

January 19, 2016

A Report by UNITE HERE

Jason Kordosky
jkordosky@unitehere.org

Do You Want to Be a Second-Class Shareholder of Red Rock Resorts?

This report examines the proposed corporate governance of Red Rock Resorts, which will make public investors second-class shareholders.

Public investors buying Class A shares in the Red Rock Resorts IPO will have all the risk of investing with no control over the company. The company is establishing a dual-class ownership structure with a super voting stock provision and other constraints on shareholder action that will lock in the Fertitta family's control of the company.

Fundamental corporate governance concerns for outside shareholders

Red Rock Resorts is proposing a corporate governance structure that will severely limit non-Fertitta shareholder influence. Public investors will have no control over the corporate governance of the company and how the company is run, including:¹

- Elections of the board of directors or the filling of vacancies on the board.
- Changes to the company's certificate of incorporation and bylaws.
- The approval of any merger or asset sales.
- The outcomes of stockholder actions by written consent.
- The outcomes of special meetings of stockholders.
- Transactions with related parties.
- Future issuances of common or preferred stock as well as terms and conditions.

Dual-Class Structure

Upon consummation of the IPO, Red Rock Resorts will have a dual-class ownership structure consisting of Class A and Class B shares voting as a single class. Public investors will be able to purchase Class A shares, while existing owners of Red Rock Resorts will be given Class B shares paired with their LLC Units in Station Holdco LLC.

Class A shareholders will have the right to one vote per share. Class B shareholders also have one vote per share, with one important exception. Any Class B shareholder who (1) owned at least 30% of the outstanding LLC Units immediately following the public offering and (2) maintains direct or indirect ownership of at least 10% of the outstanding Class A shares, will be entitled to 10 votes per share.

Since the Fertittas, through affiliates, are currently the only owners of Station Holdco who own over 30% of the LLC Units, the "super voting stock" provision will only apply to them, assuming they maintain at least 10% of Class A shares after the IPO. Owning 30% of LLC Units is not an ongoing requirement, which means the Fertitta family can continue to sell them while maintaining 10:1 voting rights.

	Voting Rights	Who Can Own These
Class B Shares (to be issued to existing holders of Holdco LLC units): voting rights, with no economic interest in SCC.	10 votes per share	Existing Holdco owners who own at least 30% of Holdco LLC units and maintain 10% ownership of Class A shares. Only the Fertittas can qualify because they, through affiliates, currently own 54.8% of Holdco. The next largest owner is Deutsche Bank's GACC at 25%.
	1 vote per share	Other existing Holdco owners
Class A Shares (to be issued through the IPO): entitled to all economic interest in SCC.	1 vote per share	Red Rock Resorts employees with profit units, Red Rock Resorts warrant holders, existing Holdco owners who exchange their LLC units (along with their Class B shares), IPO investors.

While the S-1 filing does not yet lay out the exact post-IPO numbers of LLC units, Class B shares, and Class A shares, the registration statement makes it abundantly clear that the Fertittas will control the company:

Affiliates of Frank J. Fertitta III, our Chairman and Chief Executive Officer, and Lorenzo J. Fertitta, a member of our board of directors, will hold the substantial majority of our issued and outstanding Class B Common Stock having ten votes per share. As a result, the Fertitta family will be able to control any action requiring the general approval of our stockholders, including the election of our board of directors, the adoption of amendments to our certificate of incorporation and bylaws and the approval of any merger or sale of substantially all of our assets. Accordingly, we will be a "controlled company."²

Investors At Risk

Studies show that dual-class structures can affect return for non-controlling shareholders. According to a 2012 study by the Investor Responsibility Research Center Institute (IRRCI) and Institutional Shareholder Services (ISS):

- Non-controlled companies outperformed controlled firms with multiclass capital structures over the three-year, five-year, and 10-year periods.³
- Control companies with multiclass structures consistently exhibit materially more share price volatility than non-control companies.⁴

New Study Says Multiclass Voting Companies Underperform, Riskier
IRRCI, ISS 10/02/12

While technology companies are fans of dual-class offerings, the result for investors is variable. The Groupon IPO is one example, which saw a brief upswing in share price after the initial offering in November 2011, but was back below the IPO price by February 2012 and has remained below ever since. As of December 2, 2015, Groupon shares were trading 85% below the initial offering price.⁵ Public investors who take issue with the inexperience of Groupon's CEO or the company's accounting practices have no way to change either.⁶

A dual-class structure is rare in hospitality companies. There are no dual-class structures among significant publicly traded gaming companies currently, and almost none in hotel companies. A 1990s vote of shareholders prevented Marriott International, the largest hospitality company, from becoming dual-class.⁷ That gave Marriott an important edge in the recent bidding contest to acquire Starwood Hotels against a bidder with dual-class shares. Crain's Business made the cost clear: "Shares with reduced voting rights make an unattractive buyout currency."⁸ The losing bidder in this case will be one-sixth the size of a combined Marriott-Starwood, a factor for investors in a consolidating hospitality industry.⁹

"Shares with reduced voting rights make an unattractive buyout currency."
Crain's Chicago, 11/18/15

Other Anti-takeover Devices

The newly formed Station Casino Corp. will include other anti-takeover provisions in addition to the dual-class structure and super voting stock described above. Although the company will allow shareholder action by written consent and special meetings of shareholders, these rights are only permitted when the *Fertitta Ownership Condition* is satisfied. The *Fertitta Ownership Condition* is satisfied as long as the Fertitta family owns at least 10% of the outstanding shares of Class A Common Stock. This is part of the same requirement that allows the Fertittas to exercise super voting with their Class B shares. In other words, the shareholders can request action by written consent and the board can call special meetings as long as the Fertittas control a disproportionate portion of the votes.

Red Rock Resorts has also set up a super majority approval provision if and when the Fertittas no longer own 10% of Class A shares. When the *Fertitta Ownership Condition* is not met, a 2/3 affirmative vote is required to amend the company's bylaws and certificate of incorporation, approve mergers, and other similar actions. ISS categorizes super majority provisions as Control Enhancing Mechanisms to lock in control.¹⁰ This provision works to limit stockholders from making changes to the company, even if the proposed changes are in the best interest of the company and public shareholders.

Finally, Red Rock Resorts has augmented Section 203 of Delaware General Corporation Law, an anti-takeover provision. Section 203 prevents the company from engaging in business mergers with interested stockholders. In its place, the company states:

[O]ur amended and restated certificate of incorporation will contain provisions that have the same effect as Section 203, except that they provide that the Fertitta Family Entities will not be deemed to be 'interested stockholders,' regardless of the percentage of our voting stock owned by them, and accordingly will not be subject to such restrictions.¹¹

In other words, the Fertittas set it up so they are exempted from Section 203, while all other stockholders are subject to it. This provision is not academic, as the Fertittas have moved Station Casinos' entities in and out of the public markets before.

Director Independence

Red Rock Resorts states its board will include three directors it considers independent: Dr. James E. Nave, D.V.M., Robert E. Lewis, and Robert A. Cashell, Jr.

Nave, Lewis, and Station Casinos' 2009 Bankruptcy

Dr. Nave and Mr. Lewis are long-time associates of the Fertitta family. Dr. Nave has served on the board of Station Casinos since 2001 and Mr. Lewis has served on the board of Station Casinos since 2004. Dr. Nave served on the Nevada Athletic Commission (NAC) from 1988 to 1999 – during the emergence of the Ultimate Fighting Championship, a Fertitta-owned sports company – and chaired the regulatory body from 1989 to 1992 and 1994 to 1996. Lorenzo Fertitta served on the NAC with Dr. Nave for three years during the late nineties.

Nave and Lewis were also part of the board of former Station Casinos Inc. when it allowed “excessive” equity compensation despite opposition from outside shareholders. As far back as 2005, Glass Lewis, an independent adviser to large institutional investors, had called Station Casinos’ stock compensation plan “among the most expensive and liberal we have reviewed” and an “excessive transfer of wealth” to insiders.¹² The company added \$3.3 billion of new debt in 2006 and 2007, with \$990 million of this new debt going toward share buybacks to offset dilution from stock options and restricted shares given to insiders. Another \$1.6 billion of new debt was added to finance a 2007 leveraged buyout in which insiders cashed out over \$660 million, including \$3.64 million by Nave and \$1.58 million by Lewis. These decisions contributed to Station Casinos’ Chapter 11 bankruptcy filing in 2009.¹³

“The Company’s equity-based compensation practices are among the most expensive and liberal we have reviewed.”
Glass Lewis, 5/04/2005

Cashell and Deutsche Bank

Mr. Cashell has served on the board of Station Casinos since 2011 when he was selected as German American Capital Corporation’s (GACC) at-will designee to own 38.58% of Station Voteco LLC, the pre-IPO sole voting member of Station Casinos LLC. Cashell therefore controls 38.58% of the voting power at Station Casinos. At the time, Cashell was paid \$75,000 by Deutsche Bank (the parent company of GACC) to undergo licensing investigation and suitability review by Nevada gaming regulators.¹⁴ Given Deutsche Bank’s multiple levels of transactions with Station Casinos – i.e. existing large LLC unit holder, lender, and IPO underwriter – we question Cashell’s independence and his ability to represent the interests of both a current and future LLC unit holder (as GACC is not selling all of its ownership interest) and new public investors who will hold the Class A shares.

For example, the proposed IPO will create a tax receivable agreement whereby Red Rock Resorts (and its shareholders) will only receive 15% of certain tax benefits arising from the IPO, while the other 85% will go to current Red Rock Resorts owners (including GACC). Did Cashell vote to approve this unequal agreement both as a member of the board of directors of Red Rock Resorts and a member of the board of managers of Station Casinos LLC? If so, whose interests did he represent? Secondly, did Cashell vote to approve retaining Deutsche Bank as the lead IPO underwriter, despite the conflict of interest “deemed to exist” under FINRA Rule 5121?¹⁵

To the extent that GACC continues to hold interests at multiple levels of our capital structure, it may have a conflict of interest and make decisions or take actions that reflect its interests as our secured lender, unsecured lender or equityholder that could have adverse consequences to our other stakeholders. See "Underwriting (Conflicts of Interest)."¹⁶

Third, the board of Red Rock Resorts, including Cashell, has already agreed to fix the Fertittas' compensation for two years following the offering:

[T]he limited liability company agreement will provide that the aggregate non-equity compensation of Frank J. Fertitta III will not change for two years following the consummation of this Offering, the aggregate non-cash compensation of Lorenzo J. Fertitta shall be fixed at \$500,000 for two years following the consummation of this Offering and, for so long as GACC and its affiliates beneficially own at least 5% of the outstanding Class A Common Stock of the Company (determined on an as-exchanged basis assuming that all of the LLC Units were exchanged for Class A Common Stock), the aggregate non-equity compensation payable for the second year following the consummation of this Offering to all other executives and employees employed by Fertitta Entertainment prior to the consummation of this Offering will not exceed 105% of the aggregate non-equity compensation received by such individuals, in the aggregate, during the first year following the consummation of this Offering.¹⁷

This statement implies that GACC has some relationship to the executive compensation framework disclosed in the IPO prospectus filings. Whose interests does Cashell represent?

Also, Deutsche Bank will hold Class B shares and thus wield voting power at the new Red Rock Resorts. We think this should subject it to Nevada licensing requirements, but Cashell (and the other directors) have not required the company (or its underwriters, including Deutsche Bank) to disclose in its IPO filings that Deutsche Bank has had recent and substantial regulatory problems and that its subsidiary's felony plea represents a risk in the context of operating in Nevada's highly regulated gaming industry. We have asked the SEC to require full disclosure of these regulatory risks to potential investors, and investors should review the concerns we raised before committing to participate in the IPO. See [Summary of SEC Disclosure Letter](#).

(We note that Red Rock Resorts added a paragraph in its first amendment to the S-1 regarding the potential risk that "significant stockholders" or "members of Holdco" may be required by Nevada gaming authorities to liquidate their equity holdings and the negative effects this could have on Class A shares or the company's overall financial health.¹⁸)

The Fertitta Entertainment Acquisition

Finally, Nave and Lewis comprised the special committee of the board of managers of Station Casinos LLC that recently negotiated the Fertitta Entertainment acquisition, in which Station Casinos will purchase the management company owned by the Fertitta family for \$460 million.¹⁹ While it will pay a substantial amount of cash to the Fertittas and other top company executives, it is not clear what benefits Station Casinos LLC derives from the transaction. The price is 8.9 times the trailing-12-month management fee the firm receives from Station Casinos, while its management agreement covering 13 of the 19 managed properties provides for a termination fee of 1x TTM management fee upon third-party sale of the properties. And Fertitta Entertainment, whose only existing business is to manage Station Casinos' properties, will not generate any

revenues after the acquisition, which effectively “internalizes” management by retaining existing executives. Moreover, this acquisition pays out substantial IPO proceeds to the Fertittas that could otherwise be used to buy out completely Deutsche Bank, which poses licensing risks because of its recent and mounting regulatory problems. See [First Class Risks, Second Class Shares](#).

Whether or not public investors consider each of the three non-Fertitta Directors independent enough to represent new investors’ interests after the IPO of a company riddled with potential conflicts of interest, Red Rock Resorts has stated:

Although we expect that a majority of the members of our board of directors will be independent and that our compensation and nominating and corporate governance committees will be comprised entirely of independent directors, in the future we may elect not to comply with certain corporate governance requirements that are not applicable to controlled companies.²⁰

Corporate governance in an IPO reflects the value current owners place on investment from outside investors. Red Rock Resorts’ current owners have chosen second-class status for new public investors in their company. Will you choose to be a second-class shareholder?

Notes

¹ Red Rock Resorts, Inc. SEC Form S-1/A. January 14, 2016. Prospectus cover page, Pp. 34-35, 39-41, 164-166.

² Red Rock Resorts, Inc. SEC Form S-1/A. January 14, 2016. Prospectus cover page.

³ IRRC Institute and Institutional Shareholder Services. Controlled Companies in the Standard & Poor’s 1500: A Ten Year Performance and Risk Review. October 2, 2012. P. 8. <http://irrcinstitute.org/reports/new-study-says-multiclass-voting-companies-underperform-riskier/>

⁴ IRRC Institute and Institutional Shareholder Services. Controlled Companies in the Standard & Poor’s 1500: A Ten Year Performance and Risk Review. October 2, 2012. P. 3. <http://irrcinstitute.org/reports/new-study-says-multiclass-voting-companies-underperform-riskier/>

⁵ Google Finance. Groupon Inc. <https://www.google.com/finance?q=NASDAQ:GRPN>. Accessed on December 2, 2015.

⁶ Poletti, Theresa. IPO investors: Beware the dual-class stock. MarketWatch. April 5, 2012.

<http://www.marketwatch.com/story/ipo-investors-beware-the-dual-class-stock-2012-04-05>

MarketWatch. SEC probe may pressure Groupon CFO. MarketWatch. April 3, 2015.

<http://www.marketwatch.com/story/sec-probe-may-pressure-groupon-cfo-2012-04-03>

⁷ Marriott Holders Vote Against Revamping Stock. New York Times. May 21, 1998.

<http://www.nytimes.com/1998/05/21/business/marriott-holders-vote-against-revamping-stock.html>

⁸ Crain’s Chicago Business. November 18, 2015.

<http://www.chicagobusiness.com/article/20151118/BLOGS10/151119855/hyatts-lost-hotel-deal-spotlights-the-pritzkers-dilemma>

⁹ Karmin, Craig, and Liz Hoffman. Marriot Wins Battle to Buy Starwood. Wall Street Journal. November 16, 2015.

<http://www.wsj.com/articles/marriott-to-acquire-starwood-hotels-resorts-1447673866?alg=y>

Crain’s Chicago Business. November 18, 2015.

<http://www.chicagobusiness.com/article/20151118/BLOGS10/151119855/hyatts-lost-hotel-deal-spotlights-the-pritzkers-dilemma>

¹⁰ Institutional Shareholder Services 2006. Report on the Proportionality Principle in the European Union. P. 5.

http://ec.europa.eu/internal_market/company/docs/shareholders/study/final_report_en.pdf

¹¹ Red Rock Resorts, Inc. SEC Form S-1/A. January 14, 2016. P. 166.

¹² Abaya, Lael. Glass Lewis & Co. Proxy Paper: Station Casinos, Inc. May 4, 2005. Pp. 9, 11.

¹³ Culinary Workers Union Local 226. A Postmortem: How Station Casinos Insiders Drove the Company into Bankruptcy. November 19, 2009. http://www.stationipodissected.org/wp-content/uploads/091119_Report_Postmortem-of-STN-bankruptcy_FINAL.pdf.

¹⁴ Nevada Gaming Control Board. Transcript. May 26, 2011. Pp. 58-59.

¹⁵ Red Rock Resorts, Inc. SEC Form S-1/A. January 14, 2016. P. 16.

¹⁶ Red Rock Resorts, Inc. SEC Form S-1/A. January 14, 2016. P. 35.

¹⁷ Red Rock Resorts, Inc. SEC Form S-1/A. January 14, 2016. P. 153.

¹⁸ See p. 42 of January 14, 2016 S-1/A: "Moreover, if any of our significant stockholders or members of Station Holdco is required to, but does not, apply for a finding of suitability or licensing or is found unsuitable by the Nevada Commission, they may rapidly liquidate their equity holdings, which could cause the market price of our Class A Common Stock to decline. Additionally, we could be required to repurchase any shares or LLC Units held by such significant stockholder or member for cash, notes bearing interest at the applicable federal rate or a combination of cash and notes. In the event that we were required to repurchase shares for cash, our cash position would be reduced and our liquidity and financial condition could be materially adversely affected. There can be no assurance that we would have sufficient cash available to meet such obligation as well as our continuing operating requirements or that, if additional financing were required, that such financing could be obtained on terms acceptable to us, if at all."

¹⁹ Red Rock Resorts, Inc. SEC Form S-1/A. January 14, 2016. P. 54.

²⁰ Red Rock Resorts, Inc. SEC Form S-1/A. January 14, 2016. P. 132.