

Headline News:

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6/24/14: The Bay Mills Case: An Opportunity for Native Nations (indiancountrytoday.com)

6/25/14: Court Agrees with Tribe on Gaming Compact, Poker Dispute (indiancountrytoday.com)

6/30/14: Mohegan Sun Submits License Application to New York State Gaming Commission (providencejournal.com)

Understanding Return on Investment - Part 1: What is it?

by Jeff Heimann

Similar to last month's article which marked the first in a series of articles focused on key attributes of credit agreements, this month's article marks the first in a series in which we will focus on the investment concept and comparison tool, return on investment.

Return on investment, or ROI, is a one of several methods often used to objectively evaluate an investment opportunity. The return on investment concept is simple – it provides an owner or investor an ability to evaluate the financial merits of an opportunity and, when applied consistently across investment opportunities, it provides the investor an easy way to compare the financial merits of several opportunities. In the financial world, the project with the best ROI should theoretically be given the highest priority. In the tribal sector, however, ROI is only one of many considerations for a project – political and social considerations often trump ROI considerations.

Understanding the ROI concept is one thing, but actually calculating it can be a little more complicated. The ROI formula is such that ROI equals the net gain from an investment (i.e., the total amount received from the sale of the investment plus any dividends or distributions received along the way less the total cost of the investment plus any incremental amounts invested along the way) divided by the total cost of the investment (also including any incremental amounts invested along the way).

A simple example of calculating ROI would be to imagine investing in coffee shops. Roughly a year ago, you could have bought 10 shares of Starbucks stock for \$66 each, or a \$660 total cost. If you sold them about one year later, you could have received \$78 each, or \$780, plus dividends over the year of \$1 per share, or another \$10 (10 shares x \$1/share dividend), for a total of

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TFA will be attending the Northwest Indian Gaming Conference and Expo in Shelton, WA - July 14-16



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\$790. Ignoring stock commission costs and taxes for this exercise, the ROI equals the \$130 gain (\$790 less \$660) divided by the \$660 in total cost, or about 20% ROI.

Sometimes it is not that easy to calculate an expected ROI. In the above Starbucks example, small-time stock investors don't actually model out projected cash flows for a company like Starbucks before making a decision whether to invest in Starbucks' stock; however, the big investment funds certainly do. And that gives them an edge over the investors that don't do their homework. It is important to understand all the underlying factors and risks that contribute to the cash flows being used to calculate an investment's ROI.

An example more relevant for a tribe may be where a tribe is evaluating an opportunity to buy a hotel for \$20 million that will require \$1 million of closing costs plus \$9 million of capital expenditures to improve the quality of the hotel rooms. In this example, the total cost of the investment is expected to be \$30 million. To evaluate the ROI on this project, the tribe presumably has a projection model for the anticipated performance of the hotel as well as an idea of when, and for how much, the tribe will be able to sell the property. Let's say this model suggests that in years two through five, the investor will receive \$3 million per year in profit, and at the end of year five,

will be able to sell the hotel for \$40 million (net of closing costs).

In the above example, the ROI equals the \$52 million net gain from the investment (\$40 million sale plus \$12 million profits over years two through five) less \$30 million total cost for net gain of \$22 million divided by \$30 million total cost, or an ROI of 73% (before any taxes).

In evaluating the two examples above, one key take away is that the hotel investment appears to be a much better investment given an ROI of 73% versus the Starbucks ROI of 20%; however, what ROI does not take into account are the concepts of risk and time. Risk can be complicated to analyze or describe, but the basic concept is considering what the likelihood is of actually receiving the projected cash return. With respect to the impact of time, the Starbucks example was 20% ROI over 1 year, whereas the hotel example was 73% ROI over 5 years, which is closer to 13% per year. There are several other nuances to consider when evaluating returns, but this article provides a framework by which to consider evaluating investment opportunities. Over our next articles on the subject, we will go into further discussions on understanding various investment tools and how to use them appropriately.

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