CHURCHILL DOWNS INC
Form 10-Q
November 07, 2007

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(X) QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE

SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2007

OR

( ) TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE

SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission file number 0-1469

(Exact name of registrant as specified in its charter)

Kentucky (State or other jurisdiction of incorporation or organization)	61-0156015 (IRS Employer Identification No.)

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

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

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

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

Large accelerated filer [ ] Accelerated filer [X] Non-accelerated filer [ ]

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

The number of shares outstanding of registrant s common stock at November 2, 2007 was 13,687,407 shares.

CHURCHILL DOWNS INCORPORATED

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For the Quarter Ended September 30, 2007

PART I. **FINANCIAL INFORMATION**

ITEM 1. **FINANCIAL STATEMENTS**

CHURCHILL DOWNS INCORPORATED

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited) (in thousands)

	September 30, 2007	December 31, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	$ 15,599	$ 20,751
Restricted cash	12,396	12,704
Accounts receivable, net of allowance for doubtful accounts of $901 at September 30, 2007 and $757 at December 31, 2006	30,580	42,316
Deferred income taxes	6,270	6,274
Income taxes receivable	6,030	12,217
Other current assets	10,329	8,857
Assets held for sale	-	25,422
Total current assets	81,204	128,541
Plant and equipment, net	355,639	336,068
Goodwill	107,034	53,528
Other intangible assets, net	39,850	16,048
Other assets	15,568	12,143
Total assets	$ 599,295	$ 546,328
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 31,383	$ 21,476
Purses payable	15,211	18,128
Accrued expenses	38,032	40,781
Dividends payable	-	6,670
Deferred revenue	10,399	26,165
Liabilities associated with assets held for sale	-	13,671
Total current liabilities	95,025	126,891
Long-term debt	55,049	-
Convertible note payable, related party	14,129	13,393
Other liabilities	21,983	22,485
Deferred revenue	19,680	20,416
Deferred income taxes	13,406	13,064
Total liabilities	219,272	196,249
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; 13,683 shares issued September 30, 2007 and 13,420 shares issued December 31, 2006		137,254		128,937
Retained earnings		242,769		221,142
Total shareholders equity		380,023		350,079
Total liabilities and shareholders equity	$	599,295	$	546,328

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

CHURCHILL DOWNS INCORPORATED

CONDENSED CONSOLIDATED STATEMENTS OF NET EARNINGS

for the three and nine months ended September 30,

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

	Three Months Ended September 30, 2007	Three Months Ended September 30, 2006	Nine Months Ended September 30, 2007	Nine Months Ended September 30, 2006
Net revenues	$ 103,905	$ 97,046	$ 321,680	$ 296,401
Operating expenses	86,264	82,845	247,766	229,178
Selling, general and administrative expenses	13,009	10,820	35,903	33,208
Insurance recoveries, net of losses	-	(1,832)	(784)	(12,954)
Operating profit	4,632	5,213	38,795	46,969
Other income (expense):				
Interest income	163	244	828	549
Interest expense	(1,123)	(371)	(2,254)	(1,280)
Equity in loss of unconsolidated investments	(1,278)	(319)	(2,271)	(614)
Miscellaneous, net	484	437	2,977	1,423
	(1,754)	(9)	(720)	78
Earnings from continuing operations before provision for income taxes	2,878	5,204	38,075	47,047
Provision for income taxes	(1,741)	(2,339)	(15,906)	(19,294)
Net earnings from continuing operations	1,137	2,865	22,169	27,753
Discontinued operations, net of income taxes:				
(Loss) earnings from operations	(319)	1,685	(41)	(123)
Gain (loss) on sale of business	-	4,197	(182)	4,197
Net earnings	$ 818	$ 8,747	$ 21,946	$ 31,827
Net earnings per common share:				
Basic				
Net earnings from continuing operations	$ 0.08	$ 0.21	$ 1.60	$ 2.05
Discontinued operations	(0.02)	0.43	(0.02)	0.30
Net earnings	$ 0.06	$ 0.64	$ 1.58	$ 2.35
Diluted				
Net earnings from continuing operations	$ 0.08	$ 0.21	$ 1.59	$ 2.04
Discontinued operations	(0.02)	0.43	(0.01)	0.29
Net earnings	$ 0.06	$ 0.64	$ 1.58	$ 2.33
Weighted average shares outstanding				
Basic	13,509	13,149	13,436	13,116
Diluted	14,038	13,656	13,937	13,635

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

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CHURCHILL DOWNS INCORPORATED

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

for the nine months ended September 30,

(Unaudited) (in thousands)

	2007	2006
Cash flows from operating activities:		
Net earnings	$ 21,946	$ 31,827
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	16,759	15,670
Loss on sale of business	297	3,666
Equity in loss of unconsolidated investments	2,271	614
Unrealized gain on derivative instruments	(612)	(612)
Asset impairment loss	-	13,646
Share-based compensation	4,669	999
Gain on asset disposition	(1,763)	(13)
Other	806	316
Increase (decrease) in cash resulting from changes in operating assets and liabilities:		
Restricted cash	2,993	(11,775)
Accounts receivable	3,450	(4,673)
Other current assets	(1,035)	(5,222)
Accounts payable	2,382	242
Purses payable	(429)	12,287
Accrued expenses	(1,836)	5,950
Deferred revenue	(5,238)	(2,434)
Income taxes receivable	6,188	(1,382)
Other assets and liabilities	4,493	1,245
Net cash provided by operating activities	55,341	60,351
Cash flows from investing activities:		
Additions to plant and equipment	(37,548)	(35,393)
Acquisition of businesses	(79,338)	-
Proceeds from the sale of business, net of cash sold	(8,897)	(347)
Purchases of investments	(1,480)	-
Proceeds on sale of plant and equipment	2,975	15
Change in deposit wagering asset	(3,027)	-
Net cash used in investing activities	(127,315)	(35,725)
Cash flows from financing activities:		
Borrowings on bank line of credit	250,765	217,480
Repayments on bank line of credit	(190,566)	(233,082)
Change in book overdraft	2,670	(4,161)
Windfall tax benefit from share-based compensation	509	483
Payment of dividends	(6,670)	(6,520)
Common stock issued	3,140	3,549
Change in deposit wagering liability	(347)	-
Net cash provided by (used in) financing activities	59,501	(22,251)
Net (decrease) increase in cash and cash equivalents	(12,473)	2,375
Cash and cash equivalents, beginning of period	28,072	22,488
Cash and cash equivalents, end of period	15,599	24,863
Cash and cash equivalents included in assets held for sale	-	4,924
Cash and cash equivalents in continuing operations	$ 15,599	$ 19,939

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

CHURCHILL DOWNS INCORPORATED

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)

for the nine months ended September 30,

(Unaudited) (in thousands)

	2007	2006
Cash paid during the period for:		
Interest	$ 1,177	$ 858
Income taxes	$ 8,819	$ 13,244
Schedule of non-cash activities:		
Plant and equipment additions included in accounts payable/accrued expenses	$ 14	$ 1,483
Assignment of notes receivable	$ 4,000	-
Issuance of common stock with restricted stock plan	$ 8,278	$ 216
Assets acquired and liabilities assumed in acquisition of businesses:		
Accounts receivable, net	$ 4,164	-
Prepaid expenses	$ 152	-
Other non-current assets	$ 5	-
Plant and equipment	$ 848	-
Goodwill	$ 53,506	-
Other intangible assets	$ 25,000	-
Accounts payable	$ 4,144	-
Accrued expenses	$ 162	-
Deferred revenue	$ 31	-

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

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. **Basis of Presentation**

The accompanying Condensed Consolidated Financial Statements are presented in accordance with the requirements of the Quarterly Report on Form 10-Q and consequently do not include all of the disclosures normally required by accounting principles generally accepted in the United States of America or those normally made in Churchill Downs Incorporated s (the Company) Annual Report on Form 10-K. The year-end Condensed Consolidated Balance Sheet data was derived from audited financial statements but does not include all disclosures required by accounting principles generally accepted in the United States of America. Accordingly, the reader of this Quarterly Report on Form 10-Q should refer to the Company s Amended Annual Report on Form 10-K/A for the year ended December 31, 2006 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 and recurring nature.

The accompanying Condensed Consolidated Financial Statements include the accounts of the Company and its wholly owned subsidiaries, Churchill Downs California Company and Churchill Downs California Fall Operating Company, Calder Race Course, Inc. and Tropical Park, Inc. which hold licenses to conduct horse racing at Calder Race Course (Calder Race Course), Arlington Park Racecourse, LLC and Arlington Management Services, LLC (Arlington Park), Churchill Downs Louisiana Horseracing Company, L.L.C. (CDI Louisiana), Churchill Downs Louisiana Video Poker Company, L.L.C. (CD Louisiana Video) and its wholly owned subsidiary, Video Services, Inc. (VSI), collectively referred to as the Louisiana Operations, Churchill Downs Technology Initiatives Company (CDTIC), the owner and operator of TwinSpires.com, CDTIC Acquisition, LLC, Churchill Downs Management Company (CDMC), Churchill Downs Investment Company (CDIC) and Churchill Downs Simulcast Productions (CDSP). All significant intercompany balances and transactions have been eliminated in consolidation.

The Company s revenues and earnings are significantly influenced by its racing calendar. Therefore, revenues and operating results for any interim quarter are generally not indicative of the revenues and operating results for the year and may not be comparable with results for the corresponding period of the previous year. The Company conducts the majority of its live racing during the second, third and fourth quarters, including the running of the Kentucky Derby and the Kentucky Oaks during the second quarter, the quarter during which the Company typically generates the majority of its annual operating profit.

Comprehensive Earnings (Loss)

The Company had no other components of comprehensive earnings (loss) and, as such, comprehensive earnings is the same as net earnings as presented in the accompanying Condensed Consolidated Statements of Net Earnings.

2. **Acquisitions and New Ventures**

Slots Operations

Fair Grounds Race Course (Fair Grounds) previously received all statutory, regulatory and other authorizations to operate up to 700 slot machines in a permanent facility at the racetrack. On September 18, 2007, the Louisiana Gaming Control Board, upon the recommendation of the Louisiana State Police, approved the opening of the Fair Grounds temporary slots facility. The facility was opened to the public on September 21, 2007 with a total of 245 slot machines available. Upon commencement of the temporary slots facility, the Company was required to cease video poker operations at the on-site simulcast facility.

Also, in September, Fair Grounds resumed its phase one construction of its permanent facility that had been halted due to the damages to its facilities caused by Hurricane Katrina. The permanent facility is scheduled to be completed in late 2008.

Acquisitions Closed During the Second Quarter of 2007

On June 11, 2007, the Company completed its acquisition of certain assets of AmericaTab, Bloodstock Research Information Services (BRIS) and the Thoroughbred Sports Network (TSN) (collectively, ATAB and BRIS) for an aggregate purchase price of $80 million, plus potential earn-out payments of up to $7 million, which is based

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

upon the financial performance of the operations of the account wagering business during the five years ended June 30, 2012. The transaction includes the acquisition of the following account wagering platforms: winticket.com, BrisBet.com and TsnBet.com. Through these transactions, the Company has also acquired the operations of two industry-leading data services companies, BRIS and TSN, which produce handicapping and pedigree reports that are sold to racetracks, horse owners and breeders, horse players and racing-related publications. The primary reason for these acquisitions was to invest in assets with an expected yield on investment, as well as to enter one of the fastest growing segments of the pari-mutuel industry.

The acquisition of ATAB and BRIS were accounted for under the purchase method. Upon resolution of the aforementioned earn-out contingency payment, additional consideration will be recognized as goodwill. As of September 30, 2007, goodwill recorded in connection with the acquisition of ATAB and BRIS is included in the segment Other Investments. The Company engaged a third party specialist to perform a valuation of the acquired assets. The following table summarizes the preliminary estimated fair values of the assets acquired and liabilities assumed at the date of acquisition (in thousands). Such estimates are subject to refinement as additional valuation information is received.

	Total
Accounts receivable, net	$ 4,164
Prepaid expenses	152
Other assets	5
Plant and equipment	848
Goodwill	53,506
Other intangible assets	25,000
Total assets acquired	$ 83,675
Accounts payable	$ 4,144
Accrued expenses	162
Deferred revenue	31
Total liabilities acquired	$ 4,337
Net cash paid	$ 79,338

The fair value of other intangible assets consists of the following (in thousands):

Customer relationships	$ 8,000
Technology	4,000
Favorable contracts	10,000
Tradename	3,000
Total intangible assets	$ 25,000

Depreciation of plant and equipment acquired is calculated using the straight-line method over their estimated remaining useful lives as follows: 4 years for equipment and 2 to 3 years for furniture and fixtures. Amortization of intangible assets acquired is calculated using the straight-line method over their estimated useful lives as follows: 5 years for customer relationships, 7 years for technology and 14 years for favorable contracts. The tradename was determined to have an indefinite life and is not being amortized.

Pro Forma

The following table illustrates the effect on net revenues from continuing operations, net earnings from continuing operations, and net earnings from continuing operations per common share as if the Company had consummated the acquisition of ATAB and BRIS as of the beginning of each period presented. 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 ATAB and BRIS been consummated at the beginning of the respective periods.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

	Three Months Ended September 30,	Nine Months Ended September 30,	
	2006	2007	2006
Net revenues from continuing operations	$ 105,441	$ 347,458	$ 332,633
Net earnings from continuing operations	$ 3,399	$ 23,337	$ 29,574
Net earnings from continuing operations per common share:			
Basic	$ 0.25	$ 1.68	$ 2.18
Diluted	$ 0.25	$ 1.67	$ 2.17
Shares used in computing earnings from continuing operations per common share:			
Basic	13,149	13,436	13,116
Diluted	13,656	13,937	13,635

New Ventures

On May 2, 2007, the Company launched an account wagering platform called TwinsSpires.com, which offers racing fans the opportunity to wager on racing content owned by the Company and other content providers through pre-established accounts. The Company also entered into a definitive agreement on March 4, 2007 with Magna Entertainment Corporation (MEC) to form a venture, Tracknet Media Group, LLC (TrackNet), through which racing content of the Company and MEC will be made available to third parties, including racetracks, off-track betting facilities (OTBs), casinos and account wagering providers. TrackNet, in which the Company has a 50% interest, will also act as agent on behalf of the Company and MEC to purchase racing content that can be made available at the outlets of the Company and MEC for wagering purposes. On March 4, 2007, the Company also acquired a 50% interest in a venture, HRTV, LLC, that owns and operates a horse racing television channel, HRTV, previously wholly-owned by MEC. The Company s audio visual signal of its races will be distributed by HRTV through certain cable or satellite providers to homes. Finally, on March 4, 2007, the Company and MEC entered into a reciprocal content swap agreement to exchange racing content between each other. As a result of this agreement, the content of the Company and MEC will be available for wagering through the racetracks, OTBs and account wagering providers owned by each of the Company and MEC. With respect to the Company s account wagering racing content, the racing content of Calder Race Course will be available beginning in January 2008 when its agreement with Television Games Network (TVG) expires. As of September 30, 2007, the Company has made cash investments of $0.3 million and $0.8 million in TrackNet and HRTV, LLC, respectively.

3. Discontinued Operations

Sale of Hoosier Park, L.P.

On March 30, 2007, the Company completed the sale of its 62% ownership interest in Hoosier Park, L.P. (Hoosier Park) to Centaur Racing, LLC, a privately held, Indiana-based company. Hoosier Park owns the Anderson, Indiana racetrack and its three OTBs located in Indianapolis, Merrillville and Fort Wayne. Centaur had owned 38% of Hoosier Park since December 2001 and held options to purchase a greater stake in the track and its OTBs.

Sale of Stock of Racing Corporation of America (RCA)

On September 28, 2006, the Company completed the sale of all issued and outstanding shares of common stock of RCA, the parent company of Ellis Park Race Course (Ellis Park), to EP Acquisition, LLC pursuant to the Stock Purchase Agreement dated July 15, 2006.

Financial Information

In accordance with Statement of Financial Accounting Standards (SFAS) No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, the sold businesses have been accounted for as discontinued operations. Accordingly, the results of operations of the sold businesses for all periods presented and the gains

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(losses) on sold businesses have been classified as discontinued operations, net of income taxes, in the Condensed Consolidated Statements of Net Earnings. Set forth below is a summary of the results of operations of sold businesses for the three and nine months ended September 30, 2007 and 2006 (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	**2006**	**2007**	**2006**
Net revenues	$ -	$ 18,538	$ 7,789	$ 39,236
Operating expenses	463	15,304	6,883	36,779
Selling, general and administrative expenses	65	1,385	641	2,962
Insurance recoveries, net of losses	-	(1,293)	-	(1,367)
Operating (loss) profit	(528)	3,142	265	862
Other income (expense):				
Interest income	-	28	62	85
Interest expense	-	(155)	(157)	(428)
Miscellaneous, net	785	(21)	821	361
Other income (expense)	785	(148)	726	18
Earnings before provision for income taxes	257	2,994	991	880
Provision for income taxes	(576)	(1,309)	(1,032)	(1,003)
(Loss) earnings from operations	(319)	1,685	(41)	(123)
Gain (loss) on sale of business, net of income taxes	-	4,197	(182)	4,197
Net (loss) earnings	$ (319)	$ 5,882	$ (223)	$ 4,074

Set forth below is a summary of the assets held for sale, which relate to Hoosier Park, as of December 31, 2006 (in thousands):

	December 31, 2006
Current assets:	
Cash and cash equivalents	$ 7,321
Restricted cash	20
Accounts receivable, net	6,401
Other current assets	239
Plant and equipment, net	11,441
Assets held for sale	25,422
Current liabilities:	
Accounts payable	4,849
Purses payable	3,410
Accrued expenses	2,954
Long-term debt	6,022
Deferred income taxes	(3,564)
Liabilities associated with assets held for sale	13,671
Net assets held for sale	$ 11,751

4. **Goodwill Impairment Test**

Goodwill is tested for impairment on at least an annual basis or when a triggering event indicates an impairment may have occurred in accordance with SFAS No. 142, Goodwill and Other Intangible Assets. In assessing whether goodwill is impaired, the fair market value of the related reporting unit is compared to its carrying amount, including goodwill. If the carrying amount of the reporting unit exceeds its fair market value, the second step of the goodwill impairment test is performed to measure the amount of impairment loss, if any. The second step of the goodwill impairment test consists of comparing the implied fair value of reporting unit goodwill with the carrying amount of that goodwill. If the carrying amount of reporting unit goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized equal to such excess. The implied fair value of goodwill is determined in the same manner as when determining the amount of goodwill recognized in a business combination. The

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Company completed the required annual impairment tests of goodwill and indefinite lived intangible assets as of March 31, 2007, and no adjustment to the carrying value of these assets was required.

5. Income Taxes

In June 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109, Accounting for Income Taxes (FIN 48). FIN 48 addresses the determination of whether tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under FIN 48, the Company may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such a position should be measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. FIN 48 also provides guidance on derecognition, classification, interest and penalties on income taxes and accounting in interim periods. FIN 48 also requires increased disclosures.

The Company adopted the provisions of FIN 48 on January 1, 2007. The cumulative effect of adopting FIN 48 was an increase of $0.3 million to unrecognized tax benefits, and a corresponding decrease to retained earnings at January 1, 2007. The amount of unrecognized tax benefits at January 1, 2007 was $1.3 million, all of which would impact the Company s effective tax rate, if recognized. The Company does not anticipate any significant increase or decreases in unrecognized tax benefits during the next twelve months.

The Company recognizes interest accrued related to unrecognized tax benefits in interest expense and penalties in selling, general and administrative expenses in the Condensed Consolidated Statements of Net Earnings, which is consistent with the recognition of these items in prior reporting periods.

The Company s effective tax rate increased from 45% during the three months ended September 30, 2006 to 60% during the three months ended September 30, 2007 primarily due to the non-deductibility of legislative initiative costs recognized during 2007 as well as increased state income tax expense.

The U.S. federal statute of limitation remains open for the tax year 2004 and forward. State income tax returns are generally subject to examination for a period of three years after filing of the respective form.

6. Long-Term Debt

On May 2, 2007, we entered into Amendment No. 1 (the First Amendment) to the Amended and Restated Credit Agreement dated September 23, 2005 (the Agreement). The guarantors under the First Amendment continue to be a majority of our wholly-owned subsidiaries. The First Amendment primarily serves (i) to reduce the maximum aggregate commitment under the credit facility from $200 million to $120 million and

(ii) to reduce the interest rates applicable to amounts borrowed under this facility. Given the reduction in the maximum aggregate commitment, four lenders that were originally parties to the Agreement are removed as lenders under the terms of the First Amendment. The Company recognized a loss on extinguishment of debt in the amount of $0.4 million representing the write-off of unamortized deferred financing costs related to our previous credit facility during the second quarter of 2007. All other major terms of the Agreement remain the same including the facility termination date of September 23, 2010. Subject to certain conditions, the Company may at any time increase the aggregate commitment up to an amount not to exceed $170 million.

Generally, borrowings made pursuant to the First Amendment will bear interest at a LIBOR-based rate per annum plus an applicable percentage ranging from 0.50% to 1.50% depending on certain of the Company s financial ratios. In addition, under the First Amendment, the Company agreed to pay a commitment fee at rates that range from 0.10% to 0.25% of the available aggregate commitment, depending on the Company leverage ratio.

The First Amendment contains customary financial and other covenant requirements, including specific interest coverage and leverage ratios, as well as minimum levels of net worth. The First Amendment adds a negative covenant that imposes a $100 million cap on the amount of any investment that the Company may make to construct a gaming and/or slot machine facility in Florida in the event that laws in the state permit and the Company obtains authority to engage in such activities. The First Amendment also modifies two of the financial covenants, providing for a one-time increase in the maximum leverage ratio for a period of eight consecutive quarters in the event that the

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Company constructs a gaming and/or slot facility in Florida and increasing the baseline for the minimum consolidated net worth covenant from $190 million to $290 million.

7. Earnings Per Share

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
Numerator for basic net earnings from continuing operations per common share:				
Net earnings from continuing operations	$ 1,137	$ 2,865	$ 22,169	$ 27,753
Net earnings from continuing operations allocated to convertible note payable	(37)	(95)	(722)	(926)
Numerator for basic net earnings from continuing operations per common share	$ 1,100	$ 2,770	$ 21,447	$ 26,827
Numerator for basic net earnings per common share:				
Net earnings	$ 818	$ 8,747	$ 21,946	$ 31,827
Net earnings allocated to convertible note payable	(27)	(291)	(715)	(1,062)
Numerator for basic net earnings per common share	$ 791	$ 8,456	$ 21,231	$ 30,765
Numerator for diluted net earnings per common share:				
Net earnings from continuing operations	$ 1,137	$ 2,865	$ 22,169	$ 27,753
Discontinued operations, net of income taxes	(319)	5,882	(223)	4,074
Net earnings	$ 818	$ 8,747	$ 21,946	$ 31,827
Denominator for net earnings per common share:				
Basic	13,509	13,149	13,436	13,116
Plus dilutive effect of stock options	76	54	48	66
Plus dilutive effect of convertible note payable	453	453	453	453
Diluted	14,038	13,656	13,937	13,635
Net earnings per common share:				
Basic				
Net earnings from continuing operations	$ 0.08	$ 0.21	$ 1.60	$ 2.05
Discontinued operations	(0.02)	0.43	(0.02)	0.30
Net earnings	$ 0.06	$ 0.64	$ 1.58	$ 2.35
Diluted				
Net earnings from continuing operations	$ 0.08	$ 0.21	$ 1.59	$ 2.04
Discontinued operations	(0.02)	0.43	(0.01)	0.29
Net earnings	$ 0.06	$ 0.64	$ 1.58	$ 2.33

Options to purchase six thousand and two thousand shares for the three and nine months ended September 30, 2007, respectively, and options to purchase 69 thousand and 36 thousand shares for the three and nine months ended September 30, 2006, respectively, are excluded from the computation of earnings per common share assuming dilution because the options exercise prices were greater than the average market price of the common shares during the respective periods.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

8. Segment Information

The Company has determined that it currently operates in the following five segments: (1) Churchill Downs Racetrack, which includes its on-site simulcast facility and training facility; (2) Calder Race Course; (3) Arlington Park and nine OTBs; (4) Louisiana Operations, including Fair Grounds and its slot operations, its nine OTBs and Video Services Inc. (VSI); and (5) other investments, including Churchill Downs Simulcast Productions (CDSP), TwinSpires.com, ATAB and BRIS and the Company s various equity interests, including TrackNet, HRTV and Racing World Limited. Eliminations include the elimination of intersegment transactions.

The accounting policies of the segments are the same as those described in the Summary of Significant Accounting Policies in the Company s Amended Annual Report on Form 10-K/A for the year ended December 31, 2006. The Company uses revenues and EBITDA (defined as earnings before interest, taxes, depreciation and amortization) as key performance measures of results of operations for purposes of evaluating performance internally. Furthermore, the Company believes that the use of these measures enables management and investors to evaluate and compare from period to period, the Company s operating performance in a meaningful and consistent manner. Because the Company uses EBITDA as a key performance measure of financial performance, the Company is required by accounting principles generally accepted in the United States of America to provide the information in this footnote concerning EBITDA. However, these measures should not be considered as an alternative to, or more meaningful than, net earnings (loss) (as determined in accordance with accounting principles generally accepted in the United States of America) as a measure of the Company s operating results or operating cash flows (as determined in accordance with accounting principles generally accepted in the United States of America) as a measure of the Company s liquidity.

In connection with the formation of TrackNet, the Company s internal management reporting structure was adjusted to eliminate the segment formerly known as Churchill Downs Simulcast Network (CDSN). CDSN previously sold the racing signals of the racetracks owned by the Company for wagering and simulcast purposes, but this function will be performed by TrackNet going forward. Activity previously disclosed for CDSN for the three and nine months ended September 30, 2006 has been allocated to the other segments as follows (in thousands):

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

	Three Months Ended September 30, 2006	Nine Months Ended September 30, 2006
Net revenues from external customers:		
Churchill Downs Racetrack	$ 2,958	$ 24,225
Arlington Park	6,788	10,480
Calder Race Course	4,744	8,522
Louisiana Operations	-	1,820
Corporate	471	1,382
Discontinued operations	2,540	2,540
Total CDSN	$ 17,501	$ 48,969
Intercompany net revenues:		
Churchill Downs Racetrack	$ (2,234)	$ (18,290)
Arlington Park	(5,091)	(7,860)
Calder Race Course	(3,559)	(6,392)
Louisiana Operations	-	(1,365)
Discontinued operations	(1,923)	(1,923)
Eliminations	12,807	35,830
Total CDSN	$ -	$ -
Segment EBITDA and net earnings:		
Churchill Downs Racetrack	$ 725	$ 5,932
Arlington Park	1,697	2,620
Calder Race Course	1,186	2,130
Louisiana Operations	-	455
Corporate	225	260
Discontinued operations	617	617
Total CDSN	$ 4,450	$ 12,014

Total asset information previously disclosed for CDSN as of December 31, 2006 has been allocated to the other segments as follows (in thousands):

Total assets:	
Churchill Downs Racetrack	$ 1,327
Calder Race Course	9,691
Total CDSN	$ 11,018

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

The table below presents information about reported segments for the three and nine months ended September 30, 2007 and 2006 (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,
	2007	**2006**	