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Sovereign Investor Insights
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Sovereign investment in the sports industry

Investors active in the sports industry have reaped high rewards across the globe in recent years. These investors include sovereign investors willing to enter the game and capitalize on the strong financial performance, unique investment structures and access to owners, athletes, and governments that flow from transactions in the sports sector. In addition, these investors benefit from the exciting privileges of owning a sports team. In this article, we highlight potential opportunities, risks, and special perquisites that exist for sovereign investors seeking to get in the sports game.

Profitable investments in sports on a global scale

Sports investors around the world have reaped unprecedented returns in recent years. In the National Basketball Association (NBA), the average franchise value has increased 300% or more over the past five years. [1] In the National Football League (NFL), team values have increased 8X over the past two decades, yielding an annual rate of 11.6%—7.1% more than the S&P 500's performance over the same period. [2] In Europe, the 20 most valuable football clubs are worth an average of $1.69 billion, representing a 14% increase over the past year alone and a 74% increase over a 5-year period. [3] Europe's three most highly valued clubs (Manchester United, Real Madrid and FC Barcelona) have nearly tripled in value since 2010 and are now each worth more than $4 billion. [4]

Teams around the world are also generating more operating profit than ever before, in stark contrast to the conventional wisdom that teams will require additional capital from owners to cover operating losses. In the U.S., 83% of the teams now have positive operating income across the NFL, NBA, National Hockey League (NHL), Major League Baseball (MLB), and Major League Soccer (MLS). [5] In Europe, football club operating income has reached an all-time high. [6] Liverpool Football Club posted the largest pre-tax annual profit ever of £125 million (roughly US$162 million) [7] and Manchester United had the highest overall revenue of £590 million (roughly US$776 million). [8]

A major driver of the rising European club profitability is the implementation of financial fair play rules by the Union of European Football Associations (UEFA). [9] Instituted in 2012 in response to a wave of financial losses throughout 2008 through 2011, [10] these rules have forced clubs to cut down on bloated wages, high-levels of debt and runaway losses. Non-controlling investors have benefitted greatly, as controlling investors and club management teams are now under greater financial scrutiny with pressure to increase profits rather than incur additional debt.

In the U.S., one interesting factor is the profitability of sponsorship deals, as companies compete for limited prime branding opportunities such as stadium naming rights. To date, there have been more than 20 reported naming rights deals valued at US$100 million or more.

Cross-border ownership trends

Perhaps unsurprisingly, teams around the world are attracting foreign capital at a record pace. In England's Premier League, 14 of the 20 clubs are held by foreign owners across nine different countries. [11] Egyptian Mohamed Al Fayed set the tone for this ground shift when in 1997 he purchased Fulham FC. [12] In 2003, Russian businessman Roman Abramovich followed suit and purchased Chelsea FC. [13] In 2008, Sheikh Mansour Bin Zayed Al Nahyan of the Abu Dhabi Royal Family purchased Manchester City FC. [14] Asian investment in European football has become increasingly strong as well, as groups from China now hold interests in clubs in the United Kingdom, France, Italy, and Spain. [15]

While cross-border team investment in the U.S. has been less prevalent, foreign buyers have made landmark sports investments in recent years. In 2018, Taiwanese-Canadian billionaire and Alibaba co-founder Joe Tsai reportedly purchased a 49% interest in the Brooklyn Nets NBA basketball team from Russian businessman and majority owner Mikhail Prokhorov through Mr. Prokhorov's company, Onexim Sports and Entertainment Holdings USA, Inc. [16] Mr. Tsai was welcomed by the NBA and promptly named to NBA China's board of directors on the basis of his expertise in Chinese media and e-commerce. [17] This move may signal a new perspective favoring foreign ownership—as U.S. leagues look to capitalize on international opportunities, foreign U.S. team owners could play a key role in accessing new markets. [18]

Ownership structure and influence

As sports investments become more attractive, prospective buyers should be aware that not all opportunities are created equal—special risks and opportunities emerge in different jurisdictions. A minority investor in a U.S. franchise will often be at the mercy of the common league-mandated ownership structure: a single "controlling owner" governs almost all aspects of the team's operations, while even the most significant "non-controlling owners" are generally left only with consultation and oversight rights.

In contrast, a minority ownership stake in a European club can come with tremendous influence. European club ownership is far more flexible and varied, with leagues exercising minimal oversight and ownership entities forming under different national laws. Dominance by a single controlling owner is the exception rather than the rule, and groups of minority investors commonly exercise control through board seats and shareholder rights. However, the variation in structure also creates potential pitfalls—prospective investors would be wise to retain experienced advisors for the evaluation of risks and opportunities for influence and value.

Financing solutions and opportunities

The availability of debt financing for teams also varies tremendously between continents. In the U.S., sports franchises often have access to league-wide credit facilities and traditional loans facilitated by league offices. European clubs have no such league support and, with the exception of the top few teams the world, clubs face a severe challenge in obtaining debt. Traditional lenders generally keep their distance from football clubs, as bankers see too much risk in the potential for club relegation (as discussed below) and reputational harm in the case of club default—any foreclosure action could outrage and alienate millions of fans and damage the bank's customer relationships. [19]

The harsh borrowing environment for clubs can present new opportunities for investors. Teams across Europe have been warming to the concept of a convertible debt investment, wherein the investor makes a loan to the team with the right to convert the debt into an equity stake to capture potential upside (i.e., if the team performs well). Nishant Tella, a seasoned investment banker with extensive experience in European sports transactions, describes these emerging convertible debt structures as attractive opportunities for investors with medium–long term investment horizons—such investors can use convertible debt to "combine the ancillary benefits of sports team ownership with the traditional benefits of structured finance investments—like capital structure seniority, attractive current yield, low–moderate LTVs and equity upside participation." Because European club governance is highly flexible, a convertible debt investor may well have access to the same influence and perquisites that an equity investor might expect.

Perquisites

Setting aside the immense potential financial benefits of owning a sports franchise, there are many other exciting benefits sought by investors. In the U.S., sports investors place a high premium on exclusive perquisites—special benefits available only to the highest level owners due to league limitations on influence and access. Minority owners that successfully negotiate for such "perks" may enjoy input on strategy and team decisions, premium ticketing access to exclusive events, or special access to the players.

In Europe, however, such perquisites are much more widely available because the league offices generally do not regulate the access and influence of non-controlling owners. Football club investors expect a much more extensive set of special benefits, which can be highly tailored to the desires and objectives of the new owner. As noted above, teams are eager to make deals with lenders and even debt investors can benefit from unique ownership perks—a concept that would be unheard of, if not flatly prohibited, in most U.S. leagues.

Comparing U.S. and European opportunities

Many consider U.S. franchises to be the crown jewel of a global sports investment portfolio due to the incredible profitability of certain teams, strong competition for ownership opportunities and high team valuations. These highly sought after franchises are few and far between—across the five major U.S. leagues there are only 147 teams (this total does not include the NHL's newest franchise in Seattle, Washington, which is slated to begin play during the 2021-22 season or the MLS' three forthcoming franchises, Inter Miami CF and Nashville SC, which will both begin play during 2020 season and Austin FC, which will begin play during the 2021 season), many of which are held in closely guarded family ownership structures with long term intra-family succession plans. Even for the lucky buyer who lands an investment opportunity, there are league imposed barriers to entry, including an invasive (and often opaque) investor screening process and restrictions on the use of leverage for acquisition. [20] These factors may explain the infrequency of sovereign investments in U.S. sports franchises as compared to other geographic areas.

European football clubs often present a more attractive option for new entrants into the industry. Outside of the top 20 or so European clubs, valuations can be very enticing, even for well-established teams, especially compared to the multi-billion dollar valuations that have become the norm in the U.S. In 2017, Chinese businessman Gao Jisheng purchased an 80% interest in the English Premier League's Southhampton FC for £210 million. [21] Similarly, in 2016, Chinese electronics retailer Suning Commerce Group Co. Ltd. purchased 70% of Italian soccer club Inter Milan for €270 million. [22] Debt restrictions on European clubs are significantly less burdensome than the U.S. Finally, investors in European club teams are not subject to nearly the level of scrutiny from league offices when making an initial purchase.

However, there are also special dangers associated with European club ownership. Clubs in UEFA leagues face constant risk of relegation, a process by which a fixed number of the worst-ranked clubs each year are relegated to a lower-level league and the best-ranked clubs from the lower-level league are brought up to replace them. This process increases the stakes for those clubs that fail to perform or keep up with the high-performing (and often high-budget) teams. For potential owners, these issues represent significant threats to achieving their projected return on investment. A U.S. team in the top five sports, by contrast, can stay in its league no matter how poor its on-field performance, which is a factor that certain U.S. teams are grateful for. The lack of any relegation risk is clearly one of the driving reasons why U.S. team valuations are so exceedingly high.

Branding opportunities for sovereign-owned businesses

Another benefit of sports franchise ownership is access to highly sought-after sponsorship opportunities. Whether an owner sponsors his or her own team or another team, the owner can benefit from an additional infusion of capital to help cover team expenses or align with companies as a way to enter a new market. The business opportunities stemming from sponsorship agreements may be especially beneficial for sovereign investors as they can be identified with, and share in, the goodwill of the teams that they own or sponsor, which can re-define or invigorate perception of their image, brand, products or services.

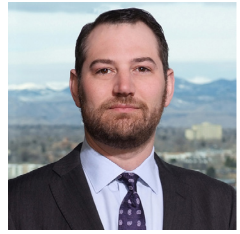
As a leading example, Emirates, an airline based in Dubai and a subsidiary of The Emirates Group, a holding company wholly owned by the government of Dubai, currently sponsors a number of the biggest names in football, including AC Milan, Arsenal FC, Hamburger SV, Olympiacos FC, Paris Saint Germain FC, and Real Madrid CF. [23] As part of its agreement with Arsenal, the club's home stadium will be adorned "The Emirates Stadium" through 2028. The relationship between Emirates and the respective Western European countries these football clubs call home goes beyond jersey and stadium sponsorships. Emirates sponsored the Rugby World Cup in 2015 in England and will do so again in 2019 in Japan. [24] Emirates has also connected with India, England, South Africa, Australia, and New Zealand by fostering its relationship with the International Cricket Council (ICC) and sponsoring many ICC events, including the ICC Cricket World Cup and ICC World Twenty20. [25] Overall, Emirates has increased its brand recognition and business footprint well beyond the Arabian Peninsula. In doing so, Emirates has also expanded its flight offerings between its headquarters and primary hub, Dubai, and many of the cities affiliated with the teams and events it sponsors. Clearly, affiliating with sports franchises has been important in expanding Emirates' brand recognition on a global scale.

Conclusion

With increasing franchise profitability and the growing trend of cross-border ownership groups, investors around the world are hungry for access to team opportunities. Setting economic and business benefits aside, the opportunity for sovereign investors engaged in sports ownership to connect with other team owners, athletes, governments, and fans throughout the world can make sports an attractive industry. To be successful, owners must strike a balance between their passion for sport and desire to win on one side and making methodical decisions that foster sustainable success on the other. Further, would-be owners must be careful to retain advisors with the requisite skills needed for success in such varied and complex fields as finance, real estate, media, tax, and cross-border regulation. Investing in a sports franchise or sponsoring a club is far from a sure bet, but when executed correctly, these investments can offer strong economic returns, transformational branding opportunities, and unique community involvement for those sovereign investors willing to take the risk.

This Sovereign Investor Insights is a summary for guidance only and should not be relied on as legal advice in relation to a particular transaction or situation. If you have any questions or would like any additional information regarding this matter, please contact your relationship partner at Hogan Lovells or any of the lawyers listed on the right.

Contacts



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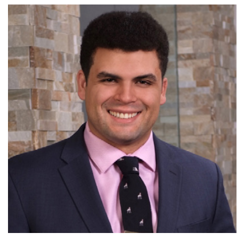

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