The University of Arizona
Race Track Industry Program

37th ANNUAL
SYMPOSIUM ON RACING & GAMING

TUESDAY, DECEMBER 7, 2010

Keynote Address

Robert Evans, President and CEO Churchill Downs, Inc.

Mr. Doug Reed: Our first speaker today joined Churchill Downs as president and chief executive officer and a member of the board of directors in August 2006. Over his 35-year career, Evans has distinguished himself as a leader in a variety of industries. Having held a position as senior executive for Caterpillar, Mazda Motor of America, Accenture Limited, and prior to joining Churchill, Evans held the top leadership positions at international technology and private equity capital companies including Symphony Technology Group.

I think the following statement he made, when he was appointed to his current position at Churchill is very relevant today for symposium attendees. In 2006 Mr. Evans said, "Ultimately, we must find innovative new ways to engage and serve customers. We must think globally to expand our market opportunities, and we must make decisions and execute at much faster speeds than in the past."

I think that's still appropriate today. Evans has also been an active participant in the thoroughbred industry since 1980 as a commercial breeder and racehorse owner. He is the president of Ten Lane Farm, a thoroughbred operation he built in Woodford County, Kentucky where he resides with his family.

I'm delighted, and it is an honor to introduce our Symposium Keynote Speaker this morning, Mr. Robert Evans. I'm also very grateful that Mr. Evans has agreed to start this week's proceedings with his views on the racing industry. Please help me welcome Mr. Robert Evans.

[Applause]

Mr. Robert Evans: Good morning everyone. When I walked in I was glad to see a full room. So Doug explained to me that he booked all the tee times this morning which pretty much forced you all to come, so I appreciate that.

So how did I end up here this morning? About 2-1/2 hours ago when I woke up, I wasn't exactly clear. I got to thinking about it.

You've all been in this situation. You get the call. Four or five months back, Doug calls and says, "Bob, would you consider being the keynote speaker," and that voice in your head is going, "No, don't do it, decline, say no."

"Sure, Doug, I'd love to."

And the reason you say yes at that point in time is that no effort is required. You don't even need to have a title for your talk. At that point you're just agreeing to be on the calendar at some future date. But you promise yourself that day that you're going to start earlier. All right, everybody has been there. We're going to start early. We're going to do it different this time.

Then a month passes, and another month, and a couple more months pass and then Doug calls one day and says, "Hey, we're about to put out the program, gotta have your title."

Now this is the first moment of truth.

You've probably all done the same thing I've done, which is you pick this glorious-sounding title and then you say a few weeks later, "How am I going to put anything under there that actually holds up to the title?"

This time, my first thought was, "Let's do something a little more light-hearted, sort of Jeff Foxworthy style," so I had a few thoughts like, "You've been in business over 125 years, but you still don't know if you're going to be open this weekend? You must be in horse racing."

[Laughter]

"If you're tearing out the fake dirt to put in new, real dirt; you gotta be in horse racing."

One kind of close to home, "If you lost $5 million doing a three-day music festival, better call your board and see if you're still in horse racing."

Then I decided that I'd go with my usual role which is, never do comedy before noon. We just found out why.

So I thought, "Well, what am I going to do?" And I was talking to my brother who runs our farming operation, and we were doing what you do every fall which is the most unpleasant thing in the market right now. It is that you first lick your wounds over your yearling sales in 2010, and then you make the next tough choice which is, what stallions am I going to breed to next year so I can lose even more money?

So we were sitting there, my brother Tom and I, discussing this; seriously, because you've got to breed the mares at some point, and he said to me — he's been in the business his entire life. He got out of Vanderbilt, went to work for Woody Stevens in New York and Florida making that cycle, and then went to work for Lee Eden. He learned a lot about the agency business and the breeding business. He then started his own farm which is now 30 years old, I think. But this is the only job he's got. He didn't inherit his money. He's made his whole way in this horse business.

So he said to me something that was kind of shocking which is, "You know, are you sure you want to do this?" And I thought that was a really good question. So I thought about it for a day or so. I thought, "You know, I could do my whole Arizona thing on that one theme."

So that's how we got to the title today, "Why I'm Still Breeding Race Horses," and what I think some of you may find a little interesting, I hope, is that I've actually got a very optimistic future about the long-term prospects for horse racing.

I thought I'd spend a few minutes this morning trying to explain to you why I think there's a lot of room for optimism here.

It's going to be different, but I think there's a lot of room for optimism in something and something that we can sort of build toward as opposed to the gloom and doom that sort of pervades the industry right now.

As Doug said, my internship turned into a job. Over the last few years, we've had the situation where my job turned into an internship.

So I want to cover three things today. I want to look at the most important trends in our industry. I want to share a few perspectives on where our industry might be headed.

Just out of curiosity, how many media people, just a quick raise of hands, are in the room today?

All right, so I'll try to give you something you can use in that particular segment and then, three, explain why I'm optimistic about our future.

Now I'm not going to spend a whole lot of time on the challenges that we face. I think we're all very much aware of those, but I wanted to comment on a few of them and maybe ask that you think about them in a different context.

Let's start on the demand side of our business. We have this cycle that sort of keeps repeating itself. Lower handle leads to lower revenues. Lower revenues lead to lower returns on invested capital. So the racetracks and the ADWs and the OTBs all invest less.

Guess what? That leads to a decline in customer experience as our facilities deteriorate. Our tote systems get older. Our video boards get older. The grandstand and the club house all get older.

As the customer experience declines they spend less money on thoroughbred racing and the handle continues to drop.

This chart shows that graphically. The black bars represent handle as a percent of personal disposable income. You can see it's been on a pretty steady decline for the last 15 years or so.

If you go back to the mid 90s, handle accounted for about 2/10th of a percent of personal disposable income. Today, it's about 1/10th of a percent so it has dropped by about 50 percent.

Just for funsies, I put casino gaming up there. That's the red bar. Casino gaming has gone from a little over 5/10th of a percent of personal disposable income. It actually got up over 6/10th of a percent, and then with the recession for the last three years, it has dropped off a little bit.

I'm actually somewhat optimistic about this because I think we've probably bottomed out, as a percent, or as a share of personal disposable income at about 1/10th of a percent. And if we can get incomes to start to grow again, which in this economy is tough, and it's going to take a long time to work off the unemployment numbers that we currently have, but once we get past that, and I think we see some income growth, I actually think we'll see handles start to grow again.

Unfortunately, I don't think that's going to happen for probably three or four more years, so if we can kind of get through this kind of short-term period, and I guess three or four years isn't short-term if you're looking at cash deficits every month, but if we can get through this short-term period, I'm pretty optimistic about the longer term trends on handle.

Total handle, needless to say, has declined pretty precipitously. Since 2003 it's down about 25 percent or $3.8 billion. To put the $3.8 billion in context, at a 20 percent take-out rate, that means we've got about $750 million less in revenues to run our tracks, our OTBs and our ADWs.

That's the money that pays for horses in training. That's the money that buys new horses.

And let's not forget, this isn't inflation adjusted, so instead of being down 25 percent in nominal dollars or actual dollars, we're probably down closer to 40 percent in inflation-adjusted dollars.

We face similar challenges on the supply side. In this cycle the supply cycle tends to reinforce itself as well.

Start with the lower handle again. Lower handle, lower purses. Lower purses, people spend less money on horses.

Since the race states are relatively sticky in a downward direction, we'd have fewer horses running across more race states. We see declining field sizes which reinforces lower handle. So this cycle keeps reinforcing itself as well.

On the supply side, I think the two most challenging trends are on the yearling market. We're off about 50 percent from where we were at the peak a few years ago.

The challenge here is that it takes a fairly long time for the yearly market to react to changes in handle, given the breeding and the gestation and sale cycle of horses. It takes three or four years for changes in handle to be reflected in the prices of thoroughbreds.

You know, when I look at this, I think I've got seven yearlings that I'll try to sell.

My brother and I have quit referring to the sales as sales. We now refer to them as outings. We get them pretty, we put on the new halters, put them on the van, ship them to the sales ground, they interact with some people for a few days and then we take them home. That's an outing, that's not a sale.

[Laughter]

The other thing that's affecting us here and this isn't a new thought with me as the research was done quite some time ago, but there's a high correlation between the stock market valuations and yearling sales. When the stock market is booming, yearling sales do particularly well and, obviously, the last couple of years it's been tough. It's done much more poorly.

So I think some of the snap back from where we are there in 2009 and 2010 will occur as the economy and the stock market improves.

But perhaps the most sobering trend of all is this chart that shows the number of US-bred horses. So this is the full crop plus three years. So instead of looking at it as the full crop, I'm looking at it as three-year-olds and using that as a proxy for horses of racing age.

I think this is the thing that gets overlooked more than anything else as you think about the near-term future, sort of the 2013-2014 timeframe because, not only are we going to have fewer horses, that's a given. The 2013 and 2014 crops are either on the ground or in utero at the moment, so it's a given. It's just a math problem from here on out as to what they end up being.

But what I've observed in the last two years is that, not only are we producing fewer horses and we're going to produce a lot less here going forward, but those horses are ending up overseas far more frequently than they used to, which is going to further reduce the available race horse population in the US. And then inside the US what's happening is that the horses are migrating from the states that don't have slots at their tracks to the states that do have slots at their tracks.

So the folks that are going to get left out of this party over the next three or four years, and I think are going to find it just incredibly difficult to get through economically, are those racetracks in states that don't have slots. That's going to be a huge shock.

If we're down 28 percent between 2010 and 2014 in the number of three-year-olds that we'll have available, gross, and then we subtract higher percentages going to Europe, Asia and South America, and then we say, "Okay, you live in a state that doesn't have slot-subsidized purses," and ask how much a horse population are you going to have available to you to fill races, I think it's going to be a 30-, 40- or maybe even a 50-percent drop.

I think we're just starting to see the early signs of that. It probably feels really bad at the moment, but I think we're at just the early signs of that in places like California and elsewhere.

So I think this is the most sobering trend that I see in the business and one that is going to be very difficult to reverse because out through 2014, this is pretty much a given. Unless someone begins importing race horses in large quantities, this is what we're going to have to conduct our racing business with in terms of available race horses.

The other problem with these two cycles is that they reinforce each other. If you kind of think of this as a figure-of-eight, going around and around, the demand side keeps pushing handle lower, which then pushes the supply side lower, which pushes handle lower, the demand side lower. So we've got to find some way to break up these self-reinforcing cycles because if we don't we're just going to spin to the bottom.

Unfortunately, what we seem to be most eager to do is either fight within our cycle. So we've got the tracks and the OTBs and the ADWs fighting over the available spoils, the economic spoils. Or, we fight between the cycles, the breeders and owners fighting with the tracks and the OTBs and the ADWs over who is going to get the available dollars.

I suppose some of that has to go on. I hope the majority of it is over, but none of the solutions to either one of those battles is going to solve our problem. So we can spend time on it, but it's not going to take us anywhere better than we currently are. The only thing that's going to change is who has the dollar in their pocket, and there's not enough dollars, so in a way it's sort of a moot point.

So the question I'd ask there at the bottom was where the heck are we headed?

Here's one answer that I don't like very much. This is from March of this year, out in Iowa. Harrah's, who has a casino and a dog track there, can help with what I would call a very innovative proposal.

What they said is, "We're subsidizing dog purses to the tune of about $10 million a year. Hey, how about if we did this differently. What if we gave $7 million of that $10 million to the state? Dear Politicians, you like that idea don't you? And of the balance $3 million, we'll keep it," so Harrah's is better off as well.

However, we know that we need a little transition period here, so for the next couple of years, we're going to pay off $3-6 million a year to the dog breeders in Iowa, sort of a soft landing.

Now why the heck did this proposal get made? You know and more than one opinion writer has opined that this is the future of horse racing and slots as well, that this is where we're going to end up.

That's not necessarily true. The reason this got made, this proposal got made, is very simple. Running a greyhound racetrack is an unprofitable business, so Harrah's is better off shutting it down and keeping part of the $10 million than they are in continuing.

If we want horse racing to continue and prosper this world, because we're setting up the same forces in horse racing that we see on this page, but they don't have to happen. The thing that has to change is the business has to become profitable. People have to earn a reasonable return on capital. If they don't, we're going to end up with another story like this, only we'll go through here and replace the word "dog" with "horse" and you get a bad answer.

So the challenge in this is trying to figure out what the future looks like, so at great personal risk, because we're dealing with the future, we took a shot at building an economic model of horse racing that was economically self-sustaining. In other words, we didn't just take trends and project them. What we said was, "If horse racing is going to be successful, it needs to be profitable."

So whatever it takes, let's build that economic model of success, and we decided to try to do it for the year 2020. Now, that seems like a long time away, although as I get older, it seems shorter and shorter, but it seems like a long time away, because as I said earlier, your 2013-2014, I think the die is already sort of cast. We may have some up years or down years, but I think basically we're going to get noise in the data around the trends which are generally that declining.

But from 2014 on, we can make it whatever we want to make it. So the way we looked at this is, we built this model for the year 2020, and we asked the question, "What is racing's economically self-sustaining business model?"

We included in this analysis the projected purse subsidies from gaming. So we left those in, but we required racetracks to operate profitably at a five percent pretax return on capital, excluding the profit they got from gaming because if we include that, it sort of masks the problem. If you take your gambling operation and you say, "That's profitable, and I've got my racing operations and it's unprofitable, and I add them together, I'm going to make the wrong decisions on both. I'm going to under-invest in the profitable one, and I'm going to over-invest in the unprofitable one."

So we put it together that way. We did this for the North American Thoroughbred Race Track Industry, and we saw it for a couple of things. We saw it for the number of races, race days and tracks. How many will we have? We saw it for handle per race and purses per race. We saw it for the number of starters per race and the total number of starters.

Now when I was discussing this with somebody, they suggested to me that we had a lot of not-for-profit entities in horse racing. They didn't need to be held to that five percent pretax return on invested capital standard. That's bunk.

I was reminded of that this past weekend when I noticed that the Louisville Symphony Orchestra after 75 years, actually 74 years. Next year would be their 75th. They have just filed for bankruptcy.

I don't care if you're a nonprofit or not, that determines whether you distribute your profits to the owners, whether there's an equity interest that receives the benefits of being profitable. I don't care if you're profitable or not, you've got to earn some return on your invested capital. Otherwise, each year more cash goes out than comes in, and that is not a sustainable model for a long period of time.

Someone might also argue that five percent pretax return on capital isn't a particularly high hurdle either. So think of that as sort of a blend between what nonprofits might be willing to accept and what the for profit entities might be willing to accept.

Now, to do this you need to make a number of assumptions. I'll just repeat the simple ones here. So handle grows two percent a year, to $15.5 billion by 2020. In 2003 it was 15.2 billion dollars. This year it's going to be $11.4 billion, give or take a dollar. In 2020 we're back to the previous peak, $15.5 billion.

So the good news is we think it goes up. The bad news is it doesn't go up by very much.

In order to do this profit modeling, we've got to have some cost model for your business, so what we did is, we took the four Churchill Downs Tracks at Churchill, Arlington, Calder and Fair Grounds, and we included in that data some of the other data we've seen over the last couple of years. We've probably seen every racetrack that's been for sale so we have a reasonably good understanding of their cost structure.

Then we put that together in a composite, average track cost structure with 13 categories, so pari-mutuel cost, insurance costs, etc. We then increased those costs two percent a year for inflation. I hope we get by with only two percent inflation over the next decade.

You have to make certain assumptions about how the handle flows through each channel. We assumed that the on-track and rebate channels at 11 and 10 percent, respectively, stay constant. We assume that ADW grows from 13 to 23 percent. That's a pretty good assumption, I think if you look at other industries that have both a bricks and mortar and an internet channel, take the travel industry, for example, or shoes or books. You see those numbers approaching 70 percent, where 70 percent of the dollar value is going through the internet channel and 30 percent is going through the bricks and mortar channel. So to get to 23 percent here does not seem like much of a stretch.

The simulcast channel, the bricks and mortar, OTBs and racetracks on simulcast signals, that decline I think continues. It's been going on for quite some time. I think that continues. And at the other channels, like the tribal casinos or Vegas, that declines from about six to four percent. So the channel mix is changed slightly.

We assume that handle, by geographic origin, so we need that to determine source market fee analysis. We assume that handle by geographic origin, what state, what county and what zip code that handle occurs in remains the same. And we assume that signal pricing and take-out splits by channel remain at the 2010 level and that purse contributions for gaming grow five percent a year.

We can be reasonably good at predicting that for the next three years because we kind of know what new casinos are going to come online in the 2011, 2012 and 2013 timeframe. Beyond that, it's anybody's guess. You tell me whether Illinois or Kentucky, for example, will pass a Slots at Tracks Bill. We don't' know, but we assumed that they'd grow five percent a year.

For my media friends in the room, this model is wrong. I don't know how it's wrong, but I know for certain that it's wrong. It's wrong because the assumptions are wrong. I just don't know which ones yet. I'll come back in 2020 and give you an update.

The other reason is racetrack operators may not face economic pressures. So everybody may not respond to the economic forces the same way. Some of them may not require a minimum return on invested capital. Some of them may elect to use gaming profits to subsidize their racing business in their thinking.

I think that's a mistake, but people are going to do it.

Or, they may have other existing or new sources of subsidies. Some states may subsidize racetracks. Frankly, Churchill Downs has a huge subsidy in the sense of the Kentucky Derby. It subsidizes a lot of what we do.

So I know the assumptions are wrong. I know that racetrack operators won't all respond in an economically rational way. We can pretty much guess that legislation and regulation will come along, or is already in existence, that keeps the market forces from working.

We may find that racing becomes socially unacceptable. I don't believe I was ever more scared for the future of racing than in early May, the first Saturday as it were, in 2008 when Eight Belles went down at the Derby.

Now, the tradition there, and it long predates me, is that I go stand in the winner's circle, the Kentucky Derby's winner circle which is in the infield, before the race. I've never actually seen the Kentucky Derby since I've worked there. I see them from about the 16th pole for about half of a second. They go by, that's it and that's all I know, and we weren't prepared when Eight Bells went down.

We didn't have a good communication system in place. We've fixed that. And so we were standing there with Bob Costas and the other people on the podium, and we didn't know what had happened, and that was one of the worst moments of my professional life.

It got worse later that day as I saw people leaving the track in tears, and it dawned on me right then that we're living on a very precarious edge of the cliff with respect to safety because a few more very public accidents like that, I'm not sure that we don't become socially unacceptable to a very large percentage of the population.

So we started with the NTRA's help and others. We started, immediately thereafter, making progress. I think that one of the things that I'm most proud of over the last couple of years has been the progress that the industry has made in safety. It's not only the new innovations that are out there. Some of this stuff is pretty mundane. I saw the starting gate out front. It's incremental progress, bit by bit, and you make it better, but also we've started to talk about it and use the PR channel much better than we used to. So we're actually telling our audience that we do care about safety and we are doing things proactively, rather than waiting for the crisis to hit and then all running around trying to figure out what to do.

Finally, we may find the "secret sauce" that makes racing more interesting to consumers. So there may be some up side around this as well.

Let me just repeat here. These are not forecasts. These are not predictions. The headline I read, if anybody writes about this, should not say, "Evans calls for …" and then what I'm going to show you on the next page.

I'm not calling for it. I'm not predicting it. I'm not forecasting it. Are we all clear on that one?

What we did is build an economic model based on a set of assumptions and said, "In order for racetracks to be profitable, what is it going to have to look like?"

It's a math problem, not a predication and not a forecast.

As I said earlier, handle goes from about (and this is North American handle by the way and not US), $12.3-15.5 billion, flat, or roughly flat. There will be some ups and downs for the next few years, and then growing at about four percent after that.

Purses go from $1.2-1.7 billion, so an increase of about $0.5 million. The breeder/owner who is at the side of me is smiling on that one. I like that. About 70 percent of that $0.5 billion increase comes from gaming. The other 30 percent comes from the growth in handle.

The number of races goes from about 56,000 (again North American) to 31,000. Number of race days cut by slightly more than half.

I mean, this is going on right now. We're probably going to lose maybe eight percent race days this year, something like that.

The number of racetracks and it's hard to count racetracks. You'd think this would be very easy, but with all the fairs and the people who are open for two days here and there, it's really hard to count them. So there's approximately 55 today. I can at least list 55 real deal racetracks. We think that number will fall by almost half to around 26.

The average handle per race goes from about $230,000 to $495,000. The average purse per race goes from $22,000 to $55,000.

The number of starters falls from about 25 percent. The breeding side of me doesn't like that at all, but I think that's the fate we face.

The average field size goes from eight to somewhere around 12. This one is a tough one to model because it's just almost impossible to understand what owners and trainers will do ten years out in terms of running horses more frequently or less frequently.

So this is a racetrack business model that works. This produces at least a five percent return on invested capital from racing operations. It continues to use gaming revenues to subsidize purses, but it's a smaller business. But it's a healthy business. It's an economically self-sustaining business. It's not a business that should result in the Harrah's, Council Bluff's greyhound track article, because there is no economic reason to get to that solution if we have a business that operates on this basis.

Not a prediction, not a forecast. Evans did not call for this outcome. It's a model.

Now, we built this for the racetrack business. It's almost impossible to model in any effective way the owners' side of the business, or the breeding side of the business. But I do have a couple of observations.

The average purse per race is $55,000 and we have 31,000 of those races. Owners and trainers that know what they're doing should prosper in that environment. They should be able to operate economically successfully and economically profitable in that environment.

In the breeding industry, it's almost certainly going to be smaller given the decline in the number of starters of about 25 percent, but those who do survive and hopefully my little operation will be one of them, but they should operate profitably given the 40 percent increase in purses that occurs here in this model, which should drive yearling prices higher over time.

So that's a macro view.

Let me make this extremely personal. Here's my view.

My little operation was founded in 1981. We started as a limited partnership operation, similar to what Team Valor, Dogwood, West Point and others do. We put partnerships together to buy horses and race them, and buy horses and breed them.

The tax law changes in the mid to late 80s pretty much destroyed that business when they made it no longer possible to pass the losses through to your limited partners. So we kind of morphed this into just a breeding operation in the late 80s. It stayed that way during the 90s, and then at the end of the 90s, I had the brilliant idea that I should own a farm.

My brother said, "You don't want to do this," but I didn't listen to his advice and so we bought 475 acres of raw land in Woodford County, Kentucky, directly across the street from my brother Tom's operation of 375 acres, and we started developing it.

There were no roads, no waters, no utilities, no barns, no house, no fence, no anything.

So from 2000 to 2003, we built all of that. If anybody needs to know what it costs to build a thoroughbred farm in Woodford County, I have good data.

And my brother, who runs the whole thing, at that time, and this is the late 90s, or '99 when we were making these decisions, he needed more capacity. He boards for clients as well as having some of his own breeding operations. I was growing pretty rapidly so we needed more capacity. So it all made more sense.

Since that time, however, following the trends of the industry, things have changed a bit. This chart shows the number of owned and boarded horses on my farm and his farm because we operate them as one contiguous operation. Back in the early 2000s we were about 170 horses that were boarded there that were owned by clients. Today, we have about 70.

The number that I personally own, the 25 that was on the previous page, that's actually gone up. I had 21 in the year 2002. So I've actually increased the number of horses that I own, but obviously the number of horses we're boarding for clients has declined pretty precipitously.

I worry about this trend, maybe more than any other, because this one affects me. But I would say, from the other Kentucky farm owners, and I don't know what this looks like elsewhere, I can guess, but I don't know, but from when I've talked to other central Kentucky farm owners, they see the same kind of patterns. You know, it's pretty grim, really, if you think of it from a Kentucky perspective.

Now, for a while, just after I got out of high school, my mom and dad who got both my brother Tom and I started in the horse business, had decided to move from Cincinnati out to a little farm that they had bought in Indiana in the middle of nowhere. It was not in Bare Branch or Cross Creek, Indiana. It was between them, so there was nothing there, and I hadn't been back for quite a long time, and neither had my brother. And he had reason, through one of his clients, to go up and look at a couple of yearlings this summer that he was going to sell for the client.

So he drove up to Indiana, came back and said, "You can't believe it. This whole area where we used to be, horse farms, new fence, new waters, new barns, you know, it's amazing. It's booming!"

I've heard similar reports from Pennsylvania and I imagine it's going on in some other states, but those are the only two anecdotal bits of evidence I've got.

So the chart here is probably going up in some states, but in central Kentucky I think they are not the exception. We're probably the rule. We're going down.

So you look at all this and you say, "Why in the world would I be optimistic about the long-term future for horse racing?"

I have five reasons:

First, alternative gaming at tracks is expanding. I'll talk about that for just a bit. Balance sheets are improving. Everybody looks at the income statement and balance sheets matter.

Racing is embracing technology that exponentially is going to expand what we know about our customers, and I'll talk about that for just a minute.

There is a market for quality. In dying industries, there's no market for anything. A high-quality buggy whip, a low-quality buggy whip, it doesn't matter; they don't sell.

There's collector value, I suppose, if you want to be an historian, but there's no market value.

And, finally, innovation is becoming the basis of competition for customers, and by competition, I mean between racetracks where customers handle — let's be honest, any racetrack that's running at the same time another racetrack is running is competing for the handle that's out there. It's fair. It's fine.

The ADWs, similarly, are competing for the handle for the customers' bet, and then we have a competition going on between racing and other forms of consumer entertainment. We're battling for that share of the consumer's personal disposable income.

So let's just take a minute and talk about these five topics.

This chart shows the sources of purses in the US. The black bar shows the purse contributions that result from handle, paramutual handle. The red bar represents the purse contributions that result from gaming. This shouldn't be a big surprise to anybody.

Now, the reason I'm optimistic, and why this is such an important factor is that we need time and money to get our economic house in order in racing. We need time and we need money.

This is the best source of both that I can think of. I think that red bar is going to continue to grow. The black bar probably flattens out at some point and then later, the latter part of this decade, it probably starts to grow again, but we need this money desperately to give us the resources and the time to make the changes that we need to make inside the horse industry.

I found this a rather interesting chart, and I don't think that you've seen this before. This chart shows the average purse per race for tracks without gaming (that's the black bar), and tracks with gaming (that's the red bar). I realize that over time this changes. So as Indiana gets slots at their tracks, they go from being a black bar track to a red bar track.

Next year, 2011, will be the first year where average purses per race at racinos are greater than the average purses per race at the non-racinos.

There are currently 24 racinos, tracks with slots or other forms of alternative gaming or some subsidy that flows from gaming, and we can identify four more that are coming; that's 28. There are 31 tracks without racinos.

If you go back a few pages to where we put up our "not a prediction, not a forecast, and I'm not calling for the outcome of our model," the number of racetracks goes from about 55 to about 26. So we've got 24 racinos that already exist and four more coming. I think we're probably defining most of the winners. I think most of the survivors, as we go from 55-ish racetracks to 26-ish racetracks, are going to be those that have alternative gaming. I don't think there are going to be too many exceptions to that rule over a ten-year timeframe.

Balance sheets are improving. Granted, this is a low bar, but the industry is financially stronger than it was even two years ago. Magna and NYRA, New York OTB, and I haven't followed that one this morning yet, so I don't know what the status is. If you've been in business a hundred years but you're not sure you're going to reopen this weekend, it must be horse racing.

But they are largely through the bankruptcy process. Over $600 million of debt and roughly $50 million of annual debt service (that's interest) has been eliminated from our industry. That's a good thing.

Alternative gaming is generating about $800 million of cash flow annually. About $500 million goes to the tracks and $300 million goes to purses. Of course, the track piece has to pay for all the investments and the gaming assets that were there, the casinos that were built and the operation thereof, but there is $800 million more annual cash flow flowing toward us.

Since 2009, and some of you may greet this with a variety of responses, but since 2009 a number of tracks are now owned with companies with stronger balance sheets than their previous owner had.

Beulah that's owned by Penn, Laurel and Pimlico that are owned by Penn in some percentage (and I'm not sure what that is, but let's call it 50/50 for the moment), Lone Star and Remington, Global Gaming LLC and Thistle Downs is Harrah's.

So if we're going to be successful, if we're going to build a viable economic business model of the future, we need capital. The way you get capital and have access to capital, both equity capital and debt capital, is to clean up your balance sheet.

One of the great advantages I had when I joined Churchill Downs is that my predecessor, Tom Meeker, had done a great job of managing the balance sheet. The income statement may have been a bit challenged in terms of growth, but the balance sheet was strong. Had that not been the case, I guarantee I wouldn't be standing here because it was the first thing I wanted to look at when I first discussed joining Churchill Downs. I wanted to see where the balance sheet was.

Racing is embracing technology and I noticed there are a number of panels on this over the next couple of days. So I'm not going to try to do anything exhaustive on this one, but I want to call out three things that I think are really important.

One is high-definition video. The video experience, both at the track, OTB, online and cable (HRTV and TVG), the video experience we deliver to our customers is awful. It's awful. And if you think it's bad now, I've been recently to some of the new stadiums that are out there, most notably the new Dallas Cowboy stadium because my wife is a Texan, the video experiences in these places are spectacular.

We're abysmal. Within about two or three years we're going to look like black and white TV in a color TV world. We've got to fix this.

Now, this is expensive. We've converted all four of our tracks to high-definition video. You can break this in to three pieces.

The first is, what do you have to spend at the track to produce the high-def video signals. That's roughly $1 million to $1.2 million for new cameras, new video boards and the cabling and stuff that you need to put it together. So $1 million to $1.2 million per track. We've done all four.

The next thing that you've got to do is that you've got to send that signal to the place where it's going to be used. That costs us $750,000 a year. We've been doing it for over a year now. There are 42 sites. You can think of them as simulcast sites, tracks and OTBs, 42 with type of signal.

All you have to buy is a decoder and a flat screen TV and you can put a high-def signal in your OTB or track. Forty-two out of 1600, roughly, 42 have taken us up on that so far.

I'm scratching my head as to why I'm paying $750,000 a year to send a signal to 42 entities, but we're doing it for now.

We've got to do some work to bring our video experience for our customers, whether they're at the track, OTB, online or watching a cable show. We've got to bring that up to 21st century standards. If we don't, we're just going to look stupid.

By the way, I didn't include in any of this the cost of actually buying the flat panel displays. Does anyone want to take a guess at how many we have at Churchill Downs, Inc., all tracks OTBs? Nine thousand.

Go into Best Buy, "Hi, I need some of those Samsung 50-inchers."

"How many do you need?"

"Nine thousand."

So we've got a lot of work to do on this one. You know, Keeneland, I think went first. They were the first track, to my knowledge, to do a high-definition video signal on track. I think that we were the first to send it out to the simulcast market although, like I said, I'm scratching my head as to why I'm doing that, given there's only 42 takers, but it's there.

We've got to get better at this. I saw Scott Daruty in here somewhere. The HRTV folks have got to figure this one out. The TVG folks have got to figure this one out. We've got to bring our video product up to 21st century standards.

Second, is ADW. The whole industry is just getting started on this. I think there's a huge amount of upside. Through social networking, I'm seeing better and better stuff in that regard. With online handicapping tournaments and contests, I think the NTRA contest just went to a $2 million purse which is terrific. That's the kind of thing that gets people's attention.

And then the single-most important thing, I think, is mobile. Making racing available everywhere. I don't want there to be — it's like Coke, right? What is Coke's goal, to always be within an arm's reach of a Coke, anywhere in the world you are. I want the betting customer to be within arm's reach of a way to wager on a horse race, and mobile is the way to do that.

The last piece of this is customer analytics which is very nascent. So let me put this into context. We process — TwinSpires.com, we process 66 million wagers a year, 66 million. We know what the customer did in terms of their "click" behavior.

How did they get to the site? Where have they been on the site? And then they place a wager. What do they do after?

We have that information, 66 million times a year. Shame on us if we can't figure out some way to do a better job of marketing our product online given the fact that we know what the customer is doing. We don't have this luxury on track or in an OTB. In fact, many times, we don't even know who the customer is.

Here, we've got it because they've had to create an account. We've got demo information. We've got all the historical wagering and we know what their "click" behavior is before and after they place a bet. So we should be able to extract knowledge from that through improved customer analytics and use it to drive the marketing side of our business.

Another important reason I'm optimistic, there is a market for quality. Now, think about this for a minute, total US (and I had to use 2009 here because 2010 is not over yet and there are a couple of races left when I did this in 2010) but total handle 2003 to 2009, down 19 percent. I showed you a number earlier and it was down 25 percent through 2010, 2009, here.

If you look at the handle on the top 25 races, the best we've got, arguably the best products we've got, it's up 18 percent. There is a market for quality. If we put good quality stuff in front of the customer, they spend more money on it.

I was going to have a quiz here as to can anyone name the top 25 races in 2009, but I'll cheat and tell you what they are. They occur on nine days. The top 25 races occur on nine days.

It's the Derby and Oaks, there's two. There are four other races on the Oaks' card like the Humana Distaff etc. That's six. There's the two other Triple Crown races, Preakness and Belmont. That's eight. There's the 14 Breeders Cup Race, that's 22. There's the Travers the Manhattan and the Acorn; that's three more, 25.

Those 25 products can hold their own. Handle on those are up 18 percent, a 37 percent gap between all racing and the top quality products we've got. That's a great thing to discover.

I pushed it a little farther and said, "At what point is it flat? How many races do I have to get to before handle 2003 to 2009 is flat?"

That answer is 465 races.

So if we produce a quality product, there is not only just a market for it, but there's a market that's actually growing.

The last of my five reasons to be optimistic, innovation. I love this. I love the fact that Monmouth is doing their "elite meet" thing. It beat the heck out of us at Arlington Park, in terms of Arlington's handle. We saw a lot of it go to Monmouth, but I like the fact that somebody is out there taking big risks and doing big stuff.

Similarly with Saratoga, a lot of people said expanding it from 36 to 40 days was a bad thing to do. It turned out to be a good thing to do.

By the way, I'm not passing judgment on any of these ideas, I'm just excited that people are trying big stuff. That's where innovation comes from.

We've had some success with our Downs after Dark, our night racing program, we had 126,000 people out this year for the events that we did, the night racing events that we did. TVG has been successful in pushing exchange wagering through in California.

Again, I'm not passing judgment on whether these things are good or bad, but I think it's exciting that somebody has a new form of wagering out there. Let's keep pushing the innovation envelope. Not all of these things are going to be good ideas, but let's keep pushing it out there.

Promotion innovation, Magna — I have to admit it's kind of clever, the 2.2 and 5.5 bonus programs, and we'll see how that affects the market next year.

California is experimenting pretty boldly with price innovation by raising take-out on California racing and diverting that money to the purse accounts there.

Let me see if I can wrap this up.

Racing faces a lot of challenges. Hopefully, I've shared a few different perspectives on some of those with you today. The economic forces that are out there, and will probably continue to be out there for the next three or four years at least, are pushing us in the direction of consolidation. They're not pushing us to get bigger; they're pushing us to consolidate and get somewhat smaller. But there is a viable business model at the foundation of racing's future. I didn't predict it, I didn't forecast it and I'm not calling for it, but there is a viable business model there.

Alternative gaming and the improved balance sheets that we've seen give us the time and the financial resources to make the necessary investments and changes.

So we've got two assets here that we can take advantage of in building the future. Innovation, technology and quality are the paths to success.

Now, a lot of the discussion that I read in the industry tends to focus on how do we change the macro things? Should we have a commissioner or not? How do we change the pricing model in the industry? We need to centrally schedule all of the races.

These are big macro, really hard things to ever get done.

What do you do if you run a racetrack or two? I mean, we can pay lip service to these big macro things, but it's a lot of pounding on nails that don't get too far into the wood.

What we've tried to do at Churchill, at the four tracks we own, in terms of our racing business is a simple thought, which is focus on creating one more profitable day. Don't change the intergalactic scope of the thoroughbred racing in North America. Go change what you do. Make one more day profitable.

That's where night racing came from. Night racing didn't come from, "Hey, let's put up lights, it might look cool." Night racing came from, "Is there a way for us to take one day, a Friday in late June that otherwise doesn't have anything going on, and turn it into from a close-to-break-even (maybe $100,000 EBITDA contributor), how can we turn that into a $500-600-700,000 EBITDA contributor?"

It's to make one more profitable day, and I think that's the way we can make progress. For those of you who run racetracks, engage your teams in finding the answer to that question, and there's 55 of us out there, at least, today. If we can all make one, two or three more profitable days in the next year, that's 150 more profitable days across the industry, and that will drive a lot more success than spending huge amounts of time debating, arguing and trying to make happen these intergalactic ideas that probably have no way to get done.

Create one more profitable day.

Thanks very much for your attention, this morning. I'd like to spend more time on this, but truth is I have to call my brother and sign off on two stallion agreements for next year, $40,000 and $32,000 stallions that basically stood for double that two years ago. So I feel like I'm getting a bargain, until I look at what I'm selling them for, and then it doesn't seem quite so much of a bargain.

So thanks very much for your attention. I think, Doug, we've got a few minutes. If anybody has some questions, I think there are some microphones. I'd be glad to try to do that, but I did promise that I would be done no later than 9:30, so we've got six or eight minutes here if anybody's got any questions that they'd like to ask.

All right, well thank you very much. Have a great Symposium. See you next year!

[Applause]