OWNERS' INVESTMENT IN THE CALIFORNIA RACING INDUSTRY

Are Owners Getting the Same Bang For Their Buck as Racetracks and ADW Providers?

By Guy Lamothe

It is common knowledge Thoroughbred owners, as a collective entity, are the single largest investor in California racing. But would it be surprising to discover that owners annually invest about 25 times *more* than all the California race tracks combined, yet receive about 20% *less* revenues from handle than those same race tracks? A review of annual investment and revenues suggests a wide disparity between what owners pay to do business compared to their track and ADW "partners."

California Thoroughbred Owners
Estimated Annual Investment & Handle-based Revenues

Description	Avg. Annual Estimate	
Investment in New Racing Stock		
# starters per foal crop	3,500	(1)
Starters:total foal crop ratio	70%	(2)
# starters & non-starters	5,000	
Avg. value of racing age horse	$40,000	(3)
Total investment	($200,000,000)	
Horse Maintenance & Training		
Starters	($241,000,000)	(4)
Non-starters	($19,000,000)	(5)
Total maintenance	($260,000,000)	
Total Investment & Maintenance	**($460,000,000)**	
Purses & other revenues	**$150,000,000**	(6)
Net Outlay by Owners	**($310,000,000)**	

(1) Based on 10 years of *Equibase* data.
(2) Source: *Thoroughbred Times.*
(3) Conservatively based on 77% of 2004 N.A. 0-2YO average of $52,000/horse, per Jockey Club; 2005 U.S. select sales 2YO average is apprx. $66,000.
(4) 7,221 starters (2004, CHRIMS) at $2,781/mo for training, vet, farrier, and other costs per 2005 TOC survey.
(5) 1,805 non-starters (assuming 80% starters:total racing age ratio) at $900/mo per discussions with horsemen.
(6) 2005 purses paid, stabling & vanning subsidy, and workers' comp subsidy per CHRMS, less trainers' and jockeys' estimated share of purses.

In order to better understand these basic finances, *Owners' Circle* conducted a review of available information to estimate the relative size of annual investment and handle-based revenues among California Thoroughbred owners, racetracks, and ADW companies. Though quantifying investment levels precisely is practically impossible, this article aims to provide a general and reasonable comparison among industry investors.

Thoroughbred Owners

Every year, Thoroughbred owners invest a conservatively estimated $200 million in new racing stock in California, plus another $260 million to maintain and train horses, for a combined commitment of $460 million annually. In return, owners receive approximately $150 million in purses and subsidy support annually, or only 33% of total investment, resulting in a net outlay of about *negative $310 million each year.*

The methodology used to estimate the value of new racing stock was to take the average auction value of two-year olds and under as the "entry" point for new investment each year, and apply that to racing age starters and non-starters per foal crop. In order to simplify the analysis, the values of horses established via the claiming or private transaction markets were not used, as these transactions can be regarded as a transfer of assets resulting in a net "wash" on a consolidated basis (i.e., buyer's expenditure equals seller's proceeds.) Furthermore, this analysis does not account for investment required in the breeding sector. Maintenance and training expenditures were based on a recent TOC survey conducted in Fall 2005 (refer to "Costs Behind the 'Day Rate'", *Owners' Circle,* Winter 2006.)

Admittedly, an annual outlay in excess of over negative $300 million every year could be improved if the racing life of a horse were extended beyond what is currently a very short span, but the fact remains that investment in new racing stock is required every year to sustain the viability of the industry. The same is not necessarily true for investment in racetrack and ADW assets, which can be amortized over many years and, in the case of real estate, actually appreciate over time.

Racetracks

Since 1998, four California Thoroughbred tracks have been purchased, resulting in significant profits for previous shareholders. And if the recent Hollywood Park purchase is any indication, racetrack assets will continue to appreciate primarily due to the underlying real estate values. Acknowledging these as sizeable investments for the new

California Racetracks (1)
Estimated Annual Investment & Handle-based Revenues

Description		Avg. Annual Estimate	
Project and Maintenance Capital Expenditures			
Project capex - identifiable		($9,000,000)	(2)
Maintenance capex		($9,000,000)	(3)
Total capex investment		**($18,000,000)**	
Track Purchases and Major Renovations			
Aggregate value of all tracks (4)	($634,000,000)		
Estimated useful life in years	30		
Amortized annual value (non-cash)		($21,133,333)	(5)
Commissions & other revenues		$186,000,000	(6)

(1) Bay Meadows, Del Mar, Golden Gate Fields, Hollywood Park, Fairplex, Santa Anita.
(2) Identifiable project-related capex of $64 million from 1999-2005 at SA, GGF, HP, and DM based on SEC filings, public announcements, and discussions with track management; data on BM and FPX not available.
(3) Estimated at $1.5 million/track at each of the six tracks; actual data not available.
(4) Based on public purchase prices of SA (12/98), SLRD (5/99), GGF (12/99), HP (9/05), DM rebuilt grandstand (1993); BM based on Patriot American purchase in 1997, since Bay Meadows Land Company's purchase data n/a; Fairplex data n/a.
(5) Aggregate value divided by useful life; this is a NON-CASH item.
(6) 2005 commissions, satellite location fees, SCOTW/NCOTW reimbursed costs, CMC, ADW-related location fees (est.) Excludes on-track, attendance-based revenues.

shareholders, these transactions reflected a transfer of assets and not new investment in racing facilities by themselves.

A closer look at available data from public disclosures since 1999 shows California racetracks spent over $64 million in identifiable capital projects, or an average of about $9 million annually. Add to that on-going maintenance capital expenditures of $1.5 million per year (est.) for each primary track, and racetracks in aggregate spent an estimated $18 million annually since 1999. (Of course, investment in any given year can fluctuate depending on what major projects are in the pipeline.)

In return, tracks receive about $186 million per year in commissions and fees – 24% more than horse owners – excluding on-track revenues such as admissions, concessions, sponsorships, etc. One could propose that a track's initial purchase investment should be included in the analysis. This position seems hardly relevant when compared to the nature of Thoroughbred owners' investment. Unlike horses, which have little value at the end of their racing lives apart from a remote chance at a breeding career, track assets have "terminal" or exit values that continue to appreciate because of their alternative uses and underlying real estate. Even so, if the purchase values of the major California racetracks were amortized over 30 years, then the amortized annual value (non-cash) would be about $21 million.

Nonetheless, taking this into account, racetrack investment would fall well short of horse owners' investment by more than $420 million per year.

Advanced Deposit Wagering Companies

ADW companies differ from racetracks because most of their capital investments are geared towards the

CA Advanced Deposit Wagering Companies (1)
Estimated Annual Investment & Handle-based Revenues

Description	Inception to-date	Avg. Annual Estimate	
Estimated annual capital expenditures - U.S. Operations			
Youbet.com		($1,500,000)	(2)
TVG		($4,500,000)	(3)
Xpressbet/HRTV		($3,000,000)	(4)
Total annual capital expenditures		**($9,000,000)**	
Start-up Investment - U.S. Operations		***Amortized***	
Youbet.com (est. launch in 1995)	($105,000,000)	($9,500,000)	(5)
TVG (est. launch in 1997)	($168,000,000)	($18,700,000)	(6)
Xpressbet/HRTV	n/a	($14,100,000)	(7)
Total Investment in U.S. Operations		**($42,300,000)**	
ADW Fees - California-based only		$21,000,000	(8)

(1) TVG, Xxpressbet/HRTV, and Youbet.com.
(2) 2005 capital expenditures, per 2005 10-K.
(3) Estimated as 3-times the amount of Youbet, to account for television production assets.
(4) Estimated as 2-times the amount of Youbet; less than TVG to account for HRTV's use of existing production assets.
(5) Gross assets, working capital, and accumulated losses amortized over 11 years since 1995 launch, per 2005 10-K Balance Sheet.
(6) Assumes $150 million invested through 2001, per CEO Mark Wilson's comments at CHRB board meeting Jan. 2002, plus estimate of $18 million invested 2002-2005; amortized over 9 years since 1997 launch.
(7) Data not available; estimated as average of Youbet and TVG.
(8) 2005 hub fees for all three CA ADW's, per CHRIMS, plus estimated host fees assuming 5.5% net rate on out-of-state handle.

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entire United States and global markets, not just California. Combined capital investment for the three companies is roughly estimated at $9 million annually, based on available financial data from Youbet only. (As with racetracks, actual investment in any given year can fluctuate.)

In 2004, California ADW's received $21 million in fees. It is important to note that fees continue to grow each year, as required capital investment in the infrastructure has likely decreased significantly since the early launch years. Also, this analysis does not include fees received from operations in *other states.* Of course, one could suggest that the entire capital invested by ADW's since inception should be considered "new" investment because of the new distribution channel created for the industry. Even so, that amount might approach $400 million spent by all three ADW companies *over the last decade* (assuming comparable investment by Xpressbet/HRTV, for which data is not available), or about as much as California Thoroughbred owners spend in ***one year***.

Future Policies and Distribution Models

At a gathering of California industry executives earlier this year to discuss long-term strategic issues, all participants agreed that the number one imperative was to increase purses to deliver a quality product and regain a competitive advantage versus other jurisdictions. **As the industry pursues potential opportunities for the future, such as alternative gaming, it might be prudent to reevaluate how the present-day revenue pie is divided if healthy purses really are a common goal. This analysis suggests a more equitable distribution model may be required to sustain long-term viability – not just short-term profits – for all participants.**

Tracking Trends

DAILY ATTENDANCE & WAGERING through Sunday, March 5, 2006

	Racedays	Reported Attendance		Pari-mutuel Wagering		Pari-mutuel Purse Revenues	
2006 Los Angeles Turf Club - Current	51	18,539	9.5%	$11,480,036	14.8%	$442,676	13.9%
On-Track		9,297	23.7%	$2,309,425	18.2%	$160,795	17.9%
Off-Track		9,243	-1.8%	$2,993,152	4.4%	$140,957	3.8%
CA ADW				$801,289	19.1%	$40,349	25.7%
Out-of-State (Reg. & ADW)				$5,376,170	19.3%	$100,575	19.4%
2006 Golden Gate Fields - Current	20	5,915	-3.4%	$4,171,250	-1.5%	$163,435	0.9%
On-Track		2,103	-18.4%	$599,524	-15.3%	$41,049	-15.8%
Off-Track		3,812	7.5%	$1,439,724	8.6%	$76,739	8.6%
CA ADW				$327,784	8.3%	$18,196	36.5%
Out-of-State (Reg. & ADW)				$1,804,218	-5.0%	$27,452	-6.1%
2006 Bay Meadows Holiday - Final	31	5,936	-2.8%	$4,070,685	-4.0%	$156,018	0.7%
On-Track		2,551	10.4%	$660,788	12.0%	$45,915	10.9%
Off-Track		3,385	-10.8%	$1,208,251	-6.5%	$65,313	-6.9%
CA ADW				$275,328	28.3%	$15,121	41.1%
Out-of-State (Reg. & ADW)				$1,926,319	-10.0%	$29,669	-9.3%