CHURCHILL DOWNS Inc
Form 10-Q
October 31, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2018

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission file number 001-33998

(Exact name of registrant as specified in its charter)

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

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

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

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

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

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

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

The number of shares outstanding of Registrant’s common stock at October 24, 2018 was 13,571,770 shares.

CHURCHILL DOWNS INCORPORATED
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For the Quarter Ended September 30, 2018

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in millions, except per common share data)	2018	2017	2018	2017
Net revenue:				
Racing	$37.6	$38.8	$243.8	$228.0
TwinSpires	71.8	65.9	228.7	198.4
Casino	105.0	87.5	301.3	263.3
Other Investments	6.9	4.7	16.2	14.0
Total net revenue	221.3	196.9	790.0	703.7
Operating expense:				
Racing	43.9	40.8	165.1	153.7
TwinSpires	49.2	42.8	152.6	130.6
Casino	72.2	60.7	204.3	185.5
Other Investments	7.8	4.3	17.4	13.1
Corporate	0.6	0.6	1.7	1.8
Selling, general and administrative expense	21.7	19.9	63.2	58.7
Calder exit costs	—	0.2	—	0.8
Transaction expense, net	5.4	0.6	8.9	1.1
Total operating expense	200.8	169.9	613.2	545.3
Operating income	20.5	27.0	176.8	158.4
Other income (expense):				
Interest expense, net	(9.9)	(12.6)	(29.2)	(36.0)
Equity in income of unconsolidated investments	9.1	8.9	24.4	22.7
Gain on Ocean Downs/Saratoga transaction	54.9	—	54.9	—
Miscellaneous, net	0.1	0.1	0.5	0.8
Total other income (expense)	54.2	(3.6)	50.6	(12.5)
Income from continuing operations before provision for income taxes	74.7	23.4	227.4	145.9
Income tax provision	(16.7)	(10.3)	(52.1)	(57.9)
Income from continuing operations, net of tax	58.0	13.1	175.3	88.0
(Loss) income from discontinued operations, net of tax	(1.7)	3.6	166.1	14.3
Net income	$56.3	$16.7	$341.4	$102.3
Net income (loss) per common share data - basic:				
Continuing operations	$4.27	$0.85	$12.65	$5.53
Discontinued operations	$(0.12)	$0.24	$11.99	$0.90
Net income per common share data - basic:	$4.15	$1.09	$24.64	$6.43
Net income (loss) per common share data - diluted:				
Continuing operations	$4.24	$0.84	$12.58	$5.44
Discontinued operations	$(0.12)	$0.24	$11.92	$0.88
Net income per common share data - diluted:	$4.12	$1.08	$24.50	$6.32
Weighted average shares outstanding:				
Basic	13.6	15.3	13.8	15.9
Diluted	13.7	15.5	13.9	16.2
Other comprehensive income:				
Foreign currency translation, net of tax	$0.4	$0.5	$0.4	$0.1

Change in pension benefits, net of tax	0.2	0.1	—	0.1
Other comprehensive income	0.6	0.6	0.4	0.2
Comprehensive income	$56.9	$17.3	$341.8	$102.5

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

CHURCHILL DOWNS INCORPORATED
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

(in millions)	September 30, 2018	December 31, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	$ 131.3	$ 51.7
Restricted cash	38.8	31.2
Accounts receivable, net	33.8	49.6
Income taxes receivable	—	35.6
Other current assets	26.4	18.9
Current assets of discontinued operations held for sale	—	69.1
Total current assets	230.3	256.1
Property and equipment, net	753.4	608.0
Investment in and advances to unconsolidated affiliates	107.9	171.3
Goodwill	337.8	317.6
Other intangible assets, net	264.8	169.4
Other assets	17.5	13.6
Long-term assets of discontinued operations held for sale	—	823.4
Total assets	$ 1,711.7	$ 2,359.4
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 60.1	$ 54.1
Purses payable	20.8	12.5
Account wagering deposit liabilities	29.7	24.0
Accrued expense	83.0	75.8
Income taxes payable	0.5	—
Current deferred revenue	12.8	70.9
Current maturities of long-term debt	4.0	4.0
Dividends payable	—	23.7
Current liabilities of discontinued operations held for sale	—	188.2
Total current liabilities	210.9	453.2
Long-term debt, net of current maturities and loan origination fees	388.2	632.9
Notes payable, net of debt issuance costs	492.9	492.3
Non-current deferred revenue	21.1	29.3
Deferred income taxes	66.4	40.6
Other liabilities	17.5	16.0
Non-current liabilities of discontinued operations held for sale	—	54.8
Total liabilities	1,197.0	1,719.1
Commitments and contingencies		
Shareholders' equity:		
Preferred stock, no par value; 0.3 shares authorized; no shares issued or outstanding	—	—
Common stock, no par value; 50.0 shares authorized; 13.6 shares issued and outstanding at September 30, 2018 and 15.4 shares at December 31, 2017	11.5	7.3
Retained earnings	504.1	634.3
Accumulated other comprehensive loss	(0.9)	(1.3)
Total shareholders' equity	514.7	640.3
Total liabilities and shareholders' equity	$ 1,711.7	$ 2,359.4

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

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

(in millions)	Nine Months Ended September 30, 2018	2017
Cash flows from operating activities:		
Net income	$341.4	$102.3
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	45.8	73.3
Game technology and rights amortization	0.4	13.5
Acquisition expenses, net	—	1.7
Gain on sale of Big Fish Games	(219.5)	—
Gain on Ocean Downs/Saratoga transaction	(54.9)	—
Distributed earnings from equity investments	14.4	11.7
Big Fish Games earnout payment	(2.4)	(2.5)
Big Fish Games deferred payment	(2.0)	—
Equity in income of unconsolidated investments	(24.4)	(22.7)
Stock-based compensation	16.5	17.5
Deferred income taxes	24.7	(13.0)
Other	2.2	1.0
Increase (decrease) in cash resulting from changes in operating assets and liabilities, net of business acquisitions and dispositions:		
Game software development	(0.3)	(17.1)
Income taxes	31.2	24.5
Deferred revenue	(43.6)	(27.4)
Other assets and liabilities	5.9	4.4
Net cash provided by operating activities	135.4	167.2
Cash flows from investing activities:		
Capital maintenance expenditures	(19.9)	(26.7)
Capital project expenditures	(105.6)	(62.4)
Receivable from escrow	—	13.6
Acquisition of businesses, net of cash acquired	13.1	(23.1)
Proceeds from sale of Big Fish Games	970.7	—
Investment in joint venture	—	(24.0)
Other	(9.4)	(2.0)
Net cash provided by (used in) investing activities	848.9	(124.6)
Cash flows from financing activities:		
Proceeds from borrowings under long-term debt obligations	129.7	769.1
Repayments of borrowings under long-term debt obligations	(374.7)	(567.7)
Repayment of Ocean Downs debt	(54.7)	—
Big Fish Games earnout payment	(31.8)	(31.7)
Big Fish Games deferred payment	(26.4)	—
Payment of dividends	(23.5)	(21.8)
Repurchase of common stock	(514.7)	(181.1)
Other	(3.0)	1.5
Net cash used in financing activities	(899.1)	(31.7)
Net increase in cash, cash equivalents and restricted cash	85.2	10.9
Effect of exchange rate changes on cash flows	(0.6)	1.2

Cash, cash equivalents and restricted cash, beginning of period	85.5	83.0
Cash, cash equivalents and restricted cash, end of period	$170.1	$95.1

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

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

(in millions)	Nine Months Ended September 30, 2018	2017
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	$26.1	$25.4
Income taxes	48.0	48.0
Schedule of non-cash investing and financing activities:		
Property and equipment additions included in accounts payable and accrued expenses	11.4	5.6
Acquisition of Ocean Downs, net of cash acquired	115.2	—

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

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. DESCRIPTION OF BUSINESS
Basis of Presentation
The Churchill Downs Incorporated (the "Company", "we", "us", "our") financial statements are presented in conformity with the requirements of this Quarterly Report on Form 10-Q and consequently do not include all of the disclosures normally required by U.S. generally accepted accounting principles ("GAAP") or those normally made in our Annual Report on Form 10-K. The December 31, 2017 condensed consolidated balance sheet data was derived from audited financial statements but does not include all disclosures required by GAAP.
On November 29, 2017, the Company entered into a definitive Stock Purchase Agreement (the "Stock Purchase Agreement") to sell its mobile gaming subsidiary, Big Fish Games, Inc., a Washington corporation ("Big Fish Games"), to Aristocrat Technologies, Inc., a Nevada corporation (the "Purchaser"), an indirect, wholly owned subsidiary of Aristocrat Leisure Limited, an Australian corporation (the "Big Fish Transaction"). On January 9, 2018, pursuant to the Stock Purchase Agreement, the Company completed the Big Fish Transaction. The Purchaser paid an aggregate consideration of $990.0 million in cash in connection with the Big Fish Transaction, subject to customary adjustments for working capital and indebtedness and certain other adjustments as set forth in the Stock Purchase Agreement.
The Big Fish Games segment and related Big Fish Transaction meet the criteria for held for sale and discontinued operation presentation. Accordingly, the condensed consolidated statements of comprehensive income, condensed consolidated balance sheets, and the notes to financial statements reflect the Big Fish Games segment as discontinued operations for all periods presented. Unless otherwise specified, disclosures in these condensed consolidated financial statements reflect continuing operations only. The condensed consolidated statements of cash flows include both continuing and discontinued operations. Refer to Note 5, Discontinued Operations, for further information on the discontinued operations relating to the Big Fish Transaction.
On July 16, 2018, the Company announced its entry into a tax-efficient partial liquidation agreement (the "Liquidation Agreement") for the remaining 50% ownership of the Casino at Ocean Downs and Ocean Downs Racetrack located in Berlin, Maryland ("Ocean Downs") owned by Saratoga Casino Holdings LLC ("SCH") in exchange for the Company's 25% equity interest in SCH, which is the parent company of Saratoga Casino Hotel in Saratoga Springs, New York ("Saratoga New York") and Saratoga Casino Black Hawk in Black Hawk, Colorado ("Saratoga Colorado") (collectively, the "Ocean Downs/Saratoga Transaction"). On August 31, 2018, the Company closed the Ocean Downs/Saratoga Transaction, which resulted in the Company owning 100% of Ocean Downs and no further equity interest or management involvement in Saratoga New York or Saratoga Colorado.
As part of the Ocean Downs/Saratoga Transaction, Saratoga Harness Racing, Inc. ("SHRI") has agreed to grant the Company and its affiliates exclusive rights to operate online real-money sports betting and real-money iGaming on behalf of SHRI in New York and Colorado for a period of fifteen years from the date of the Liquidation Agreement, should such states permit SHRI to engage in sports betting and iGaming, subject to payment of commercially reasonable royalties to SHRI. Refer to Note 6, Acquisitions, for further information on the Ocean Downs/Saratoga Transaction.
In August 2018, we launched our BetAmerica Sportsbook at our two Mississippi properties included in our Casino segment.
In September 2018, we opened our new $65.0 million, 85,000 square-foot, state-of-the-art historical racing machine facility, Derby City Gaming, in Louisville, Kentucky, which is included in our Other Investments segment.
The following information is unaudited. All per share amounts assume dilution unless otherwise noted. This report should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2017.
In the opinion of management, all adjustments necessary for a fair statement of this information have been made, and all such adjustments are of a normal, recurring nature.
Seasonality

Racing

Due to the seasonal nature of our live racing business, revenue and operating results for any interim quarter are generally not indicative of the revenues and operating results for the year and may not be comparable with results for the corresponding period of the previous year. Historically, we have had fewer live racing days during the first quarter of each year, and the majority of our live racing revenue occurs during the second quarter, with the running of the Kentucky Derby and the Kentucky Oaks. We conducted 56 live thoroughbred race days in the third quarter of 2018, compared to 57 live thoroughbred race days during the third quarter of 2017. For the nine months ended September 30, 2018, we conducted 174 live thoroughbred race days, compared to 176 live thoroughbred race days during the nine months ended September 30, 2017.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

TwinSpires
Due to the seasonal nature of the racing business, revenue and operating results for any interim quarter are generally not indicative of the revenues and operating results for the year and may not be comparable with results for the corresponding period of the previous year. Historically, our revenue is higher in the second quarter with the running of the Kentucky Derby and the Kentucky Oaks.
Casino
Revenue from our casino properties has a seasonal component and is typically higher during the first and second quarters.
2. RECENT ACCOUNTING PRONOUNCEMENTS
Recent Accounting Pronouncement - Adopted on January 1, 2018
In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Updated ("ASU") No. 2014-09, Revenue from Contracts with Customers ("ASC 606") which provides a five-step analysis of transactions to determine when and how revenue is recognized. We adopted ASC 606 on January 1, 2018 using the modified retrospective method. We recognized the cumulative effect of initially applying the new revenue standard as an adjustment to the opening balance of retained earnings. The comparative information has not been retrospectively adjusted and continues to be reported under the accounting standards in effect for those periods. We expect the adoption of the new revenue standard will not have a material impact on our net income on an ongoing basis in future periods.
The cumulative effects of the changes made to our condensed consolidated balance sheet as of January 1, 2018 for the adoption of ASC 606 were as follows:

(in millions)	As Reported at December 31, 2017	Adoption of ASC 606	Balance at January 1, 2018
ASSETS			
Accounts receivable, net	$ 49.6	$ (21.8)	$ 27.8
Income taxes receivable	35.6	(4.1)	31.5
Current assets of discontinued operations held for sale	69.1	0.7	69.8
Other assets	13.6	(1.1)	12.5
LIABILITIES			
Accrued expense	75.8	0.8	76.6
Current deferred revenue	70.9	(18.9)	52.0
Current liabilities of discontinued operations held for sale	188.2	(38.8)	149.4
Non-current deferred revenue	29.3	(4.5)	24.8
Deferred income taxes	40.6	(0.1)	40.5
Non-current liabilities of discontinued operations held for sale	54.8	5.5	60.3
SHAREHOLDERS' EQUITY			
Retained earnings	634.3	29.7	664.0

There were two primary changes to our condensed consolidated balance sheet resulting from the adoption of ASC 606. The most significant change was in current and non-current liabilities of discontinued operations held for sale and retained earnings related to breakage revenue for outstanding Big Fish Game Club credits. The other primary change was in accounts receivable, net of allowance for doubtful accounts, current deferred revenue, and non-current deferred revenue related to the timing of when we have a right to consideration under our contracts.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

In accordance with ASC 606 requirements, the disclosure of the impact of adoption on our condensed consolidated balance sheet was as follows:

(in millions)	At September 30, 2018 As Reported	Balances without Adoption of ASC 606	Effect of Change Increase/(Decrease)
ASSETS			
Accounts receivable, net	$33.8	$ 37.0	$ (3.2)
Other assets	17.5	18.0	(0.5)
LIABILITIES			
Accrued expense	83.0	82.1	0.9
Income taxes payable	0.5	0.3	0.2
Current deferred revenue	12.8	16.7	(3.9)
Non-current deferred revenue	21.1	22.4	(1.3)
Deferred income taxes	66.4	66.2	0.2
SHAREHOLDERS' EQUITY			
Retained earnings	504.1	503.9	0.2

The adoption of ASC 606 had no impact on cash provided by or used in operating, financing, or investing activities on our condensed consolidated statement of cash flows for the nine months ended September 30, 2018. As part of the transition to ASC 606 on January 1, 2018, there have been certain modifications between the classification of net revenue and operating expenses in the TwinSpires segment in the current period. The impact of adopting ASC 606 on our condensed consolidated statements of comprehensive income for the three and nine months ended September 30, 2018 was not material.

In November 2016, the FASB issued ASU No. 2016-18, Statement of Cash Flows: Restricted Cash ("ASU 2016-18"). The new standard requires that the statement of cash flows explain the change during the period of cash, cash equivalents, and amounts generally described as restricted cash. Entities are also required to reconcile the cash, cash equivalents, and restricted cash in the statement of cash flows to the balance sheet and disclose the nature of the restrictions on restricted cash. We adopted ASU 2016-18 on January 1, 2018 using the retrospective method. As a result, we began including amounts generally described as restricted cash with cash and cash equivalents when reconciling the beginning of period and end of period total amounts shown on the statement of cash flows. We adjusted our condensed consolidated statement of cash flows for the nine months ended September 30, 2017 from amounts previously reported due to the adoption of ASU 2016-18. The effects of adopting ASU 2016-18 on our condensed consolidated statement of cash flows were as follows:

(in millions)	Nine Months Ended September 30, 2017 As Previously Reported	Adoption of ASU 2016-18	As Adjusted
Net cash provided by operating activities	$164.2	$ 3.0	$ 167.2
Cash, cash equivalents and restricted cash, beginning of period	$48.7	$ 34.3	$ 83.0

Net increase in cash, cash equivalents and restricted cash	7.9	3.0	10.9
Effect of exchange rate changes on cash	1.2	—	1.2
Cash, cash equivalents and restricted cash, end of period	$57.8	$ 37.3	$ 95.1

In August 2016, the FASB issued ASU No. 2016-15, Statement of Cash Flows: Classification of Certain Cash Receipts and Cash Payments. The new guidance reduces diversity in practice in how certain transactions are classified in the statement of cash flows. We adopted the new guidance on January 1, 2018 and it did not have a material impact on our consolidated results of operations, financial condition, or cash flows. We will utilize the cumulative earnings approach under the ASU to present distributions received from equity method investees which is consistent with our previous existing policy.

In February 2018, the FASB issued ASU No. 2018-02, Income Statement - Reporting Comprehensive Income: Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income ("ASU 2018-02"), which allows an entity to make an election to reclassify amounts from accumulated other comprehensive income to retained earnings for stranded tax effects resulting

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

from the Tax Cuts and Jobs Act (the "Tax Act"). We early adopted ASU 2018-02 on January 1, 2018 at the beginning of the period of adoption and elected to reclassify the income tax effects of the Tax Act from accumulated other comprehensive income to retained earnings. The adoption of ASU 2018-02 did not have a material impact on our consolidated results of operations, financial condition, or cash flows.

In May 2017, the FASB issued ASU No. 2017-09, Compensation - Stock Compensation: Scope of Modification Accounting, which provides clarity about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting for stock compensation expense. The guidance became effective in 2018 and is to be applied prospectively. We adopted the new guidance on January 1, 2018 and it did not have a material impact on our consolidated results of operations, financial condition, or cash flows.

In January 2017, the FASB issued ASU No. 2017-01, Business Combinations: Clarifying the Definition of a Business, in an effort to clarify the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The guidance became effective in 2018 and is to be applied prospectively. We adopted the new guidance on January 1, 2018 and it did not have a material impact on our consolidated results of operations, financial condition, or cash flows.

Recent Accounting Pronouncements - effective in 2019 or thereafter

In February 2016, the FASB issued ASU No. 2016-02, Leases, and subsequently has issued additional guidance (collectively, “ASC 842”) which requires companies to generally recognize on the balance sheet, operating and financing lease liabilities and corresponding right-of-use assets. The new guidance is effective on January 1, 2019 with early adoption permitted. ASC 842 may be applied at the beginning of the earliest comparative period in the financial statements or at the effective date by recognizing a cumulative effect adjustment in the period of adoption with comparative periods being reported under the accounting standards in effect for those periods. The modified transition method must be used when adopting ASC 842. We are planning to adopt ASC 842 on January 1, 2019 by recognizing a cumulative effect adjustment at that date and reporting comparative periods under the accounting standards in effect for those periods. We are in the process of aggregating our lease contracts and evaluating them under the new standard. We currently expect that most of our operating lease commitments will be subject to the new standard and recognized as operating lease liabilities and right-of-use assets upon our adoption of ASC 842. We plan to elect the package of practical expedients that allows us to not reassess: (1) whether any expired or existing contracts are or contain leases, (2) lease classification for any expired or existing leases and (3) initial direct costs for any expired or existing leases. We do not expect the adoption of ASC 842 to have a material effect on our results of operations or cash flows.

In August 2018, the FASB issued ASU No. 2018-15, Intangibles-Goodwill and Other: Internal-Use Software, which aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software. The new guidance also requires an entity to expense the capitalized implementation costs of a hosting arrangement over the term of the hosting arrangement. The guidance is effective in 2020 with early adoption permitted and may be applied prospectively or retrospectively. We are assessing the impact of the new accounting guidance and currently cannot estimate the financial statement impact of adoption.

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

In January 2017, the FASB issued ASU No. 2017-04, Intangibles-Goodwill and Other: Simplifying the Test for Goodwill Impairment. This new guidance simplifies the accounting for goodwill impairments by removing step two from the goodwill impairment test. Instead, if the carrying amount of a reporting unit exceeds its fair value, an impairment loss shall be recognized in an amount equal to that excess. The new guidance is effective in 2020 with early adoption permitted for any goodwill impairment test performed between January 1, 2017 and January 1, 2020, and is to be applied prospectively. We are currently evaluating the timing of our adoption and impact of the new accounting guidance on our financial statements and related disclosures.

3. SIGNIFICANT ACCOUNTING POLICIES

Except for the accounting policies for revenue recognition, casino and pari-mutuel taxes, and restricted cash, all of which were updated as a result of our recently adopted accounting pronouncements on January 1, 2018, as described in Note 2, Recent Accounting Pronouncements, there have been no changes to our significant accounting policies described in the Annual Report on Form 10-K for the year ended December 31, 2017, that have had a material impact on our condensed consolidated financial statements and related notes.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Revenue Recognition
Racing
Racing revenue is generated by pari-mutuel wagering transactions with customers on live and simulcast racing content as well as simulcast host fees earned from other wagering sites. Additionally, we generate revenue through sponsorships, admissions (including luxury suites), personal seat licenses ("PSLs"), television rights, concessions, programs and parking.
Our Racing revenue and income are influenced by our racing calendar. Therefore, revenue and operating results for any interim quarter are not generally indicative of the revenue and operating results for the year and may not be comparable with results for the corresponding period of the previous year. We historically have had fewer live racing days during the first quarter of each year, and the majority of our live racing revenue occurs during the second quarter with the running of the Kentucky Oaks and Kentucky Derby.
For live races we present at our racetracks, we recognize revenue on wagers we accept from customers at our racetrack ("on-track revenue") and revenue we earn from exporting our live racing signals to other race tracks, off-track betting facilities ("OTBs"), and advance deposit wagering providers ("export revenue"). For simulcast races we display at our racetracks, OTBs, and TwinSpires, we recognize revenue we earn from providing a wagering service to our customers on these imported live races ("import revenue"). Each wagering contract for on-track revenue and import revenue contains a single performance obligation and our export revenue contracts contain a series of distinct services that form a single performance obligation. The transaction price for on-track revenue and import revenue is fixed based on the established commission rate we are entitled to retain. The transaction price for export revenue is variable based on the simulcast host fee we charge our customers for exporting our signal. Our export revenue contracts generally have a duration of one year or less. These arrangements are licenses of intellectual property containing a usage based royalty. As a result, we have elected to use the practical expedient to omit disclosure related to remaining performance obligations for our export revenue contracts. We recognize on-track revenue, export revenue, and import revenue once the live race event is made official by the relevant racing regulatory body.
We evaluate our on-track revenue, export revenue, and import revenue contracts in order to determine whether we are acting as the principal or as the agent when providing services, which we consider in determining if revenue should be reported gross or net. An entity is a principal if it controls the specified service before that service is transferred to a customer.
The revenue we recognize for on-track revenue and import revenue is the commission we are entitled to retain for providing a wagering service to our customers. For these arrangements, we are the principal as we control the wagering service; therefore, any charges, including simulcast fees, we incur for delivering the wagering service are presented as operating expenses.
For export revenue, our customer is the third party wagering site such as a race track, OTB, or advance deposit wagering provider. Therefore, the revenue we recognize for export revenue is the simulcast host fee we earn for exporting our racing signal to the third party wagering site.
Our admission contracts are either for a single live racing event day or multiple days. Our PSLs, sponsorships, and television rights contracts generally relate to multiple live racing event days. Multiple day admission, PSLs, sponsorships, and television rights contracts contain a distinct series of services that form single performance obligations. Sponsorships contracts generally include performance obligations related to admissions and advertising rights at our racetracks. Television rights contracts contain a performance obligation related to the rights to distribute certain live racing events on media platforms. The transaction prices for our admissions, PSLs, sponsorships, and television rights contracts are fixed. We allocate the transaction price to our sponsorship contract performance obligations based on the estimated relative standalone selling price of each distinct service.
The revenue we recognize for admissions to a live racing event day is recognized once the related event is complete. For admissions, PSLs, sponsorships, and television rights contracts that relate to multiple live racing event days, we recognize revenue over time using an output method of each completed live racing event day as our measure of

progress. Each completed live racing event day corresponds with the transfer of the relevant service to a customer and therefore is considered a faithful depiction of our efforts to satisfy the promises in these contracts. This output method results in measuring the value transferred to date to the customer relative to the remaining services promised under the contracts. Certain premium live racing event days such as the Kentucky Derby and Oaks result in a higher value of revenue allocated relative to other live racing event days due to, among other things, the quality of thoroughbreds racing, higher levels of on-track attendance, national broadcast audience, local and national media coverage, and overall entertainment value of the event.

Timing of revenue recognition may differ from the timing of invoicing to customers for our long-term contracts in our Racing segment. We generally invoice customers prior to delivery of services for our admissions, PSLs, sponsorships, and television rights contracts. Accordingly, we recognize a receivable and a contract liability at the time we have an unconditional right to receive payment. When cash is received in advance of delivering services under our contracts, we defer revenue and recognize it in accordance with our policies for that type of contract. In situations where the timing of revenue recognition differs from the timing of invoicing, we have determined our contracts do not include a significant financing component. The primary purpose of

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our invoicing terms is to allow our customers to secure the right to the specific services provided under our contracts, not to receive financing from our customers.

Concessions, programs, and parking revenue is recognized once the good or service is delivered.

TwinSpires

TwinSpires revenue is generated through pari-mutuel wagering transactions with customers on simulcast racing content through advance deposit wagering. Advance deposit wagering consists of patrons wagering through an advance deposit account.

Our TwinSpires revenue and income are influenced by racing calendars similar to our Racing segment. Therefore, revenue and operating results for any interim quarter are not generally indicative of the revenue and operating results for the year and may not be comparable with results for the corresponding period of the previous year.

We recognize import revenue in our TwinSpires segment consistent with our policy described in Racing.

We may provide cash incentives in conjunction with wagering transactions we accept from customers. These cash incentives represent consideration payable to a customer and therefore are treated as a reduction of the transaction price for the wagering transaction.

Casino

Casino revenue primarily consists of gaming wager transactions. Other operating revenue, such as food and beverage or hotel revenue, is recognized once delivery of the product or service has occurred.

The transaction price for gaming wager transactions is the difference between gaming wins and losses. The majority of our casinos offer loyalty programs that enable customers to earn loyalty points based on their gaming play. Gaming wager transactions involve two performance obligations for those customers earning loyalty points under the Company’s loyalty programs and a single performance obligation for customers who do not participate in the program. Loyalty points are primarily redeemable for free gaming activities and food and beverage. For purposes of allocating the transaction price in a wagering transaction between the wagering performance obligation and the obligation associated with the loyalty points earned, the Company allocates an amount to the loyalty point contract liability based on the stand-alone selling price of the points earned, which is determined by the value of a loyalty point that can be redeemed for gaming activities or food and beverage. An amount is allocated to the gaming wager performance obligation using the residual approach as the stand-alone price for wagers is highly variable and no set established price exists for such wagers. The allocated revenue for gaming wagers is recognized when the wagers settle. The loyalty point contract liability amount is deferred and recognized as revenue when the customer redeems the points for a gaming wagering transaction or food and beverage and such goods or services are delivered to the customer.

Casino and Pari-mutuel Taxes

We recognize casino and pari-mutuel tax expense based on the statutory requirements of the federal, state, and local jurisdictions in which we conduct business. All of our casino taxes and the majority of our pari-mutuel taxes are gross receipts taxes levied on the gaming entity. We recognize these taxes as Racing, TwinSpires and Casino operating expenses in our consolidated statements of comprehensive income. In certain jurisdictions governing our Racing and TwinSpires pari-mutuel contracts with customers, there are specific pari-mutuel taxes that are assessed on winning wagers from our customers, which we collect and remit to the government. These taxes are presented on a net basis.

Restricted Cash and Account Wagering Deposit Liabilities

Amounts included in restricted cash represent amounts due to horsemen for purses, stakes and awards that are paid in accordance with the terms of our contractual agreements or statutory requirements. Restricted cash also includes deposits collected from our TwinSpires segment customers for account wagering that are paid when customers withdraw cash from their account.

4. REVENUE FROM CONTRACTS WITH CUSTOMERS

Performance Obligations

As of September 30, 2018, our Racing segment had remaining performance obligations with an aggregate transaction price of $183.6 million. The revenue we expect to recognize on these remaining performance obligations is $1.1

million for the remainder of 2018, $46.8 million in 2019, $35.7 million in 2020, and the remainder thereafter.
As of September 30, 2018, our remaining performance obligations in segments other than Racing were not material.

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Contract Assets and Contract Liabilities
As of January 1, 2018 and September 30, 2018, contract assets were not material.
As of January 1, 2018 and September 30, 2018, contract liabilities were $78.7 million and $37.5 million, respectively, which are included in current deferred revenue, non-current deferred revenue, and accrued expense in the accompanying condensed consolidated balance sheets. Contract liabilities primarily relate to our Racing segment and the decrease was primarily due to revenue recognized for fulfilled performance obligations. We recognized $1.2 million of revenue during the three months ended September 30, 2018 and $51.3 million of revenue during the nine months ended September 30, 2018 that was included in the contract liabilities balance at January 1, 2018.
Disaggregation of Revenue
To determine how we disaggregate our revenue from contracts with customers, we consider the information regularly reviewed by our chief operating decision maker for evaluating the financial performance of operating segments, disclosures presented in our earnings releases, and other similar information that is used by the Company and users of our financial statements to evaluate our financial performance. We believe that the disaggregation of our revenue included in Note 15, Segment Information, coupled with the disclosures included in Note 3, Significant Accounting Policies, reflects these considerations and depicts how the nature, timing, and uncertainty of revenue and cash flows are affected by economic factors.
5. DISCONTINUED OPERATIONS
On January 9, 2018, the Company completed the Big Fish Transaction which had a purchase price of $990.0 million. The Company received cash proceeds of $970.7 million which was net of $5.2 million of working capital adjustments and $14.1 million of transaction costs. The Company derecognized the following upon the Big Fish Transaction:

(in millions)	
Cash and cash equivalents	$0.3
Accounts receivable	34.7
Game software development, net	6.7
Other current assets	17.0
Property and equipment, net	17.8
Game software development, net	13.8
Goodwill	530.7
Other intangible assets, net	238.4
Other assets	24.0
Accounts payable	(8.5)
Accrued expense	(22.6)
Deferred revenue	(44.2)
Deferred income taxes	(52.0)
Other liabilities	(4.9)
Carrying value of Big Fish Games	$751.2

The Company recognized a gain of $219.5 million upon the sale recorded in income from discontinued operations on the condensed consolidated statement of comprehensive income for the nine months ended September 30, 2018. The gain consisted of cash proceeds of $970.7 million offset by the carrying value of Big Fish Games of $751.2 million. The income tax provision on the gain was $51.2 million, resulting in an after tax gain of $168.3 million.

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The following table presents the financial results of Big Fish Games included in "(loss) income from discontinued operations, net of tax":

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in millions)	2018	2017	2018	2017
Net revenue	$—	$118.0	$13.2	$342.5
Operating expenses	—	95.3	8.4	271.5
Selling, general and administrative expense	0.7	6.7	5.6	18.9
Research and development	—	9.8	0.9	30.0
Transaction expense, net	—	0.2	—	0.6
Total operating expense	0.7	112.0	14.9	321.0
Operating (loss) income	(0.7)	6.0	(1.7)	21.5
Other income (expense)				
Gain on sale of Big Fish Games	—	—	219.5	—
Other expense	—	(1.2)	(0.1)	(1.6)
Total other income (loss)	—	(1.2)	219.4	(1.6)
(Loss) income from discontinued operations before provision for income taxes	(0.7)	4.8	217.7	19.9
Income tax provision	(1.0)	(1.2)	(51.6)	(5.6)
(Loss) income from discontinued operations, net of tax	$(1.7)	$3.6	$166.1	$14.3

Stock-Based Compensation

For the nine months ended September 30, 2018, the Company recognized $3.4 million of stock-based compensation expense related to Big Fish Games, which included the impact of the accelerated vesting dates of restricted stock awards held by Big Fish Games' employees in conjunction with the Big Fish Transaction.

Earnout Liabilities

As of December 31, 2017, we had $34.2 million of deferred earnout consideration and $28.4 million of deferred payments due to the founder of Big Fish Games, both of which were paid on January 3, 2018.

6. ACQUISITIONS

Ocean Downs

On July 16, 2018, the Company announced its entry into the Liquidation Agreement for the Ocean Downs/Saratoga Transaction. As part of the Ocean Downs/Saratoga Transaction, SHRI has agreed to grant the Company and its affiliates exclusive rights to operate online real-money sports betting and real-money iGaming on behalf of SHRI in New York and Colorado for a period of fifteen years from the date of the Liquidation Agreement, should such states permit SHRI to engage in sports betting and iGaming, subject to payment of commercially reasonable royalties to SHRI.

On August 31, 2018, the Company completed the Ocean Downs/Saratoga Transaction, which resulted in the Company owning 100% of the equity interests of Ocean Downs, and therefore consolidated Ocean Downs as of the acquisition date. Upon the closing of the Ocean Downs/Saratoga Transaction, the Company no longer has an equity interest or management involvement in Saratoga New York or Saratoga Colorado. Prior to the Ocean Downs/Saratoga Transaction, the Company held an effective 62.5% ownership interest in Ocean Downs, and a 25% ownership interest in Saratoga New York and Saratoga Colorado, all of which were accounted for under the equity method. The consideration transferred to SCH to acquire the remaining interest in Ocean Downs were the Company's equity investments in Saratoga New York and Saratoga Colorado, which had a fair value of $47.8 million at the acquisition date. Under the acquisition method, the fair values of the consideration transferred and the Company's equity method investment in Ocean Downs, which had a fair value of $80.5 million at the acquisition date, were allocated to the

assets acquired and liabilities assumed in the Ocean Downs/Saratoga Transaction. The Company's carrying values in these equity method investments were significantly less than their fair values, resulting in a pre-tax gain of $54.9 million, which is included in the accompanying condensed consolidated statements of comprehensive income. The fair value of the Company's equity method investments in Ocean Downs, Saratoga New York, and Saratoga Colorado were determined under the market and income valuation

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approaches using inputs primarily related to discounted projected cash flows and price multiples of publicly traded comparable companies.
The fair values of the Ocean Downs/Saratoga Transaction were based upon preliminary valuations. Estimates and assumptions used in such valuations are subject to change, which could be significant, within the measurement period up to one year from the acquisition date. The primary areas of the preliminary valuations that are not yet finalized relate to the fair value of amounts for income taxes and the final amount of residual goodwill. The Company expects to continue to obtain information to assist in determining the fair values of the net assets acquired at the acquisition date during the measurement period. The following table summarizes the preliminary fair values of the assets acquired and liabilities assumed, net of cash acquired of $13.1 million, at the date of the acquisition.

(in millions)	Total
Current assets	$2.1
Property and equipment	57.4
Goodwill	20.2
Intangible assets	95.4
Current liabilities	(5.2)
Debt	(54.7)
	$115.2

The preliminary fair value of the intangible assets consists of the following:

(in millions)	Fair Value Recognized	Weighted-Average Useful Life
Gaming rights	$ 87.0	N/A
Tradename	8.3	N/A
Other	0.1	1.3 years
Total intangible assets	$ 95.4	

Current assets and current liabilities were valued at the existing carrying values as they are short term in nature and represented management's estimated fair value of the respective items at August 31, 2018. The debt of $54.7 million assumed by the Company was valued at its outstanding principal balance which approximated fair value at August 31, 2018. The Company subsequently paid off the debt in full on September 4, 2018.
The property and equipment acquired primarily relates to land, buildings, equipment, and furniture and fixtures. The fair values of the property and equipment were primarily determined using the cost replacement method which is based on replacement or reproduction costs of the assets.
The fair value of the Ocean Downs gaming rights was determined using the Greenfield Method, which is an income approach methodology that calculates the present value of the overall business enterprise based on a projected cash flow stream. This method assumes that the gaming rights intangible asset provides the opportunity to develop a casino in a specified region, and that the present value of the projected cash flows are a result of the realization of advantages contained in these rights. Under this methodology, the acquirer is expected to absorb all start-up costs, as well as incur all expenses pertaining to the acquisition and/or the creation of all tangible and intangible assets. The estimated future revenue and operating expenses and start-up costs of Ocean Downs were the primary inputs in the valuation. The gaming rights intangible asset was assigned an indefinite useful life based on the Company's expected use of the asset and determination that no legal, regulatory, contractual, competitive, economic, or other factors limit the useful life of the gaming rights. The renewal of the gaming rights in Maryland is subject to various legal requirements. However, the Company's historical experience has not indicated, nor does the Company expect, any limitations regarding its ability to continue to renew its gaming rights in Maryland.
The tradename intangible asset was valued using the relief-from-royalty method of the income approach, which estimates the fair value of the intangible asset by discounting the fair value of the hypothetical royalty payments a market participant would be willing to pay to enjoy the benefits of the asset. The tradename was assigned an indefinite

useful life based on the Company’s intention to keep the Ocean Downs name for an indefinite period of time. Goodwill of $20.2 million was recognized due to the expected contribution of Ocean Downs to the Company's overall business strategy. The goodwill was assigned to the Casino segment and is not deductible for tax purposes.

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In connection with the Ocean Downs/Saratoga Transaction, the Company recorded a deferred tax liability and income tax expense of $12.6 million. The deferred tax liability represents the excess of the financial reporting amounts of the net assets of Ocean Downs over their respective basis under U.S., state, and local tax law expected to be applied to taxable income in the periods such differences are expected to be realized.

For the period from the Ocean Downs/Saratoga Transaction on September 1 through September 30, 2018, net revenue was $8.1 million, and net income was not material for the period.

The following unaudited pro forma consolidated financial information for the Company has been prepared assuming the Company's acquisition of the remaining 50% interest in Ocean Downs occurred as of January 1, 2017 and excludes the gain recognized from the Ocean Downs/Saratoga Transaction. The unaudited pro forma financial information is not necessarily indicative of either future results of operations or results of operations that might have been achieved had the acquisition been consummated as of January 1, 2017.

	Company Pro Forma Information			
	Three Months Ended September 30,		Nine Months Ended September 30,	
(in millions)	2018	2017	2018	2017
Net revenue	$240.2	$218.7	$845.7	$754.8
Net income	15.5	18.2	302.4	104.1

Presque Isle and Nemacolin

On February 28, 2018, the Company entered into two separate definitive asset purchase agreements with Eldorado Resorts, Inc. ("ERI") to acquire substantially all of the assets and properties used in connection with the operation of Presque Isle Downs & Casino in Erie, Pennsylvania (the "Presque Isle Transaction"), and Lady Luck Casino in Vicksburg, Mississippi (the "Lady Luck Vicksburg Transaction") for total aggregate consideration of approximately $229.5 million, to be paid in cash, subject to certain working capital and other purchase price adjustments.

On July 6, 2018, the Company and ERI mutually agreed to terminate the asset purchase agreement with respect to the Lady Luck Vicksburg Transaction (the "Termination Agreement"). Concurrently with the entry into the Termination Agreement, the Company and ERI also entered into an amendment to the previously announced asset purchase agreement relating to the Presque Isle Transaction (the "Amendment"). Pursuant to the Amendment, the Company and ERI agreed to, among other things, cooperate in good faith, subject to certain conditions, to enter into an agreement pursuant to which the Company, for cash consideration of $100,000, will assume the rights and obligations of an affiliate of ERI to operate the Lady Luck Casino Nemacolin in Farmington, Pennsylvania (the "Lady Luck Nemacolin Transaction"). The Presque Isle Transaction reflects a stand-alone purchase price of $178.9 million. Closing of the Presque Isle Transaction was also conditioned on the execution of the definitive agreement with respect to the Lady Luck Nemacolin Transaction, which occurred on August 10, 2018 (the "Lady Luck Nemacolin Agreement"). Subject to receipt of Pennsylvania regulatory approvals and other customary closing conditions, the Presque Isle Transaction and the Lady Luck Nemacolin Transaction are expected to close in the first quarter of 2019.

Upon the execution of the Lady Luck Nemacolin Agreement and pursuant to the Termination Agreement, the Company paid ERI a termination fee of $5.0 million, which is included in "Transaction expense, net" in the accompanying condensed consolidated statements of comprehensive income.

BetAmerica

On April 24, 2017, we completed the acquisition of certain assets of BAM Software and Services, LLC ("BetAmerica"), which has not had a material impact on our results of operations, financial condition or cash flows. The Company has not included other disclosures regarding BetAmerica because the acquired business is immaterial to our business.

7. INVESTMENTS IN AND ADVANCES TO UNCONSOLIDATED AFFILIATES

As of September 30, 2018 and as a result of the Ocean Downs/Saratoga Transaction, the Company's only equity investments were the 50% joint venture ownership in Miami Valley Gaming ("MVG") in Lebanon, Ohio and other equity investments that are not material. As further discussed in Note 6, Acquisitions, the Company closed the acquisition of the remaining 50% ownership of Ocean Downs owned by SCH in exchange for liquidating the Company's 25% equity interest in SCH, which is the parent company of Saratoga New York and Saratoga Colorado. Upon closing of the Ocean Downs/Saratoga Transaction on August 31, 2018, the Company owns 100% of Ocean Downs and has no equity interest or management involvement in Saratoga New York or Saratoga Colorado. Prior to August 31, 2018, Ocean Downs was accounted for under the equity method.

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Summarized below are the financial results for our unconsolidated affiliates:

(in millions)	Three Months Ended September 30, 2018	Three Months Ended September 30, 2017	Nine Months Ended September 30, 2018	Nine Months Ended September 30, 2017
Net revenue	$105.2	$128.4	$322.1	$340.9
Operating and SG&A expense	76.4	97.9	240.5	263.3
Depreciation and amortization	5.9	5.2	19.0	16.1
Total operating expense	82.3	103.1	259.5	279.4
Operating income	22.9	25.3	62.6	61.5
Interest and other, net	(1.0)	0.3	(5.6)	(4.7)
Net income	$21.9	$25.6	$57.0	$56.8

(in millions)	September 30, 2018	December 31, 2017
Assets		
Current assets	$ 21.5	$ 64.5
Property and equipment, net	98.0	234.6
Other assets, net	107.0	236.5
Total assets	$ 226.5	$ 535.6
Liabilities and Members' Equity		
Current liabilities	$ 19.3	$ 100.3
Long-term debt	1.6	110.1
Other liabilities	0.1	0.1
Members' equity	205.5	325.1
Total liabilities and members' equity	$ 226.5	$ 535.6

8. GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill is comprised of the following:

(in millions)	Racing	TwinSpires	Casino	Total
Balances as of December 31, 2017	$ 51.7	$ 148.2	$117.7	$317.6
Ocean Downs/Saratoga Transaction	—	—	20.2	20.2
Balances as of September 30, 2018	$ 51.7	$ 148.2	$137.9	$337.8

We performed our annual goodwill impairment analysis as of April 1, 2018 and no adjustment to the carrying value of goodwill was required. We assessed goodwill for impairment by performing step one fair value calculations on a quantitative basis for each reporting unit. We concluded that the fair values of our reporting units exceeded their carrying value and therefore step two of the assessment was not required.

Other intangible assets are comprised of the following:

(in millions)	September 30, 2018 Gross Carrying Amount	September 30, 2018 Accumulated Amortization	September 30, 2018 Net Carrying Amount	December 31, 2017 Gross Carrying Amount	December 31, 2017 Accumulated Amortization	December 31, 2017 Net Carrying Amount
Definite-lived intangible assets	$42.3	$ (23.0)	$ 19.3	$39.8	$ (20.6)	$ 19.2
Indefinite-lived intangible assets			245.5			150.2
Total			$ 264.8			$ 169.4

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We performed our annual indefinite-lived intangible assets impairment analysis as of April 1, 2018, which included an assessment of qualitative and quantitative factors to determine whether it is more likely than not that the fair values of the indefinite-lived intangible assets are less than the carrying amount. We concluded that the fair values of our indefinite-lived intangible assets exceeded carrying value and therefore step two of the assessment was not required.

9. INCOME TAXES

The Company’s income tax rate for the three and nine months ended September 30, 2018 was higher than the U.S. federal statutory rate of 21.0% primarily due to state income taxes and certain expenses that are not deductible for income tax purposes, partially offset by tax benefits resulting from tax deductions from vesting of restricted stock units in excess of book deductions.

The Company’s income tax rate for the three and nine months ended September 30, 2017 was higher than the U.S. federal statutory rate of 35.0% primarily due to state income taxes and certain expenses that are not deductible for income tax purposes, partially offset by tax benefits resulting from tax credits and tax deductions from vesting of restricted stock units in excess of book deductions.

10. FAIR VALUE OF ASSETS AND LIABILITIES

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

	Level 1	
(in millions)	September 30, 2018	December 31, 2017
Restricted cash	$ 38.8	$ 31.2

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

We currently have no other assets or liabilities subject to fair value measurement on a recurring basis. Our 4.75% Senior Notes due 2028 (the "Senior Notes") are disclosed at fair value which is based on unadjusted quoted prices for similar liabilities in markets that are not active. The fair value of the Senior Notes was $466.9 million at September 30, 2018 and $496.8 million at December 31, 2017.

The carrying amounts of the borrowings under the $700.0 million revolving credit facility and $400.0 million Senior Secured Term Loan B due 2024 (the "2017 Credit Agreement") approximate fair value, based upon current interest rates, representing a Level 2 fair value measurement.

Refer to Note 6, Acquisitions, for assets and liabilities measured at fair value using Level 2 and Level 3 inputs on a non-recurring basis in connection with the Ocean Downs/Saratoga Transaction.

11. SHAREHOLDERS’ EQUITY

On November 29, 2017, the Board of Directors of the Company authorized a $500.0 million share repurchase program in a "modified Dutch auction" tender offer utilizing a portion of the proceeds from the Big Fish Transaction. The Company completed the tender offer on February 12, 2018, and repurchased 1,886,792 shares of the Company's common stock at a purchase price of $265 per share with an aggregate cost of $500.0 million, excluding fees and expenses related to the tender offer.

12. STOCK-BASED COMPENSATION PLANS

We have stock-based employee compensation plans with awards outstanding under the Churchill Downs Incorporated 2007 Omnibus Stock Incentive Plan, the Churchill Downs Incorporated 2016 Omnibus Stock Incentive Plan ("the 2016 Plan"), and the Executive Long-Term Incentive Compensation Plan, which was adopted pursuant to the 2016 Plan. Our total stock-based compensation expense, which includes expenses related to restricted stock awards ("RSAs"), restricted stock unit awards ("RSUs"), performance share unit awards ("PSUs"), and stock options associated with our employee stock purchase plan was $3.9 million for the three months ended September 30, 2018 and 2017. Stock-based compensation expense was $13.1 million for the nine months ended September 30, 2018 and

$11.7 million for the nine months ended September 30, 2017.

During the nine months ended September 30, 2018, the Company awarded RSAs to employees, RSUs and PSUs to certain named executive officers, and RSUs to directors. The vesting criteria for the PSU awards granted in 2018 were based on a three year service period with two performance conditions and a market condition related to relative total shareholder return ("TSR") consistent with prior year grants. The total compensation cost we will recognize under the PSUs will be determined using the Monte Carlo valuation methodology, which factors in the value of the TSR market condition when determining the grant date fair value of the

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PSU. Compensation cost for each PSU is recognized during the performance and service period based on the probable achievement of the two performance criteria. The PSUs are converted into shares of our common stock at the time the PSU award value is finalized.

A summary of the RSAs, RSUs, and PSUs granted during 2018 is presented below:

Grant Year	Award Type	Number of Shares/Units Awarded (in thousands)	Vesting Terms
2018	RSA	18	Vest equally over three service periods ending in February of 2019, 2020, and 2021
2018	RSU	16	Vest equally over three service periods ending December 31 of 2018, 2019, and 2020
2018	PSU	16	Three year performance and service period ending December 31, 2020
2018	RSU	3	One year service period ending in April 2019

13. CONTINGENCIES

We are involved in litigation arising in the ordinary course of conducting business. We carry insurance for workers' compensation claims from our employees and general liability for claims from independent contractors, customers and guests. We are self-insured up to an aggregate stop loss for our general liability and workers' compensation coverages. In accordance with current accounting standards for loss contingencies and based upon information currently known to us, we establish reserves for litigation when it is probable that a loss associated with a claim or proceeding has been incurred and the amount of the loss or range of loss can be reasonably estimated. When no amount within the range of loss is a better estimate than any other amount, we accrue the minimum amount of the estimable loss. To the extent that such litigation against us may have an exposure to a loss in excess of the amount we have accrued, we believe that such excess would not be material to our consolidated financial condition, results of operations, or cash flows. Legal fees are expensed as incurred.

We review all litigation on an ongoing basis when making accrual and disclosure decisions. For certain legal proceedings, we cannot reasonably estimate losses or a range of loss, if any, particularly for proceedings that are in the early stages of development or where the plaintiffs seek indeterminate damages. Various factors, including, but not limited to, the outcome of potentially lengthy discovery and the resolution of important factual questions, may need to be determined before probability can be established or before a loss or range of loss can be reasonably estimated.

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

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14. NET INCOME PER COMMON SHARE COMPUTATIONS

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

(in millions, except per share data)	Three Months Ended September 30, 2018	Three Months Ended September 30, 2017	Nine Months Ended September 30, 2018	Nine Months Ended September 30, 2017
Numerator for basic net income per common share:				
Net income from continuing operations	$58.0	$13.1	$175.3	$88.0
Net loss from continuing operations allocated to participating securities	—	—	—	(0.1)
Net (loss) income from discontinued operations	(1.7)	3.6	166.1	14.3
Numerator for basic net income per common share	$56.3	$16.7	$341.4	$102.2
Numerator for diluted net income from continuing operations per common share	$58.0	$13.1	$175.3	$88.0
Numerator for diluted net income per common share:	$56.3	$16.7	$341.4	$102.3
Denominator for net income per common share:				
Basic	13.6	15.3	13.8	15.9
Plus dilutive effect of stock awards	0.1	0.2	0.1	0.2
Plus dilutive effect of participating securities	—	—	—	0.1
Diluted	13.7	15.5	13.9	16.2
Net income (loss) per common share data:				
Basic				
Continuing operations	$4.27	$0.85	$12.65	$5.53
Discontinued operations	$(0.12)	$0.24	$11.99	$0.90
Net income per common share - basic	$4.15	$1.09	$24.64	$6.43
Diluted				
Continuing operations	$4.24	$0.84	$12.58	$5.44
Discontinued operations	$(0.12)	$0.24	$11.92	$0.88
Net income per common share - diluted	$4.12	$1.08	$24.50	$6.32

15. SEGMENT INFORMATION

We manage our operations through five operating segments:

- Racing, which includes Churchill Downs Racetrack ("Churchill Downs"), Arlington International Race Course ("Arlington"), Fair Grounds Race Course ("Fair Grounds") and Calder Race Course ("Calder");
- TwinSpires, which includes TwinSpires.com, Fair Grounds Account Wagering, Velocity, BetAmerica and Bloodstock Research Information Services;
- Casino, which includes Oxford Casino ("Oxford"), Riverwalk Casino ("Riverwalk"), Harlow's Casino ("Harlow’s"), Calder Casino, Fair Grounds Slots, Video Services, LLC ("VSI"), 50% equity investment in MVG, 50% equity investment in Ocean Downs and 25% equity investment in SCH, which includes investments in Saratoga Casino Hotel, Saratoga Casino Black Hawk and Ocean Downs. On August 31, 2018, the Company completed the Ocean Downs/Saratoga Transaction, which resulted in the Company's 100% ownership of Ocean Downs, and no further equity interest or management involvement in Saratoga New York or Saratoga Colorado.
- Other Investments, which includes United Tote, Derby City Gaming and other minor investments; and
-

Corporate, which includes miscellaneous and other revenue, compensation expense, professional fees and other general and administrative expense not allocated to our other operating segments.

Big Fish Games is a global producer and distributor of social casino, casual and mid-core free-to-play, and premium paid games for PC, Mac and mobile devices. On January 9, 2018, we closed the Big Fish Transaction, at which time Big Fish Games ceased to be an operating segment. Due to the Big Fish Transaction, the Company has presented Big Fish Games as held for sale and

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discontinued operations in the accompanying condensed consolidated financial statements and these notes. The Company has not allocated corporate and other certain expenses to Big Fish Games consistent with the discontinued operations presentation in the accompanying condensed consolidated statements of comprehensive income. Accordingly, the prior year amounts were reclassified to conform to this presentation.

Eliminations include the elimination of intersegment transactions. We utilize non-GAAP measures, including EBITDA (earnings before interest, taxes, depreciation and amortization) and adjusted EBITDA. Our chief operating decision maker utilizes adjusted EBITDA to evaluate segment performance, develop strategy and allocate resources.

Adjusted EBITDA includes the following adjustments:

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

Adjusted EBITDA excludes:

- Transaction expense, net which includes:
- Acquisition and disposition related charges, including fair value adjustments related to earnouts and deferred payments; and
- Other transaction expense, including legal, accounting, and other deal-related expense;
- Stock-based compensation expense;
- Asset impairments;
- Gain on Ocean Downs/Saratoga Transaction;
- Gain on Calder land sale;
- Calder exit costs;
- Loss on extinguishment of debt;
- Pre-opening expense; and
- Other charges, recoveries and expenses

We utilize the adjusted EBITDA metric because we believe the inclusion or exclusion of certain non-recurring items is necessary to provide a more accurate measure of our core operating results and enables management and investors to evaluate and compare from period to period our operating performance in a meaningful and consistent manner. Adjusted EBITDA should not be considered as an alternative to operating income as an indicator of performance, as an alternative to cash flows from operating activities as a measure of liquidity, or as an alternative to any other measure provided in accordance with GAAP. Our calculation of adjusted EBITDA may be different from the calculation used by other companies and, therefore, comparability may be limited. For segment reporting, adjusted EBITDA includes intercompany revenue and expense totals that are eliminated in the accompanying condensed consolidated statements of comprehensive income.

The tables below present net revenue from external customers and intercompany revenue from each of our operating segments, adjusted EBITDA by segment and reconciles comprehensive income to adjusted EBITDA:

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(in millions)	Three Months Ended September 30, 2018	Three Months Ended September 30, 2017	Nine Months Ended September 30, 2018	Nine Months Ended September 30, 2017
Net revenue from external customers:				
Racing:				
Churchill Downs	$8.5	$8.1	$165.4	$147.1
Arlington	23.7	25.0	49.7	51.5
Fair Grounds	4.8	5.0	26.8	27.5
Calder	0.6	0.7	1.9	1.9
Total Racing	37.6	38.8	243.8	228.0
TwinSpires	71.8	65.9	228.7	198.4
Casino:				
Oxford Casino	28.9	25.2	79.3	69.2
Calder Casino	23.4	19.4	73.0	62.6
Riverwalk Casino	12.8	12.2	40.8	35.7
Harlow’s Casino	12.1	12.3	37.9	38.3
VSI	10.6	9.3	32.7	28.8
Fair Grounds Slots	9.1	8.7	28.9	27.7
Ocean Downs	8.1	—	8.1	—
Saratoga	—	0.4	0.6	1.0
Total Casino	105.0	87.5	301.3	263.3
Other Investments	6.9	4.7	16.2	14.0
Net revenue from external customers	$221.3	$196.9	$790.0	$703.7

(in millions)	Three Months Ended September 30, 2018	Three Months Ended September 30, 2017	Nine Months Ended September 30, 2018	Nine Months Ended September 30, 2017
Intercompany net revenue:				
Racing:				
Churchill Downs	$1.0	$0.9	$10.7	$9.6
Arlington	2.3	2.2	5.6	5.1
Fair Grounds	—	—	1.1	1.0
Calder	0.1	—	0.1	—
Total Racing	3.4	3.1	17.5	15.7
TwinSpires	0.3	0.2	1.1	0.8
Other Investments	0.9	1.0	3.6	3.7
Eliminations	(4.6)	(4.3)		