

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

FORM 10-Q

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

For the quarterly period ended September 30, 2006

OR

**() TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934**

For the transition period from _____ to _____

Commission file number 0-1469



(Exact name of registrant as specified in its charter)

Kentucky
(State or other jurisdiction of incorporation or organization)

61-0156015
(IRS Employer Identification No.)

700 Central Avenue, Louisville, Kentucky 40208
(Address of principal executive offices) (zip code)

(502) 636-4400
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one): Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

The number of shares outstanding of registrant's common stock at November 2, 2006 was 13,373,387 shares.

CHURCHILL DOWNS INCORPORATED
INDEX TO QUARTERLY REPORT ON FORM 10-Q
For the Quarter Ended September 30, 2006

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PART I. FINANCIAL INFORMATION**ITEM 1. FINANCIAL STATEMENTS**

CHURCHILL DOWNS INCORPORATED
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited) (in thousands)

| | <u>September 30, 2006</u> | <u>December 31, 2005</u> |
|---|---------------------------|--------------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 24,863 | \$ 22,347 |
| Restricted cash | 16,721 | 4,946 |
| Accounts receivable, net of allowance for doubtful accounts of \$679 at September 30, 2006 and \$786 at December 31, 2005 | 38,268 | 42,823 |
| Deferred income taxes | 3,907 | 3,949 |
| Income taxes receivable | 2,079 | 697 |
| Other current assets | 12,046 | 6,942 |
| Assets held for sale | - | 3,938 |
| Total current assets | 97,884 | 85,642 |
| Other assets | 13,120 | 13,020 |
| Plant and equipment, net | 347,544 | 342,845 |
| Goodwill | 53,528 | 53,528 |
| Other intangible assets, net | 17,594 | 18,130 |
| Total assets | \$ 529,670 | \$ 513,165 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Current Liabilities: | | |
| Accounts payable | \$ 23,843 | \$ 27,844 |
| Purses payable | 26,727 | 14,195 |
| Accrued expenses | 45,356 | 41,844 |
| Dividends payable | - | 6,520 |
| Deferred revenue | 14,725 | 26,216 |
| Liabilities associated with assets held for sale | - | 790 |
| Total current liabilities | 110,651 | 117,409 |
| Long-term debt | 19,154 | 33,793 |
| Other liabilities | 23,215 | 21,448 |
| Deferred revenue | 18,443 | 18,614 |
| Deferred income taxes | 5,119 | 5,670 |
| Total liabilities | 176,582 | 196,934 |
| Commitments and contingencies | | |
| Shareholders' equity: | | |
| Preferred stock, no par value; 250 shares authorized; no shares issued | - | - |
| Common stock, no par value; 50,000 shares authorized; issued 13,285 shares September 30, 2006 and 13,132 shares December 31, 2005 | 123,260 | 121,270 |
| Retained earnings | 229,828 | 198,001 |
| Unearned stock compensation | - | (3,040) |
| Total shareholders' equity | 353,088 | 316,231 |
| Total liabilities and shareholders' equity | \$ 529,670 | \$ 513,165 |

The accompanying notes are an integral part of the Condensed Consolidated Financial Statements.

CHURCHILL DOWNS INCORPORATED
CONDENSED CONSOLIDATED STATEMENTS OF NET EARNINGS
AND COMPREHENSIVE EARNINGS

for the three and nine months ended September 30, 2006 and 2005

(Unaudited) (in thousands, except per share data)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|------------|------------------------------------|------------|
| | 2006 | 2005 | 2006 | 2005 |
| Net revenues | \$ 106,350 | \$ 101,661 | \$ 324,684 | \$ 315,129 |
| Operating expenses | 91,742 | 88,177 | 256,010 | 252,452 |
| Gross profit | 14,608 | 13,484 | 68,674 | 62,677 |
| Selling, general and administrative expenses | 11,452 | 10,244 | 35,018 | 34,918 |
| Insurance recoveries, net of losses | (1,832) | (1,363) | (12,954) | (1,363) |
| Operating income | 4,988 | 4,603 | 46,610 | 29,122 |
| Other income (expense): | | | | |
| Interest income | 272 | 135 | 634 | 296 |
| Interest expense | (526) | (265) | (1,708) | (950) |
| Unrealized gain on derivative instruments | 204 | 204 | 612 | 614 |
| Miscellaneous, net | (92) | 715 | 510 | 1,308 |
| | (142) | 789 | 48 | 1,268 |
| Earnings from continuing operations before provision for income taxes | 4,846 | 5,392 | 46,658 | 30,390 |
| Provision for income taxes | (2,128) | (2,233) | (19,772) | (13,240) |
| Net earnings from continuing operations | 2,718 | 3,159 | 26,886 | 17,150 |
| Discontinued operations, net of income taxes: | | | | |
| Earnings (loss) from operations | 1,832 | (1,441) | 744 | (5,143) |
| Gain on sale of assets | 4,197 | 69,917 | 4,197 | 69,917 |
| Net earnings | 8,747 | 71,635 | 31,827 | 81,924 |
| Other comprehensive (loss) income, net of income taxes: | | | | |
| Change in fair value of cash flow hedges | - | (215) | - | 180 |
| Comprehensive earnings | \$ 8,747 | \$ 71,420 | \$ 31,827 | \$ 82,104 |
| Net earnings per common share data: | | | | |
| Basic | | | | |
| Net earnings from continuing operations | \$ 0.20 | \$ 0.24 | \$ 1.98 | \$ 1.28 |
| Discontinued operations | 0.44 | 5.12 | 0.37 | 4.86 |
| Net earnings | \$ 0.64 | \$ 5.36 | \$ 2.35 | \$ 6.14 |
| Diluted | | | | |
| Net earnings from continuing operations | \$ 0.20 | \$ 0.23 | \$ 1.97 | \$ 1.27 |
| Discontinued operations | 0.44 | 5.07 | 0.36 | 4.80 |
| Net earnings | \$ 0.64 | \$ 5.30 | \$ 2.33 | \$ 6.07 |
| Weighted average shares outstanding: | | | | |
| Basic | 13,149 | 12,913 | 13,116 | 12,893 |
| Diluted | 13,656 | 13,511 | 13,635 | 13,507 |

The accompanying notes are an integral part of the Condensed Consolidated Financial Statements.

CHURCHILL DOWNS INCORPORATED
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
for the nine months ended September 30,
(Unaudited) (in thousands)

| | <u>2006</u> | <u>2005</u> |
|--|------------------|------------------|
| Cash flows from operating activities: | | |
| Net earnings | \$ 31,827 | \$ 81,924 |
| Adjustments to reconcile net earnings to net cash provided by operating activities: | | |
| Depreciation and amortization | 15,670 | 18,883 |
| Unrealized gain on derivative instruments | (612) | (614) |
| Loss (gain) on sale of business | 3,666 | (112,370) |
| Other | 1,301 | 870 |
| Increase (decrease) in cash resulting from changes in operating assets and liabilities: | | |
| Restricted cash | (11,775) | (5,477) |
| Accounts receivable | (4,673) | 1,852 |
| Other current assets | (5,222) | (2,674) |
| Income taxes | (1,382) | 40,740 |
| Accounts payable | 242 | (9,522) |
| Purses payable | 12,287 | 13,767 |
| Accrued expenses and other liabilities | 5,950 | 2,021 |
| Deferred revenue | (2,434) | (2,944) |
| Other assets and liabilities | 1,859 | 6,044 |
| Net cash provided by operating activities | <u>46,704</u> | <u>32,500</u> |
| Cash flows from investing activities: | | |
| Additions to plant and equipment | (21,746) | (40,594) |
| Proceeds on sale of fixed assets | 15 | 3 |
| Proceeds from sale of business, net of cash sold | (347) | 248,323 |
| Net cash (used in) provided by investing activities | <u>(22,078)</u> | <u>207,732</u> |
| Cash flows from financing activities: | | |
| Borrowings on bank line of credit | 217,480 | 445,202 |
| Repayments of bank line of credit | (233,082) | (570,202) |
| Repayments of Senior Notes | - | (100,000) |
| Change in book overdraft | (4,161) | (901) |
| Payment of dividends | (6,520) | (6,430) |
| Windfall tax benefit from share-based compensation | 483 | - |
| Common stock issued | 3,549 | 2,612 |
| Net cash used in financing activities | <u>(22,251)</u> | <u>(229,719)</u> |
| Net increase in cash and cash equivalents | 2,375 | 10,513 |
| Cash and cash equivalents, beginning of period | 22,488 | 27,712 |
| Cash and cash equivalents, end of period | 24,863 | 38,225 |
| Cash and cash equivalents included in assets held for sale | - | (345) |
| Cash and cash equivalents in continuing operations | <u>\$ 24,863</u> | <u>\$ 37,880</u> |
| Cash paid during the period for: | | |
| Interest | \$ 622 | \$ 10,082 |
| Income taxes | \$ 13,244 | \$ 12,678 |
| Schedule of non-cash activities: | | |
| Plant and equipment additions included in accounts payable/accrued expenses | \$ 1,483 | \$ 2,621 |
| Issuance of common stock in connection with restricted stock plan | \$ 216 | \$ 277 |

The accompanying notes are an integral part of the Condensed Consolidated Financial Statements.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Basis of Presentation

The accompanying Condensed Consolidated Financial Statements are presented in accordance with the requirements of Form 10-Q and consequently do not include all of the disclosures required by accounting principles generally accepted in the United States of America or those normally made in Churchill Downs Incorporated's (the "Company") Annual Report on Form 10-K. The year-end Condensed Consolidated Balance Sheet data was derived from audited financial statements but does not include all disclosures required by accounting principles generally accepted in the United States of America. Accordingly, the reader of this Quarterly Report on Form 10-Q should refer to the Company's Annual Report on Form 10-K for the year ended December 31, 2005 for further information. The accompanying Condensed Consolidated Financial Statements have been prepared in accordance with the Company's customary accounting practices and have not been audited.

Certain prior period financial statement amounts have been reclassified to conform to the current period presentation. In the opinion of management, all adjustments considered necessary for a fair statement of this information have been made and all such adjustments are of a normal recurring nature.

The Company's revenues and earnings are significantly influenced by its racing calendar. Therefore, revenues and operating results for any interim quarter are generally not indicative of the revenues and operating results for the year and may not be comparable with results for the corresponding period of the previous year. The Company historically has had very few live racing days during the first quarter, with a majority of its live racing occurring in the second, third and fourth quarters, including the running of the Kentucky Derby and the Kentucky Oaks during the second quarter, the quarter during which the Company typically generates the majority of its annual operating income.

Long-Lived Assets

In the event that facts and circumstances indicate that the carrying amount of tangible or intangible long-lived assets or groups of assets may be impaired, an evaluation of recoverability is performed. If an evaluation was required, the estimated future undiscounted cash flows associated with the assets would be compared to the assets' carrying amount to determine if an impairment loss should be recorded. In addition, goodwill is otherwise tested for impairment on an annual basis in accordance with Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets." In assessing whether goodwill is impaired, the fair market value of the related reporting unit is compared to its carrying amount, including goodwill. If the carrying amount of the reporting unit exceeds its fair market value, the second step of the goodwill impairment test is performed to measure the amount of impairment loss, if any. The second step of the goodwill impairment test consists of comparing the implied fair value of reporting unit goodwill with the carrying amount of that goodwill. If the carrying amount of reporting unit goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized equal to such excess. The implied fair value of goodwill is determined in the same manner as the amount of goodwill recognized in a business combination is determined. The Company completed the required impairment tests of goodwill and indefinite-lived intangible assets as of March 31, 2006, and no adjustment to the carrying value of goodwill was required.

Revenue Recognition

The Company's pari-mutuel revenues include commissions on pari-mutuel wagering at its racetracks and off-track betting facilities ("OTBs") (net of state and local pari-mutuel taxes), plus simulcast host fees from other wagering sites and source market fees generated from contracts with in-home wagering providers. In addition to the commissions and fees earned on pari-mutuel wagering, the Company earns pari-mutuel related streams of revenues from sources that are not directly related to wagering. These other revenues are primarily derived from statutory racing regulations in some of the states where the facilities are located and can fluctuate materially year-to-year. Non-pari-mutuel revenues are primarily generated from admissions, sponsorships, licensing rights and broadcast fees, concessions, video poker, lease income and other sources and are recognized when the related service is performed. Non-pari-mutuel revenues also include the Indiana riverboat admissions subsidy, which is recognized ratably over the Company's fiscal year.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Pari-mutuel revenues are recognized upon occurrence of the live race that is presented for wagering and after that live race is made official by the respective state's racing regulatory body. Additional non-wagering revenues such as admissions, programs and concession revenues are recognized as delivery of the product or services has occurred.

Greater than 70% of the Company's annual revenues are generated by pari-mutuel wagering on live and simulcast racing content and in-home wagering. Live racing handle includes patron wagers made on live races at the Company's racetracks and also wagers made on imported simulcast signals at the Company's racetracks during live meets. Import simulcasting handle includes wagers on imported signals at the Company's racetracks when the respective racetracks are not conducting live race meets and at the Company's OTBs throughout the year. Export handle includes all patron wagers made on live racing signals sent to other tracks, OTBs and in-home wagering. In-home wagering, or advance deposit wagering, consists of patron wagers through a pre-funded account.

The Company retains as revenue a pre-determined percentage or commission on the total amount wagered on live and import simulcasting sources, and the balance is distributed to the winning patrons. The gross percentages retained on live racing and import simulcasting at the Company's various locations range from approximately 16% to 21%. In general, the fees earned from export simulcasting are contractually determined and average approximately 3.5%. All commissions and fees earned from pari-mutuel wagering are shared with horsemen through payment of purses based on local contracts and statutes and average approximately 50%.

Purse Expense

The Company recognizes purse expense from the statutorily or contractually required percentage of revenue that is required to be paid out in the form of purses to the winning owners of horses in races run at the Company's racetracks in the period in which wagering occurs. The Company incurs a liability for all unpaid purses to be paid out. The Company may pay out purses in excess of statutorily or contractually required amounts resulting in purse overpayments, which are expensed as incurred. Recoveries of purse overpayments are recognized in the period they are realized.

Share-Based Compensation

In December 2004, the Financial Accounting Standards Board issued SFAS No. 123(R), "Share-Based Payment" ("SFAS No. 123(R)"), which requires companies to measure compensation costs for all share-based payments (including employee stock options) at fair value for interim or annual periods beginning after June 15, 2005. In April 2005, the U.S. Securities and Exchange Commission issued a rule allowing public companies to delay the adoption of SFAS No. 123(R) to annual periods beginning after June 15, 2005. As a result, the Company adopted SFAS No. 123(R) using the modified-prospective transition method, beginning on January 1, 2006, and therefore began to expense the fair value of all outstanding options related to an employee stock purchase plan over their remaining vesting periods to the extent the options were not fully vested as of the adoption date and will begin to expense the fair value of all options granted subsequent to December 31, 2005 over their requisite service periods. During the three and nine months ended September 30, 2006, the Company recorded \$13 thousand and \$69 thousand, respectively, net of a related income tax benefit of \$8 thousand and \$48 thousand, respectively, of additional share-based compensation expense as a result of adopting SFAS No. 123(R). Previous periods have not been restated. See Note 5 for further details.

2. Discontinued Operations

Sale of Stock of Racing Corporation of America ("RCA")

On September 28, 2006, the Company completed the sale of all issued and outstanding common shares of stock (the "Stock") of RCA, the parent company of Ellis Park Race Course ("Ellis Park"), to EP Acquisition, LLC (the "Purchaser") pursuant to the Stock Purchase Agreement (the "Agreement") dated July 15, 2006. In conjunction with the sale of the Stock, the Company recognized a tax benefit of \$7.9 million, which is included in discontinued operations, during the three and nine months ended September 30, 2006.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Financial Information

In accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," the results of operations of Hollywood Park Racetrack, sold on September 23, 2005, and Ellis Park, for all periods presented, and the gains on the sales have been classified as discontinued operations, net of income taxes, in the Condensed Consolidated Statement of Net Earnings and Comprehensive Earnings. Set forth below is a summary of the results of discontinued operations for the three and nine months ended September 30, 2006 and 2005 (in thousands):

| | Three Months Ended | | Nine Months Ended | |
|---|---------------------------|------------------|--------------------------|------------------|
| | September 30, | | September 30, | |
| | 2006 | 2005 | 2006 | 2005 |
| Net revenues | \$ 9,234 | \$ 26,680 | \$ 10,953 | \$ 82,105 |
| Operating expenses | 6,407 | 25,230 | 9,947 | 75,723 |
| Gross profit | 2,827 | 1,450 | 1,006 | 6,382 |
| Selling, general and administrative expenses | 753 | 151 | 1,152 | 3,858 |
| Insurance recoveries, net of losses | (1,293) | - | (1,367) | - |
| Operating income | 3,367 | 1,299 | 1,221 | 2,524 |
| Other income (expense): | | | | |
| Interest income | - | 6 | - | 20 |
| Interest expense | - | (3,173) | - | (8,806) |
| Miscellaneous, net | (15) | 6 | 48 | 80 |
| Other income (expense) | (15) | (3,161) | 48 | (8,706) |
| Earnings (loss) before income taxes | 3,352 | (1,862) | 1,269 | (6,182) |
| (Provision) benefit for income taxes | (1,520) | 421 | (525) | 1,039 |
| Earnings (loss) from operations | 1,832 | (1,441) | 744 | (5,143) |
| Gain on sale of business, net of income taxes | 4,197 | 69,917 | 4,197 | 69,917 |
| Net earnings | <u>\$ 6,029</u> | <u>\$ 68,476</u> | <u>\$ 4,941</u> | <u>\$ 64,774</u> |

Set forth below is a summary of the net assets held for sale, which relate to Ellis Park, as of December 31, 2005 (in thousands):

| December 31, 2005 | |
|--|-----------------|
| Current assets: | |
| Cash and cash equivalents | \$ 141 |
| Other current assets | 112 |
| Plant and equipment, net | 3,685 |
| Assets held for sale | 3,938 |
| Current liabilities: | |
| Accounts payable | 113 |
| Purses payable | 369 |
| Accrued expenses | 128 |
| Deferred revenue | 3 |
| Other liabilities | 177 |
| Liabilities associated with assets held for sale | 790 |
| Net assets held for sale | <u>\$ 3,148</u> |

Tornado Damage

On November 6, 2005, a tornado caused significant damage to portions of southwestern Indiana and northwestern Kentucky, including Henderson, Kentucky, the location of Ellis Park Race Course and its on-site simulcast facility. Ellis Park sustained damage to its stable area, as well as several other buildings at the racetrack. Under existing insurance policies, the Company is required to pay a \$500 thousand deductible related to any recoveries for damages. As of September 30, 2006, the Company has received \$8.1 million in insurance recoveries.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

3. Natural Disasters

Hurricane Katrina

On August 29, 2005, Hurricane Katrina caused significant damage to the metropolitan New Orleans, Louisiana area. A significant portion of the assets of the Company's Louisiana Operations suffered damages from Hurricane Katrina. The Company carries property and casualty insurance, as well as business interruption insurance. Under existing policies, the Company is required to pay a \$500 thousand deductible related to any recoveries for damages. The Company is currently working with its insurance carriers to determine to what extent insurance proceeds may exceed any losses. The Company has not yet determined the ultimate impact that Hurricane Katrina will have on its results of operations. As of September 30, 2006, the Company has received \$18.0 million in insurance recoveries.

Hurricane Wilma

On October 24, 2005, Hurricane Wilma caused significant damage to Miami, as well as other parts of South Florida. A significant portion of the assets of Calder Race Course suffered damages from Hurricane Wilma. The Company carries property and casualty insurance as well as business interruption insurance. Under existing policies, the Company is required to pay a deductible equal to 2% of the total insured value on an insurable unit basis related to any recoveries for damages. The Company is currently working with its insurance carriers to determine to what extent insurance proceeds may exceed any losses. As of September 30, 2006, the Company has received \$4.0 million in insurance recoveries.

Financial Information

The casualty losses and related insurance recoveries have been included as components of operating income in the Company's Condensed Consolidated Statements of Net Earnings and Comprehensive Earnings. Set forth below is a summary of the impact of the natural disasters on the results of operations of the Company for the three and nine months ended September 30, 2006 (in thousands):

Three Months ended September 30, 2006

| | <u>Casualty Losses</u> | <u>Insurance Recoveries</u> | <u>Insurance Recoveries, Net of Losses</u> |
|----------------------|------------------------|-----------------------------|--|
| Louisiana Operations | - | - | - |
| Calder Race Course | \$ (168) | \$ 2,000 | \$ 1,832 |
| Total | <u>\$ (168)</u> | <u>\$ 2,000</u> | <u>\$ 1,832</u> |

Nine Months ended September 30, 2006

| | <u>Casualty Losses</u> | <u>Insurance Recoveries</u> | <u>Insurance Recoveries, Net of Losses</u> |
|----------------------|------------------------|-----------------------------|--|
| Louisiana Operations | \$ (5,543) | \$ 15,827 | \$ 10,284 |
| Calder Race Course | (1,330) | 4,000 | 2,670 |
| Total | <u>\$ (6,873)</u> | <u>\$ 19,827</u> | <u>\$ 12,954</u> |

As of December 31, 2005, approximately \$1.8 million of insurance proceeds were included as a current liability in the Company's Consolidated Balance Sheets, which represent amounts recovered for costs yet to be incurred.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

4. Earnings Per Share

The following is a reconciliation of the numerator and denominator of the earnings per common share computations (in thousands, except per share data):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|---|------------------|--|------------------|
| | 2006 | 2005 | 2006 | 2005 |
| Numerator for basic net earnings from continuing operations per common share: | | | | |
| Net earnings from continuing operations | \$ 2,718 | \$ 3,159 | \$ 26,886 | \$ 17,150 |
| Net earnings from continuing operations allocated to participating securities | (90) | (107) | (897) | (582) |
| Numerator for basic net earnings from continuing operations per common share | \$ 2,628 | \$ 3,052 | \$ 25,989 | \$ 16,568 |
| Numerator for basic net earnings per common share: | | | | |
| Net earnings | \$ 8,747 | \$ 71,635 | \$ 31,827 | \$ 81,924 |
| Net earnings allocated to participating securities | (291) | (2,426) | (1,062) | (2,779) |
| Numerator for basic net earnings per common share | \$ 8,456 | \$ 69,209 | \$ 30,765 | \$ 79,145 |
| Numerator for diluted net earnings per common share: | | | | |
| Net earnings from continuing operations | \$ 2,718 | \$ 3,159 | \$ 26,886 | \$ 17,150 |
| Discontinued operations, net of income taxes | 6,029 | 68,476 | 4,941 | 64,774 |
| Net earnings | \$ 8,747 | \$ 71,635 | \$ 31,827 | \$ 81,924 |
| Denominator for net earnings per common share: | | | | |
| Basic | 13,149 | 12,913 | 13,116 | 12,893 |
| Plus dilutive effect of stock options | 54 | 145 | 66 | 161 |
| Plus dilutive effect of convertible note | 453 | 453 | 453 | 453 |
| Diluted | 13,656 | 13,511 | 13,635 | 13,507 |
| Earnings per common share: | | | | |
| Basic | | | | |
| Net earnings from continuing operations | \$ 0.20 | \$ 0.24 | \$ 1.98 | \$ 1.28 |
| Discontinued operations | 0.44 | 5.12 | 0.37 | 4.86 |
| Net earnings | \$ 0.64 | \$ 5.36 | \$ 2.35 | \$ 6.14 |
| Diluted | | | | |
| Net earnings from continuing operations | \$ 0.20 | \$ 0.23 | \$ 1.97 | \$ 1.27 |
| Discontinued operations | 0.44 | 5.07 | 0.36 | 4.80 |
| Net earnings | \$ 0.64 | \$ 5.30 | \$ 2.33 | \$ 6.07 |

Options to purchase 69 thousand and 38 thousand shares for the three months ended September 30, 2006 and 2005, respectively, and options to purchase 36 thousand and 28 thousand shares for the nine months ended September 30, 2006 and 2005, respectively, were not included in the computation of earnings per common share assuming dilution because the options' exercise prices were greater than the average market price of the common shares during the respective periods.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

5. Share-Based Compensation

At September 30, 2006, the Company has share-based employee compensation plans as described below. The total compensation expense related to these plans, which include a restricted stock plan as well as an employee stock purchase plan, was \$184 thousand and \$62 thousand, net of an income tax benefit of \$141 thousand and \$45 thousand, for the three months ended September 30, 2006 and 2005, respectively, and \$585 thousand and \$173 thousand, net of an income tax benefit of \$413 thousand and \$134 thousand for the nine months ended September 30, 2006 and 2005, respectively. Prior to January 1, 2006, the Company accounted for these plans under the recognition and measurement provisions of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB No. 25"). Accordingly, the Company generally recognized compensation expense only when it granted options with a discounted exercise price. Any resulting compensation expense was recognized ratably over the associated service period, which was generally the vested term.

Prior to January 1, 2006, the Company provided pro forma disclosure amounts in accordance with SFAS No. 148, "Accounting for Stock-Based Compensation - Transaction and Disclosure," as if the fair value method defined by SFAS No. 123, "Accounting for Stock-Based Compensation" has been applied to its share-based compensation.

Effective January 1, 2006, the Company adopted the fair value recognition provisions of SFAS No. 123(R) using the modified prospective transition method and therefore has not restated prior periods' results. Under this transition method, share-based compensation expense for the nine months ended September 30, 2006 included compensation expense for all share-based compensation awards granted prior to, but not yet vested as of, January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123. Share-based compensation expense for all share-based payment awards granted after January 1, 2006, is based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123(R). The Company recognized these compensation costs for only those shares expected to vest on a straight-line basis over the requisite service period of the award, which is generally the option vesting term of one year for options related to an employee stock purchase plan.

As a result of adopting SFAS No. 123(R), the impact to the Condensed Consolidated Financial Statements for the three months ended September 30, 2006 on earnings from continuing operations before provision for income taxes and net earnings from continuing operations was \$21 thousand and \$13 thousand lower, respectively, than if the Company had continued to account for share-based compensation under APB No. 25. The impact to the Condensed Consolidated Financial Statements for the nine months ended September 30, 2006 on earnings from continuing operations before provision for income taxes and net earnings from continuing operations was \$117 thousand and \$69 thousand lower, respectively. Such impact relates to the recognition of expense of the fair value of all outstanding options associated with the Company's Employee Stock Purchase Plan (the "Employee Stock Purchase Plan") over their requisite service period. Amounts previously recorded as unearned compensation within shareholders' equity on the Condensed Consolidated Balance Sheets were reclassified to common stock as of January 1, 2006. In addition, prior to the adoption of SFAS No. 123(R), the Company presented the tax benefit of stock option exercises as operating cash flows. Upon adoption of SFAS No. 123(R), tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options are classified as financing cash flows.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

The Company accounted for share-based compensation in accordance with APB No. 25 for the three and nine months ended September 30, 2005. Had the compensation cost for the Company's share-based compensation plans been determined consistent with SFAS No. 123(R), the Company's net earnings from continuing operations and net earnings from continuing operations per common share for the three and nine months ended September 30, 2005 would approximate the pro forma amounts presented below:

(in thousands, except per share data)

| | Three Months Ended September 30, 2005 | Nine Months Ended September 30, 2005 |
|--|--|---|
| Net earnings from continuing operations, as reported | \$ 3,159 | \$ 17,150 |
| Add: Stock based compensation expense included in reported net earnings from continuing operations | 64 | 173 |
| Deduct: Pro forma stock-based compensation expense, net of tax benefit | (118) | (747) |
| Pro forma net earnings from continuing operations | <u>\$ 3,105</u> | <u>\$ 16,576</u> |
| Net earnings from continuing operations per common share: | | |
| As reported | | |
| Basic | \$ 0.24 | \$ 1.28 |
| Diluted | \$ 0.23 | \$ 1.27 |
| Pro forma | | |
| Basic | \$ 0.23 | \$ 1.24 |
| Diluted | \$ 0.23 | \$ 1.23 |

Employee Stock Options

The Company sponsors the Churchill Downs Incorporated 2003 Stock Option Plan (the "03 Plan"), the Churchill Downs Incorporated 1997 Stock Option Plan (the "97 Plan"), and the Churchill Downs Incorporated 1993 Stock Option Plan (the "93 Plan"), also collectively referred to as the "Stock Option Plans." These share-based incentive compensation plans are described below.

No stock options are available under the 93 Plan. On March 13, 2003, the Board of Directors suspended the 97 Plan effective upon the shareholders' approval of the 03 Plan. Awards issued under the 97 Plan prior to its suspension were unaffected by such suspension. On November 13, 2003, the Board of Directors terminated the 03 Plan, effective upon the shareholders' approval of the Churchill Downs Incorporated 2004 Restricted Stock Plan (the "Restricted Stock Plan"). Awards issued under the 03 Plan prior to its termination were unaffected by such termination.

The Stock Option Plans provide that the exercise price of any incentive stock option may not be less than the fair market value of the common stock on the date of grant. All outstanding stock options have contractual terms of ten years and generally vest three years from the date of grant.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Activity for the Company's Stock Option Plans during the quarters ended March 31, 2006, June 30, 2006 and September 30, 2006 is presented below (in thousands, except per share data):

| | Number of Shares Under Option | Weighted Average Exercise Price |
|-----------------------------|--|--|
| Balance, December 31, 2005 | 525 | \$ 28.30 |
| Granted | - | - |
| Exercised | (59) | \$ 19.01 |
| Cancelled/Forfeited | (10) | \$ 34.64 |
| <hr/> | | |
| Balance, March 31, 2006 | 456 | \$ 29.37 |
| Granted | - | - |
| Exercised | (36) | \$ 24.75 |
| Cancelled/Forfeited | (1) | \$ 38.92 |
| <hr/> | | |
| Balance, June 30, 2006 | 419 | \$ 29.72 |
| Granted | - | - |
| Exercised | (44) | \$ 41.03 |
| Cancelled/Forfeited | - | - |
| <hr/> | | |
| Balance, September 30, 2006 | <u>375</u> | <u>\$ 29.96</u> |

The following table summarizes information about stock options outstanding and exercisable at September 30, 2006 (in thousands, except per share data):

| | Shares Under Option | Weighted Average Remaining Contractual Life | Weighted Average Exercise Price | Aggregate Intrinsic Value per Share (1) | Aggregate Intrinsic Value (1) |
|---|--------------------------------|--|--|--|--|
| Options outstanding, exercisable and vested at September 30, 2006 | 375 | 4.3 | \$29.96 | \$12.10 | \$4,538 |

(1) Computed based upon the amount by which the fair market value of the Company's common stock at September 30, 2006 of \$42.06 per share exceeded the weighted average exercise price.

The total intrinsic value of stock options exercised during the three and nine months ended September 30, 2006 was \$0.6 million and \$2.4 million, compared with \$1.0 million and \$1.4 million for the three and nine months ended September 30, 2005, respectively. Cash received from stock option exercises totaled \$1.2 million and \$3.2 million for the three and nine months ended September 30, 2006, respectively, and \$1.6 million and \$2.3 million for the three and nine months ended September 30, 2005, respectively.

At December 31, 2005, there were 514 thousand options exercisable with a weighted average exercise price of \$28.17.

Restricted Stock Plan

On November 13, 2003, the Board of Directors adopted the Restricted Stock Plan, which was subsequently approved by the shareholders in June of 2004. The Restricted Stock Plan permits the award of common stock to directors and key employees, including officers, of the Company and its subsidiaries who are from time to time responsible for the management, growth and protection of the business of the Company and its subsidiaries. Up to 315 thousand shares of common stock have been reserved and set aside out of the Company's authorized but unissued common stock for issuance under the Restricted Stock Plan. Restricted shares generally vest in full five years from the date of grant or upon retirement at or after age 60. The fair value of restricted shares under the Restricted Stock Plan is

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

determined by the product of the number of shares granted and the grant date market price of the Company's common stock. For grants made prior to January 1, 2006, the fair value of restricted shares is expensed on a straight-line basis over the requisite service period of five years. For nonvested restricted shares granted prior to January 1, 2006, the unrecognized compensation expense was recognized immediately in current earnings using the nominal vesting approach upon retirement at or after age 60 of a participant. The Company recorded approximately \$303 thousand and \$881 thousand of compensation expense, included in net earnings from continuing operations, during the three and nine months ended September 30, 2006, respectively, and \$109 thousand and \$307 thousand of compensation expense, included in net earnings from continuing operations, during the three and nine months ended September 30, 2005, respectively. SFAS No. 123(R), as described above, requires the use of the non-substantive vesting period approach for new grants. That is, compensation expense must be recognized immediately for awards granted to retirement eligible employees or over the period from the grant date to the date retirement eligibility is achieved, if that is expected to occur during the nominal vesting period. If the Company had used the non-substantive vesting approach for awards existing prior to January 1, 2006, compensation expense included in net earnings from continuing operations during the three and nine months ended September 30, 2006 would have been \$161 thousand and \$632 thousand, respectively, and \$169 and \$376 thousand during the three and nine months ended September 30, 2005, respectively.

Activity for the Restricted Stock Plan for the quarters ended March 31, 2006, June 30, 2006 and September 30, 2006 is presented below (in thousands, except per share data):

| | <u>Number of Shares</u> | <u>Weighted Average Grant Date Fair Value</u> |
|-----------------------------|-----------------------------|---|
| Balance, December 31, 2005 | 88 | \$ 39.47 |
| Granted | - | - |
| Vested | - | - |
| Cancelled/Forfeited | - | - |
| <hr/> | | |
| Balance, March 31, 2006 | 88 | \$ 39.47 |
| Granted | 5 | \$ 43.20 |
| Vested | - | - |
| Cancelled/Forfeited | (1) | \$ 44.02 |
| <hr/> | | |
| Balance, June 30, 2006 | 92 | \$ 39.61 |
| Granted | - | - |
| Vested | - | - |
| Cancelled/Forfeited | - | - |
| <hr/> | | |
| Balance, September 30, 2006 | <u>92</u> | <u>\$ 39.61</u> |

As of September 30, 2006, there was \$2.3 million unrecognized share-based compensation expense related to nonvested restricted stock awards that the Company expects to recognize over a weighted average period of 3.7 years.

Employee Stock Purchase Plan

Under the Employee Stock Purchase Plan, the Company is authorized to sell, pursuant to short-term stock options, shares of its common stock to its full-time (or part-time for at least 20 hours per week and at least five months per year) employees at a discount from the common stock's fair market value. The Employee Stock Purchase Plan operates on the basis of recurring, consecutive one-year periods. Each period commences on August 1 and ends on the following July 31.

On the first day of each 12-month period, August 1, the Company offers to each eligible employee the opportunity to purchase common stock. Employees who elect to participate for each period have a designated percentage of their compensation withheld (after-tax) and applied to the purchase of shares of common stock on the last day of the period, July 31. The Employee Stock Purchase Plan allows withdrawals, terminations and reductions on the amounts being deducted. The purchase price for the common stock is 85% of the lesser of the fair market value of the common stock on (i) the first day of the period, or (ii) the last day of the period. No employee may purchase common stock under the Employee Stock Purchase Plan valued at more than \$25 thousand for each calendar year.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Under the Employee Stock Purchase Plan, the Company sold approximately ten thousand shares of common stock to employees pursuant to options granted on August 1, 2005 and exercised on July 31, 2006. Because the plan year overlaps the Company's fiscal year, the number of shares to be sold pursuant to options granted on August 1, 2006 can only be estimated because the 2006 plan year is not yet complete. The Company's estimate of options granted in 2006 under the Plan is based on the number of shares sold to employees under the Plan for the 2005 plan year, adjusted to reflect the change in the number of employees participating in the Plan in 2006. During the three and nine months ended September 30, 2006, the Company recognized \$21 thousand and \$117 thousand of compensation expense related to the unvested portion of the grant made during the 2005 and 2006 plan years.

6. Segment Information

The Company has determined that it currently operates in the following seven segments: (1) Churchill Downs Racetrack, which includes its on-site simulcast facility and training facility; (2) Calder Race Course; (3) Arlington Park and its eight OTBs; (4) Hoosier Park racetrack, its on-site simulcast facility and its three OTBs; (5) Louisiana Operations, including Fair Grounds, its nine OTBs and Video Services, Inc.; (6) Churchill Downs Simulcast Network ("CDSN"), the simulcast product provider of the Company; and (7) other investments, including Churchill Downs Simulcast Productions ("CDSP") and the Company's various equity interests, which are not material. In accordance with the sale of the Stock of RCA, the segment formerly known as Kentucky Operations has been restated for all periods presented to reflect only the information of Churchill Downs Racetrack. Eliminations include the elimination of management fees and other intersegment transactions, primarily between CDSN and the racetracks.

The accounting policies of the segments are the same as those described in the "Summary of Significant Accounting Policies" in the Company's Annual Report on Form 10-K for the year ended December 31, 2005. The Company uses revenues and EBITDA (defined as earnings before interest, taxes, depreciation and amortization) as key performance measures of results of operations for purposes of evaluating performance internally. Furthermore, management believes that the use of these measures enables management and investors to evaluate and compare from period to period, the Company's operating performance in a meaningful and consistent manner. Because the Company uses EBITDA as a key performance measure of financial performance, the Company is required by accounting principles generally accepted in the United States of America to provide the information in this footnote concerning EBITDA. However, these measures should not be considered as an alternative to, or more meaningful than, net earnings (loss) (as determined in accordance with accounting principles generally accepted in the United States of America) as a measure of the Company's operating results or operating cash flows (as determined in accordance with accounting principles generally accepted in the United States of America) as a measure of the Company's liquidity. EBITDA of the corporate segment includes approximately \$0.3 million and \$0.4 million of management fees for the three months ended September 30, 2006 and 2005, respectively, and \$0.3 million and \$1.7 million of management fees for the nine months ended September 30, 2006 and 2005, respectively, related to Hollywood Park Racetrack and Ellis Park, which were sold on September 23, 2005 and September 28, 2006, respectively.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

The table below presents information about reported segments for the three and nine months ended September 30, 2006 and 2005 (in thousands):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|-------------------------------------|-------------------|------------------------------------|-------------------|
| | 2006 | 2005 | 2006 | 2005 |
| Net revenues from external customers: | | | | |
| Churchill Downs Racetrack | \$ 8,078 | \$ 6,708 | \$ 79,980 | \$ 75,385 |
| Arlington Park | 28,531 | 33,507 | 64,175 | 67,436 |
| Calder Race Course | 29,450 | 28,612 | 54,603 | 53,052 |
| Hoosier Park | 9,458 | 9,704 | 28,801 | 30,144 |
| Louisiana Operations | 15,048 | 7,474 | 48,966 | 38,951 |
| CDSN | 14,961 | 15,065 | 46,429 | 49,354 |
| Total racing operations | 105,526 | 101,070 | 322,954 | 314,322 |
| Other investments | 883 | 663 | 1,626 | 869 |
| Corporate | - | 136 | 162 | 556 |
| Net revenues from continuing operations | 106,409 | 101,869 | 324,742 | 315,747 |
| Discontinued operations | 9,175 | 26,472 | 10,895 | 81,487 |
| | <u>\$ 115,584</u> | <u>\$ 128,341</u> | <u>\$ 335,637</u> | <u>\$ 397,234</u> |
| Intercompany net revenues: | | | | |
| Churchill Downs Racetrack | \$ 2,426 | \$ 1,960 | \$ 19,586 | \$ 16,712 |
| Arlington Park | 5,453 | 6,103 | 8,451 | 8,714 |
| Calder Race Course | 3,807 | 3,665 | 6,831 | 6,646 |
| Hoosier Park | 69 | 27 | 165 | 101 |
| Louisiana Operations | - | - | 1,402 | 6,315 |
| Total racing operations | 11,755 | 11,755 | 36,435 | 38,488 |
| Other investments | 558 | 571 | 1,396 | 1,388 |
| Eliminations | (12,372) | (12,534) | (37,889) | (40,494) |
| | (59) | (208) | (58) | (618) |
| Discontinued operations | 59 | 208 | 58 | 618 |
| | <u>\$ -</u> | <u>\$ -</u> | <u>\$ -</u> | <u>\$ -</u> |
| Segment EBITDA and net earnings: | | | | |
| Churchill Downs Racetrack | \$ (3,331) | \$ (4,657) | \$ 29,338 | \$ 27,235 |
| Arlington Park | 2,415 | 8,330 | 1,219 | 8,342 |
| Calder Race Course | 6,855 | 5,065 | 6,306 | 1,844 |
| Hoosier Park | 22 | (39) | 296 | 843 |
| Louisiana Operations | 1,211 | (1,267) | 15,572 | (1,674) |
| CDSN | 3,833 | 3,745 | 11,397 | 12,062 |
| Total racing operations | 11,005 | 11,177 | 64,128 | 48,652 |
| Other investments | 471 | 1,139 | 1,485 | 1,695 |
| Corporate | (1,159) | (1,417) | (2,409) | (3,814) |
| Total | 10,317 | 10,899 | 63,204 | 46,533 |
| Eliminations | (120) | (183) | (90) | (155) |
| Depreciation and amortization | (5,097) | (5,194) | (15,382) | (15,334) |
| Interest income (expense), net | (254) | (130) | (1,074) | (654) |
| Provision for income taxes | (2,128) | (2,233) | (19,772) | (13,240) |
| Net earnings from continuing operations | 2,718 | 3,159 | 26,886 | 17,150 |
| Discontinued operations, net of income taxes | 6,029 | 68,476 | 4,941 | 64,774 |
| Net earnings | <u>\$ 8,747</u> | <u>\$ 71,635</u> | <u>\$ 31,827</u> | <u>\$ 81,924</u> |

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

The table below presents total asset information about reported segments (in thousands):

| | September 30, 2006 | December 31, 2005 |
|---------------------------|-----------------------|----------------------|
| Total assets: | | |
| Churchill Downs Racetrack | \$ 417,469 | \$ 436,931 |
| Arlington Park | 87,007 | 84,797 |
| Calder Race Course | 96,594 | 92,155 |
| Hoosier Park | 38,256 | 33,317 |
| Louisiana Operations | 93,000 | 74,157 |
| CDSN | 11,018 | 11,018 |
| Other investments | 146,975 | 141,453 |
| Assets held for sale | - | 3,938 |
| | <u>890,319</u> | <u>877,766</u> |
| Eliminations | (360,649) | (364,601) |
| | <u>\$ 529,670</u> | <u>\$ 513,165</u> |

Nine Months Ended September 30,

| | 2006 | 2005 |
|------------------------------|------------------|------------------|
| Capital expenditures: | | |
| Churchill Downs Racetrack | \$ 5,189 | \$ 26,582 |
| Ellis Park | 424 | 515 |
| Hollywood Park | - | 2,161 |
| Calder Race Course | 6,300 | 1,689 |
| Arlington Park | 1,984 | 4,801 |
| Hoosier Park | 299 | 392 |
| Louisiana Operations | 7,275 | 4,337 |
| Other Investments | 275 | 117 |
| | <u>\$ 21,746</u> | <u>\$ 40,594</u> |

7. Recently Issued Accounting Pronouncements

In July of 2006, the Financial Accounting Standards Board (the "FASB") issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement 109" ("FIN 48"). FIN 48 establishes, among other things, that a tax benefit from an uncertain position may only be recognized if it is "more likely than not" that the position is sustainable based on its technical merits. The tax benefit of a qualifying position will be measured by calculating the largest amount of tax benefit that is greater than 50 percent likely of being realized upon ultimate settlement with a taxing authority having full knowledge of all relevant information. The assessment of the recognition threshold and the measurement of the associated tax benefit might change as new information becomes available. Unrecognized tax benefits will be recognized in the period that the position reaches the recognition threshold, which might occur prior to absolute finality of the matter. Similarly, recognized tax benefits will be derecognized in the period in which the position falls below the threshold. FIN 48 also requires qualitative and quantitative disclosures, including discussion of reasonably possible changes that might occur in the recognized tax benefits over the next twelve months, a description of open tax years by major jurisdictions and a roll-forward of all unrecognized tax benefits, presented as a reconciliation of the beginning and ending balances of the unrecognized tax benefits on a worldwide aggregated basis. FIN 48 is effective for the Company as of January 1, 2007. The change in net assets, if any, that results from the application of FIN 48 will be recorded as an adjustment to retained earnings. Management has not yet determined the impact that the adoption of FIN 48 will have on the Company's consolidated financial position, results of operations and earnings per common share.

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

Information set forth in this discussion and analysis contains various "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. The Private Securities Litigation Reform Act of 1995 (the "Act") provides certain "safe harbor" provisions for forward-looking statements. All forward-looking statements made in this Quarterly Report on Form 10-Q are made pursuant to the Act. The reader is cautioned that such forward-looking statements are based on information available at the time and/or management's good faith belief with respect to future events, and are subject to risks and uncertainties that could cause actual performance or results to differ materially from those expressed in the statements. Forward-looking statements speak only as of the date the statement was made. We assume no obligation to update forward-looking information to reflect actual results, changes in assumptions or changes in other factors affecting forward-looking information. Forward-looking statements are typically identified by the use of terms such as "anticipate," "believe," "could," "estimate," "expect," "intend," "may," "might," "plan," "predict," "project," "should," "will," and similar words, although some forward-looking statements are expressed differently. Although we believe that the expectations reflected in such forward-looking statements are reasonable, we can give no assurance that such expectations will prove to be correct. Important factors that could cause actual results to differ materially from expectations include: the effect of global economic conditions; the effect (including possible increases in the cost of doing business) resulting from future war and terrorist activities or political uncertainties; the economic environment; the impact of increasing insurance costs; the impact of interest rate fluctuations; the effect of any change in our accounting policies or practices; the financial performance of our racing operations; the impact of gaming competition (including lotteries and riverboat, cruise ship and land-based casinos) and other sports and entertainment options in those markets in which we operate; the impact of live racing day competition with other Florida, Illinois and Louisiana racetracks within those respective markets; costs associated with our efforts in support of alternative gaming initiatives; costs associated with Customer Relationship Management initiatives; a substantial change in law or regulations affecting pari-mutuel and gaming activities; a substantial change in allocation of live racing days; litigation surrounding the Rosemont, Illinois riverboat casino; changes in Illinois law that impact revenues of racing operations in Illinois; a decrease in riverboat admissions subsidy revenue from our Indiana operations; the impact of an additional Indiana racetrack and its wagering facilities near our operations; our continued ability to effectively compete for the country's top horses and trainers necessary to field high-quality horse racing; our continued ability to grow our share of the interstate simulcast market; our ability to execute our acquisition strategy and to complete or successfully operate planned expansion projects; our ability to successfully complete any divestiture transaction; our ability to adequately integrate acquired businesses; market reaction to our expansion projects; the loss of our totalisator companies or their inability to provide assurance on the reliability of their internal control processes through Statement on Auditing Standards No. 70 audits or to keep their technology current; the need for various alternative gaming approvals in Louisiana; our accountability for environmental contamination; the loss of key personnel; the impact of natural disasters, including Hurricanes Katrina, Rita and Wilma, on our operations and our ability to adjust the casualty losses through our property and business interruption insurance coverage; any business disruption associated with a natural disaster and/or its aftermath; and the volatility of our stock price.

You should read this discussion in conjunction with the Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q and the Company's Annual Report on Form 10-K for the year ended December 31, 2005 for further information, including Part I - Item 1A for a discussion regarding some of the reasons that actual results may be materially different from those we anticipate, as modified by Part II - Item 1A of the Quarterly Report on Form 10-Q.

Overview

We conduct pari-mutuel wagering on live Thoroughbred, Quarter Horse and Standardbred horse racing and simulcast signals of races. Additionally, we offer racing services through our other interests, as well as alternative gaming through video poker machines in Louisiana.

We operate the Churchill Downs racetrack, its on-site simulcast facility and training facility in Louisville, Kentucky, which has conducted Thoroughbred racing since 1875 and is internationally known as the home of the Kentucky Derby.

We also own and operate Arlington Park, a Thoroughbred racing operation in Arlington Heights, Illinois and its eight off-track betting facilities ("OTBs"); Calder Race Course, a Thoroughbred racing operation in Miami Gardens, Florida; and Fair Grounds Race Course ("Fair Grounds"), a Thoroughbred racing operation in New Orleans, Louisiana, its nine OTBs and Video Services, Inc. ("VSI") (collectively referred to as "Louisiana Operations"). Additionally, we are the majority owner and operator of Hoosier Park in Anderson, Indiana, which conducts Thoroughbred, Quarter Horse and Standardbred horse racing, its on-site simulcast facility and its three OTBs.

The Churchill Downs Simulcast Network ("CDSN") provides the principal oversight of interstate and international simulcast and wagering opportunities, as well as the marketing, sales, operations and data support efforts related to the Company-owned racing content.

Recent Developments

Sale of the stock of Racing Corporation of America ("RCA")

On September 28, 2006 we sold all of the issued and outstanding common shares of stock (the "Stock") of RCA, the parent company of Ellis Park Race Course ("Ellis Park"), to EP Acquisition, LLC. In conjunction with the sale of the Stock, the Company recognized a tax benefit of \$7.9 million, which is included in discontinued operations, during the three and nine months ended September 30, 2006.

Employment Agreement - Robert L. Evans

On July 18, 2006, we entered into an employment agreement (the "Employment Agreement") with Robert L. Evans, who has replaced Thomas H. Meeker as President and Chief Executive Officer of the Company, and now serves as a member of the Board of Directors of the Company (the "Board"), effective August 14, 2006. The Employment Agreement was approved by the Board.

The Employment Agreement has an initial term of employment for three years, with automatic one-year extensions (unless either party provides a written notice not to extend the term of employment at least 90 days prior to the then-current expiration date). The Employment Agreement provides for earlier termination under certain circumstances.

The Employment Agreement provides for an annual base salary of \$450,000, with reviews for potential increase at the discretion of the Board. Mr. Evans will be first eligible to participate in the annual performance bonus plan for the performance period commencing January 1, 2007, with his initial target bonus opportunity for such period to be 75% of his base salary.

The Employment Agreement further provides that Mr. Evans will receive the following equity-based awards: (i) 65,000 restricted stock units representing shares of the Company's common stock, vesting quarterly over five years, with Mr. Evans entitled to receive the shares underlying the units (along with a cash payment equal to accumulated dividend equivalents beginning with the lapse of forfeiture, plus interest at a 3% annual rate) six months after termination of employment; (ii) 90,000 restricted shares of the Company's common stock, with vesting contingent upon the Company's common stock reaching certain closing prices on Nasdaq for twenty consecutive trading days; (iii) 65,000 restricted shares of the Company's common stock, vesting quarterly over five years, and contingent upon the Company's common stock reaching a certain closing price on Nasdaq for ten consecutive trading days; and (iv) a stock option, vesting quarterly over three years, to purchase an aggregate of 130,000 shares of the Company's common stock, with an exercise price equal to the fair market value of a share of the Company's common stock on the date of the grant.

Racing World

On April 3, 2006, we entered into a definitive agreement (the "Agreement") with Magna Entertainment Corporation ("MEC") and Racing UK to form a subscription television channel that will broadcast races from our racetracks, racetracks of MEC, as well as other North American and international racetracks, into the United Kingdom and Ireland. As part of the Agreement, the Company, MEC and Racing UK became owners of Racing World Limited. Under the terms of the Agreement, we have made a total investment in this venture of 375 thousand British pounds as of September 30, 2006.

Insurance Recoveries, Net of Losses

As of September 30, 2006, we have received \$18.0 million and \$4.0 million in insurance recoveries related to damages suffered from natural disasters by our Louisiana Operations and Calder Race Course, respectively. We recorded \$13.0 million of insurance recoveries, net of losses in our net earnings from continuing operations for the nine months ended September 30, 2006. Please refer to Note 3 to our Condensed Consolidated Financial Statements for further details regarding the natural disasters and related casualty losses and insurance recoveries.

Legislative and Regulatory Developments

Federal

WTO

In 2003, the country of Antigua filed a formal complaint against the United States with the World Trade Organization ("WTO"), challenging the United States' ability to enforce certain Federal gaming laws (Sections 1084, 1952 and 1955 of Title 18 of the United States Code known as the Wire Act, the Travel Act and the Illegal Gambling Business Act, respectively, and collectively the "Acts") against foreign companies that were accepting Internet wagers from United States residents. At issue was whether the United States' enforcement of the Acts against foreign companies violated the General Agreement on Trade in Services ("GATS"). In November of 2004, a WTO panel ruled that the United States, as a signatory of GATS, could not enforce the Acts against foreign companies that were accepting Internet wagers from United States residents. The United States appealed the ruling and, in April of 2005, the WTO's appellate body ruled that the United States had demonstrated that the Acts were measures necessary to protect public morals or maintain public order, but that the United States did not enforce the Acts consistently between domestic companies and foreign companies as required by GATS. The WTO's appellate body specifically referenced the Interstate Horseracing Act ("IHA"), which appeared to authorize domestic companies to accept Internet wagers on horseracing, as being inconsistent with the United States' stated policy against Internet wagering. In arguments and briefs before the WTO's appellate body, the United States argued that the Acts, specifically the Wire Act, applies equally to domestic companies and foreign companies and the IHA does not create an exception for domestic companies to accept Internet wagering on horseracing. The WTO's appellate body did not rule on whether an exception for domestic U.S. companies was created under the IHA, but recommended that the WTO's Dispute Settlement Body request the United States to bring measures found to be inconsistent with GATS into conformity with its obligations under GATS. The United States was given until April 3, 2006 to bring its policies in line with the ruling, assuming it believed any changes were necessary. On April 10, 2006, the United States delegation to the WTO submitted a brief report to the Chairman of the Dispute Settlement Body ("U.S. Report") stating that no changes are necessary to bring U.S. policies in line with the ruling. In support of its position, the United States delegation informed the Dispute Settlement Body that on April 5, 2006, the United States Department of Justice confirmed the United States Government position regarding remote wagering on horseracing in testimony before a subcommittee of the United States House of Representatives. According to the U.S. Report, in that testimony, the Department of Justice stated its view that regardless of the IHA, existing criminal statutes prohibit the interstate transmission of bets or wagers, including wagers on horseracing, and informed the subcommittee that it is currently undertaking a civil investigation relating to a potential violation of law regarding this activity. Antigua has not indicated what actions, if any, it will take in response to the U.S. Report and the United States' position relative to interstate wagering on horseracing. The effect of the WTO ruling on the ability of domestic companies to accept Internet wagers and other account wagers on horseracing remains unclear. While the WTO decision does not affect any existing federal or state law, we cannot predict what actions, if any, the U.S. government will take in response to the request of the WTO in light of the appellate body report of the WTO and in light of the U.S. Report and what impact, if any, the appellate body report and the U.S. Report will have on our business and operations. One of the options available to Congress and the White House is to prohibit or restrict substantially the conduct of interstate simulcast wagering or account wagering. If the U.S. government elects to take such an approach (including through any action by the Department of Justice), it will have a material, adverse impact on our business, financial condition and results of operations.

Other Federal Legislation

On September 29, 2006, the United States Congress passed the Safe Port Act (“HR 4954”). An amendment to this act incorporated the Internet Gambling Enforcement Act (“HR 4411”). The act prohibits those involved in the business of betting or wagering from accepting any financial instrument, electronic or otherwise, for deposit that is intended to be utilized for unlawful Internet gambling. The definition of unlawful Internet gambling specifically excludes all activities which are legal under the Interstate Horseracing Act. The act also contains a “Sense of Congress” which explicitly states that the act is not intended to criminalize any activity currently permitted by federal law. The Secretary of the Treasury is directed to promulgate regulations to enforce the provisions of this act within 270 days. The Secretary is further directed to ensure the regulations do not prohibit any activity which is excluded from the definition of unlawful Internet gambling, including those activities legal under the Interstate Horseracing Act. President Bush signed the bill in to law on October 13, 2006.

Indiana

During April of 2005, Senate Enrolled Act 92 (“SEA 92”), a bill that makes it a Class D Felony for an operator to use the Internet to engage in unlawful gambling in Indiana or with a person located in Indiana, passed both chambers of the Indiana General Assembly and was signed by the Governor. An “operator,” as defined by SEA 92, is a person who owns, maintains or operates an Internet site that is used for interactive gambling. Under SEA 92, effective July 1, 2005, an operator is guilty of professional gambling if it uses the Internet to accept, or offer to accept, for profit, money or other property risked in unlawful gambling in Indiana or in a transaction directly involving a person located in Indiana. We receive source market fees from various in-home wagering providers for the licensing of our live racing products in the distribution of such products through broadcast mediums such as television or the Internet. Some of these in-home wagering providers accept pari-mutuel wagers from Indiana residents. TVG, one of our major in-home providers in Indiana, has ceased operations in Indiana due to legal uncertainty created by SEA 92.

Florida

On November 2, 2004, Amendment 4, a slot machine question which sought to allow voters in Miami-Dade and Broward counties to hold local referenda on the issue, passed by a margin of 1.4%. On March 8, 2005, voters in Miami-Dade and Broward counties voted in separate local referenda to decide whether slot machines could be installed at the seven existing pari-mutuel sites in those counties, including Calder. Although the measure passed in Broward County, home of Gulfstream Park, it was unsuccessful in Miami-Dade County, where Calder is located. Slot machine gaming was approved by the Florida legislature during a special session of the Florida legislature on December 9, 2005. Slot operations are expected to commence in a staggered manner at Broward’s four pari-mutuel wagering facilities from September of 2006 through 2008. We believe that the failure of the local referendum to pass in Miami-Dade County was due primarily to Governor Bush’s active opposition to the measure during the final days of the campaign. We are preparing a strategy to seek passage in Miami-Dade County when the issue can again be placed on the ballot. The earliest that it can be placed on the ballot is March 8, 2007, but it may be 2008 before the issue is actually placed on the ballot. We are currently determining the most advantageous date for placing the issue on the ballot. The impact on our results of operations and financial position of the failed referendum in Miami-Dade County and the operation of slot machines at pari-mutuel wagering facilities in Broward County is uncertain at this time.

On August 8, 2006, the District Court of Appeals, First District, State of Florida rendered a decision in the case of Floridians Against Expanded Gambling (“FAEG”), et. al versus Floridians for a Level Playing Field, et. al. FAEG challenged the process by which signatures were collected in order to place a constitutional amendment on the ballot in 2004 allowing Miami-Dade and Broward County voters to approve slot machines in pari-mutuel facilities. The District Court of Appeals reversed a decision of the Florida trial court, which granted summary judgment and dismissed the challenge, and remanded the case back to the trial court for an evidentiary hearing to determine whether sufficient signatures were collected in the petition process. A motion for rehearing by the entire Court of Appeals or in the alternative a motion for certification to the Florida Supreme Court has been filed.

Illinois

Pursuant to the Illinois Horse Racing Act, Arlington Park (and all other Illinois racetracks) is permitted to receive a payment commonly known as purse recapture. Generally, in any year that wagering on Illinois horse races at Arlington Park is less than 75% of wagering both in Illinois and at Arlington Park on Illinois horse races in 1994, Arlington Park is permitted to receive 2% of the difference in wagering in the subsequent year. The payment is funded from the Arlington Park purse account. Under the Illinois Horse Racing Act, the Arlington Park purse account is to be repaid via an appropriation by the Illinois General Assembly from the Illinois General Revenue Fund. However, this appropriation has not been made since 2001. Subsequently, Illinois horsemen unsuccessfully petitioned the Illinois Racing Board ("IRB") to prevent Illinois racetracks from receiving this payment in any year that the Illinois General Assembly did not appropriate the repayment to the racetrack's purse accounts from the General Revenue Fund. Further, the Illinois horsemen filed lawsuits seeking, among other things, to block payment to Illinois racetracks, as well as to recover the 2002 and 2003 amounts already paid to the Illinois racetracks. These lawsuits filed by the Illinois horsemen challenging the 2002 and 2003 reimbursements have been resolved in favor of Arlington Park and the other Illinois racetracks. Several bills were filed in the 2003, 2004 and 2005 sessions of the Illinois legislature that, in part, would eliminate the statutory right of Arlington Park and the other Illinois racetracks to continue to receive this payment. None of these bills passed. Since the statute remains in effect, Arlington Park continues to receive the recapture payment from the purse account. If Arlington Park loses the statutory right to receive this payment, there would be a material, adverse impact on Arlington Park's results of operations.

Under previously enacted legislation, the Illinois Horse Racing Equity fund was scheduled to receive a portion (up to 15% of adjusted gross receipts) of wagering tax from the tenth riverboat casino license issued. The grant of the tenth riverboat license is currently the subject of numerous legal challenges and, as such, is currently not an operational riverboat license. The funds were scheduled to be utilized for purses and track discretionary spending. Because the tenth license has never been operational, the Illinois Horse Racing Equity fund has never had any funds to distribute.

In the Spring of 2006 session of the Illinois General Assembly, legislation was passed to create and fund the Horse Racing Equity Trust fund. The Horse Racing Equity Trust fund is to be funded from revenues of Illinois riverboat casinos that meet a certain threshold. Sixty percent of the funds are to be used for horsemen's purses (57% for thoroughbred meets and 43% for standardbred meets). The remaining 40% is to be distributed to racetracks (30.4% of that total for Arlington Park) and is to be used for improving, maintaining, marketing and operating Arlington Park and may be used for backstretch services and capital improvements. The legislation expires two years after its immediate effective date. The governor of Illinois signed the legislation on May 26, 2006 as Public Act 94-0805.

In an effort to prevent implementation of Public Act 94-0805, the four Illinois riverboat casinos that meet the threshold to contribute to the fund filed a complaint on May 30, 2006 in the Circuit Court of Will County, Illinois. The complaint was filed against the State Treasurer and the IRB to enjoin the imposition and collection of the 3% "surcharge" from the casinos, which was to be deposited in the Horse Racing Equity Trust fund. The riverboats have been paying the monies into a special escrow account and have demanded that the monies not be distributed. A temporary restraining order was granted to prevent distribution of these monies. The complaint alleges that Public Act 94-0805 is unconstitutional. The Illinois Attorney General will represent Illinois on this matter. As of the date of the filing of this Quarterly Report on Form 10-Q, management does not know the impact that the ultimate outcome of this matter will have on our consolidated financial position and results of operations.

During January and February when there is no live racing in Illinois, the IRB designates a Thoroughbred racetrack as the host track in Illinois. The IRB designated Arlington Park as host track in Illinois during January of 2006 for 29 days, which is the same as January of 2005. In addition, Arlington Park was designated as host track for eight days during February of 2006, which resulted in an increase of \$0.5 million in pre-tax earnings for the month of February of 2006 compared to the same period of 2005. The IRB appointed Arlington Park the host track in Illinois during January 2007 for 30 days, which is an increase of one day compared to the same period of 2006. In addition, Arlington Park was appointed the host track for 15 days in February 2007, which is an increase of seven days compared to the same period of 2006. Arlington Park's future designation as the host track is subject to the annual designation by the IRB. A change in the number of days that Arlington Park is designated "host track" could have a material, adverse impact on our results of operations.

Kentucky

The Kentucky horse industry continues to seek legal authority to offer alternative forms of gaming at Kentucky's eight existing racetracks. Alternative forms of gaming would enable our Kentucky racetracks to better compete with neighboring gaming venues by providing substantial new revenues for purses and capital improvements. Several alternative gaming bills were filed in the 2006 session of the Kentucky General Assembly, including two bills filed in the House and two in the Senate. The Kentucky Equine Education Project ("KEEP"), an alliance of the Commonwealth's equine industry leaders, including our Company, supported legislation that called for a statewide voter referendum in the Fall of 2006 to amend the State constitution to allow Kentucky's eight racetracks to offer full casino gaming. The Commonwealth's share of the new revenue would have been earmarked for education, healthcare, local development and environmental concerns benefiting the entire Commonwealth under the KEEP plan. For several reasons, including active and public opposition by the Senate President and the governor publicly questioning the economics of alternative gaming, no alternative gaming legislation was passed. While KEEP has stated that the legalization of casino gaming will not be a primary legislative pursuit of KEEP in the 2007 session of the Kentucky General assembly, we anticipate legislative activity with regard to this issue and bills have been pre-filed which would permit casino gaming at Kentucky's racetracks. We plan to participate actively in that effort.

Kentucky statutes provide for the payment of supplemental purses by Kentucky racetracks for designated races won by Kentucky-bred horses. A portion of the excise tax collected on live, inter-track and simulcast wagering is available to reimburse each Kentucky racetrack for monies paid out as supplemental purses. The payment of the monies is administered through the Kentucky Thoroughbred Development Fund (the "KTDF"). Ellis Park is currently seeking reimbursement for approximately \$1.3 million and Churchill Downs Racetrack is seeking reimbursement for approximately \$1.2 million from the KTDF for monies paid out as supplemental purses in 2005 and 2006. The Kentucky Horse Racing Authority has requested the Kentucky State Auditor to audit the KTDF to determine amounts owed to Ellis Park as well as other racetracks. In the event amounts are recovered from the KTDF by Ellis Park, such amounts will be remitted to the Company in accordance with the Stock Purchase Agreement between EP Acquisition, LLC and the Company related to the sale of the stock of RCA. The timing and outcome of the audit are unknown at this time.

Louisiana

We have received all statutory, regulatory and other authorizations to operate slot machines at Fair Grounds. Failure to maintain the necessary gaming licenses to own and operate slot machines at Fair Grounds could have a material, adverse impact on our results of operations. Under the Louisiana statute, Fair Grounds was permitted to operate 500 slot machines. As a result of Hurricane Katrina, the agreement between Harrah's Casino in New Orleans and the State of Louisiana has been amended to eliminate the \$350.0 million gaming revenue threshold before Fair Grounds may operate 700 slot machines. Conforming legislation was passed in the 2006 session of the Louisiana legislature. Due to Hurricane Katrina, we are currently evaluating the feasibility of beginning construction of a new slot facility.

Churchill Downs Louisiana Horseracing Company, LLC has completed the process to seek the necessary local zoning change and permits. On August 18, 2005, the New Orleans City Council passed ordinances approving hours of operation for slot machines at Fair Grounds as part of its conditional use permit. The ordinances also established additional provisos negotiated by Churchill Downs Louisiana Horseracing Company, LLC and the New Orleans City Council relating to other conditional use activities.

In April 2005, the New Orleans City Council instructed the city attorney to file a declaratory judgment action to determine if installation of slot machines at Fair Grounds would violate the City Charter. The Louisiana Attorney General has expressed an opinion that the addition of slots at the racetrack would not violate the City Charter. In June of 2005, a resident living near Fair Grounds filed a lawsuit alleging, among other claims, that slot machines at the racetrack would be a violation of the City Charter, which limits New Orleans to one land-based casino. On October 22, 2006, the Court granted our motion to dismiss. It is uncertain whether the plaintiff will appeal the Court's ruling. We do not believe the installation of slot machines at Fair Grounds violates the City Charter.

Critical Accounting Policies

Our Condensed Consolidated Financial Statements have been prepared in conformity with accounting principles generally accepted in the United States of America. Accordingly, we are required to make estimates, judgments and assumptions that we believe are reasonable based on historical experience, contract terms, observance of known trends in our company and the industry as a whole, and information available from other outside sources. Our estimates affect the reported amounts of assets and liabilities and related disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from those initial estimates. In general, however, our estimates have historically approximated actual results.

Our most significant estimates relate to the valuation of plant and equipment, receivables, goodwill and other intangible assets, which may be significantly affected by changes in the regulatory environment in which we operate, and to the aggregate costs for retentions under our liability and workers' compensation policies. Additionally, estimates are used for determining income tax liabilities and the valuation of interest rate risk derivative contracts (interest rate swaps) and other derivative instruments.

We evaluate our goodwill, intangible and other long-lived assets in accordance with the application of Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Intangible Assets" and SFAS No. 144, "Accounting for the impairment or disposal of Long-Lived Assets." For goodwill and intangible assets, we review the carrying values at least annually during the first quarter of each year or whenever events or changes in circumstances indicate that the carrying value of these assets may not be recoverable. We assign estimated useful lives to our intangible assets based on the period of time the asset is expected to contribute directly or indirectly to future cash flows. We consider certain factors when assigning useful lives such as legal, regulatory, competition and other economic factors. Intangible assets with finite lives are amortized using the straight-line method.

While we believe that our estimates of future revenues and cash flows are reasonable, different assumptions could materially affect our assessment of useful lives and fair market values. Changes in assumptions may cause modifications to our estimates for amortization or impairment, thereby impacting our results of operations. If the estimated lives of our intangible assets were to decrease based on the factors mentioned above, amortization expense could increase significantly.

Our business can be impacted positively and negatively by legislative and regulatory changes and by alternative gaming competition. A significant negative impact from these activities could result in a significant impairment of our plant and equipment and/or our goodwill and intangible assets in accordance with generally accepted accounting principles.

In connection with losses incurred from natural disasters, insurance proceeds are collected on existing business interruption and property and casualty insurance policies. When losses are sustained in one period and the amounts to be recovered are collected in a subsequent period, management uses estimates and judgment to determine the amounts that are probable of recovery under such policies as specified in Financial Accounting Standards Board Interpretation No. 30, "Accounting for Involuntary Conversion of Nonmonetary Assets to Monetary Assets."

We also use estimates and judgments for financial reporting to determine our current tax liability, as well as those taxes deferred until future periods. Net deferred and accrued income taxes represent significant assets and liabilities of the Company. In accordance with the liability method of accounting for income taxes as specified in SFAS 109, "Accounting for Income Taxes," we recognize the amount of taxes payable or refundable for the current year and deferred tax assets and liabilities for the future tax consequences of events that have been recognized in our financial statements or tax returns.

Adjustments to deferred taxes are determined annually based upon changes in differences between the book basis and tax basis of our assets and liabilities, measured by future tax rates we estimate will be applicable when these differences are expected to reverse. Changes in current tax laws, enacted tax rates or the estimated level of taxable income or non-deductible expenses could change the valuation of deferred tax assets and liabilities and affect the overall effective tax rate and tax provision.

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In the past, we have utilized interest rate swap contracts to hedge exposure to interest rate fluctuations on our variable rate debt and have designated these swaps as cash flow hedges of anticipated interest payments. Our interest rate swap contracts match the critical terms of the underlying debt, thus qualifying for hedge accounting. Such critical terms include notional amounts, benchmark interest rate basis, interest reset dates and payment dates. The fair market value of the swaps was recorded on the balance sheet as an asset or liability with the offset recorded in accumulated other comprehensive income net of income taxes. Any changes in the fair market value of the swaps were adjusted to the asset or liability account and recorded net of the income taxes in other comprehensive income.

We maintain an allowance for doubtful accounts receivable that have been deemed to have a high risk of collectibility. We analyze historical collection trends and customer creditworthiness when evaluating the adequacy of our allowance for doubtful accounts receivable. Any changes in our assumptions or estimates could impact our bad debt expense and results of operations.

For our business insurance renewals over the past several years, we have assumed more risk than in prior years, primarily through higher retentions and higher maximum losses for stop-loss insurance for certain coverages. Our March 1, 2006 business insurance renewals included substantially the same coverages and retentions as previous years. However, our property retentions in Florida and Louisiana increased significantly for wind damage. We estimate insurance liabilities for workers compensation and general liability losses based on our historical loss experience, certain actuarial assumptions of loss development factors and current industry trends. Any changes in our assumptions, actuarial assumptions or loss experience could impact the total insurance cost and overall results of operations. Our ability to obtain insurance coverage at acceptable costs in future years under terms and conditions comparable to the current year is uncertain.

Consolidated Net Revenues

Our net revenues and earnings are significantly influenced by our racing calendar. Therefore, revenues and operating results for any interim quarter are not generally indicative of the revenues and operating results for the year, and may not be comparable with results for the corresponding period of the previous year. We historically have very few live racing days during the first quarter of each year, with a majority of our live racing occurring in the second, third and fourth quarters, including the running of the Kentucky Derby and Kentucky Oaks in the second quarter, the quarter during which we typically generate the majority of our annual operating income.

Our pari-mutuel revenues include commissions on pari-mutuel wagering at our racetracks and off-track betting facilities (net of state and local pari-mutuel taxes), plus simulcast host fees from other wagering sites and source market fees generated from contracts with our in-home wagering providers. In addition to the commissions earned on pari-mutuel wagering, we earn pari-mutuel related streams of revenues from sources that are not directly related to wagering. These other revenues are primarily derived from statutory racing regulations in some of the states where our facilities are located and can fluctuate materially year-to-year. Non-pari-mutuel revenues are primarily generated from admissions, sponsorships, licensing rights and broadcast fees, Indiana riverboat admissions subsidy, concessions, video poker, lease income and other sources.

Pari-mutuel revenues are recognized upon occurrence of the live race that is presented for wagering and after that live race is made official by the respective states' racing regulatory body. Additional non-wagering revenues such as admissions, programs and concession revenues are recognized as delivery of the product or services has occurred.

Greater than 70% of our annual revenues are generated by pari-mutuel wagering on live and simulcast racing content and in-home wagering. Live racing handle includes patron wagers made on live races at our live tracks and also wagers made on imported simulcast signals at our racetracks during our live meets. Import simulcasting handle includes wagers on imported signals at our racetracks when the respective tracks are not conducting live race meets and at our OTBs throughout the year. Export handle includes all wagers made on our live racing signals sent to other tracks, OTBs and in-home wagering. In-home wagering, or advance deposit wagering, consists of patron wagers through a pre-funded account.

We retain as revenue a predetermined percentage or commission on the total amount wagered on live and import simulcasting sources, and the balance is distributed to the winning patrons. The gross

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percentages retained on live racing and import simulcasting at our various locations range from approximately 16% to 21%. In general, the fees earned from export simulcasting are contractually determined and average approximately 3.5%. All commissions and fees earned from pari-mutuel wagering are shared with horsemen through payment of purses based on local contracts and statutes and average approximately 50%.

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Results Of Continuing Operations

The following table sets forth, for the periods indicated, certain operating data:

| (In thousands, except per share data and live race days) | Three Months Ended September 30, | | Change | |
|--|---|-------------|---------------|----------|
| | 2006 | 2005 | Amount | % |
| Total pari-mutuel handle | \$ 915,100 | \$ 942,357 | \$ (27,257) | (3)% |
| Number of live race days | 142 | 148 | (6) | (4)% |
| Net pari-mutuel revenues | \$ 83,952 | \$ 82,921 | \$ 1,031 | 1% |
| Other operating revenues | 22,398 | 18,740 | 3,658 | 20% |
| Total net revenues | \$ 106,350 | \$ 101,661 | \$ 4,689 | 5% |
| Gross profit | \$ 14,608 | \$ 13,484 | \$ 1,124 | 8% |
| Gross margin percentage | 14% | 13% | | |
| Operating income | \$ 4,988 | \$ 4,603 | \$ 385 | 8% |
| Net earnings from continuing operations | \$ 2,718 | \$ 3,159 | \$ (441) | (14)% |
| Effective tax rate | 44% | 41% | | |
| Diluted net earnings from continuing operations per common share | \$ 0.20 | \$ 0.23 | | |

Three Months Ended September 30, 2006 Compared to the Three Months Ended September 30, 2005

Our total net revenues increased \$4.7 million primarily due to increased revenues from the Louisiana Operations as a result of increased wagering at our video poker operations as well as an increase in import simulcasting pari-mutuel revenues. Net revenues from the Churchill Downs Racetrack increased primarily as a result of four more live racing days during the three months ended September 30, 2006 compared to the same period of 2005. A decrease in net revenues from Arlington Park partially offset these increases primarily as a result of four fewer live racing days during the three months ended September 30, 2006 compared to the same period of 2005. Further discussion of net revenue variances by our reported segments is detailed below.

Consolidated Expenses

The following table is a summary of our consolidated expenses:

| (In thousands) | Three Months Ended September 30, | | Change | |
|---|---|-------------|---------------|----------|
| | 2006 | 2006 | Amount | % |
| Purse expenses | \$ 37,935 | \$ 35,283 | \$ 2,652 | 8% |
| Depreciation/amortization | 5,097 | 5,194 | (97) | (2)% |
| Other operating expenses | 48,710 | 47,700 | 1,010 | 2% |
| SG&A expenses | 11,452 | 10,244 | 1,208 | 12% |
| Insurance recoveries, net of losses | (1,832) | (1,363) | (469) | (34)% |
| Total expenses from continuing operations | \$ 101,362 | \$ 97,058 | \$ 4,304 | 4% |
| Percent of revenue | 95% | 95% | | |

Three Months Ended September 30, 2006 Compared to the Three Months Ended September 30, 2005

Total expenses increased 4% during the three months ended September 30, 2006, primarily as a result of increased purse and other operating expenses from the Louisiana Operations of \$2.3 million and \$0.7 million, respectively, which is consistent with higher business levels experienced from our video poker operations and import simulcasting pari-mutuel operations. Corporate expenses increased primarily due to increased costs associated with the retirement and replacement of the chief executive officer and increased payroll costs. Further discussion of expense variances by our reported segments is detailed below.

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Other Income (Expense)

The following table is a summary of our other income (expense):

| In thousands) | Three Months Ended September 30, | | | Change | |
|---|---|-------------|-----------|---------------|--|
| | 2006 | 2005 | \$ | % | |
| Interest income | \$ 272 | \$ 135 | \$ 137 | 101% | |
| Interest expense | (526) | (265) | (261) | (98)% | |
| Unrealized gain on derivative instruments | 204 | 204 | - | - | |
| Miscellaneous, net | (92) | 715 | (807) | (113)% | |
| Other income (expense) | \$ (142) | \$ 789 | \$ (931) | (118)% | |

Three Months Ended September 30, 2006 Compared to the Three Months Ended September 30, 2005

Significant items affecting the comparability of other income and expense include:

- During the three months ended September 30, 2005, we recognized a minority interest benefit within miscellaneous income related to Hoosier Park in the amount of \$0.3 million.
- During the three months ended September 30, 2005, we recognized \$0.3 million of miscellaneous income related to consideration received for the extension of an option to purchase an interest in Hoosier Park.

Net Revenues By Segment

The following table presents net revenues, including intercompany revenues, by our reported segments:

| (In thousands) | Three Months Ended September 30, | | | Change | |
|---|---|-------------|-----------|---------------|--|
| | 2006 | 2005 | \$ | % | |
| Churchill Downs Racetrack | \$ 10,504 | \$ 8,668 | \$ 1,836 | 21% | |
| Arlington Park | 33,984 | 39,610 | (5,626) | (14)% | |
| Calder Race Course | 33,257 | 32,277 | 980 | 3% | |
| Hoosier Park | 9,527 | 9,731 | (204) | (2)% | |
| Louisiana Operations | 15,048 | 7,474 | 7,574 | 101% | |
| CDSN | 14,961 | 15,065 | (104) | (1)% | |
| Total Racing Operations | 117,281 | 112,825 | 4,456 | 4% | |
| Other Investments | 1,441 | 1,234 | 207 | 17% | |
| Corporate | - | 136 | (136) | (100)% | |
| Eliminations | (12,372) | (12,534) | 162 | 1% | |
| Net revenues from continuing operations | \$ 106,350 | \$ 101,661 | \$ 4,689 | 5% | |

Three Months Ended September 30, 2006 Compared to the Three Months Ended September 30, 2005

Significant items affecting comparability of our revenues by segment include:

- Net revenues from the Louisiana Operations increased significantly primarily as a result of increased wagering at our video poker operations as well as an increase in import simulcasting pari-mutuel revenues. Since the reopening of our OTBs in Louisiana after Hurricane Katrina, we have experienced a significant rise in business levels that we believe is attributable to the limited entertainment options available in the Gulf Coast region during the hurricane reconstruction.

- Net revenues from the Churchill Downs Racetrack increased primarily as a result of four more live racing days during the three months ended September 30, 2006 compared to the same period of 2005.
- Net revenues from Arlington Park decreased primarily as a result of four fewer live racing days during the three months ended September 30, 2006 compared to the same period of 2005. In addition, net revenues decreased due to a decline in average starters per race as well as lower pari-mutuel wagering in general.

Expenses by Segment

The following table presents total expenses, including intercompany expenses, by our reported segments:

| (In thousands) | Three Months Ended September 30, | | Change | |
|--|---|------------------|-----------------|-----------|
| | 2006 | 2005 | \$ | % |
| Churchill Downs Racetrack | \$ 16,404 | \$ 15,570 | \$ 834 | 5% |
| Arlington Park | 32,301 | 32,276 | 25 | - |
| Calder Race Course | 27,334 | 27,935 | (601) | (2)% |
| Hoosier Park | 9,883 | 10,144 | (261) | (3)% |
| Louisiana Operations | 14,251 | 9,468 | 4,783 | 51% |
| CDSN | 11,128 | 11,321 | (193) | (2)% |
| Total Racing Operations | 111,301 | 106,714 | 4,587 | 4% |
| Other Investments | 944 | 937 | 7 | 1% |
| Corporate | 5,350 | 3,388 | 1,962 | 58% |
| Eliminations | (16,233) | (13,981) | (2,252) | (16)% |
| Total expenses from continuing operations | \$ 101,362 | \$ 97,058 | \$ 4,304 | 4% |

Three Months Ended September 30, 2006 Compared to the Three Months Ended September 30, 2005

Significant items affecting comparability of our expenses by segment include:

- Expenses from the Louisiana Operations increased primarily as a result of increased purses caused by the higher business levels previously mentioned. Also, during the three months ended September 30, 2005, we recognized a reduction of selling, general and administrative expenses of \$1.4 million related to an estimate of insurance proceeds that management determined are probable of recovery in connection with losses recognized from Hurricane Katrina by the Louisiana Operations.
- Corporate expenses increased primarily as a result of increased costs associated with the retirement and replacement of the chief executive officer and increased payroll costs.

Discontinued Operations

The following table presents earnings from discontinued operations for the three months ended September 30, 2006 and 2005:

| (In thousands) | Three Months Ended September 30, | | Change | |
|--|---|-------------|---------------|----------|
| | 2006 | 2005 | \$ | % |
| Net revenues | \$ 9,234 | \$ 26,680 | \$ (17,446) | (65)% |
| Operating expenses | 6,407 | 25,230 | (18,823) | (75)% |
| Gross profit | 2,827 | 1,450 | 1,377 | 95% |
| Selling, general and administrative expenses | 753 | 151 | 602 | 399% |
| Insurance recoveries, net of losses | (1,293) | - | (1,293) | (100)% |
| Operating income | 3,367 | 1,299 | 2,068 | 159% |
| Other income (expense): | | | | |
| Interest income | - | 6 | (6) | (100)% |
| Interest expense | - | (3,173) | 3,173 | 100% |
| Miscellaneous, net | (15) | 6 | (21) | (350)% |
| | (15) | (3,161) | 3,146 | 100% |
| Earnings (loss) before income taxes | 3,352 | (1,862) | 5,214 | 280% |
| (Provision) benefit for income taxes | (1,520) | 421 | (1,941) | (461)% |
| Earnings (loss) from operations | 1,832 | (1,441) | 3,273 | 227% |
| Gain on sale of assets, net of income taxes | 4,197 | 69,917 | (65,720) | (94)% |
| Net earnings | \$ 6,029 | \$ 68,476 | \$ (62,447) | (91)% |

Significant items affecting comparability of earnings from discontinued operations include:

- The results of operations of discontinued operations for the three months ended September 30, 2006 include the results of operations of Ellis Park compared to those of Hollywood Park and Ellis Park for the three months ended September 30, 2005.

Results Of Continuing Operations

The following table sets forth, for the periods indicated, certain operating data:

| (In thousands, except per share data and live race days) | Nine Months Ended September 30, | | Change | |
|--|--|--------------|---------------|----------|
| | 2006 | 2005 | \$ | % |
| Total pari-mutuel handle | \$ 2,449,582 | \$ 2,606,322 | \$ (156,740) | (6)% |
| Number of live race days | 348 | 398 | (50) | (13)% |
| Net pari-mutuel revenues | \$ 219,501 | \$ 221,708 | \$ (2,207) | (1)% |
| Other operating revenues | 105,183 | 93,421 | 11,762 | 13% |
| Total net revenues | \$ 324,684 | \$ 315,129 | \$ 9,555 | 3% |
| Gross profit | \$ 68,674 | \$ 62,677 | \$ 5,997 | 10% |
| Gross margin percentage | 21% | 20% | | |
| Operating income | \$ 46,610 | \$ 29,122 | \$ 17,488 | 60% |
| Net earnings from continuing operations | \$ 26,886 | \$ 17,150 | \$ 9,736 | 57% |
| Effective tax rate | 42% | 44% | | |
| Diluted net earnings from continuing operations per common share | \$ 1.97 | \$ 1.27 | | |

Nine Months Ended September 30, 2006 Compared to the Nine Months Ended September 30, 2005

Our total net revenues increased \$9.6 million primarily due to increased revenues during the week of the Kentucky Derby, which resulted in higher revenues in our Churchill Downs Racetrack and CDSN. We also experienced incremental net revenues from increased wagering at our video poker operations in Louisiana as well as increased import simulcasting pari-mutuel revenues. These increased net revenues were partially offset by decreased net revenues from Arlington Park primarily caused by a decline in average starters per race as well as lower pari-mutuel wagering in general. These increased net revenues were also partially offset by decreased net revenues from the Louisiana Operations and CDSN primarily as a result of 49 fewer live racing days at Fair Grounds due to the business interruption caused by Hurricane Katrina. Further discussion of net revenue variances by our reported segments is detailed below.

Significant items affecting comparability of operating income, net earnings from continuing operations and diluted net earnings from continuing operations per common share included:

- During the nine months ended September 30, 2006, we recorded a net gain of \$13.0 million compared to \$1.4 million during the same period of 2005 related to insurance recoveries, net of losses associated with damages sustained from natural disasters that occurred during 2005 by the Louisiana Operations and Calder Race Course.
- We incurred \$3.0 million of expenses related to alternative gaming initiatives in Florida during the nine months ended September 30, 2005.
- Our effective tax rate decreased from 44% to 42% resulting primarily from the non-deductibility of legislative initiative costs recognized during 2005.

Consolidated Expenses

The following table is a summary of our consolidated expenses:

| (In thousands) | <u>Nine Months Ended September 30,</u> | | <u>Change</u> | |
|---|---|--------------------|----------------------|-----------------|
| | <u>2006</u> | <u>2005</u> | <u>\$</u> | <u>%</u> |
| Purse expenses | \$ 100,532 | \$ 97,629 | \$ 2,903 | 3% |
| Depreciation/amortization | 15,382 | 15,334 | 48 | - |
| Other operating expenses | 140,096 | 139,489 | 607 | - |
| SG&A expenses | 35,018 | 34,918 | 100 | - |
| Insurance recoveries, net of losses | (12,954) | (1,363) | (11,591) | (850)% |
| Total expenses from continuing operations | <u>\$ 278,074</u> | <u>\$ 286,007</u> | <u>\$ (7,933)</u> | <u>(3)%</u> |
| Percent of revenue | 86% | 91% | | |

Nine Months Ended September 30, 2006 Compared to the Nine Months Ended September 30, 2005

Total expenses decreased 3% during the nine months ended September 30, 2006, primarily as a result of an increase in insurance recoveries, net of losses of \$11.6 million related to damages sustained from natural disasters that occurred during 2005 by the Louisiana Operations and Calder Race Course. Purse expenses of Churchill Downs Racetrack increased consistent with the higher net revenues experienced during the week of the Kentucky Derby. Further discussion of expense variances by our reported segments is detailed below.

Other Income (Expense)

The following table is a summary of our other income (expense):

(In thousands)

| | Nine Months Ended September 30, | | Change | |
|---|--|-----------------|-------------------|--------------|
| | 2006 | 2005 | \$ | % |
| Interest income | \$ 634 | \$ 296 | \$ 338 | 114% |
| Interest expense | (1,708) | (950) | (758) | (80)% |
| Unrealized gain on derivative instruments | 612 | 614 | (2) | - |
| Miscellaneous, net | 510 | 1,308 | (798) | (61)% |
| Other income (expense) | <u>\$ 48</u> | <u>\$ 1,268</u> | <u>\$ (1,220)</u> | <u>(96)%</u> |

Nine Months Ended September 30, 2006 Compared to the Nine Months Ended September 30, 2005

Significant items affecting the comparability of other income and expense include:

- During the nine months ended September 30, 2006, we recognized \$0.6 million of losses related to our equity investment in Racing World.

Net Revenues By Segment

The following table presents net revenues, including intercompany revenues, by our reported segments:

(In thousands, except per share data and live race days)

| | Nine Months Ended September 30, | | Change | |
|---|--|-------------------|-----------------|-----------|
| | 2006 | 2005 | \$ | % |
| Churchill Downs Racetrack | \$ 99,566 | \$ 92,097 | \$ 7,469 | 8% |
| Arlington Park | 72,626 | 76,150 | (3,524) | (5)% |
| Calder Race Course | 61,434 | 59,698 | 1,736 | 3% |
| Hoosier Park | 28,966 | 30,245 | (1,279) | (4)% |
| Louisiana Operations | 50,368 | 45,266 | 5,102 | 11% |
| CDSN | 46,429 | 49,354 | (2,925) | (6)% |
| Total Racing Operations | 359,389 | 352,810 | 6,579 | 2% |
| Other Investments | 3,022 | 2,257 | 765 | 34% |
| Corporate | 162 | 556 | (394) | (71)% |
| Eliminations | (37,889) | (40,494) | 2,605 | 6% |
| Net revenues from continuing operations | <u>\$ 324,684</u> | <u>\$ 315,129</u> | <u>\$ 9,555</u> | <u>3%</u> |

Nine Months Ended September 30, 2006 Compared to the Nine Months Ended September 30, 2005

Significant items affecting comparability of our revenues by segment include:

- Net revenues from Churchill Downs Racetrack increased primarily as a result of a successful Kentucky Derby, including continued benefits realized from the newly renovated Churchill Downs racetrack facility as well as higher non-wagering revenues associated with the Kentucky Derby.
- Net revenues from the Louisiana Operations increased primarily as a result of increased wagering at our video poker operations in Louisiana as well as increased import simulcasting pari-mutuel revenues. These increased net revenues were partially offset by decreased net revenues from the Louisiana Operations and CDSN primarily as a result of 49 fewer live racing days at Fair Grounds due to the business interruption caused by Hurricane Katrina.
- Net revenues from Arlington Park decreased primarily as a result of a decline in average starters per race as well as lower pari-mutuel wagering in general.

Expenses by Segment

The following table presents total expenses, including intercompany expenses, by our reported segments:

| (In thousands, except per share data and live race days) | Nine Months Ended September 30, | | Change | |
|--|--|-------------------|-------------------|-------------|
| | 2006 | 2005 | \$ | % |
| Churchill Downs Racetrack | \$ 77,972 | \$ 71,471 | \$ 6,501 | 9% |
| Arlington Park | 73,652 | 70,857 | 2,795 | 4% |
| Calder Race Course | 57,556 | 59,948 | (2,392) | (4)% |
| Hoosier Park | 29,816 | 30,584 | (768) | (3)% |
| Louisiana Operations | 36,588 | 49,083 | (12,495) | (25)% |
| CDSN | 35,032 | 37,293 | (2,261) | (6)% |
| Total Racing Operations | 310,616 | 319,236 | (8,620) | (3)% |
| Other Investments | 2,066 | 2,141 | (75) | (4)% |
| Corporate | 15,764 | 12,280 | 3,484 | 28% |
| Eliminations | (50,372) | (47,650) | (2,722) | (6)% |
| Total expenses from continuing operations | \$ 278,074 | \$ 286,007 | \$ (7,933) | (3)% |

Nine Months Ended September 30, 2006 Compared to the Nine Months Ended September 30, 2005

Significant items affecting comparability of our expenses by segment include:

- During the nine months ended September 30, 2006, we recorded insurance recoveries, net of losses of \$10.3 million compared to \$1.4 million during the same period of 2005 related to damages sustained from Hurricane Katrina that occurred during 2005 by the Louisiana Operations. Expenses from the Louisiana Operations and CDSN also decreased as a result of 49 fewer live racing days at Fair Grounds due to the business interruption caused by Hurricane Katrina. A shortened race meet was conducted at Harrah's Louisiana Downs from November 19, 2005 through January 22, 2006 resulting in 12 racing days during the nine months ended September 30, 2006 as compared to 61 days during the nine months ended September 30, 2005. Increased purse expenses and pari-mutuel related expenses as a result of increased business levels partially offset these declines.
- We incurred \$3.0 million of expenses related to the alternative gaming initiatives in Florida during the nine months ended September 30, 2005. During the nine months ended September 30, 2006, we recorded insurance recoveries, net of losses of \$2.7 million related to damages sustained from Hurricane Wilma that occurred during 2005. Higher property insurance expense partially offset this decrease, which was caused by the occurrence of significant natural disasters during 2005.
- Churchill Downs Racetrack expenses increased primarily as a result of increased expenses related to the Kentucky Derby, including higher expenses associated with fulfilling sponsorships related to the Kentucky Derby. Also, depreciation expense increased due to the recognition of a full nine months of depreciation expense related to the newly renovated Churchill Downs racetrack facility that was completed during 2005.
- Arlington Park expenses increased primarily as a result of less purse overpayment recoveries during the nine months ended September 30, 2006 in addition to the generation of additional purse overpayments during the same period.
- Corporate expenses increased during the nine months ended September 30, 2006 compared to the nine months ended September 30, 2005 primarily as a result of increased costs associated with the retirement and replacement of the chief executive officer and increased payroll costs.

Discontinued Operations

The following table presents earnings from discontinued operations for the nine months ended September 30, 2006 and 2005:

(In thousands, except per share data and live race days)

| | <u>Nine Months Ended September 30,</u> | | <u>Change</u> | |
|--|--|------------------|--------------------|--------------|
| | <u>2006</u> | <u>2005</u> | <u>\$</u> | <u>%</u> |
| Net revenues | \$ 10,953 | \$ 82,105 | \$ (71,152) | (87)% |
| Operating expenses | 9,947 | 75,723 | (65,776) | (87)% |
| Gross profit | 1,006 | 6,382 | (5,376) | (84)% |
| Selling, general and administrative expenses | 1,152 | 3,858 | (2,706) | (70)% |
| Insurance recoveries, net of losses | (1,367) | - | (1,367) | (100)% |
| Operating income | 1,221 | 2,524 | (1,303) | (52)% |
| Other income (expense): | | | | |
| Interest income | - | 20 | (20) | (100)% |
| Interest expense | - | (8,806) | 8,806 | 100% |
| Miscellaneous, net | 48 | 80 | (32) | (40)% |
| | 48 | (8,706) | 8,754 | 101% |
| Earnings (loss) before income taxes | 1,269 | (6,182) | 7,451 | 121% |
| (Provision) benefit for income taxes | (525) | 1,039 | (1,564) | (151)% |
| Earnings (loss) from operations | 744 | (5,143) | 5,887 | 114% |
| Gain on sale of assets, net of income taxes | 4,197 | 69,917 | (65,720) | (94)% |
| Net earnings | <u>\$ 4,941</u> | <u>\$ 64,774</u> | <u>\$ (59,833)</u> | <u>(92)%</u> |

Significant items affecting comparability of earnings from discontinued operations include:

- The results of operations of discontinued operations for the nine months ended September 30, 2006 include the results of operations of Ellis Park compared to those of Hollywood Park and Ellis Park for the nine months ended September 30, 2005.

Consolidated Balance Sheet

The following table is a summary of our overall financial position as of September 30, 2006 and December 31, 2005:

(In thousands)

| | <u>September 30, 2006</u> | | <u>December 31, 2005</u> | | <u>Change</u> | |
|----------------------------|---------------------------|----------|--------------------------|----------|---------------|----------|
| | <u>\$</u> | <u>%</u> | <u>\$</u> | <u>%</u> | <u>\$</u> | <u>%</u> |
| Total assets | \$ 529,670 | | \$ 513,165 | | \$ 16,505 | 3% |
| Total liabilities | \$ 176,582 | | \$ 196,934 | | \$ (20,352) | (10)% |
| Total shareholders' equity | \$ 353,088 | | \$ 316,231 | | \$ 36,857 | 12% |

Significant items affecting comparability of our consolidated balance sheet include:

- Total assets increased primarily as a result of increased restricted cash balances generated by the collection of amounts to be paid out as purses during future racing meets, which was primarily caused by the previously mentioned higher business levels in the Louisiana Operations.
- Total liabilities decreased primarily as a result of the pay-off of long-term debt using cash generated from operations. Deferred revenue decreased \$11.7 million primarily due to recognition of revenue for luxury suite sales, corporate sponsor events, season boxes, membership sales and future wagering related to the 2006 Kentucky Derby and Kentucky Oaks race days. Dividends payable decreased \$6.5 million as a result of the payment of 2005 dividends during the nine months ended September 30, 2006. Purses payable increased \$12.5 million primarily due to amounts generated by improved business levels in the Louisiana Operations and the live race meet at Hoosier Park.

Liquidity and Capital Resources

The following table is a summary of our liquidity and capital resources:

(In thousands)

| | <u>Nine Months Ended September 30,</u> | | | <u>Change</u> | |
|----------------------|---|--------------------|----|----------------------|-----------------|
| | <u>2006</u> | <u>2005</u> | | <u>\$</u> | <u>%</u> |
| Operating activities | \$ 46,704 | \$ 32,500 | \$ | 14,204 | 44% |
| Investing activities | \$ (22,078) | \$ 207,732 | \$ | (229,810) | (111)% |
| Financing activities | \$ (22,251) | \$ (229,719) | \$ | 207,468 | 90% |

Significant items affecting comparability of our liquidity and capital resources include:

- The increase in operating activities is primarily the result of cash generated by the collection of insurance proceeds related to damages sustained from natural disasters that occurred during 2005.
- During the nine months ended September 30, 2005, we received \$248.3 million of net proceeds in connection with the sale of the assets of Hollywood Park, resulting in the decrease in investing activities. Reduced capital expenditures related to the Churchill Downs racetrack facility renovation project referred to as the "Master Plan" partially offset this decrease.
- We made repayments in excess of our borrowings on our revolving loan facilities of \$15.6 million during the nine months ended September 30, 2006 compared to \$225.0 million during the nine months ended September 30, 2005 due to the fact that excess cash was generated from the sale of the assets of Hollywood Park during 2005.
- We anticipate that cash flows from operations over the next twelve months will be adequate to fund our business operations and capital expenditures.

Recently Issued Accounting Pronouncements

In July of 2006, the Financial Accounting Standards Board (the "FASB") issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement 109" ("FIN 48"). FIN 48 establishes, among other things, that a tax benefit from an uncertain position may only be recognized if it is "more likely than not" that the position is sustainable based on its technical merits. The tax benefit of a qualifying position will be measured by calculating the largest amount of tax benefit that is greater than 50 percent likely of being realized upon ultimate settlement with a taxing authority having full knowledge of all relevant information. The assessment of the recognition threshold and the measurement of the associated tax benefit might change as new information becomes available. Unrecognized tax benefits will be recognized in the period that the position reaches the recognition threshold, which might occur prior to absolute finality of the matter. Similarly, recognized tax benefits will be derecognized in the period in which the position falls below the threshold. FIN 48 also requires qualitative and quantitative disclosures, including discussion of reasonably possible changes that might occur in the recognized tax benefits over the next twelve months, a description of open tax years by major jurisdictions and a roll-forward of all unrecognized tax benefits, presented as a reconciliation of the beginning and ending balances of the unrecognized tax benefits on a worldwide aggregated basis. FIN 48 is effective for the Company as of January 1, 2007. The change in net assets, if any, that results from the application of FIN 48 will be recorded as an adjustment to retained earnings. Management has not yet determined the impact that the adoption of FIN 48 will have on our consolidated financial position, results of operations and earnings per common share.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

No material changes have occurred in our exposures to market risk during the first nine months of 2006.

ITEM 4. CONTROLS AND PROCEDURES

(a) Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by the report, the Company carried out an evaluation under the supervision and with the participation of the Company's Disclosure Committee and management, including the President and Chief Executive Officer ("CEO") and the Chief Financial Officer ("CFO"), of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rule 13a-15(b). Based upon this evaluation, the CEO and the CFO concluded that our disclosure controls and procedures were effective as of September 30, 2006.

(b) Changes in Internal Control over Financial Reporting

Management of the Company has evaluated, with the participation of our CEO and CFO, changes in the Company's internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act) during the third quarter of 2006. There have not been any changes in the Company's internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act) that occurred during the quarter ended September 30, 2006 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Not applicable.

ITEM 1A. RISK FACTORS

Information regarding risk factors appears in Part I - Item 1A of the Company's Annual Report on Form 10-K for the year ended December 31, 2005. Other than described below, there have been no material changes from the risk factors previously disclosed in the Company's Annual Report on Form 10-K.

Potential Changes in Legislation and Regulation of Our Operations

Our gaming operations exist at the discretion of the states where we conduct business. Certain aspects of our gaming operations are also subject to federal statutes or regulations. All of our pari-mutuel wagering operations are contingent upon continued governmental approval of those operations as forms of legalized gaming. Legislation to limit or prohibit gaming (pari-mutuel or non-pari-mutuel) may be introduced in the future. Any restriction on or prohibition of gaming operations could have a material, adverse impact on our business, financial condition and results of operations. In addition, any expansion of our gaming operations into alternative gaming, such as slot machines, video lottery terminals and other forms of non-pari-mutuel gaming, will likely require various additional licenses, registrations, permits and approvals. The approval process can be time-consuming and costly, and there is no assurance of success. We have and continue to seek legal authority to offer alternative gaming at our racetracks where alternative gaming is not currently permitted.

We authorize third party account wagering providers to accept pari-mutuel wagers from subscribers residing in states that expressly authorize or do not expressly prohibit account wagering. We receive host fees and source market fees from this activity. In the past, certain state attorneys general, district attorneys and other law enforcement officials have expressed concern over the legality of interstate account wagering. In December 2000, legislation was enacted in the United States that amends the Interstate Horseracing Act of 1978. We believe that this amendment clarifies that inter-track simulcasting, off-track betting and account wagering, when conducted in accordance with the IHA are authorized under U.S. federal law. The amendment may not be interpreted in this manner by all concerned, however, and there may be challenges to these activities by both state and federal law enforcement authorities, which could have a material, adverse impact on our business, financial condition and results of operations. In addition, if any proceedings were brought by governmental or private litigants who disagree with our interpretation of the applicable laws, the adverse publicity, cost of such litigation and diversion of our management's focus and time away from our business operations may have a material, adverse impact on our business, financial condition and results of operations.

On September 29, 2006, the United States Congress passed the Safe Port Act ("HR 4954"). An amendment to this act incorporated the Internet Gambling Enforcement Act ("HR 4411"). The act prohibits those involved in the business of betting or wagering from accepting any financial instrument, electronic or otherwise, for deposit that is intended to be utilized for unlawful Internet gambling. The definition of unlawful Internet gambling specifically excludes all activities which are legal under the Interstate Horseracing Act. The act also contains a "Sense of Congress" which explicitly states that the act is not intended to criminalize any activity currently permitted by federal law. The Secretary of the Treasury is directed to promulgate regulations to enforce the provisions of this act within 270 days. The Secretary is further directed to ensure the regulations do not prohibit any activity which is excluded from the definition of unlawful Internet gambling, including those activities legal under the Interstate Horseracing Act. President Bush signed the bill in to law on October 13, 2006

In 2003, the country of Antigua filed a formal complaint against the United States with the WTO, challenging the United States' ability to enforce certain Federal gaming laws against foreign companies that were accepting Internet wagers from United States residents. At issue was whether the United States' enforcement of the Acts against foreign companies violated the GATS. In November of 2004, a WTO panel ruled that the United States, as a signatory of GATS, could not enforce the Acts against foreign companies that were accepting Internet wagers from United States residents. The United States

appealed the ruling and, in April of 2005, the WTO's appellate body ruled that the United States had demonstrated that the Acts were measures necessary to protect public morals or maintain public order, but that the United States did not enforce the Acts consistently between domestic companies and foreign companies as required by GATS. The WTO's appellate body specifically referenced the IHA, which appeared to authorize domestic companies to accept Internet wagers on horseracing, as being inconsistent with the United States' stated policy against Internet wagering. In arguments and briefs before the WTO's appellate body, the United States argued that the Acts, specifically the Wire Act, applies equally to domestic companies and foreign companies and the IHA does not create an exception for domestic companies to accept Internet wagering on horseracing. The WTO's appellate body did not rule on whether an exception for domestic U.S. companies was created under the IHA, but recommended that the WTO's Dispute Settlement Body request the United States to bring measures found to be inconsistent with GATS into conformity with its obligations under GATS. The United States was given until April 3, 2006 to bring its policies in line with the ruling, assuming it believed any changes were necessary. On April 10, 2006, the United States delegation to the WTO submitted a brief report to the Chairman of the Dispute Settlement Body ("U.S. Report") stating that no changes are necessary to bring U.S. policies in line with the ruling. In support of its position, the United States delegation informed the Dispute Settlement Body that on April 5, 2006, the United States Department of Justice confirmed the United States Government position regarding remote wagering on horseracing in testimony before a subcommittee of the United States House of Representatives. According to the U.S. Report, in that testimony, the Department of Justice stated its view that regardless of the IHA, existing criminal statutes prohibit the interstate transmission of bets or wagers, including wagers on horseracing, and informed the subcommittee that it is currently undertaking a civil investigation relating to a potential violation of law regarding this activity. Antigua has not indicated what actions, if any, it will take in response to the U.S. Report and the United States' position relative to interstate wagering on horseracing. The effect of the WTO ruling on the ability of domestic companies to accept Internet wagers and other account wagers on horseracing remains unclear. While the WTO decision does not affect any existing federal or state law, we cannot predict what actions, if any, the U.S. government will take in response to the request of the WTO in light of the appellate body report of the WTO and in light of the U.S. Report and what impact, if any, the appellate body report and the U.S. Report will have on our business and operations. One of the options available to Congress and the White House is to prohibit or restrict substantially the conduct of interstate simulcast wagering or account wagering. If the U.S. government elects to take such an approach (including through any action by the Department of Justice), it will have a material, adverse impact on our business, financial condition and results of operations.

The Indiana horse racing industry currently receives a subsidy from riverboat casinos. Currently the subsidy is distributed as follows: 40% for purse expenses, 20% for breed development and 40% for the two existing racetrack operators, which is divided equally. During March of 2006, the IHRC approved "Integrity '06," a program designed to improve the integrity of horse racing in Indiana that is effective April 1, 2006. The estimated cost of complying with the rules and regulations created by "Integrity '06" will be financed by the two existing racetrack operators in Indiana using the subsidy paid by riverboat casinos, which is estimated to be 2% of the total subsidy. As a result, beginning April 1, 2006, the subsidy will be distributed as follows: 39.2% for purse expenses, 19.6% for breed development and 41.2% for the two existing racetrack operators, which is divided equally. Any change in this arrangement could adversely impact our operations in Indiana and the value of this operation.

In Illinois, the IRB has the authority to designate racetracks as "host track" for the purpose of receiving host track revenues generated during periods when no racetrack is conducting live races. Racetracks that are designated as "host track" obtain and distribute out of state simulcast signals for the State of Illinois. Under Illinois law, the "host track" is entitled to a larger portion of commissions on the related pari-mutuel wagering. Failure to designate Arlington Park as "host track" during this period could have a material, adverse impact on our business, financial condition and results of operations. In addition, Arlington Park is statutorily entitled to recapture as revenues monies that are otherwise payable to Arlington Park's purse account. The right to recapture these revenues is subject to change every legislative session.

These statutory or regulatory established revenue sources in Indiana and Illinois are subject to change every legislative session. The reduction or elimination of any one of them could have a material, adverse impact on our results of operations. In addition, certain revenue sources are dedicated by legislation or regulation and may be subject to change.

The passage of legislation permitting alternative gaming at racetracks can be a long and uncertain process. As a result, there can be no assurance that (1) jurisdictions in which we own or operate racetracks will pass legislation permitting alternative gaming, (2) if jurisdictions pass such legislation, it will be permitted at our racetracks, and (3) if alternative gaming is permitted at our racetracks, it will be on economically viable terms. If alternative gaming legislation is enacted in any jurisdiction where we own or operate a racetrack and we proceed to conduct alternative gaming, there may be significant costs and other resources to be expended and there will be significant risks involved, including the risk of changes in the enabling legislation, that racetrack's business, financial condition and results of operations.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Not applicable.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Not applicable.

ITEM 5. OTHER INFORMATION

Not applicable.

ITEM 6. EXHIBITS

See exhibit index.

SIGNATURES

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

CHURCHILL DOWNS INCORPORATED

November 7, 2006

/s/Robert L. Evans
Robert L. Evans
President and Chief Executive Officer
(Principal Executive Officer)

November 7, 2006

/s/Michael E. Miller
Michael E. Miller
Executive Vice President and
Chief Financial Officer
(Principal Financial and Accounting Officer)

EXHIBIT INDEX

| <u>Numbers</u> | <u>Description</u> | <u>By Reference To</u> |
|----------------|--|---|
| 10(a) | First Amendment to Employment Agreement, as Amended and Restated as of December 31, 2005 by and between Thomas H. Meeker and Churchill Downs Incorporated | Exhibit 10.1 to Report on Form 8-K dated July 18, 2006 |
| 10(b) | Employment Agreement dated as of July 18, 2006 by and between Churchill Downs Incorporated and Robert L. Evans * | Report on Form 10-Q for the Fiscal Quarter ended September 30, 2006 |
| 10(c) | Churchill Downs Incorporated Restricted Stock Agreement for 65,000 Shares made as of July 18, 2006 by and between Robert L. Evans and Churchill Downs Incorporated * | Report on Form 10-Q for the Fiscal Quarter ended September 30, 2006 |
| 10(d) | Churchill Downs Incorporated Restricted Stock Agreement for 90,000 Shares made as of July 18, 2006 by and between Robert L. Evans and Churchill Downs Incorporated * | Report on Form 10-Q for the Fiscal Quarter ended September 30, 2006 |
| 10(e) | Churchill Downs Incorporated Restricted Stock Units Agreement for 65,000 Units made as of July 18, 2006 by and between Robert L. Evans and Churchill Downs Incorporated | Report on Form 10-Q for the Fiscal Quarter ended September 30, 2006 |
| 10(f) | Churchill Downs Incorporated Stock Option Agreement for 130,000 Options made as of July 18, 2006 by and between Churchill Downs Incorporated and Robert L. Evans | Report on Form 10-Q for the Fiscal Quarter ended September 30, 2006 |
| 10(g) | Offer Letter to Vernon Niven, III accepted as of September 12, 2006 * | Report on Form 10-Q for the Fiscal Quarter ended September 30, 2006 |
| 10(h) | Description of Special Recognition Bonus for Thomas H. Meeker | Report on Form 8-K dated August 11, 2006 |
| 31(i)(a) | Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 | Report on Form 10-Q for the fiscal quarter ended September 30, 2006 |
| 31(i)(b) | Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 | Report on Form 10-Q for the fiscal quarter ended September 30, 2006 |
| 32 | Certification of CEO and CFO Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished pursuant to Rule 13a - 14(b)) | Report on Form 10-Q for the fiscal quarter ended September 30, 2006 |

* Portions of these exhibits have been redacted pursuant to a confidential treatment request filed with the Securities Exchange Commission. Such redacted portions have been marked with an asterisk.

EMPLOYMENT AGREEMENT

EMPLOYMENT AGREEMENT (this "Agreement"), dated as of July 18, 2006 (the "Effective Date"), by and between Churchill Downs Incorporated, a Kentucky corporation (the "Company"), and Robert L. Evans ("Executive").

WHEREAS, the Company desires to employ Executive and to enter into an agreement embodying the terms of such employment, and considers it to be in its best interests and in the best interests of its stockholders to employ Executive during the Employment Term (as defined in Section 1 below);

WHEREAS, Executive desires to accept such employment with the Company and to enter into this Agreement; and

WHEREAS, Executive is willing to accept employment on the terms hereinafter set forth in this Agreement.

NOW, THEREFORE, in consideration of the premises and mutual covenants herein and for other good and valuable consideration, the parties hereby agree as follows:

1. Term of Employment. Unless terminated earlier in accordance with the provisions of Section 7, Executive's employment under this Agreement shall be effective for a term commencing on August 14, 2006 (the "Start Date") and ending on the three (3) year anniversary of the Start Date (the "Employment Term"). Thereafter, the Employment Term shall be automatically extended for subsequent one (1)-year periods unless written notice to the contrary is given by either the Company or Executive within ninety (90) days prior to the expiration of the Employment Term or the expiration of any subsequent one (1)-year extension thereof. Notwithstanding this Section 1, the equity grants made pursuant to Section 5 of this Agreement shall be made as of the Effective Date.

2. Position and Duties.

(a) As of the Start Date, Executive shall serve as the Chief Executive Officer and President of the Company. In such position, Executive shall report directly to the Board (as defined in Section 10(c)) and have such authority, responsibilities, and duties customarily exercised by a person holding such position. The Company shall cause Executive to be appointed to the Board as of the Start Date and, during the Employment Term, to be nominated for election as a member of the Board as needed to maintain Executive's position on the Board.

(b) During the Employment Term, Executive will devote substantially all of his business time and best efforts to the performance of his duties. Executive may:

(i) in addition to being a director of the Company and with the prior written approval of the Chairman of the Board, serve as a director or trustee of: (x) up to three (3) corporate or charitable entities and (y) trade or other associations related to the Company's industry; and

(ii) manage his personal investments;

to the extent that such activities do not materially inhibit or materially interfere with the performance of Executive's duties under this Agreement.

3. Base Salary. During the Employment Term, the Company shall pay Executive a base salary (the "Base Salary") at the annual rate of \$450,000.00, payable in regular installments in accordance with the Company's usual payroll practices. The Base Salary includes fees otherwise payable for his services for the Board. The Board shall review and may consider for increase (but not decrease) at any time Executive's Base Salary in its sole discretion based on Executive's performance.

4. Incentive Compensation. Executive shall be eligible to participate in any annual or long-term, cash or equity based, incentive plan or other arrangements of the Company, as they exist from time-to-time. Executive shall first be eligible to participate in an annual performance bonus plan for the performance period commencing January 1, 2007, with a target bonus for such period at 75% of Base Salary. The Board shall determine Executive's annual incentive plan participation for subsequent years.

5. Equity Grants.

(a) Restricted Stock Units. In accordance with the terms of that certain Restricted Stock Units Agreement between the Company and Executive of even date herewith, as of the Effective Date, the Company shall grant Executive 65,000 Restricted Stock Units (as defined in Section 10(r)). The Restricted Stock Units shall vest as follows:

| <u>Vesting Date</u> | <u>Number of Units to Vest</u> |
|---------------------|--------------------------------|
| September 30, 2006 | 1,625 |
| December 31, 2006 | 3,250 |
| March 31, 2007 | 3,250 |
| June 30, 2007 | 3,250 |
| September 30, 2007 | 3,250 |
| December 31, 2007 | 3,250 |
| March 31, 2008 | 3,250 |
| June 30, 2008 | 3,250 |
| September 30, 2008 | 3,250 |
| December 31, 2008 | 3,250 |
| March 31, 2009 | 3,250 |
| June 30, 2009 | 3,250 |
| September 30, 2009 | 3,250 |
| December 31, 2009 | 3,250 |
| March 31, 2010 | 3,250 |
| June 30, 2010 | 3,250 |
| September 30, 2010 | 3,250 |
| December 31, 2010 | 3,250 |
| March 31, 2011 | 3,250 |
| June 30, 2011 | 3,250 |
| August 14, 2011 | 1,625 |

(b) Restricted Shares.

(i) In accordance with the terms of that certain Restricted Stock Agreement between the Company and Executive of even date herewith, as of the Effective Date and subject to shareholder approval, the Company shall grant Executive 90,000 Restricted Shares of Common Stock which shall vest as follows upon the Fair Market Value (as defined in Section 10(m)) of a share of the Common Stock (as defined in Section 10(g)) reaching the following prices for ^{***} (**) consecutive trading days on and after the Start Date; provided, however, that such ^{**} (**)-trading day period occurs prior to a Termination of Employment (as defined in Section 10(u)), but subject to Section 7(b) below:

| <u>** Day Fair Market Value at or Above</u> | <u>Shares Vesting</u> |
|---|-----------------------|
| \$ ^{**} . ^{**} | 22,500 |
| \$ ^{**} . ^{**} | 22,500 |
| \$ ^{**} . ^{**} | 22,500 |
| \$ ^{**} . ^{**} | 22,500 |

(ii) In accordance with the terms of that certain Restricted Stock Agreement between the Company and Executive of even date herewith, as of the Effective Date and subject to shareholder approval, the Company shall grant Executive 65,000 Restricted Shares of Common Stock which shall vest upon the satisfaction of the requirements described in Subsections (1) and (2) below:

(1) for ^{**} (**) consecutive trading days after the Start Date, the Fair Market Value of a share of the Common Stock being equal to or greater than ^{*}-%, ^{*} percent (***) of the Fair Market Value of a share of Common Stock as of the Effective Date (the "Share Price Requirement"); and

(2) for the applicable number of Restricted Shares per the schedule immediately below, the later of: (A) the corresponding vesting date as listed on the schedule below, or (B) the satisfaction of the Share Price Requirement; provided, however, that such vesting date or Share Price Requirement occurs prior to a Termination of Employment, but subject to Section 7(b) below:

| <u>Vesting Date</u> | <u>Shares Vesting</u> |
|---------------------|-----------------------|
| September 30, 2006 | 1,625 |
| December 31, 2006 | 3,250 |
| March 31, 2007 | 3,250 |
| June 30, 2007 | 3,250 |

* Confidential information omitted and filed separately with the Securities and Exchange Commission under a Confidential Treatment Request.

| | |
|--------------------|-------|
| September 30, 2007 | 3,250 |
| December 31, 2007 | 3,250 |
| March 31, 2008 | 3,250 |
| June 30, 2008 | 3,250 |
| September 30, 2008 | 3,250 |
| December 31, 2008 | 3,250 |
| March 31, 2009 | 3,250 |
| June 30, 2009 | 3,250 |
| September 30, 2009 | 3,250 |
| December 31, 2009 | 3,250 |
| March 31, 2010 | 3,250 |
| June 30, 2010 | 3,250 |
| September 30, 2010 | 3,250 |
| December 31, 2010 | 3,250 |
| March 31, 2011 | 3,250 |
| June 30, 2011 | 3,250 |
| August 14, 2011 | 1,625 |

(c) Stock Options. In accordance with the terms of that certain Stock Option Agreement between the Company and Executive of even date herewith, as of the Effective Date and subject to shareholder approval, the Company shall grant Executive six (6)-year term Options (as defined in Section 10(p)) to purchase 130,000 shares of Common Stock with a per share exercise price equal to the Fair Market Value of a share of Common Stock as of the date of grant. Such Options shall vest as follows:

| <u>Vesting Date</u> | <u>Number of Options to Vest</u> |
|---------------------|----------------------------------|
| September 30, 2006 | 5,417 |
| December 31, 2006 | 10,833 |
| March 31, 2007 | 10,833 |
| June 30, 2007 | 10,833 |
| September 30, 2007 | 10,833 |
| December 31, 2007 | 10,833 |
| March 31, 2008 | 10,833 |
| June 30, 2008 | 10,833 |
| September 30, 2008 | 10,833 |
| December 31, 2008 | 10,834 |
| March 31, 2009 | 10,834 |
| June 30, 2009 | 10,834 |
| August 14, 2009 | 5,417 |

(d) Change in Control. In the event of a Change in Control during the Employment Term, Executive shall receive accelerated vesting of: (i) fifty percent (50%) of the then-unvested Restricted Stock Units granted pursuant to Section 5(a) above, (ii) fifty percent (50%) of the then-unvested Restricted Shares granted pursuant to Subsections 5(b)(i) and (ii) above, and (iii) fifty percent (50%) of the then-unvested Stock Options granted pursuant to Section 5(c) above. The Restricted Stock Units, Restricted Shares and Stock Options that are subject to accelerated vesting pursuant to this Section 5(d) shall be taken pro-rata from each then-unvested tranche of the applicable award, and the remaining portion of each tranche shall vest according to the original terms of the applicable award agreement, subject to potential accelerated vesting pursuant to Section 7(c) below.

(e) Shareholder Approval. In the event shareholder approval of the awards granted pursuant to Subsection 5(b)(i), Subsection 5(b)(ii), and/or Section 5(c) above is not secured at or prior to the Company's annual shareholders' meeting in 2007 (the "2007 Annual Meeting"), then:

(i) the Company agrees to use its reasonable efforts to grant Executive a compensation arrangement of equivalent value; or

(ii) by written notice delivered to the Company within the thirty (30)-day period immediately following the 2007 Annual Meeting, Executive may terminate his employment with the Company and receive, subject to Section 7(g), (A) a lump-sum cash payment equal to \$400,000.00 and (B) the Accrued Obligations (as defined in Section 7(a) below); provided, however, that such notice must provide no less than thirty (30) days, but no more than one hundred twenty (120) days, prior notice of the effective date of such Termination of Employment and that such notice shall relieve the Company of its obligations per Section 5(e)(i) above. Notwithstanding the above, as needed to avoid incurring penalties under Section 409A of the Code (as defined in Section 10(f)), such payments due under this Section 5(e)(ii) shall be subject to a 6-month delay from the Termination of Employment. Except as provided herein, Executive shall have no further rights to any compensation or any other benefits under this Agreement due to such Termination of Employment. All other accrued and vested benefits, if any, due Executive following Termination of Employment pursuant to this Section 5(e)(ii) shall be determined in accordance with the plans, policies and practices of the Company.

6. Other Benefits.

(a) Retirement Benefits. During the Employment Term, Executive shall be provided with the opportunity to participate in the Company's qualified 401(k) profit sharing plan and non-qualified deferred compensation plan, as may exist from time to time, in each case, in accordance with the terms of such plans.

(b) Welfare Benefits. During the Employment Term, Executive shall be provided with the opportunity to participate in the Company's medical plan and other employee welfare benefits on a comparable basis as such benefits are generally provided by the Company from time to time to the Company's other senior executives, in each case, in accordance with the terms of such plans.

(c) Perquisites. During the Employment Term, Executive shall be provided with the opportunity to receive or participate in perquisites on a comparable basis as such perquisites are generally provided by the Company from time to time to the Company's other senior executives, subject to the following:

(i) Transportation benefit - Executive will be entitled to transportation, via car service or other comparable arrangement in connection with the performance of his duties hereunder (including but not limited to transportation between his primary residence and the Main Office (as defined in Section 10(o))), which will be in lieu of the Company's standard cash automobile subsidy provided to senior executives. To the extent this benefit is taxable income to Executive, he will receive a Tax Gross-Up Payment (as defined in Section 10(t)); and

(ii) Attorney fees - The Company will pay reasonable attorneys' fees and related expenses incurred by Executive in connection with the negotiation and review of this Agreement.

(iii) Indemnification Agreement - The Company agrees to enter into an agreement with Executive whereby the Company shall: (a) indemnify Executive to the maximum extent allowed under Kentucky law and (b) maintain directors' and officers' liability insurance for the benefit of the Executive in a form at least as comprehensive as, and in an amount that is at least equal to, that maintained by the Company at such time for any officer or director of the Company.

(d) Reimbursement of Business Expenses. During the Employment Term, all reasonable business expenses incurred by Executive in the performance of his duties hereunder shall be reimbursed by the Company upon receipt of documentation of such expenses in a form reasonably acceptable to the Company, and otherwise in accordance with the Company's expense reimbursement policies. Pursuant to the terms of this Section 6(d), the Company shall pay for the reasonable expenses of the Executive's wife when she travels with him on the Company's business.

7. Termination. Notwithstanding any other provision of the Agreement:

(a) For Cause by the Company or Voluntary Resignation by Executive Without Good Reason. If Executive is terminated by the Company for Cause (as defined in Section 10(d)) or if Executive voluntarily resigns without Good Reason (as defined in Section 10(n)), Executive shall be entitled to receive as soon as reasonably practicable after his date of termination or such earlier time as may be required by applicable statute or regulation: (i) his earned but unpaid Base Salary through the date of termination; (ii) payment in respect of any vacation days accrued but unused through the date of termination, to the extent provided by Company policy; (iii) reimbursement for all business expenses properly incurred in accordance with Company policy prior to the date of termination and not yet reimbursed by the Company; and (iv) subject to Section 7(g), any earned but unpaid annual bonus in respect of any of the Company's fiscal years preceding the fiscal year in which the termination occurs (provided, however that if Executive's termination is by the Company for Cause and such event(s) and/or action(s) that constitute Cause are materially and demonstrably injurious to the business or reputation of the Company, then no payment will be made pursuant to this clause (iv)) (the aggregate benefits payable pursuant to clauses (i), (ii), (iii) and (iv) hereafter referred to as the "Accrued Obligations"); and except as provided herein he shall have no further rights to any compensation (including any Base Salary or annual bonus, if any) or any other benefits under this Agreement. All equity-based awards shall be treated as set forth under the terms of the applicable plan or agreement. All other accrued and vested benefits, if any, due Executive following Executive's Termination of Employment pursuant to this Section 7(a) shall be determined and paid in accordance with the plans, policies, and practices of the Company.

(b) Without Cause by the Company or Voluntary Resignation by Executive for Good Reason. If Executive is terminated by the Company other than for Cause, Disability (as defined in Section 10(i)) or death, or if Executive voluntarily resigns for Good Reason, Executive shall receive: (i) the Accrued Obligations; and (ii) subject to Section 7(g), (A) Base Salary through the end of the calendar quarter in which Termination of Employment under this Section 7(b) occurs, (B) treatment of all equity-based awards per the terms of the applicable plan or agreement; provided, however, that vesting of any equity awards granted pursuant to Section 5 of this Agreement (including Restricted Shares vesting upon achievement of certain stock price targets) shall be calculated through the end of the calendar quarter in which Termination of Employment occurs, and (C) the continuation of medical benefits through the end of the calendar quarter in which Termination of Employment occurs; provided, however, that such benefit shall be reduced or eliminated to the extent Executive receives similar benefits from a subsequent employer. Notwithstanding the above, as needed to avoid incurring penalties under Section 409A of the Code, such payments due under this Section 7(b) shall be subject to a 6-month delay; provided, however, in the 7th month after Termination of Employment, a lump-sum catch-up payment shall be made for the 6-month delay. Except as provided herein, Executive shall have no further rights to any compensation (including any Base Salary) or any other benefits under this Agreement. All other accrued and vested benefits, if any, due Executive following Termination of Employment pursuant to this Section 7(b) shall be determined in accordance with the plans, policies and practices of the Company.

(c) Termination following a Change in Control. If, during the 2-year period following a Change in Control (as defined in Section 10(e)), Executive is terminated by the Company other than for Cause, Disability or death, or if Executive voluntarily resigns for Good Reason, Executive shall receive: (i) the Accrued Obligations; (ii) subject to Section 7(g): (A) the benefits set forth in Section 7(b); (B) full accelerated vesting of (x) any then-unvested Restricted Stock Units granted pursuant to Section 5(a), (y) any then-unvested Restricted Shares granted pursuant to Subsections 5(b)(i) and (ii), and (z) any then-unvested Stock Options granted pursuant to Section 5(c); and (C) a Tax Gross-Up Payment for purposes of Code Section 280G.

(d) Death. Following a Termination of Employment for death, Executive's estate shall be entitled to receive: (i) the Accrued Obligations; and (ii) subject to Section 7(g), (A) a pro-rata bonus, if any, for the year of death, based on the target bonus for such year, and paid when bonuses under such applicable bonus plans are normally paid, (B) treatment of all equity-based awards per the terms of such applicable plan or agreement, (C) all other benefits and payments per the applicable plan or program, and (D) life insurance benefits paid per such applicable plans. Except as provided herein, Executive's estate shall have no further rights to any compensation (including any Base Salary) or any other benefits under this Agreement. All other accrued and vested benefits, if any, due Executive following a Termination of Employment for death shall be determined in accordance with the plans, policies, and practices of the Company.

(e) Disability. Following a Termination of Employment for Disability, Executive shall be entitled to receive: (i) the Accrued Obligations; and (ii) subject to Section 7(g), (A) a pro-rata bonus, if any, for the year of Termination of Employment, based on the target bonus for such year, and paid when bonuses under the applicable bonus plans are normally paid, (B) treatment of all equity-based awards per the terms of the applicable plan or agreement, (C) all other benefits and payments per the applicable plan or program, and (D) short-term and long-term disability benefits per the applicable plans. Except as provided herein, Executive shall have no further rights to any compensation (including any Base Salary) or any other benefits under this Agreement. All other accrued and vested benefits, if any, due Executive following a Termination of Employment for Disability shall be determined in accordance with the plans, policies, and practices of the Company.

(f) No Mitigation or Offset. In no event shall the benefits set forth in this Section 7 be subject to mitigation or offset.

(g) Release. Notwithstanding any other provision of this Agreement to the contrary, Executive acknowledges and agrees that any and all payments to which Executive is entitled under this Section 7 which are described as being subject to this Section 7(g) are conditioned upon and subject to Executive's execution of, and not having revoked within any applicable revocation period, a general release and waiver, in such reasonable and customary form as shall be prepared by the Company, of all claims Executive may have against the Company and its directors, officers, subsidiaries and affiliates, except as to (i) matters covered by provisions of this Agreement that expressly survive the termination of this Agreement and (ii) rights to which Executive is entitled by virtue of his participation in the employee benefit plans, policies and arrangements of the Company.

8. Covenants.

(a) Confidentiality. Executive agrees that Executive will not at any time during Executive's employment with the Company or thereafter, except in performance of Executive's obligations to the Company hereunder, disclose, either directly or indirectly, any Confidential Information (as hereinafter defined) that Executive may learn by reason of his association with the Company. The term "Confidential Information" shall mean any past, present, or future confidential or secret plans, programs, documents, agreements, internal management reports, financial information, or other material relating to the business, strategies, services, or activities of the Company, including, without limitation, information with respect to the Company's operations, processes, products, inventions, business practices, finances, principals, vendors, suppliers, customers, potential customers, marketing methods, costs, prices, contractual relationships, including leases, regulatory status, compensation paid to employees, or other terms of employment, and trade secrets, market reports, customer investigations, customer lists, and other similar information that is proprietary information of the Company; provided, however, the term "Confidential Information" shall not include any of the above forms of information which has become public knowledge, unless such Confidential Information became public knowledge due to any act or acts by Executive or his representative(s) in violation of this Agreement. Notwithstanding the foregoing, Executive may disclose such Confidential Information when required to do so by a court of competent jurisdiction, by any governmental agency having supervisory authority over the business of the Company and/or its affiliates, as the case may be, or by any administrative body or legislative body (including a committee thereof) with jurisdiction to order Executive to divulge, disclose or make accessible such information; provided, further, that in the event that Executive is ordered by any such court or other government agency, administrative body, or legislative body to disclose any Confidential Information, Executive shall (i) promptly notify the Company of such order, (ii) at the reasonable written request of the Company, diligently contest such order at the sole expense of the Company as expenses occur, and (iii) at the reasonable written request of the Company, seek to obtain, at the sole expense of the Company, such confidential treatment as may be available under applicable laws for any information disclosed under such order.

(b) Non-Compete. During the Employment Term and for two (2) years immediately following a Termination of Employment for any reason, Executive shall not, without the prior written consent of the Company, participate or engage in, directly or indirectly (as an owner, partner, employee, officer, director, independent contractor, consultant, advisor or in any other capacity calling for the rendition of services, advice, or acts of management, operation or control) any business for a Competitor (as defined below). The term "Competitor" shall mean any entity whose principal business involves the operation of a pari-mutuel or casino gaming business.

(c) Non-Solicit. During the Employment Term and for two (2) years immediately following a Termination of Employment for any reason, Executive shall not, without the prior written consent of the Company, solicit or induce any then-existing employee of the Company or any of its subsidiaries to leave employment with the Company or any of its subsidiaries or contact any then-existing customer or vendor under contract with the Company or any of its subsidiaries for the purpose of obtaining business similar to that engaged in, or received (as appropriate), by the Company.

(d) Cooperation. Executive agrees that during the Employment Term or following a Termination of Employment for any reason, Executive shall, upon reasonable advance notice, assist and cooperate with the Company with regard to any investigation or litigation related to a matter or project in which Executive was involved during Executive's employment. The Company shall reimburse Executive for all reasonable and necessary expenses related to Executive's services under this Section 8(d) (i.e. travel, lodging, meals, telephone and overnight courier) within ten (10) business days of Executive submitting to Company appropriate receipts and expense statements.

(e) Survivability. The duties and obligations of Executive pursuant to this Section 8 shall survive the termination of this Agreement and Executive's Termination of Employment for any reason.

(f) Remedies. Executive acknowledges that the protections of the Company set forth in this Section 8 are fair and reasonable. Executive agrees that remedies at law for a breach or threatened breach of the provisions of this Section 8 would be inadequate and, therefore, the Company shall be entitled, in addition to any other available remedies, without posting a bond, to equitable relief in the form of specific performance, temporary restraining order, temporary or permanent injunction, or any other equitable remedy that may be then available.

(g) Limitation. If the duration, scope, or nature of any restriction on business activity covered by any provision of Section 8(b) or (c) above is in excess of what is valid and enforceable under applicable law, such restriction shall be construed to limit duration, scope or activity to an extent that is valid and enforceable, with such extent to be the maximum extent possible under applicable law. For each of Section 8(b) and (c) above, Executive hereby acknowledges that such Section shall be given the construction which renders its provisions valid and enforceable to the maximum extent, not exceeding its express terms, possible under applicable law.

9. Miscellaneous.

(a) Resolution of Disputes and Reimbursement of Legal Costs. Except as otherwise provided in Section 8, the Company and Executive agree that any controversy or claim arising out of or relating to this Agreement or the breach thereof shall be settled by arbitration administered by the American Arbitration Association in accordance with its Commercial Arbitration Rules then in effect. Venue for any arbitration pursuant to this Agreement will lie in Louisville, Kentucky. Any award entered by the arbitrator(s) shall be final, binding and nonappealable and judgment may be entered thereon by either party in accordance with applicable law in any court of competent jurisdiction. This arbitration provision shall be specifically enforceable. Each party shall be responsible for its own expenses relating to the conduct of the arbitration (including reasonable attorneys' fees and expenses) and shall share the fees of the American Arbitration Association and the arbitrator(s), if applicable, equally.

(b) Governing Law. This Agreement will be governed by, and interpreted in accordance with, the laws of the Commonwealth of Kentucky applicable to agreements made and to be wholly performed within the Commonwealth of Kentucky, without regard to the conflict of laws provisions of any jurisdiction which would cause the application of any law other than that of the Commonwealth of Kentucky.

(c) Entire Agreement/Amendments. This Agreement contains the entire understanding of the parties with respect to the employment of Executive by the Company. There are no restrictions, agreements, promises, warranties, covenants or undertakings between the parties with respect to the subject matter herein other than those expressly set forth herein. Neither this Agreement may be altered, modified, or amended except by written instrument signed by the parties hereto. Sections 7 and 8 shall survive the termination of Executive's employment with the Company, except as otherwise specifically stated therein.

(d) Neutral Interpretation. This Agreement constitutes the product of the negotiation of the parties hereto and the enforcement of this Agreement shall be interpreted in a neutral manner, and not more strongly for or against any party based upon the source of the draftsmanship of the Agreement. Each party has been provided ample time and opportunity to review and negotiate the terms of this Agreement and consult with legal counsel regarding the Agreement.

(e) No Waiver. The failure of a party to insist upon strict adherence to any term of this Agreement on any occasion shall not be considered a waiver of such party's rights or deprive such party of the right thereafter to insist upon strict adherence to that term or any other term of this Agreement.

(f) Severability. In the event that any one or more of the provisions of this Agreement shall be or become invalid, illegal or unenforceable in any respect, the validity, legality and enforceability of the remaining provisions of this Agreement shall not be affected thereby.

(g) Successors.

(i) This Agreement is personal to Executive and shall not be assignable by Executive otherwise than by will or the laws of descent and distribution. This Agreement shall inure to the benefit of and be enforceable by Executive's legal representatives.

(ii) This Agreement shall inure to the benefit of and be binding upon the Company and its successors and assigns. The Company shall require any successor (whether direct or indirect, by purchase, merger, reorganization, consolidation, acquisition of property or stock, liquidation, or otherwise) to all or a substantial portion of its business and/or assets, by agreement in form and substance reasonably satisfactory to Executive, expressly to assume and agree to perform this Agreement in the same manner and to the same extent that the Company would be required to perform this Agreement if no such succession had taken place. Regardless of whether such an agreement is executed, this Agreement shall be binding upon any successor of the Company and such successor shall be deemed the "Company" for purposes of this Agreement.

(h) Notice. For the purpose of this Agreement, notices and all other communications provided for in this Agreement shall be in writing and shall be deemed to have been duly given if delivered personally, if delivered by overnight courier service, if sent by facsimile transmission or if mailed by United States registered mail, return receipt requested, postage prepaid, addressed to the respective addresses or sent via facsimile to the respective facsimile numbers, as the case may be, as set forth below, or to such other address as either party may have furnished to the other in writing in accordance herewith, except that notice of change of address shall be effective only upon receipt; provided, however, that (i) notices sent by personal delivery or overnight courier shall be deemed given when delivered; (ii) notices sent by facsimile transmission shall be deemed given upon the sender's receipt of confirmation of complete transmission, and (iii) notices sent by United States registered mail shall be deemed given two days after the date of deposit in the United States mail.

If to the Company, to:

Churchill Downs Incorporated
Attn: General Counsel
700 Central Avenue
Louisville, KY 40208

With a copy to:

Vedder Price Kaufman & Kammholz P.C.
Attn: Michael A. Nemeroff, Esq.
222 North LaSalle Street
Chicago, IL 60601
Facsimile: (312) 609-5005

If to Executive, to such address as shall most currently appear on the records of the Company.

(i) Withholding. The Company may withhold from any amounts payable under this Agreement such Taxes (as defined in Section 10(s)) as may be required to be withheld pursuant to any applicable law or regulation.

(j) Counterparts and Signatures. This Agreement may be signed in counterparts, each of which shall be an original, with the same effect as if the signatures thereto and hereto were upon the same instrument. Signatures delivered by facsimile or PDF file shall constitute original signatures.

(k) Code Section 409A. It is intended that any amounts payable under this Agreement and the Company's and Executive's exercise of authority or discretion hereunder shall comply with Code Section 409A (including the Treasury regulations and other published guidance relating thereto) so as not to subject Executive to the payment of any interest or additional tax imposed under Code Section 409A. To the extent any amount payable under this Agreement would trigger the additional tax imposed by Code Section 409A, the Agreement shall be modified to avoid such additional tax.

10. Definitions.

(a) "Agreement" - - see the recitals to this Agreement.

(b) "Base Salary" - - see Section 3.

(c) "Board" means the Board of Directors of the Company.

(d) "Cause" for termination by the Company of Executive's employment with the Company means any of the following:

(i) the willful and continued failure of Executive to perform substantially his duties to the Company (other than any such failure resulting from incapacity due to disability), after a written demand for substantial performance is delivered to Executive by the Chairman of the Board which specifically identifies the manner in which the Board believes that Executive has not substantially performed his duties;

(ii) Executive's conviction of, or plea of guilty or no contest to (A) a felony or (B) a misdemeanor involving dishonesty or moral turpitude; or

(iii) the willful engaging by Executive in illegal conduct or gross misconduct which is materially and demonstrably injurious to the business or reputation of the Company.

For purposes of this definition, no act or failure to act, on the part of Executive, shall be considered "willful" unless it is done, or omitted to be done, by Executive in bad faith or without reasonable belief that Executive's action or omission was in the best interests of the Company. Any act, or failure to act, based upon specific authority given pursuant to a resolution duly adopted by the Board or upon instructions of the Chairman of the Board or based upon the advice of counsel of the Company which Executive honestly believes is within such counsel's competence shall be conclusively presumed to be done, or omitted to be done, by Executive in good faith and in the best interests of the Company. The Company shall give written notice to Executive of the termination for Cause. Such notice shall state in detail the particular act or acts or the failure or failures to act that constitute the grounds on which the Cause termination is based and such notice shall be given within six (6) months of the occurrence of, or, if later, the Company's actual knowledge of, the act or acts or the failure or failures to act which constitute the grounds for Cause. Executive shall have sixty (60) days upon receipt of the notice in which to cure such conduct, to the extent such cure is possible.

(e) “Change in Control” means the first to occur of the following events:

(i) excluding Duchossois Industries, Inc. and its affiliates, the acquisition by any individual, entity or group (within the meaning of Section 13(d)(3) or 14(d)(2) of the Securities Exchange Act of 1934 (the “Exchange Act”) (a “Person”) of beneficial ownership (within the meaning of Rule 13d-3 promulgated under the Exchange Act) of more than 50% of either the then outstanding voting securities of the Company (the “Outstanding Company Common Stock”) or the combined voting power of the then outstanding voting securities of the Company entitled to vote generally in the election of directors (the “Outstanding Company Voting Securities”);

(ii) individuals who, as of the Effective Date, constitute the Board (the “Incumbent Board”) cease for any reason to constitute at least a majority of the Board; provided, however, that any individual becoming a director subsequent to the Effective Date whose election, or nomination for election by the Company’s shareholders, was approved by a vote of at least a majority of the directors then comprising the Incumbent Board shall be considered as though such individual were a member of the Incumbent Board, but excluding, for this purpose, any such individual whose initial assumption of office occurs as a result an actual or threatened election contest with respect to the election or removal of directors or other actual or threatened solicitation of proxies or consents by or on behalf of a Person other than the Board;

(iii) consummation of a reorganization, merger or consolidation or sale or other disposition of all or substantially all of the assets of the Company or the acquisition of assets of another entity (a “Corporate Transaction”), in each case, unless, immediately following such Corporate Transaction, (A) all or substantially all of the individuals and entities who were the beneficial owners, respectively, of the Outstanding Company Common Stock and Outstanding Company Voting Securities immediately prior to such Corporate Transaction beneficially own, directly or indirectly, more than 60% of, respectively, the then-outstanding shares of common stock and the combined voting power of the then-outstanding voting securities entitled to vote generally in the election of directors, as the case may be, of the corporation resulting from such Corporate Transaction (including, without limitation, a corporation which as a result of such transaction owns the Company or all or substantially all of the Company’s assets either directly or through one or more subsidiaries) in substantially the same proportions as their ownership, immediately prior to such Corporate Transaction, of the Outstanding Company Common Stock and Outstanding Company Voting Securities, as the case may be, (B) no Person (excluding any employee benefit plan (or related trust) of the Company or such corporation resulting from such Corporate Transaction) beneficially owns, directly or indirectly, 20% or more of, respectively, the then-Outstanding Company Common Stock resulting from such Corporate Transaction or the Outstanding Company Voting Securities resulting from such Corporate Transaction, except to the extent that such ownership existed prior to the Corporate Transaction, and (C) at least a majority of the members of the Board of Directors of the Company resulting from such Corporate Transaction were members of the Incumbent Board at the time of the execution of the initial plan or of the action of the Board providing for such Corporate Transaction; or

- (iv) approval by the shareholders of the Company of a complete liquidation or dissolution of the Company.

Notwithstanding the foregoing, actions taken in compliance with the Stockholder's Agreement, dated as of September 8, 2000, among the Company, Duchossois Industries, Inc. and subsequent signatories thereto, as amended from time to time, shall not be deemed a Change in Control.

- (f) "Code" means the Internal Revenue Code of 1986, as amended from time to time.

- (g) "Common Stock" means the common stock, no par value, of the Company.

- (h) "Company" - - see the recitals to this Agreement.

- (i) "Disability" means the inability of Executive to perform his normal duties as a result of any physical or mental injury or ailment for (i) any consecutive ninety (90)-day period or (ii) any one hundred eighty (180) days (whether or not consecutive) during any three hundred sixty-five (365) calendar day period.

- (j) "Employment Term" - - see Section 1.

- (k) "Exchange Act" means the Securities Exchange Act of 1934.

- (l) "Executive" - - see recitals to this Agreement.

- (m) "Fair Market Value" means, as of any date, (i) the closing price of the Common Stock on such date reported on The NASDAQ Stock Market (or, if no sale of the Common Stock was reported for such date, on the next preceding date on which such a sale of such security was reported), (ii) if the Common Stock is not listed on The NASDAQ Stock Market, but is listed on a national securities exchange, the closing price of the Common Stock on such date reported by such exchange, (or, if no sale of the Common Stock was reported for such date, on the next preceding date on which such a sale of such security was reported), (iii) if the Common Stock is not listed on The NASDAQ Stock Market or any national securities exchange, the average of the high bid and low asked quotations for the Common Stock on such date in the over-the-counter market (or, if no quotation of the Common Stock was reported for such date, on the next preceding date on which such quotation of such security was reported), or (iv) if there is no public market for the Common Stock, the fair market value of the Common Stock determined by the Board in good faith exercise of its discretion; provided, however, such determination shall be made in a manner consistent with Code Section 409A and official guidance thereunder.

- (n) "Good Reason" for termination by Executive of Executive's employment means the occurrence (without Executive's express written consent) of any one of the following acts by the Company or failures by the Company to act:

- (i) the assignment to Executive of any duties inconsistent in any material respect with the position of President and Chief Executive Officer (including status, office, title and reporting requirements), or the authority, duties or responsibilities of the President and Chief Executive Officer, or any other diminution in any material respect in such position, authority, duties or responsibilities unless agreed to by Executive;

- (ii) the Company's requiring Executive to be based at, or perform his principal functions at, any office or location other than a location within 35 miles of the Main Office unless such other location is closer to Executive's then-primary residence than the Main Office;
- (iii) a reduction in Base Salary;
- (iv) a reduction in Executive's welfare benefits plans, qualified retirement plan, or paid time off benefit unless other senior executives suffer a comparable reduction;
- (v) any purported termination of Executive's employment under this Agreement by the Company other than for Cause, death or Disability; and
- (vi) the Company's notice to Executive of non-renewal of the Agreement.

Prior to Executive's right to terminate this Agreement, he shall give written notice to the Company of his intention to terminate his employment on account of a Good Reason. Such notice shall state in detail the particular act or acts or the failure or failures to act that constitute the grounds on which Executive's Good Reason termination is based and such notice shall be given within six (6) months of the occurrence of the act or acts or the failure or failures to act which constitute the grounds for Good Reason. The Company shall have sixty (60) days upon receipt of the notice in which to cure such conduct, to the extent such cure is possible.

(o) "Main Office" means 700 Central Avenue, Louisville, Kentucky.

(p) "Option" means an option to purchase shares of Common Stock.

(q) "Restricted Shares" see Section 5(b).

(r) "Restricted Stock Unit" means the right to receive a share of Common Stock after a Termination of Employment, with such right subject to a risk of forfeiture or other restrictions that will lapse upon the achievement of one or more goals, such as the completion of service by Executive or achievement of certain performance objectives. Due to Code Section 409A, it is expected that any shares of Common Stock received per a Restricted Stock Unit shall be received six (6) months after a Termination of Employment.

(s) "Taxes" means the incremental United States federal, state and local income, excise and other taxes payable by Executive with respect to any applicable item of income.

(t) "Tax Gross-Up Payment" means an amount payable to Executive such that, after payment of Taxes on such amount, there remains a balance sufficient to pay the Taxes being reimbursed.

(u) “Termination of Employment” means a termination by the Company or by Executive of Executive’s employment with the Company.

[Signature page follows.]

[Signature page follows.]

IN WITNESS WHEREOF, the parties hereto have duly executed this Agreement as of the day and year first above written.

ROBERT L. EVANS

/s/ Robert L. Evans

CHURCHILL DOWNS INCORPORATED

By: /s/ Robert L. Fealy
Robert L. Fealy,
Authorized Representative
of the Board of Directors

CHURCHILL DOWNS INCORPORATED
RESTRICTED STOCK AGREEMENT

65,000 SHARES

THIS RESTRICTED STOCK AGREEMENT (the "Agreement") is made as of the 18th day of July, 2006 by and between Robert L. Evans (the "Executive"), and Churchill Downs Incorporated (the "Company"), a Kentucky corporation with its principal place of business at 700 Central Avenue, Louisville, Kentucky 40208.

WITNESSETH:

WHEREAS, the Company has identified the Executive as the successor to the current President and Chief Executive Officer who is stepping down from such office effective August 14, 2006;

WHEREAS, the Company has entered into an employment agreement (the "Employment Agreement") between the Company and the Executive pursuant to which the Executive will become the President and Chief Executive Officer of the Company effective August 14, 2006 (the "Start Date");

WHEREAS, under the terms of the Employment Agreement, and as a material inducement to enter into the Employment Agreement, the Executive is to receive certain grants of equity compensation as a consequence of his employment by the Company;

WHEREAS, the Compensation Committee (the "Committee") of the Board of Directors of the Company at its meeting on July 12, 2006 authorized and directed the Company to make an award of stock to the Executive under the terms and conditions set forth in this Agreement; and

WHEREAS, the parties desire to enter into this Agreement to set forth the terms and conditions of such award.

NOW, THEREFORE, in consideration of the foregoing and the mutual undertakings herein contained, and for other good and valuable consideration, the mutuality, receipt and sufficiency of which are hereby acknowledged, the parties agree as follows:

1. Grant of Stock. Subject to the further terms, conditions and restrictions contained in this Agreement, the Company hereby grants to the Executive 65,000 shares (the "Shares") of the Company's common stock, no par value per share (the "Common Stock"), in consideration for services to be performed by the Executive as an employee of the Company and its subsidiaries. As long as the Shares are subject to the Restrictions set forth in Section 4 of this Agreement, such shares shall be deemed to be, and are referred to in this Agreement as, the "Restricted Shares".
 2. Certificates for Shares. Certificates evidencing Restricted Shares shall be deposited with the Company to be held in escrow until such Shares are released to the Executive or forfeited in accordance with this Agreement. The Executive shall, simultaneously with the execution and delivery of this Agreement, execute and deliver to the Company a stock power in blank with respect to the Restricted Shares. If any Restricted Shares are forfeited, the Company shall direct the transfer agent of the Common Stock to make the appropriate entries in its records showing the cancellation of the certificate or certificates for such Restricted Shares.
-

3. Adjustments in Restricted Shares.

- (a) In the event of any change in the outstanding Common Stock by reason of a stock dividend or distribution (or distribution on Common Stock of any security convertible into securities of the Company), recapitalization, merger, consolidation, split-up, combination, subdivision, reclassification, exchange of shares or the like, the Committee shall make equitable adjustments in the Restricted Shares so that the shares represent the same percentage of the Company's equity as was the case immediately prior to such change. Any new, additional or different securities to which the Executive shall be entitled in respect of Restricted Shares by reason of such adjustment shall be deemed to be Restricted Shares and shall be subject to the same terms, conditions and restrictions as the Restricted Shares so adjusted.
- (b) In the event Company merges, consolidates or effects a share exchange with another entity, or all or a substantial portion of Company's assets or outstanding capital stock are acquired (whether by merger, purchase or otherwise) by another entity (any such entity being hereafter referred to as the "Successor") each of the Restricted Shares shall automatically be converted into and replaced by shares of common stock, or such other class of securities having rights and preferences no less favorable than the Restricted Shares, of the Successor, and the number of Restricted Shares shall be correspondingly adjusted, so that Executive shall have the right to that number of shares of common stock of the Successor that have a value equal, as of the date of the merger, conversion or acquisition, to the value, as of the date of the merger, conversion or acquisition, of the Restricted Shares.

4. Restrictions. During applicable periods of restriction determined in accordance with Section 6 of this Agreement, Restricted Shares, and all rights with respect to such Shares, may not be sold, assigned, transferred, exchanged, pledged, hypothecated or otherwise encumbered or disposed of and shall be subject to the risk of forfeiture contained in Section 5 of this Agreement (such limitations on transferability and risk of forfeiture being herein referred to as the "Restrictions"), but the Executive shall have all other rights of a stockholder; provided, however, that, until such time as the Restrictions lapse, the Executive shall not have the right to vote the Restricted Shares; receive dividends thereon; or purchase any securities pursuant to that certain Rights Agreement dated as of March 19, 1998, between the Company and The Fifth Third Bank (as successor Rights Agent to Bank of Louisville), as amended, and as the same may be amended, modified or supplemented from time to time.

5. Forfeiture of Restricted Shares. Subject to Section 6 below, in the event that the Executive's employment with the Company and its subsidiaries terminates for any reason, such event shall constitute an "Event of Forfeiture" and all Shares which at that time are Restricted Shares shall thereupon be forfeited by the Executive to the Company without payment of any consideration by the Company, and neither the Executive nor any heir, personal representative, successor or assign of the Executive shall have any right, title or interest in or to such Restricted Shares or the certificates evidencing the same.

6. Lapse of Restrictions.

(a) The Restrictions on the respective Restricted Shares shall lapse upon the satisfaction of the requirements described in Subsections (i) and (ii) below:

(i) for *** (**) consecutive trading days after the Start Date, the Fair Market Value of a share of the Common Stock being equal to or greater than *-*, * percent (**%) of the Fair Market Value of a share of Common Stock as of July 18, 2006 (the "Share Price Requirement"); and

(ii) for the applicable number of Restricted Shares per the schedule immediately below, the later of: (A) the corresponding date as listed on the schedule below, or (B) the satisfaction of the Share Price Requirement; provided, however, that such corresponding date or Share Price Requirement occurs prior to a Termination of Employment, but subject to Section 6(c) below:

| <u>Date</u> | <u># of Shares for which Restrictions lapse and which become non-forfeitable</u> |
|--------------------|--|
| September 30, 2006 | 1,625 |
| December 31, 2006 | 3,250 |
| March 31, 2007 | 3,250 |
| June 30, 2007 | 3,250 |
| September 30, 2007 | 3,250 |
| December 31, 2007 | 3,250 |
| March 31, 2008 | 3,250 |
| June 30, 2008 | 3,250 |
| September 30, 2008 | 3,250 |
| December 31, 2008 | 3,250 |
| March 31, 2009 | 3,250 |
| June 30, 2009 | 3,250 |
| September 30, 2009 | 3,250 |
| December 31, 2009 | 3,250 |
| March 31, 2010 | 3,250 |
| June 30, 2010 | 3,250 |
| September 30, 2010 | 3,250 |
| December 31, 2010 | 3,250 |
| March 31, 2011 | 3,250 |
| June 30, 2011 | 3,250 |
| August 14, 2011 | 1,625 |

* Confidential information omitted and filed separately with the Securities and Exchange Commission under a Confidential Treatment Request.

- (b) Upon the lapse of the Restrictions in accordance with this Section, the Company shall, as soon as practicable thereafter, deliver to the Executive a certificate (without any restrictive endorsement referring to such Restrictions) for the Shares that are no longer subject to such Restrictions.
- (c) In the event the Executive's employment is terminated other than for Cause (as defined in the Employment Agreement) or if the Executive resigns for Good Reason (as defined in the Employment Agreement) for purposes of determining any lapse of the Restrictions in (a) above and the forfeiture of Shares, if any, under Section 5 and Section 6, the Executive's employment shall be considered to have continued through the last day of the calendar quarter in which his Termination of Employment occurs.
- (d) In the event of a Change in Control during the Employment Term, the Restrictions shall immediately lapse on fifty percent (50%) of the Shares then-subject to Restrictions. The Shares that are subject to the lapse of Restrictions pursuant to this Section 6(d) shall be taken pro-rata from each tranche of the then-Restricted Shares, and the remaining portion of each tranche shall be subject to the lapse of Restrictions according to Section 6(a) above, subject to potential accelerated lapsing of Restrictions pursuant to Section 6(e) below.
- (e) If, during the 2-year period following a Change in Control during the Employment Term: (i) the Executive is terminated by the Company other than for Cause, death or Disability, or (ii) the Executive voluntarily resigns for Good Reason, the Restrictions on all then-Restricted Shares shall fully lapse, as of the Termination of Employment.
7. Withholding Requirements. Whenever Restrictions lapse with respect to Restricted Shares, the Company shall have the right to (i) withhold from sums due to the Executive; (ii) require the Executive to remit to the Company; or (iii) retain Shares otherwise deliverable to the Executive; in an amount sufficient to satisfy any Federal, state or local withholding tax requirements prior to making such payments or delivering any such Shares to the Executive.
8. Effect Upon Employment. Nothing contained in this Agreement shall confer upon the Executive the right to continue in the employment of the Company or its subsidiaries or affect any right that the Company or its subsidiaries may have to terminate the employment of the Executive.
9. Amendment. This Agreement may not be amended, modified or supplemented except with the consent of the Committee and by a written instrument duly executed by the Executive and the Company.
10. Binding Effect. This Agreement shall be binding upon and shall inure to the benefit of the parties hereto and their heirs, personal representatives, successors and assigns. Executive accepts the award of Shares hereunder subject to all of the terms and conditions of this Agreement. Executive hereby agrees to accept as binding, conclusive and final all reasonable decisions and interpretations of the Committee upon any questions arising under this Agreement, including without limitation, the interpretation of the Restrictions imposed upon the Shares.

11. Notices. Notices shall be deemed delivered if delivered personally or if sent by registered or certified mail to the Company at its principal place of business, as set forth above, and to Executive at the address as shall most currently appear on the records of the Company, or at such other address as either party may hereafter designate in writing to the other.

12. Investment Representation. If the Shares awarded to the Executive under this Agreement are not registered under the Securities Act of 1933, as amended, pursuant to an effective registration statements, the Executive, if the Committee shall reasonably deem it advisable, may be required to represent and agree in writing (i) that any Shares acquired by the Executive under this Agreement will not be sold except pursuant to an effective registration statement under the Securities Act of 1933, as amended, or pursuant to an exemption from registration under such Act, and (ii) that the Executive has acquired such Shares for his own account and not with a view to the distribution thereof.

13. Compliance with Section 16(b). This Agreement and the grant of Shares hereunder is intended to comply with all applicable conditions of Rule 16(b)-3 of the General Rules and Regulations under the Securities Exchange Act of 1934, as amended. All transactions involving the Company's executive officers are subject to such conditions, regardless of whether the conditions are expressly set forth in this Agreement. Any provision of this Agreement that is contrary to a condition of Rule 16b-3 shall not apply.

14. Effective Date and Approval. It is the intent of the parties that the compensation payable to the Executive with respect to the Shares constitute qualified performance based compensation under Internal Revenue Code §162(m) and regulations issued thereunder. The effective date of the award of the Shares is July 18, 2006, and is subject to approval by stockholders of the Company holding not less than a majority of the shares present and voting at the Company's 2007 Annual Meeting. In the event this award of Shares is not approved by stockholders of the Company, this Agreement shall be of no effect and the award of Shares hereunder shall be null and void. The Company agrees to use its reasonable best efforts to procure shareholder approval of the award of the Shares, including, without limitation, placing such matter on the agenda for the Company's 2007 annual meeting, including appropriate disclosures in the proxy statement for such meeting, recommending to Company shareholders the approval of such Shares award and soliciting proxies for the approval of such Shares award.

15. Code Section 409A. It is intended that any amounts payable under this Agreement and the Company's and Executive's exercise of authority or discretion hereunder shall comply with Code Section 409A (including the Treasury regulations and other published guidance relating thereto) so as not to subject Executive to the payment of any interest or additional tax imposed under Code Section 409A. To the extent any amount payable under this Agreement would trigger the additional tax imposed by Code Section 409A, the Agreement shall be modified to avoid such additional tax.

16. Registration of Shares. The Company shall use its reasonable best efforts to file, within 90 days following the execution of this Agreement, a registration statement with the Securities and Exchange Commission (the "Commission") pursuant to the Securities Act of 1933, as amended (the "Act"), covering the Shares, and thereafter to cause such registration statement to become effective in accordance with the Act and the rules and regulations adopted by the Commission thereunder

17. Compliance With Other Laws And Regulations. The rights of the Executive and the obligations of Company under this Agreement shall be subject to all applicable federal and state laws, rules and regulations and to such approvals by any government or regulatory agency as may be required. Company shall not be required to issue or deliver certificates for shares of Common Stock before [i] the listing of such shares on any stock exchange or over-the-counter market, such as NASDAQ, on which the Common Stock may then be listed or traded, and [ii] the completion of any registration or qualification of any governmental body which Company shall, in its sole discretion, determine to be necessary or advisable. The Company agrees to use its best efforts to procure any such listing, registration or qualification.

18. Severability. The invalidity or unenforceability of any provision of the Agreement shall not affect the validity or enforceability of the remaining provisions of the Agreement, and such invalid or unenforceable provision shall be stricken to the extent necessary to preserve the validity and enforceability of the Agreement with the parties agreeing in such event to make all reasonable efforts to replace such invalid or unenforceable provision with a valid provision that will place the parties in approximately the same economic position as contemplated hereunder.

19. Governing Law; Jurisdiction. This Agreement shall be governed by the laws of the Commonwealth of Kentucky. The Executive consents to the exclusive jurisdiction of the courts of the Commonwealth of Kentucky and of any federal court located in Jefferson County, Kentucky in connection with any action or proceeding arising out of or relating to this Agreement, any document or instrument delivered pursuant to or in connection with this Agreement, or any breach of this Agreement or any such document or instrument.

20. Entire Agreement. This Agreement contains the entire agreement between the parties hereto with respect to the subject matter hereof.

21. Capitalized Terms. Capitalized terms not otherwise defined in this Agreement shall have the meaning given them in the Employment Agreement.

22. Counterparts and Signatures. This Agreement may be signed in counterparts, each of which shall be an original, with the effect as if the signatures thereto and hereto were upon the same instrument. Signatures conveyed by facsimile or PDF file shall constitute original signatures.

(Signature page follows.)

IN WITNESS WHEREOF, the Company and the Executive have executed and delivered this Agreement as of the date first above written.

ROBERT L. EVANS

/s/ Robert L. Evans

CHURCHILL DOWNS INCORPORATED

By: /s/ Robert L. Fealy
Robert L. Fealy,
Authorized Representative
of the Board of Directors

**CHURCHILL DOWNS INCORPORATED
RESTRICTED STOCK AGREEMENT**

90,000 SHARES

THIS RESTRICTED STOCK AGREEMENT (the "Agreement") is made as of the 18th day of July, 2006 by and between Robert L. Evans (the "Executive"), and Churchill Downs Incorporated (the "Company"), a Kentucky corporation with its principal place of business at 700 Central Avenue, Louisville, Kentucky 40208.

WITNESSETH:

WHEREAS, the Company has identified the Executive as the successor to the current President and Chief Executive Officer who is stepping down from such office effective August 14, 2006;

WHEREAS, the Company has entered into an employment agreement between the Company and the Executive pursuant to which the Executive will become the President and Chief Executive Officer of the Company effective August 14, 2006 (the "Employment Agreement");

WHEREAS, under the terms of the Employment Agreement, and as a material inducement to enter into the Employment Agreement, the Executive is to receive certain grants of equity compensation as a consequence of his employment by the Company;

WHEREAS, the Compensation Committee (the "Committee") of the Board of Directors of the Company at its meeting on July 12, 2006 authorized and directed the Company to make an award of stock to the Executive under the terms and conditions set forth in this Agreement; and

WHEREAS, the parties desire to enter into this Agreement to set forth the terms and conditions of such award.

NOW, THEREFORE, in consideration of the foregoing and the mutual undertakings herein contained, and for other good and valuable consideration, the mutuality, receipt and sufficiency of which are hereby acknowledged, the parties agree as follows:

1. **Grant of Stock.** Subject to the further terms, conditions and restrictions contained in this Agreement, the Company hereby grants to the Executive 90,000 shares (the "Shares") of the Company's common stock, no par value per share (the "Common Stock"), in consideration for services to be performed by the Executive as an employee of the Company and its subsidiaries. As long as the Shares are subject to the Restrictions set forth in Section 4 of this Agreement, such shares shall be deemed to be, and are referred to in this Agreement as, the "Restricted Shares".
 2. **Certificates for Shares.** Certificates evidencing Restricted Shares shall be deposited with the Company to be held in escrow until such Shares are released to the Executive or forfeited in accordance with this Agreement. The Executive shall, simultaneously with the execution and delivery of this Agreement, execute and deliver to the Company a stock power in blank with respect to the Restricted Shares. If any Restricted Shares are forfeited, the Company shall direct the transfer agent of the Common Stock to make the appropriate entries in its records showing the cancellation of the certificate or certificates for such Restricted Shares.
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3. Adjustments in Restricted Shares.

- (a) In the event of any change in the outstanding Common Stock by reason of a stock dividend or distribution (or distribution on Common Stock of any security convertible into securities of the Company), recapitalization, merger, consolidation, split-up, combination, subdivision, reclassification, exchange of shares or the like, the Committee shall make equitable adjustments in the Restricted Shares so that the shares represent the same percentage of the Company's equity as was the case immediately prior to such change. Any new, additional or different securities to which the Executive shall be entitled in respect of Restricted Shares by reason of such adjustment shall be deemed to be Restricted Shares and shall be subject to the same terms, conditions and restrictions as the Restricted Shares so adjusted.
- (b) In the event Company merges, consolidates or effects a share exchange with another entity, or all or a substantial portion of Company's assets or outstanding capital stock are acquired (whether by merger, purchase or otherwise) by another entity (any such entity being hereafter referred to as the "Successor") each of the Restricted Shares shall automatically be converted into and replaced by shares of common stock, or such other class of securities having rights and preferences no less favorable than the Restricted Shares, of the Successor, and the number of Restricted Shares shall be correspondingly adjusted, so that Executive shall have the right to that number of shares of common stock of the Successor that have a value equal, as of the date of the merger, conversion or acquisition, to the value, as of the date of the merger, conversion or acquisition, of the Restricted Shares.

4. Restrictions. During applicable periods of restriction determined in accordance with Section 6 of this Agreement, Restricted Shares, and all rights with respect to such Shares, may not be sold, assigned, transferred, exchanged, pledged, hypothecated or otherwise encumbered or disposed of and shall be subject to the risk of forfeiture contained in Section 5 of this Agreement (such limitations on transferability and risk of forfeiture being herein referred to as the "Restrictions"), but the Executive shall have all other rights of a stockholder; provided, however, that, until such time as the Restrictions lapse, the Executive shall not have the right to vote the Restricted Shares; receive dividends thereon; or purchase any securities pursuant to that certain Rights Agreement dated as of March 19, 1998, between the Company and The Fifth Third Bank (as successor Rights Agent to Bank of Louisville), as amended, and as the same may be amended, modified or supplemented from time to time.

5. Forfeiture of Restricted Shares. Subject to Section 6 below, in the event that the Executive's employment with the Company and its subsidiaries terminates for any reason, such event shall constitute an "Event of Forfeiture" and all Shares which at that time are Restricted Shares shall thereupon be forfeited by the Executive to the Company without payment of any consideration by the Company, and neither the Executive nor any heir, personal representative, successor or assign of the Executive shall have any right, title or interest in or to such Restricted Shares or the certificates evidencing the same.

6. Lapse of Restrictions.

- (a) In the event that the Fair Market Value (as defined in the Employment Agreement) of the Company's Common Stock on and after August 14, 2006 reaches the following prices each for ** consecutive trading days, the Restrictions on the respective Restricted Shares shall lapse as follows:

| <u># of Shares for which Restrictions lapse and which become non-forfeitable</u> | <u>** consecutive day Fair Market Value</u> |
|--|---|
| 22,500 | At or above \$**. ** |
| 22,500 | At or above \$**. ** |
| 22,500 | At or above \$**. ** |
| 22,500 | At or above \$**. ** |

provided, however, that the ** -consecutive trading day period occurs prior to a Termination of Employment (as defined in the Employment Agreement), subject to Section 6(c) below.

- (b) Upon the lapse of the Restrictions in accordance with this Section, the Company shall, as soon as practicable thereafter, deliver to the Executive a certificate (without any restrictive endorsement referring to such Restrictions) for the Shares that are no longer subject to such Restrictions.
- (c) In the event the Executive's employment is terminated other than for Cause (as defined in the Employment Agreement) or if the Executive resigns for Good Reason (as defined in the Employment Agreement) for purposes of determining any lapse of the Restrictions in (a) above and the forfeiture of Shares, if any, under Section 5 and Section 6, the Executive's employment shall be considered to have continued through the last day of the calendar quarter in which his Termination of Employment occurs.
- (d) In the event of a Change in Control during the Employment Term, the Restrictions shall immediately lapse on fifty percent (50%) of the Shares then-subject to Restrictions. The Shares that are subject to the lapse of Restrictions pursuant to this Section 6(d) shall be taken pro-rata from each tranche of the then-Restricted Shares, and the remaining portion of each tranche shall be subject to the lapse of Restrictions according to Section 6(a) above, subject to potential accelerated lapsing of Restrictions pursuant to Section 6(e) below.

*Confidential information omitted and filed separately with the Securities and Exchange Commission under a Confidential Treatment Request.

(e) If, during the 2-year period following a Change in Control during the Employment Term: (i) the Executive is terminated by the Company other than for Cause, death or Disability, or (ii) the Executive voluntarily resigns for Good Reason, the Restrictions on all then-Restricted Shares shall fully lapse, as of the Termination of Employment.

7. Withholding Requirements. Whenever Restrictions lapse with respect to Restricted Shares, the Company shall have the right to (i) withhold from sums due to the Executive; (ii) require the Executive to remit to the Company; or (iii) retain Shares otherwise deliverable to the Executive; in an amount sufficient to satisfy any Federal, state or local withholding tax requirements prior to making such payments or delivering any such Shares to the Executive.

8. Effect Upon Employment. Nothing contained in this Agreement shall confer upon the Executive the right to continue in the employment of the Company or its subsidiaries or affect any right that the Company or its subsidiaries may have to terminate the employment of the Executive.

9. Amendment. This Agreement may not be amended, modified or supplemented except with the consent of the Committee and by a written instrument duly executed by the Executive and the Company.

10. Binding Effect. This Agreement shall be binding upon and shall inure to the benefit of the parties hereto and their heirs, personal representatives, successors and assigns. Executive accepts the award of Shares hereunder subject to all of the terms and conditions of this Agreement. Executive hereby agrees to accept as binding, conclusive and final all reasonable decisions and interpretations of the Committee upon any questions arising under this Agreement, including without limitation, the interpretation of the Restrictions imposed upon the Shares.

11. Notices. Notices shall be deemed delivered if delivered personally or if sent by registered or certified mail to the Company at its principal place of business, as set forth above, and to Executive at the address as shall most currently appear on the records of the Company, or at such other address as either party may hereafter designate in writing to the other.

12. Investment Representation. If the Shares awarded to the Executive under this Agreement are not registered under the Securities Act of 1933, as amended, pursuant to an effective registration statements, the Executive, if the Committee shall reasonably deem it advisable, may be required to represent and agree in writing (i) that any Shares acquired by the Executive under this Agreement will not be sold except pursuant to an effective registration statement under the Securities Act of 1933, as amended, or pursuant to an exemption from registration under such Act, and (ii) that the Executive has acquired such Shares for his own account and not with a view to the distribution thereof.

13. Compliance with Section 16(b). This Agreement and the grant of Shares hereunder is intended to comply with all applicable conditions of Rule 16(b)-3 of the General Rules and Regulations under the Securities Exchange Act of 1934, as amended. All transactions involving the Company's executive officers are subject to such conditions, regardless of whether the conditions are expressly set forth in this Agreement. Any provision of this Agreement that is contrary to a condition of Rule 16b-3 shall not apply.

14. Effective Date and Approval. It is the intent of the parties that the compensation payable to the Executive with respect to the Shares constitute qualified performance based compensation under Internal Revenue Code §162(m) and regulations issued thereunder. The effective date of the award of the Shares is July 18, 2006, and is subject to approval by stockholders of the Company holding not less than a majority of the shares present and voting at the Company's 2007 Annual Meeting. In the event this award of Shares is not approved by stockholders of the Company, this Agreement shall be of no effect and the award of Shares hereunder shall be null and void. The Company agrees to use its reasonable best efforts to procure shareholder approval of the award of the Shares, including, without limitation, placing such matter on the agenda for the Company's 2007 annual meeting, including appropriate disclosures in the proxy statement for such meeting, recommending to Company shareholders the approval of such Shares award and soliciting proxies for the approval of such Shares award.

15. Code Section 409A. It is intended that any amounts payable under this Agreement and the Company's and Executive's exercise of authority or discretion hereunder shall comply with Code Section 409A (including the Treasury regulations and other published guidance relating thereto) so as not to subject Executive to the payment of any interest or additional tax imposed under Code Section 409A. To the extent any amount payable under this Agreement would trigger the additional tax imposed by Code Section 409A, the Agreement shall be modified to avoid such additional tax.

16. Registration of Shares. The Company shall use its reasonable best efforts to file, within 90 days following the execution of this Agreement, a registration statement with the Securities and Exchange Commission (the "Commission") pursuant to the Securities Act of 1933, as amended (the "Act"), covering the Shares, and thereafter to cause such registration statement to become effective in accordance with the Act and the rules and regulations adopted by the Commission thereunder

17. Compliance With Other Laws And Regulations. The rights of the Executive and the obligations of Company under this Agreement shall be subject to all applicable federal and state laws, rules and regulations and to such approvals by any government or regulatory agency as may be required. Company shall not be required to issue or deliver certificates for shares of Common Stock before [i] the listing of such shares on any stock exchange or over-the-counter market, such as NASDAQ, on which the Common Stock may then be listed or traded, and [ii] the completion of any registration or qualification of any governmental body which Company shall, in its sole discretion, determine to be necessary or advisable. The Company agrees to use its best efforts to procure any such listing, registration or qualification.

18. Severability. The invalidity or unenforceability of any provision of the Agreement shall not affect the validity or enforceability of the remaining provisions of the Agreement, and such invalid or unenforceable provision shall be stricken to the extent necessary to preserve the validity and enforceability of the Agreement with the parties agreeing in such event to make all reasonable efforts to replace such invalid or unenforceable provision with a valid provision that will place the parties in approximately the same economic position as contemplated hereunder.

19. Governing Law; Jurisdiction. This Agreement shall be governed by the laws of the Commonwealth of Kentucky. The Executive consents to the exclusive jurisdiction of the courts of the Commonwealth of Kentucky and of any federal court located in Jefferson County, Kentucky in connection with any action or proceeding arising out of or relating to this Agreement, any document or instrument delivered pursuant to or in connection with this Agreement, or any breach of this Agreement or any such document or instrument.

20. Entire Agreement. This Agreement contains the entire agreement between the parties hereto with respect to the subject matter hereof.

21. Capitalized Terms. Capitalized terms not otherwise defined in this Agreement shall have the meaning given them in the Employment Agreement.

22. Counterparts and Signatures. This Agreement may be signed in counterparts, each of which shall be an original, with the effect as if the signatures thereto and hereto were upon the same instrument. Signatures conveyed by facsimile or PDF file shall constitute original signatures.

(Signature page follows.)

IN WITNESS WHEREOF, the Company and the Executive have executed and delivered this Agreement as of the date first above written.

ROBERT L. EVANS

/s/ Robert L. Evans

CHURCHILL DOWNS INCORPORATED

By: /s/ Robert L. Fealy

Robert L. Fealy,
Authorized Representative
of the Board of Directors

**CHURCHILL DOWNS INCORPORATED
RESTRICTED STOCK UNITS AGREEMENT**

65,000 UNITS

THIS RESTRICTED STOCK UNITS AGREEMENT (the "Agreement") is made as of the 18th day of July, 2006 by and between Robert L. Evans (the "Executive"), and Churchill Downs Incorporated (the "Company"), a Kentucky corporation with its principal place of business at 700 Central Avenue, Louisville, Kentucky 40208.

WITNESSETH:

WHEREAS, the Company, has identified the Executive as the successor to the current President and Chief Executive Officer who is stepping down from such office effective August 14, 2006;

WHEREAS, the Company has entered into an employment agreement between the Company and the Executive pursuant to which the Executive will become the President and Chief Executive Officer of the Company effective August 14, 2006 (the "Employment Agreement");

WHEREAS, under the terms of the Employment Agreement, and as a material inducement to enter into the Employment Agreement, the Executive is to receive certain grants of equity compensation as a consequence of his employment by the Company;

WHEREAS, the Compensation Committee (the "Committee") of the Board of Directors of the Company at its meeting on July 12, 2006 authorized and directed the Company to make an award to the Executive of units entitling the Executive to receive shares of the Company's Common Stock (hereinafter defined) upon the expiration of six months following the Executive's termination of employment with the Company under the terms and conditions set forth in this Agreement; and

WHEREAS, the parties desire to enter into this Agreement to set forth the terms and conditions of such award.

NOW, THEREFORE, in consideration of the foregoing and the mutual undertakings herein contained, and for other good and valuable consideration, the mutuality, receipt and sufficiency of which are hereby acknowledged, the parties agree as follows:

1. Grant of Units. Subject to the further terms, conditions and restrictions contained in this Agreement, in consideration for services to be performed by the Executive as an employee of the Company and its subsidiaries, as of the date of this Agreement, the Company grants to the Executive 65,000 restricted stock units ("Restricted Stock Units") having the characteristics, and entitling the Executive to the benefits, hereinafter described. Each Restricted Stock Unit represents an unfunded contractual right of the Executive to receive from the Company one share of the Company's Common Stock upon the Executive's termination of employment with the Company, subject to the other terms and conditions of this Agreement. As long as the Units remain unvested and forfeitable per Section 6 of this Agreement, such Units shall be deemed to be, and are referred to in this Agreement as, the "Restricted Units".

2. Right to Receive Common Stock. The Executive shall have no rights of a shareholder with respect to the Company's Common Stock as a result of the Units. The Executive shall not be a shareholder unless and until the Executive receives a certificate for shares of Common Stock to which the Executive becomes entitled hereunder. Upon the expiration of six months following the Executive's termination of employment with the Company (or upon the Executive's earlier death following such termination), the Executive (or the Executive's representative as the case may be) shall be entitled to receive one share of Common Stock for each Unit granted hereunder which is not a Restricted Unit and which has not previously been forfeited pursuant to Section 5 (including a forfeiture resulting from such employment termination). At the time the Executive receives a share of Common Stock, and for each such share of Common Stock received by the Executive, the Executive shall also receive (a) a cash payment from the Company equal to each cash dividend declared and paid by the Company on a single share of Common Stock from and after the date on which the Unit which entitles the Executive to such share of Common Stock became non-forfeitable under Section 6 hereof, plus (b) a cash payment equivalent to simple interest on each amount determined in clause (a) at the annual rate of three (3%) percent for the period elapsed from the date such dividend was paid on such share of Common Stock to the time the payment under clause (a) is made to the Executive.

3. Adjustments in Restricted Units.

(a) In the event of any change in the outstanding Common Stock by reason of a stock dividend or distribution (or distribution on Common Stock of any security convertible into securities of the Company), recapitalization, merger, consolidation, split-up, combination, subdivision, reclassification, exchange of shares or the like, the Committee shall make equitable adjustments in the Restricted Units so that the shares of Common Stock represented by such Units represent the same percentage of the Company's equity as was the case immediately prior to such change. Any new, additional or different securities to which the Executive shall be entitled in respect of Restricted Units by reason of such adjustment shall be subject to the same terms, conditions and restrictions as the Units so adjusted.

(b) In the event Company merges, consolidates or effects a share exchange with another entity, or all or a substantial portion of Company's assets or outstanding capital stock are acquired (whether by merger, purchase or otherwise) by another entity (any such entity being hereafter referred to as the "Successor") each share of Company Common Stock represented by a Restricted Stock Unit shall automatically be converted into and replaced by shares of common stock, or such other class of securities having rights and preferences no less favorable than Company's Common Stock, of the Successor, and the number of shares represented by a Restricted Stock Unit shall be correspondingly adjusted, so that Executive shall have the right to that number of shares of common stock of the Successor that have a value equal, as of the date of the merger, conversion or acquisition, to the value, as of the date of the merger, conversion or acquisition, of the shares of Company Common Stock represented by the Restricted Stock Units.

4. Restrictions. The Units, and all rights with respect to such Units, may not be sold, assigned, transferred, exchanged, pledged, hypothecated or otherwise encumbered or disposed of and shall be subject to the risk of forfeiture contained in Section 5 of this Agreement.

5. Forfeiture of Restricted Units. Subject to Section 6 below, in the event the Executive's employment with the Company and its subsidiaries is terminated for any reason, such event shall constitute an "Event of Forfeiture" and all Units which at that time are Restricted Units shall thereupon be forfeited by the Executive to the Company without payment of any consideration by the Company, and neither the Executive nor any heir, personal representative, successor or assign of the Executive shall have any right, title or interest in or to such Restricted Units or any other property.

6. Vesting of Units.

(a) The Restricted Units shall become vested and non-forfeitable as follows:

| <u>Vesting Date</u> | <u>Number of Units to Vest</u> |
|---------------------|--------------------------------|
| September 30, 2006 | 1,625 |
| December 31, 2006 | 3,250 |
| March 31, 2007 | 3,250 |
| June 30, 2007 | 3,250 |
| September 30, 2007 | 3,250 |
| December 31, 2007 | 3,250 |
| March 31, 2008 | 3,250 |
| June 30, 2008 | 3,250 |
| September 30, 2008 | 3,250 |
| December 31, 2008 | 3,250 |
| March 31, 2009 | 3,250 |
| June 30, 2009 | 3,250 |
| September 30, 2009 | 3,250 |
| December 31, 2009 | 3,250 |
| March 31, 2010 | 3,250 |
| June 30, 2010 | 3,250 |
| September 30, 2010 | 3,250 |
| December 31, 2010 | 3,250 |
| March 31, 2011 | 3,250 |
| June 30, 2011 | 3,250 |
| August 14, 2011 | 1,625 |

In the event: (i) the Executive's employment is terminated by the Company other than for Cause, death or Disability or (ii) the Executive resigns for Good Reason, for purposes of determining the Units which have become non-forfeitable under this Section 6, the Executive's employment shall be considered to have continued through the last day of the calendar quarter in which his termination occurs.

(b) In the event of a Change in Control during the Employment Term (as defined in the Employment Agreement), the Executive shall receive accelerated vesting of fifty percent (50%) of the then-unvested Restricted Units. The Restricted Units that are subject to accelerated vesting and non-forfeiture pursuant to this Section 6(b) shall be taken pro-rata from each then-unvested tranche of the Restricted Units, and the remaining portion of each tranche shall vest according to Section 6(a) above, subject to potential accelerated vesting pursuant to Section 6(c) below.

(c) If, during the 2-year period following a Change in Control during the Employment Term: (i) Executive is terminated by the Company other than for Cause (as defined in the Employment Agreement), death or Disability, or (ii) Executive voluntarily resigns for Good Reason (as defined in the Employment Agreement), all Restricted Units shall become fully vested and non-forfeitable as of the date of such termination.

7. Withholding Requirements. Whenever the Executive becomes entitled to receive Common Stock with respect to the Units pursuant to Section 2, the Company shall have the right to (i) withhold from sums due to the Executive; (ii) require the Executive to remit to the Company; or (iii) retain shares of Common Stock otherwise deliverable to the Executive; in an amount sufficient to satisfy any Federal, state or local withholding tax requirements prior to making such payments or delivering any such shares to the Executive.

8. Effect Upon Employment. Nothing contained in this Agreement shall confer upon the Executive the right to continue in the employment of the Company or its subsidiaries or affect any right that the Company or its subsidiaries may have to terminate the employment of the Executive.

9. Amendment. This Agreement may not be amended, modified or supplemented except with the consent of the Committee and by a written instrument duly executed by the Executive and the Company.

10. Binding Effect. This Agreement shall be binding upon and shall inure to the benefit of the parties hereto and their heirs, personal representatives, successors and assigns. Executive accepts the award of Units hereunder subject to all of the terms and conditions of this Agreement. Executive hereby agrees to accept as binding, conclusive and final all reasonable decisions and interpretations of the Committee upon any questions arising under this Agreement, including without limitation, the interpretation of any restrictions imposed upon the Units.

11. Notices. Notices shall be deemed delivered if delivered personally or if sent by registered or certified mail to the Company at its principal place of business, as set forth above, and to Executive at the address that most currently appears on the records of the Company.

12. Investment Representation. If the shares of Common Stock to which the Executive becomes entitled under this Agreement as a result of the Units are not registered under the Securities Act of 1933, as amended, pursuant to an effective registration statement, the Executive, if the Committee shall reasonably deem it advisable, may be required to represent and agree in writing (i) that any shares of Common Stock acquired by the Executive as a result of the Units under this Agreement will not be sold except pursuant to an effective registration statement under the Securities Act of 1933, as amended, or pursuant to an exemption from registration under such Act, and (ii) that the Executive has acquired such shares for his own account and not with a view to the distribution thereof.

13. Compliance with Section 16(b). This Agreement and the entitlement of the Executive to receive any shares of Common Stock for the Units awarded hereunder is intended to comply with all applicable conditions of Rule 16(b)-3 of the General Rules and Regulations under the Securities Exchange Act of 1934, as amended. All transactions involving the Company's executive officers are subject to such conditions, regardless of whether the conditions are expressly set forth in this Agreement. Any provision of this Agreement that is contrary to a condition of Rule 16b-3 shall not apply.

14. Registration of Shares. The Company shall use its reasonable best efforts to file, within 90 days following the execution of this Agreement, a registration statement with the Securities and Exchange Commission (the "Commission") pursuant to the Securities Act of 1933, as amended (the "Act"), covering the shares to be received pursuant to the Units, and thereafter to cause such registration statement to become effective in accordance with the Act and the rules and regulations adopted by the Commission thereunder.

15. Code Section 409A. It is intended that any amounts payable under this Agreement and the Company's and Executive's exercise of authority or discretion hereunder shall comply with Internal Revenue Code Section 409A (including the Treasury regulations and other published guidance relating thereto) so as not to subject Executive to the payment of any interest or additional tax imposed under Code Section 409A. To the extent any amount payable under this Agreement would trigger the additional tax imposed by Code Section 409A, the Agreement shall be modified to avoid such additional tax.

16. Compliance With Other Laws And Regulations. The rights of the Executive and the obligations of Company under this Agreement shall be subject to all applicable federal and state laws, rules and regulations and to such approvals by any government or regulatory agency as may be required. Company shall not be required to issue or deliver certificates for shares of Common Stock before [i] the listing of such shares on any stock exchange or over-the-counter market, such as NASDAQ, on which the Common Stock may then be listed or traded, and [ii] the completion of any registration or qualification of any governmental body which Company shall, in its sole discretion, determine to be necessary or advisable. The Company agrees to use its best efforts to procure any such listing, registration or qualification.

17. Severability. The invalidity or unenforceability of any provision of the Agreement shall not affect the validity or enforceability of the remaining provisions of the Agreement, and such invalid or unenforceable provision shall be stricken to the extent necessary to preserve the validity and enforceability of the Agreement, with the parties agreeing in such event to make all reasonable efforts to replace such invalid or unenforceable provision with a valid provision that will place the parties in approximately the same economic position as contemplated hereunder.

18. Governing Law; Jurisdiction. This Agreement shall be governed by the laws of the Commonwealth of Kentucky. The Executive consents to the exclusive jurisdiction of the courts of the Commonwealth of Kentucky and of any federal court located in Jefferson County, Kentucky in connection with any action or proceeding arising out of or relating to this Agreement, any document or instrument delivered pursuant to or in connection with this Agreement, or any breach of this Agreement or any such document or instrument.

19. Entire Agreement. This Agreement contains the entire agreement between the parties hereto with respect to the subject matter hereof.

20. Capitalized Terms. Capitalized terms not otherwise defined in this Agreement shall have the meaning given them in the Employment Agreement.

21. Counterparts and Signatures. This Agreement may be signed in counterparts, each of which shall be an original, with the effect as if the signatures thereto and hereto were upon the same instrument. Signatures conveyed by facsimile or PDF file shall constitute original signatures.

(Signature page follows.)

IN WITNESS WHEREOF, the Company and the Executive have executed and delivered this Agreement as of the date first above written.

ROBERT L. EVANS

/s/ Robert L. Evans

CHURCHILL DOWNS INCORPORATED

By: /s/ Robert L. Fealy

Robert L. Fealy,
Authorized Representative
of the Board of Directors

CHURCHILL DOWNS INCORPORATED

STOCK OPTION AGREEMENT

130,000 OPTIONS

THIS STOCK OPTION AGREEMENT ("Agreement") is made as of the 18th day of July, 2006, between Churchill Downs Incorporated, a Kentucky corporation, with its principal place of business at 700 Central Avenue, Louisville, Kentucky 40208 ("Company"), and Robert L. Evans ("Executive").

WHEREAS, Company has identified Executive as the successor to the current President and Chief Executive Officer who will be stepping down from such office effective August 14, 2006;

WHEREAS, Company has entered into an employment agreement between the Company and Executive pursuant to which Executive will become the President and Chief Executive Officer of Company effective August 14, 2006 (the "Employment Agreement");

WHEREAS, under the terms of the Employment Agreement, and as a material inducement to enter into the Employment Agreement, Executive is to receive certain grants of equity compensation as a consequence of his employment by Company;

WHEREAS, the Compensation Committee (the "Committee") of the Board of Directors of the Company at its meeting on July 12, 2006 authorized and directed Company to make an award of options to Executive under the terms and conditions set forth in this Agreement; and

WHEREAS, the parties desire to enter into this Agreement to set forth the terms and conditions of such award.

1. DEFINITIONS.

- a. "Board" means Company's Board of Directors.
 - b. "Change in Control" shall have the meaning ascribed to such term in the Employment Agreement.
 - c. "Code" means the Internal Revenue Code of 1986, as amended.
 - d. "Common Stock" means Company's common stock, no par value, or the common stock or securities of a Successor that have been substituted therefore pursuant to Section 10.
 - e. "Company" means Churchill Downs Incorporated, a Kentucky corporation, with its principal place of business at 700 Central Avenue, Louisville, Kentucky 40208.
 - f. "Disability" has the meaning ascribed to such term in the Employment Agreement.
-

- g. “Employment Agreement” has the meaning set forth in the recitals above.
 - h. “Fair Market Value” has the meaning given such term in the Employment Agreement.
 - i. “Option Price” means the price to be paid for Common Stock upon the exercise of an option, in accordance with Section 3.
 - j. “Executive’s Representative” means the personal representative of Executive’s estate, and after final settlement of Executive’s estate, the successor or successors entitled thereto by law.
 - k. “Subsidiary” means any corporation or other entity that at the time an option is granted under the Plan qualifies as a subsidiary of Company as defined by Code Section 424(f).
 - l. “Successor” means the entity surviving a merger or consolidation with Company, or the entity that acquires all or a substantial portion of Company’s assets or outstanding capital stock (whether by merger, purchase or otherwise).
2. GRANT OF NON-QUALIFIED STOCK OPTION. Company hereby grants to the Executive the right and option to purchase from Company an aggregate of 130,000 shares of Common Stock (the “Options”), which Options are not intended to constitute an incentive stock option under Code §422.
3. OPTION PRICE. The price to be paid for the Common Stock upon exercise of the Options is the Fair Market Value of Company’s Common Stock as of July 18, 2006.
4. OPTION EXPIRATION. The Options shall expire, and cease to be exercisable, at the earliest of the following times:
- a. August 14, 2012;
 - b. the date of Executive’s Termination of Employment for Cause (as defined in the Employment Agreement);
 - c. the date of the Executive’s voluntary Termination of Employment without Good Reason (as defined in the Employment Agreement);
 - d. one (1) year after the Executive’s Termination of Employment as a result of death or Disability (as defined in the Employment Agreement); or
 - e. if the Executive’s employment terminates other than a termination under (b), (c) or (d) of this Section 4, the later of: (i) the last day of the calendar quarter in which the Executive’s Termination of Employment occurs or (ii) the day thirty (30) days after such Termination of Employment.

5. VESTING OF OPTIONS.

- a. Vesting Period. No part of the Options may be exercised unless and until such Options or part thereof shall have become vested based upon the continuous employment of Executive after August 14, 2006. The Options shall vest and become exercisable as follows:

| <u>Vesting Date</u> | <u>Number of Options to Vest</u> |
|---------------------|----------------------------------|
| September 30, 2006 | 5,417 |
| December 31, 2006 | 10,833 |
| March 31, 2007 | 10,833 |
| June 30, 2007 | 10,833 |
| September 30, 2007 | 10,833 |
| December 31, 2007 | 10,833 |
| March 31, 2008 | 10,833 |
| June 30, 2008 | 10,833 |
| September 30, 2008 | 10,833 |
| December 31, 2008 | 10,834 |
| March 31, 2009 | 10,834 |
| June 30, 2009 | 10,834 |
| August 14, 2009 | 5,417 |

In the event: (i) the Executive's employment is terminated by the Company other than for Cause, death or Disability or (ii) the Executive resigns for Good Reason, for purposes of determining the vesting of Options under this Section 5, the Executive's employment shall be considered to have continued through the last day of the calendar quarter in which his Termination of Employment occurs.

- b. Partial Accelerated Vesting upon Change in Control. In the event of a Change in Control during the Employment Term (as defined in the Employment Agreement), Executive shall receive accelerated vesting of fifty percent (50%) of the then-unvested Options. The Options that are subject to accelerated vesting pursuant to this Section 5.b. shall be taken pro-rata from each then-unvested tranche of the Option award, and the remaining portion of each tranche shall vest according to Section 5.a. above, subject to potential accelerated vesting pursuant to Section 5.c. below.
- c. Accelerated Vesting upon Termination after Change in Control. If, during the 2-year period following a Change in Control during the Employment Term: (i) Executive is terminated by the Company other than for Cause (as defined in the Employment Agreement), death or Disability, or (ii) Executive voluntarily resigns for Good Reason (as defined in the Employment Agreement), all Options shall become fully vested as of the date of such termination.

6. **EXERCISE OF OPTIONS.** To exercise an Option, Executive or Executive's Representative shall deliver to Company, or to a broker-dealer in the Common Stock with the original copy to Company, the following: [i] seven (7) day prior written notice (which notice may be sent prior to the vesting date of the options to be exercised with exercise contingent on such vesting) specifying the number of shares as to which the Option is being exercised and, if determined by counsel for Company to be necessary, representing that such shares are being acquired for investment purposes only and not for purpose of resale or distribution; and [ii] payment by Executive or Executive's Representative, or the broker-dealer, of the Option Price for such shares in cash, or if the Committee in its discretion agrees to so accept, by delivery to Company of other Common Stock owned by Executive, or in some combination of cash and Common Stock acceptable to the Committee. At the expiration of the seven (7) day notice period, and provided that all conditions precedent contained in this Agreement are satisfied, Company shall, without transfer or issuance tax or other incidental expenses to Executive, deliver to Executive, at the offices of Company, a certificate or certificates for the Common Stock. If Executive fails to accept delivery of the Common Stock, Executive's right to exercise the applicable portion of the Options shall terminate. The Options may be exercised in whole or in part at any time before their expiration. If payment of the Option Price is made in Common Stock, the value of the Common Stock used for payment of the Option Price shall be the Fair Market Value of the Common Stock on the business day preceding the day written notice of exercise is delivered to Company. The Option Price shall be subject to adjustments in accordance with the provisions of Section 10.
7. **NONTRANSFERABILITY.** The Options are not transferable other than by will or by the laws of descent and distribution. During Executive's lifetime, the Options are exercisable only by Executive, and after Executive's death, to the extent exercisable by Executive on the date of Executive's death, by Executive's Representative at any time before expiration of said Options. Any attempted assignment, transfer, pledge, hypothecation or other disposition of an Option or levy or attachment or similar process not specifically permitted herein, shall be null and void and without effect.
8. **INVESTMENT REPRESENTATION.** Upon reasonable demand by the Committee for such a representation, Executive or Executive's Representative shall deliver to the Committee at the time of exercise a written representation that the shares to be acquired upon exercise of the Options are to be acquired for investment and not for resale or distribution. Upon such demand, delivery of such representation before delivery of Common Stock shall be a condition precedent to the right of Executive or Executive's Representative to purchase Common Stock.
9. **COMPLIANCE WITH OTHER LAWS AND REGULATIONS.** The grant and exercise of Options and the obligation of Company to sell and deliver shares under the Options shall be subject to all applicable federal and state laws, rules and regulations and to such approvals by any government or regulatory agency as may be required. Company shall not be required to issue or deliver certificates for shares of Common Stock before [i] the listing of such shares on any stock exchange or over-the-counter market, such as NASDAQ, on which the Common Stock may then be listed or traded, and [ii] the completion of any registration or qualification of any governmental body which Company shall, in its sole discretion, determine to be necessary or advisable. The Company agrees to use its best efforts to procure any such listing, registration or qualification.

10. CAPITAL ADJUSTMENTS AND MERGERS AND CONSOLIDATIONS.

- a. Capital Adjustments. In the event of a Company stock dividend or distribution (or distribution on Common Stock of any security convertible into securities of the Company), stock split, reorganization, merger, consolidation, subdivision, reclassification, combination or exchange of shares or the like, the number of shares of Common Stock subject to the Options shall be automatically adjusted to take into account such capital adjustment. The price of any share under the Options shall be adjusted so that there will be no change in the aggregate purchase price payable upon exercise of the Options.
- b. Mergers and Consolidations. In the event Company merges, consolidates or effects a share exchange with another entity, or all or a substantial portion of Company's assets or outstanding capital stock are acquired (whether by merger, purchase or otherwise) by a Successor, the kind of shares of Common Stock that shall be subject to the Options shall automatically be converted into and replaced by shares of common stock, or such other class of securities having rights and preferences no less favorable than Company's Common Stock, of the Successor, and the number of shares subject to the Options and the purchase price per share upon exercise of the Options shall be correspondingly adjusted, so that Executive shall have the right to purchase [a] that number of shares of common stock of the Successor that have a value equal, as of the date of the merger, conversion or acquisition, to the value, as of the date of the merger, conversion or acquisition, of the shares of Common Stock of Company theretofore subject to Executive's Options, [b] for a purchase price per share that, when multiplied by the number of shares of common stock of the Successor subject to the Options, shall equal the aggregate exercise price at which Executive could have acquired all of the shares of Common Stock of Company theretofore optioned by Executive.
- c. No Effect on Company's Rights. The granting of the Options shall not affect in any way the right and power of Company to make adjustments, reorganizations, reclassifications, or changes of its capital or business structure or to merge, consolidate, dissolve, liquidate, sell or transfer all or any part of its business or assets.

11. TAX WITHHOLDING. Company shall have the right to: [i] withhold from any payment due to Executive or Executive's Representative; or [ii] require Executive or the Executive's Representative to remit to Company; or [iii] retain cash or Common Stock otherwise deliverable to Executive or Executive's Representative, in an amount sufficient to satisfy applicable tax withholding requirements resulting from the grant or exercise of the Options pursuant to this Agreement.

12. NO RIGHTS AS SHAREHOLDER. Executive or Executive's Representative shall have no rights as a shareholder with respect to Common Stock subject to the Options before the date of transfer to Executive of a certificate for such shares.
13. NO RIGHTS TO CONTINUED EMPLOYMENT. Nothing contained in this Agreement nor any award herewith shall confer upon Executive any right with respect to continuance of employment by Company or Subsidiary nor interfere with the right of Company or Subsidiary to terminate Executive's employment.
14. EFFECTIVE DATE AND APPROVAL. It is the intent of the parties that the compensation payable to the Executive with respect to the Options constitute qualified performance based compensation under Internal Revenue Code §162(m) and regulations issued thereunder. The effective date of the Options is July 18, 2006, subject to approval by stockholders of the Company holding not less than a majority of the shares present and voting at Company's 2007 Annual Meeting. In the event the grant of the Options is not approved by stockholders of the Company, this Option Agreement shall be of no effect and the Options shall be null and void. The Company agrees to use its reasonable best efforts to procure shareholder approval of the award of the Options, including, without limitation, placing such matter on the agenda for the Company's 2007 annual meeting, including appropriate disclosures in the proxy statement for such meeting, recommending to Company shareholders the approval of such Options and soliciting proxies for the approval of such Options.
15. NOTICES. Notices shall be deemed delivered if delivered personally or if sent by registered or certified mail to the Company at its principal place of business, as set forth above, and to Executive at the address as shall most currently appear on the records of the Company, or at such other address as either party may hereafter designate in writing to the other.
16. REGISTRATION OF SHARES SUBJECT TO OPTIONS. The Company shall use its reasonable best efforts to file, within 90 days following the execution of this Agreement, a registration statement with the Securities and Exchange Commission (the "Commission") pursuant to the Securities Act of 1933, as amended (the "Act"), covering the shares subject to the Options, and thereafter to cause such registration statement to become effective in accordance with the Act and the rules and regulations adopted by the Commission thereunder.
17. CODE SECTION 409A. It is intended that any amounts payable under this Agreement and the Company's and Executive's exercise of authority or discretion hereunder shall comply with Code Section 409A (including the Treasury regulations and other published guidance relating thereto) so as not to subject Executive to the payment of any interest or additional tax imposed under Code Section 409A. To the extent any amount payable under this Agreement would trigger the additional tax imposed by Code Section 409A, the Agreement shall be modified to avoid such additional tax.

18. **SEVERABILITY**. The invalidity or unenforceability of any provision of the Agreement shall not affect the validity and enforceability of the remaining provisions of the Agreement, and such invalid or unenforceable provision shall be stricken to the extent necessary to preserve the validity and enforceability of the Agreement, with the parties agreeing in such event to make all reasonable efforts to replace such invalid or unenforceable provision with a valid provision that will place the parties in approximately the same economic position as contemplated hereunder.
19. **BINDING EFFECT**. This Agreement shall be binding upon and inure to the benefit of the parties and their respective legal representatives, successors and assigns. Executive hereby agrees to accept as binding, conclusive and final all reasonable decisions and interpretations of the Committee upon any questions arising under this Agreement, including without limitation, the interpretation of the terms, conditions and restrictions applicable to the Options granted hereunder and the terms and conditions of this Agreement.
20. **GOVERNING LAW; JURISDICTION; SERVICE OF PROCESS**. This Agreement shall be governed by the laws of the Commonwealth of Kentucky. Executive consents to the exclusive jurisdiction of the courts of the Commonwealth of Kentucky and of any federal court located in Jefferson County, Kentucky in connection with any action or proceeding arising out of or relating to this Agreement, any document or instrument delivered pursuant to or in connection with this Agreement, or any breach of this Agreement or any such document or instrument.
21. **ENTIRE AGREEMENT**. This Agreement contains the entire agreement between the parties hereto with respect to the subject matter hereof and may not be amended, modified or supplemented except in a writing signed by Company and Executive.
22. **CAPITALIZED TERMS**. Capitalized terms not otherwise defined in this Agreement shall have the meaning given them in the Employment Agreement.
23. **COUNTERPARTS AND SIGNATURES**. This Agreement may be signed in counterparts, each of which shall be an original, with the effect as if the signatures thereto and hereto were upon the same instrument. Signatures conveyed by facsimile or PDF file shall constitute original signatures.

(Signature Page follows.)

IN WITNESS WHEREOF, the Company and the Executive have executed and delivered this Agreement as of the date first above written.

ROBERT L. EVANS

/s/ Robert L. Evans

CHURCHILL DOWNS INCORPORATED

By: /s/ Robert L. Fealy

Robert L. Fealy,
Authorized Representative
of the Board of Directors

September 8, 2006

Mr. Vernon Niven III
1310 Quiet Cove Lane
Gulf Breeze, FL 32563

Dear Vernon:

I am pleased to offer you the position of Executive Vice President technology initiatives, as a Churchill Downs Incorporated (CDI) employee, reporting directly to our CEO, Bob Evans. Your responsibilities will be similar to those of other CDI business unit leaders. Your start date will be Monday, September 11, 2006.

Your base salary will be \$11,538.46 bi-weekly. You will be eligible to participate in a cash bonus plan beginning for calendar year 2007, which is payable in March 2008 and is based on objectives mutually agreed upon between you and our CEO, and approved by the Compensation Committee of the Board of Directors. The target bonus for this position is 60% of base pay. In calendar year 2007 (paid out in March 2008) your target bonus award is up to \$180,000.

In this role, you may also be eligible for Long Term Incentives based on achievement of certain performance goals and vesting criteria as described in Exhibit A (attached). The Long Term Incentive payments are intended to be in the form of Company stock but require Board of Director and shareholder approval. Should Company stock not be available at the time of payment (based on the performance and vesting criteria in Exhibit A), the Long Term Incentives will be paid in cash. Should there be a change in control, defined as an acquisition by any individual, entity or group, with at least 51% of the voting control of CDI or CDI's technology initiative, the remaining unforfeited Long Term Incentives as outlined in Exhibit A will vest at 50% of the scheduled value, paid in the year that the incentive otherwise would have been paid by Churchill Downs Incorporated.

You will be provided relocation assistance similar to that offered to other senior CDI executives of comparable level, once your relocation destination has been mutually agreed upon. Relocation Today, Inc. will administer and manage your relocation.

We will forward to you separately a summary of the customary fringe benefits you will be entitled to, including health insurance, life insurance, 401(k), Employee Stock Purchase Plan, Deferred Compensation Plan, and our executive severance policy. Please refer to the benefits summary for a description of the benefit, corresponding employee contribution and eligibility dates.

Your employment with Churchill Downs Incorporated is "at will" and it can be terminated with or without cause, and with or without notice, at any time, at the option of either Churchill Downs Incorporated or yourself.

Vernon Niven III
September 8, 2006
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Should your employment be terminated by the Company without “just cause” as defined below, the Company will convey the following:

- a. pay through the month in which the severance occurs and severance pay and benefits per the Executive Severance Policy,
- b. pay a pro rata annual bonus for the year in which your termination occurs based on the bonus target,
- c. pay the balance of any long term incentive awards, if any, earned through your termination date but not yet paid,
- d. pay 20% of the then remaining unforfeited Long Term Incentives (payable only if executive has completed one year of continuous service)

“Just cause” shall mean [i] failure to perform substantially your duties after written demand for substantial performance improvement, or [ii] engaging in illegal conduct or gross misconduct which, in the sole direction of the Company, is injurious to the business or reputation of the Company.

You agree that for a period of two years from the date you cease to be an employee of CDI or any subsidiary of CDI, regardless of the reason for no longer being an employee, you will not directly or indirectly:

- solicit any customers or prospective customers of CDI for the purpose of selling them products or services that compete with those of CDI;
- solicit or recruit in any form, as employees, contractors, sub-contractors, consultants or other capacity in which such individuals provide services of material business value, any employees or ex-employees of CDI, unless such ex-employees’ employment with CDI has been terminated for at least two years;
- disclose to any third parties or use to your own benefit, directly or indirectly, any confidential or proprietary information or knowledge of CDI; and
- work with or for a competitor of CDI or yourself which would potentially subject CDI trade secrets or confidential information to misuse.

Furthermore, you agree that any intellectual property developed while an employee of CDI is the sole exclusive property of CDI, including but not limited to any business processes, product or service designs, software code, and other such knowledge regardless of its form of expression, including such knowledge developed by contractors employed by you on CDI’s behalf.

While you are employed by CDI, you agree to devote 100% of your business efforts to CDI and not to accept employment or otherwise engage with any third-parties whereby your obligations to such third-parties inhibit in any way your performance in discharging your CDI responsibilities.

Vernon Niven III
September 8, 2006
Page 3

Our employment offer is contingent upon a successful background check and submission of satisfactory proof of your identity and legal authorization to work in the United States. If you fail to submit this proof, federal law prohibits us from hiring you. As an Officer of Churchill Downs Incorporated, this employment agreement is also subject to the approval of the Board of Directors.

Vernon, we are excited about the prospect of you joining us during this most exciting period for our Company. Please call me at 502-636-4836 as soon as you have had the opportunity to review the contents of this letter so I may promptly address any concerns you may have.

If you agree with and accept the terms of this offer of employment, please sign the letter and return it to me. We are confident your employment with Churchill Downs Incorporated will prove mutually beneficial, and we look forward to having you join the team.

Sincerely,

/s/ Chuck Kenyon
Chuck Kenyon
Vice President Human Resources
Churchill Downs Incorporated

Accepted by:

/s/ Vernon Niven

Sept. 12, 2006

Vernon Niven III

Date

Exhibit A

Long Term Incentive Performance Criteria for EVP Tech Initiatives Vernon Niven, III

When in any Calendar Year:

| | | |
|--|------|---------|
| LTI performance vesting no later than calendar year: | 2008 | ■ ***** |
| | 2009 | ■ *** |
| | 2010 | ■ *** |
| | 2011 | ■ *** |

Any performance criteria not achieved by the calendar year shown will be deemed to have not been achieved and the payouts shown in the table below for that year will be forfeited.

Long Term Incentive Payout by Year (assuming performance criteria are met in the last calendar year of eligibility):

- Calendar Year 2006 – \$**
- Calendar Year 2007 – \$**
- Calendar Year 2008 – \$**
- Calendar Year 2009 – \$**
- Calendar Year 2010 – \$**
- Calendar Year 2011 – \$**

Any Long Term Incentive payouts earned will be paid in four (4) equal installments in March, June, September and December of the calendar year following the year in which such payouts are earned. In order for these payouts to be made Vernon must continue to be employed by CDI on a full-time basis at both (i) the time the Long Term Incentive is earned; and (ii) the time the Long Term Incentive is paid.

| | | | |
|---------------------------|-----------------------|--|-----------------------|
| <u>/s/Robert L. Evans</u> | <u>Sept. 12, 2006</u> | <u>/s/ Vernon Niven</u> | <u>Sept. 12, 2006</u> |
| Bob Evans CEO | Date | Vernon Niven, III EVP Tech Initiatives | Date |

*Confidential information omitted and filed separately with the Securities and Exchange Commission under a Confidential Treatment Request



CERTIFICATION OF CHIEF EXECUTIVE OFFICER

I, Robert L. Evans, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Churchill Downs Incorporated;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 7, 2006

/s/Robert L. Evans
Robert L. Evans
President and Chief Executive Officer

CERTIFICATION OF CHIEF FINANCIAL OFFICER

I, Michael E. Miller, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Churchill Downs Incorporated;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 7, 2006

/s/Michael E. Miller

Michael E. Miller

Executive Vice President and Chief Financial Officer

**Certification of CEO and CFO Pursuant to
18 U.S.C. Section 1350,
As Adopted Pursuant to
Section 906 of the Sarbanes-Oxley Act of 2002**

In connection with the Quarterly Report on Form 10-Q of Churchill Downs Incorporated (the "Company") for the quarterly period ended September 30, 2006 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), Robert L. Evans, as President and Chief Executive Officer of the Company, and Michael E. Miller, as Executive Vice President and Chief Financial Officer of the Company, each hereby certifies, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, to the best of his knowledge, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/Robert L. Evans

Robert L. Evans
President and Chief Executive Officer
November 7, 2006

/s/Michael E. Miller

Michael E. Miller
Executive Vice President and Chief Financial Officer
November 7, 2006

This certification is being furnished to the Securities and Exchange Commission as an exhibit to the Report and shall not be deemed filed by the Company for purposes of § 18 of the Securities Exchange Act of 1934, as amended.

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to Churchill Downs Incorporated and will be retained by Churchill Downs Incorporated and furnished to the Securities and Exchange Commission or its staff upon request.