



MOHEGAN SUN CASINO, ON THE MOHEGAN TRIBE RESERVATION, CONNECTICUT

IN THE NEWS

Understanding Return on Investment Part 2: How Can ROI Be Used by a Tribe?

by Jeffrey Heimann

Over the summer, we started a series of monthly newsletters in which we focus on the topic of understanding return on investment, or ROI. The first article provided an overview of ROI, what it means and how it is calculated. This second article focuses on how to apply ROI and other similar investment tools in a Tribal context.

A Tribe we recently worked with asked us for assistance in evaluating the merits of an investment involving a hotel property. While many factors need to be considered in making a decision of this nature – what is the underlying risk, how will it be financed, what is the investment time horizon, what other financial obligations does the Tribe have, etc. – the core question in which to balance these factors is, how much will the investment make for the Tribe?

Using a set of management forecasts for the hotel property (and for the purpose of this article, ignoring the fact that actual

performance will differ from forecasted performance), we were able to show the Tribe how much it could expect to receive each year in the form of cash distributions from the investment. In this case, a \$50 million purchase price was to be financed with a cash investment of \$10 million from the Tribe and \$40 million borrowed from a bank. After servicing the bank loan debt and providing for a capital expenditure reserve to maintain the quality of the property, the investment was projected to increase distributions to the Tribe by over \$2 million the first year and growing slightly each year thereafter.

To complete the analysis of an ROI, we then made assumptions about when and for how much the Tribe would sell its hotel property investment. Given that Tribes tend to have long investment horizons, we projected out 25 years. Based on moderate growth in the performance of the hotel, we estimated the net sales proceeds after repaying the loan at the

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Above: Tribal Board of Advisors Member, Valerie Spicer, speaking during AIGA in November.

North Dakota Tribe to Drill Own Oil Wells

11/25/14 – HuffingtonPost.com

Mohegan Sun Interested in Adding a Gaming Facility in Connecticut

11/11/14 – CTMirror.org

Pala Interactive Live in New Jersey with PalaCasino.com

11/25/14 – iGamingBusiness.com

Beyond Gaming: Tribal Casinos Look at Alternatives to Boost Revenues

11/25/14 – GGBMagazine.com

'Discussion's Coming' on Florida's Difficult Gaming Deal

11/25/14 – BizJournals.com

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end of year 25 would be approximately \$40 million. The return on the Tribe's initial \$10 million investment then, when accounting for each year's distributions and the "exit value" of \$40 million, was an attention-grabbing 1,015%!

Of course, the above view is simplistic and represents just the beginning of the analysis. An important factor for any investment is understanding what the projected annual rate of return is. In the above example, when we factor in the investment cost to the Tribe, each year's distribution to the Tribe, and the exit value, we calculated the projected rate of return at 23.8%. Basically, the rate of return is simply adjusting the ROI to an annual metric.

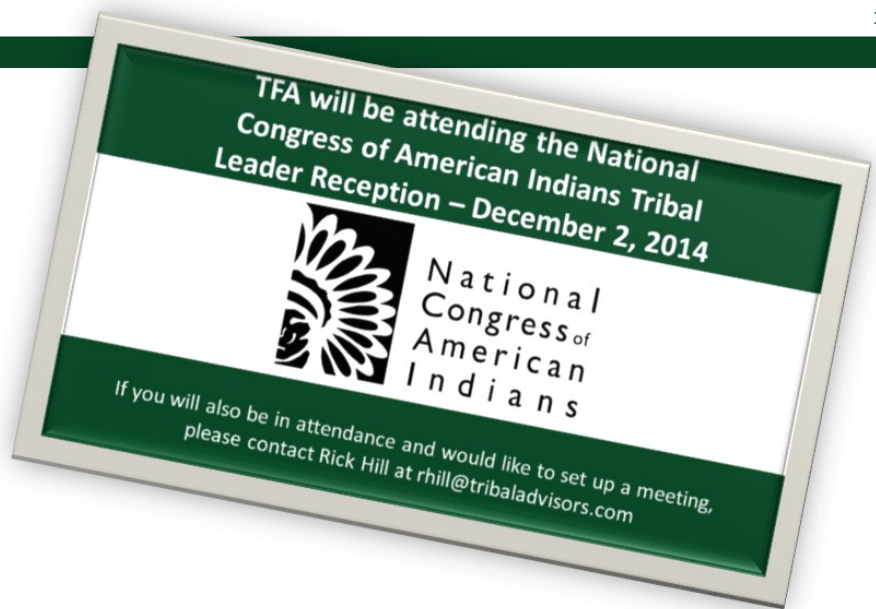
Next, we switched gears a bit to answer the question of, how much better off will the Tribe be financially if it were to make the hotel investment (assuming performance matched the projections)? The simple answer is that over the 25 year time horizon, the Tribe would make about \$100 million in excess of its investment. A more common approach, however, is to apply a "discount factor" to account not just the time value of money but also the risk associated with achieving the projected cash flows. Discount factors are highly subjective, but generally for a hotel investment a discount rate in the range of 9% to 11% is reasonable. Using 10% then results in a "net present value" of \$17 million – essentially, the discounted value of the \$100 million in-

crease in projected cash flows to current dollars after accounting for risk and time value of money.

Finally, we took yet another approach so the Tribe could think about the investment opportunity somewhat differently: what is the pay-back period of the investment? In other words, how long will it take for the projected increase in distributions to the Tribe to pay back the original \$10 million investment? In this case, about halfway through the fifth year (56 months after the investment), the Tribe and made back the initial investment, and the rest is all profit.

While the above metrics are very useful tools to use when contemplating an investment, many considerations exist and need to be thoroughly analyzed. In fact, of the above only the NPV analysis incorporated the concept of risk into the equa-

tion, and even that was based on a highly subjective discount number. At the end of the day, however, the Tribe's decision makers have to ask themselves the question, does the return of investment appropriately compensate us for the risks and opportunity costs associated with the investment? Having a well-thought out ROI analysis certainly helps in answering such a tough question.



TRIBAL FINANCIAL ADVISORS INCORPORATED

TFA

400 Continental Boulevard
Suite 320
El Segundo, CA 90245
tribaladvisors.com

KRISTI JACKSON
VICE CHAIR and CEO
310.341.2335
kjackson@tribaladvisors.com

JEFF HEIMANN
MANAGING DIRECTOR
310.341.2518
jheimann@tribaladvisors.com

DAVID HOWARD
PRESIDENT
310.341.2795
dhoward@tribaladvisors.com

WILLIAM CRADER
MANAGING DIRECTOR
310.341.2336
wcrader@tribaladvisors.com

TRIBAL BOARD OF ADVISORS

RICK HILL
CHAIRMAN
310.341.2796
rhill@tribaladvisors.com

BOARD MEMBERS
BRIAN PATTERSON
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