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**Financing New Slot Machines—Evaluating Buy or Lease Options**

by David Howard

As many Tribes investigate upgrading their casinos' slot floors in order to fend off increasing competition or simply drive more cash flow to the bottom line, we thought we would share the math behind the evaluation to buy or lease new machines.

For our example, we will assume the following: the Tribe has proven demand for 100 new slot machines; the purchase price of the machines is \$20,000 per device; the financing rate is 5% per year; and the new machines are expected to produce a win per unit of \$150 per day. Let's calculate the return:

**Slot Purchase Analysis**

(\$ in millions)

Purchase Price (100 machines x \$20,000)						\$	2.0
Cash Flows	Year						
	1	2	3	4	5		
Slot Win (WPU \$150)	\$ 5.5	\$ 5.5	\$ 5.5	\$ 5.5	\$ 5.5	\$	5.5
Interest Expense (Rate 5%)	(0.1)	(0.1)	(0.1)	(0.0)	(0.0)		(0.0)
Debt Repayment	(0.4)	(0.4)	(0.4)	(0.4)	(0.4)		(0.4)
Cash Flow	\$ 5.0	\$ 5.0	\$ 5.0	\$ 5.1	\$ 5.1		5.1

**Total Cash Flow before Operating Expenses \$ 25.1**

At the end of five years, the Tribe would have repaid the debt in full, would own the machines outright and would have **increased cash flow by over \$25 million**. Note, to keep the analysis simple, we assume that the machines have zero value at the end of the five years and there is no increase to operating expenses.

Now, using the same need of 100 new slot machines, we assume the Tribe leases the machines by paying the vendor 20% of the win per unit:

**Slot Lease Analysis**

(\$ in millions, except per unit amounts)

Lease Amount (100 machines x \$20,000)						\$	2.0
Cash Flows	Year						
	1	2	3	4	5		
Slot Win (WPU \$150)	\$ 5.5	\$ 5.5	\$ 5.5	\$ 5.5	\$ 5.5	\$	5.5
Lease Payment (Rate 20%)	(1.1)	(1.1)	(1.1)	(1.1)	(1.1)		(1.1)
Cash Flow	\$ 4.4	\$ 4.4	\$ 4.4	\$ 4.4	\$ 4.4		4.4

**Total Cash Flow before Operating Expenses \$ 21.9**



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Over the five year period, the total net cash flow is almost **\$22 million**, and because there was no required investment by the Tribe, the rate of return is through the roof.

Although this example is admittedly simplistic, the implication is clear: purchasing the machines, even with debt financing, results in higher cash flow available to the Tribe. This is because the lease payment is significantly higher than the combined principal and interest payments in the purchase option. The lease payment is the equivalent of paying over 46% in interest expense versus 5% on the borrowed money, a very lucrative return for the vendor.

As with any business decision, there are numerous factors to consider, including:

- **Funding availability for a purchase.** Does the Tribe have access to either excess cash (this is a much better return than a typical investment portfolio) or access to borrow the necessary capital to purchase slot machines? Unlike when Tribes were first seeking capital to finance slot machine purchases, today most banks are willing to provide less expensive loans to fund slot machine purchases.
- **Expected Win per Unit.** Because the lease payment is tied to WPU, the vendor “shares the pain” with the Tribe in the event the WPU is lower than

expected. However, these leases typically have a lot of cushion built into them. For example, based on the scenarios presented here, the WPU would need to be approximately \$60 per day for the two scenarios to generate similar net cash flows.

- **Tribe’s risk tolerance:** We would be remiss not to point out that by purchasing the slot machines, the Tribe bears all the risk for their performance. If the machines perform well, the Tribe captures most of the benefit from owning the machines. However, if the machines underperform, the Tribe would have the burden of debt without the cash flow to repay it. A benefit to lease arrangements is that the risk of performance is primarily borne by the investor financing the slot machine purchase—which explains why investors typically demand 20% or higher revenue sharing agreements.

Clearly, benefits exist to both purchasing and leasing machines – we hope this example provides a sound framework by which to start evaluating your Tribe’s options. Understanding the cost of capital and the risk of a project remains a key component to maximizing the cash flow available to Tribes.



TFA will be attending this upcoming conference. Please reach out to us if you will be there and would like to arrange a meeting.

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