Sports Litigation Alert

Sports Franchise Transactions: Unlike Anything Else

By Matt Eisler and Andrew Brandes, of Hogan Lovells

Passions in the sports world affect people in all walks of life, and transcend geographic boundaries and (most of the time) politics. But at the end of the day, teams, venues, stadiums, leagues, and even players are all effectively "assets." Sure, people are fanatical about these particular types of assets, and sports related transactions tend to get a lot more press coverage than, say, a midmarket light industrials company, but is M&A in the sports sector different than any other transaction? The answer is yes, and some of the reasons why may be surprising.

League oversight and approval

The most imposing challenge is the involvement of a league office that requires vast amounts of information, oversight, and approval over any franchise transaction. By way of example, the National Basketball Association (NBA) operates as a self-regulating organization that has separate rules and operating procedures that govern each of its 30 franchises. In order to be admitted as a team owner, each individual owner is reviewed for fit and creditworthiness. The NBA undergoes an extensive diligence process, inquiring about the purchaser's proposed ownership group, indebtedness, prior financial performance, and economic projections.

Once the NBA approves a potential new owner, it also needs to approve the transaction and the related documents, as well as obtain various agreements for credit support and cooperation. Moreover, after the NBA itself approves documents, it submits the entire transaction to its Board of Governors for approval by controlling owners of the teams.

Ultimately, each professional sports league itself is a business. Each league, as with any business, has a vested interest in maintaining a top-quality experience and worldclass real estate. However, because leagues have such strong brands, and are so visible in the media, they go to great lengths to protect their brands and prevent interruption from credit concerns and owner-level issues.

Large sales price with significant debt limitations

Another differentiating factor from most other transactions is the significant price tag of a sports franchise, coupled with a strict limitation on the amount of debt allowed to be incurred by the team and its owners.

NBA franchise values have tripled over the past five years.[1] National Football League (NFL) franchises are currently valued at nearly six times their revenue.[2] According to Forbes, each NBA franchise is now worth at least $1 billion for the first time and the average team is worth $1.65 billion, up 22 percent from 2017. This makes these franchises an attractive business for those of particular means.[3]

In June 2018, the NBA's board of governors approved rules increasing the debt limit for owners from $250 million to $325 million. While the permitted debt increase may be helpful to some ownership groups, when the av-

1 Kurt Badenhausen, *NBA Team Values 2018: Every Club Now Worth At Least $1 Billion*, Forbes, Feb. 7, 2018, available at https://www.forbes.com/sites/kurtbadenhausen/2018/02/07/nba-team-values-2018-every-club-now-worth-at-least-1-billion/.

2 *Id.*

3 *Id.*

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erage NBA franchise is worth $1.65 billion, the leveraged buyout approach is clearly off the table. With financing at slightly less than 20 percent of the purchase price, as well as cash flow needs to drive operations, potential owners cannot rely on third party indebtedness to acquire teams. The NFL permits even less leverage when measured against the average valuation of its franchises. The NFL allows up to $350 million in debt per team,[4] which when measured against the $2.57 billion average franchise value[5] is only around 13.5 percent. These debt restrictions further whittle down the number of buyers that can feasibly purchase a franchise.

Due to limitations on indebtedness, potential buyers must have vast amounts of liquidity to pay such hefty price tags in cash, as well as the will to part with such large amounts. These barriers to entry makes it more likely that only the most sophisticated and successful parties will be able to navigate the lengthy and difficult process required to purchase a sports franchise.

Franchise scarcity

Each NBA franchise averages $52 million in earnings per year.[6] At an average price tag of $1.65 billion, that means that the price to earnings ratio, or "multiple," implied in the acquisition of a team is over 31 times. Practical Law and Houlihan Lokey studied 50 going-private transactions between 2016 and 2017, and found that for the trailing threemonth period prior to a takeover, the average mean pricetoearnings multiples for transactions over $1 billion was 20.1 times, with a mean of 18.9 times.[7] Why then do sports teams garner such huge valuations? Clearly, buyers of teams are not in it for just the cash flow.

Generally, team owners are very passionate about their business. As Steve Greenberg, a distinguished sports industry deal-maker and managing director at the investment bank Allen & Company LLC, stated in 2015, "[t]here's been a fabulous amount of wealth created in the last decade. Many of those people are sports fans and have kids that are fans. If they're good custodians for the team, the community and the league, that's a good thing."[8]

4 Daniel Kaplan, *Breaking the Bank*, Street & Smith's SportsBusiness Journal, Nov. 26, 2018, available at https://www.sportsbusinessdaily.com/Journal/Issues/2018/11/26/In-Depth/Franchise-valuations.aspx.

5 Forbes Corporate Communications, *Forbes Releases 21st Annual NFL Team Valuations*, Forbes, Sept. 20, 2018, available at https://www.forbes.com/sites/forbespr/2018/09/20/forbes-releases-21st-annual-nfl-team-valuations/#504ee1cb7af4.

6 *Id.*

7 Houlihan Lokey & Practical Law, *2016/2017 Going Private Transactions Study*, Published on October 25, 2018.

8 Abraham D. Madkour, *The Life, Times and Work of Dealmaker Steve Greenberg*, Street & Smith's SportsBusiness Journal, March 30, 2015, available at https://www.sportsbusinessdaily.com/Journal/Issues/2015/03/30/Opinion/From-the-Executive-Editor.aspx.

As the world continues to churn out more billionaires, the major sports leagues have not kept pace by increasing the number of franchises. The NBA and Major League Baseball (MLB) each have only 30 franchises, the NFL has 32 franchises, the National Hockey League (NHL) has 31 franchises, and Major League Soccer (MLS) has 26 franchises (Miami and Nashville's respective franchises will begin play in 2020). Additionally, each of these leagues appears unlikely to undertake large-scale growth by aggressively expanding with expansion teams in the coming years. This leaves a fixed number of teams available to potential buyers and often makes buying a team, rather than waiting for an expansion team opportunity, the only avenue to own a franchise.

According to *SportsBusiness Journal*, between 2000 and 2014, an average of five sports franchises across the MLB, NBA, NFL, and NHL were sold annually. Then, from 2015 to 2018, only nine teams total were sold.[9] This slow down in transactions spotlights the lack of options available to potential buyers, but also shows that the value of franchises makes them less likely to hit the open market.

Are we there yet?

For years commentators have speculated whether sports franchise valuations have finally reached their peak. As 2018 shows, the cost of purchasing a franchise continues to increase and profits show no sign of leveling. There continues to be opportunities for franchises to change hands. For example, Paul Allen's recent passing puts the NFL's Seattle Seahawks in play for a potential sale and the Bowlen family's succession issues have led to increased speculation that the Denver Broncos may be on the block in the near future. As such, the complexities of sports transactions will continue to be examined in the national spotlight in a way that makes the industry unlike any other.

9 Daniel Kaplan, *Breaking the Bank*, Street & Smith's SportsBusiness Journal, Nov. 26, 2018, available at https://www.sportsbusinessdaily.com/Journal/Issues/2018/11/26/In-Depth/Franchise-valuations.aspx.