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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Churchill Downs Incorporated 2016 third quarter earnings conference call. At this time all participants are in a listen only mode. Later we'll conduct a question-and-answer session and instructions will be given at that time. As a reminder this conference call is being recorded. I would now like to introduce your host for today's conference Mr. Mike Anderson, Vice President, Treasury and Investor Relations.

Mike Anderson - *Churchill Downs Incorporated - VP of Corporate Finance and Treasurer*

Great, thank you, Liz. Good morning and welcome to our third quarter 2016 earnings conference call. After the Company's prepared remarks we will open the call for your questions. The Company's 2016 third 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 filing 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 obligations 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 would like to turn the call over to our Chief Executive Officer, Bill Carstanjen.

Bill Carstanjen - *Churchill Downs Incorporated - CEO*

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 Alan Tse, our General Counsel. I will make a few general comments about the third quarter and then turn this over to Marcia. After she is finished her comments Marcia, Bill Mudd and I will be happy to take your questions.

The Company produced record net revenues and significant growth in net income and net income per share for the quarter. However, we reported adjusted EBITDA that is down $4.9 million, or 6.8% compared to prior year. Our Casino's, TwinSpires and Racing segments are firing on all cylinders and all produced strong growth and adjusted EBITDA for the quarter for their respective segments. That being said, adjusted EBITDA overall for the Company was lower primarily due to a $9.8 million year-over-year decrease from Big Fish. This is not the result we wanted to see for this quarter because we were light on Big Fish, but note that the third quarter of 2015 has been a high water mark for Big Fish adjusted EBITDA and we have steadily grown Big Fish adjusted EBITDA and adjusted EBITDA margin each quarter during 2016.

We continue to refine our investment and operational methodologies across our portfolio of games, and hope recent performance improvements continue. I am going to spend time talking about all of our segments this morning, but we will dig a little deeper into Big Fish in a few minutes.

Turning to our business segments with respect to our brick and mortar casinos business net revenue increased slightly over prior year while adjusted EBITDA was up $3.7 million, or 14%. Marcia will explain the variances over prior year in more detail. I would just like to offer a couple general comments. First, we are seeing a solid contribution from our Saratoga Casino investment in which we have a 25% interest, as well as the management contract. That transaction closed in October 2015.

Saratoga contributed $1.8 million in adjusted EBITDA to Churchill Downs in the third quarter and we were pleased that the facility opened its new 117 room four star hotel in July just in time for the height of the tourism season. The partnership entity through which we own our 25% interest in Saratoga is also our 50% partner in the transaction we announced in the third quarter to purchase the Casino at Ocean Downs in Berlin, Maryland.

Again, Churchill Downs will participate in this transaction by directly acquiring 50% of the Ocean Downs property and will also participate indirectly through owning 25% of the Saratoga entity that will own the other half of Ocean Downs. Resulting in an effective total ownership of 62.5%. We expect to close this transaction in the fourth quarter. As we discussed last quarter, the Ocean Downs property is relatively new, having just opened in 2011, and is in a stable area unlikely to see new competition.

The Casino also has the right to install table games, but has not yet done so. It has approximately 800 machines with a small capital footprint that is easy to maintain. Our partners in Saratoga introduced us to this transaction and we decided to do it together. We have not disclosed the transaction purchase price but the EBITDA multiple is very reasonable.

This will be an accretive transaction that will be a nice addition to our portfolio of properties, and we look forward to getting the transaction closed. We do see some upside here. We also hope to close our 25% purchase of the Saratoga Casino Blackhawk in Colorado before the end of the year. As you may recall, this small asset was a part of the Saratoga transaction we announced in October of 2014.

The closing of this part of the transaction has taken longer than we had hoped, due to the Colorado licensing process. We believe we are now very close to obtaining approval of our Colorado license. Turning to our current portfolio of properties some of our markets remain better than others but generally this continues to be a stable and predictable segment for us. In particular, our 50% owned JV Miami Valley Gaming located between Cincinnati and Dayton, Ohio, and the Oxford Casino in Oxford, Maine, have both been doing well.

Miami Valley again gained market share in the third quarter and Oxford is also growing its revenue and adjusted EBITDA very nicely. As we discussed in our second quarter earnings call, we were building a 109 room hotel at our Oxford Casino property for approximately $25 million. We hope to be open around the middle of next year. We are excited about this amenity. As you all know we like small capital footprints in order to minimize maintenance capital so it's a big step for us to decide to add a hotel to our property. In this case it just makes a lot of sense.

Switching gears, our to properties in Mississippi and our fairgrounds operations in Louisiana are currently experiencing challenging market conditions that are affecting the properties. In Louisiana in particular, we see pretty clear evidence that the depressed Gulf coast oil and gas industries are impacting our performance, as well as the smoking ban in Orleans parish, which went into effect April 2015.

Continues to negatively impact (inaudible). To conclude on this segment, across the portfolio of properties that are tied to local GDP and are geographically diverse, we are never surprised to see some areas doing better than others. Our operating teams are very focused on cost efficiencies and that helps us manage effectively to the bottom line even in some of our markets that at any given time are more challenged for top line growth.

The current macro environment seems relatively consistent with recent periods. We have no cause to expect significant changes and we will continue to be conservative in how we invest in and operate our properties. With respect to our racing segment, our third quarter is typically fairly quiet.

We continue to work very hard under challenging market conditions to keep adjusted EBITDA flat to slightly growing. Racing is a tough business, but we know how to do it and they're always technology improvements and efficiencies to help drive performance. As you may have seen last week, we announced the $16 million project for Churchill Downs Racetrack completed by next year's Kentucky Derby.

As many of our investors understand, the investment return for projects such as this is built almost entirely around the Kentucky Derby. We will improve about 95,000 square feet including upgrades to several of our restaurants and seating areas, as well as to our restrooms and common areas, all in the second floor clubhouse area. We are not introducing a significant number of new seats overall, but we are very much improving the amenities of current seating areas as well as creating new seating options.

We are at the same time losing a similar number of current lower end seats as part of this project. We expect to generate most of our return from higher end offerings and amenities. We continue to believe strongly in the Kentucky Derby, our signature event and the Crown Jewel of our Company. We are excited about announcing future projects and continue making investments to improve the Kentucky Derby and drive growth. Turning to our TwinSpires segment this segment of our Company has performed very strongly, wagering or handle, as we call it, was up 14% in the third quarter after being up 16% in the second quarter and 11% in the first quarter.

According to the industry resource Equibase, handle across the industry as a whole was up a little less than 1%, in the third quarter. Meaning, we out grew the industry by over 13 percentage points. While wagering on horse racing has ranged from low single digit declines to flat over the last handful of years, our team is continuing to prove it can acquire new users and also improve revenues per existing users. While we continue to benefit from the trend of horse players moving their play online from traditional brick and mortar outlets we extensively market for new players around the Kentucky Derby, the Triple Crown season and the Breeder's Cup since that is when new and more casual fans enter or re-enter the game.

TwinSpires adjusted EBITDA was up $1.2 million, or 9% in the third quarter. We thought this was a very solid result given we were moving to headquarters of TwinSpires out of Mountain View, California to Louisville, to be co-located with our Corporate Headquarters. We will fully accomplish this move prior to the end of the year, although our lease in California continues through the first quarter of 2017. There will be costs and capital efficiencies associated with the office move that will materialize in 2017 and 2018.

As I noted last quarter, we made the decision to move the business because we built the technology and business capabilities in Louisville that we didn't have when we started this business back in 2007. With our office leasing costs in the Bay Area expected to rise significantly, and the challenge of attracting and retaining personnel increasing in the Bay Area, we are excited to bring this business to Louisville. Several critical team members including Ted Gay, the President of TwinSpires, are relocating to Louisville with the business.

Now let's turn to Big Fish. Big Fish contributed $118.5 million of bookings and $23.4 million of adjusted EBITDA in the third quarter. Bookings were up about 4% compared to the third quarter of last year and down about 7% compared to the second quarter of this year. Adjusted EBITDA was down 29.5% compared to the third quarter of last year but up 14% compared to the second quarter of this year.

I will dig into this a bit more when I talk about each Big Fish segment, but generally the year-over-year bookings growth compared to the third quarter of 2015 and our Casual and Mid-Core free-to-play segments was offset by modest declines in our Social Casino and Premium segments and we believe the effects of the seasonally slower summer months magnified by the Olympics, the prolonged controversy election cycle and the phenomenon known as Pokemon Go.

Before diving into each of these segments I want to describe some larger trends and themes that we are seeing. First, Big Fish's rate of revenue growth has been declining over time, and in particular this year. And this is despite the fact that our User Acquisition, or UA budgets, as a percentage of revenue has been relatively consistent over time.

In fact, we took our UA spend as a percentage of revenues up above our historical average over the first and second quarters of this year, when the early data on some of our new games like Sunken Secret and Dungeon Boss appeared to support it. So, why do I mention this? It means we are generally seeing less return on our UA spend as time goes on so our marketing spend is becoming less efficient than it's been in the past.

Now with respect to any individual game, we expect that over time, as a game matures and becomes familiar to the market it gets more expensive to reach new customers, we can grow into highly profitable ones. This is a phenomenon we anticipated with respect to Big Fish Casino and Gummy Drop! which are both games that have been in the market for a fair amount of time and are familiar to many players who generally play these genres of games.

What we've learned with respect to these games is actually encouraging. We know we have good products that have stood the test of time. While it's gotten more expensive to acquire new customers for some of these titles when we do reach them we do a good job of keeping and growing play and can achieve long and high term returns. With these titles, we have a better understanding of what the right UA level is to generate long-term profits.

We also know that incremental improvements on these titles can greatly improve UA efficiencies and open up new opportunities for further growth. That's what we're doing with our Social Casino business. We're very hard at work introducing new community and social features into our flagship game, Big Fish Casino and launching new Social Casino products like Jackpot City Slots built with our deep understanding of the Social Casino genre.

Early metrics on Jackpot City Slots are very encouraging but we would best describe our disposition on this new title as cautiously optimistic and we will be measured in our approach to scaling UA in the coming months. With the renewed focus on this genre and the positive early results with Jackpot City Slots, we're working on more Social Casino product and features that will launch in 2017.

In essence one thing that I'm saying here is that we've under invested recently in a genre that is a core strength and key driver of profits and long-term revenue, Social Casino. We believe very strongly in the Social Casino space and in our ability to deliver quality product and innovation to this customer base. It's a critical Big Fish business and deserves to be measured and run according to it's specific performance over the last number of years as opposed to being measured against new games that do not have as much of a proven track record.

We believe we have the focus and strategy to return this segment to growth. The flip side of this learning for us has been the realization that some of our efforts into newer genres like Mid-Core with Dungeon Boss, and simulation games, The Sunken Secret, have led us to over invest based on limited short-term data only to see them not produce the long-term returns we see in our best products.

Based on early data and compared to prior successful games we felt we had solid hits coming. We will get our money back but we haven't seen the straight long term LTV curves we experienced in Gummy Drop! or in our Social Casino products. This long lifetime value is necessary for sustained revenue growth. We will continue to evolve these lower performing newer games but they will not get significant UA budget until they have improved and we have strong conviction around their long-term performance. This does not mean we do not have good growth prospects with many of our games.

It means that the limited history and data we had on some of our games caused inefficiencies in how we allocated UA budget early in the year. We were too aggressive with several titles and under funded a few others. While these were reasonable decisions given the data we had at the time, the inefficiencies of this allocation has become clear as time passed and going forward we're adopting a more cautious approach scaling titles with limited history, regardless of how they perform early on. Going forward, you will see us continue to introduce many new innovate games in a variety of genres but will approach UA more cautiously.

However the biggest area of product development and UA focus will be our flagship properties and genres where we have a long history of success like Social Casino and Match Three. We will continue to improve the games and continue to scale these games as their metrics dictate.

At a divisional level we'll 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 earlier in the year, unless there is a very, very compelling investment case to do so where we have reliable data and very strong conviction in the long-term return on that investment.

A fair question to ask and certainly we asked it of our teams, whether the declining yields we see in our UA investments is more than a reflection of the performance and quality of our games but also reflects increased competition and expense in the mobile and online advertising space as a whole. Yes, we think that is part of the equation. There are not only lots of games, lots of other products, and competition in the internet and mobile segments. It's harder and more expensive to get noticed and there are ever increasing places to spend time and money searching for online customers.

That just puts a premium on being really good at marketing and analytics which we are, and illustrates why there is more long-term to being a successful mobile games company than just making quality games. We will continue to focus on becoming best-in-class in all of these areas. As we look at the LTV curves of our various games over the last quarter, we have dialed back our UA spend but we still spent $4.5 million, 21% more than we did in the third quarter of 2015. The data said it made sense to do so.

Again, we are very focused on the long-term profitability of growth in each game. Long term cohort value retention is really the primary indicator of a successful game and short term sharp LTV curves are not necessarily indicative of long-term cohort value. We have a very good pipeline of new and for the most part inexpensively produced games that we expect to release in 2017. You will see us with new offerings in the Social Casino, Match Three, Casual Puzzle, and Mid-Core genres among others, these are genres that we increasingly understand from a game design operations and marketing perspective.

I think it is fair to say if you examine the recent history of Churchill Downs across our various businesses, we get smarter and perform better as we take the lessons we learn to heart. That's happening here. This business is built on growing or sustaining proven profitable gains while efficiently introducing new games and features that we market and analyse quickly and effectively. You will see us improve on these core strengths over the rest of this year and in 2017.

A few quick thoughts on each of our Big Fish segments. Free-to-play Social Casino. The growth rate in the Social Casino genre as a whole has started to slow, and competition continues to stiffen as both major players and new entrants compete in this very attractive space. While Big Fish Casino continues to be a leader in the space, it also continues to mature as it has been a stalwart in the high position on the top grossing mobile app's list for more than four years. Combined, our gains in the Social Casino segment experienced an approximately 6.9% decline in booking in the third quarter versus prior year and a 4.5% decline in booking versus the last quarter.

However, we also saw an 8% increase in average paying users in the third quarter of last year versus the third quarter of last year. I'm not discouraged by any of this. Big Fish Casino remains a very stable and profitable business lead by a deeply experienced and capable team. With our new UA investment focus and product feature strategy for this title it is well positioned for long-term profitable growth. You will see further improvements this quarter and next in our core Big Fish Casino and in Jackpot City Slots. We have no greater priority or focus across Big Fish than the Social Casino business.

Now on to our free-to-play casual and mid core segment. As a whole, our gains in this segment experienced approximately 28.5% bookings growth in the third quarter versus prior year, and an approximately 10% sequential bookings decline versus the second quarter of this year. As we traditionally experience seasonality in the summer months, and North America or largest market, and think as I said, we saw some impact on the Olympics, the prolonged Presidential election cycle and Pokemon Go.

As I have discussed at length this morning, we are not chasing bookings and are making sure our UA dollars are going to generate a strong long-term return particularly in free-to-play genres in which we do not have extensive historical data to analyze. Our portfolio is made up of highly profitable games like Gummy Drop!, lower scale games where we're still analyzing them and improving metrics before committing more UA dollars, like Sunken Secret and an expensive pipeline of new games, several of which are launching this quarter and next. We're getting better at understanding and responding quickly to the facts but also giving title enough time in the market to gather data so we can set our UA investments at appropriate level.

Finally, the Premium Casual Games division, our legacy PC and mobile pay up front games business. This segment continues to experience secular decline as has always been our expectation, as consumer preference shifts towards free-to-play mobile products. This segment produces attractive margins by operating efficiently and sensibly, and there are some early signs that the sector's decline is slowing.

We have a lot of work to do to significantly grow our Big Fish segment over the long-term and we remain very excited about its capabilities and potential. We feel that we understand this business better than ever, and that we have the right strategy and team to succeed. With that I would like to turn this over to Marcia to provide some additional details on the quarter. After that we'll be happy to take questions. Thank you all. Marcia?

Marcia Dall - *Churchill Downs Incorporated - CFO*

Thanks, Bill, and good morning, everyone. We are pleased that we generated $8.7 million of net income, and $0.52 of diluted net income per share, both more than double the prior year quarter. We delivered record net revenue of $303 million, up $24 million or 8%. However, as Bill discussed, adjusted EBITDA was $67 million, down $4.9 million or 6.8% from the prior year quarter.

These results collectively reflect strong operating performance by our Casinos, especially from our Oxford main casino and the contribution from our equity investments in Saratoga and Miami Valley Gaming. We also continued to benefit from the growth in our TwinSpires business. As I'll discuss in more detail in a new minutes Big Fish games was the primary driver of our record net revenue growth. Although our adjust EBITDA for the segment was down $9.8 million, compared to the prior year quarter. When we reflect on the financials for the quarter, there are items that I would like to highlight for each of our segments.

I'll begin with our Racing segment. Racing revenue and adjusted EBITDA were both relatively flat in the quarter. With a strong September live race meet, at Churchill Downs Racetrack, with handle for the quarter up 13%, compared to the prior year quarter. Our Churchill Downs on track handle grew as a result of an additional day of night racing, resulting from a calendar shift that included the closing day of our Spring meet in this quarter.

And our export handle group based on a variety of factors including an improvement in starters per race and the positive impact of our pick-six carry over. Overall the strong results at Churchill Downs were offset by slight declines in parimutuel revenue, and Arlington Fairgrounds Racetrack's along with incremental expenses at fairgrounds.

Revenue from our Casinos was up slightly compared to the prior year quarter. Our Oxford Casino revenue was up $2.1 million on industry growth, and increased visitation. Successful marketing and promotional efforts at our Calder Casino also led to growth in new members and increased slot handle. This growth was mostly offset by softness in our Riverwalk Casino in Mississippi and our Louisiana Fairgrounds Slots facility.

The economic environment in Louisiana driven by a soft oil industry and heavy promotional environment in Vicksburg, MS, created top line growth challenges for both of these properties. Even with this top line growth pressure, our Casino segment adjusted EBITDA improved by $3.7 million over the prior year quarter. Our investments in Miami Valley Gaming and Saratoga contributed $2.7 million of this growth.

Our Oxford Maine Casino also added an additional $1.1 million of adjusted EBITDA compared to the prior year quarter. Turning to our TwinSpires segment, our revenue increased $4.4 million, or 9% compared to the prior year. Handle increased 14.3%, which was 13.5 points higher than the US Thoroughbred industry performance in the quarter. Our active players increased by 8% in the quarter driven by our continued marketing efforts around big events. As a result of this growth, TwinSpires delivered $1.2 million of incremental adjusted EBITDA.

Turning to Big Fish games, Big Fish revenue grew $18.7 million or 18%, reflecting strong growth in our casual Mid-Core free-to-play games, that was partially offset by a 6.5% decline in our Social Casino game revenue. And a continued decline as expected in our premium game revenue. Big Fish games had a $4 million or 3.5% growth in bookings from the prior year quarter.

Our Social Casino bookings were down $3.3 million, or 7%, due to 14% decline in average bookings for paying user that was partially offset by an 8% increase in average paying users. We launched Jackpot City Slots in July 2016. Early indications are that the game is performing well, and as expected from a growth in users. However, due to early life age Jackpot City's growth is partly the reason our total Casino segment average bookings for paying user were lower in the current quarter.

Our bookings from our casual and Mid-Core free-to-play games were up $11.5 million, or 29%, compared to the prior year quarter. The growth in bookings from our casual and Mid-Core free-to-play games was fueled by a 23% increase in average paying users, and a 5% increase in average bookings per paying user compared to the prior year quarter. We did see a $4.2 million or 16% decline in bookings compared to the prior year quarter, as expected, related to our premium pay games.

On a sequential basis our bookings were down $9.4 million, or 7%, reflecting the impact of the third quarter seasonality and other competition for entertainment time from a number of factors including the Olympics, the elections, and other new games such as Pokemon Go. Big Fish Social Casino bookings were down 2.1 million, or 4.5% on a sequential basis, as our Big Fish Casino platform bookings decline was partially offset by sequential growth from our newer Social Casino titles. Our casual and Mid-Core free-to-play bookings declined $5.8 million, or 10% sequentially, reflecting the impact of almost $10 million of reduced UA spent on sequential basis due to seasonality as well as concerns with the performance of new user cohorts for some of the games that we invested more in during the first quarter and second quarter of 2016.

Some of the newer games in the segment performed well in the early months of the life of a new user cohort, but unfortunately did not ultimately continue to progress to meet our return expectations. Our premium games declined 6% as expected on a sequential basis. As Bill mentioned Big Fish games did have a $9.8 million decline in adjusted EBITDA compared to the prior year quarter.

Our $4 million increase in bookings was more than offset by a $4.4 million increase in user acquisition expense, a $5.5 million increase in platform fees, and $2.2 million increase in developer fees compared to the prior year quarter. We also had a benefit from business combination accounting rules that was $1.6 million higher in the prior year than the third quarter of 2016. We were pleased with the $2.9 million sequential growth in adjusted EBITDA for Big Fish, as well as the sequential growth and adjusted EBITDA margin as a percentage of bookings from 16% in second quarter to 20% in third quarter.

We anticipate that our UA spend in the fourth quarter will be relatively consistent in total with our third quarter UA spend. We do anticipate that there will be some shifting of UA spend between Casino and casual and Mid-Core free-to-play games as we continue to optimize the allocation of our UA spend across our games, based on performance and growth opportunities.

Regarding free cash flow. We generated $14.3 million of free cash flow in the quarter. This was $9 million lower than the prior year, primarily driven by lower cash flow from Big Fish games. Our total leverage was 2.7 times adjusted EBITDA at the end of September. And lastly, at our Board meeting this week our Board of Directors approved an annual dividend of $1.32 per share, to be paid on January 6, 2017, to shareholders of record on December 2, 2016. This reflects a 15% increase in our dividend and the sixth consecutive year of increased dividends.

We are committed to using our free cash flow to support our growth organically and through acquisitions, to pay down our debt, to pay our dividends, and to repurchase stock when it makes sense, to create long-term shareholder value. With that I'll turn the call back over to Bill so that he can open the call for questions. Bill?

Bill Carstanjen - *Churchill Downs Incorporated - CEO*

Thank you, Marcia. At this time I think we're ready to take any questions if anybody has any.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Our first question comes from the line of Cameron McKnight with Wells Fargo. Your line is open.

Cameron McKnight - *Wells Fargo Bank - Analyst*

Good morning. Question on Big Fish. Just joining the dots on your prepared comments on the top line in UA investment, it sounds as though we interpret the comments to mean that perhaps revenue growth will be a little more muted going forward, but margins should improve over time?

Bill Carstanjen - *Churchill Downs Incorporated - CEO*

Fair question. I always look at our lawyers as we start talking about the future and generally there are some restrictions as you know. I would say this. I think it's easy in this space, and I think you can see it out there, and other companies to chase bookings, but for us, at the end of the day, we respond to adjusted EBITDA. That's how we want to run the business. So we want to focus on margins. We want to focus on smart long-term growth. So all things moving in the right direction are good, but the goal of this business is not to drive bookings, the goal of this business is to drive profitability over time.

And certainly we are increasingly thoughtful and considerate with regard to how the margins look, especially since when you make UA investments they're long-term returns associated with that, and you have to be careful about your margins at all times.

Cameron McKnight - *Wells Fargo Bank - Analyst*

Got it. Makes sense. And as far as the change in UA strategy is concerned, did that happen during the third quarter or is that something that happened after the third quarter?

Bill Carstanjen - *Churchill Downs Incorporated - CEO*

That's something that we started to understand much better coming out of the second quarter. So that's something that is in play in the third quarter and certainly continues to be part of our experience now.

Cameron McKnight - *Wells Fargo Bank - Analyst*

Okay. Sure. And then one more from me. The mix of games seems to be changing with Casino in decline and decelerating premium in decline as expected. And casual gains growing. Does that change in mix over time have an impact on margins?

Bill Carstanjen - *Churchill Downs Incorporated - CEO*

It certainly can, because I think the returns on games are different. Short term, some of the other genres in our experience have a different profile of customer participation. The customers don't stay in the games as long. But with Casino, we have found that the customers that we acquired do stay in the game for an extended period of time. So focusing on that business, it still within this space as a whole, the mobile and on line game space, that genre we really, really like the most because those customers are long-term customers once you acquire them.

Now, at any given point that you measure the first day you have acquired them, the first month you have acquired them after you acquired them or the first year, they may or may not look as good as a comparison against some other genre, some customer from another genre, a different type of game. But over the long term, these are great customers to acquire. So I think as we've gotten smarter and again I think our track record within

Churchill if you look at the TwinSpires, the evolution of the TwinSpires business or the evolution of the Derby or the evolution of brick and mortar Casino we do as a Company get smarter at these things. We do talk a lot about these things. We focus on these things.

We try to get smarter as a team. And I think what we determined is the Casino is a great genre to focus on, and we can't get trapped and thrown off our game by seeing other games that start out hot and fast with steep LTV curves but maybe don't hold those curves over time or we don't know if they'll hold the curves over time. We do know a lot about the Casino space, not just our properties but the other properties we see in the market. Focusing on Casino makes more sense for us now and over time and it's not something we can ever take our eye off that ball.

Cameron McKnight - *Wells Fargo Bank - Analyst*

Okay. Thanks very much, Bill.

Operator

Our next question comes from David Katz with Telsey. Your line is now open.

David Katz - *Telsey Advisory Group (TAG) - Analyst*

So I wanted to go back to Big Fish, and I do appreciate all of the commentary around it. My question is when we look at this business today, do you have a plan and not asking for specifics in terms of new term or long-term timing or anything like that, but is there a plan that could lead this business to double its cash flow or some bigger growth profile than where we are? And I ask the question for two reasons.

One, I feel as though we may have been drawn into thinking about the specific quarterly performance which is less important, really, than the bigger long-term picture of what return you think you can get on this investment ultimately.

And the second part of it is the question is has the return opportunity for that business has it shifted at all in some way since you bought it? Is it better in some ways than you thought and worse than some others, or is this doing what you thought it was going to do when you bought it?

Bill Carstanjen - *Churchill Downs Incorporated - CEO*

Okay. So there are a couple layers of questions within there. And I appreciate the questions. Very good questions. Let me start higher end and then I'll during down deeper. And if I end up leaving off a segment of the questions unintentionally, remind me and we'll return to it. So this space starting with this space, forget about our business for one second and just start with this space, the explosion of mobile devices and the role they play in people's lives not only in North America, but around the world, is one of the remarkable stories in American business, in our world business in the recent past.

It's amazing how these devices have exploded in popularity, and wormed their way into everything people do during their day and how they organize their day. When you talk about where people spend their time, mobile device is a good place to look. They spend a lot of their time on these devices.

You look at where they spend their time within the device and where they spend their money, I know everyone wants to think that when they're bosses and they're issuing cell phones and mobile devices, that they're using those devices to work, and they are, I'm sure, but you can also see by the raw numbers that people are using these devices to purchase games and to play games. And they spend more time doing that than any other one particular thing. So I don't see that changing. Keep your eye on that at all times because it might change. But I don't see that changing right now.

And that makes this as I good place for an entertainment company to look and invest and create more growth. So it's a good space to look, and when we look at our particular business our business and other businesses that are in the space, this is still a relatively immature, undeveloped space. It's not a space that existed in the way it looks now, five or ten-years ago.

It's still a very evolving space with a lot of opportunity and a lot of change. So of course there are going to be winners and losers and you have to be smart about every element of this space to be a winner, but it's still very much a market where there is a lot of opportunity. When we looked at it, we thought what was important long-term in a space where games are not generally protected with deep levels of IP protection, we thought there would be some level of copycat games and commodity of games, particularly for casual games, so we thought we needed to be good at games but what we really needed to be good was at efficiently producing games and getting lots of swings at that. And what we needed to be best at was after getting the games out inexpensively was marketing and analyzing the results of that marketing spend.

So what we learned so far this year is we need to be a lot better at that. We have the tools and the team and the processes and the culture, but there is a lot to learn in the space because it's not a space with a deep history that anybody can rely on, let alone any particular company like ours.

So what we talk about when we meet as a group and we look at the performance of our businesses, how do we get better at what we think the key attributes are to be successful in the space? What do we have to do? How do we have to invest to make sure that we've learned the lessons and taken them to heart from our prior experiences so that going forward we're a better Company? So this is a space where you're going to see big, long-term winners, and you'll see lots of sorting out over time.

Digging down into another level of your question, I really like where we are in this space. We have a foundation in Social Casino that maybe we didn't focus on as much as we should have, because we were a little bit dazzled by another component of our business, which is the casual and Mid-Core free-to-play segment, where you do see rapid growth in bookings on your UA investment. So put that aside, I'll talk about it in a minute. When you talk first about the Casino piece, that's a very good business. It's a very stable business.

It's a product that people like in the brick and mortar environment, and it's a product that's been proven over the last number of years that they like in the online environment. We're good at that product. We have to get better. We have to introduce more products, and not just rely on the ones we have. We have to introduce more features and not rely just on the ones we have. And we'll do that.

We're committed to doing that. Moving into other genres, other casual games and mid core games there is a lot to learn there. We've had some success with the Gummy Drop! game and some other games we introduced, but there is a whole bunch of learning and a whole bunch of data to crunch there and to digest to get better at that space. But that's another area of growth that we like that we think is bonus for our investment in this space. I'm going to shut up for a second. I think I covered the components of your question. Of I didn't let us know and we'll pick it back up.

David Katz - *Telsey Advisory Group (TAG) - Analyst*

You did get a lot of it, and I do appreciate the answer, but I think where perhaps the rubber meets the road is whether it's social gaming or building or anything, I think one of the things that we're trained to look at is your allocating an amount of capital which all in was about 850. What is a reasonable pay back period or what is a reasonable return on that 850? And how should we think about, or how did you think about what those metrics could be? At the moment we're on a run rate that's $80 million, $90 million of EBITDA. Is it possible and are you thinking about getting to a run rate that's 200 or 300 or more than that over time? Is that a realistic expectation of ours?

Bill Carstanjen - *Churchill Downs Incorporated - CEO*

Again, I'm slightly out of reach from our lawyers so you can't quite kick me under the table. David, I hope you can appreciate, I have to be careful how I answer questions like that just the nature of overreaching, forward-looking statements, but I'm still going to answer it. We didn't buy this business because we approached it like a brick and mortar Casino that we thought we had stable, but consistent cash flow that wouldn't potentially grow over time, but we would have efficiencies that we could rely on.

We didn't approach it as a conservative investment like that where we thought we were basically going to acquire cash flow that was relatively stable and just changing based on GDP. We thought this was a space where there is opportunity for significant growth and significant change. We realized it's a space with disruptive technology possibilities, and other risks overtime, but we thought it was a space with a lot of opportunity and our investment when we stepped beyond our core at the time into what we viewed as an agency, our investment was based on expecting to generate returns in excess of what we find within our core space.

David Katz - *Telsey Advisory Group (TAG) - Analyst*

Okay. Fair enough. I have more but I want to give someone else a chance so I'll go back in. Thanks, very much. Appreciate it.

Operator

Our next question comes from the line of Dan Politzer, JPMorgan. Your line is open.

Dan Politzer - *JPMorgan - Analyst*

Thanks for taking my question. Just another one on the shifting of the UA strategy. You guys are kind of moving away from the casual and Mid-Core free-to-play it sounds like and shifting more towards Social Casino. Obviously the free-to-play area has been the fastest growing segment while Social Casino has been ticking down. And this is an area you've talked about a stiff level of competition. So I'm just trying to piece together if you could opine more on your rationale there?

Bill Carstanjen - *Churchill Downs Incorporated - CEO*

Sure. I didn't mean to say that we weren't going to focus on, or that we shifted away from free-to-play, mobile and Casual. I didn't mean to suggest that. I think there's a lot of opportunity in that space. I think we need to be smarter about our UA dollars, particularly early in the life cycle of games. The point I was making was I think fairly evaluating us I think we were a little dazzled by some of the early returns that we saw in those games, but those games over time don't match the consistent long-term curves that we see in Casino.

So I think it was a good reminder that for us, over this year, to make sure we focus on what we know is there for sure, and to be a little more conservative and careful as we explore the mobile, Mid-Core and Casual space. We know how to do games in that space. We have a great series of studios both internal and external that we can rely on to produce games that are competitive with the games in the marketplace that are successful, so we'll keep playing there. We're just going to be really thoughtful about being better at what we need to be best at long term, to be a player in this space. And that is, marketing and analytics.

Dan Politzer - *JPMorgan - Analyst*

Got it. And then I'm actually going to ask a question that is not on Big Fish. Could you give us an update on some of the Greenfield options? And the legislative situation in Illinois and Kentucky, to that end? How are you thinking about Arlington? What are the different variables that go into your thought process there for how you can potentially monetize that asset?

Bill Carstanjen - *Churchill Downs Incorporated - CEO*

Okay. I'm feeling a little bit guilty because mostly on these calls the team Bill and Marcia get to answer a bulk of these questions, and the way this call in particular has gone that hasn't been possible today. But since we're talking really legislative I'm going to jump in on this one. And start. And you guys jump in as you see fit. Illinois is an extremely attractive Greenfield opportunity. And twice we have gotten through the legislature slot legislation that would allow us to put slot machines at Arlington Park. And twice we were essentially blocked by the executive branch, the governor branch.

Alan Tse - *Churchill Downs Incorporated - EVP, General Counsel*

There is a different governor now but the environment in Illinois has also changed in the sense that there hasn't been a budget in Illinois for a period of time, and there has been a sort of gridlock in the Illinois government, state government. In my opinion this hasn't been an issue of the attractiveness or ability to get gaming through the legislature or the will of the legislative body in Illinois around alternative gaming. This has really been our issue getting trapped and caught up in some of these larger Illinois issues and Illinois political issues.

So that's something that we evaluate constantly and look at constantly. And if it were an answer of there's no will for this, we don't want this, that would be something we would have to think through and respond to. But that's not been where we've been. Instead it's been understanding and respect for our issues in the state, but they are minor issues compared to the issues that are driving politics within that state, particularly around budgets and under funded pensions. All those things suggest over time were an additional source of funding to help on those issues but those issues drive the agenda, not our issues. So we've been patient.

We continue to be patient. And that's where we are in that right now. In Kentucky, pretty conservative state. It may be getting more conservative. We'll have to see. But right now, I don't think for slot machine gaming there is any expectation that that is in the near term a realistic possibility. That's just the current political environment that we're in. A number of other tracks in the state have implemented a product called historical racing machines or instant racing machines. We have not done that. We have not implemented that product.

But a number of the other tracts in the state have implemented that and we continue to watch the legal issues around that product, but also just a performance of that product because right now that is the product that is the only one on the horizon.

Dan Politzer - *JPMorgan - Analyst*

All right. Great. Thanks a lot, guys.

Operator

(Operator Instructions). Our next question comes from the line of Adam Trivison with Gabelli & Company. Your line is now open.

Adam Trivison - *Gabelli & Co. - Analyst*

Focusing in on the Social Casino segment at Big Fish, if we look at the 8% paying user growth offset by the 14% decline in bookings for paying user it would seem that part of this is due to the introduction of Jackpot City and the growth of the Vegas Party Slots games. Can you kind of separate out that mix of those players coming into the base versus the trends at Big Fish Casino? And maybe just monetization of those two games versus the legacy platform?

Bill Carstanjen - *Churchill Downs Incorporated - CEO*

I'm going to talk conceptually. I don't think we've disclosed that level of detail about how these businesses function and don't have that, so I'm not going to be able to disclose the specifics.

Adam Trivison - *Gabelli & Co. - Analyst*

Okay.

Bill Carstanjen - *Churchill Downs Incorporated - CEO*

Talk afterwards on whether we should be but I'm not sure we want to go into that level of disclosure. But generally when you acquire a player into a new game like Jackpot City or Vegas Party Slot, they become great customers over time. So at first, they come in the game, they monetize at a more modest level and over time as they take advantage of bonus cycles and features and functionality in the game, and they get more interested and committed to the game, you grow their participation economically in the game.

When you introduce new products you're going to find that your average revenue per user is going to drop because new customers in a new game do not produce like more mature customers in a more mature product. But with any mature product, like we have with our Big Fish Social Casino, our flagship product, you're going to find that there are other players that get to the end of their life cycle in the game, and they bleed off. We find that in TwinSpires. We find that in horse racing. We find that in brick and mortar Casino.

You're always trying to grow at a rate where you can grow your new customers more customers and get them to a higher average revenue per user to make up for the fact that you reduce the natural attrition in any mature product.

Adam Trivison - *Gabelli & Co. - Analyst*

Okay. That makes sense. That's helpful. And then it looks like you had higher Big Fish developer and platform fees relative to bookings. Is that a function of game mix or something else? And will that reverse with this change in strategy?

Alan Tse - *Churchill Downs Incorporated - EVP, General Counsel*

I'm dominating the answers to this question, which is what it is this time. Most of the platform fees are really what Google and Apple charges us when revenue comes in through their stores. So Marcia do you want to add to that? I think you do, so go ahead.

Marcia Dall - *Churchill Downs Incorporated - CFO*

It's basically tied to the revenue recognition, and Adam, just as you mentioned there is some increase in that as a percentage, just due to the mix. I talked about it at our last quarter earnings call related to the fact that free-to-play becoming a little bit larger part of our revenue mix, that means we're going to recognize more platform fees associated with that. You remember the revenue recognition for free-to-play is over four months.

Adam Trivison - *Gabelli & Co. - Analyst*

That's helpful. Great. Thank you very much.

Operator

We have a follow up question from the line of Cameron McKnight with Wells Fargo. Your line is now open.

Cameron McKnight - *Wells Fargo Bank - Analyst*

Thanks very much. Just circling become to Social Casino, I think maybe four quarters ago or three quarters ago could have been longer, you mentioned that Social Casino was an area that had become much more competitive, a lot more promotional. Has that changed or is your attitude towards Social Casino changed?

Alan Tse - *Churchill Downs Incorporated - EVP, General Counsel*

Yes. I think it is a competitive environment that I think there is some established players and we're one of them. And then also there is still plenty of evidence to show that new games can come in and make a difference. I think the learning for us has been over the last number of quarters how good it is when you acquire these customers that they are more sticky than what you find in other games. And that makes it worth it to cycle through some of the disadvantages of a competitive space. But these are good customers when you get them.

Bill Carstanjen - *Churchill Downs Incorporated - CEO*

The other thing I would add Cameron the thing that's changed too is we came out with a new product called Jackpot City Slot, which is a Big Fish developed product. Whereas the Vegas Party Slots was a third party developed product. But the Vegas Party Slots product, very good product. We found that we have been advertising Big Fish so many times people have seen the brand, they've seen the product and it's tougher to find new customers that haven't heard of it. When you come out with a new brand, new product people try that because they haven't seen that brand yet. It's a lot more effective to put marketing dollars to work on a new brand if people aren't familiar with yet.

Cameron McKnight - *Wells Fargo Bank - Analyst*

Okay. Thanks. And one follow up. Can you just talk about the buy back program and capital returns and the strategy?

Marcia Dall - *Churchill Downs Incorporated - CFO*

Cameron, as I mentioned in my comments, every quarter, every month as we go through we think about things around using our free cash flow to really support our growth. We look at whether there are acquisitions on the horizon, related to the need for cash flow. We also, as you know, are focused on paying down our debt. The business has a great discipline over the history of the last five to ten-years of just really when the leverage goes up, based on acquisition, then focusing on paying down that debt after the acquisition, which gives us greater flexibility going forward.

We do also think about the amount of our dividend as part of what we use our cash flow for. And then opportunistly we look periodically at whether it makes sense to buy back shares in the open market in the open market periods. So although we did not buy any back in third quarter as you know we bought some back in second quarter, and we may buy back additional shares in future quarters. We have $135 million of share repurchase authority available to us, based on a Board approval earlier this year. And so you may see us in that area over the coming year. Again, we're really just focused on create long-term shareholder value.

Cameron McKnight - *Wells Fargo Bank - Analyst*

Okay. Thank you very much.

Operator

We have a follow up question from the line of David Katz with Telsey. Your line is now open.

David Katz - *Telsey Advisory Group (TAG) - Analyst*

Hi. Thank you for allowing me back in here. I wanted to just ask about more of a big picture question about value, because if we look at where your stock is trading next year, and I recognize this is more our job it suggests that there are some regional Casinos in there. There is a trophy level asset in the Kentucky Derby and the Churchill Downs track, as well as a Big Fish game. My point is, do you think about strategies to establish or capture more credit for what you have? We've seen M&A deals in regional Casinos at higher levels than where your stock is trading. We've seen some trophy type assets and some other deals trade, and we've also obviously seen public market deals and the online space that are compelling also. How do you think about strategies to raise awareness to the value that you have?

Bill Carstanjen - *Churchill Downs Incorporated - CEO*

Well, David, in some sense these are obviously good challenges to have. Good problems to have. Do you think that the market doesn't understand the true value of the company? That's a good problem to have, and there are plenty of companies that have the reverse problem. That said, speaking as a member of a management team we need to go out and perform every day and every quarter, and there are lots of theories and lots of ideas and lots of smart people that have great ideas about structure. But the fact is we're always just around the corner from the next call like this, and we need to produce results.

So the bulk of our management time, mine included, really focuses on building these businesses successfully. And then we use our time with the Board and with our advisers to listen to other ideas and theories out there and to watch the markets around us to see what other people do to prove out some of the theories of additional ways to create value. So we're all obviously focused on understanding the markets and the evolution of structures. We're all very inclined to do those things, to pay attention to those things, I should say, and to understand those things and those options, and we try to. But on a day-to-day basis, if we spend too much time worrying about stuff like that, we're not going to get our day jobs done.

And it's important that for all the businesses that we have, we get our day jobs done and position those businesses to grow as best as we can get them to grow. So I know that's not a totally satisfying answer to you, but I guess if I had to summarize I would say yes, we pay a lot of attention to the type of issues that you're talking about. And lots of theories and lots of ideas, but our reality is we need to build this Company for our shareholders that we have and we need to build it today and then we need to be at work tomorrow building it tomorrow.

David Katz - *Telsey Advisory Group (TAG) - Analyst*

All right. I appreciate that. And I hope you'll appreciate that it's a discussion that comes up with investors and prospective ones and that's why it's being asked.

Bill Carstanjen - *Churchill Downs Incorporated - CEO*

Absolutely. Thanks for asking it.

David Katz - *Telsey Advisory Group (TAG) - Analyst*

Sure. Thanks for your answers.

Operator

I'm showing no further questions in queue at this time. I'd like to turn the call back to Mr. Carstanjen for closing remarks.

Bill Carstanjen - *Churchill Downs Incorporated - CEO*

Thank you very much everybody. I appreciate your time on the call this morning. I appreciate your interest in our Company, your investment in our Company. We'll work hard not to let you down, and we'll talk to you next time. Thanks, everyone.

Operator

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