



COMPANY UPDATE / ESTIMATE CHANGE

Key Metrics	
CHDN - NASDAQ (as of 5/1/17)	\$166.00
Price Target	N/A
52-Week Range	\$118.76 - \$173.50
Shares Outstanding (mm) (basic)	16.3
Market Cap. (\$mm)	\$2,706
3-Mo. Average Daily Volume	64,815
Institutional Ownership	70%
Total Debt/Total Capital (3/17) *	58%
ROE (TTM ended 3/17)	18%
Book Value/Share (3/17)	\$42.26
Price/Book Value	3.9x
Annual Dividend & Yield	\$1.32 0.8%
EBITDA Margin (TTM ended 3/17)	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		\$4.55		
3Q	\$0.52		\$0.93		
4Q	\$1.60		\$0.63		
Year	\$6.42	\$6.70	\$6.55		\$7.40
P/E	25.9x		25.3x		22.4x

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		\$442		
3Q	\$303		\$309		
4Q	\$278		\$284		
Year	\$1,309	\$1,330	\$1,315		\$1,335

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

1Q Results Represented Good Start to 2017; Maintain Neutral Rating Due to Valuation

Investment Highlights

- **Overall, we thought 1Q results were encouraging.** Total revenues of \$279.5 million were down 3% from the year ago period. However, declines at the live racing and Big Fish Games segments came with valid reasons, in our view. Adjusted EBITDA (earnings before interest, taxes, depreciation and amortization) of \$57.3 million came in above our expectation, as all four of the major business segments achieved gains. Also, we were impressed by the 431 basis point rise in adjusted EBITDA margin.
- **We believe business prospects for 2Q are favorable.** The 143rd running of the Kentucky Derby on May 6—and the brisk nature of the business for the week—could help lead to record 2Q revenues and profits, in our view. The event has consistently been a major contributor to the company's annual financial results. Higher pricing, greater venue capacity, more sponsorship dollars, and expanded geographic reach for online wagering could be positive factors this year.
- **We have fine-tuned our 2017 outlook.** We have lowered our revenue estimate by \$15 million and lowered our adjusted EBITDA estimate by \$10 million. These updates primarily reflect a more conservative assumption at Big Fish Games, with relatively modest changes at the other segments. We have also initiated 2018 estimates.
- **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, assuming no change in the current business mix. We could consider a return to a purchase recommendation at a lower valuation, assuming no change in company fundamentals. Our Suitability rating on CHDN remains 3.

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

Exhibit 1**Consolidated Statements of Income** (figures are in thousands and rounded, except per share data and percentages)

	Quarter Ended		
	<u>3/31/17</u>	<u>3/31/16</u>	<u>% chg.</u>
Net Revenues	\$279,500	\$288,400	(3.1%)
Operating Expenses	<u>227,000</u>	<u>245,100</u>	(7.4%)
Gross Profit	52,500	43,300	21.2%
Selling, Gen. and Admin. Exp.	24,100	23,100	4.3%
Research & Development	10,300	10,800	(4.6%)
Calder Exit Costs	400	400	0.0%
Acquisition related charges	<u>200</u>	<u>2,700</u>	(92.6%)
Operating Income	17,500	6,300	177.8%
Interest Expense	(11,800)	(10,600)	11.3%
Equity in Unconsol. Invest.	6,100	3,800	60.5%
Misc. Income., net	<u>0</u>	<u>(500)</u>	N/A
Total Other Income	(5,700)	(7,300)	(21.9%)
Income Before Taxes	11,800	(1,000)	N/A
Taxes (Benefit)	<u>4,500</u>	<u>(3,800)</u>	N/A
Net Income from Contin. Oper.	<u>\$7,300</u>	<u>\$2,800</u>	160.7%
Diluted EPS from Contin. Oper.	\$0.44	\$0.16	167.1%
Avg. Diluted Shares Outst.	16,800	17,000	(1.2%)
Segment Adjusted EBITDA (Earnings Before Interest, Taxes, Deprec. & Amort.)	\$57,300	\$46,700	22.7%
% of Net Revenues:			<u>bp chg.</u>
Gross Profit	18.78%	15.01%	377
Selling, Gen. and Admin. Exp.	8.62%	8.01%	61
Segment Adjusted EBITDA	20.50%	16.19%	431
Operating Income	6.26%	2.18%	408
Net Income from Contin. Oper.	2.61%	0.97%	164

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

Source: Churchill Downs Incorporated

Additional comments on 1Q. In the Casino segment, issues such as competition and regional economies continued to represent challenges, but we count more solid markets than weak ones. Total segment revenue rose 1% and adjusted EBITDA increased 3%. Highlights included solid results at the Harlow's (Mississippi) and Oxford (Maine) properties, the latter of which is on pace to debut an adjacent hotel by year-end. In addition, contributions from equity investments—including the recently added Ocean Downs in Maryland (62.5% ownership stake)—was a collective positive factor.

The TwinSpires (online wagering) segment performed well once again as it continued to add customers and capture market share. This segment produced an approximate 5% revenue gain and a 9% rise in adjusted EBITDA, with margin up 99 basis points.

In the Racing segment, the company's Fair Grounds track had some challenges. A calendar shift led to the annual Louisiana Derby being held in April (2Q) rather than March (1Q). Also, an equine illness at the track impacted race fields and wagering levels. These factors led to the track's double-digit decline in revenue and contributed to the entire Racing segment's 9% drop in revenues and a wider seasonal loss.

Big Fish Games saw an 8% decrease in 1Q revenues as the mid-core and free-to-play casual categories were impacted by a strategic decline in user acquisition expense in 2H 2016. The lower expense level led to a jump in adjusted EBITDA and adjusted EBITDA margin. This was a bit of a positive surprise to us—not directionally but in magnitude.

The company's GAAP-based EPS for 1Q were \$0.44, well above the year ago figure of \$0.16. However, we do not feel GAAP-based earnings is a major focal point among investors. The weighted average share count in 1Q was 1.2% lower due to past repurchases made under the company's repurchase authorization. A new \$250 million authorization was recently approved by the Board.

Exhibit 2**Supplemental Information by Operating Unit** (figures are in thousands and rounded, except percentages)

	Quarter Ended		% chg
	<u>3/31/17</u>	<u>3/31/16</u>	
Net Revenues:			
Churchill Downs Racetrack	\$2,300	\$2,300	0.0%
Calder Race Course	600	600	0.0%
Arlington Park	8,500	9,000	(5.6%)
Fair Grounds	<u>12,500</u>	<u>14,300</u>	(12.6%)
Total Racing Operations	23,900	26,200	(8.8%)
Calder Casino	21,400	20,300	5.4%
Fair Grounds Slots	10,200	10,600	(3.8%)
VSI	9,700	9,800	(1.0%)
Harlow's Casino	13,500	13,000	3.8%
Oxford Casino	20,900	19,900	5.0%
Riverwalk Casino	11,500	12,700	(9.4%)
Saratoga	<u>300</u>	<u>200</u>	50.0%
Total Casinos	87,500	86,500	1.2%
TwinSpires	52,000	49,600	4.8%
Big Fish Games	112,000	122,100	(8.3%)
Other Investments	<u>4,100</u>	<u>4,000</u>	2.5%
Net Revenues	<u>\$279,500</u>	<u>\$288,400</u>	(3.1%)
EBITDA:			
Racing Operations	(\$9,700)	(\$7,400)	31.1%
Casinos	35,300	34,300	2.9%
TwinSpires	13,200	12,100	9.1%
Big Fish Games	20,300	8,900	128.1%
Other Investments	600	800	(25.0%)
Corporate	<u>(2,400)</u>	<u>(2,000)</u>	20.0%
Segment Adjusted EBITDA	<u>\$57,300</u>	<u>\$46,700</u>	22.7%
EBITDA Margins:			
			<u>bp chg.</u>
Racing Operations	N/A	N/A	N/A
Casinos	40.34%	39.65%	69
TwinSpires	25.38%	24.40%	99
Big Fish Games	18.13%	7.29%	1,084
Total Company	20.50%	16.19%	431

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

Source: Churchill Downs Incorporated

Financial condition. We consider CHDN's financial condition solid. At the end of 1Q 2017, total interest-bearing debt was \$968.3 million (not including earn-out and deferred payment liabilities related to Big Fish Games). This represented about 58% of total capitalization. Shareholders' equity was \$688.9 million. The period-end leverage ratio (total debt excluding Big Fish deferred liabilities divided by trailing adjusted EBITDA) was approximately 2.7x, 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 years. We also expect annual increases in the dividend (we note a 15% rate increase effective with the January 2017 payment) and continued share buybacks depending on market prices.

Outlook. We continue to view CHDN's business prospects favorably. For 2017, we expect successful spring and fall meets at the Churchill Downs track in Louisville, KY, including a potential record haul from Kentucky Derby week in May based on capacity additions, some pricing benefit, and generally high levels of popularity for the week's events. We also expect continued outperformance from the TwinSpires online wagering platform versus the thoroughbred wagering industry and overall stable contribution from the wholly owned casinos. Equity stakes in various casino/hotel joint ventures add to our bullish view. We have slightly lowered our revenue and adjusted EBITDA forecast at Big Fish Games after incorporating 1Q results and factoring less aggressive user acquisition spending.

For 2017, we project total revenue of \$1.315 billion, adjusted EBITDA of \$355 million, and GAAP-based EPS of \$6.55. These figures represent slight declines from our previous figures. We have also initiated 2018 estimates. In general, we expect it to be a year of modest growth and record results. This includes total revenue of \$1.335 billion, adjusted EBITDA of \$370 million, and GAAP-based EPS of \$7.40.

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 gaming operations at the company's Kentucky and Illinois racetracks.

Stock price and valuation. CHDN shares are currently trading at 25.3x our 2017 EPS 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 2, Enterprise Value (using estimated year-end net debt figures) divided by our projections of 2017 adjusted EBITDA and year-end net debt is 10.4x. This is above the valuation at the time of our rating downgrade to Neutral on 12/9/16. Furthermore, roughly one year ago, the EV/adjusted EBITDA valuation was 8.8x based on our 2016 adjusted EBITDA estimate. We estimate a historical range of 8-11x over the past five years. We feel a multiple in the 9-10x range can be justified by company fundamentals, recent and future growth initiatives, and the cash flow outlook.

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 (non-interest bearing) obligations of CHDN. Subtracting period end cash, we arrive at 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 (5/1/17)	\$166.00				
Recent Diluted Share Count	16.8				
Market Capitalization	\$2,789				
Net Debt, year end ~	\$825	\$900	\$969	\$1,107	\$1,104
Enterprise Value (EV)	\$3,614	\$3,689	\$3,758	\$3,896	
Adj. EBITDA	\$370	\$355	\$335	\$303	\$202
year-over-year % growth	4.2%	6.1%	10.6%	49.4%	14.9%
EV / Adj. EBITDA	9.8x	10.4x	11.2x		

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

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 sequential profit volatility at Big Fish Games related to factors such as user acquisition spending and platform fees, and 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 addition, we like the company's 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	\$166.0	2.7%	\$161.7	4.2%	\$155.2	2.7%	\$151.1
Calder Race Course	2.6	(3.7%)	2.7	3.8%	2.6	(3.7%)	2.7
Arlington Park	54.5	0.6%	54.2	(2.0%)	55.3	1.7%	54.4
Fair Grounds	36.9	1.4%	36.4	(4.2%)	38.0	(4.5%)	39.8
Total Racing Operations	260.0	2.0%	255.0	1.6%	251.1	1.2%	248.0
TwinSpires	237.0	2.2%	232.0	5.2%	220.6	10.2%	200.2
Casinos - excluding JVs	340.0	0.3%	339.0	1.9%	332.8	(0.0%)	332.9
Big Fish Games	480.0	2.1%	470.0	(3.3%)	486.2	17.5%	413.7
Other & Corporate	18.0	(5.3%)	19.0	6.1%	17.9	2.0%	17.5
Net Revenues from Contin. Oper.	\$1,335.0	1.5%	\$1,315.0	0.5%	\$1,308.6	7.9%	\$1,212.3
Adjusted Segment EBITDA:							
Racing Operations	87.0	3.6%	84.0	5.4%	79.7	10.9%	71.8
TwinSpires	60.0	2.6%	58.5	6.0%	55.2	13.6%	48.6
Casinos - exclud. JVs	105.5	0.5%	105.0	2.1%	102.8	0.6%	102.2
Casinos - equity inv. in JVs, estim.	27.5	3.8%	26.5	15.2%	23.0	81.1%	12.7
Big Fish Games	96.0	9.1%	88.0	11.3%	79.1	15.5%	68.5
Other & Corporate	(6.0)	(14.3%)	(7.0)	32.1%	(5.3)	307.7%	(1.3)
Adjusted Segment EBITDA ~	\$370.0	4.2%	\$355.0	6.1%	\$334.5	10.6%	\$302.5
Adjusted EBITDA Margins							
		bp chg.		bp chg.		bp chg.	
Racing Operations	33.46%	52	32.94%	120	31.74%	277	28.97%
TwinSpires	25.32%	10	25.22%	19	25.02%	74	24.28%
Casinos - exclud. JVs	31.03%	6	30.97%	8	30.89%	19	30.70%
Casinos - includ. equity inv. in JVs	39.12%	33	38.79%	99	37.80%	329	34.51%
Big Fish Games	20.00%	128	18.72%	245	16.27%	(29)	16.56%
Total	27.72%	72	27.00%	143	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

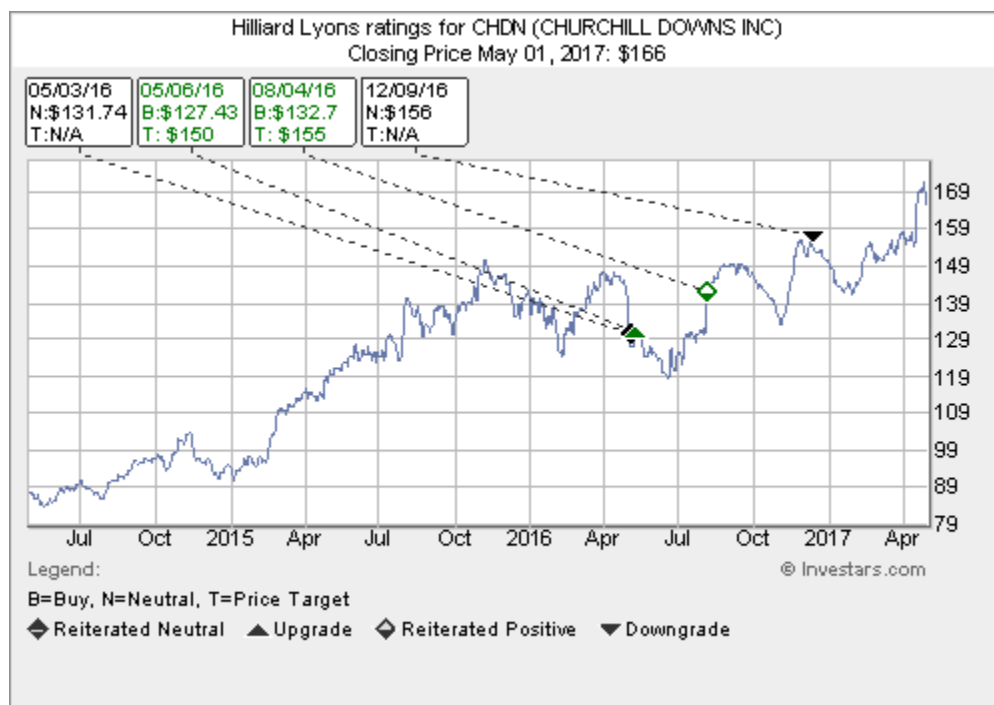
2 - A historically secure company which could be cyclical, has a shorter history than a "1" or is subject to event driven setbacks

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	30%	14%	86%
Hold/Neutral	71	58%	6%	94%
Sell	15	12%	7%	93%

As of 5 April 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

Opinions expressed are subject to change without notice and do not take into account the particular investment objectives, financial situation or needs of individual investors. Employees of J.J.B. Hilliard, W.L. Lyons, LLC or its affiliates may, at times, release written or oral commentary, technical analysis or trading strategies that differ from the opinions expressed here.

J.J.B. Hilliard, W.L. Lyons, LLC is a multi-disciplined financial services firm that regularly seeks investment banking assignments and compensation from issuers for services including, but not limited to, acting as an underwriter in an offering or financial advisor in a merger or acquisition, or serving as placement agent in private transactions.

The information herein has been obtained from sources we believe to be reliable but is not guaranteed and does not purport to be a complete statement of all material factors. This is for informational purposes and is not a solicitation of orders to purchase or sell securities. Reproduction is forbidden unless authorized. All rights reserved.