BTG Advisory

INDUSTRY UPDATE

Professional Sport Sector May 2016

Money management

BTG Advisory provide comment on investment going to top-tier sport while some sports organisations fail to attract funds, changes in broadcast sales, and management in sports ruling bodies.

Top-tier sport continues to receive investment from states, broadcasters and specialist funds, but scratch beneath the surface and you'll find a collection of sports organisations relatively struggling and living hand-to-mouth.

For a number of years, it was the oligarchs of the Middle East and Russia who saw major European sports businesses as the perfect investment vehicles to help them enter the inner circle of global political influence – while having a bit of fun with some of the planet's best status symbols in the process.

But the tide has turned, and the eyes of the sports industry are now looking further eastwards: to China. The Red Dragon's economy is the world's second largest by GDP – and largest by purchasing power parity, according to the International Monetary Fund – but after ten years of rapid growth, an increase of 6.9% in 2015 marked its slowest annual growth in a quarter of a century.

To combat the slowdown and diversify the economy, the Chinese government and associated state-owned companies have looked abroad for investment opportunities in numerous key sectors and, in barely a decade, taken China's OFDI (outward foreign direct investments) from almost zero to over $100bn annually.

While early Chinese investments focused on energy and natural resources in developing countries, the scope has now been broadened to include TMT (technology, media and telecommunications), real estate, leisure, construction and, sitting across several of those, sport.

Budding and internationally known sports properties, of course, not only give China sound investments but also strategic vehicles that make China a strong political influence on the global stage – platforms to show that China is a friendly and welcoming nation to a world that often views it with distrust.

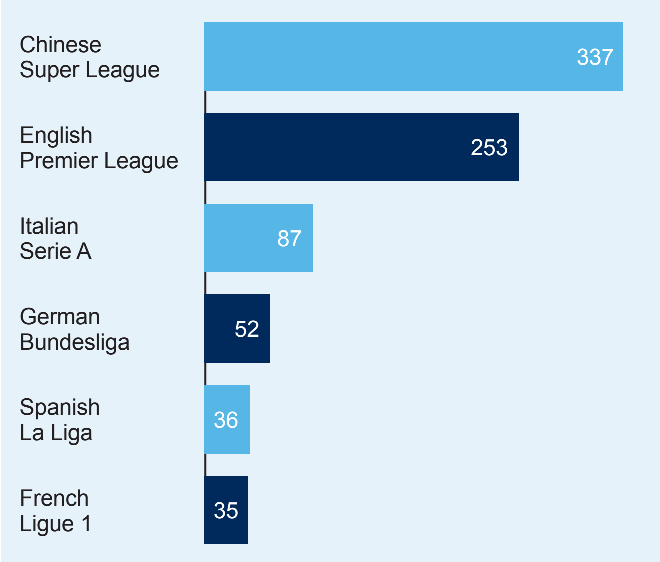
It is no coincidence, therefore, that the sports industry back pages currently feature Chinese conglomerate Dalian Wanda, owned by Asia's richest man Wang Jianlin. In the past 18 months Wanda has acquired part-ownership of Spanish football club Atlético Madrid, sports marketing agency Infront Sports & Media (for $1.2bn) and elite triathlon event Ironman (for $650m), while signing up to sponsor the next four FIFA World Cups for $850m. Wang says there's a lot more to come.

In December 2015, meanwhile, City Football Group, parent group of English football team Manchester City, received a $400m investment from state-backed CMC (China Media Capital). There's no doubt more investment across the sporting landscape is coming thick and fast – focused around growing businesses and established, internationally known sports brands.

Any mention of China must also nod to Chinese sports investment domestically. In late 2014, the Chinese government revealed plans to build a domestic sports economy worth $850bn by 2025, and football is a pet project of President Xi Jinping, who rose to power in 2013 and quickly went about developing the domestic game from grassroots upwards. His goal, one day soon, is for China to both host and win the FIFA World Cup.

These plans have resulted in significant amounts of money being pumped into domestic clubs playing in the top-tier CSL (Chinese Super League), which in the 2016 winter transfer window became the highest spending league in the world (see chart). Big-money moves included Brazilian Alex Teixeira (signed by Jiangsu Suning for $56m), Colombian Jackson Martinez (signed by Guangzhou Evergrande for $46m) and Brazilian Ramires (signed by Jiangsu Suning for $36m).

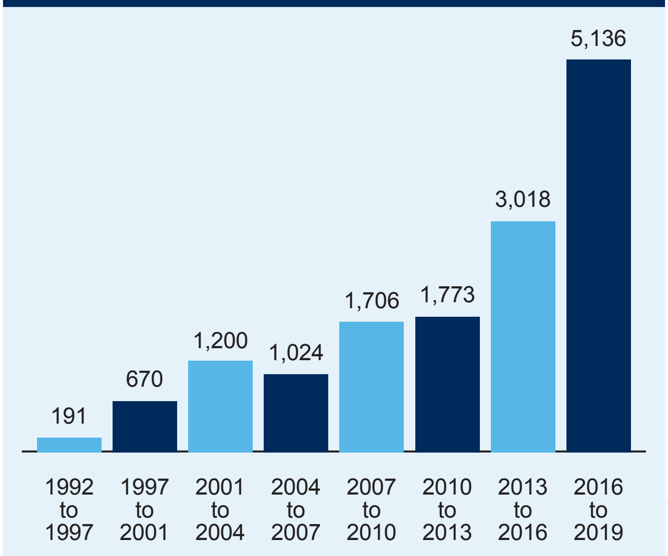
League Spending in 2016 Winter Transfer Window (€m)



Source: www.transfermarkt.com

So while non-Chinese sports organisations are receiving investment, the country is also creating its own to rival them for business. Indeed, many observers believe the CSL – and the riches it can offer – will have a negative impact on the Premier League creating more competition, alongside the likes of Spain's La Liga and Germany's Bundesliga, for top talent.

Domestic Premier League TV Value Since Inception (€m)



Source: Statista

But others counter that, saying Premier League clubs are actually better placed than their European counterparts to attract and keep the best footballers because of the league's new, £5.14bn three-year domestic broadcast deal kicking in from 2016/17 – up 71% compared with the previous contract (see chart).

When international broadcast sales are folded in, the league's total broadcast sales income will be around £8bn, making Premier League clubs richer than they could have ever imagined. Premier League clubs will experience two main benefits from this: more money, obviously, to invest in players and wages – so expect transfer fees and wage bills to continue rising – and soaring valuations. The new broadcast deal was followed by a string of investments into Premier League clubs including, in the last 12 months, Manchester City, Everton (Iranian Farhad Moshiri), Crystal Palace (Americans Josh Harris and David Blitzer) and Bournemouth (American private equity firm PEAK6 Investments). All new owners will have looked wide-eyed at the future TV income earnings column on the balance sheets.

However, it's not all good news for English football, as Premier League TV money will cause the huge gulf between the top-tier and lower tiers to increase once again. Yes, increased parachute payments will help ease the financial pain for clubs relegated from the Premier League, but the impact of being relegated from the Premier League or missing out on promotion from the Championship is now more perilous than ever – and could see even more clubs spending beyond their financial means on the road to El Dorado.

In March, for instance, Bolton Wanderers was only just able to avoid being wound up by HMRC after settling a tax bill of just over £2m, shortly after owner Eddie Davies sold the club for £7.5m. Davies wrote off £170m owed to him by the football club – spent trying to keep the club in the Premier League and failing in the long term – before selling.

Like Leeds United and Portsmouth before it, Bolton spent more than it could afford trying to stay in the top-tier and on losing the lucrative TV revenues, failed to cut its wage bill fast enough to shore up its finances. Spending big on players is the only way clubs can boost their chances of top-tier status, and the line between success and failure is so narrow that financial stability – for clubs outside the top ten or so in the Premier League – won't be achieved for many clubs for a long time to come.

European Football

On the continent, the top clubs continue to prosper – particularly those with wealthy owners such as Paris Saint-Germain, whose Qatar-funded squad won the 2015/16 French top-tier title with eight games remaining – but many still struggle, with the state more interested than ever in their tax affairs, driven by the financial crisis.

This is the case particularly in Spain and Portugal, where even top-tier clubs outside the big names live in a constant cycle of selling top talent to pay their players, reduce debt and pay off hundreds of millions of euros in unpaid taxes.

In Spain, La Liga's move to collective selling of broadcast rights from 2016/17 will ensure a more equal distribution of broadcast revenues – bringing the ratio between the highest and lowest earning La Liga clubs – but many still require financial solutions that give them cash up front.

In April 2015 FIFA outlawed one way many clubs, particularly in Portugal, had been doing this: third-party ownership (TPO). TPO is a means of raising cash by selling a share in a football player owned by the club down – commonplace in South America – and adopted in particular in Portugal for the reasons stated above. Critics have described it as "modern-day slavery", however.

The Spanish and Portuguese leagues, and separately hedge fund Doyen Sports, have both filed legal challenges to the ban – with the European Commission and French courts respectively – which effectively cuts off a main revenue stream for many clubs on the Iberian Peninsula.

No doubt these same clubs will now be looking for new sources of income, or at least ways to get hold of money they are, or may be owed in seasons to come. This may come in the form of traditional borrowing – companies lending against assets such as stadiums or predicted future earnings such as shares of broadcast rights – or more sophisticated organisations such as Sportsrisq, a London-based company that gives a club cash up front based on its future earnings and covering itself by hedging the risk elsewhere.

Football clubs spending more than they can afford, of course, was why leagues and international governing bodies introduced financial fair play (FFP) regulations. Has it worked? The jury is still out on that, as increasing revenues from TV and the ability to offload players to places like China has meant top clubs can still justify large transfer fees and associated wages.

However, top clubs do appear to be playing ball with the regulators; look no further than a club like Manchester City, which was handed a £49m fine for breaching UEFA FFP regulations in 2014 but recorded a £10.7m profit in 2014/15, the first since Sheikh Mansour bought the club in 2008.

As recently as March, Premier League clubs also agreed to continue STCC (short-term cost control) rules that limit the amount they can spend on player wages; in particular, agreeing not to increase their wage bills by more than £7m compared with the previous year, unless they can demonstrate "any excess is due to individual club revenue sources" – i.e. they are able to afford it.

Broadcast Competition

Other recent developments in the sports industry that could have a significant impact for a variety of stakeholders in the years ahead include increased competition in the broadcast space globally – particularly in Europe – and a new guard of professional, more accountable administrators heading up sport's most influential international governing bodies.

On the former, pay-TV operator beIN Sports – owned by Qatar Sports Investments, an arm of Qatar Investment Authority, the Middle East state's sovereign wealth fund – and Eurosport, the channel known for showing second-tier sports across the continent, are the two driving competition.

beIN's ambition is to be the world's global sports broadcaster – and is setting up operations in almost every market by snapping up premium sports content, so expect a UK channel in the next few years – while Eurosport is reinventing itself as a premium channel under new owner Discovery, which became the majority shareholder of the sports broadcaster in 2014.

When any major sports property tenders its broadcast rights anywhere in the world, beIN is there, while Eurosport has thrown its hat into the ring where it wouldn't have previously, famously in July 2015 when it acquired exclusive rights for the Olympics from 2018–2024 for €1.3bn. The activities of these two players are welcome news for top-tier sports properties, who will expect the competition to drive their rights-fees northwards.

On the latter, the ascension of Gianni Infantino (FIFA), Seb Coe (IAAF) and Brian Cookson (World Cycling) – and others – to the chairs of three major sports federations plagued by corruption over the last few decades reflects a root-and-branch reform of how sports are run at an international level.

Expect far more accountability at these organisations, and a proactive agenda to ensure that doping, bribery and financial mismanagement is significantly reduced in the years to come. It's been a long time coming, but the old guard looks like it is finally on its way out and the money made by sport will be far better managed, reinvested into grassroots and good causes.

For Further Information

If you would like to discuss any of the issues raised in this update or would like to know further details about the services we provide to the sector, please contact me.

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