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CHDN - Q1 2019 Churchill Downs Inc Earnings Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Churchill Downs Incorporated 2019 First Quarter Earnings Conference Call. (Operator Instructions) As a reminder, this conference call is being recorded.

I'd now like to introduce your host for today's conference call, Mr. Nick Zangari, Vice President, Treasury, Risk Management and Investor Relations.

Nick Zangari - *Churchill Downs Incorporated - VP of Treasury, IR & Risk Management*

Thank you, Kevin. Good morning and welcome to our first quarter 2019 earnings conference call. After the Company's prepared remarks, we will open the call for your questions.

The Company's 2019 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 Investors section.

Before we get started, I would like to remind you that some of the statements that we make today may include forward-looking statements. These statements involve a number of risks and uncertainties that could cause actual results to differ materially. All forward-looking statements should be considered in conjunction with the cautionary statements in our earnings release and the risk factors included in our filings with the SEC, specifically the most recent report on Form 10-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'll turn the call over to our Chief Executive Officer, Mr. Bill Carstanjen.

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

Thanks, Nick. 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. As most of you have seen, we issued an 8-K earlier this week redefining our segments for external financial reporting purposes to reflect the evolution and growth of our Company. Marcia will provide more color on this decision. I will share some thoughts on our first quarter performance and the upcoming Kentucky Derby. Marcia will then provide additional details on the quarter and on our capital management. After she is finished, we will be happy to take your questions.



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First quarter has been very busy. We closed 3 acquisitions, completed the preparation for the 2019 Kentucky Derby, including the new Starting Gates Suites rooftop lounge, broke ground on our Oak Grove Kentucky historical racing machine facility, refinanced \$600 million of our variable rate debt into an 8-year bond and completed a 3-for-1 stock split. We did this while delivering double-digit revenue and adjusted EBITDA growth for first quarter compared to prior year.

Our net revenues for the quarter were up 40% and adjusted EBITDA was up 52% over prior year. Those are meaningful increases and there are few key developments that drive that year-over-year change.

In January, we completed the acquisition of Presque Isle Downs and Casino, an excellent brick-and-mortar facility, which also provides us an opportunity to launch our retail BetAmerica Sportsbooks at the Casino and launch our BetAmerica Online Sportsbooks and iGaming platform across the entire Pennsylvania market later this year.

Next, in early March, we completed our acquisition of approximately 61% of Rivers Casino and Des Plaines, Illinois, which proceeded to deliver a strongest March ever with respect to adjusted EBITDA. Derby City Gaming, our historical racing machine facility in Louisville also contributed to our Company's net revenue and adjusted EBITDA growth with a strong 41% margin.

Our BetAmerica Sportsbooks at our 2 Mississippi casinos, added incremental adjusted EBITDA and drove overall increased customer visitation. We believe brick-and-mortar Sportsbooks, when efficiently run, directly contribute to adjusted EBITDA and also deliver additional slot and table game activity. And last, our Gaming segment contributed growth from 2 new off-track betting parlors with video poker in Louisiana and from our now 100% ownership of Ocean Downs.

I will provide some additional color on our performance and growth plan for each of our operating segments, then I'll provide some insights into the upcoming Kentucky Derby. First, let's talk about the new Churchill Downs segment. This segment includes the results of Churchill Downs Racetrack and Derby City Gaming. First quarter is a quiet quarter for Churchill Downs Racetrack, given that we do not start racing until this Saturday, one week before the Derby.

Derby City Gaming contributed \$18.7 million of net revenue growth and \$7.6 million of adjusted EBITDA growth in first quarter. We opened the facility in September of last year and are very pleased with the ramp up, growth in customer database and key operational metrics. As a reminder, our capital investment in this facility was \$62 million. We plan to add an additional 100 machines to the floor in May. We believe the property has a long way for maturity.

We are also pleased with the incremental purse contributions that Derby City Gaming is making, the Churchill Downs Racetrack, which will help support the long-term sustainability of the horseracing industry in Kentucky.

Turning to our Online Wagering segment, which includes TwinSpires and our online sports betting and iGaming operations in New Jersey. First, our TwinSpires business grew handle slightly less than 1% and outpaced the industry by 3.6%. The handle for the industry was negatively impacted by Oaklawn Park and Santa Anita.

Oaklawn Park moved 2 weeks of premium racing from January until the second quarter and Santa Anita in response to the tragic rash of horse breakdowns on its racetrack canceled 13 days of racing in the first quarter. Santa Anita provides the Elite West Coast racing content during the first quarter and into the second quarter. Even as racing resumed, Santa Anita's field sizes and handle have not returned to the previous year's level, and consequently, TwinSpires was seeing declines in wagering on this specific track. Our customers during the first quarter tend to be relatively sophisticated horseplayers, who have a heightened interest and appreciation for the traditional top-level racing content.

Despite the industry challenges, TwinSpires' net revenues dropped only very modestly in the first quarter, less than 1%. There are a few churns to explain this. First, total active players were up 2.4% in the first quarter. We continue to reach new customers and to reengage with previous ones through our marketing programs, even though the first quarter is not one where we are aggressively marketing. We focus a significant portion of our marketing dollars on the Kentucky Derby and other Triple Crown races in the second quarter because we believe we can acquire large blocks of customers cost effectively during this window of time. We also believe these customers can provide superior returns over the long-term.



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While the number of active players rose in the first quarter, the revenues per player declined slightly by 3.3% reflecting the growth in newer players who are higher margin, however, are on average less experienced and wager less. The TwinSpires team will be working to add many new customers during the upcoming Derby Week and this year's Triple Crown season. Our team believes there is real organic growth that TwinSpires can continue to harvest in the ADW space. This is a very good business and we remain very optimistic about this long-term growth.

Adjusted EBITDA for the Online segment as a whole was down approximately \$900,000 in the first quarter because of the ramp up and launch of our BetAmerica online sports betting and iGaming business in New Jersey. In New Jersey, we have entered into what is known as a skins agreement with the Golden Nugget Atlantic City Casino to gain access to the New Jersey online market. We do not have a casino in New Jersey to enter the market directly but have an arrangement with Golden Nugget, which allows us full management and control of our own site.

We have launched our BetAmerica online platform and have recently received approval from Apple to put our iOS app in the Apple Store. We are also still completing the implementation of our full list of payment and casino game vendors, which we think will give us an extremely competitive compelling iGaming product.

Turning to the Gaming segment, in the first quarter, we experienced encouraging operating environments across our markets and we grew net revenue and adjusted EBITDA at each of our existing properties with the exceptions of Oxford and Calder. Even though Oxford was impacted by severe winter weather over 2 holiday weekends in the quarter, we're pleased with the performance of our new hotel and expanded gaming floor. Regarding Calder, we incurred additional expenses in connection with opening our new Isle operation, as well as related legal expenses. We are planning to hold our first Isle event in May of this year.

Our casino properties are well positioned in their respective markets and we have incremental growth already locked in for the segment with the addition of Rivers Des Plaines, Presque Isle and Nemaquin. We now have over 11,000 slot machines and VLTs and approximately 200 table games in 8 states. We have a long held strategy of pursuing both acquisitions and Greenfield investments in gaming properties we believe will offer stable, predictable cash flows in diverse markets. We also like states that we believe may grant access to sports and online casino gaming to their brick-and-mortar casinos license holders.

Turning to our other investments, we broke ground on our Oak Grove Kentucky historical racing machine facility on April 9th. Based on the results of Derby City Gaming, we have updated our revenue projections and have finalized the designs and bids for all of the various aspects of this project. We are increasing the project -- the projected cost by \$50 million to \$200 million to accommodate for a higher than expected costs of construction and some modifications to support the expected consumer demand for this property.

We are thrilled about the opportunity to build this facility about an hour north of Nashville, Tennessee, which was ranked by Forbes as the 7th fastest growing city in America in 2018. Based on our research of the Nashville area, along with the very encouraging results from our Derby City project, we feel that this increase in investment will exceed our return requirements.

We expect to conduct 12 Harness Racing days in October 2019 and plan to open the historical racing facility and hotel during the first half of 2020. We will update you further in the coming quarters.

Now a few additional comments on Churchill Downs Racetrack and the Kentucky Derby. As many of you saw last week, we announced a series of safety initiatives with respect to Churchill Downs Racetrack and our other racing operations. We want to protect the history and tradition of the Kentucky Derby and that means we will also always pursue best-in-class practices to protect our athletes, both human and equine. The owners and trainers of the very best horses in the world who like to bring their horses to Churchill Downs and they have done so for well more than 100 years. There is a reason for that, and we will continue to meet the highest standards of safety and integrity. We have an obligation to follow and implement best practices in equine care, as well as an obligation to educate and encourage others in the industry to do the same. That is what is behind the commitments we announced last week.

Regarding the Kentucky Derby, we have good visibility into our admissions, sponsorships and a number of other categories of revenue in advance of the event and all of these areas look very promising at this time. We're optimistic for great Kentucky Derby. We set records last year for virtually all of our significant financial benchmarks despite suffering the wettest Kentucky Derby in history. We are aiming high again this year.



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We will be unveiling our \$5 million rooftop lounge and entertainment area on top of the Starting Gates Suites at this year's Derby. The new area consists of approximately 250 new seats and an additional 250 access tickets. We are pleased to report it is sold out.

Last year at the Derby, we debuted the first stage of our \$32 million project to significantly improve the parking and transportation ingress and egress to our facility as well as the external aesthetic. We completed the second stage of the project prior to the 2018 Breeders' Cup, which we hosted at the track last November. We added further improvements and enhancements over this past off-season. As our customers arrive for the Derby this year, we hope they are wowed not only from an aesthetic perspective but also with respect to ease of entry and exit.

I'm also pleased to report that the Japanese horse Master Fencer is entered in this year's Derby. This is the first time we have had a starter from our Japanese road to the Kentucky Derby series. Also for the first time ever, we will simulcast the Kentucky Derby into Japan for wagering and we look forward to seeing how the Japanese betters react to this opportunity. Due to the time zone difference between the U.S. and Japan, the Kentucky Derby will be simulcast around 7:50 a.m. on Sunday morning in Japan. Japanese betters who have online wagering on horse racing as we do in the U.S. will be able to place their bet on the day before the race right up to the moment the race starts.

As you may recall, we issue a press release immediately after each Kentucky Derby detailing the financial and other metrics for the week. Please watch for this press release.

There are many avenues to grow our signature event over the coming years from additional pricing segmentation, additional seating capacity for portions of the roughly 110,000 guests who come to the Derby and do not have a seat, additional sponsorships, and harvesting international customer interest to name a few of our past forward. Our team is engaged in numerous growth initiatives and we expect to provide an update on some of these on our next earnings call.

Beyond the metrics, our mission is to improve everything we do surrounding the Kentucky Derby. We've consistently invested to deliver a world-class experience for our customers. Our strategy for the long-term is to invest in projects that help more of our guests feel a strong connection to the event and to experience as a participant, not just as a spectator, the unique magic that is the Kentucky Derby.

We hope to see many of you at this upcoming Derby week's event starting with Opening Night this Saturday Night, on Tuesday with our Champions Day Event, on Thursday for Derby and on Friday and Saturday for Oaks and Derby.

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

Marcia Ann Dall - Churchill Downs Incorporated - Executive VP & CFO

Thanks, Bill, and good morning everyone. As Bill said, I will provide some details on our first quarter 2019 financial results and then provide an update on our capital management plans. As you review our first quarter financials, it is important that you also review the 8-K that we filed on Tuesday after the market closed. The 8-K walks through the changes we've made to our segments for financial reporting purposes and also realize our historical financials to the full year 2017 and 2018 as well as quarterly financials for 2018 and the new segment format.

We believe our new segmentation will provide better transparency and clarity to our results in 3 areas. First, the Churchill Downs segment will provide the financial results of Churchill Downs Racetrack, including our iconic asset, the Kentucky Derby, as well as the emerging financial results of our new historical horse racing machine facility that is named Derby City Gaming in Louisville, Kentucky. As we've discussed in the past, the Churchill Downs Racetrack license supports Derby City Gaming, which is located on the Churchill Downs ancillary training facility property near Churchill Downs Racetrack.

Second by aligning our race tracks with the casinos that the license supports, we've improved the alignment of our management and our financial reporting. And lastly, we will no longer allocate corporate overhead out to each of the segments for external financial reporting purposes. We've included additional disclosures related to our wholly owned gaming margins and same-store wholly owned gaming margins as an exhibit to our

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earnings release. We believe this will enable the analyst who cover our stock and our investors to more easily compare our industry leading casino property margins with our competitors.

So turning to our first quarter 2019 results, we reported first quarter net revenue of \$265 million, up \$76 million or 40% compared to the prior year quarter. Three-fourth of this increase was driven by revenue growth from our gaming segment, including the addition of the Presque Isle Downs & Casino in Erie, Pennsylvania, the consolidation of Ocean Downs revenue as a result of acquiring a 100% ownership of the property on August 31, 2018, and the strong performance of our Mississippi properties from the crossover traffic from our retail BetAmerica Sportsbooks at these 2 locations. The other primary driver of the revenue increase in the first quarter compared to the prior year quarter was the addition of Derby City Gaming, which opened in September 2018.

Our first quarter adjusted EBITDA was up \$25 million or 52% compared to the prior year quarter. Our equity investment in Rivers Des Plaines, the acquisition of Presque Isle and the [addition] of the management agreement for Nemaocolin collectively contributed \$13 million of this increase. Our investment in Derby City Gaming contributed nearly \$8 million of the increase as this property continues to ramp up by growing its customer database through effective marketing.

Our gaming properties contributed the remaining \$5 million for the growth primarily from solid operating performance at Ocean Downs and from retail sports betting crossover traffic at our 2 Mississippi gaming properties. As Bill mentioned, we did have a nominal investment in the setup and launch of our online BetAmerica Sportsbooks and iGaming platform in New Jersey during the quarter, which impacted our Online Wagering segment.

As you can see from the additional disclosure in our press release, our same-store wholly owned casino margin was 36.5% for first quarter 2019. Our same store wholly owned casino margin excludes Ocean Downs, which we acquired 100% of in August 2018 as well as Presque Isle and the Nemaocolin management agreement that we acquired during the quarter. We believe this is an industry leading regional casino margin. Our overall wholly-owned casino margins including the Presque Isle and Nemaocolin acquisitions decreased by 4.6% due to the addition of these 2 properties, which have lower margins as a result of the higher Pennsylvania tax rates. As a reminder, we factored these margins into the purchase price and return on investment expectations for these properties and knew we had the potential upside from retail and online sports betting in iGaming in the entire state of Pennsylvania as a result of the acquisition of Presque Isle.

Turning to net income. First quarter net income from continuing operations was \$11.9 million compared to \$14.1 million in the prior year quarter. There were 4 items that impacted the comparability of our first quarter net income from continuing operations.

The first item is a \$6.6 million of after-tax costs related to our equity portion of the noncash recapitalization costs for the Midwest Gaming entity that owns Rivers Des Plaines. As part of Midwest Gaming's recapitalization, previously capitalized debt financing costs were written off and the interest rate swaps related to Midwest Gaming's existing debt were fair valued as of the date of the recapitalization.

The second item was also a noncash item and related to \$2.8 million revaluing of our deferred tax liabilities based on an increase in expected revenue related to states with higher tax rates including Illinois and Pennsylvania due to our recent acquisitions in these states.

And the remaining 2 items are higher transaction related expenses and pre-opening expenses related to continuing operations in the first quarter 2019 compared to the prior year quarter.

Excluding these items, our first quarter net income from continuing operations grew \$9.7 million or 61% compared to the prior year quarter. Our operating segments results including our equity investments were higher by \$12.5 million after tax, which was partially offset by \$2.8 million of higher after-tax interest expense as a result of higher outstanding debt.

First quarter cash flow from operations was \$70 million, up \$14 million from the prior year quarter. We benefited from significant growth in operating cash flow from our core operations, partially offset by higher cash paid interest due to not having interest payment in the first half of 2018 for the bonds we issued in December 2017. We spent \$14 million on maintenance capital in the first quarter, which was \$6 million higher than the prior year quarter due primarily to the timing of payments for slot capital purchases.



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Regarding project capital, we spent \$14 million in the first quarter, primarily on 4 major projects finishing the Starting Gates Suites rooftop and the Infield Gate at Churchill Downs Racetrack, building out the Isle facility at Calder and the initial construction spend at Oak Grove.

And [finally] regarding capital management for 2019, our project capital projections have not changed except, as Bill discussed, we have revised our estimated investment for Oak Grove from \$150 million to \$200 million. We anticipate that the majority of this incremental spend will occur in 2020 and therefore we are not changing our estimated range for project capital for 2019 of \$110 million to \$130 million. We also have not changed our estimated range of \$45 million to \$55 million from maintenance capital spending in 2019.

In first quarter, we repurchased \$25 million of our stock and we have \$243 million remaining capacity under our existing share repurchase program. Our net leverage on a reported basis at March 31st remains relatively low at 3.8 times and on a pro forma basis is 3.2 times, which includes 12 months trailing adjusted EBITDA for the 3 acquisitions that were completed in the quarter.

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

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

Okay. Thank you, Marcia. Everybody, if you have any questions, we are ready to take them far away. Thanks.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from David Katz with Jefferies.

David Brian Katz - *Jefferies LLC, Research Division - MD and Senior Equity Analyst of Gaming, Lodging & Leisure*

I wanted to just start off and get some perspective from you on, I mean, I appreciate your commentary about the Derby. We've thought about this event and the property and the context that, it can grow at a certain trajectory in the high-single digits, et cetera. One, if you could just share a bit more color around what we're -- what you're expecting for this year and then, paint us a little longer-term picture of what the Derby can be going out in the future, please.

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

Sure. With respect to this year, there are a number of metrics that we already have very good visibility into such as ticket sales, sponsorships, media, so everything this year looks very strong. And as I mentioned, the Rooftop Garden Lounge, we're very pleased that in the first year where it hasn't ever been a product that's been available to people before, so there isn't a word of mouth. So despite that, we still sold it out. We're also excited about the opportunity with respect to Japan and pushing our product into Japan. So all things so far look really good. I know a question that is often on everybody's mind is well, what about the weather? What's the impact of the weather? Look, we don't control the weather, so we focused on what we can control and we prepare the best we can around that. So that being said, the last few years seems like we've had very rough weather last year being the wettest Derby. And it wasn't -- but a couple of years ago where we had the coldest. So hopefully we get a break on weather, but ultimately the bulk of the economics are going to flow in independent of that. So I feel very, very good about this year's Kentucky Derby. Another item worth mentioning is our relationship with Quicken Loans, which is a new sponsorship opportunity for us, their program where they selected out of a raffle, 20 participants, each of them is coming to the Derby and gets assigned a horse. And then for the lucky person whose horse actually wins the race, they get up to \$250,000 of their mortgage paid off. That's been a huge success. We understand from our Quicken Loans partners and so that's the hope, the type of thing that we could hope we can do more of in the future and the type of thing that's different this year than last year. So lots and lots of good things going on for this year's Derby. I think I've been as precise as I responsibly can on a call like this, but lots of good things going on that we're excited about. Long-term, I'm really excited about further developing the facility. I think unlocking the



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Derby in part depends on building more and more hospitality for the folks that don't have seats, the 110,000 people that attend the Derby every year that do not have a seat. I think further segmentation with respect to the people that do have seats to create better experiences, a richer experiences that they're willing to pay more for. I think that's a great opportunity for us. And I'm excited about reaching further internationally. This is a great event. It's a truly unique and iconic American event and opportunity to push this product internationally to encourage folks to come to our country and make it a stop on their bucket list of U.S. items to our U.S. events to attend. There's also, I think, something that that there's great promise with respect to, and that's something that we'll keep working on as well to reach those international guests. So David, I hope that gives you a flavor of how to think about the Derby. If you have any follow-ups on that, I'll be more specific.

David Brian Katz - *Jefferies LLC, Research Division - MD and Senior Equity Analyst of Gaming, Lodging & Leisure*

Yes, I do. And one of the approaches to adding to the Derby has been to spend capital within the span of respective Derby. And I know that you may have started to think about the prospect of a hotel or a boutique casino property or other kinds of larger assets that it would expect, would take longer than a Derby cycle to construct. Any updated thoughts to that end?

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

Certainly, those are very logical things for us to be considering. Further hospitality at the Derby, particularly around a hotel. And certainly the way our license works with respect to historical racing machines gives us the right to place those machines at the racetrack. So certainly those are things that we think about. But we don't have anything specific to announce at this time on those items or any others. But as I mentioned during my comments, we think by the next earnings call, we're going to be more specific on some of our growth initiatives, including capital investments for the future.

David Brian Katz - *Jefferies LLC, Research Division - MD and Senior Equity Analyst of Gaming, Lodging & Leisure*

Got it. And if I can ask one other question about TwinSpires, and I heard your commentary and some of the detail that you've given. We do, I guess get a sense in our travels that competition for that business may be ramping. Are we hearing correctly to the degree that you can talk about any strategies to mitigate that, would be helpful as well? Just thinking about how we should model the trajectory of the business going forward.

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

In the previous quarter, we had talked a little bit about competition at the higher volume player segment and some of that continued into first quarter. That was really some of our competitors following an aggressive strategy with respect to rebating. And we've always been hesitant to adopt that strategy because it's a slippery slope. Some of that pressure continued into the first quarter but largely mitigated. So it wasn't a topic that I really highlighted in my comments for first quarter. But I would say that there was so much noise in the first quarter because of the change in content with Oaklawn Park moving premium race days out of the first quarter and into the second quarter. And with the turmoil at Santa Anita out in California where we not only is that premium content, but there are a lot of west coast customers of our business that look at the west coast content.

With some of that turmoil going on, I would be really hesitant to take first quarter as any sort of watershed moment where we needed to -- where we thought we really identified long-term trends. There's just too much noise. So having been involved with this business since before it started and through every aspect of its evolution over the last dozen years, I would say that eyes wide open, watching it carefully, but I wouldn't take any long-term trends out of the first quarter. And I would say as we look in the second quarter as we approach the Derby I feel very comfortable and confident about the performance of the business right now.



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David Brian Katz - *Jefferies LLC, Research Division - MD and Senior Equity Analyst of Gaming, Lodging & Leisure*

Okay. If I can ask one more detail and then I will step aside. Around Arlington Park and for those of us that are just trying to keep tabs on, any political winds of change around the possibility of slots at that track. Is there anything that is discussable at this point to that end?

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

Well, I would -- not in great detail, but I would say in the legislative cycle that's our session that's going on right now. There was a lot of talk about sports wagering. There isn't as much talk about a full scale expanded gaming. So we participate very heavily and pay very close attention to legislative and regulatory developments in the state of Illinois, and we are so now. We have 2 properties for which we need to do so, one is our significant investment in Rivers, which has a very important business for our company in the Northwest Suburbs of Chicago and then Arlington Park, our traditional horse track. So we have 2 reasons to pay a whole lot of attention to what goes on there. But right now, I'd say, it's -- as you often see in Illinois, it's in session, it's hard to draw any conclusions about what's going to happen going forward. So we'll monitor and make the best decisions we can. But certainly, we don't want to talk more broadly about long-term strategies, and so it is clear what the legislative body in Illinois is going to offer the industry in that State.

Operator

Our next question comes from Daniel Politzer with JPMorgan.

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

So I mean, Derby Cities are entering nicely and I think it was particularly impressive to us the first quarter margin of 41%. And Bill, if you could elaborate on what you see there long-term and the opportunity? And then I have a follow-up regarding Oak Grove in that regard too.

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

Hi, Dan. Yes. So we've been very pleased with the start of Derby City and I'm really proud of our team, that's a project that Bill Mudd worked on for a couple of years before any of you were even thinking about potential facility there. So a long time and a long effort to think through our strategy for our property there and to work with our game manufacturer to create compelling games that would be competitive with Class 3 machines that we have across the River from Louisville on the Indiana side. So I think we're in the early innings of the property. I hope over time, we can improve our selection of games, I hope over time perhaps we can add manufacturers. I think we can get better at running our facility. I think we can understand our customers better. I think we can market to them better, as we learn more about them and as we learn the true competitive positioning of the product in the marketplace. So I think, there are a lot of lessons still be -- still to be learned in Louisville. And I think there is a lot to the idea that we're expanding the market, not just trying to take share from what may be across the River. And I think, just as exciting is what we can take from Derby City Gaming and our Louisville experience and apply down to Oak Grove when we open that property, which is a more significant capital investment, \$62 million for Louisville, approximately \$204 million Oak Grove Kentucky. So everything we can possibly learn to get better at running that operation, we want to take those lessons and apply them down South. Bill, do you want to add -- go ahead.

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

Thanks, Dan, I want to -- yes, I would say, Dan, as Bill mentioned in his comments, we're adding another 100 machines to the floor. We hope to have those installed by mid-May and just last week, for example, we introduced 8 new themes to the floor and 5 of those 8 games are in our top -- of those 8 themes, I should say, 5 of those themes are in our top 10 already. So we'll continue to develop that product and continue to work with our partners to develop that product, and I think we're going to even better. And in terms of the ramp up at Derby City, it's taking a while just for people to kind of understand what a historical racing machine is and I think, we're getting over that barrier here. We'll have to do the same thing down at the Oak Grove facility. But we're very excited about it.



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

So with Oak Grove, I mean, how should we think about the return relative to Derby City? I mean, is it like getting into different property and a different footprint and different area? But I mean, can you, I guess, talk about the puts and takes that how you think about the return potential for something like an Oak Grove relative to Derby City?

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

I think the Derby City return is sort of best-in-class and we're very pleased with what we've seen there. And certainly, we expect a return down in Oak Grove that more than exceeds our hurdles. But I don't want to give more specific than that. And I would say that we're going to have a few more amenities down there, we're going to have a hotel, we're going to have an events center, all the items can affect margin somewhat. But I don't want to give more specific than what I just offered. And just reiterate that we are more and more comfortable and more and more confident that we are understanding, what we can do with historical racing machines. And when we do open up down there we'll be better than -- operationally than we were when we first opened up here, because we will have taken all the learnings from what we've learned in Louisville. So I'm optimistic, but I hope you understand I'm not going to be real specific.

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

Yes, and I appreciate that though. And then just turning to Rivers, I think that came in along with lot of your -- other of your properties much better than expected. So could you maybe talk a little bit about what you've seen there so far and how it's performing, I guess, relative to maybe your initial expectations and maybe even on a year-over-year basis? And how do you think about the opportunities for growth there?

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

The property had a very good marks and the property is a property we feel like we understand pretty well because it's been in the marketplace for a long time. So when we decided to pursue an investment there, we had a great deal of confidence in the market. We had a very -- a great deal of confidence in that team and our partner. And I would say from our perspective, we feel it's a very stable good operating environment for us to make an investment. When we think most about the future, we are optimistic and willing to work hard to see if we can expand some of the options or the properties such as sports wagering and online wagering. And those may happen, they may not happen, they may happen soon, they may happen in the future, it's hard to be specific and it's not responsible to be specific on a call like this. But certainly those are avenues that we're interested in as a Company. We've explained that we're interested in those options for different markets and those options should be in play in Illinois over time. So legislative advancements, legislative strategy is an important part of expanding the opportunity for the property, but [overall even] without that, we feel very, very good about what that market holds, given its demographics, both in terms of population, density and wealth.

Operator

And I'm not showing any further questions at this time. I'd like to turn the conference back over to our host.

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

We appreciate your investment and confidence in our Company and your interest in our Company. I hope you all enjoy the Kentucky Derby. We're about to exit this conference room and go to work to help our team prepare for that event, that's what we're focused on now. So fingers crossed for a great Derby. And again, thank you for all your support of our Company, it gives us confidence and optimism in our future. Thank you.



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Operator

Ladies and gentlemen, this does conclude today's presentation. You may now disconnect and have a wonderful day.

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