



COMPANY UPDATE / ESTIMATE CHANGE

Key Metrics

CHDN - NASDAQ (as of 7/31/17)	\$187.05
Price Target	N/A
52-Week Range	\$129.85 - \$194.75
Shares Outstanding (mm) (basic)	16.1
Market Cap. (\$mm)	\$3,012
3-Mo. Average Daily Volume	72,200
Institutional Ownership	63%
Total Debt/Total Capital (6/17) *	64%
ROE (TTM ended 6/17)	19%
Book Value/Share (6/17)	\$37.35
Price/Book Value	5.0x
Annual Dividend & Yield	\$1.32 0.7%
EBITDA Margin (TTM ended 6/17)	27%

* excludes earn-out and deferred payment liabilities associated with 2015 acquisition

EPS FY 12/31 (GAAP-based, from contin. operations)

	2016	Prior 2017E	Curr. 2017E	Prior 2018E	Curr. 2018E
1Q	\$0.16		\$0.44	A	
2Q	\$4.11		\$4.81	A	
3Q	\$0.52	\$0.93	\$0.90		
4Q	\$1.60	\$0.63	\$0.60		
Year	\$6.42	\$6.55	\$6.75	\$7.40	\$7.50
P/E	29.1x		27.7x		24.9x

Note: Quarterly EPS figures may not add to annual figure due to rounding.

Revenue (\$mm)

	2016	Prior 2017E	Curr. 2017E	Prior 2018E	Curr. 2018E
1Q	\$288		\$280	A	
2Q	\$439		\$452	A	
3Q	\$303	\$309	\$306		
4Q	\$278	\$284	\$283		
Year	\$1,309	\$1,315	\$1,320	\$1,335	\$1,365

Company Description: Churchill Downs Incorporated, headquartered in Louisville, KY, is a racing, gaming, and online entertainment company. It owns and operates several thoroughbred racetracks including its namesake facility, which hosts the annual Kentucky Derby. The company's other businesses include land-based casino gaming, the TwinSpires online account wagering platform, and mobile videogame developing/publishing.

Churchill Downs Incorporated

CHDN — NASDAQ — Neutral-3

Company Produced Another Good Quarter; Our Neutral Rating Is Based on Valuation

Investment Highlights

- In what is typically the largest quarter of CHDN's year, 2Q results exceeded our expectation.** Total revenues of \$451.9 million were up 3% from the year ago period. Adjusted EBITDA (earnings before interest, taxes, depreciation and amortization) of \$173.0 million rose 8% and exceeded our expectation by several million dollars. All four of the major business segments generated higher adjusted EBITDA. Furthermore, we were impressed by the quarter's 175 basis point rise in adjusted EBITDA margin.
- The company's most iconic annual event was a success.** The 143rd running of the Kentucky Derby on May 6—and the brisk nature of the business for that week—helped lead to CHDN's record 2Q revenues and profits. Record wagering on Derby Day, higher ticket pricing, expanded venue capacity, and greater sponsorship dollars were among the positive factors, with undesirable weather being a negative factor.
- We have fine-tuned our 2017 outlook.** We have raised our revenue estimate by \$5 million and increased our adjusted EBITDA estimate by \$5 million. These increases are generally spread across all of the company's operations rather than any one segment. We have also raised our estimates for key metrics in 2018.
- We maintain our Neutral rating on CHDN due to valuation.** The shares are currently above our preferred level for purchases. We maintain our overall favorable view of the company and its portfolio of businesses. We expect single-digit growth in CHDN's overall revenues and cash flows in 2017 and 2018, with improving margins. We could consider a purchase recommendation at a lower valuation, assuming no change in company fundamentals. Our Suitability rating on CHDN is 3.

**Note Important Disclosures on Pages 7-8.
Note Analyst Certification on Page 7.**

Exhibit 1**Consolidated Statements of Income** (figures in millions except per share data and percentages)

	Quarter Ended			Six Months Ended		
	<u>6/30/17</u>	<u>6/30/16</u>	<u>% chg.</u>	<u>6/30/17</u>	<u>6/30/16</u>	<u>% chg.</u>
Net Revenues	\$451.9	\$438.5	3.1%	\$731.4	\$726.9	0.6%
Operating Expenses	284.8	284.2	0.2%	511.8	529.3	(3.3%)
Gross Profit	167.1	154.3	8.3%	219.6	197.6	11.1%
Selling, Gen. and Admin. Exp.	26.7	24.6	8.5%	50.8	47.7	6.5%
Acquisition Related Charges	0.8	1.1	(27.3%)	1.0	3.8	(73.7%)
Research & Development	9.9	9.7	2.1%	20.2	20.5	(1.5%)
Calder Exit Costs	0.2	1.5	(86.7%)	0.6	1.9	(68.4%)
Operating Income	129.5	117.4	10.3%	147.0	123.7	18.8%
Interest Expense, net	(11.6)	(11.1)	4.5%	(23.4)	(21.7)	7.8%
Equity in Unconsol. Invest.	7.7	4.8	60.4%	13.8	8.6	60.5%
Misc., net	0.2	0.4	N/A	0.2	(0.1)	N/A
Total Other Income	(3.7)	(5.9)	(37.3%)	(9.4)	(13.2)	(28.8%)
Income Before Taxes	125.8	111.5	12.8%	137.6	110.5	24.5%
Taxes	47.5	41.7	13.9%	52.0	37.9	37.2%
Net Income from Contin. Oper.	\$78.3	\$69.8	12.2%	\$85.6	\$72.6	17.9%
Diluted EPS from Contin. Oper.	\$4.81	\$4.11	17.1%	\$5.18	\$4.27	21.3%
Segment Adj. EBITDA (Earnings Before Int., Taxes, Deprec. & Amort.)	\$173.0	\$160.2	8.0%	\$230.3	\$206.9	11.3%
Avg. Diluted Shares Outst.	16.3	17.0	(4.1%)	16.5	17.0	(2.9%)
% of Net Revenues:			bp chg.			bp chg.
Gross Profit	36.98%	35.19%	179	30.02%	27.18%	284
Selling, Gen. and Admin. Exp.	5.91%	5.61%	30	6.95%	6.56%	38
Segment EBITDA	38.28%	36.53%	175	31.49%	28.46%	302
Operating Income	28.66%	26.77%	188	20.10%	17.02%	308
Net Income from Contin. Oper.	17.33%	15.92%	141	11.70%	9.99%	172
Tax Rate	37.76%	37.40%	36	37.79%	34.30%	349

Note: Segment adjusted EBITDA excludes insurance recoveries, if any, received during the periods.

Source: Churchill Downs Incorporated

Note: Results are from continuing operations only

Additional comments on 2Q. In the Racing segment, the clear highlight of the quarter was the Kentucky Derby and the week of brisk business that typically coincides with the event. Despite rainy weather for Kentucky Oaks (May 5) and Kentucky Derby days (May 6), wagering levels were strong, in our view. This led to record profits for the week, including an adjusted EBITDA increase of nearly \$5 million compared to last year. For the entire 2Q period, the Racing segment's adjusted EBITDA dollars rose 8% and adjusted EBITDA margin increased 122 basis points.

In the Casino segment, issues such as competition and regional economies continued to represent challenges, but the company's portfolio of properties collectively generated gains in revenues and adjusted EBITDA. Highlights included solid results at the Oxford property in Maine (which is on pace to debut an adjacent hotel by year-end) and Calder Casino in Florida. We were also impressed with the performance of recent joint venture entities such as Miami Valley Gaming in Ohio, Saratoga Casino Holdings in New York and Colorado, and the recently added Ocean Downs in Maryland. We recently visited the Miami Valley Gaming facility for the second time in the past twelve months, and once again we came away impressed by the operations and feeling good about its prospects.

The TwinSpires online wagering business performed well once again as it continued to add customers and capture market share. This segment produced an approximate 18% revenue gain (reflective of a 34% gain in active players) and a 3% rise in adjusted EBITDA (lower than the revenue gain due partly to a Pennsylvania tax refund that did not occur this year as it did in the prior year).

Big Fish Games saw a 10% decrease in 2Q revenues as the mid-core and free-to-play casual categories were impacted by a strategic decline in user acquisition expense in 2016. However, lower expenses led to a 3% increase in adjusted EBITDA and a 203 basis point increase in adjusted EBITDA margin. Acquired in late 2014, Big Fish has become an important segment for CHDN, noted by our projection of the segment's adjusted EBITDA this year exceeding that of the storied Racing segment.

Exhibit 2**Supplemental Information by Operating Unit** (figures in millions except percentages)

	Quarter Ended			Six Months Ended		
	6/30/17	6/30/16	% chg	6/30/17	6/30/16	% chg
Net Revenues:						
Churchill Downs Racetrack	\$136.7	\$129.1	5.9%	\$139.0	\$131.4	5.8%
Calder Race Course	0.6	0.7	(14.3%)	1.2	1.3	(7.7%)
Arlington Park	18.0	16.8	7.1%	26.5	25.8	2.7%
Fair Grounds Race Course	10.0	9.5	5.3%	22.5	23.8	(5.5%)
Total Racing Operations	165.3	156.1	5.9%	189.2	182.3	3.8%
Big Fish Games	112.6	125.2	(10.1%)	224.6	247.3	(9.2%)
TwinSpires	80.5	68.4	17.7%	132.5	118.0	12.3%
Calder Casino	21.8	20.5	6.3%	43.2	40.8	5.9%
Fair Grounds Slots	8.8	8.8	0.0%	19.0	19.4	(2.1%)
VSI (LA video poker machines)	9.8	9.5	3.2%	19.5	19.3	1.0%
Harlow's Casino	12.5	11.9	5.0%	26.0	24.9	4.4%
Oxford Casino	23.1	21.1	9.5%	44.0	41.0	7.3%
Riverwalk Casino	12.0	12.4	(3.2%)	23.5	25.1	(6.4%)
Saratoga Casino & Raceway	0.3	0.2	N/A	0.6	0.4	N/A
Total Casinos	88.3	84.4	4.6%	175.8	170.9	2.9%
Other Investments	5.2	4.4	18.2%	9.3	8.4	10.7%
Net Revenues from Contin. Oper.	\$451.9	\$438.5	3.1%	\$731.4	\$726.9	0.6%
Segment EBITDA:						
Racing Operations	98.7	91.3	8.1%	89.0	83.9	6.1%
Big Fish Games	18.3	17.8	2.8%	38.6	26.7	44.6%
TwinSpires	19.3	18.8	2.7%	32.5	30.9	5.2%
Casinos	37.5	33.3	12.6%	72.8	67.6	7.7%
Other Investments	1.3	1.3	0.0%	1.9	2.1	(9.5%)
Corporate	(2.1)	(2.3)	(8.7%)	(4.5)	(4.3)	4.7%
EBITDA from Contin. Oper.	\$173.0	\$160.2	8.0%	\$230.3	\$206.9	11.3%
Segment EBITDA Margins						
			bp chg.			bp chg.
Racing Operations	59.71%	58.49%	122	47.04%	46.02%	102
Big Fish Games	16.25%	14.22%	203	17.19%	10.80%	639
TwinSpires	23.98%	27.49%	(351)	24.53%	26.19%	(166)
Casinos	42.47%	39.45%	301	41.41%	39.56%	186
Total	38.28%	36.53%	175	31.49%	28.46%	302

Source: Churchill Downs Incorporated

Note: Results are from continuing operations only

The company's GAAP-based EPS for 2Q were \$4.81 versus the year ago figure of \$4.11. However, we do not feel GAAP-based earnings are a major focal point among investors. The weighted average share count in 2Q was 4% lower due to past activity under the company's repurchase authorization, including the repurchase of some shares owned by long-time investor (with current Board representation) The Duchossois Group.

Financial condition. We consider CHDN's financial condition solid, although debt has increased this year. At the end of 2Q 2017, total interest-bearing debt was \$1.071 billion (not including earn-out and deferred payment liabilities related to Big Fish Games). This represented about 64% of total capitalization. At the end of 2016, total interest-bearing debt represented 57% of total capitalization. Shareholders' equity at the end of 2Q was \$601.3 million. The period-end leverage ratio (total debt excluding Big Fish deferred liabilities divided by trailing adjusted EBITDA) was 3.0x, a manageable figure that leaves room for future borrowing if needed, in our view. Also, we believe strong cash flows from CHDN's mix of businesses can allow for deleveraging in the coming year. We expect an increase in the annual dividend each year (we note a 15% rate increase effective with the January 2017 payment) and possibly share buybacks depending on market prices.

Outlook. We continue to view CHDN's business prospects favorably. For 2H 2017, we expect a successful fall meet at the Churchill Downs track in Louisville, KY, continued outperformance from the TwinSpires online wagering platform versus the thoroughbred wagering industry, solid contributions from Big Fish Games, and overall growth from the wholly owned casinos. Equity stakes in various casino/hotel joint ventures add to the Casino segment's growth potential, in our view.

We have fine-tuned our financial estimates. For all of 2017, we project total revenue of \$1.320 billion, adjusted EBITDA of \$360 million, and GAAP-based EPS of \$6.75. These figures represent slight increases from our previous estimates. We have also updated our 2018 estimates; in general, we expect it to be a year of modest growth and record results. This includes total revenue of \$1.365 billion, adjusted EBITDA of \$377 million, and GAAP-based EPS of \$7.50.

Although we consider our outlook to be favorable, we are mindful of issues such as start-up expenses for new businesses, competitive environments, regional economies, legislative factors, and total debt levels. We have not assumed future contributions from online casino-style gaming, a business the company continues to pursue yet is dependent on legislative approvals. Similarly, we have not assumed future passage of legislation that could allow traditional gaming operations at the company's Kentucky and Illinois racetracks. We have also not factored in the company's plans to open a wagering facility in Louisville, KY by Fall 2018 featuring 600 "historical racing" machines. This form of wagering—very similar to traditional slot machines, in our opinion—was approved by the state of Kentucky several years ago but to date Churchill has only monitored the business environment.

Stock price and valuation. CHDN shares are currently trading at 27.7x our 2017 EPS estimate and 24.9x times our 2018 estimate; however, we feel an Enterprise Value/EBITDA (earnings before interest, taxes, depreciation and amortization) valuation approach is most relevant due to CHDN's debt levels and non-cash expenses such as depreciation & amortization. This measure focuses on the implied total value of a company (market capitalization plus net debt) relative to its cash flow generating ability and is commonly used in the analysis of many companies in the Entertainment & Leisure spectrum, including CHDN.

As noted in Exhibit 3, Enterprise Value (using estimated year-end net debt figures) divided by our projections of 2017 adjusted EBITDA and year-end net debt is 11.2x. This is above the valuation at the time of our rating downgrade to Neutral from Buy on 12/9/16. Furthermore, roughly one year ago, the EV/adjusted EBITDA valuation was 9.2x based on our 2016 adjusted EBITDA estimate.

In what we view as a conservative measure, for the purpose of an EV/EBITDA valuation analysis we have added certain short-term and long-term liabilities related to Big Fish Games (deferred payments and earn-out liabilities) to the traditional debt categories of term debt and notes, as we view these as future (though non-interest bearing) obligations of CHDN. Subtracting period end cash, we arrive at estimated net debt.

Exhibit 3**Valuation Analysis** (figures in millions except ratios, percentages, and per share data)

	<u>2018E</u>	<u>2017E</u>	<u>2016</u>	<u>2015</u>	<u>2014</u>
Share Price (7/31/17)	\$187.05				
Recent Diluted Share Count	16.3				
Market Capitalization	\$3,049				
Net Debt, year end ~	\$900	\$975	\$969	\$1,107	\$1,104
Enterprise Value (EV)	\$3,949	\$4,024	\$4,018	\$4,156	
Adj. EBITDA	\$377	\$360	\$335	\$303	\$202
year-over-year % growth	4.7%	7.6%	10.6%	49.4%	14.9%
EV / Adj. EBITDA	10.5x	11.2x	12.0x		

Note: Valuation multiples are based on current market capitalization figures and projected year-end net debt levels.

~ Net debt figures include short-term and long-term notes and term loan balances, plus short-term and long-term earn-out liabilities and deferred payments owed to Big Fish Games, minus cash & cash equivalents.

Source: Churchill Downs Incorporated and Hilliard Lyons estimates

We estimate an EV/adjusted EBITDA ratio range of 8-11x over the past five years. We feel a multiple in the 9-11x range can be justified by company fundamentals, recent and future growth initiatives, and the cash flow outlook. While the current EV/EBITDA multiple is at the upper end of this range, we acknowledge company fundamentals and business diversification appear to be stronger now than at any point in the company's history.

Opinion. We rate CHDN Neutral due to valuation. We expect higher revenues, cash flow, and profits each year, yet recognize challenges such as a mature live racing industry and competitive environments at the regional casino business. We are also mindful of possible sequential profit volatility at Big Fish Games due to factors such as user acquisition spending and platform fees, as well as perhaps the most important variable, game popularity.

On the positive side, we consider the Kentucky Derby event to be one of the most valuable sports/entertainment assets in existence, and believe there are opportunities for continued growth in revenues and profits from the week of related business activity. In fact, we believe projects currently in place are likely to result in record EBITDA for Kentucky Derby week in 2018. In addition, we like the company's added diversification and expansion efforts over the years, and believe free cash flow can continue to allow for debt reduction, dividend service, and pursuit of growth initiatives. If the stock price and valuation were to decline, we would consider a rating upgrade assuming no change in company fundamentals.

Suitability. Our Suitability rating on CHDN is 3 on a 1-to-4 scale (1=most conservative, 4=most aggressive), and is based on factors such as industry and company risks, market capitalization, and seasonality to the company's operations.

Risks. In addition to legalities and contractual issues pertaining to alternative gaming, simulcasting, and advance deposit wagering, other factors that could affect the company's financial results and/or its stock price include: general economic conditions, technological advancements, new business ventures, the cost and integration of acquisitions, weather anomalies, insurance costs, the impact of gaming competition, legislative expenses, allocation of live racing days, overall popularity of thoroughbred racing, and competition for top horses and trainers.

Exhibit 4**Business Segment Outlook** (figures in millions except percentages)

	<u>2018E</u>	<u>% chg</u>	<u>2017E</u>	<u>% chg</u>	<u>2016</u>	<u>% chg</u>	<u>2015</u>
Net Revenues:							
Churchill Downs Racetrack	\$168.5	3.4%	\$163.0	5.0%	\$155.2	2.7%	\$151.1
Calder Race Course	2.4	(4.0%)	2.5	(3.8%)	2.6	(3.7%)	2.7
Arlington Park	58.4	2.5%	57.0	3.1%	55.3	1.7%	54.4
Fair Grounds	37.7	3.3%	36.5	(3.9%)	38.0	(4.5%)	39.8
Total Racing Operations	267.0	3.1%	259.0	3.1%	251.1	1.2%	248.0
TwinSpires	250.0	4.2%	240.0	8.8%	220.6	10.2%	200.2
Casinos - excluding JVs	346.0	2.1%	339.0	1.9%	332.8	(0.0%)	332.9
Big Fish Games	481.0	3.9%	463.0	(4.8%)	486.2	17.5%	413.7
Other & Corporate	21.0	10.5%	19.0	6.1%	17.9	2.0%	17.5
Net Revenues from Contin. Oper.	\$1,365.0	3.4%	\$1,320.0	0.9%	\$1,308.6	7.9%	\$1,212.3
Adjusted Segment EBITDA:							
Racing Operations	89.5	4.7%	85.5	7.3%	79.7	10.9%	71.8
TwinSpires	62.5	5.0%	59.5	7.8%	55.2	13.6%	48.6
Casinos - exclud. JVs	109.0	3.1%	105.7	2.8%	102.8	0.6%	102.2
Casinos - equity inv. in JVs, estim.	29.0	11.5%	26.0	13.0%	23.0	81.1%	12.7
Big Fish Games	94.0	4.4%	90.0	13.8%	79.1	15.5%	68.5
Other & Corporate	(7.0)	4.5%	(6.7)	26.4%	(5.3)	307.7%	(1.3)
Adjusted Segment EBITDA ~	\$377.0	4.7%	\$360.0	7.6%	\$334.5	10.6%	\$302.5
Adjusted EBITDA Margins							
		<u>bp chg.</u>		<u>bp chg.</u>		<u>bp chg.</u>	
Racing Operations	33.52%	51	33.01%	127	31.74%	277	28.97%
TwinSpires	25.00%	21	24.79%	(23)	25.02%	74	24.28%
Casinos - exclud. JVs	31.50%	32	31.18%	29	30.89%	19	30.70%
Casinos - includ. equity inv. in JVs	39.88%	103	38.85%	105	37.80%	329	34.51%
Big Fish Games	19.54%	10	19.44%	317	16.27%	(29)	16.56%
Total	27.62%	35	27.27%	171	25.56%	61	24.96%

~ Adjusted EBITDA figures exclude nonrecurring items such as insurance losses/recoveries and racing industry trust fund proceeds, and also exclude items such as share-based compensation expense and pre-opening costs.

Source: Churchill Downs Incorporated and Hilliard Lyons estimates

Note: Figures reflect continuing operations only

Additional information is available upon request.

Analyst Certification

I, Jeffrey S. Thomison, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject company(ies) and its (their) securities. I also certify that I have not been, am not, and will not be receiving direct or indirect compensation in exchange for expressing the specific recommendation(s) in this report.

Important Disclosures

Hilliard Lyons' analysts receive bonus compensation based on Hilliard Lyons' profitability. They do not receive direct payments from investment banking activity.

Investment Ratings

Buy - We believe the stock has significant total return potential in the coming 12 months.

Long-term Buy - We believe the stock is an above average holding in its sector, and expect solid returns to be realized over a longer time frame than our Buy rated issues, typically 2-3 years.

Neutral - We believe the stock is an average holding in its sector, is currently fully valued, and may be used as a source of funds if better opportunities arise.

Underperform - We believe the stock is vulnerable to a price set back in the next 12 months.

Suitability Ratings

1 - A large cap, core holding with a solid history

2 - A historically secure company which could be cyclical, has a shorter history than a "1" or is subject to event driven setbacks

3 - An above average risk/reward ratio could be due to small size, lack of product diversity, sporadic earnings or high leverage

4 - Speculative, due to small size, inconsistent profitability, erratic revenue, volatility, low trading volume or a narrow customer or product base

<u>Rating</u>	<u>Hilliard Lyons Recommended Issues</u>		<u>Investment Banking Provided in Past 12 Mo.</u>	
	<u># of Stocks Covered</u>	<u>% of Stocks Covered</u>	<u>Banking</u>	<u>No Banking</u>
Buy	36	29%	14%	86%
Hold/Neutral	79	63%	5%	95%
Sell	10	8%	0%	100%

As of 7 July 2017



Note: Price targets accompanying Buy ratings reflect a one year time period while price targets accompanying Long-term Buy ratings reflect a two to three year time period.

Other Disclosures

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