

CHURCHILL DOWNS INC  
Form 10-Q  
August 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 June 30, 2007**

**OR**

**o 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

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to such filing requirements for the past 90 days. Yes  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  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

The number of shares outstanding of registrant's common stock at August 2, 2007 was 13,649,929 shares.

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**CHURCHILL DOWNS INCORPORATED**  
**I N D E X TO QUARTERLY REPORT ON FORM 10-Q**  
**For the Quarter Ended June 30, 2007**

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

	<b>June 30, 2007</b>	<b>December 31, 2006</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 21,798	\$ 20,751
Restricted cash	3,073	12,704
Accounts receivable, net of allowance for doubtful accounts of \$754 at June 30, 2007 and \$757 at December 31, 2006	42,777	42,316
Deferred income taxes	6,274	6,274
Income taxes receivable	3,301	12,217
Other current assets	12,984	8,857
Assets held for sale	-	25,422
Total current assets	90,207	128,541
Plant and equipment, net	351,758	336,068
Goodwill	106,993	53,528
Other intangible assets, net	40,581	16,048
Other assets	16,926	12,143
Total assets	\$ 606,465	\$ 546,328
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 38,652	\$ 21,476
Purses payable	17,983	18,128
Accrued expenses	38,675	40,781
Dividends payable	-	6,670
Deferred revenue	9,726	26,165
Liabilities associated with assets held for sale	-	13,671
Total current liabilities	105,036	126,891
Long-term debt	69,024	13,393
Other liabilities	22,876	22,485
Deferred revenue	19,626	20,416
Deferred income taxes	13,064	13,064
Total liabilities	229,626	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; 13,650 shares issued June 30, 2007 and 13,420 shares issued December 31, 2006	134,888	128,937
Retained earnings	241,951	221,142
Total shareholders' equity	376,839	350,079
Total liabilities and shareholders' equity	\$ 606,465	\$ 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 six months ended June 30,

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Net revenues	\$ 169,933	\$ 163,262	\$ 217,775	\$ 199,355
Operating expenses	108,577	103,607	161,502	146,333
Gross profit	61,356	59,655	56,273	53,022
Selling, general and administrative expenses	13,069	11,620	22,894	22,387
Insurance recoveries, net of losses	-	(10,124)	(784)	(11,121)
Operating profit	48,287	58,159	34,163	41,756
Other income (expense):				
Interest income	393	222	665	305
Interest expense	(841)	(436)	(1,131)	(909)
Unrealized gain on derivative instruments	204	204	408	408
Miscellaneous, net	932	(65)	1,092	283
	688	(75)	1,034	87
Earnings from continuing operations before provision for income taxes	48,975	58,084	35,197	41,843
Provision for income taxes	(19,513)	(23,266)	(14,165)	(16,955)
Net earnings from continuing operations	29,462	34,818	21,032	24,888
Discontinued operations, net of income taxes:				
(Loss) earnings from operations	(143)	(1,465)	278	(1,808)
Loss on sale of business	-	-	(182)	-
Net earnings	\$ 29,319	\$ 33,353	\$ 21,128	\$ 23,080
Net earnings (loss) per common share:				
Basic				
Net earnings from continuing operations	\$ 2.12	\$ 2.57	\$ 1.52	\$ 1.84
Discontinued operations	(0.01)	(0.11)	0.01	(0.14)
Net earnings	\$ 2.11	\$ 2.46	\$ 1.53	\$ 1.70
Diluted				
Net earnings from continuing operations	\$ 2.12	\$ 2.56	\$ 1.52	\$ 1.83
Discontinued operations	(0.01)	(0.11)	-	(0.14)
Net earnings	\$ 2.11	\$ 2.45	\$ 1.52	\$ 1.69
Weighted average shares outstanding				
Basic	13,427	13,124	13,399	13,099
Diluted	13,903	13,623	13,886	13,624

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



## CHURCHILL DOWNS INCORPORATED

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
for the six months ended June 30,

(Unaudited) (in thousands)

	2007	2006
<b>Cash flows from operating activities:</b>		
Net earnings	\$ 21,128	\$ 23,080
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	10,619	10,573
Loss on sale of business	297	-
Equity in loss of unconsolidated investments	911	-
Unrealized gain on derivative instruments	(408)	(408)
Asset impairment loss	-	9,985
Share-based compensation	3,164	674
Gain on asset disposition	(1,699)	(5)
Other	744	211
Increase (decrease) in cash resulting from changes in operating assets and liabilities:		
Restricted cash	9,806	(5,736)
Accounts receivable	(11,232)	(10,767)
Other current assets	(3,689)	(6,489)
Accounts payable	11,589	13,756
Purses payable	2,342	12,763
Accrued expenses	(1,184)	4,556
Deferred revenue	(3,341)	(1,776)
Income taxes receivable	8,916	9,814
Other assets and liabilities	4,657	1,397
Net cash provided by operating activities	52,620	61,628
<b>Cash flows from investing activities:</b>		
Additions to plant and equipment	(27,675)	(24,165)
Acquisitions of businesses	(79,297)	-
Proceeds from sale of business, net of cash sold	(8,897)	-
Purchases of investments	(1,480)	-
Proceeds on sale of plant and equipment	2,320	7
Change in deposit wagering asset	(516)	-
Net cash used in investing activities	(115,545)	(24,158)
<b>Cash flows from financing activities:</b>		
Borrowings on bank line of credit	200,073	159,885
Repayments of bank line of credit	(139,923)	(171,772)
Change in book overdraft	-	(4,161)
Windfall tax benefit from share-based compensation	479	573
Payment of dividends	(6,670)	(6,520)
Common stock issued	2,307	2,023
Change in deposit wagering liability	385	-
Net cash provided by (used in) financing activities	56,651	(19,972)
Net (decrease) increase in cash and cash equivalents	(6,274)	17,498
Cash and cash equivalents, beginning of period	28,072	22,488
Cash and cash equivalents, end of period	21,798	39,986
Cash and cash equivalents included in assets held for sale	-	3,806
Cash and cash equivalents in continuing operations	\$ 21,798	\$ 36,180

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 six months ended June 30,

(Unaudited) (in thousands)

	2007	2006
<b>Cash paid during the period for:</b>		
Interest	\$ 502	\$ 754
Income taxes	\$ 4,123	\$ 6,019
<b>Schedule of non-cash activities:</b>		
Plant and equipment additions included in accounts payable/accrued expenses	\$ 5	\$ 1,453
Assignment of notes receivable	\$ 4,000	-
Issuance of common stock with restricted stock plan	\$ 7,844	\$ 216
<b>Assets acquired and liabilities assumed in acquisitions of businesses:</b>		
Accounts receivable, net	\$ 4,164	-
Prepaid expenses	\$ 152	-
Other non-current assets	\$ 5	-
Plant and equipment	\$ 848	-
Goodwill	\$ 53,465	-
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 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 Annual Report on Form 10-K 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 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 income.

**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**

**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 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 acquisitions 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. The following table summarizes the preliminary estimated fair values of the assets acquired and liabilities assumed at the date of acquisition. Such estimates are subject to refinement as additional valuation information is received.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)

	<b>Total</b>
Accounts receivable, net	\$ 4,164
Prepaid expenses	152
Other assets	5
Plant and equipment	848
Goodwill	53,465
Other intangible assets	25,000
<b>Total assets acquired</b>	<b>83,634</b>
Accounts payable	4,144
Accrued expenses	162
Deferred revenue	31
<b>Total liabilities acquired</b>	<b>4,337</b>
Net cash paid	\$ 79,297

Depreciation of plant and equipment acquired is calculated using the straight-line method over the estimated useful lives of the related assets as follows: 4 years for equipment and 2 to 3 years for furniture and fixtures. Amortization of other intangible assets acquired is calculated using the straight-line method over the estimated useful lives of the related intangible assets as follows: 5 years for customer relationships, 7 years for technology and 14 years for favorable contracts.

Pro Forma

The following table illustrates the effect on net revenues 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.

	<b>Unaudited Three months ended June 30, 2007</b>		<b>Six months ended June 30, 2007</b>	
	<b>2006</b>	<b>2006</b>	<b>2006</b>	<b>2006</b>
Net revenues from continuing operations	\$ 182,012	\$ 177,401	\$ 243,553	\$ 227,192
Net earnings from continuing operations	\$ 30,286	\$ 35,899	\$ 22,200	\$ 26,312
Earnings from continuing operations per common share				
Basic:				
Net earnings from continuing operations	\$ 2.18	\$ 2.64	\$ 1.60	\$ 1.94
Diluted:				
Net earnings from continuing operations	\$ 2.18	\$ 2.64	\$ 1.60	\$ 1.93
Shares used in computing earnings from continuing operations per common share:				
Basic	13,427	13,124	13,399	13,099
Diluted	13,903	13,623	13,886	13,624

New Ventures

On May 2, 2007, the Company launched an account wagering platform called www.twinspires.com, which offers racing fans the opportunity to wager on racing content owned by the Company and other content providers. 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, OTBs, casinos and account wagering providers.

TrackNet, in which the Company has a 50% interest, will also act as agent on behalf of the

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### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

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 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 Arlington Park and Calder Race Course will be available beginning in August 2007 and January 2008 when their respective agreements with Television Games Network ( TVG ) expire. As of June 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 (the Purchaser ) 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 (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 six months ended June 30, 2007 and 2006 (in thousands):

	Three months ended		Six months ended	
	June 30, 2007	2006	June 30, 2007	2006
Net revenues	\$ -	\$ 11,763	\$ 7,789	\$ 20,698
Operating expenses	21	12,330	6,419	21,475
Gross (loss) profit	(21 )	(567 )	1,370	(777 )
Selling, general and administrative expenses	26	811	576	1,577
Insurance recoveries, net of losses	-	-	-	(74 )
Operating (loss) income	(47 )	(1,378 )	794	(2,280 )
Other income (expense):				
Interest income	-	21	62	57
Interest expense	-	(143 )	(157 )	(273 )
Miscellaneous, net	101	78	36	382
Other income (expense)	101	(44 )	(59 )	166
Earnings (loss) before income taxes	54	(1,422 )	735	(2,114 )
(Provision) benefit for income taxes	(197 )	(43 )	(457 )	306
(Loss) earnings from operations	(143 )	(1,465 )	278	(1,808 )
Loss on sale of business, net of income taxes	-	-	(182 )	-
Net (loss) earnings	\$ (143 )	\$ (1,465 )	\$ 96	\$ (1,808 )



NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)

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

	<b>December 31, 2006</b>
<b>Current assets:</b>	
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
<b>Current liabilities:</b>	
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
<b>Net assets held for sale</b>	<b>\$ 11,751</b>

**4. Goodwill Impairment Test**

Goodwill is tested for impairment on an annual basis 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 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 goodwill 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, accounting in interim periods and 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 is \$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.





NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)

The U.S. federal statute of limitation remains open for the tax year 2003 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, we 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 our financial ratios. In addition, under the First Amendment, we agreed to pay a commitment fee at rates that range from 0.10% to 0.25% of the available aggregate commitment, depending on our 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 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.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)

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 June 30,		Six Months Ended June 30	
	2007	2006	2007	2006
Numerator for basic net earnings from continuing operations per common share:				
Net earnings from continuing operations	\$ 29,462	\$ 34,818	\$ 21,032	\$ 24,888
Net earnings from continuing operations allocated to participating securities	(961 )	(1,161 )	(687 )	(831 )
Numerator for basic net earnings from continuing operations per common share	\$ 28,501	\$ 33,657	\$ 20,345	\$ 24,057
Numerator for basic net earnings per common share:				
Net earnings	\$ 29,319	\$ 33,353	\$ 21,128	\$ 23,080
Net earnings allocated to participating securities	(956 )	(1,111 )	(690 )	(770 )
Numerator for basic net earnings per common share	\$ 28,363	\$ 32,242	\$ 20,438	\$ 22,310
Numerator for diluted net earnings per common share:				
Net earnings from continuing operations	\$ 29,462	\$ 34,818	\$ 21,032	\$ 24,888
Discontinued operations, net of income taxes	(143 )	(1,465 )	96	(1,808 )
Net earnings	\$ 29,319	\$ 33,353	\$ 21,128	\$ 23,080
Denominator for net earnings per common share:				
Basic	13,427	13,124	13,399	13,099
Plus dilutive effect of stock options	23	46	34	72
Plus dilutive effect of convertible note	453	453	453	453
Diluted	13,903	13,623	13,886	13,624
Earnings per common share:				
Basic				
Net earnings from continuing operations	\$ 2.12	\$ 2.57	\$ 1.52	\$ 1.84
Discontinued operations	(0.01 )	(0.11 )	0.01	(0.14 )
Net earnings	\$ 2.11	\$ 2.46	\$ 1.53	\$ 1.70
Diluted				
Net earnings from continuing operations	\$ 2.12	\$ 2.56	\$ 1.52	\$ 1.83
Discontinued operations	(0.01 )	(0.11 )	-	(0.14 )
Net earnings	\$ 2.11	\$ 2.45	\$ 1.52	\$ 1.69

Options to purchase 37 thousand and 19 thousand shares for the three and six months ended June 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 its nine off-track betting facilities ( OTBs ); (4) Louisiana Operations, including Fair Grounds Race Course ( Fair Grounds ), 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, which are not material. 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 Annual Report on Form 10-K 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.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)

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 six months ended June 30, 2006 has been allocated to the other segments as follows (in thousands):

	<b>Three Months Ended June 30, 2006</b>	<b>Six Months Ended June 30, 2006</b>
<b>Net revenues from external customers:</b>		
Churchill Downs Racetrack	\$ 21,267	\$ 21,267
Arlington Park	3,692	3,692
Calder Race Course	3,450	3,778
Louisiana Operations	-	1,820
Corporate	495	911
Total CDSN	\$ 28,904	\$ 31,468
<b>Intercompany net revenues:</b>		
Churchill Downs Racetrack	\$ (16,056 )	\$ (16,056 )
Arlington Park	(2,769 )	(2,769 )
Calder Race Course	(2,587 )	(2,833 )
Louisiana Operations	-	(1,365 )
Eliminations	21,412	23,023
Total CDSN	\$ -	\$ -
<b>Segment EBITDA and net loss:</b>		
Churchill Downs Racetrack	\$ 5,209	\$ 5,207
Arlington Park	923	923
Calder Race Course	862	944
Louisiana Operations	-	455
Corporate	11	35
Total CDSN	\$ 7,005	\$ 7,564

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

<b>Total assets:</b>	
Churchill Downs Racetrack	\$ 1,327
Calder Race Course	9,691
Total CDSN	\$ 11,018

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
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The table below presents information about reported segments for the three and six months ended June 30, 2007 and 2006 (in thousands):

	Three months ended June 30,		Six months ended June 30,	
	2007	2006	2007	2006
<b>Net revenues from external customers:</b>				
Churchill Downs Racetrack	\$ 91,550	\$ 90,093	\$ 94,846	\$ 93,331
Arlington Park	28,762	26,943	41,952	39,370
Calder Race Course	26,635	26,693	27,833	28,960
Louisiana Operations	18,834	18,679	48,313	35,752
Total racing operations	165,781	162,408	212,944	197,413
Other investments	3,642	288	3,763	743
Corporate	510	492	1,020	1,073
Net revenues from continuing operations	169,933	163,188	217,727	199,229
Discontinued operations	-	11,837	7,837	20,824
	\$ 169,933	\$ 175,025	\$ 225,564	\$ 220,053
<b>Intercompany net revenues:</b>				
Churchill Downs Racetrack	\$ 1,702	\$ 942	\$ 1,702	\$ 942
Arlington Park	256	195	256	195
Calder Race Course	183	155	190	162
Louisiana Operations	2	-	232	23
Total racing operations	2,143	1,292	2,380	1,322
Other investments	559	738	655	838
Eliminations	(2,702 )	(1,956 )	(2,987 )	(2,034 )
	-	74	48	126
Discontinued Operations	-	(74 )	(48 )	(126 )
	\$ -	\$ -	\$ -	\$ -
<b>Segment EBITDA and net earnings:</b>				
Churchill Downs Racetrack	\$ 46,302	\$ 43,978	\$ 40,576	\$ 37,877
Arlington Park	4,290	1,679	2,200	(273 )
Calder Race Course	3,294	3,718	722	395
Louisiana Operations	3,066	14,222	5,832	14,815
Total racing operations	56,952	63,597	49,330	52,814
Other investments	(939 )	381	(1,844 )	698
Corporate	(948 )	(1,083 )	(1,261 )	(1,715 )
Total EBITDA from continuing operations	55,065	62,895	46,225	51,797
Eliminations	-	145	57	168
Depreciation and amortization	(5,642 )	(4,742 )	(10,619 )	(9,518 )
Interest income (expense), net	(448 )	(214 )	(466 )	(604 )
Provision for income taxes	(19,513 )	(23,266 )	(14,165 )	(16,955 )
Net earnings from continuing operations	29,462	34,818	21,032	24,888
Discontinued operations, net of income taxes	(143 )	(1,465 )	96	(1,808 )
Net earnings	\$ 29,319	\$ 33,353	\$ 21,128	\$ 23,080

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)

The table below presents total asset information about reported segments (in thousands):

	June 30, 2007	December 31, 2006
<b>Total assets:</b>		
Churchill Downs Racetrack	\$ 286,000	\$ 442,724
Arlington Park	99,832	80,956
Calder Race Course	101,251	103,217
Louisiana Operations	89,710	98,053
Other investments	246,324	154,301
Assets held for sale	-	25,422
	823,117	904,673
Eliminations	(216,652 )	(358,345 )
	\$ 606,465	\$ 546,328

	Six Months Ended June 30, 2007	2006
<b>Capital expenditures:</b>		
Churchill Downs Racetrack	\$ 4,311	\$ 4,609
Arlington Park	16,298	1,305
Calder Race Course	1,235	7,019
Louisiana Operations	4,643	7,248
Hoosier Park	227	261
Ellis Park	-	3,485
Other investments	961	238
	\$ 27,675	\$ 24,165

**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 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; the effect (including possible increases in the cost of doing business) resulting from future war and terrorist activities or political uncertainties; the economic environment; the impact of increasing insurance costs; the impact of interest rate fluctuations; the effect of any change in our accounting policies or practices; the financial performance of our racing operations; the impact of gaming competition (including lotteries and riverboat, cruise ship and land-based casinos) and other sports and entertainment options in those markets in which we operate; the impact of live racing day competition with other Florida and Louisiana racetracks within those respective markets; 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 and gaming activities; a substantial change in allocation of live racing days; changes in Illinois law that impact revenues of racing operations in Illinois; the presence of wagering facilities of Indiana racetracks near our operations; our continued ability to effectively compete for the country's top horses and trainers necessary to field high-quality horse racing; our continued ability to grow our share of the interstate simulcast market; our ability to execute our acquisition strategy and to complete or successfully operate planned expansion projects; our ability to successfully complete any divestiture transaction; our ability to execute on our temporary and permanent slot facilities in Louisiana; market reaction to our expansion projects; the loss of our totalisator companies or their inability to provide us assurance of the reliability of their internal control processes through Statement on Auditing Standards No. 70 audits or to keep their technology current; the need for various alternative gaming approvals in Louisiana; our accountability for environmental contamination; the loss of key personnel; the impact of natural disasters, including Hurricanes Katrina, Rita and Wilma on our operations and our ability to adjust the casualty losses through our property and business interruption insurance coverage; any business disruption associated with a natural disaster and/or its aftermath; our ability to integrate businesses we acquire, including our ability to maintain revenues at historic levels and achieve anticipated cost savings; the impact of wagering laws, including changes in laws or enforcement of those laws by regulatory agencies; 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 the Company's Annual Report on Form 10-K for the year ended December 31, 2006 for further information, including Part I Item 1A for a discussion regarding some of the reasons that actual results may be materially different from those we anticipate, as modified by Part II Item 1A of this Quarterly Report on Form 10-Q.*

**Overview**

We conduct pari-mutuel wagering on live Thoroughbred horse racing and simulcast signals of races. Additionally, we offer racing services through our other interests as well as alternative gaming through video poker machines in Louisiana. Also, we are expected to commence slot machine operations in Louisiana during the second half of 2007.

We operate the Churchill Downs Racetrack in Louisville, Kentucky, which has conducted Thoroughbred racing since 1875 and is internationally known as the home of the Kentucky Derby. We also own and operate Arlington



Park, a Thoroughbred racing operation in Arlington Heights, Illinois; Calder Race Course, a Thoroughbred racing operation in Miami Gardens, Florida; Fair Grounds Race Course ( Fair Grounds ), a Thoroughbred racing operation in New Orleans, Louisiana; and Video Services Inc. ( VSI ), the owner and operator of more than 600 video poker machines in Louisiana. We conduct simulcast wagering on horse racing at 19 simulcast wagering facilities in Kentucky, Illinois and Louisiana, as well as at our four racetracks.

## Recent Developments

### Acquisitions

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. 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.

### New Ventures

On May 2, 2007, we launched an account wagering platform called www.twinspires.com, which offers racing fans the opportunity to wager on racing content owned by the Company and other sources. We 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 the racing content of the Company and MEC will be made available to third parties, including racetracks, OTBs, casinos and account wagering providers. TrackNet 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, we also acquired a 50% interest in a venture, HRTV, LLC, that owns and operates a horse racing television channel, HRTV, previously 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 Arlington Park and Calder Race Course will be available beginning in August 2007 and January 2008 when their respective agreements with Television Games Network ( TVG ) expire.

## Legislative and Regulatory Changes

### Federal

#### *WTO*

In 2003, the country of Antigua filed a formal complaint against the United States with the World Trade Organization ( WTO ), challenging the United States' ability to enforce certain Federal gaming laws (Sections 1084, 1952 and 1955 of Title 18 of the United States Code known as the Wire Act, the Travel Act and the Illegal Gambling Business Act, respectively, and collectively the Acts ) against foreign companies that were accepting Internet wagers from United States residents. At issue was whether the United States' enforcement of the Acts against foreign companies violated the General Agreement on Trade in Services ( GATS ). In November 2004, a WTO panel ruled that the United States, as a signatory of GATS, could not enforce the Acts against foreign companies that were accepting Internet wagers from United States residents. The United States appealed the ruling and, in April 2005, the WTO's appellate body ruled that the United States had demonstrated that the Acts were measures necessary to protect public morals or maintain public order, but that the United States did not enforce the Acts consistently between domestic companies and foreign companies as required by GATS. The WTO's appellate body specifically referenced the Interstate Horseracing Act ( IHA ), which appeared to authorize domestic companies to accept Internet wagers on horse racing, as being inconsistent with the United States' stated policy against Internet wagering. In arguments and briefs before the WTO's appellate body, the United States argued that the Acts, specifically the Wire Act, apply equally to domestic companies and foreign companies and the IHA does

not create an exception for domestic companies to accept Internet wagering on horse racing. The WTO's appellate body did not rule on whether an exception for domestic U.S. companies was created under the IHA, but recommended that the WTO's Dispute Settlement Body request the United States to bring measures found to be inconsistent with GATS into conformity with its obligations under GATS. The United States was given until April 3, 2006 to bring its policies in line with the ruling, assuming it believed any changes were necessary. On April 10, 2006, the United States delegation to the WTO submitted a brief report to the Chairman of the Dispute Settlement Body ( U.S. Report ) stating that no changes are necessary to bring U.S. policies in line with the ruling. In support of its position, the United States delegation informed the Dispute Settlement Body that on April 5, 2006, the United States Department of Justice confirmed the United States Government position regarding remote wagering on horse racing in testimony before a subcommittee of the United States House of Representatives. According to the U.S. Report, in that testimony, the Department of Justice stated its view that regardless of the IHA, existing criminal statutes prohibit the interstate transmission of bets or wagers, including wagers on horse racing, and informed the subcommittee that it is currently undertaking a civil investigation relating to a potential violation of law regarding this activity. On January 25, 2007, the WTO compliance panel issued its interim finding in response to the U.S. Report and found that the United States has failed to comply with previous WTO rulings regarding restrictions on access to the U.S. Internet gaming market. On March 30, 2007, the final report was issued upholding all lower panel decisions. On May 4, 2007, the United States Trade Representative (the USTR ) announced that it had initiated the formal process by the United States of withdrawing its GATS commitment to clarify an error that it had made in 1994 by including gambling services in its schedule of commitments. The USTR stated that the United States will use the WTO procedures for clarifying its commitments under the GATS. The USTR also stated that the United States intends to modify its services schedule by clearly defining gambling as an excluded commitment under the GATS. The result of withdrawal would be that the United States would not be obligated to provide foreign providers of gambling services access to the United States market. At this time, the only remaining issue before the WTO appears to be appropriate compensation to affected members of the treaty. The USTR has made no specific statement regarding how this will impact interstate gambling on horse racing. When the United States submits its proposed modification to the service schedule, we will be able to assess the impact, if any, on our business and results of operations. One of the options available to Congress and the White House is to prohibit or restrict substantially the conduct of interstate simulcast wagering or account wagering. If the U.S. government elects to take such an approach (including through any action by the Department of Justice), it will have a material, adverse impact on our business, financial condition and results of operations.

#### *Other Federal Legislation/Regulation*

On October 13, 2006, President Bush signed into law The Internet Gambling Prohibition and Enforcement Act of 2006. This act prohibits those involved in the business of betting or wagering from accepting any financial instrument, electronic or otherwise, for deposit that is intended to be utilized for unlawful Internet gambling. This act declares that nothing in the act may be construed to prohibit any activity allowed by the IHA. This act also contains a Sense of Congress which explicitly states that it is not intended to criminalize any activity currently permitted by federal law. The Secretary of the Treasury is directed to promulgate regulations to enforce the provisions of this act within 270 days. The Secretary is further directed to ensure the regulations do not prohibit any activity which is excluded from the definition of unlawful Internet gambling, including those activities legal under the IHA. The Treasury Department is currently gathering information for the promulgation of applicable regulations. We are working with other industry representatives to provide information to the Treasury Department. We will continue to urge that the Secretary of the Treasury adhere to the provisions of this act, which exclude horse racing from the definition of unlawful Internet gambling.

#### Florida

On November 2, 2004, Amendment 4, a slot machine question which sought to allow voters in Miami-Dade and Broward counties to hold local referenda on the issue, passed by a margin of 1.4%. On March 8, 2005, voters in Miami-Dade and Broward counties voted in separate local referenda to decide whether slot machines could be installed at the seven existing pari-mutuel sites in those counties, including Calder Race Course. Although the measure passed in Broward County, home of Gulfstream Park, it was unsuccessful in Miami-Dade County, where Calder Race Course is located. Slot machine gaming was approved by the Florida legislature during a special session of the Florida legislature on December 9, 2005. Slot operations are expected to commence in a staggered manner at Broward's four pari-mutuel wagering facilities. Gulfstream Park commenced slot operations in the fall of 2006. The remaining facilities are expected to commence slot operations in a staggered manner through 2008. On July 10, 2007, the Miami-Dade

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County Commission approved a second referendum for slot machines in local pari-mutuel facilities in Miami-Dade County. The referendum will take place on January 29, 2008, Florida's presidential primary date. We will support this referendum. We anticipate the cost of our support of the referendum to be \$3 million to \$5 million. In addition, a statewide initiative designed to lower property taxes will be on the ballot. The impact on our results of operations and financial position of the operation of slot machines at pari-mutuel wagering facilities in Broward County is uncertain at this time.

On August 8, 2006, the District Court of Appeals, First District, State of Florida rendered a decision in the case of Floridians Against Expanded Gambling (FAEG), et. al versus Floridians for a Level Playing Field, et. al. FAEG challenged the process by which signatures were collected in order to place a constitutional amendment on the ballot in 2004 allowing Miami-Dade and Broward County voters to approve slot machines in pari-mutuel facilities. The District Court of Appeals reversed a decision of the Florida trial court, which granted summary judgment and dismissed the challenge, and remanded the case back to the trial court for an evidentiary hearing to determine whether sufficient signatures were collected in the petition process. A motion for rehearing by the entire Court of Appeals or in the alternative a motion for certification to the Florida Supreme Court was filed. The case was re-heard by the entire Court of Appeals and the panel's decision was upheld. The question of law has been certified to the Florida Supreme Court, which has accepted jurisdiction. A decision is not expected until after oral arguments, which are scheduled to occur on September 17, 2007.

Legislation permitting an additional 500 slot machines (from 1,500 to 2,000) in Broward County, permitting ATM machines at the pari-mutuel facilities, and extending hours of operation became law in Florida in 2007. Should voters in Miami-Dade County approve slot machines at pari-mutuel facilities, the provisions of this legislation would apply to Calder Race Course. In addition, legislation allowing year-round operation of poker rooms and raising the maximum wager on poker from \$2 to \$5 successfully passed both chambers. At this time, it is unclear what impact this legislation will have on our results of operations.

### Illinois

Pursuant to the Illinois Horse Racing Act, Arlington Park and all other Illinois racetracks are permitted to receive a payment commonly known as purse recapture. Generally, in any year that wagering on Illinois horse races at Arlington Park is less than 75% of wagering both in Illinois and at Arlington Park on Illinois horse races in 1994, Arlington Park is permitted to receive 2% of the difference in wagering in the subsequent year. The payment is funded from the Arlington Park purse account. Under the Illinois Horse Racing Act, the Arlington Park purse account is to be repaid via an appropriation by the Illinois General Assembly from the Illinois General Revenue Fund. However, this appropriation has not been made since 2001. Subsequently, Illinois horsemen unsuccessfully petitioned the Illinois Racing Board (IRB) to prevent Illinois racetracks from receiving this payment in any year that the Illinois General Assembly did not appropriate the repayment to the racetrack's purse accounts from the General Revenue Fund. Further, the Illinois horsemen filed lawsuits seeking, among other things, to block payment to Illinois racetracks, as well as to recover the 2002 and 2003 amounts already paid to the Illinois racetracks. These lawsuits filed by the Illinois horsemen challenging the 2002 and 2003 reimbursements have been resolved in favor of Arlington Park and the other Illinois racetracks. Several bills were filed in the 2003, 2004 and 2005 sessions of the Illinois legislature that, in part, would eliminate the statutory right of Arlington Park and the other Illinois racetracks to continue to receive this payment. None of these bills passed. Since the statute remains in effect, Arlington Park continues to receive the recapture payment from the purse account. If Arlington Park loses the statutory right to receive this payment, there would be a material, adverse impact on Arlington Park's results of operations.

Under previously enacted legislation, the Illinois Horse Racing Equity fund was scheduled to receive a portion (up to 15% of adjusted gross receipts) of wagering tax from the tenth riverboat casino license issued. The grant of the tenth riverboat license is currently the subject of numerous legal and regulatory challenges and, as such, is currently not an operational riverboat license. The funds were scheduled to be utilized for purses and track discretionary spending. Because the tenth license has never been operational, the Illinois Horse Racing Equity fund has never had any funds to distribute.

In the Spring of 2006 session of the Illinois General Assembly, legislation was passed to create and fund the Horse Racing Equity Trust fund. The Horse Racing Equity Trust fund is to be funded from revenues of Illinois riverboat casinos that meet a certain threshold. Sixty percent of the funds is to be used for horsemen's purses (57% for thoroughbred meets and 43% for standardbred meets). The remaining 40% is to be distributed to racetracks (30.4%

of that total for Arlington Park) and is to be used for improving, maintaining, marketing and operating Arlington Park and may be used for backstretch services and capital improvements. The legislation expires two years after its immediate effective date. The governor of Illinois signed the legislation on May 26, 2006 as Public Act 94-0805.

In an effort to prevent implementation of Public Act 94-0805, the four Illinois riverboat casinos that meet the threshold to contribute to the Horse Racing Equity Trust fund filed a complaint on May 30, 2006 in the Circuit Court of Will County, Illinois. The complaint was filed against the State Treasurer and the IRB to enjoin the imposition and collection of the 3% surcharge from the casinos, which was to be deposited in the Horse Racing Equity Trust fund. The Will County Circuit Judge ruled in April 2007 that the law was unconstitutional as the law only affects the four suburban casinos and not the five downstate casinos. The Attorney General is filing an appeal of this ruling to the Illinois Supreme Court. The riverboats have been paying the monies into a special escrow account and have demanded that the monies not be distributed. A temporary restraining order was granted to prevent distribution of these monies. The complaint alleges that Public Act 94-0805 is unconstitutional. The Illinois Attorney General is representing Illinois on this matter, and the litigation is on going. As of the date of the filing of this Quarterly Report on Form 10-Q, management does not know the impact that the ultimate outcome of this matter will have on our consolidated financial position and results of operations.

Arlington Park will continue to seek authority to conduct alternative gaming at the racetrack. The 2007 session of the Illinois legislature is currently in extended session in an effort to enact a statewide budget. As part of the budget process, several alternative bills are being considered that could impact Arlington Park, including permitting slot machines at the racetracks, extension of the Horse Racing Equity Trust Fund and potentially a Chicago stand-alone casino. At this point, it is too early to determine whether those initiatives will be successful.

During January and February when there is no live racing in Illinois, the IRB designates a Thoroughbred racetrack as the host track in Illinois, for which the host track receives a higher percentage of earnings from pari-mutuel activity throughout Illinois. The IRB appointed Arlington Park the host track in Illinois during January of 2007 for 30 days, which is an increase of one day compared to the same period of 2006. In addition, Arlington Park was appointed the host track for 15 days in February of 2007, which is an increase of seven days compared to the same period of 2006. Arlington Park's future designation as the host track is subject to the annual designation by the IRB. A change in the number of days that Arlington Park is designated host track could have a material, adverse impact on our results of operations.

#### Kentucky

The Kentucky horse industry continues to seek legal authority to offer alternative forms of gaming at Kentucky's eight existing racetracks. Alternative forms of gaming would enable our Kentucky racetracks to better compete with neighboring gaming venues by providing substantial new revenues for purses and capital improvements. Several alternative gaming bills were filed in the 2006 and 2007 session of the Kentucky General Assembly. The Kentucky Equine Education Project (KEEP), an alliance of the Commonwealth's equine industry leaders, including our Company, supported legislation in 2006 that called for a statewide voter referendum in the Fall of 2006 to amend the State constitution to allow Kentucky's eight racetracks to offer full casino gaming. None of these bills were successful. Kentucky's gubernatorial election is slated for the fall of 2007. The incumbent republican Governor has made his opposition to expanded gaming a central theme of the early campaign. The democratic opponent has publicly stated his support for limited gaming at racetracks and a few other select locations as a key revenue enhancement strategy for Kentucky.

#### Louisiana

During 2005, Fair Grounds received all statutory, regulatory and other authorizations to operate up to 700 slot machines in a permanent facility at the racetrack. Under Louisiana law, Fair Grounds was allowed to operate 500 slot machines as of July 1, 2005 and an additional 200 slot machines once Harrah's Casino in New Orleans reached annual revenues of \$350 million. As a result of Hurricane Katrina, on August 29, 2005, the agreement between Harrah's Casino in New Orleans and the state of Louisiana was amended to conclude that Harrah's Casino in New Orleans attained the \$350 million revenue threshold and therefore allow Fair Grounds to operate 700 slot machines.

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Conforming legislation was passed in the 2006 legislative session to validate the amendment.

Fair Grounds has received the necessary regulatory approvals to operate a temporary slot machine venue offering up to 250 devices in the adjacent OTB while construction begins on the permanent facility. Approval of the temporary facility has been granted by the Louisiana Gaming Control Board and the Louisiana State Racing Commission. A zoning docket application allowing for the temporary slots venue has been filed with the New Orleans City Planning Commission and the New Orleans City Council. On April 19, 2007, both local government bodies voted in favor of approving the zoning application. On May 3, 2007, the City Council approved the ordinance and associated provisos which provide legality to the zoning application.

Upon commencement of the operation of slot machines at Fair Grounds, we are required to cease video poker operations at the on-site OTB. Failure to maintain the necessary gaming licenses to own and operate slot machines at Fair Grounds could have a material, adverse impact on our results of operations.

In April 2005, the New Orleans City Council instructed the city attorney to file a declaratory judgment action to determine if installation of slot machines at Fair Grounds would violate the City Charter. The Louisiana Attorney General has expressed an opinion that the addition of slot machines at the racetrack would not violate the City Charter. In June 2005, a resident living near Fair Grounds filed a lawsuit alleging, among other claims, that slot machines at the racetrack would be a violation of the City Charter, which limits New Orleans to one land-based casino. On October 22, 2006, the Court granted our motion to dismiss. The plaintiff has appealed the dismissal of the action, and the appeal is pending. Although we do not believe the installation of slot machines at Fair Grounds violates the City Charter, the outcome of the litigation is uncertain at this time.

Senate Bill No. 190, Act No. 469 ( SB 190 ) was signed into law by the Louisiana Governor on July 11, 2007 effective July 1, 2008. SB 190 changes the calculation of the video poker franchise tax from a tax based on gross revenues to a tax based on gross revenues less purse expenses. SB 190 will have a favorable impact on our video poker results of operations beginning July 1, 2008.

### Indiana

The 2007 Indiana General Assembly approved the operation of slot machines at Indiana's horse racetracks. Each racetrack is granted permission to operate up to 2,000 slot machines. In order to operate these slot machines, Hoosier Park will be required to invest \$100 million in capital improvements, pay a \$150 million licensing fee by November 1, 2007 and an additional \$100 million licensing fee by November 1, 2008. We completed the sale of our interest in Hoosier Park on March 30, 2007. As part of that agreement, the Company is entitled to payments of up to \$15 million once slot machines are operational. The Governor of Indiana signed this legislation into law, and Hoosier Park officials have indicated they intend to move forward with construction and operation of an appropriate slots facility.

### **Critical Accounting Policies**

Our Condensed Consolidated Financial Statements have been prepared in conformity with accounting principles generally accepted in the United States of America. Accordingly, we are required to make estimates, judgments and assumptions that we believe are reasonable based on our historical experience, contract terms, observance of known trends in our company and the industry as a whole, and information available from other outside sources. Our estimates affect the reported amounts of assets and liabilities and related disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from those initial estimates.

Our most significant estimates relate to the valuation of plant and equipment, receivables, goodwill and other intangible assets, which may be significantly affected by changes in the regulatory environment in which we operate, and to the aggregate costs for self-insured liability and workers' compensation claims. Additionally, estimates are used for determining income tax liabilities and other derivative instruments.

We evaluate our goodwill, intangible and other long-lived assets in accordance with the Statement of Financial Accounting Standards ( SFAS ) No. 142, Goodwill and Intangible Assets and SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. For goodwill and intangible assets, we review the carrying

values at least annually during the first quarter of each year or whenever events or changes in circumstances indicate that the carrying value of these assets may not be recoverable. We 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 goodwill was required. We assign estimated useful lives to our intangible assets based on the period of time the asset is expected to contribute directly or indirectly to future cash flows. We consider certain factors when assigning useful lives such as legal, regulatory, competition and other economic factors. Intangible assets with finite lives are amortized using the straight-line method.

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, accounting in interim periods and 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 is \$1.3 million, all of which would impact the Company's effective tax rate, if recognized.

### Results of Continuing Operations

The following table sets forth, for the periods indicated, certain operating data (in thousands, except per common share data and live race days):

	Three months ended June 30,		Change		
	2007	2006	\$	%	
Total pari-mutuel handle	\$ 1,093,195	\$ 1,112,258	\$ (19,063 )	(2 )	%
Number of live race days	127	132	(5 )	(4 )	%
Net pari-mutuel revenues	\$ 99,950	\$ 97,431	\$ 2,519	3	%
Other operating revenues	69,983	65,831	4,152	6	%
Total net revenues from continuing operations	\$ 169,933	\$ 163,262	\$ 6,671	4	%
Gross profit	\$ 61,356	\$ 59,655	\$ 1,701	3	%
Gross margin percentage	36	% 37	%		
Operating profit	\$ 48,287	\$ 58,159	\$ (9,872 )	(17 )	%
Net earnings from continuing operations	\$ 29,462	\$ 34,818	\$ (5,356 )	(15 )	%
Diluted net earnings from continuing operations per common share	\$ 2.12	\$ 2.56			

### Three Months Ended June 30, 2007 Compared to the Three Months Ended June 30, 2006

Our total net revenues increased \$6.7 million primarily as a result of the launch of twinspires.com and the acquisition of ATAB and BRIS. Revenues also increased due to increased admission and seating revenues associated with the 2007 Kentucky Derby and Kentucky Oaks. Further discussion of net revenue variances by our reported segments is detailed below.

**Consolidated Expenses**

The following table is a summary of our consolidated expenses (in thousands):

	Three months ended June 30,		Change		
	2007	2006	\$	%	
Purse expense	\$ 44,982	\$ 44,738	\$ 244	1	%
Depreciation and amortization	5,642	4,742	900	19	%
Other operating expenses	57,953	54,127	3,826	7	%
SG&A expenses	13,069	11,620	1,449	12	%
Insurance recoveries, net of losses	-	(10,124 )	10,124	100	%
Total	\$ 121,646	\$ 105,103	\$ 16,543	16	%
Percent of revenue	72	% 64			%

**Three Months Ended June 30, 2007 Compared to the Three Months Ended June 30, 2006**

Total expenses increased 16% during the three months ended June 30, 2007 primarily as a result of the recognition of insurance recoveries, net of losses of \$10.1 million related to Hurricanes Katrina and Wilma during the three months ended June 30, 2006. Expenses also increased due to the launch of twinspace.com and the acquisition of ATAB and BRIS during the three months ended June 30, 2007. Further discussion of expense variances by our reported segments is detailed below.

**Other Income (Expense) and Provision for Income Taxes**

The following table is a summary of our other income (expense) and provision for income taxes (in thousands):

	Three months ended June 30,		Change		
	2007	2006	\$	%	
Interest income	\$ 393	\$ 222	\$ 171	77	%
Interest expense	(841 )	(436 )	(405 )	(93 )	%
Unrealized gain on derivative instruments	204	204	-	-	%
Miscellaneous, net	932	(65 )	997	1,534	%
Other income (expense)	\$ 688	\$ (75 )	\$ 763	1,017	%
Provision for income taxes	\$ (19,513 )	\$ (23,266 )	\$ 3,753	16	%
Effective tax rate	40	% 40			%

**Three Months Ended June 30, 2007 Compared to the Three Months Ended June 30, 2006**

Significant items affecting the comparability of other income and expense and income tax benefit include:

- Interest expense increased during the three months ended June 30, 2007 primarily due to the recognition of 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 three months ended June 30, 2007.
- Miscellaneous income increased during the three months ended June 30, 2007 primarily as a result of a gain of \$1.7 million recognized related to the sale of a tract of land held by Arlington Park, which was partially offset by the performance of our investments in TrackNet and HRTV.





**Net Revenues By Segment**

The following table presents net revenues, including intercompany revenues, by our reported segments (in thousands):

	Three months ended June 30,		Change		
	2007	2006	\$	%	
Churchill Downs Racetrack	\$ 93,252	\$ 91,035	\$ 2,217	2	%
Arlington Park	29,018	27,138	1,880	7	%
Calder Race Course	26,818	26,848	(30 )	-	%
Louisiana Operations	18,836	18,679	157	1	%
Total racing operations	167,924	163,700	4,224	3	%
Other investments	4,201	1,026	3,175	309	%
Corporate revenues	510	492	18	4	%
Eliminations	(2,702 )	(1,956 )	(746 )	(38 )	%
	\$ 169,933	\$ 163,262	\$ 6,671	4	%

**Three Months Ended June 30, 2007 Compared to the Three Months Ended June 30, 2006**

Significant items affecting comparability of our revenues by segment include:

- Net revenues from other investments increased primarily as a result of the launch of twinspires.com and the acquisition of ATAB and BRIS during the three months ended June 30, 2007.
- Churchill Downs Racetrack revenues increased during the three months ended June 30, 2007 primarily as a result of increased prices in the 2007 Kentucky Derby and Kentucky Oaks seating as well as an increase in corporate hospitality areas.
- Arlington Park revenues increased, despite three fewer live race days, primarily as a result of increased pari-mutuel revenues. We experienced an increase in average starters per race, which we believe is partially attributable to the installation of a new Polytrack racing surface.

**Expenses by Segment**

The following table presents total expenses, including intercompany expenses, by our reported segments (in thousands):

	Three months ended June 30,		Change		
	2007	2006	\$	%	
Churchill Downs Racetrack	\$ 49,521	\$ 49,643	\$ (122 )	-	%
Arlington Park	27,304	26,166	1,138	4	%
Calder Race Course	24,081	23,927	154	1	%
Louisiana Operations	16,750	5,088	11,662	229	%
Total racing operations	117,656	104,824	12,832	12	%
Other investments	5,025	602	4,423	735	%
Corporate expenses	7,568	5,723	1,845	32	%
Eliminations	(8,603 )	(6,046 )	(2,557 )	(42 )	%
	\$ 121,646	\$ 105,103	\$ 16,543	16	%

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### Three Months Ended June 30, 2007 Compared to the Three Months Ended June 30, 2006

Significant items affecting comparability of our expenses by segment include:

- Louisiana Operations expenses increased primarily as a result of the recognition of insurance recoveries, net of losses of \$9.3 million related to Hurricane Katrina during the three months ended June 30, 2006.
- Other investments expenses increased during the three months ended June 30, 2007 primarily due to the launch of twinspires.com and the acquisition of ATAB and BRIS.
- Corporate expenses increased during the three months ended June 30, 2007 compared to the three months ended June 30, 2006 primarily as a result of increased share-based compensation costs, which are attributable to awards granted to the chief executive officer that were recently approved by shareholders at the Annual Meeting of Shareholders on June 28, 2007.

### Discontinued Operations

The following table presents losses from discontinued operations for the three months ended June 30, 2007 and 2006 (in thousands):

	<b>Three months ended June 30,</b>		<b>Change</b>			
	<b>2007</b>	<b>2006</b>	<b>\$</b>		<b>%</b>	
Net revenues	-	\$ 11,763	\$ (11,763 )		(100 )	)%
Operating expenses	\$ 21	12,330	(12,309 )		(100 )	)%
Gross loss	(21 )	(567 )	546		96	)%
Selling, general and administrative expenses	26	811	(785 )		(97 )	)%
Operating loss	(47 )	(1,378 )	1,331		97	)%
Other income (expense):						
Interest income	-	21	(21 )		(100 )	)%
Interest expense	-	(143 )	143		100	)%
Miscellaneous, net	101	78	23		29	)%
	101	(44 )	145		330	)%
Earnings (loss) before income taxes	54	(1,422 )	1,476		104	)%
Provision for income taxes	(197 )	(43 )	(154 )		(358 )	)%
Net loss	\$ (143 )	\$ (1,465 )	\$ 1,322		90	)%

Significant items affecting comparability of losses from discontinued operations include:

- The results of operations of discontinued operations for the three months ended June 30, 2007 include the results of operations of Hoosier Park compared to those of both Ellis Park and Hoosier Park for the three months ended June 30, 2006.

**Results of Continuing Operations**

The following table sets forth, for the periods indicated, certain operating data (in thousands, except per common share data and live race days):

	Six months ended June 30,		Change	
	2007	2006	\$	%
Total pari-mutuel handle	\$ 1,532,216	\$ 1,348,575	\$ 183,641	14 %
Number of live race days	187	146	41	28 %
Net pari-mutuel revenues	\$ 136,063	\$ 123,527	\$ 12,536	10 %
Other operating revenues	81,712	75,828	5,884	8 %
Total net revenues from continuing operations	\$ 217,775	\$ 199,355	\$ 18,420	9 %
Gross profit	\$ 56,273	\$ 53,022	\$ 3,251	6 %
Gross margin percentage	26	27		
		%		%
Operating profit	\$ 34,163	\$ 41,756	\$ (7,593 )	(18 )%
Net earnings from continuing operations	\$ 21,032	\$ 24,888	\$ (3,856 )	(15 )%
Diluted net earnings from continuing operations per common share	\$ 1.52	\$ 1.83		

Six Months Ended June 30, 2007 Compared to the Six Months Ended June 30, 2006

Our total net revenues increased \$18.4 million primarily as a result of 46 additional live racing days at Fair Grounds during the six months ended June 30, 2007 compared to the same period of 2006. Live racing returned to Fair Grounds in New Orleans in November 2006 following the shortened race meet that was conducted at Harrah's Louisiana Downs in the prior year and resulted in only 12 racing days during the six months ended June 30, 2006. Revenues also increased during the six months ended June 30, 2007 due to the launch of twinspires.com and the acquisition of ATAB and BRIS. Further discussion of net revenue variances by our reported segments is detailed below.

**Consolidated Expenses**

The following table is a summary of our consolidated expenses (in thousands):

	Six months ended June 30,		Change	
	2007	2006	\$	%
Purse expense	\$ 62,123	\$ 56,088	\$ 6,035	11 %
Depreciation and amortization	10,619	9,518	1,101	12 %
Other operating expenses	88,760	80,727	8,033	10 %
SG&A expenses	22,894	22,387	507	2 %
Insurance recoveries, net of losses	(784 )	(11,121 )	10,337	93 %
Total	\$ 183,612	\$ 157,599	\$ 26,013	17 %
Percent of revenue	84	79		
		%		%

Six Months Ended June 30, 2007 Compared to the Six Months Ended June 30, 2006

Total expenses increased 17% during the six months ended June 30, 2007 primarily as a result of 46 additional live racing days at Fair Grounds as well as a reduction in the recognition of insurance recoveries, net of losses of \$10.3 million related to Hurricanes Katrina and Wilma. Expenses also increased due to the launch of twinspires.com and the acquisition of ATAB and BRIS. Further discussion of expense variances by our reported segments is detailed below.



**Other Income (Expense) and Provision for Income Taxes**

The following table is a summary of our other income (expense) and provision for income taxes (in thousands):

	<b>Six months ended June 30,</b>		<b>Change</b>	
	<b>2007</b>	<b>2006</b>	<b>\$</b>	<b>%</b>
Interest income	\$ 665	\$ 305	\$ 360	118 %
Interest expense	(1,131 )	(909 )	(222 )	(24 )%
Unrealized gain on derivative instruments	408	408	-	-
Miscellaneous, net	1,092	283	809	286 %
Other income (expense)	\$ 1,034	\$ 87	\$	