Caesar's Entertainment

New Hotel & Casino Project

Caesar's Entertainment seeks to increase their stockholders' equity through expansion with the proposal of a new hotel and casino complex, which would be one of the largest in North America with over 3,100 rooms and 140,000 square feet of casino floor space. The state-of-the-art complex wouldn't just increase revenues and market share but enhance Caesar's Entertainment overall brand recognition solidifying them as one of the largest hotel and casino proprietors in the world.

The benefits of such a project would be to increase the total stockholders equity by approximately 2% year-over-year than without the project. Additionally, gross profit would also increase nearly 150 million dollars on an annual basis projected through 2020; as well as nearly doubling net income over the same period. With the new hotel and casino complex, the project represents a NPV of $27,567,000,000 over 20 years with an IRR of 6.31%. Although the WACC is higher than the IRR at 8.91% comparatively to 6.31%; and generally should be rejected due to this, the project should still be executed as the WACC is currently significantly higher at 12.89% and does provide a substantial increase in stockholders equity overall.

Project Financing

The hotel and casino industry standard overwhelmingly uses debt to finance new projects. There is an investment pecking order that is Ill-adhered to, which is to use retained earnings *(if any exists,)* then to use debt, and finally equity financing if additional funds are needed.

In this case, the Caesar's Entertainment has negative retained earnings; therefore, debt is the next best option to finance this proposed project. Additionally, is known that equity is generally more expensive than debt due to the numerous fees and debt is tax deductible. Although the potential for bankruptcy risk is greater when highly levered, margins are so low that the reduction of costs are critical to achieving or maintaining profitability. The banking industry's allowance for high debt levels and risk of default is probably due to the nature of the tangible assets that a hotel and casino complex would leave behind if default would occur.

Utilizing long-term debt instruments for the creation of the hotel and casino complex project would have an after-tax cost of 7%, financing $3,900,000,000. Under this proposed plan, the project would be completely financed using debt, as there are no retained earnings available for investment, and the cost of equity is too high relative to debt.

Financial Analysis

Income Statement

After forecasting Caesar's Entertainment revenues, gross profit, operating income, and net income from 2018 to 2020 with and without the proposed project, an analysis of the income statement can be performed.

First examining the gross profit, the firm has an increase of approximately 150 million dollars year-over-year. Next, by looking at the operating income, I can see that the project has negatively impacted the balance sheet significantly with a spread of approximately 900-700 million dollars from 2018 to 2020, respectively. These figures culminate in an overall 419.4 million-dollar loss in operating income in 2020 with the proposed project. Finally, by dividing the

income tax expense over the EBIT, I was able to find an average tax rate of approximately 35% year-over-year with and without the proposed project.

Balance Sheet

By looking at the forecasted balance sheets with and without the proposed project, I can determine changes in the total assets, total liabilities and total equity, culminating in the total liabilities and stockholder's equity for each scenario.

First analyzing the total asset portions of the forecasted balance sheets, I found that there is a significant increase in total assets overall with the proposed project included from 26.8 to 34.7 billion in the first year. This is largely attributable to the increases in plant, property, and equipment; as well as other long-term assets which come from the construction of the new hotel and casino project. Next, total liabilities are expected to significantly increase with the debt financing for the new project than without and this is a major proponent in the increase in total liabilities and stockholder's equity.

Ratio Analysis

Liquidity Ratios

First, by looking at Caesar's Entertainment's current ratio, I found that it increases significantly from .14 in 2017 to .17, .21, and .24 in the projected years of 2018 to 2020 without undertaking the project respectively. In contrast, the company is projected to maintain the same current ratio in 2018 with the proposed project and growing only moderately over the next 2 years. This can largely be attributed to the fact that the firm is in an expansion process and the hotel and casino complex will still be under construction, so liquidity should be depressed. It should be noted

however, that the quick ratio does improve with the project over the non-growth quick ratio counterpart.

Finally, the interest coverage ratio does increase with the project as expected due to current interest rates for long-term debt based upon the project risk. The figures are still relatively low, fluctuating from 1.61 to - 0.48 over the forecasted period with the project and demonstrates that the firm should be able to continue paying its interest expenses on the current portion of, and projects long-term debts

Asset Utilization Ratios

Inventory turnover from the projected project forecast decreases from the 2018 base-year and continues a downward trend, as does the projected non-project ratio, although the decline is significantly greater with the project. Receivables turnover ratio is similarly trending downward for both projections, with the larger decrease occurring with the project. Additionally, fixed asset turnover and total asset turnover are both trending downward as well in both scenarios.

The downward pressure on the asset utilization ratios may be attributed to the overall downward trending of the firm, as sales and revenues are both in the decline. Although these forecasted figures do not look favorable to completing the project, it should be noted that this forecast ends right as the construction on the project should end and asset utilization ratios should improve over time if the hotel and casino are completed.

DuPont Analysis

When reviewing the DuPont ratios, the increase in net profit margin is very impactful by undertaking the project averaging over 50% during the projected period; in contrast to, approximately 20% without it. While the total asset turnover is trending downward in both

scenarios, they are similar with and without the project. Finally, the return on equity has a massive increase year-over-year with the project relative to not undertaking it; however, this is largely attributable to increasing the levels of long-term debt to finance the project.

Profitability Ratios

The gross profit margin ratio remains the same under both scenarios, with and without the project; although, the operating profit margin decreases with the project being undertaken. In contrast, the net profit margin does increase significantly comparatively than without the project. Return on assets and return on equity both provide superior ratios when projected out to 2020 with the project as well. This may signal the project may be a more viable option than choosing to not undertake the project.

WACC

The WACC is currently at 12.89%, while the projected WACC with the project lowers significantly to 8.91%. With this decrease in the WACC, it will decrease current risk and be more favorable for Caesar's Entertainment to fund projects than in the current environment .

Overview

Overall, it is my view that the project should be undertaken. While the projected WACC is lower than the projected IRR levels that generally aid decision-making processes, it should be noted that the firm is in a downward trajectory overall and this project will provide a positive increase to shareholder's equity. It will also decrease the WACC so future projects may become more viable and may lead to the firm increasing its overall value when other opportunities arise.

Other factors, such as increasing market share, goodwill and brand awareness, will increase project viability as well.