



COMPANY UPDATE / ESTIMATE CHANGE

Key Metrics

CHDN - NASDAQ (as of 11/2/17)	\$209.35
Price Target	N/A
52-Week Range	\$132.80 - \$218.05
Shares Outstanding (mm) (basic)	15.3
Market Cap. (\$mm)	\$3,203
3-Mo. Average Daily Volume	72,540
Institutional Ownership	76%
Total Debt/Total Capital (9/17) *	65%
ROE (TTM ended 9/17)	20%
Book Value/Share (9/17)	\$40.93
Price/Book Value	5.1x
Annual Dividend & Yield	\$1.52 0.7%
EBITDA Margin (TTM ended 9/17)	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		\$1.08	A	
4Q	\$1.60	\$0.60	\$0.67		
Year	\$6.42	\$6.75	\$7.00	\$7.50	\$8.25
P/E	32.6x		29.9x		25.4x

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		\$452	A	
3Q	\$303		\$315	A	
4Q	\$278	\$283	\$294		
Year	\$1,309	\$1,320	\$1,340	\$1,365	\$1,400

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

Impressive 3Q Results

Investment Highlights

- **CHDN's 3Q results exceeded our expectation.** Total revenues of \$314.8 million were up nearly 4% from the year ago period. Adjusted EBITDA (earnings before interest, taxes, depreciation and amortization) of \$76.0 million rose 7% and exceeded our expectation by several million dollars. Three of the four major business segments generated higher adjusted EBITDA, with Big Fish Games down due mainly to higher user acquisition spending. Total company adjusted EBITDA margin rose 71 basis points.
- **Our outlook for this year has improved further.** We raised key financial estimates after 2Q results and we are doing likewise after 3Q results. We have increased our 2017 revenue estimate by \$20 million and raised our adjusted EBITDA estimate by \$8 million. These increases are generally spread across the company's operations. We have also raised our estimates for key metrics in 2018.
- **The annual dividend is set to rise.** On October 26, 2017, the company announced a 15% increase to the annual dividend. The new rate is \$1.52 per share, and is payable on January 5, 2018. The 15% hike is identical to the increase implemented one year ago.
- **We maintain our Neutral rating due to valuation.** We maintain our overall favorable view of the company and its portfolio of businesses. Growth initiatives are abundant, in our view. This includes the iconic Kentucky Derby and several other businesses. We expect adjusted EBITDA (the most watched financial metric) to grow 10% and 8% in 2017 and 2018, respectively, with margin improving each year. CHDN shares are currently above our preferred level for purchases. We could consider a rating upgrade 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			Nine Months Ended		
	9/30/17	9/30/16	% chg.	9/30/17	9/30/16	% chg.
Net Revenues	\$314.8	\$303.4	3.8%	\$1,046.2	\$1,030.3	1.5%
Segment & Corporate Expenses	244.4	238.6	2.4%	756.2	767.9	(1.5%)
Selling, Gen. and Admin. Exp.	26.8	27.6	(2.9%)	77.6	75.3	3.1%
Research and Development	9.7	8.8	10.2%	29.9	29.3	2.0%
Calder Exit Costs	0.2	0.5		0.8	2.4	
Acquisition Related Charges	0.7	1.1		1.7	4.9	
Operating Income	33.0	26.8	23.1%	180.0	150.5	19.6%
Interest Expense, net	(12.6)	(11.1)	13.5%	(36.0)	(32.8)	9.8%
Equity in Income of Unconsol. Invest.	8.9	4.9	81.6%	22.7	13.5	68.1%
Misc., net	(1.0)	(0.2)		(0.8)	(0.3)	
Total Other Income	(4.7)	(6.4)	(26.6%)	(14.1)	(19.6)	(28.1%)
Income Before Taxes	28.3	20.4	38.7%	165.9	130.9	26.7%
Taxes	11.6	11.7	(0.9%)	63.6	49.6	28.2%
Net Income from Contin. Oper.	16.7	8.7	92.0%	102.3	81.3	25.8%
Diluted EPS from Contin. Oper.	\$1.08	\$0.52	107.2%	\$6.32	\$4.79	31.9%
Segment Adjusted EBITDA (Earnings Before Int., Taxes, Deprec. & Amort.)	\$76.0	\$71.1	6.9%	\$306.3	\$278.0	10.2%
Avg. Diluted Shares Outst.	15.5	16.9	(8.3%)	16.2	17.0	(4.7%)
% of Net Revenues:			bp chg.			bp chg.
Gross Profit	22.36%	21.36%	101	27.72%	25.47%	225
Selling, Gen. and Admin. Exp.	8.51%	9.10%	(58)	7.42%	7.31%	11
Adjusted EBITDA	24.14%	23.43%	71	29.28%	26.98%	229
Operating Income	10.48%	8.83%	165	17.21%	14.61%	260
Net Income from Contin. Oper.	5.30%	2.87%	244	9.78%	7.89%	189
Tax Rate	40.99%	57.35%	(1,636)	38.34%	37.89%	44

Source: Churchill Downs Incorporated and Hilliard Lyons estimates

Additional comments on 3Q. This was a seasonally slow quarter for the Racing segment, yet revenues and adjusted EBITDA improved slightly from year ago levels due in large part to greater results at Arlington Park.

Our biggest surprise in the quarter came from the Casino segment, which benefited from successful marketing and promotional activities despite increased competition in some regions. Overall revenues rose 5%, with solid performances coming from CHDN's Oxford Casino (Maine), Riverwalk Casino (Mississippi), Harlow's Casino (Mississippi), VSI (video lottery business in Louisiana), and Calder Casino (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. Total adjusted EBITDA from the Casino segment rose an impressive 30%.

The TwinSpires online wagering business performed well once again as it continued to add customers and capture market share. This segment produced an approximate 20% revenue gain (reflective of a 24% gain in active players) and a 28% rise in adjusted EBITDA as margin rose 185 basis points. We feel the Twin Spires team has done an impressive job developing technologically advanced platforms (for various devices) while conducting effective marketing.

Big Fish Games saw a 4% decrease in 3Q revenues as the casual and free-to-play casual categories were impacted by lower levels of user acquisition spending over the past year or so. Spending returned to higher levels in the recent quarter, which crimped adjusted EBITDA (down \$10 million from a year ago) and margin (a 782 basis point drop). However, this could help spur revenue growth in future quarters. Acquired in late 2014, Big Fish is quite important to CHDN, with annual revenues larger than any other segment.

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

	Quarter Ended			Nine Months Ended		
	<u>9/30/17</u>	<u>9/30/16</u>	<u>% chg</u>	<u>9/30/17</u>	<u>9/30/16</u>	<u>% chg</u>
Net Revenues:						
Churchill Downs Racetrack	\$8.1	\$8.7	(6.9%)	\$147.1	\$140.1	5.0%
Arlington Park	25.0	24.0	4.2%	51.5	49.8	3.4%
Fair Grounds Race Course	5.0	5.1	(2.0%)	27.5	28.9	(4.8%)
Calder Race Course	0.7	0.7		1.9	2.0	
Total Racing Operations	38.1	37.8	0.8%	226.1	218.8	3.3%
Big Fish Games	117.9	122.3	(3.6%)	342.5	369.6	(7.3%)
TwinSpires	65.9	55.1	19.6%	198.4	173.1	14.6%
Calder Casino	19.4	19.0	2.1%	62.6	59.8	4.7%
Fair Grounds Slots	8.7	8.5	2.4%	27.7	27.9	(0.7%)
VSI (LA video poker machines)	9.3	8.6	8.1%	28.8	27.9	3.2%
Harlow's Casino	12.3	11.7	5.1%	38.3	36.6	4.6%
Oxford Casino	25.2	24.4	3.3%	69.2	65.4	5.8%
Riverwalk Casino	12.2	10.6	15.1%	35.7	35.7	0.0%
Saratoga	0.4	0.2		1.0	0.6	
Total Casinos	87.5	83.0	5.4%	263.3	253.9	3.7%
Other Investments	4.7	4.5	4.4%	14.0	12.9	8.5%
Net Revenues from Contin. Oper.	\$314.1	\$302.7	3.8%	\$1,044.3	\$1,028.3	1.6%
Segment EBITDA:						
Racing Operations	\$1.7	\$0.4	325.0%	\$90.7	\$84.3	7.6%
Big Fish Games	17.0	27.2	(37.5%)	55.6	53.9	3.2%
TwinSpires	18.8	14.7	27.9%	51.3	45.6	12.5%
Casinos	39.5	30.4	29.9%	112.3	98.0	14.6%
Other Investments	1.1	0.8	37.5%	3.0	2.9	3.4%
Corporate	(2.1)	(2.4)	(12.5%)	(6.6)	(6.7)	(1.5%)
EBITDA from Contin. Oper.	\$76.0	\$71.1	6.9%	\$306.3	\$278.0	10.2%
Segment EBITDA Margins						
			bp chg.			bp chg.
Racing Operations	4.46%	1.06%	340	40.11%	38.53%	159
Big Fish Games	14.42%	22.24%	(782)	16.23%	14.58%	165
TwinSpires	28.53%	26.68%	185	25.86%	26.34%	(49)
Casinos	45.14%	36.63%	852	42.65%	38.60%	405
Total	24.20%	23.49%	71	29.33%	27.03%	230

Source: Churchill Downs Incorporated

Note: Results are from continuing operations only

The company's GAAP-based EPS for 3Q were \$1.08 versus the year ago figure of \$0.52. However, we do not feel GAAP-based earnings are a major focal point among investors. The weighted average share count in 3Q was 8% 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, including 1 million shares in June 2017.

Financial condition. We consider CHDN's balance sheet levered, but in solid condition. At the end of 3Q 2017, total interest-bearing debt was \$1.124 billion, not including earn-out and deferred payment liabilities related to Big Fish Games. Including these amounts, total indebtedness represented about 65% of total capitalization. Shareholders' equity at the end of 3Q was \$626.3 million. The period-end leverage ratio (total debt excluding Big Fish deferred liabilities divided by trailing adjusted EBITDA) was about 3.1x, 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.

Outlook. We continue to view CHDN's business prospects favorably. For 4Q 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, decent 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. For all of 2017, we project total revenue of \$1.340 billion, adjusted EBITDA of \$368 million, and GAAP-based EPS of \$7.00. Each of these figures represent increases from our previous estimates.

We have also updated our 2018 estimates to reflect continuation of the aforementioned factors and a few others, such as new additions to the namesake track for Kentucky Derby growth potential and a new gaming center featuring "historical racing machines" (very similar to slot machines) expected to debut in Louisville, KY in the Fall. In general, we expect 2018 to be another year of record results. This includes total revenue of \$1.400 billion, adjusted EBITDA of \$398 million, and GAAP-based EPS of \$8.25.

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.

Stock price and valuation. CHDN shares are currently trading at 29.9x our 2017 EPS estimate and 25.4x 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 11.8x. The multiple based on our 2018 projections is 10.6x. This equates to an approximate 10.8x multiple on expected twelve-month forward adjusted EBITDA. As a matter of information, we note this is above the approximate 9.6x valuation on projected forward adjusted EBITDA at the time of our rating downgrade to Neutral from Buy on 12/9/16.

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 (11/2/17)	\$209.35					
Recent Diluted Share Count	15.5					
Market Capitalization	\$3,245					
Net Debt, year end ~		\$975	\$1,100	\$969	\$1,107	\$1,104
Enterprise Value (EV)		\$4,220	\$4,345	\$4,214	\$4,352	
Adj. EBITDA		\$398	\$368	\$335	\$303	\$202
year-over-year % growth		8.2%	10.0%	10.6%	49.4%	14.9%
EV / Adj. EBITDA		10.6x	11.8x	12.6x		

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. Currently, 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	\$170.0	3.0%	\$165.0	6.3%	\$155.2	2.7%	\$151.1
Calder Race Course	2.6	4.0%	2.5	(3.8%)	2.6	(3.7%)	2.7
Arlington Park	58.0	0.9%	57.5	4.0%	55.3	1.7%	54.4
Fair Grounds	37.4	2.5%	36.5	(3.9%)	38.0	(4.5%)	39.8
Total Racing Operations	268.0	2.5%	261.5	4.1%	251.1	1.2%	248.0
TwinSpires	278.0	9.9%	253.0	14.7%	220.6	10.2%	200.2
Casinos - excluding JVs	358.0	3.8%	345.0	3.7%	332.8	(0.0%)	332.9
Big Fish Games	475.0	3.0%	461.0	(5.2%)	486.2	17.5%	413.7
Other & Corporate	21.0	7.7%	19.5	8.9%	17.9	2.0%	17.5
Net Revenues from Contin. Oper.	\$1,400.0	4.5%	\$1,340.0	2.4%	\$1,308.6	7.9%	\$1,212.3
Adjusted Segment EBITDA:							
Racing Operations	91.0	5.8%	86.0	7.9%	79.7	10.9%	71.8
TwinSpires	70.0	12.0%	62.5	13.2%	55.2	13.6%	48.6
Casinos - exclud. JVs	112.0	5.2%	106.5	3.6%	102.8	0.6%	102.2
Casinos - equity inv. in JVs, estim.	48.0	23.1%	39.0	69.6%	23.0	81.1%	12.7
Big Fish Games	83.5	4.4%	80.0	1.1%	79.1	15.5%	68.5
Other & Corporate	(6.5)	8.3%	(6.0)	13.2%	(5.3)	307.7%	(1.3)
Adjusted Segment EBITDA ~	\$398.0	8.2%	\$368.0	10.0%	\$334.5	10.6%	\$302.5
Adjusted EBITDA Margins							
		<u>bp chg.</u>		<u>bp chg.</u>		<u>bp chg.</u>	
Racing Operations	33.96%	107	32.89%	115	31.74%	277	28.97%
TwinSpires	25.18%	48	24.70%	(32)	25.02%	74	24.28%
Casinos - exclud. JVs	31.28%	42	30.87%	(2)	30.89%	19	30.70%
Casinos - includ. equity inv. in JVs	44.69%	252	42.17%	437	37.80%	329	34.51%
Big Fish Games	17.58%	23	17.35%	108	16.27%	(29)	16.56%
Total	28.43%	97	27.46%	190	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

Rating	Hilliard Lyons Recommended Issues		Investment Banking Provided in Past 12 Mo.	
	# of Stocks Covered	% of Stocks Covered	Banking	No Banking
Buy	39	32%	8%	92%
Hold/Neutral	74	60%	9%	91%
Sell	8	7%	0%	100%
Restriction	2	2%	100%	0%

As of 5 October 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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