THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

CHDN - Q1 2017 Churchill Downs Inc Earnings Call

EVENT DATE/TIME: APRIL 27, 2017 / 1:00PM GMT

THOMSON REUTERS

CORPORATE PARTICIPANTS

Marcia A. Dall *Churchill Downs Incorporated - CFO and EVP*

Michael W. Anderson *Churchill Downs Incorporated - VP of Corporate Finance and Treasurer*

William C. Carstanjen *Churchill Downs Incorporated - CEO and Director*

William E. Mudd *Churchill Downs Incorporated - President and COO*

CONFERENCE CALL PARTICIPANTS

Adam Joseph Trivison *G. Research, LLC - Research Analyst*

Cameron Philip Sean McKnight *Wells Fargo Securities, LLC, Research Division - Director and Senior Analyst*

Daniel Brian Politzer *JP Morgan Chase & Co, Research Division - Analyst*

David Brian Katz *Telsey Advisory Group LLC - MD and Senior Research Analyst*

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Churchill Downs Incorporated First Quarter 2017 Earnings Conference Call. (Operator Instructions) As a reminder, this conference call is being recorded.

I would now like to introduce your host for today's call, Mr. Mike Anderson, Vice President, Treasurer and Investor Relations.

Michael W. Anderson - *Churchill Downs Incorporated - VP of Corporate Finance and Treasurer*

Great, Thank you, Vicki. Good morning, and welcome to our First Quarter 2017 Earnings Conference Call. After the company's prepared remarks, we will open the call for your questions. The company's 2017 first quarter business results were released yesterday afternoon. A copy of this release announcing results and other financial and statistical information about the period to be presented in this conference call, including information required by Regulation G, is available at the section of the company's website titled "News" located at churchilldownsincorporated.com as well as in the website's investor section.

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

During this call, we will present both GAAP and non-GAAP financial measures. A reconciliation of GAAP to non-GAAP measures is included in today's earnings press release. The press release and Form 10-Q are available on our website at churchilldownsincorporated.com. And now I'd like to turn the call over to our Chief Executive Officer, Mr. Bill Carstanjen.

William C. Carstanjen - *Churchill Downs Incorporated - CEO and Director*

Thanks, Mike. Good morning, everyone. With me today are several members of our team, including Bill Mudd, our President and Chief Operating Officer;

Marcia Dall, our Chief Financial Officer; and Brad Blackwell, our General Counsel.

I'll make a few general comments and then turn this over to Marcia. After she has finished her comments, Marcia, Bill Mudd and I will be happy to take your questions. The company's adjusted EBITDA was up $10.6 million, 23% above the first quarter of 2016.

Big Fish Games was the major driver of that result, and I will talk about their performance in a few minutes. We also achieved adjusted EBITDA growth in the TwinSpires and Casino segments, and generally, those 2 segments performed as we expected.

Consequently, our results were up nicely versus first quarter 2016 with respect to adjusted EBITDA, diluted earnings per share, free cash flow and cash flow per diluted share.

While Big Fish Games, TwinSpires, and the Casino segments drove our positive results in the first quarter, our Racing segment was a headwind for us. Its adjusted EBITDA was down $2.3 million in the quarter, primarily because of 2 unusual factors that I'll describe briefly.

Racing is usually a fairly quiet segment for us in the first quarter. Fair Grounds Race Course in New Orleans is our only thoroughbred track conducting live racing. This year, the economic performance of the race meet was affected by an equine illness that was detected in a number of horses stabling at our facility.

The presence of the illness resulted in quarantine procedures that greatly restricted the movement of horses to and from our facility. This resulted in reduced average field sizes for our races, which in turn, directly correlated with wagering handled.

On average, when there are fewer horses and consequently fewer potential outcomes, there tends to be less wagering activity. The other unusual event in our Racing segment was really just a function of this year's calendar.

The Louisiana Derby, which is the biggest economic day of the Fair Grounds race meet fell in the second quarter this year and thus is not included in the first quarter results.

With respect to our Casino segment, net revenue and adjusted EBITDA both increased $1 million over prior year. Marcia will explain the variances in more detail. I would just like to offer a couple of general comments.

Oxford and Miami Valley continue to be strong and consistent performers for us. We believe that both properties have not yet reached their full potential in their respective markets, and that is really nice to see.

As you know, we are constructing a 107-room hotel at Oxford. Really severe weather conditions caused some delays to the construction process in the first quarter. We still plan to open the hotel expansion in the fourth quarter.

In addition to Oxford and Miami Valley, Harlow's showed improvement this past quarter in both net revenues and adjusted EBITDA over prior year. One quarter is not a trend, but nevertheless, we are encouraged and think we have the right team in place.

We are also encouraged with how well Saratoga is holding up in the face of the new Rivers Casino nearby in Schenectady, which opened in February. We do not have enough data points yet to understand the long-term impact of the new competition. Our facility is paying close attention to any changing dynamics in that market so that we can adjust accordingly.

We continue to be challenged at our operations in the New Orleans and Vicksburg, Mississippi, markets.

Our operating teams are very focused on cost efficiencies, and that helps us manage to the bottom line even when we are more challenged for top line growth. Those are both just tough markets right now.

Overall, some of our markets remain better than others, but generally, the Casino segment continues to be relatively stable and predictable for us. The current macro environment seems relatively consistent with recent periods. We have no cause to expect significant changes, and thus, we will continue to be conservative in how we invest in and operate our properties.

Finally, we closed in January on our purchase of the Ocean Downs casino in Berlin, Maryland.

As you may recall, we announced the signing of the Ocean Downs acquisition in July 2016.

We own directly and indirectly 62.5% of Ocean Downs, with our partner, Saratoga Casino Holdings, owning the rest. We manage the facility. Ocean Downs has approximately 800 video lottery terminals as well as seasonal harness racing.

We are currently constructing an expansion to increase the number of slot machines and to conduct live table games, which the property is permitted to do under existing law. We expect to be operating table games by New Year's Eve. This is an approximately $15 million project that is being funded with debt at the joint venture level.

Finally, in other good news for this property, a bill was recently passed and signed by the governor that reduces our gaming tax rate by 10% if we assume ownership or the right to lease the VLPs at Ocean Downs by January 1, 2019. Currently, the state of Maryland owns or leases each of the gaming machines.

Depending on how many of the existing machines on the floor we purchase compared to the number of new machines we order, we expect it will cost us between $10 million and $15 million and be less than a 3-year payback. We would likely fund this with additional debt at the joint venture level.

Turning to our TwinSpires segment. Wagering was up 6.8% in the first quarter after being up 14% for the full year of 2016. According to Equibase, handle across the industry as a whole was down about 1% for the quarter after being up less than 1% in 2016. Adjusted EBITDA was $1.1 million or about 9% in the first quarter.

The team at TwinSpires continues to demonstrate that it can drive top line growth in a flat to declining market. While our growth rate slowed in the first quarter versus full year 2016, that is not cause for concern. We compete every quarter to grow our business, but the second quarter is where we have the most opportunity to reach new customers and reconnect with inactive ones.

Our team is hyperfocused on acquiring new users and improving revenues per existing user as we head into the Kentucky Derby season.

While we have benefited over a long period of time from the trend of horseplayers moving their play online from traditional brick-and-mortar outlets, we market extensively around the Kentucky Derby, the Triple Crown season and the Breeder's Cup, since that is when the sport acquires new fans. All of you on this call should help us on this. Please remember to download the TwinSpires.com app so that you can bet the Kentucky Derby and all of the other races from the convenience of wherever you happen to be.

Let's turn to Big Fish Games. Adjusted EBITDA for the quarter increased $11.4 million or 128% over the first quarter of 2016. Our increase in adjusted EBITDA occurred despite the fact that our net revenues declined by $10.1 million. Our user acquisition spending declined $18.3 million and our other business expenses declined $3.2 million. This resulted in our adjusted EBITDA and adjusted EBITDA margin increasing over prior year.

As I will discuss in more detail in a moment, the reduction in UA spending occurred entirely within the free-to-play casual and mid-core segment. We reduced UA $21 million in the segment compared to the first quarter of 2016, and it was relatively flat compared to the fourth quarter. We actually increased UA in the social casino segment by $2.8 million over the first quarter prior year, and $2 million over fourth quarter.

We are increasing our focus and investment in the social casino genre and we are rightsizing our UA investment based on the performance of our current games in the free-to-play casual and mid-core space.

In the first quarter, bookings overall were down less than 1% compared to the fourth quarter and down about 13.5% compared to the first quarter of last year. These numbers were consistent with our plan and reflective of our pivot to put the business on a path to sustainable and predictable long-term growth.

I've stated repeatedly over the last several quarters that our objective is not to simply chase bookings for bookings' sake, but rather to achieve sustainable, profitable bookings growth. I'm going to talk separately about each of our major segments within Big Fish: social casino, free-to-play casual and mid-core, and finally, Premium.

Social casino bookings increased $2.1 million or nearly 5% over fourth quarter and slightly decreased about $1 million or 2% over first quarter of 2016.

We have been hard at work introducing new community and social features into our flagship game, Big Fish Casino, and refining new social casino products like Jackpot City Slots. In the first quarter, we launched the Clubs and Clubs Tournament features in both Big Fish Casino and Jackpot City Slots. These features allow players to team up with other players and earn in-game rewards as well as compete against other clubs in tournaments. In addition to these new features, we have been laser-focused on improving the user experience, particularly the first-time user experience. This is not only true across our social casino products, but applies to everything we are doing in free-to-play casual and mid-core as well.

We are seeing increases of many of our metrics as we have modified our approach. For those of you who follow the social casino segment, you may have noted that Jackpot City Slots has steadily and increasingly been climbing the download and bookings charts. This product is getting as much attention and all of the features and functionality of our flagship product, Big Fish Casino. It has been showing encouraging results and now is meaningfully adding to the bookings and other metrics our of social casino segment. We are cautiously optimistic we have a sustainable addition to our portfolio.

We think it is important to continue to introduce new stand-alone products to our social casino offerings. We have in soft launch now a new product called Sunset Riches, which combines classic 3-reel slot machines with a travel theme.

While the social casino genre continues to grow, the growth rate has slowed and competition has stiffened as both major players and new entrants compete in this very attractive space.

Big Fish Casino remains a leader in the space. That said, we can and will introduce new products while also staying absolutely committed to our traditional franchise.

We believe Big Fish Casino has a great deal of unreached potential. It is very hard for new entrants to reach sustainable profitability on the scale that we have built over time with Big Fish Casino. It remains a very stable and profitable business led by a deeply experienced and capable team.

Many casino products have come and gone chasing bookings in this space, but very few can demonstrate significant profitability and still say near the top of the charts for bookings, downloads and other key metrics, as we continue to do.

Now let's discuss the free-to-play casual and mid-core segment. Bookings declined about 6% compared to the fourth quarter and approximately 20% compared to the first quarter of 2016. We grew bookings rapidly through the first few quarters of 2016, but in retrospect, we did not do so in a manner that is best for our long-term profitability because we overinvested in user acquisition. I discussed that last quarter, and won't repeat it again now beyond making the point that it largely explains our declines in the top line compared to prior year.

With respect to our more significant gains, Gummy Drop! remains a highly profitable, well-performing game, but it is maturing. We are retooling the game play experience to improve retention. While we will continue to be very disciplined in our UA spend, we believe Gummy Drop! still has upside as we improve the user experience, particularly in the earlier levels of the game. We are also seeing improvements from another one of our well-established casual games, Fairway Solitaire, which continues to trend in the right direction.

We have really focused on reinvigorating our pipeline for free-to-play casual and mid-core games.

One of our strengths over time has been our deep network of third-party, offshore, low-cost game studios whom we have developed relationships with over many years.

We've delivered new games to the market cheaply, and then iterated quickly in response to customer feedback. We plan to do more of this while also introducing several new products out of our very talented and highly experienced in-house studios.

Pipeline production is a real emphasis for us over this next year. That said, we will keep a very close eye on UA investment as a percentage of revenues and are not likely to return to the high percentages you saw in the early quarters -- earlier quarters of 2016, unless there is a very compelling investment case to do so.

In sum, we have to expect our bookings, and therefore, associated revenues to decline in 2017 with respect to the free-to-play casual and mid-core segment, as we are more conservative with our UA spend on our current roster of games and the new games that will come from our pipeline.

Finally, a brief comment on the Premium segment. Bookings were flat through the fourth quarter and down 20% to the first quarter of 2016. The decline in bookings in the Premium segment has been expected and consistent since we've been involved in the Big Fish business. We've always felt this trend would continue as customers transitioned to mobile devices and free-to-play games.

This segment produces attractive margins by operating efficiently, and we will continue to operate it with this focus. We are encouraged that we may soon be able to offer a premium mobile games subscription service in the Apple Store. Apple has not previously permitted a game subscription model. No doubt, a great deal of work will be necessary to develop a compelling product in the mobile space, but subscriptions have always been a key attribute to Big Fish's success, with premium games directed towards customers using desktops. So we are encouraged by this possibility.

In sum, Big Fish is a complex business functioning in a sophisticated and competitive marketplace. The scale, experience and capability of our business and team gives us a great sense of optimism that we will continue to perform and iterate successfully.

Okay, the Kentucky Derby. The Kentucky Derby is a week from this Saturday. As you may recall, we put out a press release very shortly after each Kentucky Derby covering some of the key operating and financial metrics for the event.

We will have to let that press release speak for itself. We are very excited for the 143rd edition of the Run for the Roses. We have completed our $16 million renovation of the Clubhouse area. The improved amenities and features in the clubhouse will be apparent to everyone who passes by, but will be especially appreciated by the nearly 18,000 guests who utilize the restrooms, food and beverage offerings and wagering windows in this section of our facility. We have focused on improving on everything we do and hope our customers appreciate and feel the difference. Like I said, we are excited about next Saturday, May 6, and look to be in good shape.

One brief update. We announced earlier this year our inaugural Japan Road to the Kentucky Derby, which would select a qualified Japanese horse to take the starting gate at this year's Kentucky Derby and allow us to simulcast the race into Japan for wagering.

Unfortunately, we will have to wait until next year for a Japanese runner, as none of the 3 qualifiers this year are able to make the trip. We did not build in any economic expectations for this into our plan, and it would have been all additional upside. Next year, we will try again.

Two other quick notes. We were asked during the last conference call about any plans we may have in Kentucky to install instant racing machines at Churchill Downs Racetrack or at our training facility, called Trackside. We are very intrigued by the idea, and continue to consider it closely. We don't have anything else to announce on the subject at this time. Finally, as most of you will have seen, our Board of Directors just authorized a $250 million share repurchase program, which replaces the current authorized program.

We will continue to evaluate repurchasing shares so long as it is among the best way to deploy our capital. Our net leverage remains below 3x adjusted EBITDA, and that gives us great flexibility to support organic growth, dividends, acquisitions and share repurchases. With that, I would like to turn this over to Marcia who will provide some additional details on the quarter. After that, we'll be happy to take questions. Thank you. Marcia?

Marcia A. Dall - *Churchill Downs Incorporated - CFO and EVP*

Thanks, Bill, and good morning, everyone. First, I'll provide some high-level comments on the company's results and then I will provide some additional highlights for each of our segments. As you can see from our press release, although our top line revenue declined in the first quarter compared to a year ago, we had strong growth in adjusted EBITDA and, therefore, strong growth in net income and earnings per share compared to the prior year quarter.

Our company generated net revenue of $279.5 million for the first quarter, down $8.9 million or 3% compared to the prior year quarter.

This decrease was primarily driven by a $10.1 million decline from our Big Fish Games segment and a $2.4 million decline from our Racing segment. Our TwinSpires segment revenue growth of $2.4 million and our Casino segment revenue growth of $1 million partially offset these declines.

Adjusted EBITDA for the first quarter was $57.3 million, reflecting a $10.6 million or 23% increase over the prior year quarter. The high-level drivers of this increase are as follows.

Big Fish adjusted EBITDA grew $11.4 million, primarily due to a significant reduction in user acquisition spending compared to the prior year quarter. TwinSpires adjusted EBITDA grew $1.1 million. Our Casino segment grew $1 million dollars, reflecting the addition of our equity investment in Ocean Downs and strong performance from our MVG and Saratoga equity investments. Weakness at our Riverwalk and Fair Grounds facilities partially offset this growth in our Casino segment.

We also had a $2.3 million decline in our Racing segment, primarily due to a decline year-over-year in our Fair Grounds Race Course adjusted EBITDA. Our company generated net income of $7.3 million in the first quarter, up $4.5 million compared to the prior year quarter.

We also delivered diluted net income of $0.44 per share, up from $0.16 per share in the first quarter of 2016. Strong growth in net operating income and net income from our equity investments were partially offset by higher interest expense as a result of higher debt levels compared to the prior year quarter.

Turning to cash flow. We produced $75 million of cash flow from operations in the first quarter, an increase of $8 million from the prior year quarter, primarily as a result of the $17.2 million decrease in the impact of the Big Fish Games earn-out payment fair value accounting compared to the prior year quarter. Partially offsetting this benefit was an $11.6 million reduction in the change in deferred revenue driven by the timing of the Derby and Oaks collections in 2016 and lower Big Fish Games bookings.

We accelerated the timing of Derby Week ticket billings and collections for the 2017 Derby. This resulted in early collections of revenue for this year's Derby and, therefore, a higher deferred revenue balance at the end of 2016.

The majority of the all other current deferred revenue on the balance sheet of $85.2 million at the end of first quarter is related to Derby Week. This compares to $81.1 million at the end of the prior year quarter.

Turning to maintenance capital spending. We spent $10 million on maintenance capital in the quarter, which was up $2 million compared to the prior year quarter. We continue to expect our maintenance capital spending to tick up slightly in 2017 based primarily on replacement of aging slot inventory.

Regarding project capital for the quarter, we spent $27 million in the quarter, of which $10 million was related to strategic property acquisitions around Churchill Downs Racetrack as part of the Calder lifetime exchange transaction last year that allowed us to defer the taxes on $14 million of the gain.

The $10 million had been set aside in escrow at the time of the Calder excess property sale. The majority of the balance of the capital spend related to finishing the previously announced $16 million renovation at Churchill Downs Racetrack. And beginning of the construction of the $25 million hotel at our Oxford property also was -- made up the balance of the $25 million.

As we look to the balance of the year for project capital, we will continue to work on the $37 million new starting gate addition at Churchill Downs Racetrack. We will finish the new $25 million Oxford Hotel, with a targeted opening in the second half of this year, and we have a number of smaller strategic projects planned at our other properties.

We have a disciplined capital management process that requires project capital investments to fit with the strategic goals of the company and to have returns that exceed our cost of capital for the segment.

Turning to share repurchases. We repurchased approximately 54,000 shares of our stock in the first quarter for a total price of $7.8 million, as part of our stock repurchase program.

As Bill mentioned, our Board of Directors reauthorized a $250 million share repurchase program. Our net leverage remains low at 2.7x adjusted EBITDA, giving us significant capacity to support organic growth, dividends, strategic investments, acquisitions and share repurchases over the coming years.

Now I'll provide some additional highlights for each of our segments. As I mentioned a few minutes ago, our Racing segment had a $2.3 million decline and adjusted EBITDA compared to the prior year quarter. First quarter's always a tough quarter for Racing, given that we only have live racing at Fair Grounds and simulcast revenue for Churchill Downs and for Arlington.

The $1.5 million reduction in adjusted EBITDA at our Fair Grounds Race Course was the result of an equine quarantine that impacted operations until mid-February as well as the timing of one of their larger race day events, the Louisiana Derby, falling into the second quarter this year.

Adjusted EBITDA for the Casino segment was up $1 million compared to the prior year quarter. We benefited from the addition of our Ocean Downs equity investment. And our Saratoga and Miami Valley Gaming equity investments contributed strong quarter-over-quarter growth, offsetting weakness in our Riverwalk, Fair Grounds, and VSI properties. Our Riverwalk facility experienced inclement weather, casino floor disruptions from carpet replacement, and a heavy promotional environment in an overall declining market.

Our Fair Grounds and VSI facilities experienced adverse weather conditions and continued economic softness created by the oil and gas industry.

The TwinSpires segment grew adjusted EBITDA 9% compared to the prior year, reflecting strong top line growth from a 20% increase in active players. Industry handle was down 1% for the quarter, while the TwinSpires team was able to grow handle 6.8%. Adjusted EBITDA for Big Fish was $20.3 million in the quarter compared to $8.9 million in the prior year quarter, up $11.4 million even though revenue was down $10.1 million.

The decline in revenue was more than offset by an $18.3 million reduction in user acquisition spending and a $3.2 million reduction in all other expenses.

As Bill discussed, we decreased our UA spend on free-to-play casual and mid-core games by $21 million and increased our UA spend on our social casino games by $2.8 million compared to the prior year quarter.

Overall, on a sequential basis from fourth quarter 2016 to first quarter 2017, bookings were down less than 1%.

Our social casino bookings were up nearly 5%, reflecting the first period of sequential bookings growth since fourth quarter 2015.

We have begun to gradually increase our UA spending on our Big Fish Casino and Jackpot City Slots games based on the long-term performance of these games, and we are seeing the benefit in growth and bookings begin to pay off.

Our free-to-play casual and mid-core bookings were down 6% sequentially, as expected. And lastly, our Premium bookings were essentially flat on a sequential basis. As we look to the balance for the year for Big Fish, first, we continue to expect our bookings, and therefore associated revenue, to decline modestly in 2017 compared to the prior year as we refocus UA spend in the social casino space, which we believe will support long-term profitable growth for Big Fish.

Second, the Big Fish team is working to improve the sequential quarterly growth in casino bookings, which will be supported by sequential growth in UA spend, primarily on Big Fish Casino and on Jackpot City Slots from first quarter to second quarter.

Third, as I mentioned on the last earnings call, we expect the UA run rate in the casual and mid core free-to-play space to continue at the current levels until we have a new investable game. And lastly, related to Big Fish, as Bill discussed, the team has a number of new games soft launching in the second quarter. While it is too early to tell if any of the games will be a success, having a robust pipeline of games, as the team now has, is a key long-term catalyst for growth.

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

William C. Carstanjen - *Churchill Downs Incorporated - CEO and Director*

Thanks, Marcia. Okay, everyone, if you have any questions, please let us know. We're available to answer them for you.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question comes from the line of Cameron McKnight with Wells Fargo.

Cameron Philip Sean McKnight - *Wells Fargo Securities, LLC, Research Division - Director and Senior Analyst*

A question for you, Bill. I mean, we all saw that IGT sold its Double Down asset recently for 12 to 14x EBITDA, depending on how you cut the numbers. We've now had 2 pretty high profile sales in the social gaming space. How are you thinking about Big Fish in that context?

William C. Carstanjen - *Churchill Downs Incorporated - CEO and Director*

Well, first, I would say that it's nice validation of the attractiveness of the space. And maybe we were a little ahead of that curve back in 2014 when we identified this space as a place where we thought we could grow our company. So it's nice to see that others are clearly appreciating the opportunities in the space. So it's hard to really comment specifically on other people's transaction, and we won't, but we're obviously very cognizant that those activities are taking place and there is a lot of interest in social games assets, particularly, social casino assets. So we're monitoring the market, making sure we understand the trends and the thought processes behind some of this activity, and we'll keep doing so.

Cameron Philip Sean McKnight - *Wells Fargo Securities, LLC, Research Division - Director and Senior Analyst*

Perfect. And then just still on the topic of Big Fish. Are we now at the point where we should be starting to think a little bit more about seasonality and either bookings or EBITDA?

William C. Carstanjen - *Churchill Downs Incorporated - CEO and Director*

There is definitely seasonality that's already evident across the calendar. Sometimes, for our business, it can be clouded by the fact that there are so many other trends that there also going on, new competition or rapid growth in the space or maturing in another. But certainly, it's the case that there is seasonality in this business, and I don't know that a business with this much change going on where it will make sense in the short run to focus on seasonality as the big driver in change, but, certainly, it is a relevant driver even now. It just gets clouded with some of the other things that are going on at any given time.

Cameron Philip Sean McKnight - *Wells Fargo Securities, LLC, Research Division - Director and Senior Analyst*

Got it. And then a question for you, Bill, or for Marcia. As you sit here with leverage under 3x now and leverage likely dropping over the next year as you continue to generate cash, is there a hard or a soft leverage target that you guys have?

Marcia A. Dall - *Churchill Downs Incorporated - CFO and EVP*

No, I think, we don't really set a hard or soft leverage target. I think what we focus on as a leadership team is are there opportunities where we can successfully invest capital to grow the business. And whether that be strategic investments, as I mentioned regarding growing the investment at the Derby, to as we've mentioned, the $16 million that was invested at the Derby for this year, the $37 million that we're investing in the Starting Gate Suite addition for next year that will help us grow the business, we're always looking at things that will help us sustain and support the growth of the business in the long term, where we're getting -- supporting an acceptable return on cost of capital for the long term. That's the decisions even around the Oxford Hotel, where the business is making that investment as well. Very disciplined acquisitions as well that the business looks at, whether it be the Ocean Downs equity investment that was made, the team is always looking at that and always staying thoughtful about how high or low that takes the leverage over time. But clearly, having the leverage where it is gives us a lot of flexibility for making those strategic investments. It gives us a lot of flexibility for acquisitions as they come up, and it also gives us flexibility related to share repurchases in the future.

Operator

And our next question comes from the line of David Katz with Telsey Advisory Group.

David Brian Katz - *Telsey Advisory Group LLC - MD and Senior Research Analyst*

So without asking any -- asking questions in an appropriate way that you can actually answer about whether someone's tried to buy or you've tried to sell, or any -- that sort of thing, I think there's probably -- there certainly is confidence that you sort of deal with those matters in an appropriate way. But assuming that there was some demand, and I think we probably agree that there is a market for social gaming companies in the M&A market at this point, the alternative is to compare Big Fish with your short-, medium- and long-term model for what you think you can do with it. And my question is, how is that -- what is that qualitatively speaking, because I understand we don't want to guide too much. But how does that model look today? And what does it look like compared with when you bought Big Fish a couple of years ago? Clearly, some things have changed, and given the cost and the investment, how are you thinking about getting to an appropriate return? And what do you think an appropriate return on that ultimately should be?

William C. Carstanjen - *Churchill Downs Incorporated - CEO and Director*

David, I'm going to start on that question. There were a lot of levels of that to peel back. So let me start, and I'll try to give you sort of a fair and appropriate answer given that in this kind of forum, it isn't appropriate to be too forward-looking. I think there'll be a lot of things that come out over time with respect to some of these transactions that we are seeing occur in the social gaming space. One point that's been heartening for us is it's affirming of -- it's affirmational of the decision we've been making that -- to focus on the social casino portion, that, that is a linchpin, that, that is a foundation of stability around which you can build a social games company. So I think from our perspective, whether fair or not, but our perspective when we see some of the activity that we have recently, it's a nice marker out there that focusing on the social casino piece as a foundation is a smart way to grow this company and it allows you to produce consistently and in a stable manner, hopefully, growth and profitability over time. And that gives you the flexibility to use those skills that you have in that segment and that genre to explore other genres that are related where there might be more upside but also might be more volatility. So that's how we've been thinking about Big Fish. We think the foundation and the key to health of that division is performance in social casino and that, that is the springboard to try other things and to be aggressive about other things if we think there's an opportunity to do so. So what the future holds is always a question that's hard to talk about in this, and it's hard to know. But we think we have a deeply, deeply experienced team with a lot of capability in a number of genres, and we have some of the flexibility to explore that so as long as we consistently produce on the social casino side. So for us, it's full speed ahead. There has been some affirmation out there about the attractiveness of the space and we think within that, the attractiveness of the social casino space, and as you have seen over our quarters that -- the couple of years that we've owned Big Fish in the various quarters, we've learned a lot of lessons about not overinvesting in UA, not betting too much on unproven concepts and unproven games, but just trying to be consistent and thorough and data-driven in the decisions that we make and to grow based on those decisions as opposed to sort of pie in the sky wishes or what we may see in some other outfit out there that might have produced something that we admire and respect. So I think that's the first level of answers on your question and I -- give me some follow-ups if you want, but I think that's an appropriate place for me to stop for a second, especially when the concerns about just being -- answering appropriately in a public company context.

David Brian Katz - *Telsey Advisory Group LLC - MD and Senior Research Analyst*

No, understood. And I appreciate it. If I can follow it up, given -- I think it's fair to characterize the social casino business as having changed in some ways since you made the acquisition and clearly in some ways since before you notionally started looking at it in the first place. And so in that context, how would you have us think about the length of the tail or the progression of this business, not yours specifically but the industry overall? And is it a fair concern that this kind of a business will not follow a straight path down the road and could morph into something entirely different by 2 to 5 years from now, right? And I think in some respects, the question may be shouldn't we -- do we have the time? Do you feel like you have the time to ramp this business at a moderate trajectory in its current form with -- when it may change into something entirely different down the road?

William C. Carstanjen - *Churchill Downs Incorporated - CEO and Director*

I think that's a fair question. I think within the social casino genre, there is as much stickiness and consistency to the customer base as we would ever hope. It is a competitive space. And I think what makes the competitive environment even more challenging to analyze and understand is many competitors that are new to the space just focus on bookings growth. So they're not driving towards profitability; they're just trying to perhaps get a quick score, show a lot of bookings growth and not focus on the more traditional fundamental metrics of good performance in a company, which revolve around free cash flow and profitability. So sometimes when we're competing with new entrants into the genre, we're running into that phenomena. Where we're making UA investments based on profitability and long-term returns, others may not be making the same choices because they have a more short-term profile. If you look at the leaders in the space, though, the company that have shown sustained profitability and performance over time, I think there is some consistency within that genre, and I think we're pleased that we're one of those players that has demonstrated the ability to be a leader in terms of the various key metrics over an extended period of time. So when it comes to that genre, we feel pretty good. There is innovation that happens within the genre, features and functionality, but I think there's a real advantage to having scale and predictability, and you can't fake those things. Those things ultimately get translated on the bottom line performance of that segment, and I think that's something we've been demonstrating. And so I feel good about that, feel that, that is a business with legs that now has a track record that demonstrates it's pretty -- it's a fairly consistent and likely to be around for an extended period of time. Some of the other games -- I think there is more volatility in some of the other games, the casual and -- free-to-play casual and mid-core segment, there is a great deal of competition, and their blending between genres can create new entrants and new competition. And that's a space where we've just learned a lot. So we're being thoughtful and careful so that we can be consistent and predictable in how we play in those other spaces.

David Brian Katz - *Telsey Advisory Group LLC - MD and Senior Research Analyst*

Understood. And my last thing, and then I'll sort of give somebody else a chance, is I believe, as a management team, you've always talked about being thoughtful and analytical about the assets that you have. And not in any way emotionally attached to any of the business units or assets that you have. With respect to Big Fish, there is sort of the old expression there's a number for everything. I suppose all of us would love to just be comfortable that there is an ongoing analysis about what that number is and that there is one. And that, that sort of analytical approach and lack of emotional attachment applies to Big Fish as well as it always has for your other assets.

William C. Carstanjen - *Churchill Downs Incorporated - CEO and Director*

I think we look at all our business the same way. I mean, we are constantly reviewing our businesses, our strategy, our place in our competitive universes that we find our businesses. I think for that -- for us, that is a constant and continuing process that we've always been committed to and that we'll continue to be committed to. We know who we work for. We work for the shareholders of this company, and I think our performance over time has demonstrated we do understand who we work for, and we haven't lost sight of that. We will continue to do the strategic and long-term work necessary to decisions with all of our businesses, not just the one you just mentioned.

Operator

(Operator Instructions) And our next question comes from the line of Adam Trivison with Gabelli & Company.

Adam Joseph Trivison - *G. Research, LLC - Research Analyst*

First, Bill, I know you said that we won't have a Japanese horse running this year in the Derby, but can you just help us frame our thinking on how this effort may show up in the P&L in coming years? And also, are you still simulcasting from Japan -- or to Japan?

William E. Mudd - *Churchill Downs Incorporated - President and COO*

Adam, this is Bill Mudd. Good question. First, to understand what's going on in Japan, Japan has typically been a closed country so they didn't allow simulcasting of any horse racing outside of Japan for Japanese customers to wager on. That opened up in the late spring of last year. So it was a great opportunity for us to evaluate. And we had Lani in the race, in the Kentucky Derby last year. So there was a lot of excitement from the Japanese last year around our event. When that law passed,

(technical difficulty)

it was a year to go in to that market outside of Japan to be simulcast. The first race that went in was the Arc de Triomphe out of France, and it did $40 million of handle on that race, that one race. That was more than I think the rest of the world did, certainly more than France itself did on the race. And that's a great race. So we created a Japan Road to the Derby. We had 2 horses in it. Unfortunately, we do not have a horse this year. But, I think the prospects are very good for future years, and we'll probably expand the number of races this year. And the way that it would show up is one, it would be more excitement in wagering on our product. But what -- also, NBC, hopefully, it'd be more opportunity for them to distribute their signal, which will hopefully turn into economics at some point down the road. Sponsors, obviously, there are a lot of Japanese sponsors that are potentially lucrative to us as part of the Derby. And then we're also building 36 new suites, as you know. And we've had a number of people inquire about adding some hospitality to what we give on the Japanese side. So there's lots of ways. I mean, it's all the same ways that we monetize the Derby today, largely. This gives us another market to get into.

Adam Joseph Trivison - *G. Research, LLC - Research Analyst*

Okay, great. That's helpful. I guess second, on Big Fish, two things. I guess, one, how should we think about UA spending and how it tracks for the rest of the year in light of the new game launches you spoke about? I guess -- I know the guidance was for levels kind of consistent with this quarter, but help us think about if one of these games takes off, could we see a marked increase?

William C. Carstanjen - *Churchill Downs Incorporated - CEO and Director*

I'll take that one. This is Bill Carstanjen, again. We'll be very, very, very careful about significant changes in UA spend even in the face of a game that shows, if we are so fortunate to have this circumstance, a game that shows wildly good metrics and the nuance to long-term value of customers. You may see hot and heavy monetization early, but just because you see it early doesn't mean it sustains itself over time. So truly, theoretically, there isn't a way to know when you launch a new game how sticky the customers will be over time, and you can't just rely on the fact that they monetize quickly to assume that they'll be sticky and monetizing at a high level over a long period of time. So I think we learned that lesson over 2016. So even in the face of launching new products, and if we're so fortunate for them to show really good metrics early on, we'll still be fairly cautious because of the lack of clarity of how that customer long-term value curve holds up over time, given that there won't be any data in a new game for the long term yet. So I think you'll see us be more thoughtful and careful about that even in the face of good metrics for a new game if we're lucky enough to have it. We want to be a little more predictable and data-driven in UA and, thus, have our performance be a little more predictable at the bottom line.

Adam Joseph Trivison - *G. Research, LLC - Research Analyst*

Okay, that makes sense. And I guess related to that, I guess, and I don't want to pile on, but, Bill, you spoke about scale being important in the social casino space now increasingly. I guess, with some of these big tie-ups and some of the leaders in the space launching multiple brands, I guess, do you feel like you're at where you need to be in terms of the scale? Or should we see more consolidation? Or would -- I guess, to a certain degree, you're putting out multiple skins and multiple games, and that's, I guess, broadening the revenue base which you could derive the UA spending from. But, I guess, do you feel like there is a need if we see more consolidation to do something yourself?

William C. Carstanjen - *Churchill Downs Incorporated - CEO and Director*

Well, I have to be careful about answering that kind of question because it's pretty forward-looking, and we try not to talk about consolidation or acquisition activity. But I would say, speaking more generally about it, I would say that our Big Fish model is really an organic growth model. That when we acquired the platform, one of the things that was really important to us and one of the things that we were most excited about is the capabilities within the existing team. And with a network of third-party developers, many of who we work with exclusively, but all of whom we have deep long-term relationships with, really, our feeling from the beginning is that this collection of people and this collection of assets called Big Fish really has the capabilities to pursue most things of interest organically. At least that's our approach to it. Others approach their business differently, and others have different needs than we have. But at least from one perspective, I would say we're really more organic growth as we think about Big Fish.

Operator

And our next question come from the line of Dan Politzer with JPMorgan.

Daniel Brian Politzer - *JP Morgan Chase & Co, Research Division - Analyst*

Sorry, I've been hopping around a bit. But I was wondering, did you guys quantify the breakdown between the impact from the Louisiana Derby and the quarantined horses?

Marcia A. Dall - *Churchill Downs Incorporated - CFO and EVP*

No, we did not actually put that out from a disclosure perspective. But I think the thing is, obviously, both of those are sort of -- the way to think about it are really sort of unique events. We'll pick up the Louisiana Derby right in the second quarter, again. The quarantine we hope is a onetime event.

Daniel Brian Politzer - *JP Morgan Chase & Co, Research Division - Analyst*

Okay, on TwinSpires, your active players were up 20%. Your revenues were up 5%. I guess, how do we think about retention of these players? Is this kind of like a short-term phenomena leading up to the Derby? Or is this increase sustainable and part of your ongoing strategy for the business?

William E. Mudd - *Churchill Downs Incorporated - President and COO*

Yes, I think Bill's comment said it best. Where we really focus on getting new customers, in the past it's been transitioning. We still see quite a bit of that; it's not as much as it used to be, people transitioning from going to brick-and-mortar locations like OTBs to going online. Now what we're seeing is the majority of new customers we have signing up are really new to the sport and are realizing they can do this online. So as you bring those people online, they're not as comfortable betting as big of numbers as the people that we historically got. So that's why you see that the percentage of users are going up faster than the revenue line. And the hope is, over time, you build them into more core players and you just have to train them and they learn the system and get more comfortable with betting and more familiar with the horses and the trainers and the jockeys and the stars of the show. And then you grow them into your core audience over time.

Operator

And I'm showing no further questions at this time. I would now like to turn the call back over to Mr. Bill Carstanjen for closing remarks.

William C. Carstanjen - *Churchill Downs Incorporated - CEO and Director*

Thank you. Well, our team is now going to put this morning behind us and go get busy on what everybody here now needs to focus on, which is a successful Kentucky Derby. So we hope you all enjoy that as well, either in person or on television if you can't make it. And don't forget about your TwinSpires accounts, and if you don't have one, get one. But broader than that, thank you for your interest in our company. Thank you for investing in our company. We appreciate it. We try to be good stewards of your investments, and we'll keep doing the best we can to generate returns for you. So with that, thanks very much, and Happy Derby, everybody.

Operator

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