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RACING AND GAMING SUMMIT

Afternoon Session 2

INVESTING IN RACETRACKS

Moderator:
Joseph Harper, President and General Manager, Del Mar Thoroughbred Club

Speakers:
Marc Falcone, Managing Director, North American Equity Research Group, Deutsche Bank Securities
Jim McAlpine, President & CEO, Magna Entertainment Corp.
Anthony Sanfilippo, Central Division President, Harrah's Entertainment
Steven T. Snyder, Senior Vice President-Corporate Development, Penn National Gaming Inc.

MR. JOE HARPER: Well, I want to thank all of you for being here. I realize it's been a long day and we've heard a lot of interesting things, a lot of interesting folks talk about a very changing business.

And this is a panel that — I'm not sure really what the hell we're supposed to talk about, it says "Investing in Racetracks," I think was the title of this. I guess we invest in racetracks for the same reason we all bought beta tape instead of VHS and we bought — yeah — Edsel, I guess that's probably the reason.

But I know that we've got a really interesting panel, we've got some the racetrack people, we've got some operators, we've got some casino folks. We all seem to be more and more joining hands here.

So I'll introduce them as I call on them. But from the racetrack side we've got Jim McAlpine, who is obviously we all know from Magna. Magna certainly has the biggest investment, I think, in racetracks of any of us. And I remember from my Magna days I was on the board for a few years and I found it very interesting.

I have to tell you a little story, probably out of school but what the hell.

(Chuckles)

I'd never met Frank Stronach when he bought Santa Anita first, and so I was really surprised when one Sunday afternoon there was a knock on my door at home and I opened it and there he was. And he came in and he said, "I want to tell you about what I want to do for racing."

I said, "Okay, come on in."

And he sat down and proceeded — as we've all been kind of a victim of his — in the explanation of how Magna International worked and how he saw Magna Entertainment working and the tracks.

And of course I, like everyone, was captivated by his passion for the racing industry. And now he's turned that passion into probably having more racing dates I guess in North America than anyone. And yet still, you know, the investment I'm not sure of.

Before he started with that after our meeting Frank asked me to come to a meeting of Magna International, a board meeting that was held in Los Angeles. That surprised me somewhat; I wasn't sure why I was there, but he asked me. And so I went.

And at lunch break he asked me to come in. And there was a Magna board of directors, and a very impressive group of people. And these were people who had been running a car parts business that was doing, at that time, probably seven billion a year I think, now it's probably closer to 10.

MR. McALPINE: Twenty.

MR. HARPER: Twenty. So I was impressed, still not sure why I was there. There was a lull in the conversation at lunch and Frank introduced me and said I was from Del Mar, and did anybody have any questions?

And one guy spoke up and he said, "Well, we're in the car parts business, we understand it, it's been very profitable. We don't know anything about the racing business. But what little we do know we don't think it's any return on our investment. And we don't think we should go into it. What do you think?"

I realized then what my job was, so I said, "Well, let me tell you about Del Mar." I said, "We've got a great investment there."

I didn't tell them at that time the state owns the whole thing so I hadn't put any money up.

But I said, "You know, we're just making a lot of money. We just built a $100 million grandstand, and boy, the people are just coming in from everywhere and betting all this money, and it's incredible. Boy, I wish I could go out there and invest some more."

I was dismissed then and Frank thanked me for obviously doing what I was supposed to do and I went on. But I don't know whether he's had any second thoughts since then. I know the investment has been tremendous, the time and effort that fellows like Jim McAlpine put into it is very impressive.

Jim comes from Magna's international side where he was I think chief financial officer for a while, and certainly knew that company inside and out. And there aren't many companies that are doing that kind of business nowadays, and it's very impressive. And I think Magna's lucky to have him over on this side.

Last quarter earnings were kind of disappointing I would imagine, $50.3 million loss, Jim. I'll tell you though, after that came out he said that his long-range strategic goals were in place and looking good.

If I'd announced to my board I lost $50 million in three months my strategic goal would be to write a resume.

(Laughter)

Jim, he's smiling, sort of. And he smiled through this. And I was always impressed with Jim and so I'm going to ask him to go first. And what were you thinking about buying all those racetracks?

(Laughter)

MR. JIM McALPINE: Well, I don't — I'm sorry you feel like a victim of Frank, because I don't think Frank thinks he has any victims, I think he thinks that he meets people, and with his passion, he infects them; and that he has this view from 50,000 feet and our job is to implement it at five to seven feet off the ground. Some of us are challenged more than others, and I don't know any seven-footers on the team yet, but we all aspire to be seven-footers.

I thought that the premise of this conversation needed to be added to somewhat. And I put together a couple of slides just to give you a perspective, because I thought Joe might ask that kind of a leading questioning. And so I want to draw your attention to the slides.

And before I do that I should compliment Tom Meeker at lunch. I don't know if any of you heard Tom, but frankly Tom gave one of the best speeches that I've ever heard him make. And —

(Applause)

One of the key points of his speech was passion. And if anybody doubts Frank's passion or my passion or the passion of all the other MEC people that are here and also back in our business units, all you have to think about is we've only been in business for 250 weeks, and over that period of time we've invested between $4 million and $5 million a week.

So as Joe said, we've put our money where our mouth is. And we do believe that long term our strategic direction is the right direction. But there's no question there are huge challenges to delivering on our vision.

Very quickly if I can just — I have to do this, don't I? It's over here somewhere. Excuse me.

Our mission is simple. It's to create a global entertainment company built around horse racing. And when we look at the competition, what is the competition?

The competition is sports, gaming and family entertainment. If you look at the marketplace, which is where we start when we look at any business proposition, whether it's automotive or entertainment-related, basically we're in a $900 billion market. And the tragedy is that horse racing only has a $15 billion slice, that's less than two percent of the market; and we were the guys who originally had a monopoly on gaming in North America.

So we look at this as a $900 billion opportunity. And if you look at horse racing itself and thoroughbred wagering on horse racing, if you look at the world, it's not the $15 billion that happens here, it's the $100 billion around the world. So again, to us that spells opportunity in the horse racing segment of this business.

And if you look further at the horse racing segment, you say, "Why are you so enthusiastic? What is the opportunity?" A large part of the opportunity comes from creating an environment where the people who run racetracks can make the decisions to satisfy the customer; and Tom talked a lot about that at lunch today.

Unfortunately, however, there are a lot of impediments to us conducting what most of us would think of as a normal business practice, every day getting up saying, "How can I look after at the customer better?"

And if we did that, it's our belief that there's $18 billion of handle that could be generated in these different markets.

I'll just give you a real simple example. Last week we had hearings before the California Horse Racing Board. And one of the items on the agenda was a pari-mutuel operator had to request permission from the board to move start time from one o'clock in the afternoon to 1:15.

Now, can you imagine Wal-Mart going to a municipal or state government and saying, "You know what, instead of opening at 9 o'clock in the morning we want to open at 9:15. Can we have your permission?”

That's the kind of impediment that stands in the way of our industry being truly successful, and companies like MEC and others being able to realize their vision.

Another great opportunity, there's 3.2 million core customers based on lots of research that lots of people have done, but there are 98 million Americans who say that they are fans of horse racing and excited about the opportunity to participate in pari-mutuel wagering. So we see that as an enormous opportunity to get more of those 98 million people into our game.

Let's talk a little just quickly about lotteries, and I showed the slide. And lotteries basically sell $60 billion worth of tickets either in the U.S. — and I look at this slide and, I mean, this is the — basically the worst form of gaming possible. You go to a 7-11, you buy a ticket, and a week later or a few days later you sit in front of your television set and watch a bunch of ping-pong balls come down a chute.

How the hell did they get to be four times bigger than horse racing? Because when you think about it, horse racing equals excitement. Watching ping-pong balls come down a chute does not.

So what do you do? You create lottery-type bets built around horse racing. It's a natch. Our industry should be finding more and more of these lottery-type bets and going to that lottery player and saying, "Play with us."

The difference is the lottery's got thousands of outlets around the country and we have a few hundred. Regulatory inertia. Casinos. And some of my colleagues here are in the casino business. And we've got nothing against casinos, but what's so special about that opportunity for people to game?

We looked at horse racing and said, why can't horse racing create a pari-mutuel terminal that looks like a slot machine? And we did. It's called the Horse Wizard. You can play it outside, and I hope you will. We didn't develop this to be a Magna-only technology, we developed this because we think it's an answer to our industry's challenges to compete with the casinos with a game that's already legal.

This is a pari-mutuel terminal but it looks like a slot machine and it acts like a slot machine, and please go and play it. It's about environment.

So you’ve got to have a machine, you’ve got to create the right environment. Casinos have done a great job, racetracks haven't reinvested. There's the machine; and again, as I say, you can play it outside. There's the environment. Our competitors, how did they succeed? They invested in facilities, marketing and entertainment.

Well, we are investing in facilities. We built a new facility in Austria, it's a combination of slot floor and sports bar. This is a design for the new Meadows, this is the design for Gulfstream Park, and this was designed before there was any hope of slot machines in Florida.

But we believed it can create an entertainment environment, and that the investment in racetracks for the purpose of horse racing and expanded horse racing entertainment around the world is a proper basis for a business plan.

You have to add technology to it, and then instead of having 1.5 percent of the market horse racing and pari-mutuel wagering should share in 20 percent of that total $900 billion market. And that's what we're excited about and that's why we invest in horse racing.

(Applause)

MR. HARPER: Thank you, Jim. And I'll tell the rest of the panel here to feel free to ask questions as we go along, as well as the audience after we're through making some semi-formal presentations here. Because this is an informal gathering.

Steve Snyder, Penn National. Those are folks that used to be in the racetrack business. Now they're heavily into casino businesses; and tell me a little bit about how you this future?

MR. STEVEN T. SNYDER: Thanks, Joe. And I guess it's probably no coincidence I'm seated behind — or next to someone from Magna and between a gentleman from Harrah's, so you hit the nail on the head.

We at Penn National Gaming still draw our name from the thoroughbred racetrack in Grantville. We are still deeply immersed in the racing industry. As recently as this year we've made another investment in a racetrack by acquiring a facility in Bangor, Maine, a harness track that we will develop into a racino gaming facility with slots at the racetrack.

But we have looked consciously as a company as we've developed our business model over the course of the last five years at the highest return opportunities for us on behalf of our public shareholders; where can we deploy capital as a management team to generate the highest rates of return on invested capital for our public shareholders?

I think the proof is obviously in the performance in terms of valuations on our company, on our business. Unfortunately what it indicates is exactly what Jim was mentioning earlier. We as an industry, as the racing industry, need to actively and much more effectively than we we've done, look for new opportunities to supplement what's going on in the pari-mutuel industry.

We've done that in Pennsylvania after 10 years of trying, and James only lived a fraction of the 10 years that we had at Penn National and have lived in this legislative process. We've done it, our predecessor had done it in Maine, we're seeing it around the country as other jurisdictions look at opportunities to both create revenues for municipal governments, state governments that are coming up short because of the general economy, but also looking to regenerate the racing industry, looking at opportunities to regenerate purses and the industry itself.

What we are concerned with and what we look for as an enterprise that invests in racing around the country, and we've looked at many racetracks for investment opportunities — a company which we just announced an acquisition with, Argosy has recently made an acquisition in the State of Ohio of a racetrack outside of Toledo.

We will continue to look at racing as an opportunity to expand our business, but not purely as a racing enterprise. We need to achieve higher rates of return on invested capital than we have historically on our pure play racing assets.

I think Jim's experience has suggested that the returns on investment in the racing business in the last few years have not been what they should have been, have not been what hopefully they could be and will be on a go-forward basis, because of the return on those investments not being up to par with other opportunities in the casino industry.

What we tried to do as a company is look to effect legislative change, to encourage investment in this industry, and the types of things that we're concerned with when we look to influence that legislative change are: What will the structural impediments be to operating in that racing environment in that jurisdiction?

The types of structural impediments that you may or may not run into as operators, as investors in racetracks; start with the issue of the tax structure. And New York is an example of what sort of egregious tax models may do in terms of regenerating the industry, and looking at more sort of investor-friendly models for creating an environment where the investor gets a return on his capital that he's invested in the industry.

The industry grows, creates more jobs, creates more green space by supporting the racing industry, and the municipal taxing entities get their share, and it's everyone rowing the boat in the same direction to generate an economic engine that benefits those three constituencies — the operator, the race, the horsemen and the political jurisdiction. So the tax structure is first and foremost, in terms of what we are concerned with, in investing in this industry.

Next is the operating environment. What's the operating environment like? And what we found, and Anthony can attest to this from the experience that Harrah's has had, is in those new jurisdictions where casino-style or slot machine gaming has become accepted as a mechanism to help regenerate the racing industry, those new jurisdictions are very deliberate, are very slow in moving up the learning curve.

Pennsylvania is an example. The governor signed our bill on the 4th of July this year, and I will be shocked if I see the first dollar of revenue out of slot machines in Pennsylvania much before the second anniversary of his signing that bill.

So this industry is evolving, we're looking at opportunities to invest as the industry evolves, but it will take time. It will take time to work out the kinks, it will take time as suspicious legislatures, suspicious regulators try to move up the learning curve and replicate the experience that New Jersey has had now for 25 years, what Delaware has had for a decade, what we in West Virginia have had now going on nearly a decade, to get the models right.

What we've heard from earlier panelists is the technology is there, technology is sort of coming together so that the implementation of these new enhancements to the racing industry are out there. The proof will be in sort of the performance.

The next two years as the State of Maine, as the State of Pennsylvania, as any new states come on line, actually implement slot machine gaming, video lottery at their racetracks, this industry will expand, this industry will create an opportunity for more investment, more dollars being invested in the types of construction plans and building plans that Jim has shared with you that Magna has developed, but it will also lead to further consolidation.

What you're going to see is the industry participants who have the lowest-cost access to capital, who have the ability to raise capital and deploy that capital in sort of economic models which create returns on that capital will continue to grow, either through building programs like ours in Pennsylvania or Maine, or through acquisition programs like our announced acquisition with Argosy.

So to sort of summarize and move this more to the discussion that it's meant to be, we at Penn National, when we look at investment opportunities in racing, we have unfortunately been forced to look beyond racing to the alternative revenue sources that are being made available from various jurisdictions and make a "buy or build" decision to move into those jurisdictions, acquire those properties based on those alternative opportunities that are presenting themselves more frequently, but not as frequently as we as an industry would like.

MR. HARPER: Great. Thank you.

(Applause)

Anthony Sanfilippo is from Harrah's. He's the President of Harrah's Entertainment, type —

MR. ANTHONY SANFILIPPO: Central Division.

MR. HARPER: Here you are sitting with some racetrackers, semi-racetrackers maybe in one case, but trying to make something happen for us. Here you are coming out of the casino industry and looking at racetracks. What, have you lost your mind?

MR. SANFILIPPO: We've got a little racetrack in us. We've been operating down in Louisiana, thoroughbred and quarter horse racetrack for a while. Steve said a lot of things that I think covered a broad look, and in some cases very specific about what it took to or what it's going to take to have investments with the racing industry.

If I can just broadly talk about Harrah's and then more specifically our Louisiana Downs project. And then we'll go on to Mark to try to fill in some of the gaps.

Harrah's is a company that's 67 years old, and a company that saw very little growth or opportunity for the first 52 years, 55 years. Because gaming entertainment wasn't legalized outside of New Jersey and Nevada. We became a public company in the '70s. And I've been with the company over 20 years.

And as I've looked for where else can we grow, and our company looked at for where else we could grow, it's pretty limited. When in 1993 we started to see riverboats, first one that we got into was in Joliet and then we went into many states past that.

We started to see that as an opportunity to grow a distribution of properties throughout the United States. And at the same time we started looking from a technology standpoint to, how can we tie the customer base together? And our focus is on gaming entertainment, and how can we facilitate the supply of gaming entertainment worldwide?

And that's what we focus on, and then how do we tie our customer base together so that we can have the brands that we're establishing appeal to a broad group of customers? We own the Rio Grande, the Harrah's brand; recently we bought Horseshoe, we have announced the Caesar's Entertainment brand that we think will be a great brand for us.

Today we have 28 properties, soon we'll have over 50, and domestically we're going to have a great distribution of properties. We got into Louisiana Downs about a year and a half ago because we saw an opportunity in that market to be able to buy a racetrack that hadn't had a lot of capital put into it in the last 30 years and place a casino into that location.

And there were a couple of factors that were appealing.

One. The location. It's a great location that has wonderful interstate access to it.

Two. Our ability to build a one-level casino. We put a lot of money into the track, we improved the track. The money that's going in, the 15 percent that goes from slot win goes into enhancing the purses, and we have the longest racing season this year that that track has seen in many, many years; 122 racing days, both thoroughbred and quarter horse.

It had a lot of land. It's appealing for us when we think of the next 20 years what we can do there to grow that facility, with other amenities that may not be specific to gaming; they may be specific to a cutting horse arena, hotel rooms that are there, shopping that could be there.

So when we started to look at this as an opportunity, we looked at it not for what is it going to bring us next year, but what's the future growth of that site?

And as we look at going more into thoroughbred racing, it is to compliment out strategy of worldwide distribution of gaming entertainment, that's how we look at it, and this is a great vehicle for us to do that.

We've already been very successful in developing a strong database, well over 20 million people in our database that is connected to any Harrah's entertainment property that they go to. And we think under the right conditions — and I think Steve articulated it very well — that this is another vehicle for us to continue the distribution of gaming entertainment worldwide.

MR. HARPER: Thanks very much. I think I have a few questions for you and I know the audience does, and we'll get to those in a minute. I appreciate your comments.

(Applause)

Marc Falcone, obviously you know him from CNBC, he's always out there in the forefront giving good sound advice. He's managing director of securities for Deutsche Bank. He obviously knows quite a bit about the gaming industry and from probably a step back, maybe a little more than even some of the people who are emotionally tied to it.

I think you have a good sound judgment of it, at least from what I've heard you on the air. You know, you've got a racetrack operator who has an incredible investment in this business, and looking for, obviously, return.

You've got a racetrack operator that took the step and went to the slot machines, you've got another guy here from the casino industry that is expanding through racing. Are we kidding ourselves here? Is there such a thing as a real racetrack anymore? Or how do you see this as an investment?

MR. MARC FALCONE: Well, I mean, clearly to have a collection of different profiles in the racing business helps dissect the opportunities that exist in this business and the specific growth outlooks that we have for the individual companies and specific business models; but my job and what I immerse myself in on a daily basis is evaluating public companies and whether they're good investments for shareholders of those companies.

And the single most important aspect that we look at in today's day and age is what Steve highlighted as an important reason why they were looking beyond racing as a pure play business into alternative gaming revenue streams, is the return on invested capital.

And the challenge that I think the physical racetrack industry faces today is the difficulty of driving and monetizing a racetrack which has in many cases, as Jim can attest to, significant amount of land holding that's not utilized and does not get public market valuation for, but you cannot do that today, you cannot monetize that investment that Jim and his company has made and that Penn National has and Harrah's have both identified, without racino-type gaming.

I think it's important, and I think that all of us up here can collectively say that the racetrack business as a pure play racing industry will face additional challenges going forward as we seek competition from sports, casino gaming, other entertainment alternatives.

So what we look at is how disciplined companies, and no matter what aspect of this business they're involved in, how they invest that capital. And the challenges that we see in the racino side of the business can be both challenges and opportunities, but specifically high tax rates. And we're seeing tax rates of 80 percent in New York that Steve pointed out.

But slowly most racino markets today are looking at the 50 percent tax bracket. So you have to carefully evaluate what type of return you get on that investment and that type of a tax structure.

And I think overall, as long as these companies invest wisely at a higher tax rate, we anticipate they will be able to get acceptable returns to appeal to shareholders, and therefore that ultimately will create additional growth opportunities.

One of the issues that I think is also important is each of these companies — or specifically Harrah's and I think Magna — definitely have an increased focus on technology and using technology to leverage and increase that return on invested capital.

I mean, Jim's company over the last several years has been focused on many different applications of technology from the television station to the new Casino Wizard machine, Harrah's obviously with Total Rewards Program, but those are the types of additional capital investments that we feel can make the racino business, not the racing business, more profitable and higher return on invested capital business.

And as we look at public companies, there is one key thing. I think if Jim's company had started acquiring assets today versus five years ago I'd be interested to see what level of capital and access of capital he would have. The market today, in the last 12 to 18 months for gaming companies specifically, has significant access to capital at very attractive interest rates.

Given that type of scenario, we're seeing higher returns on invested capital because borrowing costs are so low, and you're getting a higher return on that capital that you're investing. I think when they started acquiring their assets it probably was not in as attractive an interest rate environment, could get better returns, and I think ultimately they will get business returns, and specifically in a situation like Magna Entertainment, where they control so much racing content and so much physical racetracks we are seeing proliferation of racinos; we're seeing positive legislative moves in Pennsylvania, we're seeing positive legislative moves in Oklahoma, where they have a racetrack, we are seeing directional changes in Florida, and I would anticipate Texas, Maryland, and also Ohio by 2006 will all likely have some form of racino-style gambling legislatively passed, the question is how long it actually takes to get open, but Jim has a good footprint there. So the early returns in Jim's business may come later, so the $50.3 million loss may be reversed down the line, for some defense in Jim's case.

And I think you know Harrah's and Penn both have done an excellent job specifically identifying directionally where they believe their companies' best growth prospects are, and clearly the share price performance of both these companies this year have been absolutely outstanding. I think Penn National is up over 50 percent, as is Harrah's very close to being up 50 percent, identifying the strategic directions they take with their specific business models.

MR. HARPER: Jim, sounds like you should all go out and get some more money?

MR. McALPINE: No, the challenge now is to make what we've got work better, and to be astute when it comes to opportunities not just for new investments, but to manage the investments we've already got. And in certain circumstances we're now in a position where we can entertain partnerships with people who can bring something to the table, and leverage other people's money and other people's expertise, which we think is a smart way to go.

MR. HARPER: Well, obviously the investments you have in this business haven't been just purchasing racetracks, you're obviously putting a great deal of capital money out there; Gulfstream training center in Florida, things like that. You do see a long-term position in this industry, I guess, with Magna; and when do you see a turnaround?

MR. McALPINE: Well, I was quoted in some article recently as saying Magna wasn't a get-rich-quick scheme, or never said it was a get-rich-quick scheme, and that's the truth. I mean, we took a long-term view of the industry and the potential for the industry and the Horse Wizard I showed you, if you can picture that Horse Wizard with a race coming down the line every two minutes to participants at racetracks, OTBs, sports bars, even casinos around the world, we think you've got a winning proposition that supports the content investment we've made.

That's not going to happen instantly. It took us three years of hard work with very smart engineers, software developers, game thinkers, to develop the Horse Wizard. We've now developed it, we've got patents and we've created four showrooms at four of our locations, and we're going out to the market to educate people like the ones in this room and others as to what that could represent for the horse racing business.

So technology has been a huge part of what we've been about, including AmTote, which we are one-third owner of. And as you mentioned, Horse Racing TV and XpressBet, that's all part of the platform, that's all part of how do you get this content in front of people around the world.

And we think when you do that you've got an absolutely incredible business proposition. And the short answer to your question is: Hopefully in another couple years. Or faster.

MR. HARPER: Well, I think certainly all of us in California, we may all knock each other from time to time, but there's two circuits in Southern California, and I guess the Southern California is one circuit. But I think that we're all kind of dependent on the help of the other guy. And somebody will say to me, "Gee, how about — you know, Hollywood Park's numbers are bad."

And I say, "You know, their numbers are — if Magna goes away, Del Mar is in trouble, so is Hollywood Park. If Hollywood Park goes away we're both in trouble."

I think you need a circuit there, and it's a healthy one. I think it's very difficult for one of us, I know I might get a little disagreement from Jim because he'd kind of like to have all the dates; but I think it's probably better that we all stay as healthy as we can in this industry strength in numbers too.

MR. FALCONE: If I could add one additional instance to investing in racetracks; I mean, you're seeing an emerging trend of non-traditional gaming participants investing in gaming and gaming-like assets like racinos; and specifically, Penn National sold one of its racetracks to a Native American tribe from Connecticut, the Mohegan tribe. You see Foxwoods has now announced an initiative to diversify away from their core facility in Connecticut and look at various alternatives in gaming.

And you're seeing a significant interest across many different platforms now including private equity participants, traditional private equity participants that have historically avoided this business and they are looking at racinos and racetracks as real estate plays and gaming plays.

So this is an investible business and it can generate returns. And I think it's important to identify if there is a non-traditional buyer of these type of assets, I think that supports the thesis that these are still investible assets.

MR. HARPER: Steve, you were in the racing business, now you're heading in the casino business big time. Do you see a time where you won't have racing?

MR. SNYDER: No, Joe, I don't think there will be a time in the future, looking into my crystal ball, that Penn National won't continue to have a significant presence in the racing industry. We won't, however, have a large presence in stand-alone racing. It will be in conjunction with, as Andy mentioned, a larger platform to provide an entertainment option to people in those markets in which we operate, and that option will be whether or not it's going to play a slot machine, going after hours to a simulcast facility or witnessing a live racing event; but they'll continue to be intertwined whether it's at Charles Town in West Virginia or at Penn National in Pennsylvania; and I think you'll continue to see that in the industry.

Unfortunately, Mark highlights and the other panelists mentioned this is a game of dollars and cents. This is an industry that is quickly becoming much more responsive and reacting to how dollars are invested. And if people make wise choices with the money that they invest and are rewarded with access to more capital — to reinvest that capital, and that's what we like to look at as our responsibility to our stakeholders, invest their money wisely in racetracks with alternative gaming opportunity — have been a very wise investment for Penn National to have made over the last five to 10 years.

MR. HARPER: I guess I'm concerned, being a racetracker, and I'm always concerned about; okay, racetracks, you know, the legislation is there. It's easy to — not always easy but it's probably the easiest route to slide in to get slot machines or a casino, racino into a new or existing track.

Let's face it, operating a racetrack is expensive, and all of a sudden when the return, when the revenues are coming in they're not really all — if racing, all of a sudden you start thinking, "You know if I get rid of these horses over ever here, I'm going to make a lot more money." And do you see that? I mean, is that a problem we all should be worried about?

MR. SANFILIPPO: If I can address this, and I'll use Louisiana. The only way we're allowed to have a casino at the racetrack is if we race a minimum 80 days a year, so we don't have a option there. And so our focus there is to continue to look for ways to build on that complex to get more people there.

We happen to have a Horseshoe Casino there so we look at how do we, with both the Horseshoe Casino and Harrah's Louisiana Downs, maximize a second stop strategy in that market and try to attract more people here?

So it's not an option for us in that situation — because it's the way it's been set up at the state — not to have racing, and we have a minimum number of racing days there.

Now, I like what I heard from Jim, because the more we can do to make racing, pure racing more appealing and more interesting, will be better for this industry. We need to continue to find ways to do that. We continue to look for ways to utilize the facility to try to attract more people who will, whether they bet on the races or whether they go into the casino, that they're attracted to our facility.

MR. HARPER: Well, you've been in your industry for a long time, but you know, the statistics, I think, say now that what, less than 50 percent of the revenues are from gaming?

MR. SANFILIPPO: Depends on the market you're in. If you're looking at a Las Vegas, where there are a lot of hotel rooms and a lot of food and beverage venues, then that would be the case. If you're looking in other markets outside of Las Vegas that's not quite the same.

MR. HARPER: Did they have to reinvent themselves?

MR. SANFILIPPO: Las Vegas absolutely reinvented itself, absolutely did in the late '80s. When Steve Wynn built the Mirage people said, "Oh, my goodness, how is he going to be able to bring in at least a million dollars a day to pay the expenses on that place?"

And what it did was it started just a cascade of new products, and that city continued to develop the infrastructure of the city. Make sure you get more people into the city and continue to work to welcome tourism into that city.

MR. HARPER: What kind of percentage do you see on revenue other than Las Vegas?

MR. SANFILIPPO: It varies by market. Most of the markets though, the majority of the revenue, over 90 percent would be from gaming revenue.

MR. HARPER: I think this industry always has to reinvent itself obviously for the racing side. I know Del Mar, for instance, we don't obviously have slot machines there in California, but we're certainly going to keep trying; right, Jim?

And people say to me all the time, "Gee, at Del Mar you've done such a great job. Is the business up or making money?"

Our on-track business probably next to Saratoga is the best of the country. But we had to reinvent ourselves to get that way.

I'd love to make this statement; 10 to 15 years ago, I forgot exactly when it came about, but we were pretty much decided not to market our product. Sad to say, but our product was going downhill. It was becoming more unattractive to a large number of people as our aging fan base died off.

We did, at Del Mar, the best we could, being in the position where we were location-wise; we felt that we better kind of market our venue, and so in came concerts, in came Del Margaritas and fancy other signature drinks, we brought in sponsorships.

And it turned out to be, Del Mar is pretty much the social place to be if you're young and attractive, and Southern California has got a whole bunch of young, attractive people.

I always make the joke that really our secret to success is silicone and Spandex.

(Chuckles)

I think that that continuing on pretty much to get us through a difficult time with shrinking field sizes and things like that as racing for a pure sport.

So I kind of understand the casino/racino business because it obviously is part of reinventing ourselves.

Gentlemen, you guys must have some questions of each other? Or do you want to argue with each other?

MR. McALPINE: I'll just pick up on two things you said. First of all, we don't want all of everybody's dates. We very much believe that as many locations as we have today in horse racing are just fine. Because to us they do two things. First of all, they're part of the distribution system, and we very much want to support racing across the country.

Secondly, they're part of the content side of the business. And to run the simplified wagering machine or the Horse Wizard with a race coming every two to three minutes you need a hell of a lot of races, so we don't want all of everybody's dates; and I know you were being facetious when you said that.

MR. HARPER: I was just talking Southern California.

MR. McALPINE: We don't even want them all there, we want everybody to survive. But it's a chicken and egg situation in terms of the investment. And you know, if we don't reinvest — and you did it, you guys had the courage, you had the conviction of your board and you're invested.

But you look at a lot of tracks across the country, they haven't; and if the washrooms are lousy, if the food service is lousy, if the grounds are kept poorly, how the hell can we compete with casino operators who've got lots of cash flow and they're able to reinvest?

So our choice was to a little bit, put the chicken before the egg; and Gulfstream's a perfect example. And we're experiencing a small success there.

The other thing I think is very important is the fact that, where does government come out in all this? And the governments aren't putting us in these businesses for ourselves or our shareholders, they're putting us in these businesses, so-called racinos, because they need the revenue to solve a deficit problem. And as time goes on, they can change that lever and a guy like Mark can look at the numbers and all of a sudden they don't look so good because the tax rate went up to solve somebody's deficit problem. Frankly, that doesn't help long term, and that's why we don't really see this being the panacea.

It's a piece of the puzzle, it's an important piece of the puzzle, but don't forget the guy who makes the rules is the guy who's only in office for two or four years and they're trying to get reelected again, and they've got a whole bunch of demands far greater than what our industry needs to sustain itself and grow.

MR. HARPER: Anybody else want to talk to each other? I know we've got probably some questions, we're getting down to the end.

Yes, sir?

MR. JERRY CONNORS: One of the things that we've heard repeatedly is that as venture capitalists you have to get an acceptable rate on your investment, and that you have to tell your story to the people in charge to try to get a lower rate which would help your business.

I'm a venture capitalist, my name is Mr. Twobucks. I go to your racetracks. I come from Pennsylvania where one track has a 35 percent takeout on certain bets.

I don't want a big return, I believe in the racetrack story. I hope I break even at the track today; I need the money.

(Chuckles)

That's the return on investment I'm looking for. But I have to invest my money in an area where there's a high rate of tax, in my opinion. Is there anything you can do for me?

MR. SNYDER: As a pari-mutuel operator in the State of Pennsylvania — as Jim had mentioned, in every jurisdiction the rate of taxation is one of if not the single most critical variable that we measure in terms of going into and investing in that jurisdiction.

When I talk about Penn National and how we deploy capital, we do it on behalf of our stakeholders, and they are our customers, they're our shareholder, they're our lenders, the people that have lent us the money to build the business as we have.

So we've got all those constituencies that we've got to answer to. So your comment doesn't fall on deaf ears.

MR. CONNORS: I asked me, Twobucks.

MR. SNYDER: I understand that, I understand that. But unfortunately based on the operating performance of the racing business in Pennsylvania, it hasn't been where we've reinvested our capital. We've reinvested our capital in places like Charles Town, where not only have we built a gaming facility with 3,800 slot machines, but we've taken a racetrack that was on the verge of closing and built it into a 270-day live racing event with purse structures that have gone from $20,000 a day to $200,000 a day; with handles that have gone up proportionately.

So when there's an opportunity because of the economic incentive to do so, we've done it. In the State of Pennsylvania, it's been a matter of creating the economic opportunity, and we've taken a decade, and I think we're now closer to the goal line, but we're still two years away from it.

MR. McALPINE: I've got a simpler answer for you; open an XpressBet account and bet on California racing.

(Chuckles)

The lowest takeout in the country.

MR. HARPER: And the takeout is a problem facing all of us, all track operators. I mean, you invest in racing, we try to make a return on investment. But I've always looked at Del Mar, our most important product is the guy that is betting the $2. And it's hard, and I get complaint letters from bettors because they feel the takeout is excessive. And it's probably, judging from some recent studies we've done, it's probably a little higher than you really think it is, especially with off-shore business and rebates and things like that.

So I guess our answer at Del Mar was to try to make it a nicer place, to kind of reinvent ourselves as a facility, and at the same time try to get a little better product going for the patron.

It's worked for us, but it hasn't really worked for our hardcore; and I think that's probably what most tracks are realizing, that no matter how you fix it up, I mean, the hardcore patron is going to see a form in front of him, television over his head, and that's it. So it is a problem.

MR. ROBERT L. DECKER: Yes, I'm Bob Decker, I'm a business consultant. And my question has to do with the continuing ability to find good returns on investments.

Clearly, all of the companies represented here see that there are good returns on the investments that you're making with racino opportunities. But I'm wondering, as racino opportunities continue to proliferate and as we have 61,000 machines ultimately in Pennsylvania, Maryland, Ohio and other states that you mentioned, is there a point where that proliferation will bring so much competition that those returns will no longer be acceptable?

And how do you protect yourself and how do you as companies look at that now to protect yourself going into the future? Like in Ontario, for instance, where with the competition and some other factors they're seeing significant drops in their revenues and their income.

And is that something that you ultimately will be concerned about for your companies?

MR. SANFILIPPO: I'm happy to take a stab on that. A lot's been said about having the right conditions in a state to be able to operate, a tax structure, and what allows you to be able to come in and invest, to have a shot at having a good return on your investment.

If you look throughout the United States, I'll just take casinos because I know that best: Nevada has a very favorable tax structure, has for a long time, there's been billions and billions and billions of dollars worth of investment in Nevada.

If you look at Mississippi, very favorable tax structure; and if you went and looked on the Mississippi Gulf Coast or in Tunica, it's a tremendous story of investment, jobs in those areas.

We don't think that the demand has been even close to being met on a casino side, that there's still many, many people who haven't experienced a casino.

So we think that that supply has room to run. If it runs in an environment that gives you a shot at having a good return, you're going to see the investment. We don't think at all we're at the point of being saturated. When I mentioned in the late '80s, when Steve Wynn you opened up the Mirage, everybody said, "There goes Las Vegas, and it's going to be saturated."

It's just the opposite. It continued to grow, and Las Vegas has done just a masterful job at being a great place to have investments. Our company is increasing our exposure in Las Vegas with the acquisition of Caesars Entertainment.

So a lot of it has to do with what's been said up here; our ability to have an appealing facility and the facility be exciting enough for people to spend time there, I think you'll see will allow us to continue to grow in different markets.

MR. FALCONE: From my perspective it is a very good question, because the point I make to Anthony's comment is: Yeah; well Las Vegas has a great attractive tax rate, it's invested billions of dollars and it's continued to grow.

But the price of entry and cost of development in Las Vegas has gone from $300 million to $2 billion projects. As a result we get returns that were 24, 25 percent on cash returns in the early to mid-'90s down to maybe a mid to high teens return.

So there is an issue of, where is the overall return on invested capital? The point I'll go back to my earlier comment is all the major gaming companies in the industry today in the last two years have completely refinanced balance sheets, and with that it's a very unappreciated statistic on Wall Street.

But as they've redone their balance sheets their average cost of capital has come down anywhere — it depends on the company, but it could be 200 to 700 basis points or percentage points below where they borrowed in the riverboat period to the last major wave of development in Las Vegas.

As a result, even though you're getting declines of returning capital and the industry is growing overall, you're still creating a significant spread over your cost of capital with your return on investment capital, still providing good returns to your shareholders. But that's the very mathematical, analytical way for me to answer that question.

More qualitatively I will tell you it is something we're focused on quite specifically right now, we're looking at northeast U.S. I mean, New England has tremendously pent up gaming demand, Penn National will be successful in Bangor, Harrah's continues to make efforts to try to develop the Native American facility in West Warwick, Rhode Island.

But if you move just south and we look at the racinos that still haven't opened in New York City, we had Governor Pataki yesterday announced potentially two more major Native American facilities in the Catskills, we have the chance that racino, Meadowlands actually in New Jersey going to get slot machines, we have 61,000 slot machines in Pennsylvania, more slot machines in Delaware, Atlantic City.

How does that fit on a competitive spectrum? We are concerned about those growth opportunities and returns on capital. But the emphasis and the point that I make to my investors; if Atlantic City, for example, continues to invest high quality capital to generate additional revenue streams; Harrah's, for instance, putting in a House of Blues facility at the Showboat or Borgata continuing to expand its retail offering, Tropicana just opened a $275 million hotel expansion; you mentioned, that's the way that those properties stay competitive in an increasing environment and an increasing competitive environment with new supply, but we've never seen the market slow down or be cannibalized with growth. We've actually seen that market continue to grow as the distribution points that Anthony mentioned now have been introduced into the marketplaces. But it is something I watch very closely.

MR. McALPINE: The good news is, Bob, you'll be retired by then.

(Chuckles)

MR. HARPER: It's 4:30, and I want to thank my panel, Jim, Stephen, Anthony, Mark; that we're delighted you guys came here.

(Applause)

MR. HARPER: And thank you folks for being here.