

## **BIG AND SMALL: WHAT'S AHEAD FOR HARNESS RACING**

### **IN THE AGE OF THE GIANTS**

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*Moderator*

**Stan Bergstein:** John Long is president of Churchill Downs Management and executive vice-president and chief operating officer of Churchill Downs. He formerly worked for Ladbroke at the Meadows. David Willmot is the current president of Harness Tracks of America and president and CEO of Woodbine Entertainment in Toronto.

**David Willmot:** I'd like to start off by asking John to give an overview of the Churchill strategic plan, of the direction in which Churchill was going, of what they see for the future of consolidation in this industry, and perhaps to touch on the smaller tracks and the independent tracks that are out there. Do those tracks have something to fear from the big consolidators in terms of distribution and simulcast rates and that sort of thing?

**John Long:** First of all, it's nice to be back. I think I attended my first HTA meeting in 1990, when we were down in Palm Beach and I had just joined Ladbroke. I remember saying at that presentation that I had somehow managed to go through the first 40 years of my life—those were the days—but the first 40 years of my life without ever managing to make it to a racetrack. And now I've been in the business for 13 years

At the outset, let me answer the question in kind of a long-winded way, and then get to the specifics. I think, to a very large degree, a lot of what exists in racing today is a result of consolidation and the way simulcasting has become so important to all of our businesses really had its origin in the standardbred industry. My company, Churchill Downs, was very, very resistant to any kind of discussions about simulcasting, import or export, up until really only a few short years ago. It was the imagination that the standardbred industry had early on, where they realized the importance of simulcasting and especially what thoroughbred simulcasting could be at the standardbred tracks throughout the U.S. I know through most of the '90s the business that Ladbroke's enjoyed at the Meadows was principally the result of some very innovative legislation that occurred in Pennsylvania, and the business grew really as a result of being able to build out a terrific OTB system, and then to simulcast at the racetrack.

From that came one of the earliest versions of in-home wagering, which is still in operation at the Meadows, and all of that was really the result of some very forward-thinking guys who saw the way to create a nexus between the standardbred industry and thoroughbred simulcasting. So I think the standardbred industry is really owed a great credit for where racing is today.

As it relates to consolidation, I think that the smaller, unaffiliated tracks really have nothing to worry about. I think that since there are two companies that have both come to the same conclusion, this business is worth investing in. I think that it creates strength, and that creates a future that we can all look forward to.

At the same time, I know that we have to be responsible, and Churchill Downs is. We think we are very responsible, in terms of the way that we put the simulcasting programs together. Just over the last couple of years the success that we've enjoyed at Ellis Park, and what you've enjoyed as our customers as a result of the growth of that simulcast product, has been good for both of us. We've been able to increase the number of runners per race from about 7.2 to almost 8.5 runners per race in the meet that finished this last year. Churchill Downs is racing better than it ever has been before. Its runners per race, and ultimately the betting

opportunities and the action that you receive from your customers and your places, increase as well.

We've had terrific luck with Arlington this last year, where the racing over the last couple of years has been mediocre. I think that we've been able to show good improvements on that, so I don't think that there's anything to fear. I think it's responsible and it's incumbent, on at least my company, to make sure that what we put out to you, in terms of simulcast product, is the absolute best that can be put together at fair and equitable rates.

**David Willmot:** Thanks, John. Now I'm going to ask a tougher question. You're a public company, you have shareholders and those shareholders are going to demand earnings per share growth. One would assume that the two big consolidators are making acquisitions, buying more racetracks, to get more control of the content, so that they have more leverage in pricing that product with the rest of the industry, that's all part of the one pari-mutuel family. The concerns that I've heard expressed, I've expressed them myself and I think some of the buying groups that are being established are a response to this, is that both Magna and Churchill, being public companies and having to serve the needs of shareholders, will hopefully balance with horsemen and the industry. But we all know that every

year now there are intense discussions going on regarding simulcasting rates. One of my concerns is that the rest of the industry, excluding NYRA and a few other places like that, that there's going to be pressure on the rest of the industry to basically be distribution outlets for the big consolidators' product. And as the rates negotiations go forward, and especially some of the smaller harness tracks that don't have the leverage to defend themselves in those discussions, will the smaller tracks, the independents, will they become marginally profitable, to the extent that they're profitable today. Will they become more marginally profitable, and just be allowed by the consolidators to remain barely above water so that they can be part of the consolidator's distribution network? Or do you believe that your organization, and McAlpine's since he's not here to speak for himself, where is your organization, in terms of its approach to these simulcasting discussions?

**John Long:** Okay, let me pick it off one at a time. We need to be responsible. We need to understand, and we do understand at Churchill Downs, that we can have all of the great racing signals that we have right now but if there is not a place in which they can be displayed and bet on, it makes no sense to go forward. So you really are our customers, and if someone decides to charge a rate that is in excess of what the customer wants to pay, then they're not going to pay it.

We're very sensitive to that. It makes no sense to try to put anybody out of business. In fact, the opposite is true; we need to have all the distribution outlets that we have in place today to continue to grow the business in the future.

We've also taken a different approach, really, in this last year. We ran a big-ticket promotion in the summer and then we also did a promotion with the Churchill Downs Simulcast Network up in the Connecticut OTB system last October and November. The concept was this. By and large, an OTB manager or an individual or group that's in charge of a simulcasting center or a racing system may never see us. All they see is our racing product, but they never see us. And what would it be like to go into an OTB system and work a promotion with the OTB system where we can put Derby seats, for example, out there and let the OTB manager figure out a way that he wants to give that Derby box to his customers. Is it because they're frequent players, or because they come five days a week? Maybe they're horse owners. But how can we best connect with the customers, which are you guys? More than just sending a signal and we're just doing a settlement process, once a week or once a month. Are we going to continue that promotional approach into five different racing systems over the course of this summer? We're out to make a profit, of course we are. We want to increase our market share. And we think we can do that by offering a better product than anybody else, at a price that is

equitable and yet we can work promotional opportunities between the Churchill Downs Simulcasting Network and the places in which the signal goes.

To the last point on return on shareholder equity. We're publicly traded and everybody knows that. But the growth of the company can't come on the backs of the simulcast network, it just doesn't make any sense. We spent probably more time thinking about how we can gain synergies from the racetracks that we've acquired and merged with over the last couple of years. How we can take costs out. How can we find great ways of doing things that may exist at Arlington and then extend it over across all of the Churchill Downs properties? I don't know what the number would be off the top of my head, but in terms of energy expended, we've spent at least the same amount of time trying to think how we can become more efficient, and we get growth from that as well.

And again I would just reaffirm the fact that 20% of our simulcast business, nearly 20% of the business that we derive from the Churchill Downs Simulcast Network, comes from standardbred tracks and standardbred hubs. We're very mindful of that, and we're going to be responsible about it. We'd like to see that number grow and we're going to do that by being good partners.

**David Willmot:** Thanks, John. I would have loved to have asked the same question of Jim McAlpine and get their perspective. In our own negotiations, and we're not a small independent we're a large independent and that shows for a number of reasons, we were contemplating going public. One of the reasons that we didn't go public was the concern that the goal of the current shareholders might cause us to do things that were not in the best interest of racing. But that was our choice. In our discussions with Magna just recently on simulcasting, quite frankly, already entering into it is the idea that they want to sell a lot more to us than they want to buy, and they want to sell at a higher rate than they want to buy. And so, as they say, it would have been nice. The idea was to get both consolidators' views. But I think that pulling your financial statements off and Magna's financial statements off recently on any basis of comparison—your return on equity, your return on capital employed—your profit on about the same contribution for the horse racing activities was much, much higher than Magna's. Their profit was mostly made up of real estate transactions. In one case where Magna Entertainment was selling back a piece of land to Magna International for the same piece of land they received two years earlier for a \$6 million profit. These are the things that the rest of us in the industry sort of sit back and look at, what the big companies are doing, and get a little bit itchy in terms of how it might impact the entire pari-mutuel industry if the right strategies aren't implemented. In that

regard, could you comment on that? Churchill certainly was one of the founding tracks of TVG, bought into the idea of exclusives, and now of course Magna has expressed that going in, too. We've got some of the chaos we've got in California because of that. Could you comment on how you see the future of the in-home television distribution system, and how this problem might resolve itself at the moment?

**John Long:** Great question. California's in a bit of disarray right now, as California frequently is when it comes to racing. TVG is up right now using Los Alamitos as the racing facility in California, and you would think that with Santa Anita running and Gulfstream running, that ExpressBet would be taking the lion's share of account wagering activity in the state. We were surprised to see the numbers last week that over 40% of the account wagering handle is actually going to Los Al.

Now what does that mean? We think it means that the television is the way forward. There's always going to be guys, there are probably many of us in the room that would like and will play at the office. And we'll be able to do that on our laptop. We'll be able to get a bet down, and we'll be able to check our account at the end of the day and find out how we did. But for us, the way out of the

woods is TVG. I'm struck by the fact that while TVG are three letters that we had been bantering around in the industry over the last half-dozen years, more than half of the people that I talk to, groups like this, have never even see the show. They've never had the opportunity to see the show. They may have seen snippets or they may have seen a promotional piece, but it is truly first-class programming. And the surrounding programming that we have the opportunity to see—older Breeders Cups or the work show in the morning, or for a Derby and Oaks—is as good as any racing journalism that exists in America today. It is exciting stuff, and we think it's the kind of thing that is going to get people to come back to the sport again.

So what happens in California? I think California will be the watershed location for how account wagering will go forward in the future. In a perfect world, we'd like to see TVG and Magna and the founding tracks kind of all sing off the same page of the songbook, because it's very confusing to the fan right now. We've put the fan in a very awkward position. He has to have a variety of different accounts to be able to bet on each of the tracks that are going to be coming up this year.

I'm very, very optimistic about Hollywood Park and TVG in this spring meet. We've seen subscriptions going up. TVG is just about ready to bring Cox and

Adelphia on in southern California and we're going to see a tremendous amount of people that are going to have the opportunity to watch this product on television for the first time. So I light a little joss stick every night and think that by the time we get to the end of 2002 we will have figured out a way to eliminate this unnecessary competition and to be able to form some kind of alliance between ExpressBet, TRN, and TVG. But I think it's going to get messier before it gets clean.

**David Willmot:** You mentioned TRN, or I guess in its metamorphosized form RTN as brought back to life by Magna, Philadelphia Park and Todd Roberts' company. The age-old debate you talked about, TVG in terms of servicing the harness industry. Can TVG service the harness industry in the way that RTN or TRN did by way of exposure for harness tracks, adequate exposure for harness tracks of all sizes, which was accomplished on TRN and I presume will be accomplished on RTN? Can TVG, with the programming form that it has, adequately service the harness racing industry and be so limited with respect to the one signal?

**John Long:** Well, that's probably a better question to put to TVG, but I think the answer will be yes. You know, it's not outside the realm of possibility that over

time there may be more than one TVG channel. That you would have a series of channels that you would be able to click on to or to turn your television on and watch whatever you wanted to watch at the end of the day. I welcome TRN, whatever its new name is, coming back into the marketplace because it is television and I think that that's what the fan wants and that's what the casual fan is going to get excited about being able to play this sport. I think it will be good for them to get back up and running again, and that competition on a TV-to-TV basis, I think will be good for the industry.

**David Willmot:** If you can be candid about this, does Churchill have any intention of attempting not to provide its product on an exclusive basis going forward at some time? Or are you committed to the exclusive model of TVG?

**John Long:** No, we are committed to the exclusive model, and personally, it took me a long time to get there, but I can say it because I believe it now. In an earlier life, I was involved with setting up Youbet and that concept was essentially built on non-exclusivity. I thought it made excellent sense at the time, because the business model was not to go out and build new fans, it was to be able to better access existing fans, to give them the ultimate convenience. But today, having seen the success or lack of success of Youbet, the company and I are fully

committed to sticking with TVG. We think that the idea of being able to do a contract in a business relationship is essential to the way anybody does business. No one tells you guys what tote company you have to do a deal with, or no one tells you what teletimer company you have to do with. We think that mass over time by being able to collect all of these signals and to display them on TVG makes just as much sense today as it did four, five years ago.

**David Willmot:** Well, this would be a lot more fun if McAlpine were here, because of course he feels precisely the opposite. It's been a long morning. As I said, I thought there were some wonderful speakers this morning. I think it's a great credit to Stan that we've been informed and entertained as we have been this morning. Thank you.