Churchill Downs, Inc. (NASDAQ:CHDN)

Churchill Downs, Inc. (NASDAQ:CHDN) is an American gaming company owning and operating racetracks, casinos, and online gambling systems. It has a market capitalization of $6,3651mm.

Comparable Companies Analysis

We conducted comparable companies analysis comparing Churchill Downs with eighteen other companies. We used a roughly even mix of gaming companies (whose business is primarily online) and casino companies, to capture the diverse operations of Churchill Downs.

Churchill Downs recently reported an abysmal net loss for the period ending 6/30/20 induced by significant losses of business from closures prompted by COVID-19. As a result its P/E multiple is not meaningful, but it is worth noting that some of its peers reported positive net income, suggesting that this was not an unavoidable result of its industry exposure.

Churchill Downs has P/B (price-to-book value), P/FCF (price-to-free cash flow per share), and P/C (price-to-cash per share) multiples of 20.99x, 70.56x, and 10.16x, respectively, each of these several times greater than the mean and median multiples of its peers and the former two greater than the maximum of its peers.[1] Each of these ratios suggest an overvaluation of the company relative to its financial performance It further has a D/E (debt-to-equity, by book value) ratio of 6.77x (again well above peers' median and mean), suggesting very concerning leverage. (These multiples would be concerning for nearly any company even absent the comparison conducted here.)

Churchill Downs has liquidity roughly in line with the median of its peers and slightly below the mean of its peers.

Concerns and Mitigation

Churchill Downs' statements of cash flows demonstrate greater net increases in cash for the six months ending 6/30 and the three months ending 3/31 in 2020 relative to 2019. We do not believe this to be indicative of superior financial performance. The company reported significantly decreased cash from operating activities, and the majors sources of differences between the results from the two years seems to stem from non-recurring expenses in financing and investing activities.

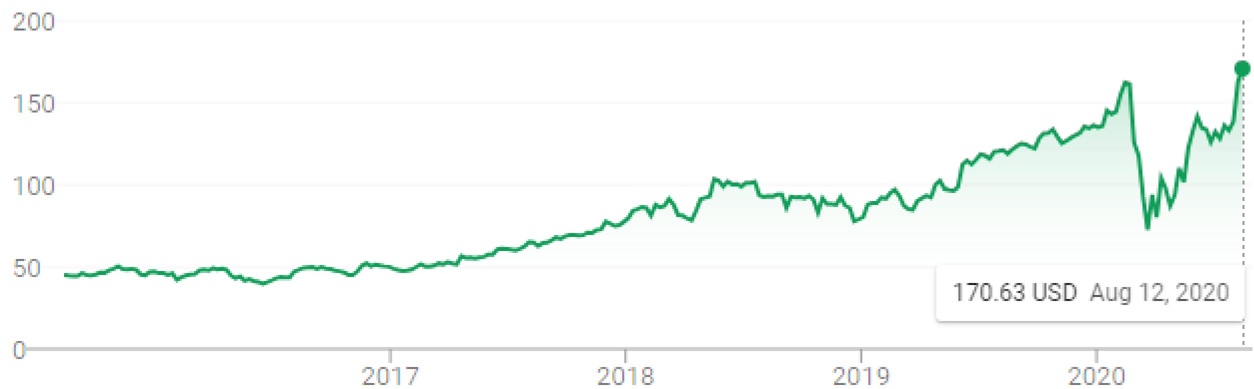
In investing activities, Churchill Downs reported significantly greater cash spent on inorganic investments: acquisition of business net of cash acquired of $171.3mm & investments in and advances to unconsolidated affiliates of $409.8mm. No expenses were reported for these line items in the 2020 periods.

In financing activities, the company had significantly greater repayments of long-term debt in the 2019 periods than in the 2020 periods ($632.9mm vs. $32.4mm). These repayments to not reduce our concerns about the

[1] All but one of the peer companies had P/C multiples below that of Churchill Downs. The exception was the Las Vegas Sands Corporation, a company that benefits from significantly greater size (by approximately a factor of six) than Churchill Downs.

company's leverage, as the leverage ratios referenced above are calculated in light of these repayments, and the company borrowed significantly more than it repaid in both years.

The P/B, P/FCF, and P/C ratios cited above each refute any concern that the company's financial position is already "priced in" to its share price. If one desired further proof, one could note that the stock is currently trading near a five-year high (as shown in the graph below).[2]



Taking a short position brings with it the additional risk of the obligation to cover dividend payments made by the company. This does not concern us in this case: Churchill Downs reported a significant net loss for the quarter. Thus, to pay common dividends would require borrowing on the part of the already highly leveraged company, an unwise move by its management that could strengthen the short position. In addition, its historical dividend yield is a nontrivial but ungenerous 0.34% (of share price), suggesting that any dividends the company may pay are unlikely to be of great size.

Conclusion

Due to our belief that the company's current share price does not accurately reflect its financial performance, we have taken a short position on Churchill Downs, Inc.

[2] As a matter of curiosity, an examination of Churchill Downs' reports reveals instances of notably generous accounting. The company reported Q2 net loss of $118.8mm and "adjusted" net loss of $21.1mm. For this same period, the company reported EBITDA of $10.9mm and "adjusted" EBITDA of $30.1mm. These latter adjustments included a hefty add-back of stock-based compensation, which is well-established to be a true expense the exclusion of which is inaccurate.