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CHDN - Q4 2016 Churchill Downs Inc Earnings Call

EVENT DATE/TIME: MARCH 01, 2017 / 2:00PM GMT

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PRESENTATION

Operator

Welcome to the Churchill Downs Incorporated 2016 fourth-quarter and year-end earnings conference call.

(Operator Instructions)

As a reminder, this conference call is being recorded. I would now like to introduce your host for today's conference, Mr. Mike Anderson, Vice President, Treasury, and Investor Relations.

Mike Anderson - *Churchill Downs Inc - VP of Treasury and IR*

Think you, Leanne. Good morning and welcome to our fourth-quarter and year-end 2016 earnings conference call. After the Company's prepared remarks, we will open the call for your questions.

The Company's 2016 fourth-quarter and year-end business results were released yesterday afternoon. A copy of this release announcing results and other financial and statistical information about the period to be presented in this conference call, including information required by Regulation G, is available at the section of the Company's website titled, News, located at churchilldownsincorporated.com, as well as in the website's Investor section.

Before we get started, I would like to remind you that some of the statements that we make today may include forward-looking statements. These statements involve a number of risks and uncertainties that could cause actual results to differ materially. All forward-looking statements should be considered in conjunction with the cautionary statements in our earnings release and the risk factors included in our filings with the SEC, specifically the most recent report on Form 10-K. Any forward-looking statements that we make are based on assumptions as of today and we undertake no obligation to update these statements as a result of new information or future events.

During this call, we will present both GAAP and non-GAAP financial measures. A reconciliation of GAAP to non-GAAP measures is included in today's earnings press release. The press release and Form 10-K are available on our website at churchilldownsincorporated.com.

I would also like to point out that we issued a press release on February 16 that announced that we have updated our definition of adjusted EBITDA for external reporting purposes. After consideration of the SEC's guidance regarding non-GAAP metrics, we have decided to exclude changes in a Big Fish Games to deferred revenue in our computation of adjusted EBITDA. This is only a change in external non-GAAP financial reporting and has no effect on our business. We made this change on a prospective basis beginning with our fourth-quarter 2016 and full-year 2016 business results. All of the adjusted EBITDA metrics we discuss on the call today will be based on this new definition.

And now I will turn the call over to our Chief Executive Officer, Mr. Bill Carstanjen.

Bill Carstanjen - *Churchill Downs Inc - CEO*

Thanks, Mike. With me today are several members of our team including; Bill Mudd, our President and Chief Operating Officer; and Marcia Dall, our Chief Financial Officer. I will make a few general comments about FY16 and offer some additional color on the fourth quarter and then turn this over to Marcia. After she is finished with her comments, Bill Mudd, Marcia, and I will be happy to take your questions.

Overall, the Company produced record net revenue of $1.3 billion in the 2016, up 8% over prior year, and adjusted EBITDA of $334.5 million, up 11% over prior year. Net income was $108 million, a 66% increase over prior year ; diluted net income per share was $6.42, up 73% over prior year. In the fourth quarter, the Company produced record net revenue of $278.3 million, up 2% over prior year, and adjusted EBITDA $56.5 million, up 5% over fourth-quarter prior-year.

Certainly, there are some things that went well for our Company in 2016. There also some things that we need and expect to do much better. I will now focus my comments on each of our four main business segments to better shape your understanding of our quarter, our year, and how we think about our results. I will start with our TwinSpires.com business.

For the full year, wagering at TwinSpires was up 14% while the industry was up slightly less than 1%. Our adjusted EBITDA was up 13.6% despite a $1.5 million increase in marketing and advertising spend, which helped drive a 23% increase in active players. In the fourth quarter, TwinSpires wagering was up 12% over prior year while the industry, as a whole, was down 1%. Adjusted EBITDA was also up about 12%.

Note that in the fourth quarter, wagering is more concentrated on the Florida, California, and New York tracks, which is more expensive content for us. This impacts our margins compared to other quarters. Looking at the macro environment for the horse Racing industry, wagering was up very slightly in 2016 following a few years of being relatively flat and stable.

Against this backdrop, our TwinSpires team continues its long-term pattern of organic growth on the top and bottom line, nicely above industry trends. We are improving our marketing and customer retention strategies to better drive increases in active users as well as revenues per user. We also believe strongly that customers will continue to migrate to mobile and that they value additional features and functionality.

We really like this business. We have a deeply experienced management team running it. We have a number of ideas that we are pursuing that will improve on what we have already done.

Now moving on to our Racing division. Our brick-and-mortar Racing business is seasonal and the fourth quarter every year is relatively quiet. For the full year, net revenues increased 2.2% while adjusted EBITDA was up 11%, or $7.9 million compared to prior year. The Kentucky Derby is the big driver of the continued growth and success of our Racing segment.

While we detailed in the press release and in our 10-K some of the incremental improvements and efficiencies we continue to find across our Racing assets. Our passion and our best opportunities lie with improving everything we do around the Kentucky Derby.

The Kentucky Derby will continue to be the crown jewel of our Company. We set the record for many of our significant metrics in 2016 from attendance for the week, to wagering for the week, to adjusted EBITDA, to TwinSpires wagering for the week, and several others. I have been able to make this statement for a few years now and that is deeply gratifying. This is a special time for us as we build this amazing event and I feel privileged every day to work with our fantastic experienced team to make improvements happen.

We are now 67 days away from the 143rd Kentucky Derby and our team is completely absorbed in preparation. For those of you still looking for seats, inventory has never been tighter so get on it now as there is limited availability.

The big change you will see this year is the $16 million renovation project of the clubhouse. These improved amenities and features will be apparent to everyone who enters the clubhouse but will be especially appreciated by the nearly 18,000 guests who utilize the restrooms, food and beverage offerings, and wagering windows in this section of our facility.

As we have previously said, these improvements will be completed in time for the 2017 Kentucky Derby. Our goal is to surprise our customers and exceed their expectations. I am confident we will achieve that this year.

Every year, we want to be able to demonstrate to our customers that we are making the event bigger, better, and more fun for everyone. For the 2018 Derby, we have already announced our $37 million expansion plan to deliver another tower of luxury suites that will add more than 1,800 new seats and other premium entertainment spaces. Our plans are well underway for that project.

One final brief comment on this year's Kentucky Derby. I want to congratulate Epicharis, the Japanese horse who won our inaugural Japan Road to the Kentucky Derby, a series of two races in Japan for the right to earn one of the 20 starting spots in this year's Kentucky Derby. We are excited to include Japan in the spectacle that is qualifying a horse for the Kentucky Derby.

Many may not realize that Japan is the largest wagering market in the world for horse Racing, with over $28 billion wagering annually versus approximately $10.7 billion in the United States.

We are pleased to partner with the Racing authorities in Japan and hope to thrill their Racing fans as they watch a homegrown horse compete against the best in the United States. We plan to simulcast the race in Japan for the first time ever so that Japanese handicappers can place their bets on the greatest two minutes in sports.

A few comments on the casino segment. For the full year, net revenue was flat and adjusted EBITDA was up $10.9 million, or 9.5%, a pretty solid year. In the fourth quarter, net revenue decreased $1.5 million for the quarter and adjusted EBITDA was down $0.5 million at 1.8%, a mixed bag for the quarter. Marcia will explained the variance in more detail in her comments.

From my perspective, Riverwalk in Vicksburg, Mississippi, is a nice facility but is struggling against aggressive competition and a weak market. We can do better there.

Our Louisiana slots and video poker operations were also negatively affected by the overall poor local economy. While we have to expect the Mississippi and New Orleans markets to continue to be a challenge, we are focused on running those businesses efficiently and looking for opportunities to gain share when possible.

Our Ohio, Maine, and New York properties, on the other hand, were strong. We have been very pleased with Miami Valley Gaming in Ohio and continue to believe we built the right facility in the right location. We are still seeing growth and we modestly expanded the gaming floor in late December. We obviously like our property in Oxford, Maine, and that is why we are investing in building a hotel, we see upside.

Clearly, Saratoga was a nice contributor for us in 2016. As of this month, the property has increased competition with a new Casino nearby in Schenectady. But we have long since anticipated this and we will adjust our business model as necessary, while also taking advantage of the legislative tax rate adjustment that we received in connection with the new competition. It is still very early but so far we are holding up quite well in the face of the new competition.

As a reminder, we closed on the Saratoga Casino Black Hawk equity investment in November and in January 2017, closed on our equity investment in Ocean Downs In Berlin, Maryland. Finally, Calder continues to perform well, even with new entrants into the market.

As I look across our portfolio, the bottom line is that some of our markets are a bit better than others but generally, this remains a relatively stable and predictable segment for us. We have chosen over time to invest in properties that are relatively small without large capital footprints to maintain. We ask our teams to focus on variable costs and other operating efficiencies in order to best adjust for the low-growth economic climate in which we generally find ourselves.

We will continue to be conservative in our operating assumptions. We also have had success over time finding or developing new opportunities. We will continue to show the same discipline and careful approach going forward.

Now let's talk about Big Fish. For the full year 2016, bookings grew 7.2% overall, with a 39.6% growth in the casual and mid-core free-to-play segment, partially offset by a 5.5% decline in social casino bookings and a 14.8% decline in premium bookings. In the fourth quarter, bookings were down about 5.8% compared to the third-quarter and down about 7.9% compared to the fourth quarter of last year.

Clearly, regardless of our revenue or adjusted EBITDA numbers in any given period, we don't want to see bookings decline consistently over time. Long-term help depends on bookings growth. That said, I have stated repeatedly over the last few quarters that our objective is not to simply chase bookings for bookings' sake but rather to achieve sustainable profitable bookings growth.

Digging a little deeper into our segments within Big Fish, for the fourth quarter, premium declined 20%; social casino bookings declined about 7.9%; and casual and mid-core free-to-play bookings declined about 1.7% versus prior year.

The decline in bookings with respect to the premium segment has been expected and consistent since we have been involved in the Big Fish business. We have always felt this trend would continue as customers transition to mobile devices and free-to-play games. The segment produces attractive margins by operating efficiently and will continue to operate it with this focus.

The decline in the Social Casino segment, however, has not been something we are happy with or accept. This genre overall has continued to grow while our business has slightly contracted. We have actually under-invested in UA recently in this genre.

We were distracted by short-term results from some of our new free-to-play games and that wasn't optimal for our long-term growth as a Company. We still believe very strongly in the social casino space and in our ability to deliver quality products and innovation to this customer base. It is a critical business for Big Fish.

We believe we have the focus and the strategy to return this segment to growth. We are hard at work introducing new community and social features into our flagship game, Big Fish Casino, and refining new social casino products like Jackpot City Slots.

On January 12, we launched Jackpot Clubs, which allows players to team up with other players and earn in-game rewards. We have recently released a major enhancement to the Jackpot Club feature, including club tournaments, which allow clubs to compete in tournaments against other clubs. We have got several additional features on our product roadmap to continue enhancing Jackpot Clubs that we plan to release over the next few months.

While the social casino genre continues to grow, the growth rate has slowed and competition continues to stiffen as both major players and new entrants compete in this very attractive space. While Big Fish Casino is a leader in the space, it also is maturing, as it has been a stalwart in a high position on the top grossing mobile app's list for more than four years. That said, it is very hard for new entrants to reach the scale of success that we have built over time with Big Fish Casino, it remains a very stable and profitable business, led by deeply experienced and capable team.

One final note on the casino. UA payback on social casino tends to be longer because we have historical data that the acquired customers are very sticky and have a long life cycle. That gives us confidence over the long-term regarding return on investment but it can lead to slightly lower margins in the short term for this segment of Big Fish.

With respect to the casual and mid-core free-to-play segment, we grew bookings rapidly through the first few quarters of 2016, but in retrospect, we did not do so in a manner that is best for our long-term profitability. I discussed this last quarter and will touch on it again now.

First, Gummy Drop remains a highly profitable, well-performing game but it is maturing. Our ability to invest in UA in this game is declining. That's fine. With respect to any individual game, we expect that, over time, as the game matures and becomes familiar to the market, it gets more expensive to reach new customers we can grow into highly profitable ones.

We will be very disciplined in UA spend which may impact bookings growth but will also help with margin and profitability. We got better at that over the course of 2016 with respect to Gummy Drop.

Over the year, we realized that some of our efforts into newer genres like mid-core with Dungeon Boss and simulation games with Sunken Secrets have led us to over invest in user acquisition, based on limited short-term data only to see these games not produce the long-term returns we see in our best products. Based on early data and compared to our prior successful games, we felt we had solid hits so we invested in acquiring users.

We will earn our money back but we haven't seen the straight long-term LTV curves we experienced in Gummy Drop, or our social casino products. This long lifetime value is necessary for sustained revenue growth and it justified spending in UA. Plus, the bookings growth we saw with these games, particularly in the first half of 2016 is not something we will attempt to match in 2017, it's not a good enough investment. Bookings have dropped for these games but margins and profitability have also improved.

The pipeline of new games is strong and we hope to take what we have learned from Gummy Drop, and other games to deliver new profitable games. As I have said this morning, we are not chasing bookings and are making sure our UA dollars are going to generate a strong long-term return, particularly in free-to-play genres in which we do not have extensive historical data to analyze.

We also have a very keen eye on margins. Our portfolio is made up of highly profitable games like Gummy Drop, lower scale games where we are still analyzing and improving metrics before committing more UA dollars and an extensive pipeline of new games, several of which we are launching in 2017. New games bring a lot of potential upside unless we will continue to produce them.

We will keep a very close eye on UA investment as a percentage of revenue and are now likely to return to the high percentages you saw in the earlier quarters of 2016 unless there is a very compelling investment case to do so. In sum, we have to expect our bookings and therefore, associated revenues to decline modestly in 2017 as we are more conservative with our UA spend with respect to our current roster of games.

That said, our data suggests that UA on social casino may make sense to incrementally increase because the customer generally continue to remain in the game longer and at higher general levels of monetary spend. They don't generally start at the expend levels early one but they stay longer.

Other than that, real change in UA patterns would really be a function of new games being launched with clear positive metrics of performance behind them. We will work to achieve that but run our business based on what we have in our portfolio now and not what we hope to have. I think it's fair to say if you examine the recent history of Churchill Downs across our various businesses, we get smarter and perform better as we take the lessons we learned to heart. That is happening here.

A few final thoughts. As many of you saw, we sold about 60 acres of our property at Calder that we were no longer using because we have leased our Racing operations to a third party. This blocked 60 acres had the least economic or commercial potential. We were pleased to see it generate price per acre that we received. The transaction stands for larger point that we will monetize our assets in a manner that best serves our shareholders, including selling real estate formerly devoted to Racing operations.

Regarding our cash flow and use of cash, in 2016, we generated $227 million of cash flow from operations and we returned $58 million to our shareholders in the form of dividends and share repurchases. We are fortunate to have strong cash flow generating businesses that produce cash that can be used to fuel organic growth to pay dividends and make strategic investments in acquisitions, to pay down debt and to opportunistically buy back stock.

Finally, I hope as many as you as possible will join us on May 6 for the 2017 Kentucky Derby. It is the best day of year for us in every respect and we hope you can be a part of it.

Now I'd like to turn the call over to Marcia, our CFO, to provide some additional details on the quarter. After that, we will answer any questions. Thank you. Marcia?

Marcia Dall - *Churchill Downs Inc - CFO*

Thanks, Bill. As Mike discussed in his intro to the call, based on SEC guidance, we have made a change to our definition of adjusted EBITDA to exclude the change in deferred revenue related to Big Fish Games for this non-GAAP metric. A number of Big Fish's competitors also made this change in 2016 based on SEC guidance regarding non-GAAP metrics. As Mike mentioned, all of the numbers in our press release, 10-K and in my comments that follow will be based on this new definition.

I will provide some comments on the Company's results first and then I will provide some additional highlight for each of our segments. As Bill shared with you and as you can see from our press release, we delivered a strong performance in 2016. Our Company generated record net revenue of $1.3 billion for the year, up $96 million, or 8% compared to 2015, this increase was driven by three primary factors.

First, Big Fish revenue grew $73 million, primarily from casual and mid-core free-to-play growth compared to 2015. Second, our TwinSpires revenue increased $20 million as we continued to outpace industry growth as a result of our marketing efforts, especially around big event days, including the Derby, by taking advantage of the shifts in customer wagering habits. Last but certainly not least, we delivered a record-setting Kentucky Derby and Oaks week in the second quarter.

Total revenue for the fourth quarter was up $6 million, driven primarily from growth in TwinSpires and Big Fish Games revenue. We did have a slight decline in revenue from our Casino segment which primarily reflected competitive pressures at our Riverwalk Casino.

Adjusted EBITDA for the 2016 year was $334.5 million, reflecting a $32 million or 11% increase over 2015. Our Casino segment contributed $10.9 million of the increase, reflecting strong performance from our MVG and Saratoga equity investments. Big Fish contributed $10.6 million of the increase as a result of the growth in casual and mid-core free-to-play games during 2016.

Our Racing segment, driven by a strong Derby week performance at Churchill Downs, contributed $7.9 million of the increase. And TwinSpires contributed $6.6 million based on strong top line growth from a 23% increase in active players. We also did have a $3.8 million decline in adjusted EBITDA in our corporate segment primarily related to a fourth-quarter 2015 benefit related to a nonrecurring item.

Our adjusted EBITDA for the fourth quarter was up $2.9 million compared to the prior year, reflecting lower user acquisition spending at Big Fish Games and strong top line growth from TwinSpires. Our Company generated record net income of $108 million for the year, up $43 million compared to the prior year.

We also delivered record diluted net income per share of $6.42 per share, up from $3.71 per share in 2015. As I have discussed, we have strong operating performance and 2016 that was partially offset by higher interest expense associated with higher outstanding debt balances. We also have an increase in SG&A expenses and higher taxes.

In fourth quarter of 2016, we had the benefit of a nonrecurring item related to a game on sale of property. We sold 61 excess acres of land at our Calder facility in November and realized a $23.7 million book gain on the sale. We are utilizing a like-kind exchange program to defer $14 million of the gain for tax purposes by purchasing certain strategic properties that will help facilitate our long-term growth at Churchill Downs Racetrack. In 2015, we also had a $5.8 million benefit from a nonrecurring gain on sale related to our HRTV investment that impacted our net income.

Turning to cash flow, we will no longer be reporting free cash flow, as we had historically defined it. We utilize the cash flow metric that is defined as cash flow from operations less maintenance-related expenditures to evaluate our performance. We will continue to utilize this metric internally and will provide our investors the detail to calculate this metric that they desire.

We produced $227 million of cash flow from operations in 2016, which was down $38 million from the prior year. Our operating cash flows were higher as a result of growth in EBITDA, higher deferred revenues primarily related to the timing of advanced ticket sales for the 2017 Kentucky Derby and Oaks and from lower taxes as a result of deductions related to the Big Fish earn-out payments. These increases were more than offset by higher interest payments as a result of increased debt; $40 million of lower Big Fish deferred revenue ; and $46 million of other nonrecurring cash-related items primarily related to Big Fish earn-out payments and prior year tax refunds.

We spent $31 million on maintenance capital in 2016 which was relatively consistent with the amount we spent in 2015. We continue to maintain our discipline related to maintenance capital. We do expect our maintenance capital spending to pick up slightly in 2017 based on replacement of aging slot inventory and incremental IT infrastructure for Big Fish Games support.

As Bill mentioned, in 2016, we returned $58 million of cash flow to our shareholders in the form of dividends and share repurchases. We repurchased 217,013 shares of our stock for a total price of $28.4 million, as part of our stock repurchase program based on trade dates. We have $121.6 million of repurchase authority remaining under this program as of December 31, 2016.

Our net leverage remains low at 2.6 times adjusted EBITDA, giving us significant capacity to support organic growth, dividends, strategic investments and acquisitions and share repurchases over the coming years.

Now I will provide some additional highlights for each of our segments. Our Racing segment had a strong year, delivering $268 million of revenue and $80 million of adjusted EBITDA, up $6 million and $8 million, respectively, over the prior-year.

As we discussed in our second-quarter earnings call, we had a seventh consecutive record-setting Derby week in 2016. As Bill discussed, the team is focused on executing renovation and expansion projects that will improve the customer experience and provide earnings growth from this iconic event in the coming years.

Revenue for the Casino segment was relatively flat compared to 2015 and was down $1.5 million in the fourth quarter compared to the prior year. Strong performance at our Oxford and Calder properties reflected a combination of successful promotional activities, favorable weather conditions, and strong local economic conditions.

The strong performance at these properties was offset by continued weakness at our Louisiana and Mississippi properties from increased competition, periods of adverse weather conditions, weak local economic conditions, as well as the ongoing impact from the smoking ban in the Orleans Parish. Adjusted EBITDA for the Casino segment was up $10.9 million compared to 2015 and was slightly down in the fourth quarter compared to the prior year.

Our Saratoga and Miami Valley Gaming equity investments as well as our Oxford and Calder properties contributed to the year-over-year growth, offsetting the weakness in our Louisiana and Mississippi properties. In the fourth quarter, the growth in our equity investments and costs at our Louisiana and Mississippi properties were not enough to offset the top line impact from an increasingly competitive market and weak local economy in these two markets.

Regarding our disclosures, due to the successful growth of our equity investments, for accounting purposes, we are now required to report the aggregate of all of our equity investments in our 10-K footnotes, not just our Miami Valley Casino results. Our adjusted EBITDA for MVG was $5.3 million in the fourth quarter 2016, and $22.4 million for the total year 2016. Going forward, we will be providing the adjusted EBITDA for MVG as well as the aggregate adjusted EBITDA for all of our equity investments in our press release.

The TwinSpires segment revenue increased 10% in 2016, reflecting a 23% increase in unique players and registration. In an industry with relatively flat growth rate, the TwinSpires team was able to grow handle nearly 14%, reflecting their conservative efforts to retain existing players and activate new players that joined TwinSpires during big events, including Derby week.

TwinSpires handle of $1.1 billion represented a 10% of the total industry handle in 2016, up from 9% in 2015. The growth in TwinSpires segment revenue for the year translated into a 13.6% growth in adjusted EBITDA for the year.

Big Fish revenue was up $72.5 million in 2016 compared to the prior year, primarily from an $87 million of revenue growth related to free-to-play casual and mid-core segment bookings. The social casino segment revenue decreased approximately $11 million and revenue from premium games decreased $4 million, both as a result of lower bookings in 2016 compared to 2015. Big Fish revenue was up $3 million in the fourth quarter compared to the prior year quarter reflecting free-to-play casual and mid-core revenue growth recognized from bookings in prior quarters.

Adjusted EBITDA for Big Fish was up $10.6 million, or 15% in 2016 compared to 2015, reflecting the benefit of the margins from the top line revenue growth. In the fourth quarter, bookings for Big Fish were down $10 million, or 7.9% compared to a year ago, reflecting a $4 million, or 7.9% decline in a social casino bookings, a $1 million -- a 1.7% decline in free-to-play casual and mid-core bookings and a $5 million, or 20% decline in premium bookings. It is important to note that the 7.9% decline in bookings compared to a 30% decline in user acquisition spending for the same period, reflecting our decision to reduce the UA spending on some of our free-to-play and mid-core games, given their long-term performance is not currently meeting our expectations.

On a sequential basis from third quarter to fourth quarter 2016, bookings for Big Fish were down 5.8% overall. Our social casino bookings were relatively flat sequentially. We have begun to gradually increase our UA spending on our Big Fish Casino and Jackpot City Slots games, based on long-term performance of these games.

Our free-to-play casual and mid-core bookings were down 10%, reflecting the impact of the significant pullback in our user acquisition spending within the segment of Big Fish, given the maturing of our Gummy Drop game and the lower-than-expected long-term performance of some of the games that we viewed as investable early in 2016. On a sequential basis, our user acquisition spend decreased 35% for this segment.

Lastly, our premium bookings were down 8% on a sequential basis, reflecting the continued shift from PC to mobile games. As a reminder, we spend a very nominal level of UA dollars on this segment.

Regarding financial expectations for Big Fish in 2017, we thought it would be helpful to share some thoughts with our shareholders. First, we expect our bookings and therefore associated revenue to decline modestly in 2017, as we refocus spend in the social casino space, which we believe will support long-term possible growth for Big Fish.

Second, it is important to remember bookings and revenue growth in the social casino space are slower but are more predictable and last significantly longer. Third, during 2016, we reduced our UA spend on games in the casual and mid-core and free-to-play space and we expect the fourth quarter lower run rate to continue into 2017 until we have data proving we have a new investable game.

Lastly, as Bill discussed, the team continues to work to develop new games that will be a long-term catalyst for growth.

With that, I will turn the call back over to Bill so that he can open the call for questions. Bill?

Bill Carstanjen - *Churchill Downs Inc - CEO*

Thanks, Marcia. I think we are ready now for questions. Fire away, everybody.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

David Katz, Telsey Advisory Group.

David Katz - *Telsey Advisory Group - Analyst*

I have several questions, but first with respect to the M&A landscape, we've seen you over the past year and get involved in some new casino or racing properties. What is your appetite and what are you seeing out there for any of those kind of opportunities or should we look at the portfolio as stable at this point?

Bill Carstanjen - *Churchill Downs Inc - CEO*

Hi, David. It is Bill. So we're limited on how we can answer those kind of questions publicly. We don't comment generally on specific M&A activity. So I'm going to comment generally. We've always been very disciplined and careful. We never want to do deals to do deals. We do deals that makes sense to meet our hurdles and our sort of philosophy on where it makes sense to invest the shareholders' capital.

So generally, I don't see a lot of changes in the M&A environment. There are opportunities here and there that are out there and we never try to force it. We just wait for them to materialize if they're going to materialize. So I don't think there's been any systemic change in the market that causes me pause one way or the other. I think it's consistent with how it's been in the last few years.

David Katz - *Telsey Advisory Group - Analyst*

Okay. I have happened upon some news here and there about gaming machines in Kentucky and whether that's instant racing machines or any efforts to actually put slots or tracks and in the past, those full casino or slots or tracks efforts have not really gone anywhere. What's your view on that landscape and as well, with these instant racing machines and whether that's something you would get involved in?

Bill Mudd - *Churchill Downs Inc - President & COO*

Hi David, this is Bill Mudd. I'll give you what I know, what I call, a high level detailed overview. So IRMs, or Instant Racing Machines, and what we call them in Kentucky is Historical Racing Machines. So you'll hear IRMs and HRMs kind of used interchangeably. Started operating here about five years ago at a location in the southern part of the state, just north of Nashville.

There are now three locations that have historical racing machines installed with varying degrees of success. There have been legal challenges about the ability to operate those in the state but that's really down to one issue, which is still being reviewed by the court which really boils down to, are they pari-mutuel or not. We do believe that they will survive that legal challenge.

So we've been watching the HRM machines for quite some time, they are not competitive with Class III gaming as they exist today. There are two manufacturers out there, neither of which have had a basis or history in machine development or math modeling and games that people like to play and have fun with. So as you know in Louisville, it works okay if you're insulated from competition.

But in Louisville, we have a competitor across the bridge in southern Indiana, the Horseshoe, which is actually a very formidable competitor that knows what they're doing. So we've been following it very closely. At the same time, we've been watching what the legislature is going to do. Legislature is very unlikely to pass gaming anytime in the near future.

They've been very clear about this and that makes our decision about how to proceed a little bit easier from that perspective. I would say that, that kind of leaves us with two choices. One is we can do nothing. We can continue to push for casino gaming which we know is not going to happen any time in the near future or we can build a better HRM machine that can better compete with Class III Gaming over in Southern Indiana. So really, that's where our whole focus has been on the last few months is how do we make a better product and beyond that, I can't really say much more.

David Katz - *Telsey Advisory Group - Analyst*

Right. So in other words, you're engaged in developing these machine?

Bill Mudd - *Churchill Downs Inc - President & COO*

We are working towards figuring out if we can make a better product and I can't say that we are there yet or not, but yes. That is the goal.

David Katz - *Telsey Advisory Group - Analyst*

All right. So it isn't the sort of primary larger game machine manufacturers that are offering this? It is one or two one-off entities that are supplying what is in the market today?

Bill Mudd - *Churchill Downs Inc - President & COO*

That is correct on what is in the market today.

David Katz - *Telsey Advisory Group - Analyst*

Just to be clear on understanding what the product is, it is a pari-mutuel racing-based algorithm that is driving a sort of slot like experience?

Bill Mudd - *Churchill Downs Inc - President & COO*

Correct. In a Class III game, you have a random number generator that determines the outcome of the game. In historical racing machines, you are using races that have actually been ran n the past to determine the outcome of the game. (multiple speakers) And you have the ability to handicap that race from the game itself as well.

David Katz - *Telsey Advisory Group - Analyst*

I see. The games that are in the field at other locations now, are they currently being taxed by the state of Kentucky?

Bill Mudd - *Churchill Downs Inc - President & COO*

Yes. They are taxed at 1.5% of handle. So it's based on coin-in and not revenue.

David Katz - *Telsey Advisory Group - Analyst*

Right. So my question is, really, and this was all stuff that was discussed in the articles that I read, if the state is capturing tax revenue from them, is that not blessing them as a legal machine, right? I mean they certainly, right -- or could they be capturing tax revenue from machines which are not firmly legal?

Bill Mudd - *Churchill Downs Inc - President & COO*

Yes, they are legal in the state. We actually went all the way to Supreme Court and said, is this -- does the Horse Racing Commission have the authority to regulate this activity? Supreme Court said yes, it does not contravene statutes that are on the books. So the only challenge right now, of course, is whether or not they are pari-mutuel machines or not which the Supreme Court didn't -- they didn't digest it and get into it., They didn't make a confirmation on it; they didn't even look at it.

So they just said, Supreme Court, you guys need to go back and look at this piece of it; the rest of it we're okay with. At the same time, the legislature did pass an actual bill that taxes this activity. But they did not necessarily pass the bill saying you have do it, because it's not required. And by the way, I'm sorry, that's Kentucky Supreme Court and not the US Supreme Court.

David Katz - *Telsey Advisory Group - Analyst*

Right. Right. Okay. I have some more but I will give someone else a chance. Thanks very much.

Operator

Dan Politzer, JPMorgan.

Dan Politzer - *JPMorgan - Analyst*

Hello guys. Thank you for taking my question. Could you give just a broad update on your capital allocation strategy given the balance sheet? I know you guys repurchased some shares in the quarter. So, I mean, how do you think about broadly investing in your own stock versus kind of saving the dry powder for acquisitions?

Marcia Dall - *Churchill Downs Inc - CFO*

Dan, I'll start, and Bill can jump in here. As Bill and I both mentioned in our scripts today, with a 2.6 times leverage, we have a lot of capacity to take advantage of opportunities that might come up related to strategic acquisitions or investments. As Bill was just talking about, potential development and investment around instant racing or to take advantage of investments around future expansions related to the Kentucky Derby.

We have a lot of opportunity to make sanctions. As I mentioned in my discussion around the properties that we are acquiring around Churchill Downs race track and the expansion opportunities there that will help us grow that iconic event over the long term. Having a 2.6 times leverage, that gives us a lot of opportunity.

And along with that, we've had a very consistent dividend strategy over time and then opportunistically, we are in the market buying back shares when we find it appropriate to do that versus other opportunities that are in the hopper at that point in time.

Bill Carstanjen - *Churchill Downs Inc - CEO*

Yes. Maybe if I could just add to that, Marcia. If you look at the growth pattern of he Company over a number of years, we've grown pretty consistently and over a long period of time and the Company's changed a lot and gotten a lot bigger. And we've done that without ultimately ever compromising our balance sheet.

But it is the case that when there are bigger opportunities there's a really compelling project, we will use our balance sheet in order to pay for that project in order to put us in a position to grow our Company. So we've proven in the past we're willing to do that, and that will continue to be the case. But we also want to always be disciplined about our balance sheets.

So that we're best positioned long term to take advantage of new opportunities and to manage through tougher times if we run into them. So I think we are trying to be clear; I agree this is always a puzzle on where to devote your capital, what's the best utilization of your capital and sometimes opportunities and things that do come in bunches.

But it's something that not only just the management team but with the Board we talk a lot about; increasingly, we talk about it. So philosophically, we don't want to leverage up unless there's really good reasons to leverage up. We want to keep our powder dry, but we look at everything, organic growth, M&A growth, our returns -- capital to our shareholders. We look at the entire puzzle and try to piece it together based on the environment that we're in.

Dan Politzer - *JPMorgan - Analyst*

Got it. Thanks. Just turning to Big Fish, I mean you kind of mentioned bookings, you said it would be down in 2017. Certainly in the quarter, you pulled back a lot on the UA spend on bottom-line. But I guess that -- how should we be thinking about EBITDA or margin for 2017 relative to the deceleration in bookings?

Bill Carstanjen - *Churchill Downs Inc - CEO*

We try to -- when you try and give guidance without -- or give a general health to understand where our heads at without giving specific guidance because as a Company, we haven't generally been doing that. But here's the thing. We care a lot about margins going forward. We are an adjusted EBITDA and EBITDA Company, so we care about managing and building our business to the bottom line.

And the larger point I was trying to make in some of my comments and they were echoed by Marcia, in some cases she was more specific than I was. The larger point I was trying to make is, yes, there is generally and definitely a correlation long term to long-term profitability time to bookings, but with all the noise that's gone along with Big Fish over the last couple of years, that's not really necessarily the case right now. You don't want to manage the Company to bookings. You want to manage it to profitable growth.

So when you focus on EBITDA, when you focus on margins, long term that's our mindset. If there is a reason to return to rapid growth of bookings, it will be because we have a game that has demonstrated metrics to support it, but otherwise, we have a very sort of keen eye on managing to the bottom line and just because there are changes in our booking that doesn't mean that there are corresponding or consistent changes to our EBITDA. And I don't really want to be and don't feel like I should be more specific than that at this point.

Dan Politzer - *JPMorgan - Analyst*

All right. That's fair. Do you -- I mean as far as the releasing of the new games, is there any type of a cadence, I mean those are going to be more back-end of the year, evenly weighted or when do you think you're going to release those there?

Bill Carstanjen - *Churchill Downs Inc - CEO*

You're -- that's a really good question and it's one I've had over the time that we've been involved with social games. You can have a cadence but the bottom line is a big part of the process is the soft release portion of the process where we release the games into other English-speaking markets and really, to refine them and to get the economies right before we push hard inside the North American market where you don't necessarily get a chance to fix your mistakes.

So the soft launch process is an interim process that can take long; it's little bit harder to predict. So we definitely have not generally commented about when we're going to sort of put out a worldwide releases of games because the soft launch portion of the process isn't completely -- it's possible to reduce that to a specific process in a specific timeframe.

I would say generally, our more promising games are a little bit back-loaded this year as opposed to front-loaded this year, but all of them existing in the system and being worked on. They will happen; it's just as we work through the soft launch portion of the process in the economy, we're not sure how long some of that will take for each game. But these are just figured out these are games that exist that have been worked on for quite a while.

Dan Politzer - *JPMorgan - Analyst*

All right. Thanks. I appreciate the help.

Operator

Adam Trivison, Gabelli & Company.

Adam Trivison - *Gabelli & Co. - Analyst*

First regarding Big Fish, can you provide some color on the dynamics underlying Big Fish user and bookings per user figures within the Casino segment? I guess anything you could call out in terms of retention trends or maybe the change in a UA focus more toward the Casino segment and also increasingly toward some of the newer casino platforms?

Marcia Dall - *Churchill Downs Inc - CFO*

Adam, this is Marcia. I will take that question. When you look at -- and I do want to make a correction related to our press release. Our average paying users for social casino for the total year were actually up 6% and the average bookings for paying user were down 11%.

We had both numbers incorrect. We had them correct for the fourth quarter, but incorrect for the total year. What is happening there as you remember, we launched Jackpot City Slots in July timeframe of 2016. So you saw the increase in the number of average paying users.

But as we launched Jackpot City Slots, the average bookings per paying user for that game are lower than they are for our existing social casino game.

So that is pulling down the average bookings per paying user for our total social casino segment slightly for the year in 2016. We would anticipate that, that trend will continue but hopefully not to that level as we go forward.

Adam Trivison - *Gabelli & Co. - Analyst*

Okay. Is the lower bookings per user with Jackpot City, is that kind of intrinsic to the game or is that something you see improve as the game becomes more seasoned?

Bill Carstanjen - *Churchill Downs Inc - CEO*

I think time will tell, but here is our operating assumption having a pretty deep experience based in the social casino genre through our flagship, Big Fish Casino. You build good players over time. The day you acquire them in terms of your best players, the day you acquire them is not when they're at their best.

They build into the game over the time and their economic activity grows over time and they become -- the term you sometimes you hear, they become whales. Whales don't start out as whales. They are grown into whales.

When you launch a new product even within the social casino space like Jackpot City Slots, you have to expect that your only customers in the game are not going to be performing at the same economic level as they are later on in the game when they are more comfortable with it and it has become more of a pattern or part of their game playing.

And they spend more. So you wouldn't expect your average revenues per user in a new product like Jackpot City to be approaching what you see in a more mature product like Big Fish Casino.

Adam Trivison - *Gabelli & Co. - Analyst*

Okay. That is helpful. I guess the follow-up. Just trying to get a sense for how much UA spend is necessary to, I guess, stabilize casino in the Match Three games. would you say -- I guess you said at least for free-to-play segment of the fourth quarter bookings were kind of at a run rate, you expect going forward. Would you say UA spend, how would you relate fourth quarter UA spend to maybe how you plan to spend in the future?

Bill Carstanjen - *Churchill Downs Inc - CEO*

Excuse me -- it goes game by game, I would say. I try to highlight in my comments that I think we underspent on casino, and I think the metrics say we should be spending more. Now, that is what our metrics say. Once we start doing it, sometimes it doesn't work out that way.

But based on the data and based on what we see, we think we underspent in 2016, so we should -- consequently, we should and are now exploring more spend. That doesn't mean that, that will continue and I am not promising that, that's what will be happening.

I don't want to make long-term predictions because it will depend on the data but we think the data said we should have been spending more in the casino space because that is a better investment. That is a good rate of return for our Company.

When it comes to Big Fish, one of the themes I covered in my comments was that product is maturing so our ability to economic -- efficiently reach new customers who become good customers of the Gummy Drop product, that is declining a bit right now because Gummy Drop has been out there.

It is a known commodity. It is understood game. A lot of potential customers out there have seen or heard about it so it gets a little more expensive to reach them so we dialed back UA spend on Gummy Drop . That is a responsible thing to do.

If we come up with new features and functionality that reverse the trends, then that is fine. But it doesn't mean that the customers in the game are leaving in mass. It just means the ability to economically and efficiently acquire new customers is changing. It is getting to be a tougher equation to balance. (multiple speakers) We don't spend as much as we had.

Adam Trivison - *Gabelli & Co. - Analyst*

Okay. That is helpful. Thank you. Appreciate it.

Operator

(Operator Instructions)

I am showing no further questions. I would now like to turn the call back over to CEO, Bill Carstanjen, for any further remarks.

Bill Carstanjen - *Churchill Downs Inc - CEO*

Thank you. I appreciate everyone's time today on the call. I appreciate your interest in our Company. I appreciate your investment in the Company. We try to do the right thing with your capital, and we will talk to you next time. Again, thank you very much.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program and you may all disconnect. Everyone, have a great day.