

THE WAY FORWARD

Report and Recommendations

FRIENDS OF NEW YORK RACING, INC.

DECEMBER 2005

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Report and Recommendations of Friends of New York Racing, Inc.



Table of Contents

President's Message	2
I. Introduction: Where We Are	3
II. The Way Forward: Summary of Recommendations	5
A. Immediate Steps	
B. 2006 Steps	
C. Steps for Next 18-24 Months	
III. Conclusion: A Vision of New York Racing in 2010	10
IV. Appendices	
A. Highlights of the FNYR Preliminary Report.....	13
B. 2005 Chronology and Highlights.....	17
C. Contributors List.....	19



President's Message



Friends of New York Racing is a group of Thoroughbred industry participants who banded together a year ago to serve as a catalyst to improve the prospects for horse-racing in New York. Recognizing a looming crisis as well as the historic importance of the industry to the State, as well as nationally, our objective has been to identify and advocate the business and legal changes necessary to keep New York racing viable and growing in the years ahead.

Starting last winter, we began a rigorous analysis of the New York racing and pari-mutuel industry along with proposed structural changes based on “best practices” from other jurisdictions. Simultaneously, we worked to increase public and governmental awareness of the industry’s importance to the State’s economy. While those original purposes remain, the events of recent months – including NYRA’s possible bankruptcy and ongoing OTB financial difficulties – have created a new urgency and different set of priorities.


So, in lieu of the more research-oriented format of our Preliminary Report in June, we have tried here to boil down a year’s work to the essentials: where we stand as an industry and what needs to be done to save racing in New York, including (a) immediate actions, (b) proposed steps for 2006, and (c) remaining goals to be achieved over the next 18-24 months. More detail on these subjects is available at our web site, www.friendsofnyr.com.

As you will see, we firmly believe New York horseracing can be substantially improved, with benefits for each of its major stakeholders, including the State. We hope you agree and will join those working for racing reform in the coming months. The Empire State deserves a racing business that is as respected and admired as its racing quality. With sufficient support and cooperation from its participants, we are confident New York racing can achieve this goal and realize its considerable potential in the years ahead.

It should be noted that none of our work would have been possible without the generous support of FNYR’s Founding Contributors, starting with The Jockey Club, the non-profit, New York City-based institution that has acted as the catalyst of so many worthwhile industry projects and businesses over the decades. The Jockey Club was joined by a distinguished list of other industry leadership organizations, each directly affected by the fortunes and future of New York racing. These included the Breeders’ Cup, Keeneland, Churchill Downs, Woodbine Entertainment Group, Scientific Games, Magna Entertainment, Oak Tree, Youbet.com and Capital & Technology Advisors.

Additional significant help came from the New York Thoroughbred Horsemen’s Association, the New York Thoroughbred Breeders, Delaware North Corporation and numerous other individuals and organizations concerned about the future of New York horseracing. A complete list of contributors can be found at the conclusion of this Report. The support of each is gratefully acknowledged.

Sincerely,

A handwritten signature in black ink that reads "Tim Smith". The signature is written in a cursive, slightly slanted style.

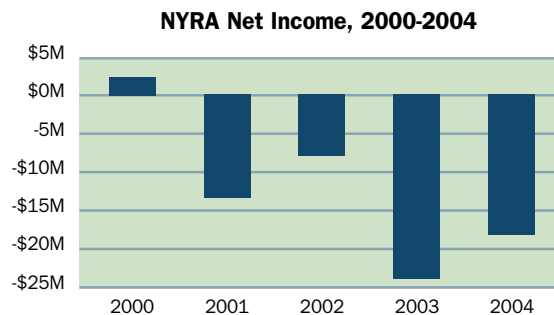
Tim Smith
President & CEO

Where We Are

1. NYRA and the New York Thoroughbred horse-racing industry, including OTBs and the pari-mutuel wagering business, are in financial crisis.

NYRA, which in recent years has operated at an average annual loss of more than \$10 million, is insolvent and faces bankruptcy. NYRA's balance sheet includes negative working capital of \$35 million and unfunded pension and post retirement liabilities in excess of \$100 million. (Source: Audited Financial Statements of New York Racing Association, Inc. for the period ending December 31, 2004.) The State's six regional off-track betting corporations ("OTBs") are facing their own severe financial challenges, with rising costs and flat or declining revenues. The largest, the New York City OTB, recently has closed branches and reduced hours in order to deal with operating deficits.

NYRA's current predicament, while partly a product of acknowledged management mistakes, is mostly a result of the antiquated and dysfunctional structure of the racing and pari-mutuel industries in New York. For example, New York is one of few jurisdictions in the country where racetracks and off-track wagering are conducted by separate, competitive businesses.

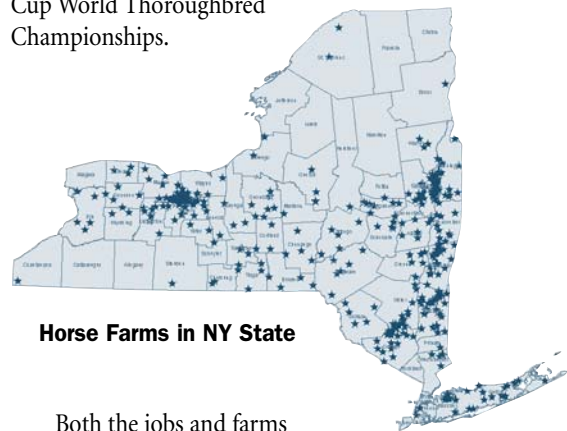


“The current structure has not, does not and will not work.”

—Attorney General Eliot Spitzer, 2003 Report

2. The industry is important to the State's economy and quality of life.

The Thoroughbred racing component of the horse business in New York accounts for 17,000 jobs and \$1.4 billion in annual impact on the State's economy.* The commercial breeding business involves 400 horse farms in 39 New York counties that keep 44,000 acres in productive open space use. New York Thoroughbred racing quality is second to none, bringing national and international visitors to major events like the Belmont Stakes, Saratoga summer race meet and the Breeders' Cup World Thoroughbred Championships.



Horse Farms in NY State

Both the jobs and farms involved depend on a healthy New York racing economy, and, most of all, growing purses. The jobs in question include everything from unionized track and OTB personnel to low-income backside workers to self-employed small business owners. Horseracing in New York, except for a small handful, is not a rich man's hobby. Rather, for most, it represents an often fragile living and "way of life," not easily replaced by another job.

* Total impacts of the horse business (including other breeds and other activities such as recreational riding) in New York are 35,200 jobs and \$2.4 billion annual economic contribution: Deloitte Consulting, LLP, *The Economic Impact of the Horse Industry on the United States* (2005). If anything, these numbers are low since they do not count related job impacts in the tourism and hospitality industry.

I. Introduction

3. Despite its current problems, New York racing has clear potential for considerable improvement and long-term success.

After several months of intensive research and study, Friends of New York Racing concluded in its first public report in June that a restructured NYRA franchise – if operated under a pro-racing, for-profit business model – could:

- attract more than *\$500 million in new capital investment*;
- produce more than *\$6 billion for Education* over 10 years;
- generate an *additional \$600 million in payments to State and local governments*; and
- *increase purses by more than 50%*, thus boosting jobs and the breeding agribusiness.

Part of this positive scenario is attributable to the State's policy of expanding legal wagering in New York, including video lottery terminals (VLTs) at racetracks. Part is due to the geographical markets involved, including some of the largest and wealthiest in the country. On the pari-mutuel side, New York owners, horses, trainers and jockeys are the best in the nation, with the result that New York racing commands nearly 20% of the \$15 billion North American handle. Private capital appears readily available for the necessary investments. *This combination of circumstances would be the envy of any other racing state in the country. But...*

“There’s general consensus in the industry and among state officials that the model is broken.”

—Jack Knowlton, member of the Committee on the Future of Racing; *Thoroughbred Times*, Nov. 18, 2005

“The system NYRA operates under doesn’t work.”

—Senate Majority Leader Joseph Bruno: *Albany Times Union*, Oct. 6, 2005

4. Legislative and regulatory changes are needed to make New York racing competitive for the future.

Commitment to structural change on the part of government and the industry is needed, in order for New York racing's potential to be realized. For example, in today's competitive environment, a successful business model for horseracing* now includes:

1. VLTs on reasonable business terms at all major racetracks with appropriate market exclusivity, dedicated revenues to purses, breeder awards and other priority racing needs;
2. racetracks and OTBs with their business interests aligned, ideally under common ownership and management;
3. use of all available technologies, including the Internet, for account (or “advance deposit”) wagering;
4. a customer loyalty or rewards program, including rebates for high-volume customers; and
5. progressive state tax policies based on licensee net revenues.

However, none of the elements listed above are present or possible today under current New York law. These flaws need to be corrected. New York has the best racing in the country, but perhaps the single worst business model.

* See, e.g., Ontario, Canada – Woodbine Entertainment Group case study contained in FNYR Preliminary Report, Appendix B (June, 2005).

Summary of Key Recommendations

A. Immediate Steps

BACKGROUND

The near-term viability of NYRA is in doubt. NYRA officials warned this fall of the possibility of a shutdown of racing if they were not permitted by the State to sell certain assets. More recently, NYRA has cited bankruptcy as a potential way to continue racing operations, with protection from creditors until it could generate additional revenue from anticipated video gaming operations at Aqueduct (beginning in 12-14 months, assuming Lottery Division approval).

All parties, including the State, now appear in fundamental agreement that prevention of any interruption to racing is of paramount importance. However, there continues to be differences among policymakers as to how best to sustain racing for the next 1-2 years, what amount and type of State assistance is appropriate and whether such measures as land sales and bankruptcy are advisable under the circumstances.

(Negotiations and public discussion of these issues were ongoing as this Report was being finalized. Other underlying legal disputes – such as NYRA’s land ownership claims and continued franchise rights – are beyond the scope of this Report.)

“We’re all becoming concerned that could happen here. I represent the people whose livelihood depends on that racetrack opening every day.”

—Alan Foreman, NYTHA counsel, on the possibility of a NYRA shutdown; *Albany Times Union*, November 18, 2005

SHORT-TERM MEASURES

1. The State and NYRA should continue efforts to reach a compromise solution to the current NYRA cash crisis.

The consequences of any significant interruption to racing this winter, or during 2006, would be disastrous for the industry and the State, particularly the employees (e.g., backside workers) least able to sustain the loss of income. Additional workout plans for 2006 and the remainder of NYRA’s franchise term should be explored. Shutdowns and lawsuits should be last alternatives.

2. In the event NYRA ceases full racing operations or declares bankruptcy, the State should take all feasible steps to prevent the interruption of racing at the NYRA tracks.

These steps should include:

- a. cash advances to the Oversight Board for the purpose of funding operations at Aqueduct, Belmont and Saratoga until an interim franchisee can be selected;
- b. authorization of the hiring by the Oversight Board of such interim personnel as may be needed, and of such other actions by the Board as may be necessary to protect the best interests of New York racing and the State.

II. The Way Forward

3. The Oversight Board should take near-term steps to increase NYRA's transparency and to provide more information to the public.

The rest of the New York racing industry, as well as members of the media and public, should have more information about NYRA and its operations and finances, particularly in the current circumstances. Horsemen, employees, retirees and others dependent on NYRA understandably are worried about the future. Dissemination of additional information and facts, if accompanied by a credible plan for continuation of racing, could only boost industry morale and public confidence.

4. The "Committee on the Future of Racing" should accelerate its organizational efforts and RFP preparations.

The Assembly should promptly appoint its three representatives to this committee, which should proceed as soon as practical to draft an initial Request for Proposals document. Interested bidders need as much time as possible to develop business plans and proposals. Questions and suggestions from bidders will require time to evaluate, and may help shape the ultimate RFP and legislative reform package by generating constructive ideas from potential investors.

B. 2006 Steps

1. The State should enact new racing legislation in 2006, not only to improve industry economics in the short run, but also to start the longer-term process of NYRA (and OTB) restructuring.

The full text of the proposed 2006 racing legislation, prepared in conjunction with the Racing and Wagering Law Program of the Government Law Center of Albany Law School, is available on-line at www.friendsofnyr.com.

For the upcoming legislative session, the proposed "Racing Reform Act of 2006" represents a way to make initial improvements in the racing and pari-mutuel

business, as well as modernize the racing law and regulations in New York. Specifically, the proposed legislation would:

- a. streamline the law itself, eliminating unnecessary provisions, providing a common set of definitions and simplifying certain unnecessarily complicated portions (e.g., simulcast payments);
- b. permit any form of business or venture (e.g., for-profit, non-profit, joint venture with OTBs, etc.) to compete for the current NYRA franchise;
- c. permit customer access to legal "advance deposit wagering" (ADW) accounts via any electronic means (e.g., personal computer), as opposed to the antiquated telephone-only access provided for in current law*;
- d. permit tracks, OTBs and ADW operators to institute customer loyalty (e.g., "player reward") programs, including cash rebates to high-volume players;
- e. give tracks and OTBs greater access to live racing signals (for simulcasting), simplify fees to host tracks and give all pari-mutuel licensees more ability to make their own economic decisions;
- f. reduce the effective tax rate on the pari-mutuel industry, while bringing it closer to the treatment of other businesses; and
- g. consolidate all regulation of gaming in the State (lottery, casino and racing) into a single agency with strengthened capabilities.

"The Racing Law has become the functional equivalent of crab grass. It is a weed that has grown unaided and unwanted that has completely enveloped New York racing."

—Bennett Liebman, Esq., Coordinator, Racing and Wagering Law Program, Government Law Center, Albany Law School and former Commissioner, New York State Racing and Wagering Board, quoted in *Thoroughbred Times*, November 26, 2005

* A majority of the FNYR board would further urge that New York tracks and OTBs operate any such Internet account wagering system on a consolidated basis.



2. The Committee on the Future of Racing should use the current RFP process to identify the best overall plan for New York Thoroughbred racing, not merely to generate the largest initial payment to the State.

In addition to asking RFP respondents about their corporate capabilities and financial bids, FNYR urges the Committee to seek answers and, where appropriate, commitments from prospective franchisees with regard to a variety of “good-of-racing” considerations, including:

- a. percentages of pari-mutuel and video gaming revenue that the applicant proposes to allocate to purses and New York breeder awards;
- b. the minimum number of racing days that are proposed;
- c. the amount and type of capital improvements to the racetracks (frontside and backside) that are planned, and whether these are proposed or guaranteed (e.g., made a condition of retaining the franchise);
- d. the amount and type of capital improvements, if any, to other portions of the properties, along with applicable land plans (e.g., for complementary entertainment or retail facilities);
- e. specific plans for increasing on-track attendance and pari-mutuel wagering activity, as well as video gaming revenue;
- f. percentages of net revenue (including VLT operator fees) that the applicant agrees to allocate, and the means of such allocation, to:
 - i. racing integrity programs, such as drug testing and research, medication rules enforcement;
 - ii. wagering integrity programs, such as electronic wagering technology upgrades;
 - iii. equine health and safety programs, including track-related factors (e.g., surfaces, gates, rails, etc.);
 - iv. rider health and safety programs;
 - v. improvements to backstretch living conditions, including health care, child care, dormitory conditions, insurance, etc.;
 - vi. Thoroughbred retirement program;
 - vii. customer service and amenities; and
 - viii. compulsive gambling programs (awareness, prevention and treatment).
- g. the applicant’s actual experience and record with regard to each of the above items (a – f).

II. The Way Forward

3. The racing and pari-mutuel industry must continue to improve its political and communication capabilities.

In order to pass new racing legislation in 2006, and to be more successful in Albany longer-term, the industry should work together in a more collaborative fashion. The industry-wide “focus group” held at the Albany Law School on November 15, 2005, in which all major industry players participated, was a good first step. Besides additional such meetings, the participants should consider formation of a new trade association (e.g., “New York Horseracing Industry Association”) to institutionalize the process of increased communications, compromise and coordinated advocacy.

“This was the first time everybody sat down and talked about things. We have to cooperate to get anything done in Albany.”

—Richard Bomze, President of the NY Thoroughbred Horsemen’s Association; *Thoroughbred Times*, November 26, 2005, article on the first industry-wide focus group

C. Steps for Next 18 - 24 Months

1. All relevant parties should forthrightly address the OTB situation.

The single most dysfunctional aspect of the horseracing business in New York is the competitive, and often adversarial, relationship between racetracks and off-track betting corporations. This unique structure of the pari-mutuel industry in New York, which exists only in New York, has often been criticized, but, tellingly, has never been imitated. As demonstrated by a recent FNYR report, the financial performance of OTBs, like NYRA, has been in serious decline, particularly in the last few years.

Each one of the six regional OTBs will need to decide for itself whether or not to merge, joint venture or otherwise align business interests with racetracks. However, State law could greatly facilitate this process by expressly permitting the municipal owners of the OTBs, which are public benefit corporations, to enter into such transactions.

The overall goal of the State policymakers should be to encourage and actively incentivize these new business structures and arrangements. Eventual consolidation of tracks and OTBs is necessary to avoid duplication and waste, attract new capital, modernize facilities and provide customers with more convenience and benefits.

2. Through legislation, VLTs should be authorized for Belmont Park.

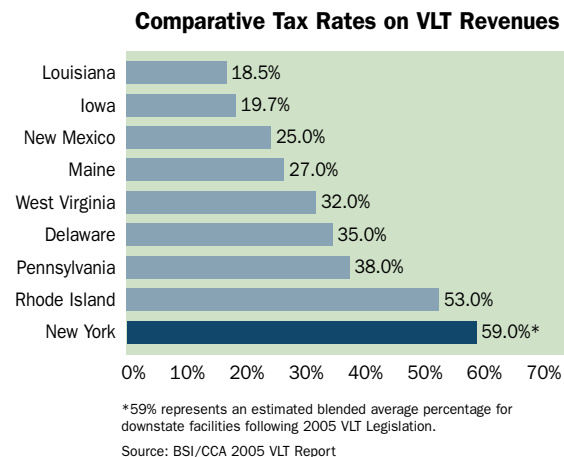
It simply makes no sense for either government or the horseracing industry to have a 350-acre facility – that is located in a large and affluent population center, that has ample parking, that has convenient expressway (and even rail) access – used to full capacity only 2-3 days (and zero nights) per year. On the other hand, if expanded legal wagering is supported by government, and preferred to further tax increases as it is in New York, then what better location could be chosen to generate additional revenues? VLTs at Belmont would produce large amounts of new funding for education, use an *existing* licensed gaming destination and simultaneously promote and enhance New York racing, creating new economic development and thousands of jobs.

Ideally, the Nassau County OTB should be part of this new business entity. This arrangement could produce additional revenue for the County without the need to construct a separate, costly facility. A joint venture or shared operation with regard to VLTs would naturally also lead to a combination of the two pari-mutuel businesses, including both OTB branch and account wagering. Similar merger or joint ventures should be considered with the New York City OTB (since Belmont is on the Queens-Nassau County border) and, eventually, with all six regional OTB corporations.

3. The Executive and Legislature should monitor performance of the VLT program and consider additional changes.

State policymakers should look for ways to improve the VLT program itself, where financial performance lags a number of other jurisdictions. New inducements to vendors (e.g., to add to the variety and customer appeal of games and machines involved) may be required, along with the marketing expense increases for operators approved by the Governor and Legislature in 2005. In addition, we urge the Legislature to permit the Division of Lottery to market and promote the VLT program statewide, just as it does with all other Lottery games. Such an effort would complement the local marketing activities of racino operators and, experts predict, produce additional net revenue for the State.

At the earliest opportunity, the State also should consider adjustments at least to the tax brackets, if not also the tax rates, applicable to the downstate racinos in large markets (e.g., Yonkers and Aqueduct). While the brackets provided for in current law* apply rationally to smaller, upstate markets, they are inappropriate and ill-suited for much higher volume, downstate markets. This reasonable change would facilitate the greater capital investment and marketing expenditures likely to be necessary in these larger markets.



4. The time for fundamental change is now.

For decades, the structural defects of the NYRA model have been obvious to virtually every group tasked with objective review of New York racing. A partial list of past studies and conclusions would include:

- **1973 - “Delafield Commission”:** Appointed by Governor Rockefeller, the Commission concluded: “NYRA’s long-term problems stem from its inability to produce growth in revenue equal to the rate and growth of expenses.”
- **1980 - “Joint Legislative Task Force”:** As a remedy for NYRA’s continued financial difficulties and unmet capital needs, the Task Force proposed creation of a public benefit corporation that could lease the NYRA facilities to a for-profit operator.
- **1992 - “New York State Advisory Commission on Racing in the 21st Century”:** The key recommendation of this Commission, formed by Governor Cuomo, was for the creation of a NYRA – OTB joint venture, capable of leading to an eventual privatization of both franchises. The report concluded: “Racing and wagering in New York State should be operated in an integrated, profit-driven structure.”
- **1995 - CIF Audit:** An independent consulting firm, working for the Thoroughbred Racing Industry Capital Investment Fund (or “CIF”) in 1995, also analyzed NYRA’s underlying problem as one of business structure, stating: “NYRA does not function as an efficiently-managed profit-making organization would function facing similar financial difficulties.”
- **2003 Reports:** Comptroller Alan Hevesi noted: “NYRA continually operates with a deficit.” Attorney General Eliot Spitzer summarized in his separate 2003 report: “The current structure has not, does not, and will not work.”

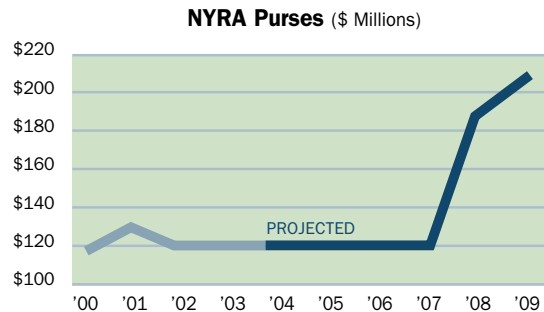
Thus, the consensus view for decades has been that it is NYRA’s *structure*, not simply its recent conduct, that needs to be changed. In the coming months, the challenge for the State and the industry will be to move beyond shared analysis to a shared vision of a new and better business model.

* Lowest rate on first \$50 million in machine revenue, higher rate between \$50 -150 million, highest rate on revenue above \$150 million.

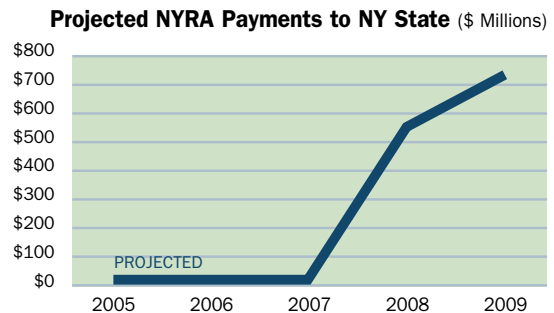
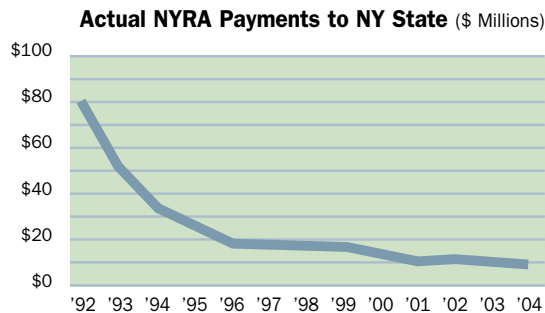
III. Conclusion

A Vision of New York Racing in 2010

Based on similar experiences in other jurisdictions, the New York horseracing and pari-mutuel wagering industry can experience a major turnaround in the next 3-5 years. By 2010, purses and breeder awards at Aqueduct, Belmont and Saratoga should be significantly higher than in 2005. In turn, purses at this increased level would grow racing-related jobs and farms for years to come.



Revenue to government in New York generated at the NYRA tracks – which has been in steep decline over the last 10 years – can be substantially increased.



The customer experience also can be much improved. In Toronto, Canada, for example, 20,000 people a day or more visit a state-of-the-art racetrack and entertainment complex. When customers can't get to the track, new OTBs are available with décor, food and entertainment amenities equivalent to those found in the most successful, upscale sports bars. From their homes, adults can wager, through advance deposit accounts, via telephone or personal computer while watching the races on cable television or broadband transmission. A seamless “player rewards” program applies to wagers at tracks, OTBs or through accounts. This array of services provides convenience to existing fans and, just as importantly, helps to create new ones*.

Woodbine — NYRA Comparison (1993-2003)

	Woodbine	NYRA
Market Size	~ 6 million	~ 14 million
Purse Growth*	85%	7%
Handle Growth*	23%	8%
Revenue to State/Province/City from Machine Gaming*	\$1.59 billion	\$0



*1999-2003.
Source: WEG Officials and
2004 NYRA Media Guide

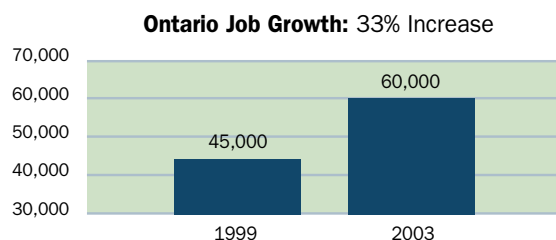
* The Woodbine Entertainment Group reports that approximately 50% of the wagers placed at the new WEGZ (sports-bar type) OTB facilities (shown above) are made by non-regular players, i.e., “new customers.”

III. Conclusion

Assuming that labor and human resource issues are appropriately addressed, local governments (e.g., New York City in the case of the NYCOTB) can earn more by partnering with private investors and racetrack/racino operators in an integrated, modernized racing and gaming enterprise than by continuing the status quo. The new business model will permit significant upgrades to off-track facilities, improving their image and expanding the current fan base.

Within the next few years, the New York racing industry – both the NYRA tracks and OTBs – can be properly capitalized for the first time in decades. Investment funds – under the business model advocated by FNYR – will be available not only for construction of video gaming facilities, but also for the long list of capital projects (and new programs) that the industry has long identified as necessary, but never has been able to fund, including, among others, racetrack improvements (including backside areas); customer improvements (e.g., racetrack front-sides and OTBs); technology upgrades (e.g., simulcasting infrastructure, electronic wagering security projects); additional drug testing research and enforcement resources; responsible wagering programs; and backstretch employee living condition improvements.

Additional investment will mean more employment, both in terms of retention of currently threatened jobs in the pari-mutuel industry and new jobs from expanded gaming and a healthier breeding business. In Ontario, for example, there was an estimated 33% jobs growth achieved during their period of restructuring and recapitalization.



“No serious analyst would suggest if the policymakers and the industry were starting fresh, that New York horseracing and wagering would be organized as it is today. Based on the current circumstances – fiscal, political, legal and otherwise – there is perhaps the best chance in several decades to create a new and better model.”

— Preliminary Report, Friends of New York Racing, June, 2005

Finally, the new business model also should address, to the extent possible, NYRA’s unfunded obligations to retired employees, which currently exceed \$100 million. The needs of the rank-and-file workers who enabled New York racing to function for the last 50 years should not be ignored or treated by the industry as someone else’s problem.

In short, there is no good reason why this pro-racing, pro-growth vision of New York racing in 2010 cannot be achieved. New York has the best Thoroughbred racing and the best markets for sports, entertainment and gaming in the world. The investment climate is favorable. *The only missing ingredient is political. The State’s elected leadership – executive and legislative – needs to focus on the serious problems and great potential of one of New York’s signature industries, and commit to making the necessary statutory and policy changes.*

Fortunately for New York racing’s diverse stakeholders, these are not uncharted waters. Our research has uncovered jurisdiction after jurisdiction, example after example, where the same principles have been applied:

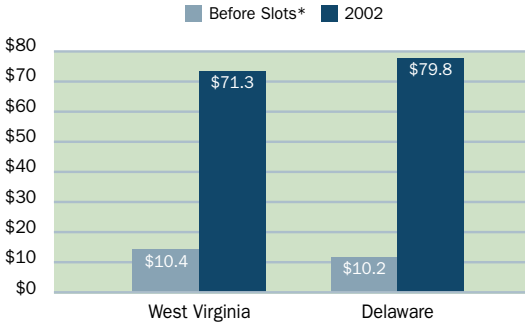
- create a public-private partnership;
- recapitalize the business;
- incentivize management, adopt good corporate governance, increase transparency;
- improve the customer experience;
- combine as many elements as possible into one integrated business (e.g., racing, pari-mutuel, video gaming, account wagering, complementary retail and entertainment);
- increase the utilization of under-used public assets (e.g., Belmont Park).

The results from such structural (and cultural) reforms have been consistently positive, in most cases dramatically so. The vision, therefore, is hardly a far-fetched dream. With sufficient political will and industry cooperation, this vision is an implementable plan and “the way forward” for New York racing.

III. Conclusion

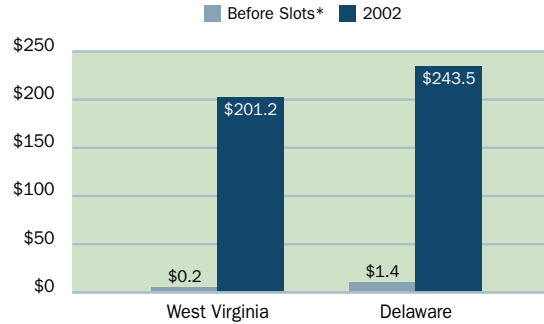
Representative Turnaround Examples

Purses Before and After the Introduction of VLTs at West Virginia and Delaware (\$ Millions)



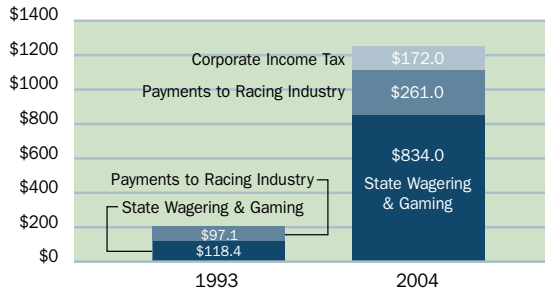
*The year before West Virginia and Delaware began full operation of machines at tracks was 1994 and 1995, respectively. Source: Christiansen Capital Advisors, LLC.

Total Gambling Privilege Tax Revenue to Government Before and After the Introduction of VLTs at West Virginia and Delaware (\$ Millions)



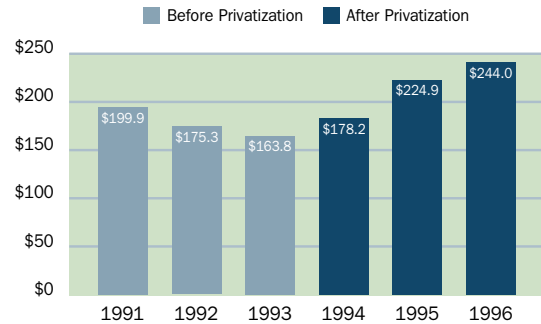
*The year before West Virginia and Delaware began full operation of machines at tracks was 1994 and 1995, respectively. Source: Christiansen Capital Advisors, LLC.

Victoria TAB/TABCORP Tax and Racing Industry Comparison (A\$ Millions)



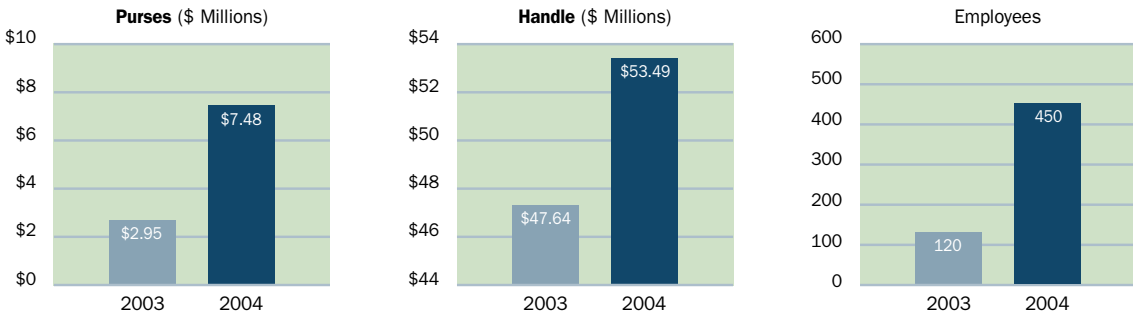
Source: Christiansen Capital Advisors, "Case Studies in Privatization," 2005

Connecticut OTB Handle, 1991 - 1996 (\$ Millions)



Source: Christiansen Capital Advisors, "Case Studies in Privatization," 2005

Saratoga Gaming & Raceway, 2003 - 2004 Comparison



Source: Saratoga Gaming & Raceway

Source: FNYR Preliminary Report (June, 2005)

Highlights of the FNYR Preliminary Report

In June of 2005, Friends of New York Racing, Inc. issued its Preliminary Findings and Recommendations. The non-profit organization, formed to develop future strategies for the State's horseracing and wagering industries, released the report following six months of study and research. It called for sweeping reforms to the business model for horseracing in New York.

The initial findings and recommendations outlined in the Report were:

1. The Present Business Model Should Be Replaced

The current structures for horseracing and off-track wagering in New York are 50 and 35 years old, respectively. Today, there is broad agreement among policymakers, industry leaders, academics and others that the current NYRA and OTB business models are "broken" in numerous ways and should be replaced.

2. Proposed New Structure: A Profitable Public-Private Partnership

To maximize the value and future performance of the current NYRA assets and related wagering rights, they should be owned and managed by a for-profit enterprise, provided that other policy priorities — such as preserving racing and fairly compensating government — also are addressed and protected. In this regard, a majority of the FNYR Board favors including government — both the State and relevant localities — and appropriate racing non-profits as minority equity owners of the proposed new for-profit enterprise ("Newco"), along the lines outlined in Chapter V of the Preliminary Report ("Preliminary Financial Modeling"). Not only would such a structure generate more revenue for government, but this Public-Private Partnership model, at least for a period of years, would assure that government and other pro-racing groups remain involved in Newco's governance, corporate conduct and ownership.

3. Alternative for Off-Track Betting Corporations (OTBs)

Each of the six regional OTBs should be permitted, but not compelled, to merge operations and assets with "Newco," the proposed for-profit entity. Depending on their individual situation and preferences, each OTB — and the localities involved — would be offered a combination of initial cash compensation and ongoing Newco equity for their respective wagering business assets, relevant real estate, and other consideration. Based on the benefits of consolidated pari-mutuel operations, participation in VLT revenue, capital improvements, modernized regulations and other factors, OTBs and local governments will have better results (i.e., earn more total revenue) under the Newco structure than they would likely experience under the status quo. Thus, taxpayers also should benefit.

4. Video Lottery Terminals (VLTs) and Belmont Park

Serious consideration — after additional discussions and further review with all relevant parties — should be given to authorizing VLTs at Belmont Park, just like at Aqueduct, Yonkers and most other State racetracks. Such a facility would produce substantial revenue for the State and education, bring new investment and employment to Nassau County and Queens, boost the future prospects of New York racing and breeding, attract badly-needed capital investment and provide other benefits.

Government in New York has made a bi-partisan policy decision to pursue selected expansion of legal wagering as a revenue source (e.g., in lieu of additional tax increases or deeper cuts to essential programs). Therefore, the use of an existing, but underutilized, facility like Belmont Park is far preferable to the location, purchase and development of a new facility. Belmont already is a licensed legal wagering destination, and parking, access and a large real estate footprint already exist there.

5. Other Preliminary Recommendations / Topics for Further Study

Other aspects of New York racing and gaming statutes and regulations should be reviewed and updated to make these businesses more competitive and customer friendly. For example:

- changes permitting greater operating flexibility based on best practices (e.g., PC-based account wagering, more franchisee discretion on pricing and marketing decisions);
- detailed study of potential improvements to New York's VLT program, including both tax rates and operating policies;
- careful design of the RFP and proposed franchise terms (for operation of Aqueduct, Belmont and Saratoga) to assure both adequate capital investment and an optimum mix of benefits for the State; and
- review of various other best-practice policies / programs for potential incorporation into an updated strategic plan, including those relating to competitive and governance issues (racing and wagering integrity, corporate accountability and transparency); social concerns (backside living conditions, problem gaming, rider health and safety, etc.); and other industry needs.



The Need for Balance

A danger for the New York racing and breeding industries — and, in our view, for the State — would be to “over correct” for the flaws in the current NYRA and OTB models (i.e., to look simply at short-term profits and government revenues from the existing real estate assets and expansion of gambling). Indeed, if gross revenue were the only criteria, Aqueduct and Belmont would logically be paved over and replaced with casinos.

Instead, we believe that the goal should be to balance the diverse, legitimate interests and policy objectives that exist in the present circumstances. Obviously, direct, short-term economics should be considered (e.g., payments to government), but these factors should be evaluated along with other, longer-term economic and quality of life benefits for the State (e.g., preservation of a signature industry, tourism benefits from major racing events, retention of jobs and open space, etc.).

Financial Modeling

Exhibit 1, on page 15, is a summary of the two financial scenarios analyzed in the Preliminary Report, the first labeled “Public-Private Partnership” and the second “Privatization.”

Subsequently, the New York Thoroughbred Horsemen (NYTHA) and Breeders (NYTB) reached an agreement with NYRA for a specific sharing of net VLT revenue to be generated at the video gaming facility planned for Aqueduct. Exhibit 2 reflects those new assumptions.

The key changes in the two versions are shaded. In essence, increased contributions to purses and awards means somewhat less revenue for the State and for investors. As a practical matter, we believe that such variables will be refined and determined through the RFP process and actual marketplace factors, including negotiations with lenders, etc.

Thus, these models are not proposals or final pro formas, but rather are planning and analytical tools designed to help policymakers and the industry consider what outcomes might be possible under different sets of structural and investment assumptions.

Exhibit 1: Summary of Preliminary Financial Modeling

	Case #1 Public-Private Partnership	Case #2 Privatization
Ownership of Newco		
State and Localities	40%	0%
Racing Non-Profits	10%	10%
Investors	50%	90%
Value to State & Localities (excluding VLT tax revenues) (\$ Millions)		
up-front cash payments		
NYRA up-front franchise fee (assumed 2007–08)	100	300
OTB up-front acquisition payments (assumed 2007–08)	50	165
5 years of dividends to State & Localities (assumed 2008–12)	141	—
proceeds of sale of State & Localities shares (assumed 2012)	276	—
total non-tax proceeds to State & Localities (assumed 2007–12)	567	495
Cumulative cash burn to reach self-funding status (\$ Millions)		
amount of burn assumed funded with equity capital (\$ Millions)	145	230
year self-funding status reached	2009	2009
Internal Rate of Return (IRR) to Investors	27%	27%
Common to Both Cases:		
Number of authorized VLTs		
Aqueduct Racino	4,500	4,500
Belmont Racino	5,000	5,000
Construction Cost (\$ Millions)		
Aqueduct Racino	175	175
Belmont Racino	225	225
Average win per VLT per day		
year 1	\$350	\$350
year 5	\$325	\$325
year 10	\$300	\$300
VLT revenue splits (% of Gross Gaming Revenue)		
to Education		
first \$50m of GGR	54.0%	54.0%
next \$100m of GGR	57.0%	57.0%
GGR amounts above \$150m	60.0%	60.0%
to Purses	6.5%	6.5%
to Breeder awards	1.0%	1.0%
to Lottery Division	10.0%	10.0%
to Newco as racino operator		
first \$50m of GGR	28.5%	28.5%
next \$100m of GGR	25.5%	25.5%
GGR amounts above \$150m	22.5%	22.5%
Amounts to Education from VLT Tax (\$ Millions)		
year 1	525	525
year 5	664	664
year 10	612	612
10-year total (2008–2017)	6,398	6,398
Amounts to Education from VLT Tax (\$ Millions)		
year 1	15	15
year 5	59	59
year 10	82	82

Appendix A

Exhibit 2: Summary of Preliminary Financial Modeling

	Case #1 Public-Private Partnership	Case #2 Privatization
Ownership of Newco		
State and Localities	40%	0%
Racing Non-Profits	10%	10%
Investors	50%	90%
Value to State & Localities (excluding VLT tax revenues) (\$ Millions)		
up-front cash payments		
NYRA up-front franchise fee (assumed 2007–08)	100	300
OTB up-front acquisition payments (assumed 2007–08)	50	150
5 years of dividends to State & Localities (assumed 2008–12)	137	—
proceeds of sale of State & Localities shares (assumed 2012)	274	—
total non-tax proceeds to State & Localities (assumed 2007–12)	561	450
Cumulative cash burn to reach self-funding status (\$ Millions)		
amount of burn assumed funded with equity capital (\$ Millions)	551	848
year self-funding status reached	138	212
year self-funding status reached	2009	2009
Internal Rate of Return (IRR) to Investors	25%	25%
Common to Both Cases:		
Number of authorized VLTs		
Aqueduct Racino	4,500	4,500
Belmont Racino	5,000	5,000
Construction Cost (\$ Millions)		
Aqueduct Racino	175	175
Belmont Racino	225	225
Average win per VLT per day		
year 1	\$350	\$350
year 5	\$325	\$325
year 10	\$300	\$300
VLT revenue splits (% of Gross Gaming Revenue)		
to Education		
first \$50m of GGR	54.0%	54.0%
next \$100m of GGR	57.0%	57.0%
GGR amounts above \$150m	60.0%	60.0%
to Purses		
year 1	7.5%	7.5%
year 6	10.0%	10.0%
to Breeder awards		
year 1	1.25%	1.25%
year 6	1.50%	1.50%
to Lottery Division (all years)		
10.0%	10.0%	10.0%
to Newco as racino operator		
year 1	22.6%	22.6%
year 6	19.6%	19.6%
Amounts to Education from VLT Tax (\$ Millions)		
year 1	525	525
year 5	664	664
year 10	612	612
10-year total (2008–2017)	6,398	6,398
Amounts to Education from VLT Tax (\$ Millions)		
year 1	15	15
year 5	59	59
year 10	82	82

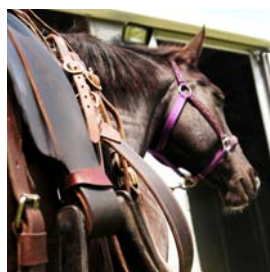
2005 Chronology and Highlights

-
- January 2005 **Formation of Friends of New York Racing, Inc.** – Creation of a broad-based board with commitment to “bidder neutral” analysis and advocacy to improve the New York racing industry, regardless of who is selected to operate the NYRA franchise in the future.
-
- February 2005 **FNYR Consumer Research Study** – A survey of over 800 respondents, conducted by research firm SDS, showed that New Yorkers highly value the state’s horseracing industry and favor expanded gaming at racing facilities as a preferred way to generate additional revenue for the state.
-
- March 2005 **Formation of FNYR Political Action Committee** – Numerous events and contributions to help raise awareness of industry importance and needs (March – November).
-
- May 2005 **Completion of Initial Case Studies and Best Practices Analysis** – Multiple domestic and international examples summarized in Preliminary Report.
-
- June 2005 **FNYR / NYTHA Economic Impact Study of the New York Horse Industry** – Conducted by Deloitte Consulting, LLP, and funded by FNYR and NYTHA, this study provided key economic statistics for the horse industry in New York State, showing that the industry provides 35,200 jobs and has an annual economic impact of \$2.4 billion. More than half of the economic impact (\$1.3 billion) was attributed to the Thoroughbred industry alone.
-
- June 2005 **FNYR Preliminary Report** – Key initial findings and recommendations included: (i) The Present Business Model Should Be Replaced (it is antiquated and dysfunctional); (ii) Proposed New Structure: A Profitable Public-Private Partnership (for-profit operating model with continued part ownership by government and other protections for racing); (iii) Alternative for Off-Track Betting Corporations (OTBs) (each should have the option to combine with the new proposed racing and gaming company) and (iv) Video Lottery Terminals (VLTs) and Belmont Park (serious consideration should be given to this additional “racino,” based on projected benefits to education, racing and Nassau County).
-
- July 2005 **FNYR / NYTB Farm Demographics Survey** – In conjunction with the NY Thoroughbred Breeders, Inc., FNYR conducted a survey of over 400 New York breeding farms. The results show that the average breeding farm is family owned and operated, is less than 100 acres in size and relies upon awards from the NY Breeding program and other non-farm income to meet operating expenses.
-

Appendix B

August 2005	FNYR Public Opinion Poll – A follow up to the February study, “favorable” opinion regarding horseracing in New York increased from a 19% net positive position in January to a 40% margin in June, directly linked to Triple Crown exposure. The survey also illustrated that New Yorkers continued to have little awareness of the legal and financial problems of the New York Racing Association.
August 2005	FNYR Industry Participant Questionnaire – This FNYR study asked those most familiar with NYRA and industry issues for their priorities, opinions and recommendations. More than 100 detailed, nine page questionnaires have been completed to date. Key finding: majority favor new business structure for New York (NYRA) racing, including a for-profit operating component. Only 14% favor the status quo.
August 2005	“Town Meeting” at Saratoga on Future of New York Racing – Approximately 200 industry participants and townspeople heard from, and questioned, representatives of FNYR, NYTHA, NYRA and NYTB.
September 2005	Results of Comment Period – Substantive and detailed feedback to the Preliminary Report was received from numerous entities and groups, particularly the New York State Senate Racing, Gaming & Wagering Committee; also the New York City and Nassau County OTBs; New York Thoroughbred Breeders, Inc.; relevant labor unions, etc.
October 2005	Thoroughbred Thank You Fund – In conjunction with West Point Thoroughbreds, FNYR raised over \$25,000 to host 100 military personnel and family members at the 22nd running of the Breeders’ Cup World Thoroughbred Championships at Belmont Park.
November 2005	OTB Trend Analysis Report – This study showed the challenges facing the State’s off-track wagering system, along with its importance to racing’s economic health. Reinforced the need for comprehensive (vs. track-only) reform.
November 2005	Industry Working Group Conference – A facilitator-led, industry-wide “focus group” to build support for racing reform legislation was conducted by the Albany Law School, with sponsorship by FNYR. (Second focus group scheduled for January, 2006.)
Ongoing	Other Outreach and Industry Advocacy – More than 100 meetings have been held with legislators, key staff members, regulators, OTB and local government officials, media members, labor union leaders, financial institution representatives, industry association leaders, various non-profit and charitable groups, academics and others. 10 PAC and other fundraising events were held for political leaders in both parties. Key learning: most know very little about the industry.

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