

CHURCHILL DOWNS INC
Form 10-Q
October 29, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

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

For the quarterly period ended September 30, 2014
OR

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

For the transition period from _____ to _____
Commission file number 001-33998
(Exact name of registrant as specified in its charter)

Kentucky
(State or other jurisdiction of incorporation or
organization)

61-0156015
(I.R.S. Employer Identification No.)

600 North Hurstbourne Parkway, Suite 400 Louisville,
Kentucky 40222

(502) 636-4400

(Address of principal executive offices) (zip code) (Registrant's telephone number, including area code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405) during the preceding 12 months (or for such shorter period that the Registrant was required to submit and post such files). Yes No

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

The number of shares outstanding of Registrant's common stock at October 24, 2014 was 17,322,487 shares.

CHURCHILL DOWNS INCORPORATED
 INDEX TO QUARTERLY REPORT ON FORM 10-Q
 For the Quarter Ended September 30, 2014

	<u>Part I-FINANCIAL INFORMATION</u>	
<u>Item 1.</u>	<u>Financial Statements</u>	
	<u>Condensed Consolidated Balance Sheets, September 30, 2014 and December 31, 2013 (Unaudited)</u>	<u>3</u>
	<u>Condensed Consolidated Statements of Comprehensive Income for the three and nine months ended September 30, 2014 and 2013 (Unaudited)</u>	<u>4</u>
	<u>Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2014 and 2013 (Unaudited)</u>	<u>5</u>
	<u>Notes to Condensed Consolidated Financial Statements (Unaudited)</u>	<u>7</u>
<u>Item 2.</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>19</u>
<u>Item 3.</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	<u>42</u>
<u>Item 4.</u>	<u>Controls and Procedures</u>	<u>42</u>
	 <u>Part II-OTHER INFORMATION</u>	
<u>Item 1.</u>	<u>Legal Proceedings</u>	<u>42</u>
<u>Item 1A.</u>	<u>Risk Factors</u>	<u>44</u>
<u>Item 2.</u>	<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>44</u>
<u>Item 3.</u>	<u>Defaults Upon Senior Securities</u>	<u>44</u>
<u>Item 4.</u>	<u>Mine Safety Disclosures</u>	<u>44</u>
<u>Item 5.</u>	<u>Other Information</u>	<u>45</u>
<u>Item 6.</u>	<u>Exhibits</u>	<u>45</u>
	<u>Signatures</u>	<u>46</u>
	<u>Exhibit Index</u>	<u>47</u>

PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS
CHURCHILL DOWNS INCORPORATED
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited) (in thousands)

	September 30, 2014	December 31, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	\$42,041	\$44,708
Restricted cash	27,144	36,074
Accounts receivable, net of allowance for doubtful accounts of \$5,020 at September 30, 2014 and \$4,338 at December 31, 2013	35,410	46,572
Deferred income taxes	5,357	8,927
Income taxes receivable	—	12,398
Other current assets	16,393	12,036
Total current assets	126,345	160,715
Property and equipment, net	591,678	585,498
Investment in and advances to unconsolidated affiliate	99,198	86,151
Goodwill	300,616	300,616
Other intangible assets, net	191,915	198,149
Other assets	22,512	21,132
Total assets	\$1,332,264	\$1,352,261
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$49,024	\$43,123
Bank overdraft	2,553	973
Account wagering deposit liabilities	18,275	18,679
Purses payable	12,503	18,839
Accrued expenses	62,891	66,469
Accrued interest payable	5,026	859
Dividends payable	—	15,186
Income taxes payable	4,513	—
Deferred revenue	12,496	49,078
Total current liabilities	167,281	213,206
Long-term debt, net of current maturities	383,391	369,191
Other liabilities	20,061	17,753
Deferred revenue	15,916	16,706
Deferred income taxes	30,616	30,616
Total liabilities	617,265	647,472
Commitments and contingencies		
Shareholders' equity:		
Preferred stock, no par value; 250 shares authorized; no shares issued	—	—
Common stock, no par value; 50,000 shares authorized; 17,322 shares issued at September 30, 2014 and 17,948 shares issued at December 31, 2013	246,001	295,955
Retained earnings	468,998	408,834
Total shareholders' equity	714,999	704,789
Total liabilities and shareholders' equity	\$1,332,264	\$1,352,261

The accompanying notes are an integral part of the condensed consolidated financial statements.

3

CHURCHILL DOWNS INCORPORATED
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

(in thousands, except per common share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Net revenues:				
Racing	\$41,055	\$50,687	\$231,069	\$235,887
Gaming	81,805	79,832	250,318	218,808
Online	46,266	48,522	149,426	143,969
Other	4,539	6,455	13,813	18,302
	173,665	185,496	644,626	616,966
Operating expenses:				
Racing	46,492	54,375	175,195	185,655
Gaming	60,618	61,086	185,017	161,698
Online	31,872	32,227	102,260	95,807
Other	5,837	6,367	17,885	17,926
Selling, general and administrative expenses	20,473	21,188	60,604	60,842
Insurance recoveries, net of losses	—	—	(431)	(375)
Operating income	8,373	10,253	104,096	95,413
Other income (expense):				
Interest income	6	6	15	105
Interest expense	(5,173)	(1,407)	(15,107)	(4,139)
Equity in gains (losses) of unconsolidated investments	1,057	(887)	5,853	(1,682)
Miscellaneous, net	114	4,438	482	5,468
	(3,996)	2,150	(8,757)	(248)
Earnings from continuing operations before provision for income taxes	4,377	12,403	95,339	95,165
Income tax provision	(846)	(3,195)	(35,175)	(34,559)
Earnings from continuing operations	3,531	9,208	60,164	60,606
Discontinued operations, net of income taxes:				
Earnings (loss) from operations	—	41	—	(1)
Net earnings and comprehensive income	\$3,531	\$9,249	\$60,164	\$60,605
Net earnings per common share data:				
Basic				
Net earnings	\$0.21	\$0.52	\$3.44	\$3.44
Diluted				
Net earnings from continuing operations	\$0.20	\$0.51	\$3.40	\$3.39
Discontinued operations	—	0.01	—	—
Net earnings	\$0.20	\$0.52	\$3.40	\$3.39
Weighted average shares outstanding:				
Basic	17,020	17,328	17,322	17,269
Diluted	17,303	17,955	17,670	17,881

The accompanying notes are an integral part of the condensed consolidated financial statements.

CHURCHILL DOWNS INCORPORATED
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited) (in thousands)

	Nine Months Ended September 30,	
	2014	2013
Cash flows from operating activities:		
Net earnings and comprehensive income	\$60,164	\$60,605
Adjustments to reconcile net earnings and comprehensive income to net cash provided by operating activities:		
Depreciation and amortization	48,324	45,822
Gain on asset disposition	(405)	(495)
Equity in (gain) loss of unconsolidated investments	(5,853)	1,682
Share-based compensation	10,567	15,567
Other	458	555
Increase (decrease) in cash resulting from changes in operating assets and liabilities, net of business acquisition:		
Restricted cash	8,525	2,056
Accounts receivable	(1,455)	(8,482)
Other current assets	(3,346)	(793)
Accounts payable	2,872	5,812
Purses payable	(6,336)	(3,284)
Accrued expenses	2,707	2,202
Deferred revenue	(24,797)	(17,100)
Income taxes receivable and payable	20,482	9,305
Other assets and liabilities	2,338	921
Net cash provided by operating activities	114,245	114,373
Cash flows from investing activities:		
Additions to property and equipment	(48,854)	(29,858)
Acquisition of business, net of cash	—	(154,872)
Acquisition of intangible asset	—	(2,500)
Acquisition of gaming license	(2,250)	(2,250)
Investment in joint ventures	(9,375)	(27,000)
Purchases of minority investments	(273)	(625)
Proceeds on sale of property and equipment	925	4
Change in deposit wagering asset	404	(3,841)
Net cash used in investing activities	(59,423)	(220,942)
Cash flows from financing activities:		
Borrowings on bank line of credit	317,379	641,665
Repayments on bank line of credit	(303,179)	(526,611)
Change in bank overdraft	1,580	(1,103)
Payment of dividends	(15,186)	—
Repurchase of common stock	(61,561)	—
Repurchase of common stock from share-based compensation	(9,298)	(5,940)
Common stock issued	7,475	1,135
Windfall tax benefit from share-based compensation	6,904	2,194
Loan origination fees	(170)	(2,038)
Debt issuance costs	(1,029)	—
Change in deposit wagering liability	(404)	3,841
Net cash (used in) provided by financing activities	(57,489)	113,143
Net (decrease) increase in cash and cash equivalents	(2,667)	6,574

Edgar Filing: CHURCHILL DOWNS INC - Form 10-Q

Cash and cash equivalents, beginning of period	44,708	37,177
Cash and cash equivalents, end of period	\$42,041	\$43,751

The accompanying notes are an integral part of the condensed consolidated financial statements.

CHURCHILL DOWNS INCORPORATED
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
 (Unaudited) (in thousands)

	Nine Months Ended September 30,	
	2014	2013
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	\$9,078	\$2,847
State tax credits	\$—	\$1,298
Income taxes	\$16,956	\$20,948
Schedule of non-cash investing and financing activities:		
Issuance of common stock in connection with the Company LTIP, the New Company LTIP and other restricted stock plans	\$2,991	\$32,460
Property and equipment additions included in accrued expenses	\$—	\$331
Assets acquired and liabilities assumed from acquisition of business:		
Fair value of assets assumed	\$—	\$161,051
Liabilities assumed	\$—	\$6,179
The accompanying notes are an integral part of the condensed consolidated financial statements.		

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 1 — BASIS OF PRESENTATION

The accompanying Condensed Consolidated Financial Statements are presented in accordance with the requirements of this Quarterly Report on Form 10-Q and consequently do not include all of the disclosures normally required by Generally Accepted Accounting Principles ("GAAP") in the United States of America or those normally made in Churchill Downs Incorporated's (the "Company") Annual Report on Form 10-K. The year-end Condensed Consolidated Balance Sheet data was derived from audited financial statements but does not include all disclosures required by accounting principles generally accepted in the United States of America. Accordingly, the reader of this Quarterly Report on Form 10-Q should refer to the Company's Annual Report on Form 10-K for the year ended December 31, 2013 for further information. The accompanying Condensed Consolidated Financial Statements have been prepared in accordance with the Company's customary accounting practices and have not been audited.

In the opinion of management, all adjustments necessary for a fair statement of this information have been made, and all such adjustments are of a normal, recurring nature.

The Company's revenues and earnings are seasonal in nature, primarily due to its Racing Operations segment.

Therefore, revenues and operating results for any interim quarter are generally not indicative of the revenues and operating results for the year and may not be comparable with results for the corresponding period of the previous year. For instance, the Company historically has had fewer live racing days during the first quarter of each year, and the majority of its live racing revenue occurs during the second quarter, with the running of the Kentucky Derby and the Kentucky Oaks. The Company conducted 65 live thoroughbred racing days during the third quarter of 2014, which compares to 104 live thoroughbred racing days during the third quarter of 2013. This decrease was due to the July 1, 2014 cessation of pari-mutuel operations at Calder Race Course ("Calder"). For the nine months ended September 30, 2014, the Company conducted 271 live thoroughbred racing days, which compares to 284 live racing days during the nine months ended September 30, 2013. Furthermore, gaming revenues and earnings have historically been higher during the first quarter due to seasonal revenues from the Company's predominately southern gaming properties.

Discontinued Operations

During the year ended December 31, 2013, the Company ceased operations of Fight! Magazine, a division of Bluff Media. Fight! Magazine, which was previously a component of the Other Investments segment, and its results of operations for the three months and nine months ended September 30, 2013 have been reclassified to discontinued operations.

Comprehensive Income

The Company had no other components of comprehensive income and, as such, comprehensive income is the same as net earnings as presented in the accompanying Condensed Consolidated Statements of Comprehensive Income.

Customer Loyalty Programs

The Company's customer loyalty programs offer incentives to customers who wager at the Company's racetracks, through its advance deposit wagering platform, TwinSpire.com, or at its gaming facilities. The TSC Elite program is for pari-mutuel wagering at the Company's racetracks or through TwinSpire.com. The Player's Club is offered at the Company's gaming facilities in Louisiana, Florida, Maine and Mississippi. As of September 30, 2014 and December 31, 2013, the outstanding reward point liabilities were \$2.0 million and \$2.1 million, respectively, and were included in accrued expenses.

Promotional Allowances

Promotional allowances, which include the Company's customer loyalty programs, primarily consist of the retail value of complimentary goods and services provided to guests at no charge. The retail value of these promotional allowances is included in gross revenue and then deducted to arrive at net revenue.

During the three months ended September 30, 2014 and 2013, promotional allowances of \$8.7 million were included as a reduction to net revenues. During those periods, Online Business promotional allowances were \$3.6 million and \$3.4 million, respectively. Gaming promotional allowances were \$5.0 million and \$5.1 million, respectively. Racing Operations promotional allowances were \$0.1 million and \$0.2 million, respectively. The estimated cost of providing

promotional allowances included in operating expenses totaled \$2.3 million and \$2.4 million for each of the three months ended September 30, 2014 and 2013.

During the nine months ended September 30, 2014 and 2013, promotional allowances of \$25.0 million and \$25.1 million, respectively, were included as a reduction to net revenues. During those periods, Online Business promotional allowances were \$9.8 million and \$9.5 million, respectively. Gaming promotional allowances were \$14.7 million and \$14.9 million, respectively. Racing Operations promotional allowances were \$0.5 million and \$0.7 million, respectively. The estimated cost of providing promotional allowances included in operating expenses for the nine months ended September 30, 2014 and 2013 totaled \$6.9 million and \$7.2 million, respectively.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 2 — NEW VENTURES & ACQUISITIONS

Saratoga Harness Racing, Inc. Joint Venture

On May 13, 2014, the Company entered into a 50% joint venture with Saratoga Harness Racing, Inc. ("SHRI") to bid on the development, construction and operation of the Capital View Casino & Resort located in the Capital Region near Albany, New York. On June 30, 2014, the joint venture filed an application with the New York State Facility Location Board to obtain a license to build and operate a facility with approximately 1,500 slot machines, 56 table games, a 100-room hotel and multiple entertainment and dining options. The expected cost of the project approximates \$330 million, which includes a \$50 million license fee. The joint venture anticipates funding a majority of the cost through project debt financing. The Company intends to fund its equity share of the joint venture from its Senior Secured Credit Facility. The joint venture is one of four remaining bidders competing for a license in the Capital Region of New York, and the Company expects, but cannot guarantee, that the state will award a license during the fourth quarter of 2014.

During the nine months ended September 30, 2014, the Company incurred \$0.8 million in equity losses in its other investments segment associated with the license application process and funded \$2.9 million to the joint venture. Should the joint venture be successful in obtaining the license for the Capital View Casino & Resort, the Company anticipates funding requirements of approximately \$1.0 million for its share of the joint venture's expenditures during the fourth quarter of 2014, when the winning bidder is expected to be announced.

Oxford Casino Acquisition

On July 17, 2013, the Company completed its acquisition of Oxford Casino ("Oxford") in Oxford, Maine for cash consideration of approximately \$168.6 million. The transaction included the acquisition of a 25,000-square-foot casino with approximately 800 slot machines, 22 table games and various dining facilities. The acquisition continued the Company's diversification and growth strategies to invest in assets with rates of returns attractive to the Company's shareholders. The Company financed the acquisition with borrowings under its revolving credit facility. The fair value of the assets acquired and liabilities assumed has been included in the Company's Annual Report on Form 10-K for the year ended December 31, 2013. During the three and nine months ended September 30, 2014, Oxford contributed revenues of \$21.9 million and \$58.8 million, respectively, and earnings from continuing operations before provision for income taxes of \$5.0 million and \$11.5 million, respectively.

Pro Forma

The following table illustrates the effect on net revenues, earnings from continuing operations and earnings from continuing operations per common share as if the Company had acquired Oxford as of the beginning of 2013. The pro forma results have been prepared for comparative purposes only and do not purport to be indicative of the results of operations that would have occurred had the acquisition of Oxford been consummated at the beginning of 2013 (in thousands, except per common share data):

	Three Months Ended September 30, 2013	Nine Months Ended September 30, 2013
Net revenues	\$189,518	\$657,938
Earnings from continuing operations	\$9,653	\$64,872
Earnings from continuing operations per common share		
Basic:		
Earnings from continuing operations	\$0.55	\$3.68
Diluted:		
Earnings from continuing operations	\$0.54	\$3.63
Shares used in computing earnings from continuing operations per common share:		
Basic	17,328	17,269
Diluted	17,955	17,881

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 3 — NATURAL DISASTERS

Kentucky Hailstorm

On April 28, 2012, a hailstorm caused damage to portions of Louisville, Kentucky including Churchill Downs Racetrack ("Churchill Downs") and its separate training facility known as Trackside Louisville. Both locations sustained damage to their stable areas as well as damages to administrative offices and several other structures. The Company carries property and casualty insurance, subject to a \$0.5 million deductible. During the years ended December 31, 2013 and 2012, the Company recorded a reduction of property and equipment of \$0.6 million and received \$1.5 million from its insurance carriers in partial settlement of its claim. During the nine months ended September 30, 2014, the Company received an additional \$0.4 million from its insurance carriers and recognized insurance recoveries, net of losses of \$0.4 million as a component of operating income. The insurance claims for this event have been finalized with our insurance carriers, and the Company does not expect to receive additional funds from this claim.

NOTE 4—INVESTMENT IN AND ADVANCES TO UNCONSOLIDATED AFFILIATE

Miami Valley Gaming

During March 2012, the Company entered into a 50% joint venture with Delaware North Companies Gaming & Entertainment Inc. ("DNC") to develop a new harness racetrack and video lottery terminal ("VLT") gaming facility in Lebanon, Ohio. Through the joint venture agreement, the Company and DNC formed a new company, Miami Valley Gaming, LLC ("MVG"), to manage both the Company's and DNC's interests in the development and operation of the racetrack and VLT gaming facility. On December 21, 2012, MVG completed the purchase of the harness racing licenses and certain assets held by Lebanon Trotting Club Inc. and Miami Valley Trotting Inc. ("MVG Sellers") for total consideration of \$60.0 million, of which \$10.0 million was funded at closing with the remainder funded through a \$50.0 million note payable with a six year term effective upon the commencement of gaming operations. In addition, there is a potential contingent consideration payment of \$10.0 million based on the financial performance of the facility during the seven-year period after gaming operations commence.

On December 12, 2013, the new facility opened in Lebanon, Ohio on a 120-acre site. The facility includes a 5/8-mile harness racing track and an 186,000-square-foot gaming facility with approximately 1,600 VLTs. MVG will invest approximately \$212.0 million in the new facility, including a \$50.0 million license fee to the Ohio Lottery Commission. One-half of the license fee was funded during 2012 and 2013, and the remaining \$25 million license fee will be funded during the fourth quarter of 2014. During the nine months ended September 30, 2014, the Company funded \$6.5 million in capital contributions to the joint venture. During the fourth quarter of 2014, the Company anticipates funding approximately \$8.5 million in additional capital contributions to the joint venture to fund the remaining portion of the license fee.

Since both DNC and the Company have participating rights over MVG, and both must consent to MVG's operating, investing and financing decisions, the Company accounts for MVG using the equity method. Summarized financial information for MVG is comprised of the following (in thousands):

	September 30, 2014	December 31, 2013
Assets		
Current assets	\$25,882	\$18,002
Property and equipment, net	133,021	151,434
Other assets, net	80,407	80,665
Total assets	\$239,310	\$250,101
Liabilities and Members' Equity		
Current liabilities	\$14,468	\$46,966
Current portion of long-term debt	8,332	8,332
Long-term debt, excluding current portion	28,039	32,426
Other liabilities	75	75

Edgar Filing: CHURCHILL DOWNS INC - Form 10-Q

Members' equity	188,396	162,302
Total liabilities and members' equity	\$239,310	\$250,101

The joint venture's long-term debt consists of a \$50 million secured note payable from MVG to the MVG Sellers payable quarterly over 6 years through August 2019 at a 5.0% interest rate.

9

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Gaming revenue	\$33,365	\$—	\$98,928	\$—
Non-gaming revenue	1,289	1,305	4,833	4,509
Net revenues	34,654	1,305	103,761	4,509
Operating and SG&A expenses	26,123	1,347	76,387	4,703
Depreciation & amortization expenses	3,474	101	10,315	114
Pre-opening expenses	—	1,001	54	2,422
Operating income (loss)	5,057	(1,144)	17,005	(2,730)
Interest (expense) income, net	(1,380)	—	(3,654)	—
Net income (loss)	\$3,677	\$(1,144)	\$13,351	\$(2,730)

The Company's 50% share of MVG's results has been included in our accompanying condensed consolidated financial statements for the three and nine months ended September 30, 2014 and 2013, as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Equity in gains (losses) of unconsolidated investments	\$1,839	\$(572)	\$6,676	\$(1,365)

NOTE 5 — INCOME TAXES

The Company's effective tax rate from continuing operations for the nine months ended September 30, 2014 and 2013 was 37% and 36%, respectively. The effective tax rate for the nine months ended September 30, 2014 was greater than the Federal statutory rate due to state income taxes and certain expenses that are not deductible for tax purposes.

Certain tax authorities may periodically audit the Company, and the Company may occasionally be assessed interest and penalties by tax jurisdictions. The Company recognizes accrued interest from uncertain income tax benefits in its income tax provision, while penalties are accrued in selling, general and administrative expenses. During the nine months ended September 30, 2014, the Company did not record interest expense related to uncertain income tax benefits and had gross uncertain tax benefits of \$0.8 million as of September 30, 2014. If these benefits had been recognized, there would have been a \$0.8 million decrease to annual income tax expense.

During October 2012, the Company funded a \$2.9 million income tax payment to the State of Illinois related to a dispute over state income tax apportionment methodology which was recorded as an other asset. The Company filed its state income tax returns related to the years 2002 through 2005 following the methodology prescribed by Illinois statute; however, the State of Illinois has taken a contrary tax position. The Company filed a formal protest with the State of Illinois during the fourth quarter of 2012. The Company does not expect this issue to have a material adverse effect on its business, financial condition and results of operations.

NOTE 6 — GOODWILL AND INDEFINITE-LIVED INTANGIBLE ASSETS IMPAIRMENT TEST

In accordance with ASU No. 2011-08, Intangibles-Goodwill and Other: Testing Goodwill for Impairment and ASU No. 2012-02, Intangibles-Goodwill and Other: Testing Indefinite-Lived Intangible Assets for Impairment, the Company completed the required annual impairment tests of goodwill and indefinite-lived intangible assets as of March 31, 2014, and no adjustment to the carrying value of goodwill or indefinite-lived intangible assets was required. The Company assessed its goodwill and indefinite-lived intangible assets by qualitatively evaluating events and circumstances that have both positive and negative factors, including macroeconomic conditions, industry events, financial performance and other changes and concluded that it was more likely than not that fair value of its reporting units was greater than their carrying value, and as such, the Company was not required to calculate the fair value of its reporting units.

Definite-lived and indefinite-lived intangible assets are summarized as follows (in thousands):

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

	September 30, 2014			December 31, 2013		
	Gross Carrying Value	Accumulated Amortization	Net Book Value	Gross Carrying Value	Accumulated Amortization	Net Book Value
Definite-lived intangible assets	\$76,002	\$(42,430)	\$33,572	\$76,002	\$(36,196)	\$39,806
Indefinite-lived intangible assets	158,343	—	158,343	158,343	—	158,343
Total	\$234,345	\$(42,430)	\$191,915	\$234,345	\$(36,196)	\$198,149

NOTE 7 — FAIR VALUE OF ASSETS AND LIABILITIES

The Company endeavors to utilize the best available information in measuring fair value. Financial assets and liabilities are classified based on the lowest level of input that is significant to the fair value measurement. The following table presents the Company's assets and liabilities measured at fair value as of September 30, 2014, and December 31, 2013, respectively (in thousands):

	Fair Value		
	Hierarchy	September 30, 2014	December 31, 2013
Cash equivalents and restricted cash	Level 1	\$28,003	\$36,940
Contingent consideration liability	Level 3	\$2,331	\$2,331
Senior Unsecured Notes	Level 2	\$300,750	\$305,250

The Company's cash equivalents and restricted cash, which are held in interest-bearing accounts, qualify for Level 1 in the fair value hierarchy which includes unadjusted quoted market prices in active markets for identical assets.

The Company's accrued liability for a contingent consideration recorded in conjunction with the Bluff Media acquisition was based on significant inputs not observed in the market and represents a Level 3 fair value measurement. The estimate of the contingent consideration liability uses an income approach and is based on the probability of achieving enabling legislation which permits Internet poker gaming and the probability-weighted discounted cash flows. Any change in the fair value of the contingent consideration subsequent to the acquisition date will be recognized in the Company's Condensed Consolidated Statements of Comprehensive Income.

The Company's \$300 million par value Senior Unsecured Notes represent a Level 2 fair value measurement. The fair value of the Senior Unsecured Notes is estimated based on unadjusted quoted prices for similar liabilities in markets that are not active.

The Company currently has no other assets or liabilities subject to fair value measurement on a recurring basis. The following methods and assumptions were used by the Company in estimating its fair value disclosures for financial instruments:

Cash Equivalents—The carrying amount reported in the balance sheet for cash equivalents approximates its fair value due to the short-term maturity of these instruments.

Long-Term Debt: Senior Secured Credit Facility—The carrying amounts of the Company's borrowings under its Senior Secured Credit Facility approximates fair value, based upon current interest rates and represents a Level 2 fair value measurement.

During the nine months ended September 30, 2014, the Company did not measure any assets at fair value on a non-recurring basis.

NOTE 8 — LONG-TERM INCENTIVE PLAN

On February 11, 2013, the Board of Directors approved the terms and conditions of performance share awards issued pursuant to the Churchill Downs Incorporated 2007 Omnibus stock incentive plan (the "New Company LTIP"). As a way to continue to encourage innovation, an entrepreneurial approach, and careful risk assessment, and in order to retain key executives, the New Company LTIP offers long-term incentive compensation to the Company's named executive officers and other key executives ("Grantees") as reported in the Company's Schedule 14A Proxy Statement

filing, with the exception of our Chairman of the Board and Chief Executive Officer.

During 2013, the Grantees received 92,000 restricted shares of the Company's common stock vesting over approximately four years and 324,000 restricted shares of the Company's common stock with vesting contingent upon the Company's common stock reaching certain closing prices on NASDAQ for 20 consecutive trading days. During the three months ended September 30, 2014, the Company's closing stock price achieved the twenty consecutive trading days closing stock price requirement for 84,500 restricted

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

shares. During the year ended December 31, 2013, the Company's closing stock price achieved the stock price requirement for 155,000 restricted shares.

During the three and nine months ended September 30, 2014, the Company recognized \$1.3 million and \$7.8 million of compensation expense related to the New Company LTIP. As of September 30, 2014, unrecognized compensation expense attributable to unvested service period awards was \$3.3 million. The weighted average period over which the Company expects to recognize the remaining compensation expense under service period awards approximates 20 months. There is no remaining unrecognized expense under the market condition awards.

NOTE 9 — EARNINGS PER COMMON SHARE COMPUTATIONS

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Numerator for basic earnings from continuing operations per common share				
Earnings from continuing operations	\$3,531	\$9,208	\$60,164	\$60,606
Earnings from continuing operations allocated to participating securities	(37	) (193	) (623	) (1,281
Numerator for basic earnings from continuing operations per common share	\$3,494	\$9,015	\$59,541	\$59,325
Numerator for basic earnings per common share				
Net earnings	\$3,531	\$9,249	\$60,164	\$60,605
Net earnings allocated to participating securities	(37	) (195	) (623	) (1,281
Numerator for basic net earnings per common share	\$3,494	\$9,054	\$59,541	\$59,324
Numerator for diluted earnings from continuing operations per common share	\$3,531	\$9,208	\$60,164	\$60,606
Numerator for diluted earnings per common share	\$3,531	\$9,249	\$60,164	\$60,605
Denominator for net earnings per common share:				
Basic	17,020	17,328	17,322	17,269
Plus dilutive effect of stock options	102	254	167	239
Plus dilutive effect of participating securities	181	373	181	373
Diluted	17,303	17,955	17,670	17,881
Earnings per common share:				
Basic				
Net earnings	\$0.21	\$0.52	\$3.44	\$3.44
Diluted				
Net earnings from continuing operations	\$0.20	\$0.51	\$3.40	\$3.39
Discontinued operations	—	0.01	—	—
Net earnings	\$0.20	\$0.52	\$3.40	\$3.39

NOTE 10 — COMMON STOCK SHARE REPURCHASE

On April 23, 2013, the Company's Board of Directors authorized the repurchase of up to \$100 million of its common stock outstanding in a stock repurchase program. During the nine months ended September 30, 2014, the Company repurchased 691 thousand shares for \$61.6 million in a privately negotiated transaction. The shares were retired, and

the cost of the shares acquired was treated as a deduction from shareholders' equity. The Company funded this repurchase using available cash and borrowing

12

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

under its Senior Secured Credit Facility. Under the terms of the stock repurchase program, the Company may repurchase an additional \$38.4 million of common stock prior to the termination of the repurchase program on December 31, 2015.

NOTE 11 — SEGMENT INFORMATION

The Company operates in the following four segments: (1) Racing Operations, which includes Churchill Downs, Arlington International Race Course ("Arlington") and its eleven off-track betting facilities ("OTBs"), Calder, which ceased pari-mutuel operations on July 1, 2014, and Fair Grounds Race Course ("Fair Grounds") and the pari-mutuel activity generated at its twelve OTBs; (2) Gaming, which includes video poker and gaming operations at Calder Casino, Fair Grounds Slots, Harlow's Casino Resort & Spa ("Harlow's"), the Company's equity investment in MVG, Oxford, Riverwalk Casino Hotel ("Riverwalk") and Video Services, LLC ("VSI"); (3) Online Business, which includes TwinSpires, our Advance Deposit Wagering ("ADW") business, Fair Grounds Account Wagering, Bloodstock Research Information Services, Velocity, a business focused on high wagering-volume international customers and Luckity, an ADW business that offers real-money bingo online with outcomes based on and determined by pari-mutuel wagers on live horseraces, as well as the Company's equity investment in HRTV, LLC; and (4) Other Investments, which includes United Tote, SHRI, Bluff Media and the Company's other minor investments. Eliminations include the elimination of intersegment transactions.

On January 1, 2014, the Company reclassified its equity investment in MVG from Other Investments to Gaming, to coincide with the first full period of operations for the venture, which opened on December 12, 2013. MVG's results of operations for the three and nine months ended September 30, 2013 have been reclassified to the Gaming segment. In order to evaluate the performance of these operating segments internally, the Company uses Adjusted EBITDA (defined as earnings before interest, taxes, depreciation, amortization, insurance recoveries net of losses, HRE Trust Fund proceeds, share-based compensation expenses, pre-opening expenses, the impairment of assets and other charges or recoveries). Adjusted EBITDA also includes 50% of the operating income or loss of our joint venture, MVG. The Company utilizes the Adjusted EBITDA metric because it believes the inclusion or exclusion of certain recurring and non-recurring items is necessary to provide a more accurate measure of its core operating results and enables management and investors to evaluate and compare from period to period our operating performance in a meaningful and consistent manner. Adjusted EBITDA should not be considered as an alternative to operating income as an indicator of performance, as an alternative to cash flows from operating activities as a measure of liquidity, or as an alternative to any other measure provided in accordance with GAAP. The Company's calculation of Adjusted EBITDA may be different from the calculation used by other companies and, therefore, comparability may be limited. The Company implemented the Adjusted EBITDA measure during the second quarter of 2013. The table below presents information about the reported segments for the three and nine months ended September 30, 2014 and 2013 (in thousands):

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

	Three Months Ended September		Nine Months Ended September	
	30,		30,	
	2014	2013	2014	2013
Net revenues from external customers:				
Churchill Downs	\$8,021	\$7,956	\$128,511	\$118,534
Arlington	26,974	28,473	54,289	57,720
Calder	786	8,597	18,524	27,908
Fair Grounds	5,274	5,661	29,745	31,725
Total Racing Operations	41,055	50,687	231,069	235,887
Calder Casino	18,104	19,157	58,560	60,109
Fair Grounds Slots	9,453	9,781	30,823	32,123
VSI	8,190	8,443	25,771	27,449
Harlow's Casino	12,197	12,082	38,425	40,533
Oxford Casino	21,887	17,730	58,808	17,730
Riverwalk Casino	11,974	12,639	37,931	40,864
Total Gaming	81,805	79,832	250,318	218,808
Online Business	46,266	48,522	149,426	143,969
Other Investments	4,249	6,135	12,864	17,408
Corporate	290	320	949	894
Net revenues from external customers	\$173,665	\$185,496	\$644,626	\$616,966
Intercompany net revenues:				
Churchill Downs	\$678	\$689	\$5,851	\$5,485
Arlington	2,001	2,070	4,795	3,110
Calder	—	412	707	917
Fair Grounds	15	22	744	855
Total Racing Operations	2,694	3,193	12,097	10,367
Online Business	240	211	714	657
Other Investments	829	938	2,937	3,188
Eliminations	(3,763)	) (4,342)	) (15,748)	) (14,212)
Net revenues	\$—	\$—	\$—	\$—
Reconciliation of segment Adjusted EBITDA to net earnings:				
Racing Operations	\$(1,229)	) \$(907)	) \$66,600	\$58,353
Gaming	24,937	20,496	78,362	61,788
Online Business	11,098	12,998	35,135	38,424
Other Investments	(1,254)	) 469	(3,280)	) 1,698
Total segment Adjusted EBITDA	33,552	33,056	176,817	160,263
Corporate Adjusted EBITDA	(1,398)	) (1,215)	) (3,645)	) (3,380)
Other charges	(2,298)	) —	(2,298)) —
Insurance recoveries, net of losses	—	—	431	375
HRE Trust Fund proceeds	—	4,249	—	4,541
Share-based compensation expense	(2,213)	) (5,990)	) (10,567)	) (15,567)
Pre-opening expense	—	(500)	) (27)	) (1,211)
MVG interest expense, net	(819)	) —	(1,956)) —
Depreciation and amortization	(17,280)	) (15,796)	) (48,324)	) (45,822)
Interest (expense) income, net	(5,167)	) (1,401)	) (15,092)	) (4,034)
Income tax provision	(846)	) (3,195)	) (35,175)	) (34,559)

Edgar Filing: CHURCHILL DOWNS INC - Form 10-Q

Earnings from continuing operations	3,531	9,208	60,164	60,606
Discontinued operations, net of income taxes	—	41	—	(1)
Net earnings and comprehensive income	\$3,531	\$9,249	\$60,164	\$60,605

14

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

The table below presents equity in earnings (losses) of unconsolidated investments included in the Company's reported segments for the three and nine months ended September 30, 2014 and 2013 (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Gaming	\$1,839	\$(572)	\$6,676	\$(1,365)
Online Business	(289)	(393)	(41)	(523)
Other Investments	(493)	78	(782)	206
	\$1,057	\$(887)	\$5,853	\$(1,682)

The table below presents total assets for the reported segments (in thousands):

	September 30, 2014	December 31, 2013
Total assets:		
Racing Operations	\$498,459	\$513,345
Gaming	618,045	622,038
Online Business	185,507	186,621
Other Investments	30,253	30,257
	\$1,332,264	\$1,352,261

The table below presents total capital expenditures for the reported segments for the nine months ended September 30, 2014 and 2013 (in thousands):

	Nine Months Ended September 30,	
	2014	2013
Capital expenditures:		
Racing Operations	\$33,491	\$11,801
Gaming	6,629	11,528
Online Business	4,716	4,857
Other Investments	4,018	1,672
	\$48,854	\$29,858

NOTE 12 — COMMITMENTS AND CONTINGENCIES

Legal Proceedings

The Company records an accrual for legal contingencies to the extent that it concludes that it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. Except as disclosed below, no estimate of the possible loss or range of loss in excess of amounts accrued, if any, can be made at this time regarding the matters specifically described below. We do not believe that the final outcome of these matters will have a material adverse impact on our business, financial condition and results of operations.

Pennsylvania ADW Taxation

On June 13, 2014, the Company filed a lawsuit in the Commonwealth Court of Pennsylvania styled Churchill Downs Incorporated and Churchill Downs Technology Initiatives Company v. the Commonwealth of Pennsylvania, et al., (Docket No. 322 MD 2014) challenging the constitutionality of Pennsylvania laws that, among other things, state that out-of-state companies must pay a 10% tax on ADW wagers. On September 30, 2014, the Company and the Commonwealth of Pennsylvania settled the above captioned dispute. The Company, through its subsidiary Churchill Downs Technology Initiatives Company, will now be subject to the same tax rate paid by in-state racetracks on online wagers. During October 2014, the Company filed a petition for refund with the Pennsylvania Department of Revenue for \$1.9 million to reimburse the Company for taxes paid at the 10% taxation rate for the period from October 1, 2013 through June 30, 2014.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Louisiana Horsemen's Purses

On April 21, 2014, John L. Soileau and other individuals filed a Petition for Declaratory Judgment, Permanent Injunction, and Damages - Class Action styled John L. Soileau, et. al. versus Churchill Downs Louisiana Horseracing, LLC, Churchill Downs Louisiana Video Poker Company, LLC (Suit No. 14-3873) in the Parish of Orleans, State of Louisiana. The petition defines the "alleged plaintiff class" as quarter-horse owners, trainers and jockeys that have won purses at the "Fair Grounds Race Course & Slots" facility in New Orleans, Louisiana since the first effective date of La. R.S. 27:438 and specifically since 2008. The petition alleges that Churchill Downs Louisiana Horseracing, L.L.C. and Churchill Downs Louisiana Video Poker Company, L.L.C. ("Fair Grounds") have collected certain monies through video draw poker devices that constitute monies earned for purse supplements and all of those supplemental purse monies have been paid to thoroughbred horsemen during Fair Grounds' live thoroughbred horse meets while La. R.S. 27:438 requires a portion of those supplemental purse monies to be paid to quarter-horse horsemen during Fair Grounds' live quarter-horse meets. The petition requests that the Court declare that Fair Grounds violated La. R.S. 27:438, issue a permanent and mandatory injunction ordering Fair Grounds to pay all future supplements due to the plaintiff class pursuant to La. R.S. 27:438, and to pay the plaintiff class such sums as it finds to reasonably represent the value of the sums due to the plaintiff class. On August 14, 2014, the plaintiffs filed their First Amended Petition for Declaratory Judgment, Permanent Injunction, and Damages-Class Action naming the Horsemen's Benevolent and Protective Association 1993, Inc. ("HBPA") as an additional defendant and alleging that HBPA is also liable to plaintiffs for the disputed purse funds. On October 9, 2014, HBPA and Fair Grounds filed exceptions to the suit seeking dismissal on various grounds.

Illinois Department of Revenue

In October 2012, the Company filed a verified complaint for preliminary and permanent injunctive relief and for declaratory judgment (the "Complaint") against the Illinois Department of Revenue (the "Department"). The Company's complaint was filed in response to Notices of Deficiency issued by the Department on March 18, 2010, and September 6, 2012. In response to said Notices of Deficiency, the Company, on October 4, 2012, issued a payment in protest in the amount of \$2.9 million (the "Protest Payment") under the State Officers and Employees Money Disposition Act and recorded this amount as an other asset. The Company subsequently filed its complaint in November 2012 alleging that the Department erroneously included handle, instead of the Company's commissions from handle, in the computation of the Company's sales factor (a computation of the Company's gross receipts from wagering within the State of Illinois) for determining the applicable tax owed. On October 30, 2012, the Company's Motion for Preliminary Injunctive Relief was granted, which prevents the Department from depositing any monies from the Protest Payment into the State of Illinois General Fund and from taking any further action against the Company until the Circuit Court takes final action on the Company's Complaint. If successful with its Complaint, the Company will be entitled to a full or partial refund of the Protest Payment from the Department. This matter remains pending before the Tax and Miscellaneous Remedies Section of the Circuit Court of Cook County. No trial date has been set.

Kentucky Downs

On September 5, 2012, Kentucky Downs Management, Inc. ("KDMI") filed a petition for declaration of rights in Kentucky Circuit Court located in Simpson County, Kentucky styled Kentucky Downs Management Inc. v. Churchill Downs Incorporated (Civil Action No. 12-CI-330) (the "Simpson County Case") requesting a declaration that the Company does not have the right to exercise its put right and require Kentucky Downs, LLC ("Kentucky Downs") and/or Kentucky Downs Partners, LLC ("KDP") to purchase the Company's ownership interest in Kentucky Downs. On September 18, 2012, the Company filed a complaint in Kentucky Circuit Court located in Jefferson County, Kentucky, styled Churchill Downs Incorporated v. Kentucky Downs, LLC; Kentucky Downs Partners, LLC; and Kentucky Downs Management Inc. (Civil Action No. 12-CI-04989) (the "Jefferson County Case") claiming that Kentucky Downs and KDP had breached the operating agreement for Kentucky Downs and requesting a declaration that the Company had validly exercised its put right and a judgment compelling Kentucky Downs and/or KDP to purchase the Company's ownership interest in Kentucky Downs pursuant to the terms of the applicable operating agreement. On October 9, 2012, the Company filed a motion to dismiss the Simpson County Case and Kentucky

Downs, KDP and KDMI filed a motion to dismiss the Jefferson County Case. A hearing for the motion to dismiss in the Simpson County Case occurred November 30, 2012. At that hearing the Company's motion to dismiss the Simpson County Case was denied. Subsequently, Kentucky Downs, KDMI and KDP's motion to dismiss the Jefferson County Case was granted on January 23, 2013, due to the Simpson County Circuit Court's assertion of jurisdiction over the dispute. On May 16, 2013, Kentucky Downs, KDP and KDMI filed a Motion for Summary Judgment against the Company and Turfway Park, LLC. On September 19, 2013, the Company filed its response to the Motion for Summary Judgment. A hearing occurred before the Simpson County Circuit Court on September 23, 2013, on the Kentucky Downs, KDP and KDMI Motion for Summary Judgment. All parties appeared before the Simpson County Court and oral arguments were heard. On October 31, 2013, the Simpson County Court entered an Order Denying Petitioners' (Kentucky Downs Management Inc. et al.) Motion for Summary Judgment. The case will now move forward through discovery and to trial. No trial date has been set.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Texas Pari-Mutuel Wagering

On September 21, 2012, the Company filed a lawsuit in the United States District Court for the Western District of Texas styled Churchill Downs Incorporated; Churchill Downs Technology Initiatives Company d/b/a TwinSpire.com v. Chuck Trout, in his official capacity as Executive Director of the Texas Racing Commission; Gary P. Aber, Susan Combs, Ronald F. Ederer, Gloria Hicks, Michael F. Martin, Allan Polunsky, Robert Schmidt, John T. Steen III, Vicki Smith Weinberg, in their official capacity as members of the Texas Racing Commission (Case No.

1:12-cv-00880-LY) challenging the constitutionality of a Texas law requiring residents of Texas that desire to wager on horseraces to wager in person at a Texas race track. In addition to its complaint, on September 21, 2012, the Company filed a motion for preliminary injunction seeking to enjoin the state from taking any action to enforce the law in question. In response, on October 9, 2012, counsel for the state assured both the Company and the court that the state would not enforce the law in question against the Company without prior notice, at which time the court could then consider the motion for preliminary injunction. On April 15, 2013, both parties filed their opening briefs, and a trial was held on May 2, 2013. On September 23, 2013, the United States District Court for the Western District of Texas ruled against the Company and upheld the Texas law at issue. Subsequently, on September 25, 2013, the Company ceased taking wagers from Texas residents via TwinSpire.com and returned deposited funds to Texas residents. The Company filed a motion for an expedited hearing in the United States Court of Appeals, which was granted on October 17, 2013. The Texas Racing Commission, et. al., filed an appellate brief on December 13, 2013. The Company filed its brief in reply on December 30, 2013. Oral arguments were heard before the United States Court of Appeals for the Fifth Circuit on February 4, 2014. On September 25, 2014, the United States Court of Appeals for the Fifth Circuit issued an unpublished opinion affirming the United States District Court for the Western District of Texas and its ruling in favor of the Texas Racing Commission. The Company is now evaluating its legal options at all levels.

There are no other material pending legal proceedings.

NOTE 13 — RECENT ACCOUNTING PRONOUNCEMENTS

In August 2014, the Financial Accounting Standards Board ("FASB") issued ASU No. 2014-15, Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern, which explicitly requires management to assess an entity's ability to continue as a going concern, and to provide related footnote disclosures in certain circumstances. Management will be required to assess, in each interim and annual period, if there is substantial doubt of an entity's ability to continue as a going concern as evidenced by relevant known or knowable conditions including an entity's ability to meet its future obligations. Management will be required to provide disclosures regardless of whether substantial doubt is alleviated by management's plans. The guidance will become effective for annual fiscal periods ending after December 15, 2016.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers, which provides a five-step analysis of transactions to determine when and how revenue is recognized. The core principle is that a company should recognize revenue in a manner that depicts the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The revised guidance will become effective for annual periods beginning after December 15, 2016 and will be applied retrospectively to each period presented or as a cumulative-effect adjustment as of the date of adoption. The Company is assessing the impact of the new accounting guidance but does not expect adoption will have a material impact on the Company's business, financial condition or results of operations.

In April 2014, the FASB issued ASU No. 2014-08, Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity which changes the criteria for determining which disposals can be presented as discontinued operations and modifies related disclosure requirements. Under the new guidance, a discontinued operation is defined as a disposal of a component or group of components that represents a strategic shift that has, or will have, a major effect on an entity's operations and financial results. The revised guidance will become effective for annual fiscal periods beginning after December 15, 2014.

NOTE 14 — CALDER RACING OPERATIONS

During 2013, Calder and Gulfstream Park began conducting concurrent live thoroughbred racing in certain months, leading to an overlapping of live racing resulting in direct competition for on-track horseracing, in the intrastate and interstate simulcast markets and for racehorses in South Florida. This negatively affected Calder's ability to achieve full field horseraces and to generate handle on live racing. On May 24, 2013, Calder filed a petition with the Florida Division of Administrative Hearings (the "DOAH") challenging the other racetracks' interpretation that they may conduct interstate simulcasting, and whether that was a valid interpretation of state law and the Interstate Horseracing Act of 1978. During 2013 and 2014, the DOAH and other state legislative bodies held public hearings and proposed modification to state laws without reaching a definitive resolution.

On July 1, 2014, the Company finalized an agreement with The Stronach Group ("TSG") under which TSG will operate, at TSG's expense, live racing and maintain certain facilities used for racing and training at Calder. The agreement, which expires on

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

December 31, 2020, will involve a lease to TSG of Calder's racetrack and certain other racing and training facilities, including a portion of the barns on Calder's backside consisting of approximately 430 stalls. TSG will operate live horse racing at Calder, under Calder's racing permits, in compliance with all applicable laws and licensing requirements. TSG will operate and maintain the racing and training facilities at Calder on a year-round basis. Furthermore, TSG will be responsible for substantially all of the direct and indirect costs associated with these activities and receive the associated revenues. The Company will continue to own and operate the Calder Casino. In addition, as part of the agreement, effective July 1, 2014, the Company amended Calder's agreement with the Florida Horsemen's Benevolent and Protective Association, Inc. ("FHBPA") which reduced the rate of non-stakes purse supplements payable by the Calder Casino from 12 percent to 10 percent of slot machine revenue. Finally, the Company and TSG modified their HRTV operating and ownership agreement which will result in the divestiture of the Company's interest in HRTV. The Company expects to complete the HRTV transaction during the first quarter of 2015.

As a result of the agreement with TSG, on July 1, 2014, the Company notified 214 Calder employees of the termination of their employment which occurred between July 8, 2014, and September 2, 2014. In accordance with the terms of a one-time benefit arrangement, the Company recognized \$2.3 million of severance and other benefit costs within selling, general and administrative expenses during the three months ended September 30, 2014. In addition, Calder recognized accelerated depreciation expense of approximately \$1.3 million related to Calder's barns, which are not expected to be utilized subsequent to December 31, 2014. The Company expects to recognize additional depreciation expense of approximately \$2.3 million during the three months ended December 31, 2014. During the fourth quarter of 2014, the Company will continue to assess potential alternative uses of its Calder facility not associated with the lease agreement.

NOTE 15 — SUBSEQUENT EVENTS

Saratoga Harness Racing, Inc. Equity Investment and Management Agreement

On October 28, 2014, the Company signed a definitive purchase agreement to acquire a 25% ownership interest in Saratoga Casino Holdings, LLC ("SCH"), a newly formed entity which owns Saratoga Casino and Raceway in Saratoga Springs, NY; SHRI's controlling interest in Saratoga Casino Black Hawk in Black Hawk, CO; SHRI's 50% interest in a joint venture with Delaware North Companies to manage the Gideon Putnam Hotel and Resort in Saratoga Springs, NY; its interest in the proposed Capital View Casino & Resort in East Greenbush, NY; and SHRI's interest in a joint venture with Rush Street Gaming to build the proposed Hudson Valley Casino and Resort in Newburgh, NY.

In addition, the Company signed a five-year management agreement pursuant to which it will manage Saratoga Casino and Raceway, Saratoga Casino Black Hawk and, should the partnership obtain the license, the Capital View Casino & Resort. Both the funding of the equity investment and the commencement of the management agreement are subject to regulatory approval and licensing requirements in New York and Colorado.

Luckity ADW Operations

During October 2014, the Company decided to cease operations of Luckity, its ADW business which offers real-money bingo with outcomes based on and determined by pari-mutuel wagers on live horseraces. Management determined that Luckity did not achieve the expected financial returns and was unlikely to significantly improve its results. During the fourth quarter of 2014, the Company expects to record an impairment charge of approximately \$3.2 million for fixed assets specifically associated with Luckity. The Company does not expect to incur any additional, material expenditures in connection with ceasing operations.

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

Information set forth in this discussion and analysis contains various "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. The Private Securities Litigation Reform Act of 1995 (the "Act") provides certain "safe harbor" provisions for forward-looking statements. All forward-looking statements made in this Quarterly Report on Form 10-Q are made pursuant to the Act. The reader is cautioned that such forward-looking statements are based on information available at the time and/or management's good faith belief with respect to future events, and are subject to risks and uncertainties that could cause actual performance or results to differ materially from those expressed in the statements. Forward-looking statements speak only as of the date the statement was made. We assume no obligation to update forward-looking information to reflect actual results, changes in assumptions or changes in other factors affecting forward-looking information. Forward-looking statements are typically identified by the use of terms such as "anticipate," "believe," "could," "estimate," "expect," "intend," "may," "might," "plan," "predict," "project," "should," "will," and similar words, although some forward-looking statements are expressed differently.

Although we believe that the expectations reflected in such forward-looking statements are reasonable, we can give no assurance that such expectations will prove to be correct. Important factors that could cause actual results to differ materially from expectations include: the effect of global economic conditions, including any disruptions in the credit markets; a decrease in consumers' discretionary income; the effect (including possible increases in the cost of doing business) resulting from future war and terrorist activities or political uncertainties; the impact of increasing insurance costs; the impact of interest rate fluctuations; the financial performance of our racing operations; the impact of gaming competition (including lotteries, online gaming and riverboat, cruise ship and land-based casinos) and other sports and entertainment options in the markets in which we operate; our ability to maintain racing and gaming licenses to conduct our businesses; the impact of live racing day competition with other Kentucky, Illinois and Louisiana racetracks within those respective markets; the impact of higher purses and other incentives in states that compete with our racetracks; costs associated with our efforts in support of alternative gaming initiatives; costs associated with customer relationship management initiatives; a substantial change in law or regulations affecting pari-mutuel or gaming activities; a substantial change in allocation of live racing days; changes in Kentucky, Illinois or Louisiana law or regulations that impact revenues or costs of racing operations in those states; the presence of wagering and gaming operations at other states' racetracks and casinos near our operations; our continued ability to effectively compete for the country's horses and trainers necessary to achieve full field horse races; our continued ability to grow our share of the interstate simulcast market and obtain the consents of horsemen's groups to interstate simulcasting; our ability to enter into agreements with other industry constituents for the purchase and sale of racing content for wagering purposes; our ability to execute our acquisition strategy and to complete or successfully operate acquisitions and planned expansion projects including the effect of required payments in the event we are unable to complete acquisitions; our ability to successfully complete any divestiture transaction; market reaction to our expansion projects; the inability of our totalisator company, United Tote, to maintain its processes accurately, keep its technology current or maintain its significant customers; our accountability for environmental contamination; the inability of our Online Business to prevent security breaches within its online technologies; the loss of key personnel; the impact of natural and other disasters on our operations and our ability to obtain insurance recoveries in respect of such losses (including losses related to business interruption); our ability to integrate any businesses we acquire into our existing operations, including our ability to maintain revenues at historic or anticipated levels and achieve anticipated cost savings; the impact of wagering laws, including changes in laws or enforcement of those laws by regulatory agencies; the outcome of pending or threatened litigation; changes in our relationships with horsemen's groups and their memberships; our ability to reach agreement with horsemen's groups on future purse and other agreements (including, without limitation, agreements on sharing of revenues from gaming and advance deposit wagering); the effect of claims of third parties to intellectual property rights; and the volatility of our stock price. You should read this discussion in conjunction with the Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q and our Annual Report on Form 10-K for the year ended December 31, 2013 for further information, including Part I – Item 1A, "Risk Factors" of our Form 10-K for a discussion regarding some of the reasons that actual results may be materially different from those we anticipate.

Overview

We are a diversified provider of pari-mutuel horseracing, casino gaming, entertainment and online account wagering on horseracing events.

We operate in four operating segments as follows:

1. Racing Operations, which includes:

Churchill Downs Racetrack (“Churchill Downs”) in Louisville, Kentucky, an internationally known thoroughbred racing operation and home of the Kentucky Oaks and Kentucky Derby since 1875;

Arlington International Race Course (“Arlington”), a thoroughbred racing operation in Arlington Heights along with eleven off-track betting facilities (“OTBs”) in Illinois;

Calder Race Course (“Calder”), a thoroughbred racing operation in Miami Gardens, Florida which ceased pari-mutuel operations on July 1, 2014; and

Fair Grounds Race Course (“Fair Grounds”), a thoroughbred racing operation in New Orleans along with twelve OTBs in Louisiana.

2. Gaming, which includes:

Oxford Casino (“Oxford”) in Oxford, Maine, which operates approximately 860 slot machines, 26 table games and various dining facilities;

Riverwalk Casino Hotel (“Riverwalk”) in Vicksburg, Mississippi, which operates approximately 690 slot machines, 15 table games, a five story, 80-room attached hotel, a multi-functional event center and dining facilities;

Harlow’s Casino Resort & Spa (“Harlow’s”) in Greenville, Mississippi, which operates approximately 740 slot machines, 13 table games, a five story, 105-room attached hotel and dining facilities;

Calder Casino, a slot facility in Florida adjacent to Calder, which operates approximately 1,120 slot machines. Results for the three months ended September 30, 2013 and nine month periods presented included a poker room operation branded “Studz Poker Club,” which ceased operations on June 30, 2014;

Fair Grounds Slots, a slot facility in Louisiana adjacent to Fair Grounds, which operates approximately 620 slot machines;

Video Services, LLC (“VSI”), the owner and operator of approximately 690 video poker machines in Louisiana; and

Our equity investment in Miami Valley Gaming, LLC (“MVG”), a 50% joint venture harness racetrack and video lottery terminal facility in Lebanon, Ohio, which opened December 12, 2013. MVG has approximately 1,580 video lottery terminals, a racing simulcast center and a harness racetrack.

3. Online Business, which includes:

TwinSpires, an Advance Deposit Wagering (“ADW”) business that is licensed as a multi-jurisdictional simulcasting and interactive wagering hub in the state of Oregon;

Fair Grounds Account Wagering (“FAW”), an ADW business that is licensed in the state of Louisiana;

Velocity, a business that is licensed in the British Dependency Isle of Man focusing on high wagering-volume international customers;

Lucky, an ADW business that offers real-money bingo with outcomes based on and determined by pari-mutuel wagers on live horseraces which will cease operations during the fourth quarter of 2014;

Bloodstock Research Information Services (“BRIS”), a data service provider for the equine industry; and

Our equity investment in HRTV, LLC (“HRTV”), a horseracing television channel.

4. Other Investments, which includes:

United Tote Company and United Tote Canada (collectively “United Tote”), which manufacture and operate pari-mutuel wagering systems for racetracks, OTBs and other pari-mutuel wagering business;

Saratoga Harness Racing, Inc. (“SHRI”), a 50% joint venture to bid on the development and manage a destination casino and resort in the Capital Region of New York;

Bluff Media (“Bluff”), a multimedia poker content brand and publishing company; and

- Our other minor investments.

In order to evaluate the performance of these operating segments internally, we use Adjusted EBITDA (defined as earnings before interest, taxes, depreciation, amortization, insurance recoveries net of losses, Horse Racing Equity Trust Fund ("HRE Trust Fund") proceeds, share-based compensation expenses, pre-opening expenses, the impairment of assets and other charges or recoveries). Adjusted EBITDA also includes 50% of the operating income or loss of our joint venture, MVG. We believe that the use of Adjusted EBITDA as a key performance measure of the results of operations enables management and investors to evaluate and compare from period to period our operating performance in a meaningful and consistent manner.

During the three months ended March 31, 2014, we reclassified our equity investment in MVG from our Other Investments segment to our Gaming segment to coincide with the first full period of operations for the venture. MVG's results of operations for the three and nine months ended September 30, 2013 were reclassified to the Gaming segment.

During the nine months ended September 30, 2014, total handle for the pari-mutuel industry, according to figures published by Equibase, decreased 2.5%, compared to the same period of 2013. During the three months ended September 30, 2014, total handle for the pari-mutuel industry, according to figures published by Equibase, decreased 4.2%, compared to the same period of 2013. TwinSpire handle increased \$22.4 million, or 3.3%, during the nine months ended September 30, 2014. Excluding the impact from Illinois and Texas, handle increased 5.6%. TwinSpire handle decreased \$6.6 million, or 2.9%, during the three months ended September 30, 2014. Excluding the impact from Illinois and Texas, TwinSpire handle increased 3.0%.

On January 18, 2013, TwinSpire ceased accepting wagers from Illinois residents due to the expiration of legislation permitting ADW wagering in the state. On June 7, 2013, TwinSpire resumed accepting wagers from Illinois residents, and on January 29, 2014, the legislature approved a bill extending advance deposit wagering by Illinois residents through January 31, 2017. During the three and nine months ended September 30, 2014, handle wagered by Illinois residents increased \$0.5 million and \$30.2 million, respectively. As further discussed in Part II Item 1. Legal Proceedings, on September 25, 2013, we suspended wagering from all Texas accounts and returned deposited funds to Texas residents. During the three and nine months ended September 30, 2014, handle wagered by Texas residents decreased \$13.2 million and \$42.2 million, respectively.

Pari-mutuel handle from our Racing Operations decreased 15.8% during the nine months ended September 30, 2014, compared to the same period of 2013 and decreased 31.5% during the three months ended September 30, 2014, primarily due to the cessation of pari-mutuel operations at Calder on July 1, 2014, and from field-size challenges impacting business levels at our Churchill Downs and Arlington locations.

Our revenues and earnings are seasonal in nature, primarily due to our Racing Operations segment. Therefore, revenues and operating results for any interim quarter are generally not indicative of the revenues and operating results for the year and may not be comparable with results for the corresponding period of the previous year. For instance, we historically have had fewer live racing days during the first quarter of each year, and the majority of our live racing revenue occurs during the second quarter, with the running of the Kentucky Derby and the Kentucky Oaks. We conducted 65 live thoroughbred racing days during the third quarter of 2014, which compares to 104 live thoroughbred racing days during the third quarter of 2013. For the nine months ended September 30, 2014, we conducted 271 live thoroughbred racing days, which compares to 284 live racing days during the nine months ended September 30, 2013. Furthermore, gaming revenues and earnings have historically been higher during the first quarter due to seasonal revenues from our predominately southern gaming properties.

We believe that, despite uncertain economic conditions, we are in a strong financial position. As of September 30, 2014, there was \$410.6 million of borrowing capacity available under our Senior Secured Credit Facility. To date, we have not experienced any limitations in our ability to access this source of liquidity.

Recent Developments

Florida Pari-Mutuel Racing Operations

During 2013, Calder and Gulfstream Park began conducting concurrent live thoroughbred racing in certain months, leading to an overlapping of live racing resulting in direct competition for on-track horseracing, in the intrastate and interstate simulcast markets and for horses in South Florida. This negatively affected Calder's ability to achieve full field horseraces and to generate handle on live racing. Previously in Florida, a thoroughbred racetrack conducting a

live racing meet had control over hosting out-of-state signals, and received commissions on wagers placed at other racetracks throughout the state. There were instances where one or more thoroughbred racetracks operated live meets concurrently, and in that instance each racetrack had the opportunity to be a “host” track for out-of-state interstate horseracing signals. When two or more thoroughbred racetracks operated live meets concurrently, other wagering sites were required to select a live racetrack to host their pari-mutuel wagering. Three Florida thoroughbred racetracks, including Calder, have historically served as the host track based on their live racing calendar. On May 7, 2013, all of Florida’s three thoroughbred racetracks began claiming that they were host tracks on a year-round basis. On May 24, 2013, Calder filed a petition with the Florida Division of Administrative Hearings (the “DOAH”) challenging the other racetracks' interpretation that they may conduct interstate simulcasting, and whether that was a valid interpretation of state

law and the Interstate Horseracing Act of 1978. During 2013 and 2014, the DOAH and other state legislative bodies held public hearings and proposed modification to state laws without reaching a definitive resolution.

On July 1, 2014, we finalized an agreement with The Stronach Group ("TSG") under which TSG will operate, at TSG's expense, live racing and maintain certain facilities used for racing and training at Calder. The agreement, which expires on December 31, 2020, will involve a lease to TSG of Calder's racetrack and certain other racing and training facilities, including a portion of the barns on Calder's backside consisting of approximately 430 stalls. TSG will operate live horse racing at Calder, under Calder's racing permits, in compliance with all applicable laws and licensing requirements. TSG will operate and maintain the racing and training facilities at Calder on a year-round basis. Furthermore, TSG will be responsible for substantially all of the direct and indirect costs associated with these activities and receive the associated revenues. We will continue to own and operate the Calder Casino.

In addition, as part of the agreement, effective July 1, 2014, we amended Calder's agreement with the Florida Horsemen's Benevolent and Protective Association, Inc. ("FHBPA") which reduced the rate of non-stakes purse supplements payable by the Calder Casino from 12 percent to 10 percent of slot machine revenue. Finally, we modified our HRTV operating and ownership agreement with TSG which will result in the divestiture of the Company's interest in HRTV. We expect to complete the HRTV transaction during the first quarter of 2015.

As a result of the agreement with TSG, on July 1, 2014, we notified 214 Calder employees of the termination of their employment which occurred between July 8, 2014, and September 2, 2014. In accordance with the terms of a one-time benefit arrangement, we recognized \$2.3 million of severance and other benefit costs within selling, general and administrative expenses during the three months ended September 30, 2014. In addition, Calder recognized accelerated depreciation expense of approximately \$1.3 million related to Calder's barns, which are not expected to be utilized subsequent to December 31, 2014. We expect to recognize additional depreciation expense of approximately \$2.3 million during the three months ended December 31, 2014. During the fourth quarter of 2014, we will continue to assess potential alternative uses of our Calder facility not associated with the lease agreement.

Saratoga Harness Racing, Inc. ("SHRI") Ventures

SHRI Joint Venture

On May 13, 2014, we entered into a 50% joint venture with SHRI to bid on the development, construction and operation of the Capital View Casino & Resort located in the Capital Region near Albany, New York. On June 30, 2014, we filed an application with the New York State Facility Location Board to obtain a license to build and operate a facility with approximately 1,500 slot machines, 56 table games, a 100-room hotel and multiple entertainment and dining options. The expected cost of the project approximates \$330 million, which includes a \$50 million license fee. The joint venture anticipates funding a majority of the cost through project debt financing. We intend to fund our equity share of the joint venture from our Senior Secured Credit Facility. The joint venture is one of four remaining bidders competing for a license in the Capital Region of New York, and we expect, but cannot guarantee, that the state will award a license during the fourth quarter of 2014.

During the nine months ended September 30, 2014, we incurred \$0.8 million in equity losses in our other investments segment associated with the license application process and funded \$2.9 million to the joint venture. Should the joint venture be successful in obtaining the license for the Capital View Casino & Resort, we anticipate funding requirements of approximately \$1.0 million for our share of the joint venture's expenditures during the fourth quarter of 2014, when the winning bidder is expected to be announced.

Saratoga Harness Racing, Inc. Equity Investment and Management Agreement

On October 28, 2014, the Company signed a definitive purchase agreement to acquire a 25% ownership interest in Saratoga Casino Holdings, LLC ("SCH"), a newly formed entity which owns Saratoga Casino and Raceway in Saratoga Springs, NY; SHRI's controlling interest in Saratoga Casino Black Hawk in Black Hawk, CO; SHRI's 50% interest in a joint venture with Delaware North Companies to manage the Gideon Putnam Hotel and Resort in Saratoga Springs, NY; its interest in the proposed Capital View Casino & Resort in East Greenbush, NY; and SHRI's interest in a joint venture with Rush Street Gaming to build the proposed Hudson Valley Casino and Resort in Newburgh, NY.

In addition, the Company signed a five-year management agreement pursuant to which it will manage Saratoga Casino and Raceway, Saratoga Casino Black Hawk and, should the partnership obtain the license, the Capital View Casino & Resort. Both the funding of the equity investment and the commencement of the management agreement are

subject to regulatory approval and licensing requirements in New York and Colorado.

Luckity ADW Operations

During October 2014, we decided to cease operations of Luckity, our ADW business which offers real-money bingo with outcomes based on and determined by pari-mutuel wagers on live horseraces. We determined that Luckity did not achieve the expected financial returns and was unlikely to significantly improve its results. During the fourth quarter of 2014, we expect to record an impairment charge of approximately \$3.2 million for fixed assets specifically associated with Luckity.

We do not expect to incur any additional, material expenditures in connection with ceasing operations.

Legislative and Regulatory Changes

Federal

Federal Internet Gaming

On March 26, 2014, the Restoration of America's Wire Act ("S2159" and "HR4301") was introduced in the U.S. Senate and House of Representatives. The bill is crafted to reverse a 2011 decision by the Justice Department which interpreted the 1961 Wire Act to not apply to interstate transmissions of wire communications except when related to sports betting. As written, the bill would restore the interpretation of the Wire Act prior to the 2011 Justice Department decision and effectively prohibit online gaming. The legislation does not grandfather in states currently operating Internet gaming, but does allow for online wagering on horseracing placed in compliance with the Interstate Horseracing Act of 1978 to continue.

At this point, it is difficult to assess the probability of passage of proposed legislation at the federal level, the form of any final legislation, or its impact on our business, financial condition and results of operations.

Kentucky

Expanded Gaming Legislation

During January 2014, two House bills related to the authorization of expanded gaming in Kentucky were filed for consideration during the 2014 legislative session. House Bill 67, a proposed constitutional amendment, would have authorized casino gaming in the state and required a three-fifths majority vote in both chambers of the Kentucky General Assembly in order to appear before the voters on the November 2014 ballot. House Bill 68 would have created the Kentucky Gaming Commission to issue licenses and serve as the regulatory body for casino gaming; stipulated casino gaming may be conducted at the state's five existing racetracks as well as at three standalone locations; established a minimum \$50 million licensing fee; provided for the distribution of gaming revenues received by the state and would have required racetracks with a casino license to set aside 14.5 percent of gambling revenues for purses and breeders incentives as well as required these tracks to increase the number of live racing days by ten percent for the first five years of casino gaming licensure.

Senate Bill 33 was also filed during January 2014 and would have amended the Kentucky Constitution to allow up to seven casino locations in the state and would have created an Equine Excellence Fund, into which ten percent of gross gaming revenues would be directed. Senate Bill 33 failed to garner the required three-fifths majority vote in both chambers of the legislature in order to appear on the November 2014 ballot.

The 2014 session ended without consideration of any legislation related to expanded gaming in Kentucky. Should similar future legislation be enacted into law, it could have a material impact on our business, financial condition and results of operations.

Historical Racing Machines

During 2010, the Kentucky Horse Racing Commission ("KHRC") approved a change in state regulations that would allow racetracks to offer pari-mutuel Historical Racing Machines ("HRMs"), which base their payouts on the results of previously-run races at racetracks across North America. During 2012, Kentucky Downs Racetrack operated an HRM facility with approximately 275 HRMs and Ellis Park Racetrack opened a HRM facility with 177 HRMs. On April 4, 2013, the KHRC approved 40 additional HRMs for use at Kentucky Downs Racetrack.

Despite the approval by the KHRC, challenges remain as to the legality of the enacted regulations. A declaratory judgment action was filed in Franklin Circuit Court on behalf of the Commonwealth of Kentucky and all Kentucky racetracks to ensure proper legal authority. The Franklin Circuit Court entered a declaratory judgment upholding the regulations in their entirety. The intervening adverse party filed a notice of appeal, and the KHRC and the racetracks filed a motion to transfer that appeal directly to the Supreme Court of Kentucky. On April 21, 2011, the Supreme Court of Kentucky denied the request to hear the case before the appeal was heard by the Kentucky Court of Appeals. On September 1, 2011, the intervening adverse party filed an injunction action with the Kentucky Court of Appeals to grant emergency relief that would prevent Kentucky Downs Racetrack from operating its HRMs. The intervening adverse party's motions were denied by the Kentucky Court of Appeals. On June 15, 2012, the Kentucky Court of Appeals vacated the lower court's decision and remanded the declaratory judgment action back to the Franklin County Circuit Court. On July 16, 2012, the Kentucky racetracks, the KHRC and the Kentucky Department of Revenue filed motions for discretionary review with the Supreme Court of Kentucky asking the court to overturn the Kentucky

Court of Appeals' decision and address the merits of the case. On August 21, 2013, the Supreme Court of Kentucky heard oral arguments on the legality of HRMs. On February 20, 2014, the Supreme Court of Kentucky issued its ruling on the motions for discretionary review affirming, in part, and reversing, in part, the Kentucky Court of Appeals. In issuing its opinion, the Supreme Court of Kentucky held that the KHRC has the statutory authority to license and regulate the operation of pari-mutuel wagering on historic horse racing. The Supreme Court of Kentucky further held that the Kentucky Department of Revenue does not have the authority to collect excise tax on the wagering handle generated by historic horse racing. On the issue of whether the operation of wagering on historic horse

racetrack violates the gambling provisions of the Kentucky Penal Code, the Supreme Court of Kentucky remanded the case back to the Franklin County Circuit Court for further proceedings. On April 10, 2014, the Governor signed House Bill 445 into law. The legislation imposes a 1.5% tax on all handle wagered on historical races and will apply both retroactively and prospectively. At this time it is unclear the extent to which this issue will materially impact our business, financial condition and results of operations.

ADW Regulations

During April 2014, House Bill 445, which imposes a 0.5% tax on all ADW wagers made by Kentucky residents, was signed into law. The bill became effective on August 1, 2014. The bill is not expected to have a material negative impact on our business, financial condition and results of operations.

Illinois

Expanded Gaming Legislation

During the 2013 legislative session, Senate Bill 1739 ("SB 1739") was introduced in the Illinois General Assembly to expand casino gaming to Illinois racetracks and to add five additional casinos within the state, including one in Chicago with 4,000 gaming positions. SB1739 won approval in the Illinois Senate but was not considered by the House of Representatives. In March 2014, two amendments to SB 1739 were filed. One amendment provides for a Chicago casino with 4,000 to 10,000 gaming positions but does not include language for additional casinos in the state or gaming positions at racetracks. The second amendment would authorize five new casinos, including a Chicago casino with 4,000 to 6,000 gaming positions. Racetracks in Cook County, which includes Arlington, would be authorized to receive 600 gaming positions and most racetracks outside of Cook County would be eligible for 450 positions. In May 2014, an amendment was filed to SB 1739 authorizing 1,200 machines at Cook County racetracks and 900 machines for racetracks in other areas of the state, the same number of gaming positions currently provided for in SB 1739. The amendment does not address the authorization of additional casinos. SB 1739 remains pending in the House. If enacted, this proposed legislation could have a material effect on our business, financial condition and results of operations.

Florida

Expanded Gaming

In March 2014, House Bill 1383 was filed for consideration during the 2014 legislative session. The proposed bill would have created a new regulatory structure under a Gaming Control Commission. A similar proposal, Senate Bill 7052, which also aimed to restructure the state's existing gaming laws under a proposed Department of Gaming Control, would have allowed for two destination resort casinos in Miami-Dade and Broward counties. Constitutional amendments requiring voter approval for any additional gaming expansion to occur in the state were filed for consideration in both the House and Senate chambers. The 2014 legislative session concluded without consideration of any legislation related to expanded gaming. It is unclear to what extent similar future legislation could have on our business, financial condition and results of operations.

Maine

Expanded Gaming

On September 27, 2013, the Maine Gaming Study Commission, whose statutorily defined mission is to examine the state's existing gaming market as well as assess expansion opportunities, voted to recommend gaming be expanded beyond the current market. Subsequent to the vote, the Commission was disbanded by the Chairman. During January 2014, the Veterans and Legal Affairs Committee, the legislative committee of jurisdiction for gaming related issues, considered legislation that would allow for further gaming expansion to occur in Maine. The Committee voted to negatively recommend to the House and Senate each of the proposed expanded gaming bills with the exception of a bill that, if approved, will allow up to three slot machines in an estimated 40 veterans halls throughout the state. Ultimately, all legislation related to gaming expansion died in the Senate.

In April 2014, a proposal authorizing the state to hire a third-party to conduct a market analysis on the feasibility of expanded gaming in Maine was approved by the legislature. On August 31, 2014 the third-party study was released which concluded that Maine's current gaming market would allow for up to two additional casinos. According to the study, the market has additional capacity for one integrated dining, entertainment and gaming property in Southern Maine. The study further suggested that a fourth casino location would be possible near the Canadian border. Should gaming expansion occur in Maine it could negatively impact our business, financial condition and results of

operations.

Louisiana

Slot Machine Revenues

On April 1, 2014, House Bill 1223 ("HB 1223") was introduced for consideration by the Louisiana legislature. HB 1223 would have required 10% of net slot machine revenues after purse contributions and taxes to be used for capital improvement projects at Fair Grounds as a condition of slot machine licensure. Capital projects include improvements to the frontside, backside, grandstands, stables and racetrack surfaces. Under the terms of the legislation, proposed plans for capital improvements would be submitted to and approved by the Louisiana State Racing Commission ("LSRC"). When reviewing the proposed plans, the

24

LSRC would be directed to consider standards and technology features present at other racetracks comparable in historical significance to Fair Grounds. Certification of completion of the projects would be submitted to the Louisiana Gaming Control Board. On April 14, 2014, HB 1223 was passed by the Louisiana House of Representatives and referred to the Senate Judiciary B Committee where the legislation failed to progress and died in Committee. Should similar future legislation be enacted into law, it could have a material impact on our business, financial condition and results of operations.

Sweepstakes