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MGM Mirage's Bid for Mandalay Resort Group (A): Communicating During the Merger Process

The combination of these two great companies would provide Mandalay shareholders with a premium price for their shares as well as providing several strategic benefits to shareholders in MGM MIRAGE.

—Terry Lanni, Chairman of the Board and CEO, MGM Mirage, June 4, 2004

On Friday, June 4, 2004, Mandalay Resort Group's stock price surged by 10%, or \$5.65, to \$60.27, fueled by Mandalay's announcement the previous evening of record first-quarter earnings and by growing speculation of closed-door merger talks between MGM Mirage (which had also recently posted record first-quarter earnings) and Mandalay.[1] Following the close of Friday's trading session, MGM Mirage confirmed rumors of merger talks between the two companies by issuing a brief press release announcing its offer to purchase the outstanding shares of Mandalay Resort Group in a transaction valued at \$7.65 billion including a cash consideration of \$68 per share of Mandalay stock (a premium of 12.8% over the Friday closing price) and the assumption of \$2.8 billion in debt.[2]

Discussions between MGM and Mandalay began quietly in late May 2004 with private, informal meetings between the presidents and CFOs of the two companies.[3] Talks intensified when Kirk Kerkorian, the majority shareholder of MGM Grand, and Michael Ensign, CEO of Mandalay, met face-to-face in a private meeting.[4] MGM's terse press release announcing its offer (but no other details) was met with a similarly brief public response from Mandalay Bay stating simply, "Mandalay Resort Group (NYSE: MBG) has received and will carefully evaluate the proposal from MGM Mirage and will respond to MGM Mirage in due course. Mandalay does not intend to make any further comment on this matter until it is finally resolved."[5]

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[1] Christina Binkley, "Buying Las Vegas—In Bid for Mandalay Resort, MGM Mirage Could Become Biggest Casino Powerhouse," *The Wall Street Journal*, June 7, 2004, p. B1.

[2] MGM Mirage press release, June 4, 2004.

[3] Christina Binkley, "Buying Las Vegas—In Bid for Mandalay Resort, MGM Mirage Could Become Biggest Casino Powerhouse," *The Wall Street Journal*, June 7, 2004, p. B1.

[4] Ibid.

[5] Mandalay Resort Group press release, June 4, 2004.

Background

MGM Mirage and Mandalay, the third- and fourth-largest casino firms in the U.S., respectively, were both headquartered in Las Vegas, Nevada. Each owned and operated a diverse portfolio of primarily domestic casinos and resorts. Although each company had a broad geographic presence in the U.S., the holdings on the famed Las Vegas Strip were undoubtedly the crown jewels for both companies in terms of both prestige and financial importance. In fact, each company derived about three-quarters of its revenue from hotels and gambling tables in Las Vegas.[6]

MGM's various theme-based Las Vegas resorts, designed to appeal to an upscale clientele, included (1) *Bellagio*, a European-style luxury resort; (2) *MGM Grand Las Vegas*, a destination resort with an extensive array of restaurants, bars, and nightclubs, a state-of-the-art convention center, and entertainment facilities that have featured sporting events such as championship boxing as well as concerts by such stars as Madonna, Paul McCartney, The Rolling Stones, Billy Joel, and others; (3) *The Mirage*, a tropical-themed resort featuring the exotic animals of Siegfried & Roy, the world-renowned illusionists; (4) *Treasure Island*, a Caribbean-themed resort featuring performances by Cirque du Soleil; and (5) *New York-New York*, a destination resort featuring replicas of many New York City landmarks.

Mandalay's Las Vegas resorts, which appealed to a more economically diverse consumer base, included (1) *Mandalay Bay*, its flagship property, featuring fine rooms, internationally renowned restaurants and entertainment attractions, as well as 2 million square feet of conference and exhibit facilities; (2) *Luxor*, an Egyptian-themed hotel and casino complex; (3) *Excalibur*, a castle-themed complex featuring a Renaissance fair, a medieval village, and an amphitheater; and (4) *Circus Circus*, a family-friendly resort featuring attractions for children. *Mandalay Bay* targeted the upper-middle-income to high-income segment of the market, *Luxor* targeted the middle- to upper-middle-income segment, while *Circus Circus* and *Excalibur* appealed to the value-oriented, middle-income segment.[7]

The two companies combined had $6.5 billion in revenue in 2003 and 70,000 employees. A combination of the two companies would be a potent force on Las Vegas's famed strip with control of 49% of the hotel rooms, 44% of the gambling tables, and 40% of the slot machines.[8]

Exhibit 1 compares financial statement and stock price data for both companies. Both companies suffered slowdowns in growth in the wake of the events of September 11, 2001, which hit the travel and tourism industry in Las Vegas hard. At the time of MGM's offer, however, both companies were experiencing a resurgence in financial performance (as evidenced, in particular, by their stellar first-quarter results) that reflected the renewed popularity of Las Vegas as a travel destination. The revitalization of Las Vegas tourism was due to (1) more frequent trips by discount airlines to Las Vegas from the East Coast, (2) the availability of cheaper hotel rooms in Las Vegas relative to alternative destinations, (3) the reluctance of Americans to venture overseas due to the threat of terrorism, (4) the success of Las Vegas's marketing efforts to encourage tourism in the city including the popular slogan "What happens in Vegas stays in Vegas," and (5) interest generated by the popularity of movies and TV shows set in Las Vegas such as "Ocean's Eleven" and "CSI."[9]

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[6] "Wedding in Vegas? Casinos," *The Economist*, June 12, 2004.

[7] Mandalay Resort Group, January 31, 2004 10-K.

[8] "Kirk's new enterprise," *The Financial Times*, June 15, 2004, p. 24.

[9] "Wedding in Vegas? Casinos," *The Economist*, June 12, 2004.

While Kerkorian was the public face of MGM Mirage, leading the helm on a daily basis was the more unassuming CEO, Lanni. Lanni joined the company in 1995 and oversaw the company's 2000 acquisition of Mirage Resorts.

The management team of Mandalay Bay included Michael Ensign, chairman and CEO; William Richardson, vice chairman; and Glenn Schaeffer, president and CFO. Both Ensign and Richardson had sold most of their unrestricted shares in Mandalay Bay the previous fall for around $40 per share and at the time of MGM's announcement were not working under employment contracts.[10] Ensign, Richardson, and Schaeffer received restricted stock grants worth $50.4 million on April 9. Such restricted stock would vest immediately if the merger was successfully completed.[11]

Reaction to the Announcement

MGM issued no public comment about the proposed merger during Mandalay's deliberations. However, there was no shortage of public discussion about the deal by observers. Several analysts spoke favorably about the prospects for the merger. Joe Greff, an analyst with Fulcrumb Global Partners LLC, indicated that the deal made financial and strategic sense and would be justified for a price of up to $81 per share.[12] J. Cogan, an analyst at Banc of America, wrote: "Even my Grandma knows Las Vegas is on fire and Mandalay Bay beat first quarter views. The irony is that the stock is still inexpensive."[13] Consistent with these analyst views, arbitrageurs were betting that Mandalay could negotiate a final transaction price in the mid-$70 range.[14] The following potential benefits were cited for these bullish views:

1. The greater range of resort options would give the combined firm access to a broader customer base as well as greater cross-marketing opportunities.[15,16]
2. Access to Mandalay's undeveloped 31-acre parcel of land just south of Mandalay Bay Hotel and Casino would allow MGM Mirage more development opportunities in the resurgent Las Vegas market.[17]
3. Access to Mandalay Bay's convention center would allow MGM Mirage to compete for convention business.[18]

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10 Christina Binkley, "Investors Bid Up Mandalay Stock in Move That May Imperil a Deal," *The Wall Street Journal*, June 8, 2004, p. A3.

11 Gretchen Morgenson, "Mandalay Executives May Still Win the Jackpot," *The New York Times*, June 13, 2004.

12 Christina Binkley, "Buying Las Vegas—In Bid for Mandalay Resort, MGM Mirage Could Become Biggest Casino Powerhouse," *The Wall Street Journal*, June 7, 2004, p. B1.

13 Andrew Ross Sorkin, "In Las Vegas, Showing Cards to Keep Ante from Rising," *The New York Times*, June 7, 2004.

14 Christina Binkley, "Investors Bid Up Mandalay Stock in Move That May Imperil a Deal," *The Wall Street Journal*, June 8, 2004, p. A3.

15 Christina Binkley, "Buying Las Vegas—In Bid for Mandalay Resort, MGM Mirage Could Become Biggest Casino Powerhouse," *The Wall Street Journal*, June 7, 2004, p. B1.

16 "Kirk's new enterprise," *The Financial Times*, June 15, 2004, p. 24.

17 "MGM Mirage's Board Votes for Deal," June 16, 2004, p. B4.

18 Christina Binkley, "Buying Las Vegas—In Bid for Mandalay Resort, MGM Mirage Could Become Biggest Casino Powerhouse," *The Wall Street Journal*, June 7, 2004, p. B1.

4. The combined firm would be large enough to support inroads into Britain, where gambling restrictions were expected to be eased, and Asia, where demand for American-style gambling was growing.[19]

Not everyone was so bullish on the deal. Three major bond-rating agencies placed both companies on a credit watch with negative implications because of the large amount of debt that would have to be assumed to consummate the deal. An editorial in *The Economist* opined, "There are few obvious efficiencies to be gained from joining two already tightly-run operations, beyond trimming some overheads and combining frequent-visitor schemes. Meanwhile rivals are adding ever more hotel rooms . . . leading to a potential glut. . . . MGM Mirage has already said that the American market is somewhat mature." [20]

Another area of uncertainty was the response of potential competitors to MGM's proposal. Investment bankers eager to profit from a potential deal spent the weekend after MGM's announcement attempting to draw MGM's rivals into a bidding war.[21] Observers watched with particular interest the response of MGM's main rivals, Harrah's Entertainment and Caesars Palace. Neither company stepped forward with plans to make a competing bid for Mandalay. Harrah's, in particular, indicated that Mandalay was not a strategic fit because Mandalay's emphasis on nongambling activities such as dining and entertainment was at odds with Harrah's focus on gambling profits and because Mandalay's casinos in Reno and Laughlin were facing tough competition from Native American casinos in California.[22]

Regulatory Concerns

An overriding concern even among those bullish on the deal's prospects was how the deal would fare under antitrust scrutiny. Based on Michigan's limits on casino control, it was clear that one of the two Detroit properties owned by MGM and Mandalay would have to be divested. Of much greater concern was whether the Federal Trade Commission (FTC) would conclude that the merged firm would have undue influence on hotel and airline prices in the gaming and convention industries. Depending on how anticompetitive the FTC concluded the merger to be, it could either squash the merger entirely or it could require the combined firm to shed certain properties in order to pass regulatory muster. Crucial to the FTC's deliberations would be the market definition it would use in assessing the deal. If the FTC viewed the market occupied by MGM and Mandalay narrowly either in geographic terms or in terms of the services these firms provided, then it would likely take a dim view of the combined firm's dominating the Las Vegas Strip. The FTC would be more likely to look favorably on the deal if it used a broader view of the geographic and service markets occupied by the two firms.

There were diverse public assessments about how the FTC would judge the merger. Most observers expected that the FTC would require the combined firm to divest itself of some holdings. However, forecasts of the likely severity of the FTC's divestiture requirements were mixed. Mike Cowie, former senior litigation counsel and assistant director at the FTC responsible for leading the Merger Litigation Task Force, opined: "I think it is more likely than not that the FTC will view that

[19] "Wedding in Vegas? Casinos," *The Economist*, June 12, 2004.

[20] Ibid.

[21] Andrew Ross Sorkin, "In Las Vegas, Showing Cards to Keep Ante from Rising," *The New York Times*, June 7, 2004.

[22] Christina Binkley, "Investors Bid Up Mandalay Stock in Move That May Imperil a Deal," *The Wall Street Journal*, June 8, 2004, p. A3.

there is a narrow market. Las Vegas is a brand. It is going to be difficult to argue that Atlantic City is a direct substitute."[23] On the other hand, Jane Pedreira, a Lehman Brothers analyst, predicted that the FTC would consider the competitive effect of the merger on the national gaming industry and on international convention business, which would make the heavy concentration of hotel rooms and gaming facilities on the Las Vegas Strip in the hands of the combined firm less problematic.[24] While the combined firm would undoubtedly wield significant influence on the conduct of business on the Las Vegas Strip, those who believed that the FTC would use a broader market definition cited the fact that MGM and Mandalay compete with hotels and gambling facilities across the country and around the world for business and leisure dollars, not just the subset located on the Las Vegas Strip. Even under a narrow geographic view, many believed that a case could be made that the merger would not adversely affect the competitiveness of the gaming industry on the Las Vegas Strip given the ease of entry into the Las Vegas market (as evidenced by rivals' continued addition of hotel rooms on the Strip), the increasing competitiveness of neighboring Indian reservations, and the vastly different market segments targeted by the resorts owned by MGM and Mandalay.

Although neither company provided public guidance on the likely course of regulatory action, their discussions in their most recent 10-Ks filed prior to the announcement provided some insight into how they viewed the competitive landscape of the gaming industry (**Exhibit 2**).

A Bump in the Road

After a week of deliberations, Mandalay issued a press release on Friday, June 11, 2004 rejecting MGM's offer, citing insufficient assurances by MGM that it would take the necessary steps to gain regulatory approval. The impasse centered on a provision in MGM's offer that would allow MGM to walk away from the deal after 15 months for a breakup fee of $100 million.[25] Schaeffer commented:

> MGM was simply unwilling to accept the risk that regulators would require any divestitures or other regulatory fixes. At the outset, we were crystal clear that any points of regulatory risk belonged to MGM Mirage, not to our shareholders. If there were any regulatory issues to be solved, they would solve them. . . . Somehow an offer to buy our shares morphed into an option to buy the company in 15 months.[26]

Revival of Talks

On Monday, June 14, 2004, MGM announced that, after a weekend of revived talks, it had reached an agreement in principle to acquire Mandalay for $71 per share. Mandalay followed up with its own less committed press release stating that the new offer was under consideration and that it provided significantly greater assurances of closing for Mandalay's shareholders than did MGM's initial acquisition proposal. On June 16, 2004, after approval of the merger terms by the boards of both companies, MGM formally announced a definitive acquisition agreement with Mandalay. **Exhibit 3** depicts the stock price movement of MGM and Mandalay Bay during the merger deliberations.

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[23] Andrew Ross Sorkin, "Regulators Will Decide Fate of Bid for Mandalay," *The New York Times*, June 15, 2004.

[24] Rod Smith, "Buzz over Possible Buyout Boosts Shares in Las Vegas' Mandalay Resort Group," *Las Vegas Review-Journal*, June 8, 2004.

[25] Jennifer Bayot and Andrew Ross Sorkin, "Mandalay Rejects MGM Mirage," *The New York Times*, June 12, 2004.

[26] Ibid.

Exhibit 1 Summary Financial Results

Panel A: MGM (December 31 year-end)

Comparative Annual Results (amounts in thousands, except per share amounts):

	2003	2002	2001	2000	1999
Net revenues	$3,908,816	$3,792,248	$3,731,636	$2,947,221	$1,330,853
Income from operations	713,069	757,747	609,693	527,686	209,868
Net income	237,112	292,435	169,815	160,744	86,058
Basic earnings per share	$1.64	$1.85	$1.07	$1.15	$0.82
End-of-year share price	$37.61	$32.97	$28.87	$28.09	$24.90

Source: MGM Mirage 2004 Annual Report.

Comparative First-Quarter 2004 Results (amounts in millions, except per share amounts):

	March 31, 2004	March 31, 2003
Net revenues	$1,066,436	$951,874
Income from operations	254,666	159,485
Net income	105,848	51,003
Basic earnings per share	$0.74	$0.34
Split-adjusted end-of-year share price	$45.34	$29.25

Source: MGM Mirage, April 21, 2004 press release.

Exhibit 1 (continued)

Panel B: Mandalay (January 31 year-end)

Comparative Annual Results (amounts in thousands, except per share amounts):

	2004	2003	2002	2001	2000
Net revenues	$2,491,099	$2,354,118	$2,348,512	$2,381,139	$1,926,278
Income from operations	490,441	452,306	351,060	431,534	273,736
Net income	149,847	115,603	53,044	119,700	42,163
Basic earnings per share	$2.40	$1.71	$0.73	$1.53	$0.47
End-of-year share price	$46.48	$24.99	$26.31	$21.11	$15.01

Source: 2004 Mandalay Resort Group Annual Report.

Comparative First-Quarter 2004 Results (amounts in millions, except per share amounts):

	April 30, 2004	April 30, 2003
Net revenues	729,368	616,510
Income from operations	199,686	137,047
Net income	87,328	44,046
Basic earnings per share	$1.32	$0.72
End-of-year share price	$57.22	$25.70

Source: Mandalay Resort Group, June 3, 2004 press release.

Exhibit 2 Discussion of Competitive Environment by MGM Mirage and Mandalay Resorts in Most Recent 10-K prior to MGM Mirage's Initial Offer

Panel A: Excerpt from MGM Mirage December 31, 2003 10-K (Item 1—Description of Business)

Our Las Vegas casino resorts compete with a large number of other hotel-casinos in the Las Vegas area, including major hotel-casinos on or near the Las Vegas Strip, major hotel-casinos in the downtown area, which is about five miles from the center of the Strip, and several major facilities elsewhere in the Las Vegas area. According to the Las Vegas Convention and Visitors Authority, there were approximately 130,000 guestrooms in Las Vegas at December 31, 2003, up from approximately 127,000 rooms at December 31, 2002. Las Vegas visitor volume was 35.5 million in 2003, a slight increase from the 35.1 million reported for 2002. Additional new hotel-casinos and expansion projects at existing Las Vegas hotel-casinos are under construction or have been proposed. In addition, further expansion of Native American gaming in California is likely. We are unable to determine to what extent increased competition will affect our future operating results. . . .

Our Company's facilities also compete for gaming customers with hotel-casino operations located in other areas of the United States and other parts of the world, and for vacationers with non-gaming tourist destinations such as Hawaii and Florida. Our hotel-casinos compete to a lesser extent with state-sponsored lotteries, off-track wagering, card parlors, and other forms of legalized gaming in the United States. In recent years, certain states have legalized, and several other states have considered legalizing, casino gaming. We do not believe that legalization or expansion of casino gaming in those jurisdictions would have a material adverse impact on our operations. However, we do believe that the legalization of large-scale land-based casino gaming in or near certain major metropolitan areas, particularly in California, could have a material adverse effect on the Las Vegas market.

Source: MGM Mirage December 31, 2003 10-K (Item 1—Description of Business).

Panel B: Excerpts from Mandalay Resorts January 31, 2004 10-K (Item 1—Description of Business)

Our core market is Las Vegas, the world's largest gaming market, where our properties are expected to generate approximately 75% of our operating income in fiscal 2005. We have the largest-scaled hotel/casino resort development in Las Vegas. This "Mandalay Mile" consists of three interconnected megaresorts on 230 acres, and includes our flagship property, Mandalay Bay. . . .

The hotel and casino industry is very competitive and the level of competition has increased as gaming has expanded dramatically in the United States in recent years. Forms of gaming include: riverboats; dockside gaming facilities; Native American gaming ventures; land-based casinos; state-sponsored lotteries; racetracks, including slot machines at racetracks; off-track wagering; Internet gaming; and card parlors.

Since 1990, when there were casinos in only three states (excluding casinos on Native American lands), gaming has spread to a number of additional states. In addition, other states have considered, or may in the future consider, legalizing casino gaming in specific geographic areas within their states.

Many Native American tribes throughout the United States, including tribes in California and Arizona, conduct casino gaming and other Native American tribes are either in the process of establishing, or are considering establishing, gaming at additional locations. On March 7, 2000, California voters approved Proposition 1A which amended the California constitution and legalized "Nevada-style" gaming on Native American reservations. The passage of this amendment has allowed the expansion of existing Native American gaming operations, as well as the opening of new Native American gaming facilities, in California. . . . Many Native American gaming facilities in California are modest compared to the larger Las Vegas and Reno casinos. However, some Native American tribes have established large-scale hotel and gaming facilities in California. Numerous tribes are at various stages of planning new or expanded facilities and some have announced that they are in the process of constructing, developing or are considering establishing large-scale hotel and gaming facilities. We believe the operation of Native American casinos in California and Arizona has adversely impacted our gaming operations in Nevada, particularly our properties in Reno, Laughlin and Jean.

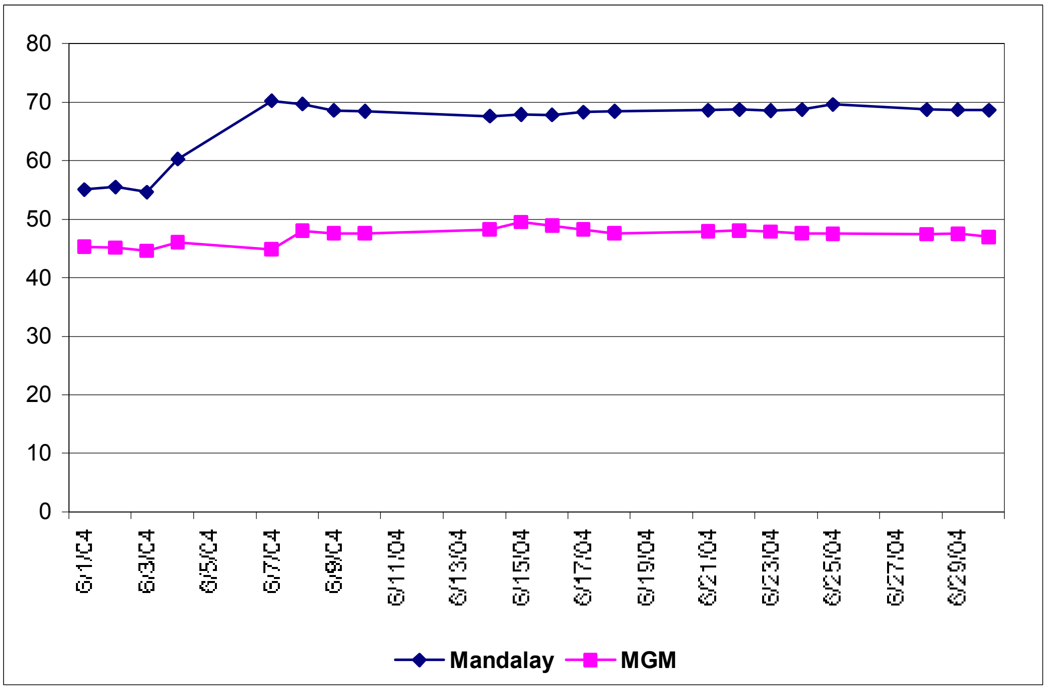
The competitive impact on Nevada gaming establishments, in general, and our operations, in particular, from the continued growth of gaming in jurisdictions outside Nevada cannot be determined at this time. We believe that the continued growth of casino gaming in markets close to Nevada, such as California and Arizona, and the expansion of the types of gaming permitted in California could have an adverse impact on our operations and, depending on the nature, location and extent of those operations outside of Nevada, the impact could be material.

. . . We are the largest hotel operator in Las Vegas (with three of our resorts ranking among the five largest in Las Vegas) in terms of the number of guest rooms. Our hotel-casino operations in Las Vegas, which are conducted primarily from properties located along the Las Vegas Strip, currently compete with numerous other major hotel-casinos and a number of smaller casinos located on or near the Las Vegas Strip. Our Las Vegas operations also compete with a dozen major hotel-casinos located in downtown Las Vegas, and other hotel-casinos elsewhere in the Las Vegas area, including our own Railroad Pass in the suburb of Henderson. To a lesser extent, our Las Vegas properties also compete with casino and hotel properties in other parts of Nevada, including Laughlin, Reno and along I-15 (the principal highway between Las Vegas and southern California) near the California-Nevada state line. Our Las Vegas casinos also compete with Native American casinos in southern California (the principal source of business for Las Vegas casinos, including our own) and central Arizona and, to a lesser extent with casinos in other parts of the country.

Construction is underway on a major new hotel-casino in Las Vegas, as well as on significant expansion projects at several existing Las Vegas properties. These projects will add roughly 5,000 rooms, as well as additional casino capacity, to the Las Vegas market over the next two years. The Las Vegas market currently has approximately 130,000 rooms. Additional expansion projects have been proposed and are anticipated in the future. The impact on our future operations of increased capacity in Las Vegas, or the impact of additional growth in Native American gaming, particularly in southern California and Arizona, cannot be determined at this time.

Source: Mandalay Resort Group January 31, 2004 10-K (Item 1—Description of Business).

Exhibit 3 MGM's and Mandalay's Stock Price throughout the Merger Negotiations



Source: Created by casewriter from company data.