CHURCHILL DOWNS Inc
Form 10-Q
April 26, 2017

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 March 31, 2017

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 001-33998

(Exact name of registrant as specified in its charter)

Kentucky	61-0156015
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
600 North Hurstbourne Parkway, Suite 400 Louisville, Kentucky 40222	(502) 636-4400
(Address of principal executive offices) (zip code)	(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer	x	Accelerated filer	o
Non-accelerated filer	o	Smaller reporting company	o
		Emerging growth company	o

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨

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 April 19, 2017 was 16,484,632 shares.

CHURCHILL DOWNS INCORPORATED
INDEX TO QUARTERLY REPORT ON FORM 10-Q
For the Quarter Ended March 31, 2017

PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS
CHURCHILL DOWNS INCORPORATED
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)

	Three Months Ended March 31,	
(in millions, except per common share data)	2017	2016
Net revenue:		
Racing	$23.9	$26.2
Casinos	87.5	86.5
TwinSpires	52.0	49.6
Big Fish Games	112.0	122.1
Other Investments	4.1	4.0
Total net revenue	279.5	288.4
Operating expense:		
Racing	36.4	35.6
Casinos	62.7	61.0
TwinSpires	36.4	34.6
Big Fish Games	86.9	109.4
Other Investments	3.9	3.9
Corporate	0.7	0.6
Selling, general and administrative expense	24.1	23.1
Research and development	10.3	10.8
Calder exit costs	0.4	0.4
Acquisition expenses, net	0.2	2.7
Total operating expense	262.0	282.1
Operating income	17.5	6.3
Other income (expense):		
Interest expense	(11.8)	(10.6)
Equity in income of unconsolidated investments	6.1	3.8
Miscellaneous, net	—	(0.5)
Total other expense	(5.7)	(7.3)
Income (loss) from operations before provision for income taxes	11.8	(1.0)
Income tax (provision) benefit	(4.5)	3.8
Net income	$7.3	$2.8
Net income per common share data:		
Basic net income	$0.44	$0.17
Diluted net income	$0.44	$0.16
Weighted average shares outstanding:		
Basic	16.3	16.5
Diluted	16.8	17.0
Other comprehensive loss:		
Foreign currency translation, net of tax	(0.1)	—
Other comprehensive loss	(0.1)	—
Comprehensive income	$7.2	$2.8

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

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CHURCHILL DOWNS INCORPORATED
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

(in millions)	March 31, 2017	December 31, 2016
ASSETS		
Current assets:		
Cash and cash equivalents	$54.9	$ 48.7
Restricted cash	25.0	34.3
Accounts receivable, net of allowance for doubtful accounts of $3.8 at March 31, 2017 and $3.5 at December 31, 2016	62.3	81.4
Receivable from escrow	3.5	13.6
Income taxes receivable	1.0	7.6
Game software development, net	8.9	9.6
Other current assets	57.7	50.8
Total current assets	213.3	246.0
Property and equipment, net	590.7	574.4
Game software development, net	8.1	6.3
Investment in and advances to unconsolidated affiliates	164.7	139.1
Goodwill	832.2	832.2
Other intangible assets, net	435.4	445.7
Other assets	11.7	10.7
Total assets	$2,256.1	$ 2,254.4
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$56.1	$ 53.2
Purses payable	9.5	12.5
Account wagering deposit liabilities	21.5	25.0
Accrued expense	92.4	100.1
Deferred revenue - Big Fish Games	80.2	81.3
Deferred revenue - all other	85.2	64.3
Big Fish Games deferred payment, current	28.0	27.8
Big Fish Games earnout liability, current	33.7	67.9
Current maturities of long-term debt	15.3	14.2
Dividends payable	—	21.8
Total current liabilities	421.9	468.1
Long-term debt (net of current maturities and loan origination fees of $0.5 at both March 31, 2017 and December 31, 2016)	358.0	312.8
Notes payable (including premium of $2.4 at March 31, 2017 and $2.5 at December 31, 2016 and net of debt issuance costs of $7.4 at March 31, 2017 and $7.8 at December 31, 2016)	595.0	594.7
Deferred revenue - all other	24.5	24.4
Deferred income taxes	150.3	153.1
Other liabilities	17.5	16.3
Total liabilities	1,567.2	1,569.4
Commitments and contingencies		
Shareholders' equity:		
Preferred stock, no par value; 0.3 shares authorized; no shares issued	—	—
Common stock, no par value; 50.0 shares authorized; 16.5 shares issued at March 31, 2017 and at December 31, 2016	113.2	116.5

Retained earnings	577.0	569.7
Accumulated other comprehensive loss	(1.3)	(1.2)
Total shareholders' equity	688.9	685.0
Total liabilities and shareholders' equity	$2,256.1	$ 2,254.4

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
(Unaudited)

	Three Months Ended March 31,	
(in millions)	2017	2016
Cash flows from operating activities:		
Net income	$7.3	$2.8
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	24.5	27.0
Game software development amortization	4.4	3.7
Acquisition expenses, net	0.2	2.7
Distributed earnings from equity investments	4.3	4.0
Earnings from equity investments, net	(6.1)	(3.8)
Stock-based compensation	4.9	4.1
Big Fish Games earnout payment	(2.5)	(19.7)
Other	0.3	0.7
Increase (decrease) in cash resulting from changes in operating assets and liabilities, net of business acquisitions and dispositions:		
Other current assets and liabilities	(5.2)	0.3
Game software development	(5.3)	(4.2)
Income taxes	6.6	(5.7)
Deferred revenue	42.4	53.9
Other assets and liabilities	(1.2)	0.8
Net cash provided by operating activities	74.6	66.6
Cash flows from investing activities:		
Capital maintenance expenditures	(10.2)	(7.9)
Capital project expenditures	(27.3)	(8.5)
Receivable from escrow	10.1	—
Investment in unconsolidated affiliates	(24.0)	—
Proceeds from sale of equity investment	—	1.4
Net cash used in investing activities	(51.4)	(15.0)
Cash flows from financing activities:		
Borrowings on bank line of credit	239.1	292.1
Repayments of bank line of credit	(192.7)	(87.0)
Big Fish Games earnout payment	(31.7)	(261.9)
Payment of dividends	(21.8)	(19.1)
Repurchase of common stock	(8.6)	(0.8)
Common stock issued	0.1	—
Loan origination fees and debt issuance costs	—	(1.4)
Other	(1.4)	3.0
Net cash used in financing activities	(17.0)	(75.1)
Net increase (decrease) in cash and cash equivalents	6.2	(23.5)
Effect of exchange rate changes on cash	—	0.1
Cash and cash equivalents, beginning of period	48.7	74.5
Cash and cash equivalents, end of period	$54.9	$51.1

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

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

(in millions)	Three Months Ended March 31, 2017	2016
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	$2.6	$1.1
Income taxes	$0.3	$2.2
Schedule of non-cash investing and financing activities:		
Issuance of common stock in connection with the Company's restricted stock plans	$18.2	$16.6
Repurchase of common stock in payment of income taxes on stock-based compensation	$—	$4.0

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

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. DESCRIPTION OF BUSINESS

Basis of Presentation

The Churchill Downs Incorporated (the "Company", "we", "us", "our") financial statements are presented in conformity with the requirements of this Quarterly Report on Form 10-Q and consequently do not include all of the disclosures normally required by U.S. generally accepted accounting principles ("GAAP") or those normally made in our 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 GAAP.

The following information is unaudited. Tabular dollars are in millions, except as otherwise noted. All per share amounts assume dilution unless otherwise noted. This report should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2016.

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

Our critical accounting policies are revenue recognition, goodwill and indefinite intangible assets, property and equipment and income taxes. Our significant accounting policies are more fully described in Note 2 to the Consolidated Financial Statements included in Item 8. "Financial Statements and Supplementary Data" of our Annual Report on Form 10-K for the year ended December 31, 2016.

Seasonality

Racing

Due to the seasonal nature of our live racing business, revenue 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. Historically, we have had fewer live racing days during the first quarter of each year, and the majority of our live racing revenue occurs during the second quarter, with the running of the Kentucky Derby and the Kentucky Oaks. We conducted 55 live thoroughbred race days in the first quarter 2017 and 54 live thoroughbred race days in the first quarter of 2016.

Casinos

Revenue from our casino properties have a seasonal component and are typically higher during the first and second quarters.

TwinSpires

Due to the seasonal nature of the racing business, revenue 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. Historically, our revenue is higher in the second quarter with the running of the Kentucky Derby and the Kentucky Oaks.

Big Fish Games

Revenue from our Big Fish Games, Inc. ("Big Fish Games") segment also have a seasonal component and are typically lower during the summer months.

2. RECENT ACCOUNTING PRONOUNCEMENTS

In January 2017, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) ASU No. 2017-04, Intangibles - Goodwill and Other: Simplifying the Test for Goodwill Impairment. This new guidance simplifies the accounting for goodwill impairments by removing step two from the goodwill impairment test. Instead, if the carrying amount of a reporting unit exceeds its fair value, an impairment loss shall be recognized in an amount equal to that excess. The new guidance is effective in 2020 with early adoption permitted for any goodwill impairment test performed between January 1, 2017 and January 1, 2020. We are assessing the impact of the new accounting guidance and currently cannot estimate the financial statement impact of adoption.

In January 2017, the FASB issued ASU No. 2017-01, Business Combinations: Clarifying the Definition of a Business, in an effort to clarify the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The guidance will become effective in 2018. We will assess the impact of the new accounting guidance as necessary for future transactions.

In November 2016, the FASB issued ASU No. 2016-18, Statement of Cash Flows: Restricted Cash. The new standard requires that the statement of cash flows explain the change during the period of cash, cash equivalents, and amounts generally described

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

as restricted cash. Entities will also be required to reconcile to the balance sheet and disclose the nature of the restrictions. The guidance will become effective in 2018. While we are continuing to assess all potential impacts of the standard, we believe the most significant impact relates to the presentation of our statement of cash flows where we will be required to reconcile to total cash, cash equivalents, and restricted cash. Currently, our statement of cash flows reconciles to total cash and cash equivalents.

In August 2016, the FASB issued ASU No. 2016-15, Statement of Cash Flows: Classification of Certain Cash Receipts and Cash Payments. The new guidance is intended to reduce diversity in practice in how certain transactions are classified in the statement of cash flows. The guidance will become effective in 2018. We are assessing the impact of the new accounting guidance and currently cannot estimate the financial statement impact of adoption.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments - Credit Losses, which introduces a new model for recognizing credit losses on financial instruments based on an estimate of current expected credit losses. The new model will apply to: (1) loans, accounts receivable, trade receivables, and other financial assets measured at amortized cost, (2) loan commitments and certain other off-balance sheet credit exposures, (3) debt securities and other financial assets measured at fair value through other comprehensive income, and (4) beneficial interests in securitized financial assets. The guidance will become effective in 2020. We are assessing the impact of the new accounting guidance and currently cannot estimate the financial statement impact of adoption.

In February 2016, the FASB issued ASU No. 2016-02, Leases, which requires companies to generally recognize on the balance sheet operating and financing lease liabilities and corresponding right-of-use assets. ASU 2016-02 is effective in our first quarter of fiscal 2019 on a modified retrospective basis and earlier adoption is permitted. We are currently evaluating the impact of our pending adoption of ASU 2016-02 on our Condensed Consolidated Financial Statements, and we currently expect that most of our operating lease commitments will be subject to the new standard and recognized as operating lease liabilities and right-of-use assets upon our adoption of ASU 2016-02.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers, which provides a five-step analysis of transactions to determine when and how revenue is recognized. The core principle is that a company should recognize revenue in a manner that depicts the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The revised guidance will become effective in 2018 and will be applied retrospectively to each period presented or as a cumulative-effect adjustment as of the date of adoption. During 2016, the FASB issued ASU No. 2016-08, Revenue from Contracts with Customers: Principal versus Agent Considerations (Reporting Revenue Gross versus Net); ASU No. 2016-10, Revenue from Contracts with Customers: Identifying Performance Obligations and Licensing; and ASU No. 2016-12, Revenue from Contracts with Customers: Narrow-Scope Improvements and Practical Expedients; which clarified the guidance on certain items such as reporting revenue gross versus net and presentation of sales tax, among other things. While we are continuing to assess all potential impacts of the new standard, we believe the most significant impact primarily relates to our accounting for breakage revenue for our outstanding premium game club credits for Big Fish Games. Currently, we record breakage revenue for our outstanding premium game credits when the credits have legally expired. Under the new standard, we will be required to recognize the expected breakage related to our outstanding premium game club credits as revenue in proportion to the pattern of game club credits redeemed by our customers. We anticipate this standard may have a material impact on our Condensed Consolidated Financial Statements.

3. RECEIVABLE FROM ESCROW

On November 8, 2016, we established a $14.0 million qualified intermediary trust with a portion of the proceeds from the sale of excess land at Calder Race Course ("Calder") to be used to purchase previously identified real property within six months post closing. As of March 31, 2017, we had a receivable from escrow of $3.5 million from the qualified intermediary trust, which is included in our accompanying Condensed Consolidated Balance Sheets, compared to $13.6 million at December 31, 2016.

4. INVESTMENTS IN AND ADVANCES TO UNCONSOLIDATED AFFILIATES

Miami Valley Gaming

We acquired a 50% joint venture in Miami Valley Gaming ("MVG"), which has a harness racetrack and video lottery terminal ("VLT") gaming facility in Lebanon, Ohio, with Delaware North Companies Gaming & Entertainment Inc. ("DNC") in 2012. Total consideration was $60.0 million, of which $10.0 million was funded at closing with the remainder funded through a $50.0 million note payable with a six year term effective upon the commencement of gaming operations.

Since both we and DNC have participating rights over MVG, and both must consent to MVG's operating, investing and financing decisions, we account for MVG using the equity method of accounting.

The joint venture's long-term debt consists of a $50.0 million secured note payable quarterly over 6 years through November 2019 at a 5.0% interest rate for which it has funded $27.1 million in principal repayments. We received distributions from MVG totaling $4.0 million for each of the three months ended March 31, 2017 and March 31, 2016.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Summarized below is financial information for our equity investment:

	Three Months Ended March 31,	
(in millions)	2017	2016
Casino revenue	$39.3	$36.0
Non-casino revenue	2.1	2.0
Net revenue	41.4	38.0
Operating and SG&A expense	28.6	26.8
Depreciation & amortization	3.1	3.2
Operating income	9.7	8.0
Interest and other expense, net	(0.7)	(0.9)
Net income	$9.0	$7.1

(in millions)	March 31, 2017	December 31, 2016
Assets		
Current assets	$ 18.6	$ 18.7
Property and equipment, net	107.3	109.8
Other assets, net	105.0	105.0
Total assets	$ 230.9	$ 233.5
Liabilities and Members' Equity		
Current liabilities	$ 10.6	$ 12.5
Current portion of long-term debt	8.3	8.3
Long-term debt, excluding current portion	12.3	14.0
Other liabilities	0.1	0.1
Members' equity	199.6	198.6
Total liabilities and members' equity	$ 230.9	$ 233.5

Our Condensed Consolidated Statements of Comprehensive Income include our 50% share of MVG's results as follows:

	Three Months Ended March 31,	
(in millions)	2017	2016
Equity in income of unconsolidated investments	$4.5	$3.6

Saratoga

On October 2, 2015, we completed the acquisition of a 25% equity investment in Saratoga Casino Holdings LLC ("SCH") which owns Saratoga Casino and Raceway ("Saratoga's New York facility") in Saratoga Springs, New York, for $24.5 million from Saratoga Harness Racing, Inc. ("SHRI"). Saratoga's New York facility has a casino with approximately 1,700 VLTs, a 1/2-mile harness racetrack with a racing simulcast center, a 117-room hotel, dining facilities and a 3,000 square-foot multi-functional event space. Saratoga's New York facility has a 50% interest in a joint venture with DNC to manage the Gideon Putnam Hotel and Resort. We signed a five-year management agreement with SCH to manage Saratoga's New York facility for which we receive management fee revenue.

On November 21, 2016, we completed the acquisition of a 25% equity investment in Saratoga Casino Black Hawk in Black Hawk, Colorado ("Saratoga's Colorado facility") for $6.5 million from SHRI. Saratoga's Colorado facility has a

casino with approximately 500 slot machines, seven table games, three lounges and two dining facilities.
Ocean Downs
In August 2016, we signed a limited liability company operating agreement with SCH, with each entity having a 50% interest, and formed Old Bay Gaming and Racing LLC ("Old Bay"). The Old Bay agreement provides both the Company and SCH equal participating rights, and both entities must consent to Old Bay's operating, investing and financing decisions.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

On January 3, 2017, Old Bay acquired all of the equity interests of Ocean Enterprise 589 LLC, Ocean Downs LLC and Racing Services LLC (collectively, "Ocean Downs"). The Company's portion of the initial equity investment in Ocean Downs was $24.0 million. Ocean Downs, located near Ocean City, Maryland, owns and operates VLTs at the Casino at Oceans Downs and conducts harness racing at Ocean Downs Racetrack. The Company's 25% interest in SCH provides an additional 12.5% interest, resulting in an effective 62.5% interest in Ocean Downs. Since both the Company and SCH have participating rights and both must consent to Old Bay's operating, investing and financing decisions, the Company accounts for Ocean Downs using the equity method of accounting.

5. GOODWILL AND OTHER INTANGIBLE ASSETS

We performed our annual goodwill and indefinite-lived intangible impairment analysis for 2017 in accordance with ASU No. 2011-08, Intangibles-Goodwill and Other: Testing Goodwill for Impairment, and ASU No. 2012-02, Intangibles-Goodwill and Other: Testing Indefinite-Lived Intangible Assets for Impairment, as of March 31, 2017, and no adjustment to the carrying value of goodwill or indefinite-lived intangible assets was required. We assessed goodwill and indefinite-lived intangible assets by performing step one fair value calculations on a quantitative basis for each reporting unit and indefinite-lived intangible asset. We concluded that the fair values of our reporting units and indefinite-lived intangible assets exceeded their carrying value and therefore step two of the assessment was not required.

During the three months ended March 31, 2017, the Company changed its annual goodwill and indefinite-lived impairment testing date from March 31 to April 1 of each year. As a result, the annual impairment tests were performed as of March 31, 2017 and will be performed again as of April 1, 2017. The change was made to better align with our forecasting process and to provide the Company with additional time to complete its annual goodwill and indefinite-lived intangible impairment testing in advance of its quarterly reporting. The Company believes this change in measurement date, which represents a change in method of applying an accounting principle, is preferable under the circumstances. We believe the resulting change in accounting principle related to changing the annual impairment testing date will not delay, accelerate, or avoid an impairment charge.

Goodwill is comprised of the following:

(in millions)	Racing	Casinos	TwinSpires	Big Fish Games	Total
Balances as of December 31, 2016	$ 51.7	$ 117.6	$ 132.1	$ 530.8	$ 832.2
Adjustments	—	—	—	—	—
Balances as of March 31, 2017	$ 51.7	$ 117.6	$ 132.1	$ 530.8	$ 832.2

Other intangible assets are comprised of the following:

	March 31, 2017			December 31, 2016		
(in millions)	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Definite-lived intangible assets	$ 187.4	$ (110.3)	$ 77.1	$ 187.4	$ (100.0)	$ 87.4
Indefinite-lived intangible assets			358.3			358.3
Total			$ 435.4			$ 445.7

6. INCOME TAXES

The Company’s income tax rate for the three months ended March 31, 2017 was higher than the U. S federal statutory rate of 35.0% primarily due to state income taxes and certain expenses that are not deductible for the purposes of income taxes. These unfavorable tax consequences are partially mitigated by benefits from tax credits and the manufacturing deduction.

The Company’s income tax rate for the three months ended March 31, 2016 was lower than the U. S federal statutory rate of 35.0% primarily due to a $3.1 million tax benefit resulting from tax deductions from vesting restricted stock units in excess of the book deductions that were recognized upon our adoption of ASU 2016-09, Improvements to Employee Share-Based Payment Accounting. This benefit was offset by state income taxes and certain expenses that are not deductible for the purposes of income taxes.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

7. FAIR VALUE OF ASSETS AND LIABILITIES

We endeavor to utilize the best available information in measuring fair value. Financial assets and liabilities are classified based on the lowest level of input that is significant to the fair value measurement. The following tables present our assets and liabilities measured at fair value on a recurring basis:

	March 31, 2017	
(in millions)	Level 1	Level 3
Cash equivalents and restricted cash	$25.0	$—
Big Fish Games deferred payments	—	28.0
Big Fish Games earnout liability	—	33.7
Total	$25.0	$61.7

	December 31, 2016	
(in millions)	Level 1	Level 3
Cash equivalents and restricted cash	$34.1	$—
Big Fish Games deferred payments	—	27.8
Big Fish Games earnout liability	—	67.9
Total	$34.1	$95.7

The following table presents the change in fair value of our Level 3:

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)		
(in millions)	Big Fish Games Deferred Payments	Big Fish Games Earnout Liability	Total
Balances as of December 31, 2016	$27.8	$ 67.9	$95.7
Payments	—	(34.2)	(34.2)
Change in fair value	0.2	—	0.2
Balances as of March 31, 2017	$28.0	$ 33.7	$61.7

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

We estimated the fair value of the Big Fish Games deferred payment and earnout liability as of March 31, 2017 using a discounted cash flows analysis over the period in which the obligation is expected to be settled, and applied a discount rate of 2.7% based on our cost of debt. The cost of debt was based on the observed market yields of our $600.0 million, 5.375% Senior Unsecured Notes ("Senior Unsecured Notes"), a Level 3 fair value measurement, and was adjusted for the difference in seniority and term of the deferred payments and earnout liability. The increase in fair values of the Big Fish Games deferred payments and earnout liability of $0.2 million during the three months ended March 31, 2017 was recorded as acquisition-related charges in the Condensed Consolidated Statements of Comprehensive Income. During 2015, Big Fish Games achieved its earnout milestones and we have made earnout payments of $34.2 million in March 2017 and $281.6 million in March 2016.

We currently have no other assets or liabilities subject to fair value measurement on a recurring basis. Our $600.0 million Senior Unsecured Notes are disclosed at fair value which is based on unadjusted quoted prices for similar liabilities in markets that are not active. The Level 3 fair value of the Senior Unsecured Notes was $622.5 million at both March 31, 2017 and December 31, 2016.

The following methods and assumptions were used in estimating our fair value disclosures for financial instruments:

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

Long-Term Debt: Senior Secured Credit Facility—The carrying amounts of the borrowings under the Senior Secured Credit Facility approximate fair value, based upon current interest rates and represent a Level 2 fair value measurement.

We did not measure any assets at fair value on a non-recurring basis for 2017 or 2016.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

8. SHAREHOLDERS' EQUITY

In February 2016, our Board of Directors authorized the repurchase of up to $150.0 million of our common stock in a stock repurchase program. Repurchases may be made at management's discretion from time to time on the open market (either with or without a 10b5-1 plan) or through privately negotiated transactions. The repurchase program has no time limit and may be suspended for periods or discontinued at any time. During the three months ended March 31, 2017, we repurchased 53,721 shares of our common stock in conjunction with our stock repurchase program at a total cost of $7.8 million. We had approximately $114.6 million of repurchase authority remaining under this program at March 31, 2017.

Refer to Note 13, Subsequent Events, for information on a new common stock repurchase program.

9. STOCK-BASED COMPENSATION PLANS

The 2016 Incentive Plan and the 2007 Incentive Plan (collectively "the 2016 and 2007 Plans") permit the award of restricted shares or restricted stock units to directors and key employees, including our officers who are from time to time responsible for the management, growth and protection of our business. Restricted shares granted under the 2016 and 2007 Plans generally vest either in full upon three years from the date of grant, on a pro-rata basis over a three year term or upon retirement at or after age 60. The fair value of restricted shares that vest solely based on continued service under the 2016 and 2007 Plans is determined by the product of the number of shares granted and the grant date market price of our common stock.

On September 22, 2015, the Board of Directors approved the adoption of the Executive Long-Term Incentive Compensation Plan (the "ELTI Plan"), pursuant to which certain named executive officers ("NEOs") and other key executives ("Grantees") may earn variable equity payouts based upon us achieving certain key performance metrics over a specified period. The ELTI Plan was adopted pursuant to 2016 and 2007 Plans, which were previously approved by our shareholders.

2017 Awards

On February 17, 2017, certain NEOs and Grantees received the following:

- 25,119 restricted stock units ("RSU") to NEOs vesting equally over three service periods ending December 31, 2017, December 31, 2018 and December 31, 2019;
- 28,467 performance share units ("PSU") to NEOs with vesting contingent on financial performance measures at the end of a 34-month performance period ending December 31, 2019; and
- 61,530 restricted stock shares to Grantees vesting equally over three service periods ending February 17, 2018, February 17, 2019 and February 17, 2020.

The performance criteria for the 2017 PSU awards are a cumulative Adjusted EBITDA target that was set at the beginning of the plan performance period for the entire three year period, and a cash flow metric that is the aggregate of the cash flow targets for the three individual years that is set annually at the beginning of each year. The cash flow metric is defined as cash flow from operating activities plus distributions of capital from equity investments less capital maintenance expenditures. The Compensation Committee can make adjustments as it may deem appropriate to these metrics. Measurement against these criteria will be determined against a payout curve which provides up to 200% of performance share units based on the original award.

The performance criteria also includes a relative total shareholder return ("TSR") component. Our TSR will be ranked versus the companies in the Russell 2000 index and will be calculated based on our relative placement within the Russell 2000 index. The PSU awards may be adjusted based on the Company's TSR, by increasing the PSU awards by 25% if the Company's TSR is in the top quartile, decreasing the PSU awards by 25% if the Company's TSR is in the bottom quartile, and providing no change to the PSU awards if the Company's TSR is in the middle two quartiles.

The total compensation cost we will recognize under the PSUs will be determined using the Monte Carlo valuation methodology and will be based upon an equal performance weighting for the two financial measures and then adjusted based on the Company's TSR performance within the Russell 2000 index. The maximum number of PSUs that can be earned for a performance period is 250% of the original award.

In 2017, we recognized compensation expense of $1.7 million for awards granted in 2017 and $3.2 million for awards granted prior to 2017. In 2016, we recognized compensation expense of $1.1 million for awards granted in 2016 and $3.0 million for awards granted prior to 2016. At March 31, 2017, compensation expense that had not been amortized attributable to unvested 2017 RSU and PSU awards was $8.0 million and $8.6 million for all other 2017 awards.

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10. CONTINGENCIES

We are involved in litigation arising in the ordinary course of conducting business. We carry insurance for workers' compensation claims from our employees and general liability for claims from independent contractors, customers and guests. We are self-insured up to an aggregate stop loss for our general liability and workers' compensation coverages. We review all litigation on an ongoing basis when making accrual and disclosure decisions. For certain legal proceedings, we cannot reasonably estimate losses or a range of loss, if any, particularly for proceedings that are in the early stages of development or where the plaintiffs seek indeterminate damages. Various factors, including, but not limited to, the outcome of potentially lengthy discovery and the resolution of important factual questions, may need to be determined before probability can be established or before a loss or range of loss can be reasonably estimated. In accordance with current accounting standards for loss contingencies and based upon information currently known to us, we establish reserves for litigation when it is probable that a loss associated with a claim or proceeding has been incurred and the amount of the loss or range of loss can be reasonably estimated. When no amount within the range of loss is a better estimate than any other amount, we accrue the minimum amount of the estimable loss. To the extent that such litigation against us may have an exposure to a loss in excess of the amount we have accrued, we believe that such excess would not be material to our consolidated financial condition, results of operations, or cash flows. Legal fees are expensed as incurred.

If the loss contingency in question is not both probable and reasonably estimable, we do not establish an accrual and the matter will continue to be monitored for any developments that would make the loss contingency both probable and reasonably estimable. In the event that a legal proceeding results in a substantial judgment against, or settlement by us, there can be no assurance that any resulting liability or financial commitment would not have a material adverse impact on our business.

11. NET INCOME PER COMMON SHARE COMPUTATIONS

The following is a reconciliation of the numerator and denominator of the net income per common share computations:

	Three Months Ended March 31,	
(in millions, except per share data)	2017	2016
Numerator for basic income per common share:		
Net income	$7.3	$2.8
Net income allocated to participating securities	(0.1)	(0.1)
Numerator for basic income per common share	$7.2	$2.7
Numerator for diluted income per common share	$7.3	$2.8
Denominator for basic and diluted net income per common share:		
Basic	16.3	16.5
Plus dilutive effect of stock options and restricted stock	0.2	0.2
Plus dilutive effect of participating securities	0.3	0.3
Diluted	16.8	17.0
Income per common share:		
Basic	$0.44	$0.17
Diluted	$0.44	$0.16

12. SEGMENT INFORMATION

We manage our operations through six operating segments:

- Racing, which includes Churchill Downs Racetrack ("Churchill Downs"), Arlington International Race Course ("Arlington"), Fair Grounds Race Course ("Fair Grounds") and Calder;
- Casinos, which includes Oxford Casino ("Oxford"), Riverwalk Casino ("Riverwalk"), Harlow's Casino ("Harlow's"), Calder Casino, Fair Grounds Slots, Video Services, LLC ("VSI"), 50% of EBITDA from our joint venture, MVG, 50% equity investment in Ocean Downs and 25% of EBITDA from our equity investment, SCH, which includes investments in Saratoga's New York facility, Saratoga's Colorado facility and Ocean Downs;

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- TwinSpires, which includes TwinSpires.com, Fair Grounds Account Wagering ("FAW"), Velocity, Bloodstock Research Information Services ("BRIS"), Bluff and I-Gaming;
- Big Fish Games, which is a global producer and distributor of social casino, casual and mid-core free-to-play, and premium paid games for PC, Mac and mobile devices;
- Other Investments, which includes United Tote and Capital View Casino & Resort Joint Venture ("Capital View"); and
- Corporate, which includes miscellaneous and other revenue, compensation expense, professional fees and other general and administrative expense not allocated to our other operating segments.

Eliminations include the elimination of intersegment transactions. Our chief operating decision maker utilizes Adjusted EBITDA to evaluate segment performance, develop strategy and allocate resources. Adjusted EBITDA is defined as earnings before interest, taxes, depreciation and amortization, adjusted for the following:

Adjusted EBITDA includes our portion of the EBITDA from our equity investments.

Adjusted EBITDA excludes:

- Acquisition expense, net which includes:
- Acquisition-related charges, including fair value adjustments related to earnouts and deferred payments; and
- Transaction expense, including legal, accounting, and other deal-related expense;
- Stock-based compensation expense;
- Calder land sale;
- Calder exit costs; and
- Other charges and recoveries.

During 2016, we updated our definition of Adjusted EBITDA to exclude changes in Big Fish Games deferred revenue and to exclude depreciation and amortization from our equity investments. Effective January 1, 2017, certain revenue previously included in our Corporate segment was deemed by management to be more closely aligned with our TwinSpires segment. The prior year amounts were reclassified to conform to this presentation.

We utilize the Adjusted EBITDA metric because we believe the inclusion or exclusion of certain non-recurring items is necessary to provide a more accurate measure of our core operating results and enables management and investors to evaluate and compare from period to period our operating performance in a meaningful and consistent manner. Adjusted EBITDA should not be considered as an alternative to operating income as an indicator of performance, as an alternative to cash flows from operating activities as a measure of liquidity, or as an alternative to any other measure provided in accordance with U.S. generally accepted accounting principles. Our calculation of Adjusted EBITDA may be different from the calculation used by other companies and, therefore, comparability may be limited.

For segment reporting, Adjusted EBITDA includes intercompany revenue and expense totals that are eliminated in the accompanying Consolidated Statements of Comprehensive Income.

The tables below present net revenue from external customers and intercompany revenue from each of our operating segments, Adjusted EBITDA by segment and reconciles Comprehensive Income to Adjusted EBITDA:

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	Three Months Ended March 31,	
(in millions)	2017	2016
Net revenue from external customers:		
Racing:		
Churchill Downs	$2.3	$2.3
Arlington	8.5	9.0
Fair Grounds	12.5	14.3
Calder	0.6	0.6
Total Racing	23.9	26.2
Casinos:		
Oxford Casino	20.9	19.9
Riverwalk Casino	11.5	12.7
Harlow’s Casino	13.5	13.0
Calder Casino	21.4	20.3
Fair Grounds Slots	10.2	10.6
VSI	9.7	9.8
Saratoga	0.3	0.2
Total Casinos	87.5	86.5
TwinSpires	52.0	49.6
Big Fish Games:		
Social casino	46.2	47.5
Casual and mid-core free-to-play	45.3	50.4
Premium	20.5	24.2
Total Big Fish Games	112.0	122.1
Other Investments	4.1	4.0
Net revenue from external customers	$279.5	$288.4

	Three Months Ended March 31,	
(in millions)	2017	2016
Intercompany net revenue:		
Racing:		
Churchill Downs	$0.3	$0.3
Arlington	1.0	1.0
Fair Grounds	0.9	1.0
Total Racing	2.2	2.3
TwinSpires	0.3	0.3
Other Investments	1.4	0.9
Eliminations	(3.9)	(3.5)
Intercompany net revenue	$—	$—

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Adjusted EBITDA by segment is comprised of the following:

	Three Months Ended March 31, 2017					
(in millions)	Racing	Casinos	TwinSpires	Big Fish Games	Other Investments	Corporate
Net revenue	$26.1	$87.5	$ 52.3	$112.0	$ 5.5	$ —
Taxes & purses	(10.2)	(29.1)	(3.0)	—	—	—
Platform & development fees	—	—	—	(41.5)	—	—
Marketing & advertising	(0.7)	(3.0)	(1.0)	(24.5)	—	—
Salaries & benefits	(8.6)	(13.1)	(2.2)	(7.0)	(2.9)	—
Content expense	(3.2)	—	(25.4)	—	—	—
SG&A expense	(3.8)	(5.2)	(2.7)	(4.7)	(0.8)	(2.2)
Research & development	—	—	—	(10.3)	—	—
Other operating expense	(9.3)	(11.4)	(4.8)	(3.7)	(1.3)	(0.2)
Other income (expense)	—	9.6	—	—	0.1	—
Adjusted EBITDA	$(9.7)	$35.3	$ 13.2	$20.3	$ 0.6	$ (2.4)

	Three Months Ended March 31, 2016					
(in millions)	Racing	Casinos	TwinSpires	Big Fish Games	Other Investments	Corporate
Net revenue	$28.5	$ 86.5	$ 49.9	$122.1	$ 4.9	$ —