

## Harrah's Kansas Proposal for Sumner County

### My Function in this review process is to:

- 1) Evaluate financial stability based on current corporate structure
- 2) Evaluate financial stability based on :
  - a. Financial liquidity
  - b. Financial solvency
  - c. Future commitments

Any financial analysis needs a comparative peer group base for the evaluation process. All current gaming jurisdictions provide analysis on a property basis, size or gaming revenues. Evaluation on a corporate level does not provide the same segmentation. There are a wider range of sizes and industry segments. It is more difficult to define peer groups.

### Peer group composite

Different investment bankers and analysts create different peer groups. Casino type businesses could fall into the service industry, the entertainment industry, or the hospitality industry. Within these groups can be different sub-groups. One of the common groups used by gaming analysts is the "service industry" with a "Casino and Gaming" subgroup.

This subgroup currently consists of 60 different companies.<sup>1</sup> The top 20 of these corporations have market capitalization of \$100 million or more<sup>2</sup>. The top corporations include several corporations who have submitted proposals: (June 11, 2008)

	Millions
1. Las Vegas Sands Corp. (LVS)	\$19,111
2. MGM Mirage (MGM)	11,797
3. Wynn Resorts, Limited (WYNN)	9,898
4. International Gaming Technology (IGT)	9,712
5. Melco PBL (MPEL)	4,359
6. Penn National Gaming (PENN)	3,729
13. Pinnacle Entertainment, Inc (PNK)	736

One of the largest casino companies in the world, Harrah's, is missing because it has been bought out by a private group of Investors (Hamlet Holdings) for a sum over \$29 billion. Before the takeover by Hamlet Holdings, Harrah's spent the last five years, buying up other well known major casino properties such as Bally's, Caesars, The Flamingo, Harvey's, Imperial Palace, Rio, and Showboat. It currently has over 51 properties around the world with the majority of them in the United States and England.

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<sup>1</sup> I use information provided by Reuters Research, which is based on this composite of 60 firms. It also appears that Standard & Poor's also uses this composite. Note that these composites can be different for other financial research.

<sup>2</sup> Market capitalization represents the current market price times the total number of shares outstanding. The Casino and Gaming market price has decreased by 41% compared to S&P 1500 which declined by 13%.

The MGM Mirage is considered Harrah's major competitor. They have 23 wholly owned casino properties plus 3 other joint ventures. Included in the group of properties are the casinos once owned by Wynn and Circus Circus.

The composition of this group includes International Gaming Technology (IGT) (\$7.9 b), a company that does not own one single casino. Other companies include Great American Financial Corp. and Medical Institutional Services Corporation. Great American Financial Corp., formerly known as Interactive Gaming and Communications Corp., is a holding company that conducts business in the gaming industry through Intersphere Communications, Ltd. (PA), a software development, marketing and Internet communications company specializing in the Internet market. Medical Institutional Services Corp, formerly Go Call, Inc., together with its wholly owned subsidiaries, Go Cash, Ltd. and Go Call Canada, Inc.(\$290,000), is principally a provider of services to businesses engaged in electronic commerce on the Internet (e-commerce).

A analysis of corporations who have submitted Kansas proposals provide a sense of the diversity of the corporations and the problem with using any type of industry norms for comparative analysis.

**Comparative Financial Information**

At 12/31/2007	In 000's				
	Harrah's	Sands	Penn	Pinnacle	Butler Nat. Co.
Total Assets	23,357,700	11,466,517	4,967,032	2,193,544	20,444
Total Equity	6,626,900	2,260,274	1,120,962	1,052,359	10,648
Total Cltd + ltd	12,440,400	7,572,330	2,974,922	841,301	6,971
Market Capitalization 7-14		14,280,900	2,117,000	562,370	25,850
Sales	10,825,200	2,950,567	2,565,737	1,068,790	14,681
Net income before Taxes	892,500	138,279	292,240	(1,851)	717
Return on Income	8.24%	4.69%	11.39%	-0.17%	4.88%
Return on Assets	3.82%	1.21%	5.88%	-0.08%	3.51%
Return on Equity	13.47%	6.12%	26.07%	-0.18%	6.73%
Current Ratio	93.01%	92.35%	61.29%	132.77%	203.12%
Debt/Equity	187.73%	335.02%	265.39%	79.94%	65.47%

As shown from the above table, the proposals have come from Harrah's, the giant in the industry with total assets exceeding \$23 billion, compared to Butler national with only \$20 million in assets. Comparison of other financial strengths shows complete disparity in all categories of corporations. A substantial amount of the growth in the industry has

been financed by way of debt.<sup>3</sup> The industry norm is sitting at 2.4 times. As can be seen, many of the current proposals come from companies that are highly leveraged. In the current economic environment, this could be a real deal breaker.

Needless to say, with all the mergers and takeovers, and developments within the industry, there are many highly leveraged corporations that are susceptible to the current downturn of the economy. Current headlines include the following.

- 1) NEW YORK, June 10 (AP) - Shares of Las Vegas Sands Corp. fell to its lowest point in two years Tuesday after two analysts raised concerns about the health of the casino operators' key markets, Las Vegas and Macau.
- 2) CHICAGO, June 16 (Market Watch) Airfare hikes, capacity cuts start to pinch Las Vegas. Soaring fuel prices are starting to hit home in Las Vegas as cash-strapped airlines hike fares and cut capacity at McCarran International Airport - Sin City's tourism lifeline - leading to pressure on room rates and lower spending levels by visitors.
- 3) NEW YORK, June 17 (Reuters) - Harrah's Entertainment Inc's debt may weaken from already distressed levels as heavy capital spending and interest payments absorb cash flows at a time when the casino operator is also facing declining gambling revenues.

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Debt-Laden Casinos Squeezed by Slowdown By TAMARA AUDI and JEFFREY MCCRACKEN  
*July 1, 2008; Page A1: Wall Street Journal*

## Corporate Structure

Gaming Zone:	South Central	
County:	Sumner	
Property Name:	Harrah's Kansas	
Company Name:	Sumner Gaming Joint Venture, LLC	
Parent Company:	Harrah's Sumner Investment Company, LLC	40%
	Sumner Gaming and Resorts, LC.	60%

“Harrah’s Kansas” will be the operating casino of a joint venture company called Sumner Gaming Joint Venture consisting of Sumner Gaming and Resorts, L.C. and Harrah’s Sumner Investment Company, LLC. **The Harrah’s Sumner Investment Company LLC is the 40% Non-Managing Member.** It is a subsidiary of Harrah’s Operating Company Inc., a 100% owned subsidiary of Harrah’s Entertainment, Inc.

Sumner Gaming and Resorts, LC. is a newly formed limited liability company formed in Kansas in August 2007. The company consists of a group of individual investors. **Sumner Gaming and Resorts will act as the managing Member with a 60% ownership interest.** Their responsibilities, subject to input and consultation with Harrah’s Sumner Investment Company will be to:

- manage the local aspects of the development of the Project e.g. obtaining utility services zoning permits, land use approvals and other entitlements
- act as the general contractor with regard to the development of the Project
- engage Harrah’s or an affiliate of Harrah’s to be the sole and exclusive manager of the Project pursuant to Management Agreement and
- engage Harrah’s or an affiliate of Harrah’s to provide construction management services pursuant to professional services agreement

### Sumner Gaming and Resorts, LC.

Sumner Gaming and Resorts L.C is a newly-formed Kansas limited liability company created in August 2007. Its members and their ownership interest are as follows:

Member	Ownership Interest
Bruce Christenson, Managing Member	28.333%
Bruce McPherson, Non-Managing Member	28.333%
Michael McPherson, Non-Managing Member	28.333%
Jeffrey Ungerer, Managing Member	4.166%
James Walker, Managing Member	8.333%
Miscellaneous Ownership Interest	2.502% *

\*with no individual interest equal to or exceeding 0.5% of the Applicant

## **The Harrah's Sumner Investment Company LLC**

Harrah's Operating Company, Inc. is the sole limited liability company member of Harrah's Entertainment, and 100% owner of both Harrah's Sumner Management Company LLC and Harrah's Sumner Investment Company LLC with power to control these LLCs. The Investment Company will have a non-management role and supply an equity contribution. The Harrah's Sumner Management Company LLC will operate as the management of the new casino, subject to ownership control by Sumner Gaming and Resorts. Effective January 28, 2008, Harrah's Entertainment Inc. became a privately held corporation when the company was formally purchased by Hamlet Holdings.

## **Overview of Sumner Gaming and Resorts, L.C.**

Sumner Gaming and Resorts L.C is newly-formed limited liability company. Its major stockholders, Bruce Christenson, Bruce McPherson, and Michael McPherson have spent a life-time specializing in the development of residential and commercial real estate. All the stockholders have Kansas connections. **Sumner Gaming and Resorts will act as the managing Member with a 60% ownership interest.** With controlling interest, they will make the major policy decisions. The Harrah Management Group will be running the operational component of the casino hotel resort.

All the stockholders have provided net worth statements as well as tax returns for the last four years. It appears that they have the ability to contribute their share of the equity contribution needed for this project.

The combined joint venture of Sumner Gaming and Resorts with Harrah's Sumner Investment Company and with Harrah's Sumner Management Company managing the new casino, should result in a very viable investment combination.

## **Overview of Harrah's Entertainment, Inc.**

Harrah's Entertainment considers itself to be one of the world's largest casino entertainment providers. Their business is primarily conducted through a wholly-owned subsidiary, Harrah's Operating Company, Inc. Harrah's owns, operates, and/or manages 51 casinos (under such names as Bally's, Caesars, Harrah's, Horseshoe, Rio, and its London Clubs casinos in the UK), primarily in the US and the UK. Operations include a wide range of venues for delivering gaming, including casino hotels, dockside and riverboat casinos, and Native American gaming establishments. It included operations in 12 different states in the United States. It includes mid-west properties in Kansas City and St. Louis, Missouri. Additional mid-west properties are in Illinois, Indiana, and Iowa.

Harrah's casino entertainment facilities include 32 land-based casinos, 12 riverboat or dockside casinos, three managed casinos on Indian lands, one combination thoroughbred racetrack and casino, one combination greyhound racetrack and casino, one combination harness racetrack and casino and one managed casino in Canada. The 32 land-based casinos include one in Uruguay, ten in the United Kingdom, two in Egypt and one in South Africa.

In 2005, Harrah's acquired rival Caesars Entertainment for \$9.4 billion in cash, stock, and debt. The transaction added 15 additional casinos around the world. The company assigned over \$2 billion goodwill. The deal cemented Harrah's as the world's largest gaming company, jumping over the merged MGM MIRAGE/Mandalay combination. Additional acquisitions since 2005 include the Imperial Palace in Las Vegas for \$373 million, London Clubs for \$591 million (which added 10 more properties), and the former Barbary Coast (now Bill's Gambling Hall) on the Las Vegas Strip at a cost of \$371 million.

In recent years, with fewer new markets opening for development, competition in existing markets has intensified. Many casino operators, including Harrah's, have invested in expanding existing facilities, developing new facilities, and acquiring established facilities in existing markets. This expansion has increased competition and this intense competition can be expected to continue.

Until January 28, 2008, the common stock of Harrah's Entertainment was traded on the New York Stock Exchange under the symbol "HET." On December 19, 2006, the board of directors approved and entered into an Agreement and Plan of Merger, (the "Merger Agreement," and the transactions contemplated thereby, the "Merger") by and among Hamlet Holdings LLC, a Delaware limited liability company ("Hamlet Holdings"), Hamlet Merger Inc., a Delaware corporation and a wholly-owned subsidiary of Hamlet Holdings ("Merger Sub") and Harrah's pursuant to which Hamlet Holdings would acquire all of the outstanding shares of common stock for \$90.00 per share. Hamlet Holdings is controlled by certain individuals affiliated with Apollo Global Management, LLC and TPG Capital, L.P. (collectively, the "Sponsors"). The Merger was completed on January 28, 2008. As a result of the Merger, the issued and outstanding shares of non-voting common stock and the non-voting preferred stock of Harrah's are owned by entities affiliated with the Sponsors and certain co-investors and members of management, and the issued and outstanding shares of voting common stock of Harrah's are owned by Hamlet Holdings. The Merger, the financing transactions related to the Merger and other related transactions consummated on January 28, 2008, had a transaction value of approximately \$29.7 billion.

### **Financial Position at 12/31/2007 and 3/31/2008**

#### **Harrah's Entertainment Earnings**

Harrah's has been one of the top casino industry companies for many years. Part of their professional image was the result of a management development system that started from the first day an employee was hired. Each employee was indoctrinated with the Harrah's philosophy of customer service being the first priority. Each step up the corporate ladder required extensive training for all the management team. This has resulted in one of the most professional and knowledgeable management teams across each property as well as in corporate offices. The company is in fact the leader for the casino industry in total generation of revenues.

For the year ended 2007, as shown in Exhibit 1, Harrah's generated over \$10.8 billion in revenues. Its closest competitor, MGM Mirage was at \$7.6 billion and the next competitor, Las Vegas Sands, generated \$3.4 billion.

Exhibit 1 reveals that, for the years 2004 to 2007, revenues more than doubled for Harrah's. But, at the same time, Exhibit 1 shows that while revenues and earnings were

growing, the growth rate fell each year. Revenues and earnings dropped for the first time in the initial quarter of 2008. The major contribution to the first 2008 quarterly loss was the merger expenses (\$142 m) and interest expenses of \$557 million.

<b>Exhibit 1: Earnings</b>							
In millions							
	1stQt2008	1stqt2007	2007	2006	2005	2004	
Revenues	2,600.60	2,655.60	10,825.20	9,673.90	7,010.00	4,396.80	
Income before taxes	-359.10	2,273.60	892.50	834.80	554.10	513.00	
% earned before taxes	-0.14	0.86	0.08	0.09	0.08	0.12	
Annual Revenue growth rate	-0.0207		0.1190	0.3800	0.5943		
Earnings growth rate	-1.1579		0.0691	0.5066	0.0801		

### Financial Viability

An analysis of the balance sheet and the cash flow statement provides evidence of possible trends and the ability to maintain a going concern. Liquidity ratios are used to measure the firm's ability to meet current obligations whereas solvency ratios tend to provide an indication of possible future cash flow problems.

#### Liquidity

The most common measure of a firm's ability to meet its current commitments is the current ratio. It compares current assets to current liabilities. The casino and gaming industry current ratio norm is 1.6. A look at Exhibit 2 demonstrates that Harrah's is below the norm (0.93) and has been dropping over the last few years.

On the other hand, Exhibit 2 finds that cash flow from operations (CFO) has increased each year since 2004. Harrah's has met its current operational needs and has cash left over to meet other commitments. Exhibit 2 shows that cash flows from operations (CFO) jumped from \$763 million in 2004 to nearly double that amount at \$1.5 billion in 2007.

But, recent news stories appear to indicate the highly leveraged company may be in trouble due to the impact of the current economy<sup>4</sup>. Harrah's in January completed a \$17.3 billion buyout by private equity firms Apollo Global Management LLC and TPG Capital LP which was financed by more than \$11 billion in debt. "They pushed it to the limit in terms of leveraging up and I feel its probably not getting any better," said Gimme Credit analyst Kim Noland. "Even though they throw up a lot of cash, they've got

<sup>4</sup> ( NEW YORK, June 17 (Reuters) - Harrah's Entertainment Inc's debt may weaken from already distressed levels as heavy capital spending and interest payments absorb cash flows at a time when the casino operator is also facing declining gambling revenues.

interest and maintenance capex that are going to eat up the positive, and then they'll have to go negative to fund its development capital spending," she said<sup>5</sup>.

Exhibit 2 provides information on the interest coverage ratio. It indicates the number of times that earnings before interest and taxes can meet current interest expenses. Given its large debt, it is below the industry norm of 3.6.

**Exhibit 2: Liquidity Ratios**

	1stQt2008	1stqt2007	2007	2006	2005	2004
Current Ratio	1.14	0.90	0.93	0.73	1.02	1.04
CFO	490	335	1,509	1,540	595	763
CFO/NI	-1.36	0.15	1.69	1.84	1.07	1.49
CFO/ CL	0.25	0.19	0.84	0.69	0.37	1.01
Interest Coverage	0.36	13.24	2.11	2.25	2.16	2.90

**Solvency Ratios**

Exhibit 3 provides a series of ratios that address the firm's ability to maintain financial flexibility in the future. An increasing amount of debt by a firm results in higher risk of not meeting future commitments when and if the economy turns sour. In the long run, a firm must be able to generate enough excess cash to not only run its operations but to also meet investment and financing commitments. The debt/equity Casino and Gaming industry norm is 2.4 whereas the norm for the service industry is only 1.2 and that for the S&P 500 is 0.8. This vast difference in norms would indicate the casino industry has grown by way of financing its acquisitions with debt instead of equity and that they are highly leveraged. Harrah's, for the last 3 years has been below the industry norm but still higher than the norm in other industries. The completion of the proposed merger that resulted in the restructuring of debt, added over \$11 billion in additional debt. A look at the first quarter 2008 debt/equity ratios finds a dramatic increase to 6.13 from the 2007 balance of 1.88. Recent headlines suggest that the downturn of the economy may reduce the earnings and the financial stability of Harrah's.

<b>Exhibit 3: Solvency Ratios</b>							
	1stQt2008	1stqt2007	2007	2006	2005	2004	
Debt/Equity	6.13	1.95	1.88	1.99	1.95	2.53	
Debt/Assets	0.65	0.54	0.53	0.54	0.54	0.60	
CFO Interest charge	0.88	1.81	1.88	2.30	1.24	2.83	
CFO/LT Debt	0.02	0.03	0.12	0.13	0.05	0.15	
CFO/Capital Expend	1.41	0.77	1.09	0.61	0.52	1.18	
Free Cash Flow	143	-100	129	-972	-554	118	

While Exhibit 2 shows the significant increases in CFO over the last few years, Exhibit 3 illustrates that Harrah's has been using large amounts on capital expenditures. The

<sup>5</sup> Ibid

CFO/Capital Expenditure ratio (also the free cash flow ratio) found that for the years 2005 and 2006, capital expenditure was substantially greater than the cash generated. That means that there was additional debt incurred to cover these expenditures.

### **Harrah's Kansas Proposal for Sumner County**

**Anticipated Project Funding in millions**

	Harrah's Kansas	Additional Development	Total
Project Debt	\$330	\$56	\$386
Sumner Gaming Equity	\$79	\$19	\$98
Harrah's Equity	\$76	0	\$76
Total	\$485	\$75	\$560

The Sumner county proposal provides a 365 room hotel with a 69,000 square foot casino handling 2,000 slots and 50 table games. The company plans on contributing \$174 million in equity funding with Harrah's Sumner Investment Company funding \$76 million and Sumner Gaming and Resorts funding \$98 million. The remaining \$386 million is expected to be funded through Wells Fargo. A letter from Wells Fargo (Section II p11) indicates high confidence in its ability to put in place financing for this project. Expectations are that it will take the form of a senior secured revolving credit facility and a senior secured construction loan.

Harrah's equity contribution will be financed through a draw on the company's revolving credit facility. As of March 31, 2008, \$7.25 billion in borrowings was outstanding under the Credit Facilities with an additional \$0.2 billion committed to back letters of credit. After consideration of these borrowings and letters of credit, \$1.8 billion of additional borrowing capacity was available to the Company under the Credit Facilities as of March 31, 2008.

The Sumner equity contribution will be financed through cash contributions by the owners of Sumner Gaming and Resorts, L.C. The Sumner Gaming and Resort LC financial template shows an initial equity contribution of \$1.2 million. Additional expected contributions by members total up to \$39 million. This is still \$29 million short of the proposal's expected contributions. No additional discussion is provided on the funding shortage. The submitted proposal suggests that the bulk of this cash will be from existing personal cash or other liquid investments and/or personal lines of credit. See the confidential report on the net worth of these investors.

## Additional Considerations

In connection with the Merger, as of March 31, 2008, \$7.7 billion of debt was retired, \$4.6 billion, of debt was retained and \$20.5 billion of new debt was issued. The current contractual debt obligations are \$25.2 billion.

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<b>Exhibit 4: Future payments</b>					
Per the March 31, 2008 10-Q					
	Total	Less 1yr	1-3 yrs	4-5 yrs	>5 yrs
Contractual Obligations(a)					
Debt	25,230.10	72.9	1,339.30	644.80	23,173.10
Capital lease obligations	2.7	1.0	1.6	0.1	
Estimated interest payments(c)	13,999.00	1,629.20	3,506.80	3,308.80	5,554.20
Operating lease obligations	2,447.30	95.4	146.6	131.8	2,073.50
Purchase orders obligations	82.9	82.9	—	—	—
Guaranteed payments to State of Louisiana	134.8	60	74.8	—	—
Community reinvestment	130.5	6.3	12.7	12.3	99.2
Construction commitments	1,289.60	1,289.60	—	—	—
Entertainment obligations	132.8	59.2	66.9	3.9	2.8
Other contractual obligations	100.2	55.2	9.2	5.7	30.1
<b>Total</b>	<b>43,549.90</b>	<b>3,351.70</b>	<b>5,157.90</b>	<b>4,107.40</b>	<b>30,932.90</b>

Exhibit 4 provides the expected future cash payments as of January 28, 2008 after adjusting for the new debt structure. Total future payments went from \$19.125 B to \$43.549 B.

### Additional Construction Costs

Per submitted materials

Harrah's Atlantic City Expansion	\$585
Horseshoe Hammond Expansion in Indiana	\$485
Caesars Palace Expansion in Las Vegas	\$1,000
Margaretville in Biloxi, Mississippi	\$704

Total additional Funds	\$2,774
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## **Concluding Points for Consideration**

### **Positives**

1. Harrah's is the largest gaming corporation in the world with 2007 revenues more than \$10.8 billion. The MGM Mirage is next at \$7.6 billion.
2. Total assets are in excess of \$37 billion.
3. Has consistently been one of the most profitable corporation in the industry.
4. Has a \$9.2 billion credit line to draw from and \$1.8 billion currently available.
5. Generating positive cash flow from operations.
6. CFO in 2007 was over \$1.5 billion.

### **Negatives**

1. Current Ratio has a negative trend
2. Refinancing of debt leaves company very leveraged.
3. Total debt in excess of \$25 billion
4. Interest charges continue to increase
5. Capital expenditures exceed the CFO forcing company to utilize more debt financing.
6. No longer a publically traded company.
7. Debt and interest payments will use large amounts of CFO.

### **Additional factors**

1. Owns or operates 51 casino operations world wide.
2. Very organized, very structured and professional
3. Has experience in running a diverse group of gaming properties
4. Has equivalent gaming properties in neighboring states.