



TFA

Monthly Newsletter

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IN THE NEWS

Fish or Cut Bait? Knowing Your Breakeven Point

by Kristi Jackson

We've all heard the story – a business is running below expectation but the forecast is rosy – next year it will turn around and prospects will improve. Clearly, many businesses need time to season and grow the demand for the service/product, or, to differentiate from the competition. Too many others, however, are a drain on resources and kicking the can is just easier than pulling the plug.

Knowing where you stand in this analysis – and making the tough decision is critical to get right before too much time lapses and value erodes.

Simple math is that you break even when your revenues cover your fixed and variable costs of producing the good or service. Revenue is fairly

easy to capture assuming you're collecting the cash and not building an ever-growing receivable. Costs are another story. Many companies can quantify the variable costs because there is raw material and direct labor involved in production for a good or widget sold. If it's a service you're selling and you maintain time sheets, you can quantify much of the variable costs too. Estimating indirect costs, allocating fixed costs and recognizing intangible benefits that are not directly shown on the financials of the business at hand are where things can get complicated. Accounting aside, we note a few of these economic analyses below:

Include the cost of capital – Know your opportunity cost – both what you pay to directly borrow the neces-
(continued on Page 2)

Quapaw Tribe Opens Craft Brewing Company

1/4/18 – JoplinGlobe.com

US Supreme Court Will Not Hear Casino Case

1/8/18 – VineyardGazette.com

Yreka's Rain Rock Casino About to Roll

1/14/18 – MailTribune.com

Indiana's Newest Casino—and First Tribal Casino—Is Now Open in South Bend

1/16/18 – IndyStar.com

Angel of the Winds to Break Ground on \$60M Casino Expansion

1/18/18 – HeraldNet.com

Secretary Zinke Approves the Shawnee Tribe's Fee-to-Trust Application for a Gaming Facility

1/19/18 – DOI.gov

NIGC Finalizes New Rule for Tribal Fees

1/22/18 – Indianz.com

(continued from page 1)

sary capital, and what you are foregoing by allocating capital (or debt capacity) to the business at hand.

Factor in time value of money – Doing this leads you to a breakeven point in time. When the magnitude and risk of cash flows is considered along with when cash flow is realized, you can hone in on a Net Present Value of the business. When you get to a NPV of zero – you’ve truly broken even – you’re covering your cost of capital but not yet making a true profit.

Recognize “Sunk costs” – You’ve spent a large amount building a plant only to have sales lower than expectation. Should you keep factoring in paying back the fixed cost of initial investment if your sales are covering your variable costs? An argument is no – consider the initial cost “sunk” – and focus on the going-forward profitability. If there is no ongoing operating cash flow loss – consider the cash-on-cash return in planning discussions. Be careful in the case where cash flow remains negative of

“doubling down” and getting caught investing more into a losing proposition – putting good money after bad is never advisable.

Understand the ancillary benefits to operating a business – Many Tribes consider adding jobs in the local community a huge social benefit from operating a business. While the P&L may show a loss, considering the number of people put to work and the fact that there may be greater empowerment, growth and fewer government assistance needs as a result may be worth the net cost to the Tribe.

This math can get complicated quickly - particularly when the intangible is factored into the equation. Knowing the breakeven point and then comparing this in a loss scenario, can help isolate the cost of the intangible. As the scope of analysis moves off the spreadsheet, presenting leadership with the facts – break-even, intangible analysis and true costs/return – will aid decision making. We are always available to discuss or provide further refinement or explanation as you work through your own analysis – reach out to us anytime.



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