ 177,150
Less: Promotional allowances	<b>(6,643)</b>	(1,480)
	\$ <b>278,104</b>	\$ 175,670

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**15. GAIN (LOSS) ON INVESTMENT AND PROPERTIES**

		<b>2005</b>	2004
Income from investments		<b>438</b>	199
Impairment of investments	Note 9	<b>(7,913)</b>	(300)
Gain (loss) on disposal of investments	Note 9	<b>(999)</b>	1,975
Gain on sale of land		<b>274</b>	-
Gain (loss) on investments and properties		<b>\$ (8,200)</b>	\$ 1,874

**16. CHANGES IN NON-CASH OPERATING WORKING CAPITAL**

		<b>2005</b>	2004
Changes in non-cash operating working capital			
Accounts receivable	\$	<b>(4,485)</b>	\$ (1,278)
Prepaid expenses and deposits		<b>(2,595)</b>	(876)
Gaming revenues payable		<b>3,758</b>	(846)
Accounts payable and accrued liabilities		<b>6,877</b>	6,066
Income taxes payable		<b>(2,409)</b>	443
	\$	<b>1,146</b>	\$ 3,509

**17. SEGMENTED INFORMATION**

The Company and its subsidiaries operate primarily in one industry segment, the gaming industry. The Company conducts business in two geographic segments: Canada and United States ("US"). Revenues are attributable to the geographic segment based on the location of the gaming facilities with the following assets:

Income statement:

	<b>2005</b>			
	Canada	US	Inter-company	Total
<b>Revenues</b>	<b>\$ 249,867</b>	<b>\$ 28,237</b>	<b>\$ -</b>	<b>\$ 278,104</b>

	<b>2004</b>			
	Canada	US	Inter-company	Total
<b>Revenues</b>	<b>\$ 149,732</b>	<b>\$ 26,326</b>	<b>\$ (388)</b>	<b>\$ 175,670</b>

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**17. SEGMENTED INFORMATION (Continued)**

Balance sheet:

	As at December 31, 2005			
	Canada	US	Inter-company	Total
Property, plant and equipment	\$ 263,623	\$ 19,448	\$ -	\$ 283,071
Goodwill	29,857	7,640	-	37,497
<b>Total assets</b>	<b>917,345</b>	<b>41,074</b>	<b>(39,749)</b>	<b>918,670</b>

	As at December 31, 2004			
	Canada	US	Inter-company	Total
Property, plant and equipment	\$ 100,198	\$ 25,154	\$ -	\$ 125,352
Goodwill	12,142	7,896	-	20,038
<b>Total assets</b>	<b>366,337</b>	<b>38,754</b>	<b>(42,676)</b>	<b>362,415</b>

**18. RELATED PARTY TRANSACTIONS**

The following related party transactions and balances are in addition to those noted elsewhere in the financial statements.

During the years ended December 31, 2005 and 2004, the Company had the following transactions with related parties:

- a) Other income includes:
  - i) interest income of \$114 (2004 - \$15) received from senior management, and Creation, a company that has a director who is a member of senior management of the Company.
  - ii) ATM revenues of \$552 (2004 - \$507) received from a company that has a director who is a member of senior management of the Company and had a director (resigned director position in April 2005) who is an officer of the Company.
- b) Human resource expenses include:
  - i) Dealer training services of \$1,164 (2004 - \$1,067) provided by a company controlled by a director of the Company.
  - ii) Consulting services of \$134 (2004 - \$563) provided by a director of the Company and a company controlled by a director of the Company.
- c) Restructuring costs include severance of \$Nil (2004 - \$715) to a former employee, who is also a director of the Company. Accounts payable and accrued liabilities include \$440 (2004 - \$678) relating to severance not yet paid to the former employee.

These related party transactions were recorded at the exchange amount, which is the amount of consideration paid or received as established and agreed to by the related parties.

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**19. EMPLOYEE FUTURE BENEFITS**

The Company maintains a defined contribution pension plan for its Canadian employees. Under this plan, eligible employees contribute a minimum of 2% to a maximum of 15% of their base salary. The Company makes contributions representing 2% of eligible employees' base pay. Contributions made by the Company during the year ended December 31, 2005 totalled \$1,398 (2004 - \$1,056).

**20. INTEREST IN JOINT VENTURES**

The following summarizes the Company's proportionate interest in joint ventures, including inter-company revenue and expenses:

	<b>2005</b>	<b>2004</b>
<b>Income (Loss)</b>		
Revenues	\$ -	\$ 5,957
Expenses	\$ -	\$ 6,454
Net loss	\$ -	\$ (612)
<b>Cash flows provided by (used in):</b>		
Operating activities	\$ -	\$ (735)
Investing activities	\$ -	\$ 4,803
Financing activities	\$ -	\$ (4,118)

During the year ended December 31, 2004, the Company acquired the remaining interests in its joint ventures and proportionate consolidation of revenues and expenses ceased (Note 3). As at December 31, 2004, there were no assets or liabilities held through joint ventures.

**21. CONTINGENCIES AND LITIGATION**

*a) Letters of credit*

As at December 31, 2005, letters of credit in the amount of \$25,536 were outstanding as security in connection with gaming cash floats and road improvements, landscaping and development permits.

*b) Litigation*

On December 7, 2004, the Company paid US \$1,800 (CAD \$2,275 inclusive of legal fees) to Allegiance Capital Corporation for the termination of the proceedings against the Company and its officers.

The Company is involved in other claims and litigation arising in the ordinary course of business. In the opinion of management, the amount of ultimate liability with respect to these actions will not materially affect the financial position of operations or cash flows of the Company.

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**22. COMMITMENTS**

a) *Commitments*

Under the terms of various operating leases and contracts, the Company is committed to future minimum contractual payments as follows:

2006	\$ 4,060
2007	3,353
2008	2,803
2009	2,678
2010	2,719
Thereafter	<u>22,923</u>
	<u>\$ 38,536</u>

The Company is committed to pay a consultant future amounts dependent upon the consultant directly or indirectly being responsible for an expansion of the gaming facility and based upon the annual increase in net income of Flamboro Downs. Similar arrangements exist for other acquisitions and expansions, if any, in Ontario, provided that the consultant is directly or indirectly responsible for the acquisition or expansion.

b) *Capital expansion*

The Company currently has committed approximately \$52,000 towards capital expansion plans over the next twelve months which the Company expects to fund by existing cash, cashflow from operations, and advances from debt facilities.

c) *Contingent payments on acquisition*

As a condition of various acquisition agreements, the Company is committed to make future contingent consideration payments as follows:

- i) *Georgian Downs* - As part of the acquisition of Georgian Downs, the Company provided a consultant a finder's fee equal to a notional equity interest in that company. The notional equity interest entitles the consultant to future finder's fee remuneration depending on the operating results of the company. The consultant has an option to sell (a "put option") his notional equity interest in Georgian Downs to the Company from January 2006 for consideration calculated using a predefined formula based on Georgian Down's operating results for the 12-month period preceding the option's exercise. The Company similarly has a call option to purchase the consultant's notional equity interest from June 2012 for consideration calculated using the same predefined formula. By applying the predefined consideration formula, the consultant's put option had no value at December 31, 2005.

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**22. COMMITMENTS (Continued)**

*c) Contingent payments on acquisition (Continued)*

- ii) Orangeville* - Payments to the former owners for a period of up to four years from March 18, 2005 based on defined levels of net gaming and racing revenues of the acquired operations.
- iii) Vetter* - Payments to the former owners based a percentage of the gross slot revenues over a specified minimum level for the first three years following the acquisition.
- iv) O'Aces* - Payments to the former owners based on 20% of the defined operating results of O'Aces operations of the Great American Casino in Kent, Washington for each of the calendar years 2004, 2005 and 2006 up to a cumulative maximum of US\$500.

The payments, if and when made, will be treated as additional costs of the respective purchases. As at December 31, 2005 and 2004, no payments were required under the acquisition agreements.

**23. RESTRUCTURING COSTS**

In addition to restructuring costs included in Note 3(c), in September 2004, the Company undertook several initiatives to improve operational efficiencies and implement restructuring of underperforming assets and recorded a restructuring cost of \$5,557. The majority of the restructuring costs related to employee severances (69%), lease and contract termination (17%), and equipment, office supplies and property write downs (12%). As at December 31, 2005, \$650 (2004 - \$2,420) of the restructuring costs remain in accounts payable and accrued liabilities which consist primarily of severances.

**24. FINANCIAL INSTRUMENTS**

The fair value of cash and cash equivalents, restricted cash, accounts receivable, deposits, promissory notes receivable, gaming revenues payable, accounts payable and accrued liabilities, Flamboro Promissory Note, HEI Promissory Note, and Credit Facility approximate their carrying value.

The fair value of the amount due from PGCs is approximately \$292,569 (carrying value - \$288,838) and the fair value of the Notes is approximately \$303,255 (carrying value - \$300,000) determined using a rate which management believes to be the market rate of interest for a similar instrument with similar terms and conditions as at December 31, 2005.

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**25. SUBSEQUENT EVENTS**

On March 27, 2006, the Company announced an equity offering subject to TSX approval, which consisted of a private placement of 6,206,361 units at a price of \$12.89 per unit for gross proceeds of \$80,000. Each unit is comprised of one common share and one share purchase warrant, which is exercisable into one common share at an exercise price of \$12.89 for a period of up to two years from the closing date. The Company's Chairman and Chief Executive Officer agreed to participate in the private placement for \$50,000 of the total offering. Each unit is subject to a four-month hold period from the closing date.

On March 27, 2006, the Company received the necessary approvals and closed the private placement on March 28, 2006.

On March 27, 2006, the holders of the Company's Notes and the lenders of the Credit Facility (collectively, the "Lenders") agreed to amend certain terms, including the financial covenants, related to the Notes and the Credit Facility. The Lenders agreed to increase the Company's Net Debt to Adjusted EBITDA ratio (defined terms in the debt agreements) to be: 3.50 or less at March 31, 2006, 3.25 or less at June 30, 2006, 3.00 or less at September 30, 2006, 2.75 or less at December 31, 2006 and for all of 2007, and 2.50 or less for any measurement period after January 1, 2008.

In consideration, the Company agreed with the Lenders to:

- pay amendment fees totaling \$1,250;
- increase the coupon rate on the Notes by 0.375% per annum for a period ending on the later of December 31, 2006 or the second consecutive quarter the Company maintains a Net Debt to Adjusted EBITDA ratio of 2.50 or less;
- increase the coupon rate on the Notes by an additional 0.75% over the 0.375% mentioned above, should DBRS downgrade the Company's credit rating at any time over the next two years from BBB (low), such increased coupon rate of interest period to end when the Company maintains a Net Debt to Adjusted EBITDA ratio of 2.50 or less for two consecutive quarters;
- agree not to make any third party acquisitions unless subsequent to the acquisition, the Company would have been in compliance with the original Net Debt to Adjusted EBITDA ratio; and
- issue sufficient equity to close by May 31, 2006 to notionally reduce the Net Debt to Adjusted EBITDA ratio to 2.75 or less at March 31, 2006.