Maryland Lottery and Gaming Control Commission
September 19, 2013

Caesars Entertainment Corporation – corporate restructuring

EXECUTIVE SUMMARY

Before the Commission is a transaction (the Transaction) proposed by Caesars Entertainment Corporation (CEC), which is the ultimate parent of the CBAC Borrower. The Video Lottery Facility Location Commission (Location Commission) awarded CBAC Borrower the Baltimore City video lottery operation license to operate Horseshoe Casino Baltimore (Horseshoe).

If implemented, the Transaction would effect a change in CEC that may impact CBAC Borrower's status and operations, and, ultimately, the State's interests. Therefore, Commission is required to review and approve the Transaction before it is implemented.

Rationale for the Transaction

CEC is proposing the Transaction as a method to bring additional liquidity to its operations and to maximize the return on some of its relatively unencumbered assets and high growth new technologies. Due to its fixed costs and highly leveraged position, CEC is unable to independently raise additional funds without issuing additional high-cost debt or substantially diluting its existing shareholders.

The Transaction is a temporary financing vehicle. Following Growth Partners' liquidation, the pre-Transaction ownership will result.

CEC has pledged a significant portion of its assets as collateral under financing agreements and a significant amount of CEC's liquidity is used for debt service. As of June 30, 2013, CEC had approximately $23.7 billion of indebtedness outstanding and interest payments for the six months ended June 30, 2013 were $947.1 million. CEC has not generated sufficient cash flows in recent years to fund additional investments, and instead has been required to fund investments with additional debt. According to CEC's 2012 annual report on Form 10-K, net losses from CEC's operations for the year ended December 31, 2012 were $1.497 billion, compared to $687.6 million for 2011, a 117% increase.

Certain covenants contained in the senior secured credit facilities of Caesars Entertainment Operating Company, Inc. (CEOC) condition CEC's ability to take actions, including incurring additional debt or making acquisitions, on CEC's ability to maintain certain financial ratios. It appears that CEC was not in compliance with several of those ratios as of June 30, 2013, although it remained in compliance overall with CEOC's credit facilities.

The consequences of CEC defaulting on the CEOC senior credit facilities may include an inability to generate sufficient cash flow from operations, unavailability of future borrowings, and inability to fund liquidity needs and pay indebtedness when due. This may negatively impact CEC's competitive position and revenue generation. Additionally, CEC has pledged a significant portion of assets as collateral under certain debt agreements and, if a lender accelerates repayment, there is no assurance that CEC will have sufficient assets to repay indebtedness.

The CEC believes that it will continue to be in compliance and meet its cash flow needs during the foreseeable future, including the next twelve months. The CEC takes the view that the new investment vehicle will have greater access to the equity markets through the combination of the new flexible capital structure resulting from the Transaction (explained below) and CEC's leading brands and management capabilities, which will provide a competitive advantage in the pursuit of high return, capital intensive investment opportunities in land-based casino gaming, regulated online real-money gaming, and social and mobile games. This will create a unique venture-oriented investment vehicle for potential equity investors.

The Transaction

The Transaction is a very complicated business reorganization that CEC has been working on for a significant period of time. The post-transaction organizational chart may be instructive. The Transaction is fully described and analyzed in the privileged memorandum that the Attorney General's Office provided to the Commission, but is summarized herein as broadly as possible:

- Two new entities will be created under the CEC parent: Caesars Growth Partners, LLC (Growth Partners), which will be owned collectively by CEC's majority shareholders and some CEC subsidiaries (collectively, the Sponsors). The Sponsors will own Growth Partners indirectly through the other newly-created entity, Caesars Acquisition Company (CAC), which will be listed on NASDAQ or another national exchange.
- In a Rights Offering, voting shares of CEC will be offered for purchase by the Sponsors through CAC. Some of CEC's subsidiaries will contribute assets to Growth Partners in exchange for nonvoting units in Growth Partners. CEC through its subsidiaries will thus own 57 – 77% of the economic interests in Growth Partners, depending on the amount of shares of CAC stock sold.
- Growth Partners will use some of the proceeds of the Rights Offering to purchase from CEC subsidiaries two casino licensees (including Awardee), and 50% of the related management fees of the two casinos, for cash.
- CAC and Growth Partners will enter into a management services agreement with another CEC subsidiary CEOC, under which CEOC will provide certain corporate services, back office support, and business advisory services to CAC, Growth Partners and their present and future subsidiaries. CBAC Gaming and another CEC subsidiary have entered into a 15-year management agreement by which CBMC (through CEOC) will provide Horseshoe with management services and use of the Horseshoe brand and CEC's Total Rewards program.
- After the third anniversary of the formation of Growth Partners, CEC will have the Call Right to acquire units of Growth Partners that are held by CAC. There are restrictions on the Call Right, including that CEC must first meet specific indicators of financial stability.
- The Transaction also plans for the full or partial liquidation of Growth Partners when the first of several liquidation events occurs.
- Other features of the transaction include: restrictions on Growth Partners' ability to transfer its ownership interest units for the first five years outside of the CEC family; and

CEC has rights of first refusal over business opportunities, right of first offer on sale of assets, and exchange rights.

Staff reviewed hundreds of pages of documents and obtained information from CEC, and analyzed the Transaction as to whether the new ownership structure would negatively affect the State or the Awardee. *See* Ann. Code of Md., State Gov't ("SG") § 9-1A-19.

Effect of the New Structure on Awardee CBAC Borrower

CEC presently has sole beneficial ownership and voting control of the Licensee. The Transaction would create a joint ownership structure in which CAC would have both a beneficial interest in the Licensee and voting control over its operations. CEC would continue to maintain a majority economic interest in the Licensee through its indirect ownership of units of Growth Partners, and CEC would be unable to repurchase voting control over the Licensee for three years after consummation of the Transaction, and then only after it satisfies criteria of financial stability. The Commission would, as now, review and approve the proposed repurchase. *See* SG §9-1A-19(b); COMAR 36.03.02.01G.

The new joint ownership structure may strengthen the Awardee's ability to withstand the financial difficulties of current parent CEC. In the event of a bankruptcy of CEC, CEC's bankruptcy estate would automatically become the owner of the Growth Partners' units owned by CEC's subsidiaries. Even if CEC's creditors obtained beneficial ownership of the Awardee, CAC would continue to have voting control, and the result would arguably do no more than place the Licensee back into the position it would occupy if the Transaction had not been attempted.

CEC's bankruptcy creditors could negatively affect the Awardee's operations through other subsidiaries of CEC, which will operate the Horseshoe Casino, through which the Licensee will have access to the "Horseshoe" brand and the Total Rewards customer loyalty program. For example, if CEC and its subsidiaries file for bankruptcy protection, its creditors may lobby to reject management agreements, such as the Management Agreement so the Awardee could no longer use the Horseshoe brand or the Total Rewards program. However, that situation would not be caused by the proposed change in ownership structure: the Awardee is presently in that same position.

The Transaction also addresses the planned liquidation of Growth Partners and the potential sale of the Licensee back to CEC or to a third party. That aspect of the Transaction does not appear to present any impediment to the State, as the Commission would have review and approval authority over any potential change in control.

Some of the remaining aspects of the Transaction appear to have little impact on Horseshoe's operations. Additionally, it does not appear that the new equity structure would impair the State's claim on gaming receipts or the Commission's regulatory authority over the Awardee.

Finally, with respect to a hypothetical bankruptcy by an owner of the Awardee, under the proposed Transaction, neither the license nor the gaming proceeds would be the property of the hypothetically bankrupt owner, and credits of the bankrupt estate of the owner would have no claim to the license or to gaming proceeds.

Conclusion

Based on the review of the documents and information provided to Staff, it is Staff's view that the Transaction does not put the State in a less advantageous position than it would have been if the Transaction was not proposed and the Awardee commenced operations under the corporate structure approved by the Location Commission. Staff recommends Commission approval of the transaction. However, approval is conditioned on CEC's demonstration, to Staff's satisfaction, of compliance with the following conditions on its approval of the Transaction:

1. All documents that were submitted to the Commission in draft must be executed with no material changes.

2. Confirm that all required consents to the ownership change have been received and the ownership change does not violate any material agreements to which Awardee or its owners are a party.

3. As an additional measure to insulate the Awardee from a CEC bankruptcy, CBAC Gaming shall explore adding a provision that its limited liability company agreement be amended to require that any bankruptcy of the Awardee requires the consent of all members of CBAC Gaming: CR Baltimore Holdings, LLC; STRON-MD Limited Partnership; CVPR Gaming Holdings, LLC; and PRT Two, LLC.

4. Require that the Transaction Agreement be adopted without material amendment.

5. Amend the Management Agreement dated October 23, 2012, by which CBAC Gaming engaged CBMC to manage and operate the Horseshoe Casino, to accurately reflect the transfer of the license award to Awardee.

6. Submit appropriate application forms for individuals as officers or directors of Growth Partners after those individuals are identified.

Commission Action necessary

Motion to approve the Transaction