



Strategic Report

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## **Company History**

Founded in 1937, Harrah's Entertainment owns or manages casinos in more areas of the United States than any other company. Its twenty-four owned casinos include Harrah's and Rio in Las Vegas as well as Harrah's and Showboat in Atlantic City. Its casino facilities typically include hotel and convention space, restaurants, and non-gaming entertainment.

Harrah's Entertainment traces its roots back to the 1937 opening of Bill Harrah's bingo parlor in Reno. Operations expanded throughout Reno and Lake Tahoe to include several clubs and hotels. Harrah's began public trading in 1971 and became the first casino company listed on the New York Stock Exchange in 1973.

Harrah's was acquired by Holiday Inns, Inc. in 1980. At the time, Holiday Inn had 1600 hotels and partial ownership in two casinos located in Atlantic City and Las Vegas. By 1985, the newly minted Holiday Corporation included Harrah's Casinos, Holiday Inn hotels, Embassy Suite hotels, and Hampton Inn hotels. The Promus Companies was formed in 1990 after the sale of Holiday Inn to a British conglomerate. The Promus brands included Harrah's, Embassy Suites, Hampton Inn and Homewood Suites.

The current corporate structure of Harrah's Entertainment was formed in June 1995, as the hotel brands of The Promus Companies were spun off. The remaining company, consisting of the Harrah's brand and assets, was renamed Harrah's Entertainment and took the ticker HET on the New York Stock Exchange.

During the 1990s, then CEO Phil Satre eschewed the building of "resort" casinos in Las Vegas and instead sought to bring the Harrah's brand to customers in the states they lived. Harrah's built a national casino brand through acquisitions and expansion into new locales like North Carolina and

Kansas. In 1994, Harrah's Ak-Chin, the company's first Indian gaming operation, opened near Phoenix. Additionally, the company launched Total Gold, a rewards program for gambling at Harrah's owned casinos. This reward program, now called Total Rewards, gives various incentives to gamble at Harrah's casinos. Current CEO Gary Loveman, an MIT economist and former Harvard Business School professor, has spearheaded Harrah's focus on using the Total Rewards program as a means to target customer preferences.

This March, shareholders approved a \$9.4 billion acquisition of Caesar's Entertainment. The acquisition may face regulatory hurdles due to high market concentration in certain regions. In all likelihood, this will not prevent the merger but merely require divestitures of certain properties. If the transaction is completed as expected in the second quarter of 2005, the combined entities would own or operate more than 50 casinos in 13 states and five countries. The merged Harrah's/Caesar's will compete head on with the recently combined MGM-Mirage/Mandalay. These two newly formed combinations will dominate Las Vegas, controlling 80% of gaming revenues on The Strip.

## Harrah's Property Descriptions

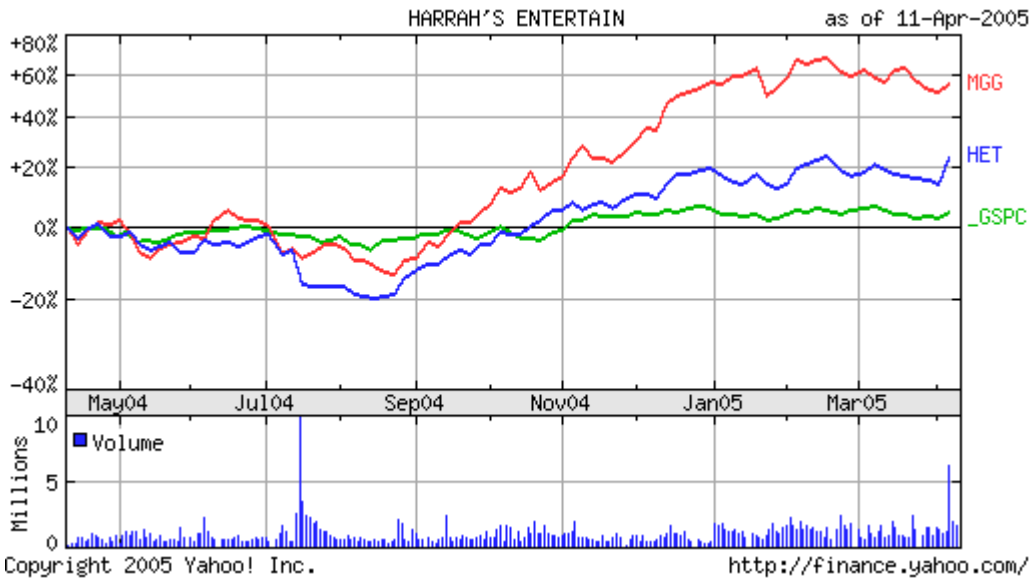
Property	Type of Casino	Casino Sq. Ft.	Slot Machines	Table Games	Hotel Rooms & Suites
<b>Las Vegas</b>					
Harrah's Las Vegas	Land-based	87700	1380	90	2530
Rio	Land-based	107000	1190	100	2550
Horseshoe	Land-based	88000	650	60	370
<i>Totals</i>		282700	3220	250	5450
<b>Other Nevada</b>					
Harrah's Laughlin	Land-based	55000	950	50	1560
Harrah's Reno	Land-based	57000	1050	60	930
Harrah's Lake Tahoe	Land-based	57600	1010	70	530
Harveys Lake Tahoe	Land-based	63300	950	80	740
Bill's Lake Tahoe	Land-based	18000	440	20	0
<i>Totals</i>		250900	4400	280	3760
<b>Atlantic City</b>					
Harrah's Atlantic City	Land-based	131800	3870	80	1630
Showboat Atlantic City	Land-based	115700	3970	60	1300
<i>Totals</i>		247500	7840	140	2930
<b>Illinois</b>					
Harrah's Joliet	Dockside	39200	1210	20	200
Harrah's Metropolis	Dockside	29800	1200	20	120
<i>Totals</i>		69000	2410	40	320
<b>Indiana</b>					
Harrah's East Chicago	Dockside	54000	1970	70	293
Horseshoe Hammond	Dockside	48300	2010	50	0
<i>Totals</i>		102300	3980	120	293
<b>Iowa</b>					
Harrah's Council Bluffs	Dockside	28000	1230	40	250
Bluffs Run Casino	Greyhound Racing Facility and land-based casino	40300	1650	0	0
<i>Totals</i>		68300	2880	40	250
<b>Mississippi</b>					
Harrah's Tunica	Dockside	35000	1180	20	200
Horseshoe Tunica	Dockside	63000	2110	80	510
<i>Totals</i>		98000	3290	100	710
<b>Missouri</b>					
Harrah's St. Louis	Dockside	120000	2770	80	500
Harrah's North Kansas City	Dockside	60100	1800	60	200
<i>Totals</i>		180100	4570	140	700
<b>Louisiana</b>					
Harrah's New Orleans	Land-based	100000	1980	130	0
Harrah's Lake Charles	Dockside	60000	1250	70	260
Horseshoe Bossier City	Dockside	30000	1690	50	610
Louisiana Downs	Racing Facility and land-based casino	15000	1400	0	0
<i>Totals</i>		205000	6320	250	870

# FINANCIAL ANALYSIS

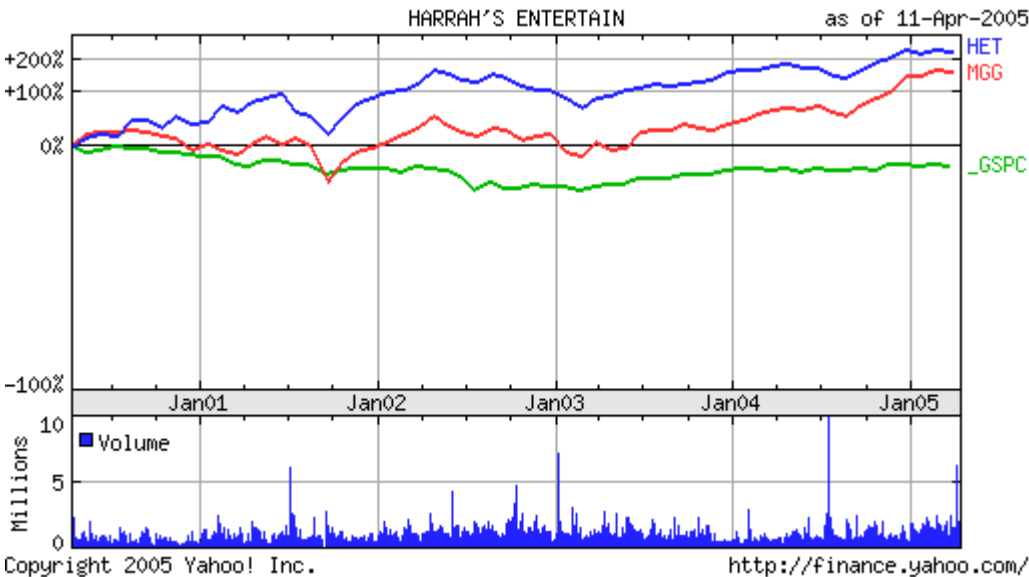
## Historical Stock Performance

HET: Harrah's Entertainment  
MGG: MGM Grand  
\_GSPC: S&P 500

### 1 Year Stock Performance



### 5 Year Stock Performance



Harrah's outperformance relative to the market is not unique for gaming stocks. The gambling industry was the number four performing industry from the year 2000 to 2004.

**5-year Annualized Returns of Top Ten Industries, 2000-2004**

Industry	One-Year		Three-Year		Five-Year	10-Year	
	Return	Rank	Return	Rank	Return	Return	Rank
1 Home Construction	38.7%	13	41.5%	2	<b>47.5%</b>	31.2%	1
2 Coal	68.6	2	26.0	8	<b>30.8</b>	9.9	52
3 Tobacco	21.6	36	16.6	16	<b>28.8</b>	17.5	10
4 Gambling	69.1	1	34.1	3	<b>25.3</b>	16.4	15
5 Specialized Consumer Services	55.3	4	30.6	4	<b>24.8</b>	8.2	65
6 Heavy Construction	24.6	30	14.6	21	<b>24.1</b>	17.8	9
7 Real Estate	34.2	16	23.2	9	<b>23.1</b>	17.1	11
8 Trucking & Transportation	52.8	5	29.3	5	<b>22.1</b>	12.8	35
9 Utilities, Water	13.9	52	13.6	24	<b>21.5</b>	22.3	3
10 Oil & Gas, Exploration & Production	44.0	8	21.4	12	<b>19.0</b>	12.0	44

The total return of Harrah's equity was below-average within the gaming group.

**5-year Annualized Returns for Gaming Stocks, 2000-2004**

COMPANY NAME	STOCK SYMBOL	5-YEAR AVERAGE RETURN (%)	SURPLUS/DEFICIT RELATIVE TO INDUSTRY [pct. pts.]
Penn National Gaming	PENN	68.2	31.7
Scientific Games	SGMS	49.0	12.5
Boyd Gaming	BYD	48.9	12.4
International Game Technology	IGT	47.2	10.8
Gtech Holdings	GTK	37.0	0.5
Station Casinos	STN	30.2	-6.3
Mandalay Resort Group	MBG	29.2	-7.3
MGM Mirage	MGG	23.8	-12.7
<b>Harrah's Entertainment</b>	<b>HET</b>	<b>21.3</b>	<b>-15.2</b>
Caesars Entertainment	CZR	10.0	-26.5
Wynn Resorts	WYNN	NA	NA
Industry Group Average		36.5	

## Brief Descriptions of Firms Used in Comparable Analysis

### MGM-Mirage (MGG)

About three quarters of MGM-Mirage's operating income is generated through its wholly owned Las Vegas Strip resorts. These properties include some of the most famous casinos on the Strip, including Bellagio, MGM Grand, The Mirage, Treasure Island, and New York-New York. MGG also has exclusive rights for Cirque du Soleil shows in Las Vegas. In June of 2004, MGG announced an agreement to purchase the Mandalay Resort Group for \$7.9 billion. Kirk Kerkorian, the octogenarian billionaire, owns 57% of MGG's outstanding shares.

### Caesars Entertainment, Inc. (CZR)

Caesars Entertainment is owns and operates casinos primarily in Nevada, Atlantic City, and Mississippi. Its Vegas properties include Caesars Palace and Paris. Shareholders of Harrah's and Caesars officially approved the merger this past March. The transaction should clear in the second quarter of 2005.

### Station Casinos Inc. (STN)

Station Casinos owns and operates casinos in the Las Vegas metropolitan area. Its properties include Palace Station Hotel & Casino, Boulder Station Hotel & Casino, Texas Station Gambling Hall & Hotel and the Sunset Station Hotel & Casino. These properties are less glamorous than the headline properties of the Las Vegas Strip and target local Nevada residents.

### Boyd Gaming (BYD)

Boyd Gaming owns and operates seventeen casinos in five different states. Its Las Vegas properties target residents of the state of Hawaii. According to Standard & Poors, 60% of the guests in Boyd's three Vegas hotels were Hawaiians.

*Note: All data in financial analysis section are for 2004. Therefore, data for HET, MGG, and CZR do not reflect the Harrah's-Caesars merger or the MGM-Mandalay merger. All of these companies were operating as separate entities during FY 2004.*

<b>Comparable Valuation Multiples</b>					
	<b>HET</b>	<b>MGG</b>	<b>CZR</b>	<b>STN</b>	<b>BYD</b>
<b>Market Cap</b>	<b>7.70B</b>	10.13B	6.43B	4.44B	4.64B
<b>Enterprise Value</b>	<b>12.36B</b>	15.15B	10.28B	5.71B	6.79B
<b>Trailing P/E</b>	<b>23.17</b>	29.25	35.09	69.82	38.88
<b>Forward P/E (fye 31-Dec-06)<sup>1</sup>:</b>	<b>16.33</b>	21.1	23.2	23.13	22.34
<b>PEG Ratio (5 yr expected)<sup>±</sup>:</b>	<b>1.22</b>	1.72	2.58	1.79	1.54
<b>Price/Sales (ttm):</b>	<b>1.69</b>	2.39	1.53	4.5	2.68
<b>Price/Book (mrq):</b>	<b>3.75</b>	3.58	1.84	9.02	4.89
<b>Enterprise Value/Revenue (ttm)</b>	<b>2.72</b>	3.58	2.44	5.78	3.91
<b>Enterprise Value/EBITDA (ttm)</b>	<b>10.96</b>	11.2	9.96	20.67	15.71

Via Yahoo! Finance, as of 4/15/05

Harrah's trades at a lower premium for many valuation metrics. Its presence in many different gaming markets is a common explanation for this. By operating in many jurisdictions, there is higher potential for changes in the regulatory and tax environment. Raising taxes on casino operators is a politically palatable means of alleviating a state's budget problem. Revenues generated within Nevada are considered more stable and less prone to unfriendly regulatory changes.

## Common Size Analysis of 2004 Income

For FY 2004

	HET	MGG	CZR	BYD	STN
(As percentage of net revenues)					
<b>Revenues</b>					
Casino	<b>89.65</b>	52.48	68.28	83.90	74.04
Food and beverage	<b>14.63</b>	19.85	16.93	14.34	14.22
Rooms	<b>8.58</b>	21.50	17.40	7.06	5.78
Management fees	<b>1.33</b>	0.00	0.00	0.00	8.58
Other	<b><u>4.78</u></b>	<u>16.43</u>	<u>8.51</u>	<u>6.12</u>	<u>4.26</u>
<b>Gross Revenues</b>	<b>118.97</b>	110.25	111.13	111.42	106.88
Less: casino promotional allowances	<b><u>-18.97</u></b>	<u>-10.25</u>	<u>-11.13</u>	<u>-11.42</u>	<u>-6.88</u>
<b>Net revenues</b>	<b>100.00</b>	100.00	100.00	100.00	100.00
<b>Operating expenses</b>					
Casino	<b>45.33</b>	26.10	34.28	39.75	27.75
Food and beverage	<b>6.11</b>	11.38	9.94	8.79	10.19
Rooms	<b>1.47</b>	5.84	4.11	2.14	2.13
Property, general, administrative	<b>20.33</b>	14.66	--	20.75	17.52
Depreciation and amortization	<b>7.40</b>	9.50	9.75	7.85	8.70
Corporate expense	<b>1.47</b>	1.84	1.14	1.90	1.08
Project opening costs	<b>0.21</b>	0.24	0.17	0.13	0.09
Merger Expense	<b>0.05</b>	0.00	0.52	0.38	0.00
Other	<b><u>0.23</u></b>	<u>10.83</u>	<u>25.42</u>	<u>5.74</u>	<u>10.40</u>
<b>Total operating expenses</b>	<b>82.61</b>	<b>80.39</b>	<b>85.33</b>	<b>87.43</b>	<b>77.86</b>
<b>Income from operations</b>	<b>17.39</b>	19.61	14.79	12.57	26.05

Company 10-K

The common size analysis of income expresses all operating revenues and expenses as a percentage of net revenues. This allows for comparisons to be made across firms, controlling for the size of the firm. Casino revenues are on a net basis, so those revenues already account for payouts to gamblers.

Compared to competitors, Harrah's derives more of its revenues from gambling. CEO Gary Loveman believes gambling offers the highest return on investment for shareholders and wants the company's focus to be on gaming, rather than high-end restaurants or premier entertainment like Cirque du Soleil. A targeted focus on gaming has gone against industry wide trends since the 1990s, as revenues from dining, entertainment, shopping,

and other activities now outpace gaming spending in all of Las Vegas by a count of three to one.

It is troubling that Harrah's casino expenses are markedly higher than competitors. The casino floor is typically considered a scale business, as there are fairly high monitoring, security, and backroom costs regardless of the volume of play. However, total operating costs for Harrah's are in-line with competitors.

Under GAAP, complimentary items given to patrons are booked as revenues. The retail value of these complimentary items is subtracted from gross revenues in the line item "Less: casino promotional allowances." The actual cost of providing these complimentary items is then allocated within the proper line item under operating expenses. It is somewhat surprising that Harrah's has the highest share of casino promotional allowances. Harrah's was the first casino operator to focus its marketing strategy through the data it gathered on customers. The company pioneered many customer tracking methods and holds several patents for analyzing and aggregating data. Approximately three quarters of gamblers at Harrah's casinos use a Total Rewards card.

If Harrah's can customize its rewards to suit its customers, this might enable a smaller budget for complimentary items because Harrah's offerings would be more focused. But this does not appear to be the case. Alternatively, it could be that it is worthwhile for Harrah's to have higher promotional expenses as it creates customer loyalty. Harrah's argues that the tiered levels in its Total Rewards program (Gold, Platinum, and Diamond) allow it to target complimentary services to customers who are truly spending money at the casino and not "free-loading." Most importantly, other customers are encouraged to spend more so they can move to a higher Total Rewards tier and receive complimentary services.

## Revenue Generation per Gambling Station

For FY 2004

	HET	MGG	CZR	STN	BYD
Table Games	1360	915	1773	3247	590
Slots	<u>40310</u>	<u>21268</u>	<u>44262</u>	<u>21239</u>	<u>24103</u>
Gambling Stations (GS)	<b>48470</b>	26758	54900	40721	27643
Casino Revenues (thousands)	<b>\$4,077,694</b>	\$2,223,965	\$2,907,000	\$730,584	\$1,454,884
Casino Expenses (thousands)	<b>\$2,061,642</b>	\$1,106,142	\$1,442,000	\$273,816	\$689,324
Net Casino Operating Income (thousands)	<b>\$2,016,052</b>	\$1,117,823	\$1,465,000	\$456,768	\$765,560
Casino Revenues per GS	<b>\$ 84,128</b>	\$ 83,114	\$ 52,951	\$ 17,941	\$ 52,631
Casino Expenses per GS	<b>\$ 42,534</b>	\$ 41,339	\$ 26,266	\$ 6,724	\$ 24,937
Net Casino Oper. Income per GS	<b>\$ 41,594</b>	\$ 41,775	\$ 26,685	\$ 11,217	\$ 27,695

Calculated using data from company reports

The above metrics on revenue from a gambling station are an attempt to quantify the returns on investment specific to gambling. The row "Table Games" denotes the number of tables for poker, blackjack, etc. in all of a firm's casinos. This number is multiplied by six and added to the number of slots to give a firm's total number of "Gambling Stations" (abbreviated as GS from here on). "Casino Revenues", "Casino Expenses", and "Net Casino Operating Income" are in thousands of dollars. For example, in the year 2004, the Net Casino Operating Income for Harrah's was slightly over two billion dollars. "Casino Revenues per GS", "Casino Expenses per GS", and "Net Casino Oper. Income per GS" are in exact dollar amounts.

This data confirms that Harrah's is generating superior revenues from its casino floor. Its performance is essentially identical to MGG. This data suggests that Harrah's management can unlock value at the Caesars' properties.

## Revenue Generation per Hotel Room

For FY 2004

	HET	MGG	CZR	STN	BYD
Rooms	<b>15,283</b>	24,959	25,969	3,247	9,026
Hotel Revenues (thousands)	<b>\$ 390,077</b>	\$ 911,259	\$ 604,000	\$ 57,057	\$ 122,496
Hotel Expenses (thousands)	<b>\$ 66,965</b>	\$ 247,387	\$ 173,000	\$ 21,053	\$ 37,184
Net Hotel Income (thousands)	<b>\$ 323,112</b>	\$ 663,872	\$ 431,000	\$ 36,004	\$ 85,312
Room Revenue per Room	<b>\$ 25,523.59</b>	\$ 36,510.24	\$23,258.50	\$17,572.22	\$13,571.46
Room Expenses per Room	<b>\$ 4,381.67</b>	\$ 9,911.74	\$ 6,661.79	\$ 6,483.83	\$ 4,119.65
NI per Room	<b>\$21,141.92</b>	\$ 26,598.50	\$16,596.71	\$11,088.39	\$9,451.81

Revenue generation per room is in-line with expectations. MGG has much higher revenues per room, as its premium hotels can charge higher room rates that Harrah's. Additionally, much more of their hotel space is in Vegas, where company's can charge higher room rates to many vacationers. But correspondingly, Harrah's has lower expenses from its hotels. Importantly, this analysis confirms that Caesars' properties are underperforming. As in gaming, strong execution from Harrah's management can deliver more revenue and better margins from these assets.

## DuPont Analysis

### Harrah's Entertainment DuPont Analysis

FY 2004

NOPAT Margins	X	Operating Asset Turnover	=	Return on Net Operating Assets
9.71%		0.53		5.15%
Financing Spread	X	Leverage	=	Return from Leverage
4.41%		3.14		13.84%

Return on Net Operating Assets	+	Return from Leverage	=	Return on Equity
5.17%		13.84%		19.00%

DuPont analysis decomposes return on equity into its component parts. Harrah's has lower leverage compared to competitors. Further borrowing and using the proceeds to repurchase outstanding shares may create source of value. The resulting tax shields due to the deductibility of interest payments may exceed the costs of potential financial distress. However, the Caesar's acquisition will increase leverage through debt assumption.

	<b>Leverage</b>
<b>MGG</b>	4.226759
<b>STN</b>	5.136133
<b>BYD</b>	4.244627

## Harrah's-Caesars Merger

Harrah's is paying \$1.8 billion in cash and 66.3 million Harrah's shares for Caesars, along with assuming \$3.6 billion in Caesars debt. Harrah's shareholders will own 63% of the combined company.

One primary benefit of the merger is bringing Harrah's management expertise to the Caesars properties. Our financial analysis suggests that Caesars assets are underperforming relative to MGG and HET. The use of data analysis techniques and marketing strategies of Harrah's Total Rewards has the potential to improve performance of at the Caesars' properties.

According to Lehman Brothers research, the Caesars' customer database may have as many as five million customers not currently in Harrah's 26 million person database. Additionally, Caesars Palace and Paris are high-end properties relative to Harrah's Las Vegas and Rio. The addition of these properties gives HET cross selling potential for its existing Total Rewards customers. Complimentary stays at Caesars Palace is something unique compared to the current Harrah's hotel brands.

A common hypothesis for the Harrah's valuation discount is its exposure to many tax jurisdictions. The Caesars acquisition will concentrate more of Harrah's revenues in Nevada. This could encourage higher trading multiples for Harrah's common stock.

Exhibit 1

### Geographic Concentration, pro-forma of Property Sales

State	Pre-Merger	Post-Merger
Nevada	31%	41%
New Jersey	20%	24%
Mississippi	6%	9%
Louisiana	13%	7%
Indiana	10%	7%
Missouri	9%	5%
Illinois	6%	3%
Iowa	6%	3%

*Note: Concentrations are a percent of domestic property-level EBITDA. Post-merger concentrations exclude the announced sale of four properties to Colony*

*E = Morgan Stanley Research Estimates*

*Source: Company Reports, Morgan Stanley Research*

Not only was the merger with Caesars a necessary defensive response to the MGM-Mirage purchase of Mandalay, but it has the potential to be a value driver for shareholders going forward.

## Competitive Analysis

### Industry

Casinos are legal in 20 states. There are approximately 500 legal casinos operating in the United States. Around 240 of those are located in the state of Nevada. The biggest development within the industry for 2005 is the mergers between MGM-Mirage/ Mandalay and Harrah's/ Caesar's. These two newly combined firms will represent 80% of the revenues on the Las Vegas Strip.

Las Vegas and Atlantic City are substantially different markets. Las Vegas is one of the fastest metropolitan areas in the country. It has many more hotel rooms than Atlantic City and is an overnight destination for vacationers and business travelers. It is also a major convention site. In contrast, Atlantic City is more of a day-tripper's destination. About 30% of its visitors arrive by charter bus and generally stay for less than a day.

Casino gaming floors are standardized with large numbers of slots and tables. Firms can attempt to differentiate casinos in a number of ways. Casinos and the accompanying hotel can have a theme, like New York, New York or Paris. Casinos can target particular types of customers, like "high-rollers" who wager large amounts of money on single bets. Different amenities in the forms of shops and shows can encourage visitors to stay and gamble at one particular hotel over another.

Growth opportunities for the industry are largely international. Macau, a former Portuguese colony near Hong Kong, is the only place where legal gambling is available in China. Revenues in Macau are expected to exceed \$6 billion in 2005, representing a 20% growth rate over 2004. For comparison, revenues from gambling in Nevada are \$9 billion. Las Vegas Sands Corp. has announced construction plans for a 10,000 room multi-hotel development with several major international hotel operators, including

Hilton, Marriott, and Starwood. Gaming deregulation in the United Kingdom could lead to the development of 15-30 regional casinos over the next 10 years. All the major publicly traded gaming companies are bidding to develop in Singapore.

### **Entry**

Casinos are subject to federal, state, and local regulations. Before operating a casino, gambling companies must acquire a license or reach an agreement with a state. Established firms have an advantage in this process.

Casinos require substantial capital investment. These high fixed costs are a high barrier to making an investment solely to move up the learning curve of the industry.

The emergence of Indian casinos has facilitated new casino construction. The Indian Gaming Regulatory Act (IGRA) permits Native American tribes to engage in and regulate gambling on their lands if their territories are located in a state that allows gambling and if federal law allows for such gambling. This has led to partnerships between the public gaming companies and different Native American nations. Gaming companies can have management contracts with the tribes but cannot own casinos on reservations.

### **Substitutes and Complements**

Other forms of legal gambling are available to consumers. Lotteries, horseracing, and charitable bingo are the three most prominent options. These three respectively took 26.7%, 5.1%, and 1.6% of the \$70 billion in revenues for legalized gambling in 2002. Casinos and Indian reservations represent 40% and 20% of total industry revenues. One development that has been worrisome for casino operators in certain jurisdictions is the legalization of slot machines at horse and greyhound tracks. The creation of "racinos" is typically lobbied against by casino companies, but gambling is

seen as a "free" source of revenue by states in budget trouble. The legalization of slot machines at racing tracks in Louisiana may pose a problem for Harrah's going forward.

For non-Vegas casinos, gambling is competing for discretionary income against entertainment options like movies and professional sports. Las Vegas, viewed as a travel destination, may be a substitute for other vacation destinations. For example, the falling dollar may make European vacations less desirable for Americans and encourage more visitors to Las Vegas.

### **Supplier Power and Buyer Power**

Slot machines now account for 70% of all casino gaming revenue. Because the machines are high ROI investments for a firm, gaming equipment companies typically have some pricing power.

Additionally, Cirque du Soleil has become a premier entertainment draw in Las Vegas. Their Vegas exclusive shows do not tour and play at MGM properties. MGM fully financed a \$135 million, 1,900-seat theatre built according to specifications just for Cirque's new show, Ka. Production costs and profits are split evenly between Cirque and MGM.

Approximately 50 million American adults gambled at a domestic casino in the last year. These consumers are price takers. Interestingly, the "price" in the form of a payout ratio would not necessarily be observed by consumers. State gambling commissions regulate payout ratios.

## Strategic Recommendations

There is no disputing the success of CEO Gary Loveman's implementation of Total Rewards. He has greatly enhanced customer loyalty through creating incentives for gamblers to devote all their gaming budgets to Harrah's. As noted in the financial analysis, we do have some concerns with the level of casino expenses in relation to comparable companies. However, our strategic recommendations will focus on potential opportunities distinguishable from Total Rewards but consistent with the underlying value of the firm: the gaming experience for loyal customers.

### World Series of Poker Brand

In March 2004, Harrah's acquired the rights to the Horseshoe brand in Nevada and to the World Series of Poker brand and tournament, from Horseshoe Clubs. The growth in the popularity of poker due to this event is well documented.

We believe this is an important brand for Harrah's to leverage. Traditionally, the company has been reluctant to undertake mass market advertising. Issuing coupons and discounts based on data from Total Rewards to targeted customers has been the preferred method of enticing casino visitors. However, we believe that the World Series of Poker brand can help create a "destination" quality for some of Harrah's casinos in Las Vegas. At a Las Vegas casino, foot traffic from other hotels' guests is an important profit driver.

An attempt to create a "destination" in Las Vegas does not mean the traditional route of light shows and pirate fights that typify some Vegas properties. In fact, Harrah's can focus on the fact that it offers the best gaming experience in the world for consumers by showcasing the best poker players in the world gambling at Harrah's casinos in the World Series of

Pokers. The focus is on the excitement of gambling itself and not the "glamour" of Vegas. This will attract the consumers that have become poker players due to their interest in the gaming experience, not the opportunity to see lions and tigers during a trip to Vegas. We believe Harrah's experience with serving dedicated slots players and its association with the World Series of Poker uniquely positions it to serve the needs of this new generation of recreational poker players.

An additional component of this strategy may be to increase poker tables at some Las Vegas properties. Harrah's is famous for its legions of slots-playing customers. However, table games, while typically keeping a earning a smaller percentage of wagers than slots, can still generate impressive returns because of greater wager volume. About 43% of MGG's casino revenues came from table games in 2004.

### **Lobby for Legalization of Internet Gaming within the U.S.**

One of the manifestations of the popularity of poker is an increase in online poker gambling. However, this gambling occurs with companies located offshore due to its illegality in the United States. Industry leader partypoker.com proudly proclaims that it is regulated by the government of Gibraltar.

Harrah's Total Rewards program has been based on gathering data and cross-selling, i.e., getting gamblers in at a Harrah's in Louisiana to gamble at Harrah's casinos when vacationing in Vegas. Online gaming is another natural vehicle for cross-selling. As poker is the game of choice online, Harrah's World Series of Poker brand would prove valuable.

This is an admittedly hard task for Harrah's to fulfill. But it is very difficult to prevent US citizens from engaging in online gaming through websites created by foreign firms. Recognition of this may lead to an evolution in the federal government's stance on internet gaming.

## Integrating Caesars Palace into the Harrah's Family

As noted in the discussion of the Harrah's-Caesars merger, the incorporation of Total Rewards into the Caesars' properties has the potential to enhance performance at these properties.

However, the flagship Caesars Palace may not be well suited to all the management techniques of a typical Harrah's property. Caesars Palace is just below the top-premium hotels of Vegas like the Bellagio and The Venetian. Hotel guests at Caesars Palace may be more focused on the "resort" aspect of Las Vegas than the gambling. Visitors at a Caesars Palace are looking for VIP treatment regardless of how much they gamble. But at a typical Harrah's property, there are different check-in lines for the different tiers of Total Rewards members. These differences in service accrue through *repeatedly* gambling large amounts of money, not necessarily paying directly for them.

Part of the value of Caesars Palace within the Harrah's portfolio of assets is that it is different. It has elaborate displays, fashionable shops, and trendy nightclubs. Having one property like this in Vegas gives Harrah's a vehicle to reward current Harrah's customers. But if the property becomes solely about catering to the traditional Harrah's customer, guests will be unwilling to pay premium prices for rooms, and the quality of the Caesars Palace brand will deteriorate. Additionally, maintaining and perhaps enhancing the Caesars Palace image will facilitate expansion attempts overseas. Singapore in particular has expressed an interest in potentially having high-end resort casinos developed. Without a high-end brand, Harrah's has been at a severe disadvantage compared to MGM-Mirage, Las Vegas Sands, and Wynn Resorts when bidding to enter Singapore and China.

## **Conclusion**

Harrah's Entertainment, through the leadership of CEO Gary Loveman, has created unrivaled customer loyalty in the gaming industry with a brand that many considered sub-par compared to other firms. This was achieved through using customer incentive programs to reward and encourage gaming at Harrah's casinos in Vegas and other locales. Today, about 80% of Harrah's gaming revenues come from members of its Total Rewards program.

We believe the challenge for the company going forward is to lure consumers that are not already part of its loyal legion of slots players. Due to a rapidly expanding property portfolio, this will be essential to Harrah's attempts to bring Caesars' properties up to higher levels of profitability. The company should not abandon its emphasis on the consumer's gaming experience. But we believe this focus has to be adapted for the more premium brands within the Caesars' properties.