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An Annual Industry Report // 2010

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Recognized worldwide as the premier provider of consulting services for the gaming, entertainment and hospitality industries, The Innovation Group of Companies has also proven to be the go-to resource for tribes looking for guidance regarding their non-gaming investment interests.

As the current economic environment has prompted a number of our tribal clients to re-evaluate their overall portfolio strategies, our affiliates have been there to offer our experience and leadership... from defining goals and establishing parameters to sourcing potential opportunities and conducting due diligence.

If now is the right time for your tribal community to further the Economic Diversification discussion, contact The Innovation Group of Companies for more information about our strategic advisory services.


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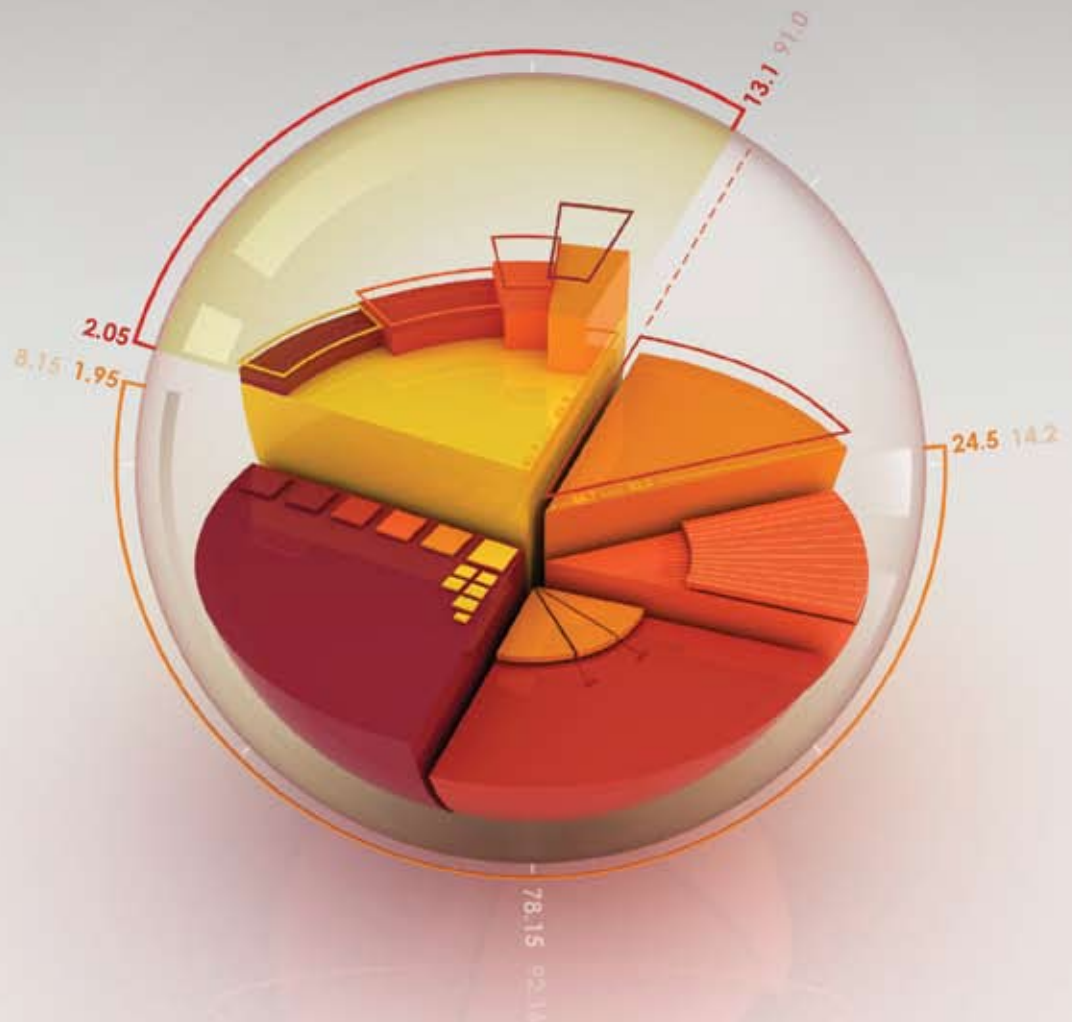


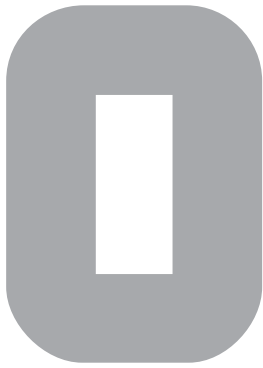
INNOVATION
PROJECT DEVELOPMENT

Tribal Economic Diversification

Leveraging
the
gaming
platform

BY STEPHEN J. SZAPOR, JR.





Over the past few decades, casino gaming has unquestionably been a catalyst for enhancing the economic situations of many Native American tribes. Successful casino operations have created hundreds of thousands of jobs, contributed to substantial development of Native American-owned small businesses, provided millions of dollars to non-gaming tribes through special trust funds, and supported essential tribal programs such as schools, hospitals, water and sewer systems, roads, police and firefighting programs, infrastructure needs, and cultural and social projects.

The lingering effects of the current economic crisis, when combined with the potential for further supply in terms of additional gaming capacity in many markets, will likely keep many gaming markets very competitive for the foreseeable future. As many tribes face the prospect of suppressed profits from casino operations for the next few years, economic diversification strategies will be increasingly important in order to continue to fund programs and grow tribal economies.

JUSTIFYING THE NEED FOR DIVERSIFICATION

Like non-tribal gaming owners and operators, tribes are being forced to address the many challenges in their gaming opera-

tions resulting from the current economic crisis. Across the U.S., gaming revenues are down, in some markets quite substantially, as consumers react to job losses as well as steep declines in their investment portfolios and housing prices.

Anecdotal evidence suggests that the revenue declines casinos are experiencing are a combination of both a cutback in the number of trips that consumers are making and a reduction in their per-trip gaming budgets. In addition, many operators have reacted to the revenue declines they are experiencing by offering more incentives to consumers, thereby putting further pressure on operating margins and profits from their casino facilities.

While there are some encouraging signs that the economy is on the mend, most financial experts agree that the timing and extent of a sustained recovery remain large question marks. When the economy does turn, the question that remains on the minds of many gaming operators is to what extent, and how quickly, consumers return to their pre-economic crisis gaming habits.

Some consumer research that the Innovation Group has completed suggests that a rebound in gaming factors (i.e. number of trips, spend per trip) back to the levels experienced during the 2006-2007 period may be prolonged.

While job growth and job stability are critical factors in getting some consumers back to feeling as if they can participate in gaming like they have in the past, other consumers have experienced such a devastating blow to their net worth and economic situations that their gaming habits may be impaired for a long period of time, thereby keeping the much-anticipated rebound somewhat subdued.

While tribal and non-tribal operators are dealing with the decreases in demand in the industry, there continue to be significant spikes in competition, primarily from new venues. While Maryland and Ohio begin to implement recently passed

legislation and Pennsylvania gears up for table games, other states such as Massachusetts, New Hampshire and Kentucky continue to seriously consider and debate the topic. Additionally, pressure builds as nearby jurisdictions like Bermuda and Jamaica also consider gaming. Finally, i-gaming is receiving serious attention, offering the prospects of even further competition for consumers' discretionary dollars.

Hence, with more supply imminent, demand subdued for the near future and profit margins already under pressure in the gaming industry, there is not only a sense of urgency to improve operational efficiencies but also the need for tribes to diversify their long-term economic and investment strategies.

Tribes with successful gaming operations have the means to discover new potential streams of economic money flow. Historically, many tribes strategically reinvested back into the gaming operations by building hotels, conference centers, golf courses and other amenities that drove incremental gaming trips to the casino.

While the right strategic developments should continue to be considered in order to augment their casino operations or provide a competitive edge, more emphasis needs to be placed on leveraging their success in casino operations into investments in energy, other strategic businesses, and even in public and private enterprises. These investments could help provide tribes with a balanced revenue stream that can be complementary to their gaming operations.

APPROACHING ECONOMIC DIVERSIFICATION

Venturing into new opportunities or lines of business has inherent risks. Tribes are often approached about investing in a wide variety of new business enterprises. Determining which ones are appropriate for a tribe to consider and ultimately invest

in can be a time-consuming and expensive process if there is not a clearly defined economic diversification plan in place.

The basis of a well-defined economic diversification plan is to provide tribes with a framework that allows them to move forward with their economic diversification goals while attempting to minimize the risks associated with new ventures or investments. Having a plan in place will ensure that only those projects or companies or investments that fit a tribe's goals in terms of size, scope, risk, acceptable returns and other factors are considered.

A well-defined economic diversification plan can be developed following several basic steps as summarized below.

STEP 1:

Identifying and Understanding Tribal Goals and Objectives

The first step in creating an economic development plan is the identification of the overall goals and objectives of the tribe. The goals of the tribe may go beyond just a pure financial return on an investment. For example, is tribal employment a consideration? What about the importance of emphasizing tribal entrepreneurship growth? From a geographic perspective, is the goal to make investments only within the local community or is a wider sphere important?

These and other key questions can be answered through a series of stakeholder interviews. By gathering feedback from tribal leaders, council members, tribal members, advisers and other parties, the specific goals and objectives can be determined.

STEP 2:

Outlining Specific Investment Criteria

The next step in the process of developing the plan is to identify specific investment criteria that are acceptable to the tribe based on desired returns, levels of risk and resources available. This step is important so the tribe (or entity charged with developing and managing these economic diversification projects) does not spend needless time evaluating projects that do not meet the minimum criteria. It is also important to have a thorough understanding of the resources, capital, time and energy that the tribe is willing to devote to projects. For example, some of the specific questions that

need to be answered regarding investment criteria may include:

- What is the size of investments or projects to be considered?
- Are there specific businesses that the tribe does or does not want to be in, and what should the priorities be?
- What capital resources are available? Internally? Externally?
- What tribal resources are available (institutional/labor/professional) for potential implementation?
- What is the tribe's acceptable level of risk?
- What is the tribe's threshold for a minimum return on investment (ROI)?

In addition to internal financial resources, tribes need to consider external financial resources that are potentially available for projects. Indeed, access to capital in these times is more difficult, especially for casino-related projects. However, there are a number of opportunities available to tribes, including stimulus funds established under the American Recovery and Reinvestment Act of 2009.

This stimulus funding can allow tribes to issue low-interest bonds for projects such as health care centers, water plants and wind farms. Tribes will be able to issue either traditional tax-exempt bonds or special Build America Bonds for designated projects. The bonds are intended to help states, local governments and tribes build schools, hospitals, roads and other infrastructure. No casinos or gambling projects are allowed under this funding.

Other tribal funding opportunities include resources from the Small Business Administration (8a), as well as tax credits for natural resource and clean energy development. The Jemez Pueblo in New Mexico recently announced it is developing a new large-scale solar energy project. The proposed 30-acre site for the project will contain 14,850 solar panels that will be able to generate four megawatts of solar energy, or enough to power approximately 600 homes. The project, which is expected to cost \$22 million, will be financed entirely through various loans, grants and tax credits from federal and local governments and other entities.

STEP 3:

Implementing the Right Governing Structure

Governing and monitoring any new tribal

economic development activities can also be a challenge for many tribes looking to diversify. Some may be branching into new businesses they will oversee, and for which they may not have in-house expertise to adequately manage. Establishing the proper approach to governance and establishing an entity and a protocol that works for the tribe are therefore essential.

There are a number of tribes around the country that have set the standard for diversifying their economic interests and establishing the appropriate governance over these investments. Benefitting from these tribes in terms of studying the best practices and lessons learned regarding how to structure the oversight of these investments can be a valuable approach for those just initiating their economic diversification strategies.

Some of the more successful tribes have established separate entities for owning the interests in these alternative investments. Separating these new business operations from the ongoing operations of the tribe and tribal councils can be an effective structure that allows these entities to operate independently on a day-to-day basis without interference, yet still allows control by the tribe over strategic initiatives.

These new entities are usually governed by a board consisting of tribal members, and in some instances outside third-party members who can bring valuable expertise to the table. In evaluating what structure is right for a tribe, the following questions should be considered:

- What type of entity should be formed to hold these alternative investments?
- Should a governance board be elected by general membership or appointed by tribal councils?
- What role should independent third parties play?
- How should the board be structured in terms of length of services, compensation, removal criteria, etc.?
- Should management of the oversight entity be in-house with dedicated staff, contracted out or a combination of the two approaches?

STEP 4:

Sourcing Deal Flow and Opportunities

Once the tribe's goals and objectives have been set, investment criteria determined

and a governing process put in place, the next step is to begin identifying and evaluating potential projects and investments.

There is a variety of ways to begin sourcing potential deals and opportunities. The key is to compare the prospective source against the strict criteria that the tribe has established, so that only opportunities that are of the right size and scope, are in geographic areas the tribe wishes to concentrate its efforts, and are in industries or businesses that the tribe has determined are a potential fit for them are presented for evaluation.

While this process will restrict the overall universe of potential opportunities, it will ensure that the tribe is properly allocating its energy and resources and evaluating only those opportunities that fit its overall goals and objectives. Potential sources of deals and opportunities can include the following:

- Industry publications
- Various conferences
- Developing relationships with banks, investment advisors, equity firms and other financial entities
- Law firms and accounting firms that the tribe works with

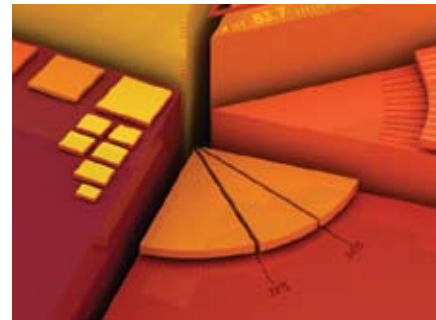
- Local chambers of commerce and business leaders
- State or regional economic development entities

DUE DILIGENCE

Once opportunities are identified that potentially fit the tribe's investment criteria, it is critical that adequate due diligence be completed on the opportunity or the company prior to committing to any investment.

Depending on the nature of the investment, the tribe may or may not have the internal expertise to adequately evaluate the prospective opportunity. In these situations, reaching out to financial and legal advisers and/or consultants knowledgeable of the industry or situation is recommended.

Casinos have been a cornerstone of many tribal economies over the past few decades. However, the current state of affairs in the gaming industry suggests that for certain tribes, now is the time to leverage the success they have had with their casino operations and invest in other businesses in order to diversify their economies.



As a senior partner of the Innovation Group of Companies, Steve Szapor has provided high-level research, analysis, strategic planning, finance, marketing, operational and management expertise to clients around the world. A 23-year veteran of the gaming, entertainment and hospitality industries, he currently serves as president of the Innovation Group and Innovation Management Services, and is also an active senior owner of the organization's other affiliates—Innovation Capital, Innovation Marketing and Innovation Project Development. He has worked with numerous tribes throughout the country on both gaming and non-gaming strategic developments. For more information, he can be reached via szapor@theinnovationgroup.com.

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