

Headline News:

2/27/12: Tribal gaming facing dual expansion threat (gamblingcompliance.com)

2/23/12: Tribe to buy out FireKeepers management (battlecreekenquirer.com)

2/22/12: New hotel tower at Seneca Allegany under budget, ahead of schedule (www.oleantimesherald.com)

2/15/12: Foxwoods marking 20th anniversary today (www.norwichbulletin.com)

2/7/12: Senate Panel rejects slot restrictions (www.news-press.com)

2/1/12: North Carolina closes in on Las Vegas style gaming (www.cardplayer.com)

Diversification — How does a Tribe Prioritize its Opportunities?

By Kristi Jackson

While tribal gaming has provided a much needed economic boost for many tribes across the country, it has not proved to be a “cure-all” for what is ailing tribal economies and limiting tribal government spending. Once thought to be relatively immune from economic downturns, the gaming industry is now understood to be highly dependent upon consumer discretionary spending. Further, with state governments expanding gaming to address budget deficits, competition is markedly increasing. These factors have left tribal gaming revenue vulnerable and make the need for tribes to diversify their economic bases an even more urgent priority. Economic diversification sounds good, but practically, how do you start? The answer lies in prioritization – ranking things according to importance.

Okay, but who decides what is important? In a tribal context, this answer can get a bit convoluted. Competing agendas and politics often play a significant role. Additionally, dollars are finite. Making one investment may in-

volve putting another perfectly good opportunity aside.

We are finance people – one way to prioritize is to look at the math surrounding various economic development opportunities. Or said another way, what project offers the best cash return for a tribe and how much risk is the tribe taking in pursuing the project? Financial advisors often consolidate return and risk considerations into a “risk adjusted return” to account for both the upside and downside potential of any investment. The first step in evaluating an opportunity is to determine all of the cash flows of the proposed project, both required inflows (cash required to fund the project) and projected outflows (cash generated by the project). Just as important, tribes should consider the time-frame over which these cash flows occur. This takes research, knowledge of the opportunity and sector, and a little educated guesswork. With the cash flows organized, they can then be compared to alternatives and adjusted for risk. A

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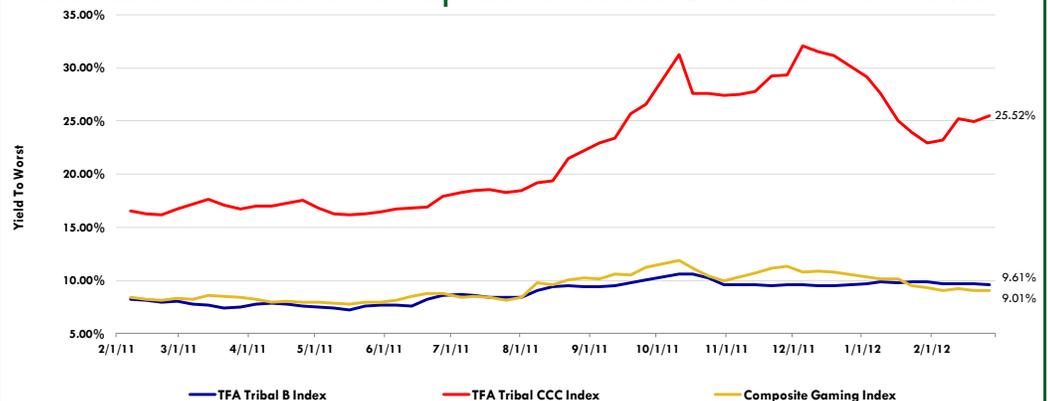
Pauma Band of Luiseño Indians

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TFA Index Chart: A Comparison of HY Bond Interest Rates



Source: Wall Street High Yield Research
Notes: Yield to Worst represents the current average interest rate on bonds that comprise each index. Composite Gaming Index represents the average market interest rate of over 80 corporate and Tribal high yield gaming issues

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benefit to relying on the math for prioritization is that there are hard numbers to point to when ranking opportunities. In the tribal context, and assuming the math is based in common sense, this exercise can serve as a solid tool for decision making rather than relying on emotion or catering to competing interests to drive investment outcomes.

Admittedly, the details necessary to arrive at a reasonable set of cash flows are complicated. It can take anywhere from several months to several years to develop a solid, well-researched and thoughtful understanding of a new economic development opportunity. Hiring professionals who are industry experts to advise tribal leadership on the specific business and potentially to manage the business once operational is paramount. Not only can expert advisors help expedite the evaluation process, but the larger the opportunity, the more important it is to get the diligence right to avoid costly missteps.

Overarching all of this is another aspect of capital planning which involves how the economic development project will be paid for – either by using cash, borrowing capital or some combination of both. Even though it sounds responsible to “pay cash” – a significant opportunity cost may exist with using the tribe’s precious cash resources. If funds are withdrawn and used for a new investment, they cannot be utilized elsewhere. The cost of capital, while complicated, can be calculated for a tribe to help with this evaluation. On the other end of the spectrum, using other people’s money may appear attractive; however, sometimes the ultimate cost of borrowing is much

more than initially promised. The devil is in the details and financing options can vary dramatically. Doing the proper diligence on various available financing alternatives is as important as determining the upfront costs of a project. Proper deployment of all forms of capital available to a tribe can result in a broader diversification strategy, which can result in more cash flow available to the tribe and lower overall risk to a tribe’s economy.

In our analyses, a common point of comparison is the case in which you simply “do nothing.” If you do not invest, what is the tribe’s alternative use for the cash? What is the impact on the tribe’s other businesses as a result of the forgone opportunity? In this age of post-credit-crisis conservatism, another alternative use of a tribe’s resources is for debt repayment and lowering the cost of debt versus building or investing in a new project. Evaluating the return implied by retiring debt is oftentimes overlooked when comparing new projects, investments or other opportunities.

Coming up with a fully vetted analysis and a proper value of the cash flows will help guide tribal leadership’s prioritization and decision making. Arm yourself with experts in the disciplines related to the potential economic development opportunity. Utilizing industry specialists, financial advisors and specialized legal counsel offers the tribe protection against poor execution and pursuing projects that do not warrant the investment of the tribe’s resources. Diversification can be a powerful and long-term economic strategy for tribes. By assessing what a tribe’s economic development priorities are and applying the appropriate analysis, these priorities can become reality.

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