PARTICIPANTS

Corporate Participants

Courtney Yopp Norris – Head-Corporate Communications & Media Relations, Churchill Downs, Inc.
Robert L. Evans – Chairman & Chief Executive Officer, Churchill Downs, Inc.
William E. Mudd – Chief Financial Officer & Executive Vice President, Churchill Downs, Inc.
William C. Carstanjen – President, Chief Operating Officer & EVP, Churchill Downs, Inc.

Other Participants

Cameron P. S. McKnight – Analyst, Wells Fargo Securities LLC
Amit Kapoor – Analyst, Gabelli & Co.
Steve T. Altebrando – Analyst, Sidoti & Co. LLC

MANAGEMENT DISCUSSION SECTION

Operator: Good day, ladies and gentlemen, and welcome to the Churchill Downs Incorporated Second Quarter Results Conference Call. [Operator Instructions] As a reminder, this conference is being recorded. I would like to introduce your host of today's conference, Mrs. Courtney Norris. Ma'am, you may begin.

Courtney Yopp Norris, Head-Corporate Communications & Media Relations

Thank you, Trea. Good morning, and welcome to this Churchill Downs Incorporated conference call to review the company's business results for the second quarter ended June 30, 2014. The company's second quarter business results were released yesterday afternoon in a news release that has been covered by the financial media. A copy of this release announcing results and any other financial and statistical information about the period to be presented in this conference call, including any information required by Regulation G, is available at the section of the company's website titled News located at churchilldownsincorporated.com, as well as on the website's Investors section. Let me also note that a news release was issued advising of the accessibility of this conference call on a listen-only basis via phone and over the Internet.

As we begin, let me express that some statements made during this call will be forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. Forward-looking statements are statements that include projections, expectations or beliefs about future events or results, or otherwise are not statements of historical fact. The actual performance of the company may differ materially from what is projected in such forward-looking statements. Investors should refer to statements included in reports filed by the company with the Securities and Exchange Commission for a discussion of additional information concerning factors that could cause our actual results of operations to differ materially from the forward-looking statements made in this call.

The information being provided today is of this date only, and Churchill Downs Incorporated expressly disclaims any obligation to release publicly any updates or revisions to these forward-looking statements to reflect any changes in expectations.

I will now turn the call over to our Chairman and CEO, Bob Evans.

Robert L. Evans, Chairman & Chief Executive Officer

Thanks, Courtney. Good morning, everyone. Thanks for joining us. I don't have any comments other than what appear in the press release, so I'll forego re-reading those to you. Turn it over to Bill Mudd, our CFO, who will take you through the numbers and then we'll come back and try to answer any questions you've got. Bill?

William E. Mudd, Chief Financial Officer & Executive Vice President

Thanks, Bob. Good morning, everyone. Overall, our results were solid despite a soft regional gaming market. It was a record second quarter with revenues up 7%, adjusted EBITDA of 12% and net income from continuing operations up 14%. Year-to-date cash provided from operating activities was $119 million, up 19% from the prior year. Debt at the end of the second quarter was even with 2013 year-end at $369 million despite spending $12 million in maintenance capital, $26 million in project capital, funding our Miami Valley Gaming development with $6.5 million and repurchasing nearly $62 million of stock during the first half of the year, the 691,000 shares we repurchased at the end of June. So the average share count for second quarter was not affected by that repurchase.

Now I'll make a few comments on our operations and make some other highlights by segment. Our racing segment revenues increased 1% and adjusted EBITDA improved 11% or $7.6 million, despite continued headwinds at our Calder facility from racing head-to-head with Gulfstream Park.

Our Kentucky Derby and Oaks weeks set another earnings record with adjusted EBITDA up $8.8 million over the prior year. The increase in revenues and earnings were broad-based, combined Oaks and Derby week generated record attendance, record pari-mutuel revenues, higher media rights fees and record admission revenue on the introduction of the Grandstand Terrace and Rooftop Garden.

We are extremely pleased with this result. The Derby continues to grow, is stronger than ever, and we've already started working on and hope to make 2015 an even bigger success. Partially offsetting this record performance was a 43% decline in revenues and a $2 million decline in adjusted EBITDA at Calder Race Course. These reductions were driven by 20% fewer live race days, a continued loss of a portion of our hosting revenues and the impact of fewer horses per race from running head-to-head against Gulfstream Park.

The good news is that we have come to an agreement with The Stronach Group allowing them to lease certain assets and to operate and maintain live racing at Calder through the end of 2020. We will continue to own the racing and gaming licenses, land and buildings, but have for all intents and purposes outsourced our racing in Florida, while we continue to operate our Calder slot facility. This agreement is a win for the customers and horsemen in South Florida, a win for the Stronach Group, and a win for Churchill Downs. The agreement is complex, needless to say, it will improve the results of CDI over the next 12 months.

Our gaming segment results were mixed this quarter, with revenue growth of 23%, and adjusted EBITDA growth of 35%. The games were driven by the July 2013 acquisition of the Oxford Casino and the opening of our joint venture Miami Valley Gaming property in mid-December of last year. Our other properties struggled with revenue declines between 3% and 10%.

On the positive side, we believe we maintained or gained share in each of the markets we operate as our top line results were in line to slightly better than our competition. The bottom and middle tier of our database continues to see fewer trips and a lower win per trip. The top tier of our database is stable to slightly growing in some locations. We believe the revenue growth will resume when we see employment gains and real disposable income growth in the markets we operate. Thus far, we have been very pleased with the performance of our Miami Valley Gaming joint venture. Second quarter total revenues were $36.3 million and total adjusted EBITDA was $10.3 million. We now have 175,000 names in our database and it continues to grow in all customer tiers. As a reminder, we include our share of operating income, which is after depreciation and amortization in our adjusted EBITDA metric. That amounted to $3.4 million this quarter.

Our online business continued to grow organically with second-quarter revenues up 9% on a 20% increase in unique players. Handle for the quarter increased 4.7% over the prior year to approximately $266 million, outperforming total industry handle, which declined 1.4% according to figures published by Equibase. The reinstatement of wagering by Illinois residents in June of last year was more than offset by the continuing loss of Texas resident wagering during the period. Excluding Illinois and Texas from both periods, our handle improved 5.5%. outpacing the industry by 6.9 percentage points. Our online business adjusted EBITDA was consistent with the prior year as organic revenue growth, the reinstatement of wagering by Illinois residents and a renewed focus on cost controls were offset by the loss of Texas resident wagering and additional taxation of online wagering in certain states.

Our other investments adjusted EBITDA declined by $1.6 million during the quarter, $0.8 million of this decline is driven by the cost associated with the continuing build out of our real-money internet gaming platform. United Tote adjusted EBITDA declined $0.4 million due to lower equipment and service sales. Finally, we incurred $0.5 million in expenditures related to our bid for the Capital Region casino license in New York. We think we have a great partner in Saratoga Casino and Raceway and believe we submitted a very competitive bid.

Yesterday, we announced that we have a binding agreement to acquire a 25% stake in Saratoga Harness Racing Inc., which includes an agreement to manage the Saratoga Springs, New York and Black Hawk, Colorado properties as well as the Capital View Casino in East Greenbush, New York should we be awarded the license. Saratoga Casino and Raceway, which operates 1,780 video lottery terminals, accounts for the vast majority of the acquisition value. While we have not made public the purchase price of the acquisition, we believe the multiple is at market and based on the pro forma profitability of the property once the Capital Region casino is open.

Additionally, while the possibility of the gaming expansion in Colorado was a concern, we believe the financial downside there is limited. Not only does this equity investment make sense economically, it is also strategically important as it provides CDI with an option on Internet gaming in two states should Internet gaming be legalized. Additionally, this equity position would entitle us to a share of the Newburgh casino in Orange County, New York, which was proposed by Saratoga Harness Racing Incorporated and Rush Street Gaming should they be the successful bidder. We are really excited to expand our relationship with the Saratoga Harness team and believe it will improve our chance of being awarded a license to build and operate the Capital View Casino & Resort.

Now I'd like to cover one item below the adjusted EBITDA line. As a reminder, a new executive long-term incentive plan went into effect March 21 of 2013. The vast majority of the expense was related to the at-risk price vesting stock award and recognized over the first 14 months of the plan. That 14 month period concluded at the end of May and is the driver of the 50% reduction in share based compensation in the quarter. The remaining unrecognized expense related to the new long-term incentive plan is $4.6 million and will be recognized over the next 23 months.

With that, I'll turn it over to Bob, who will open the call for questions. Bob?

Robert L. Evans, Chairman & Chief Executive Officer

Thanks, Bill. Also with us today are Alan Tse, our General Counsel and Bill Carstanjen, our President and COO. Trea, if there are any questions, we'll be happy to take them now.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] And I'm showing our first question is going to come from the line of Cameroon McKnight of Wells Fargo. Your line is now open.

<Q – Cameron McKnight – Wells Fargo Securities LLC>: Thanks very much. Good morning.

<A – Bill Mudd – Churchill Downs, Inc.>: Good morning.

<Q – Cameron McKnight – Wells Fargo Securities LLC>: Just, first of all question for Bob or Bill on the buyback. What was the catalyst for the change of course there in terms of starting to return big amounts of capital through a buyback? And what was the catalyst for such a big buyback in the quarter?

<A – Bill Mudd – Churchill Downs, Inc.>: Well, the catalyst was...first of all we're always interested in looking for ways to return capital to our shareholders. There was an opportunity to do a rather large buyback in a private negotiation, so we took the opportunity to go ahead and take some of the shares off the table without affecting liquidity for existing shareholders.

<Q – Cameron McKnight – Wells Fargo Securities LLC>: Right. Got it. And then, just as a follow-up, you've got, in terms of our view, you've got several assets that no one else in regional gaming has. Apart from the Derby, you've got a balance sheet that's almost unlevered. How comfortable would you be with taking leverage up, be it through buybacks or something else, and is there a target you've got in mind?

<A – Bill Mudd – Churchill Downs, Inc.>: Well, we don't provide forward-looking guidance and we don't certainly have a target on leverage. A lot of that as we've discussed before, Cameron, depends greatly on the use of proceeds. Right now, we put in $300 million high-yield long-term unsecured bonds at the end of last year, provides us a tremendous amount of liquidity on our $500 million revolver obviously. We have lots of opportunities to spend cash and we obviously continue to look for ways to invest our shareholders money to provide great returns. The share buyback at the end of last quarter is a great example of that. And in terms of leverage, it depends on the tenor of the debt and the type of transaction that we'd use the money on. So it's kind of hard to answer that question with precise comments, but that's the way we think about it.

<Q – Cameron McKnight – Wells Fargo Securities LLC>: Okay, great. Thanks very much.

Operator: Thank you. And our next question comes from the line of Amit Kapoor of Gabelli & Company. Your line is now open.

<Q – Amit Kapoor – Gabelli & Co.>: Great. Good morning. Thank you. In terms of allocation of capital, Bob, is the share buyback, I mean the stock's clearly had intrinsic value, probably has significantly outperformed the market. So in terms of timing of buyback, how do you guys think about that? If you could walk us through that thought process of what is a good point in the price versus performance of the stock to buy back stock.

<A – Bob Evans – Churchill Downs, Inc.>: I understand the question. The challenge is responding to it without making forward-looking statements. Let me just say that the regularly discuss with the board capital allocation and returns to shareholders through buybacks and dividend increases. We understand that's important to our shareholder base. We have $38 million remaining on the board authorization amount that goes through 2015, as I recall. And we'll look for other opportunities as we go through time and we'll review this subject with the board on a regular basis. Sorry, I can't be more specific.

<Q – Amit Kapoor – Gabelli & Co.>: Okay, great. Thank you. And just a different question, can you walk us through a potential timeline for the New York gaming license opportunity? Licenses, the applications were in by June 30, licenses expect to be awarded in late this year, but any specifics around that and any pins in the map would be very helpful. Thank you.

<A – Bill Carstanjen – Churchill Downs, Inc.>: Hi, Amit. This is Bill Carstanjen. You just gave a pretty good summary. We filed our application, our definitive application June 30. The expectation is that a decision will be rendered by the state around or before the end of the year. It will be great if they keep to that timetable. That's not really within our control. So we'll just have to see and what happens after that, will I think depend in part on what the state says when they award the bids. So that's as much as we know at the moment. We certainly have hopes and expectations of how quickly the project can be developed and when it can be built and opened, but it would be speculating to go much further than giving the dates we just gave.

<Q – Amit Kapoor – Gabelli & Co.>: Great. Thank you.

Operator: [Operator Instructions] Our next question comes from the line of Steve Altebrando of Sidoti & Company. Your line is now open.

<Q – Steve Altebrando – Sidoti & Co. LLC>: Hi. Good morning. How is MVG planning to fund the license fee, the $25 million license fee at the end of the year?

<A – Bill Mudd – Churchill Downs, Inc.>: Yes so, they're generating cash right now, Steve. Some of the cash that we're generating between the time we opened, we haven't given any of that money back to ourselves or DNC. The cash is building up there and then whatever's left, we're going to fund off of our balance sheet. We have $12.5 million. Part of that will come off of funds sitting on the books of MVG and part of it will come out of our debt instruments at the end of the year.

<Q – Steve Altebrando – Sidoti & Co. LLC>: Okay. That's helpful, and then in terms of the – I don't know if there's anything you can provide, but mechanics or the economics of the management agreement with SHRI, is it based on a percentage of revenue? Is there EBITDA incentives? And anything on that would be helpful?

<A – Bill Carstanjen – Churchill Downs, Inc.>: Hi, Steve. It's Bill Carstanjen again. We're not going to disclose the specifics of the management contract, but it's fairly standard and relatively consistent with what you see others do out in the market.

<Q – Steve Altebrando – Sidoti & Co. LLC>: Okay. And then you mentioned in the script the online portion, was that a meaningful motivation for this deal or just something as an aside type thing?

<A – Bill Carstanjen – Churchill Downs, Inc.>: It's always a plus. It's not the driver for any acquisition or project we've done so far on the brick and mortar side, but it's always a plus. It's always something that we factor into the mix as we look at the population demographics of the different states that are out there.

<Q – Steve Altebrando – Sidoti & Co. LLC>: Okay. All right. Thank you.

Operator: Thank you.

<A – Bob Evans – Churchill Downs, Inc.>: Trea, do we have any other questions?

Operator: At this time I'm showing no further participants in the queue. I would like to turn the call back over to management for any further remarks.

Robert L. Evans, Chairman & Chief Executive Officer

All right. Thank you, Trea. Thanks everyone for joining us. I appreciate the questions. We'll talk to you in another quarter. Thanks very much. Bye-bye.

Operator: Ladies and gentlemen, thank you for your participation on today's conference. This concludes the program. You may now disconnect. Everyone have a great day.