Harrah's Entertainment Inc

NYSE: HET, $85.54
United States

Ativo Research’s Investment Conclusion

The Ativo research team currently projects that Harrah’s will perform in line with the market over the next 6 to 12 months. Our decision is based on the stock’s relationship to its intrinsic value as well as an assessment of the momentum of the company’s fundamentals.

A BIR Research Provider Report
January 26, 2007  Page 1 of 4

Harrah's Entertainment, Inc. (HET), through its operating subsidiary, owns casinos under the Caesars and Horseshoe brands. As of September 2006, Harrah’s owned 36 casinos in U.S., including 19 land-based casinos and 11 riverboat casinos, as well as four casinos on Native American reservations, two cruise-ship casinos, a greyhound-racing facility, and a thoroughbred racetrack. In addition, the firm also offers hotel and convention space, restaurants, and non-gaming entertainment. It reported revenues of $7.1 billion in fiscal year 2005, with Casinos contributing 85%, and F&B and room revenues making up the rest. IMPORTANT: On 12/19/06, Harrah’s announced it had accepted an offer of $17.1 billion plus $10.7 billion in debt from private equity groups Apollo Management and Texas Pacific Group.

Decent Growth in Third-Quarter

The company recorded revenues of $2.5 billion in the third quarter of fiscal year 2006 — an increase of 10.6% over the year-ago period. The favorable growth was driven by a 21% expansion in revenues from the Las Vegas region. The Mississippi region’s contribution rose 15%, while Missouri chalked up 12% more. Operating profits were down 2.26 percentage points at 20.51% largely due to a 13% escalation in property operating expenses and a 23% increase in depreciation and amortization expenses. The company’s net income advanced 5% to $177 million, aided by a 74% fall in merger and integration costs.

Operational Concerns

With fewer new markets opening for development, competition between the numerous casinos and casino hotels in existing markets has intensified. Many casino operators, including Harrah’s Entertainment, have invested in expanding existing facilities. Additionally, the increase of Native American gaming in New York and California may be harmful to the company’s neighboring New Jersey and Nevada operations. Hence it becomes important for the firm to retain its customers. Therefore the company utilizes WINet, a nationwide customer database and Total Rewards, a loyalty program allowing customers to earn cash, comps and other benefits to play at its casinos. This ensures customer loyalty and also acts as a useful marketing tool.

In Expansion Mode

The company is pursuing domestic and international expansion to enhance its future growth potential. In November 2006, Harrah’s subsidiary, Daggy Holdings Ltd, acquired about 83% of London Clubs International. London Clubs operates seven casinos in the U.K., two in Egypt, and one in South Africa. Going forward, Harrah’s is expected to gain 100% ownership of London Clubs at an aggregate price of $570 million, by the end of 2006. This transaction will expand its casino operations internationally especially in the growing U.K. gaming market. Further, the company has signed an agreement to acquire the Barbary Coast property in Las Vegas. On completion of this transaction, the firm will have 350 acres of land at the intersection of Flamingo and the Las Vegas strip.

Company Guidance

Harrah’s plans to open a casino having 2,750 slot machines at Chester in January 2007. The firm also signed an agreement to acquire the Barbary Coast property in Las Vegas. On completion of this transaction, the firm will have 350 acres of land at the intersection of Flamingo and the Las Vegas strip.

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**Harrah’s Entertainment Inc**  
**NYSE: HET**

**Ativo Research Recommendation**

<table>
<thead>
<tr>
<th>Buy</th>
<th>Most Favorable</th>
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<tbody>
<tr>
<td>Hold</td>
<td>Neutral</td>
</tr>
<tr>
<td>Sell</td>
<td>Most Unfavorable</td>
</tr>
</tbody>
</table>

Current Recommendation (10/7/06)  
Previous Recommendation (9/30/06)  
Neutral  
Unfavorable

**Investment Philosophy**

Ativo’s valuation framework begins with the principles developed by Merton Miller, Franco Modigliani and others at the University of Chicago. Ativo’s contribution is the empirical validation and practical application that make these principals useful in making investment decisions. Stated briefly, stock prices are primarily determined by future cash flows and discount rates, each of which is influenced by distinct and separate factors.

**Research Process**

Fundamental data on all companies is run through a series of algorithms that adjust for the effects of inflation and remove other accounting distortions. This correctly measures the assets employed and the net cash receipts generated by companies. The resulting cash flow return on investment (CFROI) reflects economic reality. We also estimate each firm’s discount rate and flow return on investment (CFROI) reflects economic performance by systematically adjusting reported financial statements to correct for differences in accounting policies, inflation, leverage, and industry characteristics, thereby comparing all companies on a consistent basis. The resulting discounted cash-flow valuation, which incorporates industry and company growth prospects, is compared with the current price to determine relative attractiveness. This preliminary assessment is then tested against a series of short-term performance measures to determine the final recommendation. By removing all economic and accounting distortions and viewing the stock on a relative basis, we have gained a clear picture of how the stock will perform against market averages.

**Overall Recommendation: Hold**

Our review of Harrah’s is based on the methodology pioneered and developed by Chuck Callard since 1970, which calculates fundamental economic performance by systematically adjusting reported financial statements to correct for differences in accounting policies, inflation, leverage, and industry characteristics, thereby comparing all companies on a consistent basis. The resulting discounted cash-flow valuation, which incorporates industry and company growth prospects, is compared with the current price to determine relative attractiveness. This preliminary assessment is then tested against a series of short-term performance measures to determine the final recommendation. By removing all economic and accounting distortions and viewing the stock on a relative basis, we have gained a clear picture of how the stock will perform against market averages.

**In Line Performance Expected**

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**Expected Shareholder Return: Average**

Measures the return shareholders can expect to earn based on the current stock price and the firm’s projected cash flows. It is a measure of potential price appreciation over the following 26 to 104 weeks. For this firm, the potential price appreciation is 0.1% below the market’s, which is Average.

**P/E to Growth Ratio (PEG): Unfavorable**

Measures the ratio between the firm’s P/E and its forecasted asset growth rate. Ideally a firm has a low P/E and a high growth rate resulting in a low PEG ratio. Harrah’s has a P/E of 21.1 and a forecasted real asset growth rate of 4.0% resulting in a PEG ratio of 2.1. This is Unfavorable, as it is worse than 81% of all firms.

**Price Momentum: Average**

Measures the trend in relative shareholder wealth, over the last 200 days, including an adjustment for past volatility (at rare key reversal moments the favored firms are those that have been losing to the S&P). Harrah’s has a momentum score that puts it in the top 55% of all firms (Average).

**Qualitative Analysis: Average**

The attractiveness of a stock depends on certain non-numerical factors, such as quality of management, intensity of competition and brand strength. Our analysts take into account these and other factors in order to produce a comprehensive picture of the quality of each company.

**Sales Growth: Average**

Measures the growth in real four-quarter total sales per share over the last few quarters. Harrah’s sales have declined at a rate of 1% which is Average.

**Earnings Surprise: Favorable**

The EPS Surprise is computed by comparing recently reported earnings with the prior forecasts. Harrah’s has recently had positive earnings surprises, placing it in the top 20% of all firms (Favorable).

**ROI Trend: Unfavorable**

This score compares the long term ROI forecast with the average of the last 4 years. The ROIs for HET are expected to decrease by 2.3%, putting it in the bottom 89% of all firms (Unfavorable).

**Return Since Last Turning Point: Most Favorable**

We measure how the stock has performed since the last Market Turning Point, defined as either a peak, trough or change in the general character of the market. Since the Last Turning Point, this stock has gained 5.1%, which is considered Most Favorable.

**Relative Strength Rank (RS Rank): HET & the BIR Hotel & Gaming Industry**

- **Top Quartile**
  - HET RS Rank in BIR USETS Universe
- **Average**
- **Bottom Quartile**
  - HET is a Large-Cap Stock
  - with a Blend investment style.

A rising line means large-cap stocks are outperforming small-cap stocks.

A rising line means other stocks are outperforming growth stocks.
### Harrah’s Entertainment Inc
**NYSE: HET**

#### BIR Stock Classifications

<table>
<thead>
<tr>
<th>Region</th>
<th>North American Services</th>
<th>Hotel &amp; Gaming Casino Hotels</th>
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<td><strong>Casino Hotels</strong></td>
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<td><strong>NYSE: HET</strong></td>
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<tr>
<td><strong>Region</strong></td>
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#### 52-Week Sector Performance Order

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<th>Past Order (Mos. Ago)</th>
<th>Median Price Rel. St. Rank</th>
<th>Median Price Return</th>
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<td>10</td>
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<td><strong>14</strong></td>
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#### Hotel & Gaming Industry

**Jan. 5, 2007 -- Best Independent Research** -- The hotel industry includes companies that own, manage, or franchise hotels and resort properties offering a variety of amenities for business and leisure travelers. The gaming industry, on the other hand, includes companies that own and operate casino gaming operations, casino resort hotel facilities, riverboat casinos, and other gaming properties. Leading hotel groups, including InterContinental, Hilton, Marriott, and Choice Hotels International, together account for around 40% of the U.S. market. Of late, the hotel and gaming industry has been on a roll, with the hospitality segment adding flourish thanks to higher spending by consumers, increased business travel and booming growth in the demand for rooms.

**A Winning Hand in the Third Quarter**

The hotel and gaming industry reported robust results for the third quarter of fiscal year 2006, with the top line grew in the mid-teens over the year-ago period. The rise was dominated by the scintillating increase in casino revenues, while hotel companies brought up the rear. Operating margins, however, expanded by just 76 basis points to 16.08% as several players’ reorganization initiatives began to pay off. Others bore the brunt of the sale of non-strategic assets which took a toll on profits. In most cases, though, net income rose phenomenally, buoyed by higher revenues and better non-operating income.

**Spread of Gaming Threatens Old Haunts**

While most gaming firms continued to do well, the threat posed by the rise of Native American casinos looms large. What’s more, the legalization of gaming in California and New York could well threaten domination of firms operating in Las Vegas and Atlantic City, respectively. With no signs that the legalization of gaming threats posed by the rise of Native American casinos looms large. What’s more, the legalization of gaming in California and New York could well threaten domination of firms operating in Las Vegas and Atlantic City, respectively. With no signs that the legalization of gaming

### Comparing Harrah’s to its Sub-Industry Peers

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<tbody>
<tr>
<td><strong>1.60B</strong></td>
<td></td>
<td>BIR USETS UNIVERSE</td>
<td>7%</td>
<td>1%</td>
<td>11%</td>
<td>5%</td>
<td>5%</td>
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<tr>
<td><strong>2.15B</strong></td>
<td></td>
<td>Peer Group</td>
<td>13%</td>
<td>9%</td>
<td>5%</td>
<td>5%</td>
<td>5%</td>
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<tr>
<td><strong>4.76B</strong></td>
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<td>Peer Group</td>
<td>22%</td>
<td>0%</td>
<td>74%</td>
<td>67%</td>
<td>67%</td>
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### Sources

BIR consensus estimates; Reuters

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**Players Raise Stakes Overseas**

Casino operators are betting on overseas expansions, with Macau in China attracting bigwigs like the Las Vegas Sands, Wynn Resorts and MGM, all of whom are developing plush, resort style gaming facilities. While Las Vegas Sands is developing a property in Singapore – which has legalized gaming – rival Harrah’s bought an 83% stake in London Clubs International, operating casinos in the U.K., Egypt, and South Africa. Emerging markets are also in focus. Hilton Hotels and DLF plan to develop 75 hotels in India, where Wyndham Worldwide also plans to develop 10 Ramada properties. Dubai’s room count is also due to hit 20,000 by 2010. Back home, the Strip hasn’t been left behind: Harrah’s, Wynn, and Boyd are all set to begin expansion. Harrah’s is also set to go private, having accepted a buyout offer worth $28 billion from private equity groups Apollo Management and Texas Pacific Group. In other M&A activity, Columbia Entertainment completed acquiring the outstanding shares of Aztar Corp for $2.1 billion in January 2007.

### Mixed Bag in the Offing

The expansion initiatives taken by gaming companies could prove to be a trump card in the long run. There may be trouble in the near term, with GDP growth down to 1% at the end of 2006. This could result in reduced consumer spending – something that the industry depends upon heavily – and reduce revenues in the next quarter. However, the F.W. Dodge Construction survey indicates hotel construction will be up in 2007, and demand is expected to outpace supply, leading to a hike in room rates.
Glossary

BIR Stock Coverage and Market Indices The BIR USETS® (US exchange-traded stocks) universe and indexes include over 3000 of the largest domestic and international stocks that trade in the United States. BIR’s stock classifications (BIR’s GIC) reflect their membership in the firm’s industry and country indices.

BIR Asset Class and Investment Style large-caps are the largest 1000 US stocks by capitalization; the remainder are small-caps. Non-US stocks are separated using the same breakpoint. Value, blend and growth styles are set using a blend of valuation ratios and growth rates.

BIR Risk Profile Rank This rank reflects the stability of the company’s business and its stock’s price volatility. Risk ranks do not project price direction.

BIR Financial Quality This measure of a company’s creditworthiness reflects BIR’s assessment of its working capital, debt ratios, business risk and potential legal liabilities.

BIR Consensus Sales & Earnings Estimates These are compiled by BIR weekly using fresh estimates from a select number of Wall Street security analysts.

Chart pg 2: Relative Strength Rank A stock’s RS Rank is its 52-week return ranked from 1 (best) to 99 within the BIR USETS universe. This chart shows that a stock’s price may be influenced by the popularity of its industry, asset class or investment style. An industry RS Rank is the average RS Rank of the stocks in that industry. Large vs. Small and Value vs. Growth performance is presented to enable observation of their influence.

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