



CBV INSIGHTS

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VALUATION OF SPORTS TEAMS AND FRANCHISES

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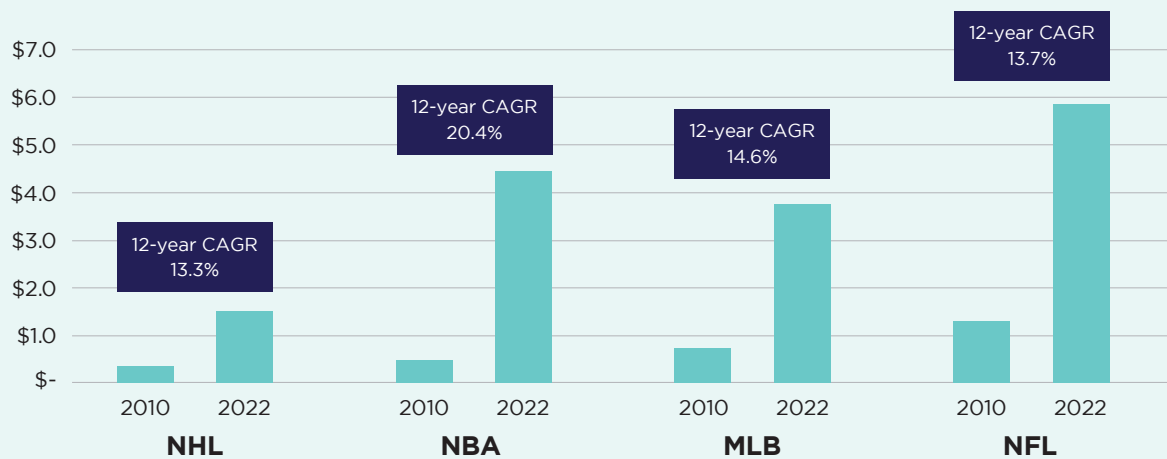


INTRODUCTION

During times of global and regional division, sports are one of the few constants that bring us together. Transcending language, borders, and cultures, sports help to bring a common ground for otherwise different communities. Sport truly is a unique and unifying platform for communities, cities, and countries. However, the business aspects driving valuations are not widely understood. As fans cheer for their favourite teams and players, an entirely unique economic ecosystem makes it all possible. Over the past couple of decades, the growth in the value of sports franchises has noticeably outperformed the S&P 500¹, driven by increasingly lucrative media rights deals, the globalization of content, and an overall resilience to macroeconomic downturns. As such, sports assets are attracting increasing attention from institutional investors.

Growth in Sports Franchise Value²

(USD billions)



Media rights, revenue sharing, salary caps, luxury taxes, collective bargaining agreements: these are all terms that the casual sports enthusiast might hear, but how does it all come together in valuing a sports franchise?

The difficulty in estimating the value of a sports franchise lies in the inherent opacity of the industry. With a limited number of franchises in every major league, and with only a few of those companies publicly releasing their financial statements (if any), it is relatively difficult to understand the key financial drivers of a sports franchise, and more importantly to identify and compare subject companies against relevant guideline public companies.

However, this article aims to demystify the economics of sports franchises and provide an introduction into the world of sports franchise valuations.



Common valuation approaches and methodologies

In the context of sports franchise valuations, the market approach, specifically the precedent transactions method, is typically used as the primary valuation approach. This is primarily driven by the fact that the intrinsic value derived from the income approach is an imperfect way to capture the value ascribed to sports franchises observed in market transactions.

Additionally, some sports franchises fail to generate consistent and reliable positive operating cash flows, or they generate marginally positive operating cash flows, which make an income approach difficult to implement in most situations.

This disconnect between a sports franchise's intrinsic value derived using the income approach and transacted values observed in the market can be attributed to a variety of factors unique to sports franchises such as:

- Trophy asset / emotional value - An investor's passion for the sport, specific locale, franchise and/or the prestige associated with owning a sports franchise can drive the price paid for a sports franchise up significantly.
- Scarcity value - Sports franchises are relatively unique in that there are a finite number in any given league, and only a few of these may be available for sale at any given time. Combined with the sustained high level of investor demand, this scarcity creates a supply / demand imbalance, which has ultimately driven strong value appreciation of sports franchises over time.

In this manner, the prices that are transacted in the market may oftentimes be impacted by non-quantifiable factors, biases, or synergies such as those listed above, which ultimately drives the inherent disconnect between "price" and "fair market value".³





Market Approach

GUIDELINE PUBLIC COMPANIES

Before getting into the precedent transactions method, it is worth addressing the guideline public company method, although its use is relatively limited. There are a small number of publicly traded sports franchises, most of them being European soccer clubs. Even when valuing a European soccer club, implied valuation multiples from guideline public companies tend to exhibit a significant discount relative to transacted values in the market. This is primarily driven by a minority discount inherent in public markets. Most publicly traded sports franchises have a relatively small trading float and more importantly, have a small number of controlling shareholders. These controlling shareholders tend to hold their stakes for long periods of time and control the day-to-day operations of the franchise. Therefore, the discount applied in public markets reflects the limited ability for minority shareholders to maximize value and liquidity through a private buyout.

PRECEDENT TRANSACTIONS

Turning back to precedent transactions, the most common valuation method in the world of sports franchises, the starting point is identifying transactions with readily available and reliable data for comparable sports franchises.

Screening for guideline transactions and sourcing reliable data

Screening for guideline transactions typically begins with sourcing transactions in the same league.

Given the degree of public interest in sports, sports franchise transactions tend to be relatively easy to identify, with headline prices typically shared in the public domain. With that said, it can be challenging to verify the accuracy of reported prices without access to confidential transaction details, and it may be unclear whether headline prices reported are an equity price paid or an enterprise value.

In addition, most sports franchises are privately owned businesses and therefore, sourcing reliable and accurate financial information to derive implied valuation multiples can be difficult. With that said, publications like Forbes and Sportico publish headline financial information that can be used to calculate broad (or general) implied valuation multiples.

Recent select sports franchise transactions^{4, 5, 6, 7}

TEAM	LEAGUE	DATE	REPORTED PRICE (USD)
Washington Commanders	NFL	May 2023	\$6.0B
Nashville Predators	NHL	April 2023	\$0.9B
Phoenix Suns	NBA	December 2022	\$4.0B
Denver Broncos	NFL	June 2022	\$4.7B
New York Mets	MLB	November 2020	\$2.4B
Kansas City Royals	MLB	November 2019	\$1.0B
Brooklyn Nets	NBA	August 2019	\$3.3B

Determining implied multiples

As previously mentioned, some sports franchises are either loss making or generate marginally positive operating profits. As a result, it is often difficult to determine an implied earnings-based multiple (e.g., EBITDA) and therefore, the default implied multiple is typically an enterprise value (EV) to revenue multiple.



Normalized revenue

With guideline transactions screened, reliable data sourced and implied valuation multiples derived, the next step is to determine normalized revenue for the target sports franchise. Typically, last-twelve-months (LTM) revenue is used as a starting point for most sports franchises with normalization adjustments made to reflect the steady-state, long-term revenues generated by the target sports franchise. These normalization adjustments can relate to several franchise and/or league-wide developments such as:

- Adjustments for a new broadcasting or sponsorship deal that has been secured but has not come into effect in the historical period;
- Non-recurring fees received, e.g., one-off expansion fees from creation of a new franchise that are distributed to existing teams;
- Participation in playoff games (or lack thereof); and
- Adjustments for any changes in run-rate ticketing, gameday or sponsorship revenue from progressed improvements to the target franchise's stadium / arena.

Calibration of market multiples

Arguably the most difficult part in any market approach valuation is the calibration of observed market multiples to the target business. The same can be said, and is likely exacerbated, when it comes to sports franchises. Conceptually, this part of the process involves comparing the target sports franchise against its peers across key value drivers and from this analysis, selecting an appropriate multiple or range of multiples. The key value drivers that are most relevant will vary by sport and geography but broadly speaking, a potential buyer would seek to assess the strengths and weaknesses of the target sports franchise relative to the comparable sports franchises at the time of their respective transactions, across the following key value drivers:

- Quality, degree of ownership and economics of stadium / arena infrastructure;
- Strength and growth trajectory of the league in which the franchise participates;
- Strength and size of local market;
- Strength and size of fanbase;
- Brand value;
- Operational efficiency;
- Profitability;
- Salary cap / financial regulation compliance;
- Collective bargaining risk / security;
- Historical team performance;
- Strength of players and associated player value;
- Strength of management team; and
- Player development strategy, track record and infrastructure.

Another important consideration in respect of sports franchise valuations is the interplay between real estate and sports franchises. Oftentimes and especially prevalent for North American sports franchises, real estate adjacencies will exist within transactions that warrant some distinct, if not significant value considerations. These real estate adjacencies can take the form of tangible, income-producing real estate assets that are not used for sporting purposes. On the other hand, these real estate adjacencies can also come in the form of perceived synergies whereby a sports franchise has a strong relationship with local stakeholders, which can result in public funding for a new stadium or public support for future income-producing real estate developments.





Income Approach

While the market approach is generally the main valuation approach used for sports franchises, the income approach may provide an important sanity check on valuation conclusions. Additionally, the income approach, specifically a discounted cash flow analysis, may be more appropriate for smaller sports franchises that are not as frequently transacted by third parties.

As with any income approach analysis, the valuation outputs are only as reliable as the inputs, and as such, high levels of scrutiny must be applied to the value drivers of the franchise. The following section will highlight key considerations for an income approach valuation using a discounted cash flow analysis.

REVENUE

Sports organizations generally share similar revenue streams, irrespective of their sport, and size. These revenue streams are:

Ticketing	Revenue related to the sale of tickets for live games in the form of season tickets, single game tickets, suite sales, and other forms of ticketing.	<ul style="list-style-type: none"> • Ticket volumes are generally estimated as a percentage of maximum capacity. • Depending on the team, ticketing volumes and prices will have varying degrees of elasticity depending on team success.
Broadcasting / League Distributions	<p>Revenue related to league-wide TV deals with national broadcasters and sponsorship deals managed and distributed by respective leagues.</p> <p>In addition, franchises will generate revenues from regional broadcasters, which vary by franchise.</p>	<ul style="list-style-type: none"> • Broadcast figures are generally large, multi-year contracts. • Renewal estimates, including both term and amount, can be uncertain and can be impacted by a number of factors.
Game day	Revenue related to other commercial aspects of game days, such as concessions.	<ul style="list-style-type: none"> • Attendance numbers are generally projected by applying a 'turnstile' factor to the ticketing estimate used to drive ticketing revenue. • Certain teams may have licensing agreements with venues and/or retailers, and receive only a portion of sales.
Sponsorship	Revenue related to sponsorship deals that leverage the team's tangible and intangible assets	<ul style="list-style-type: none"> • Estimates of future sponsorship generally correlate to expected attendance, and therefore, team success. • Most teams, irrespective of sport or league, will have a minimum number of sponsorships that are secured by long-term contracts (e.g., stadium naming rights, title sponsors, etc.)
Merchandise	Revenue related to the sale of team-branded merchandise	<ul style="list-style-type: none"> • Certain teams and leagues may have licensing agreements with retailers and manufacturers to outsource merchandising business secured by long-term contracts

The value drivers noted above will vary in terms of relevance across leagues and franchises. As an example, NHL franchises are much more reliant on ticketing and game day revenue in comparison with NFL franchises that tend to rely more on broadcasting revenue as part of their overall economic model.

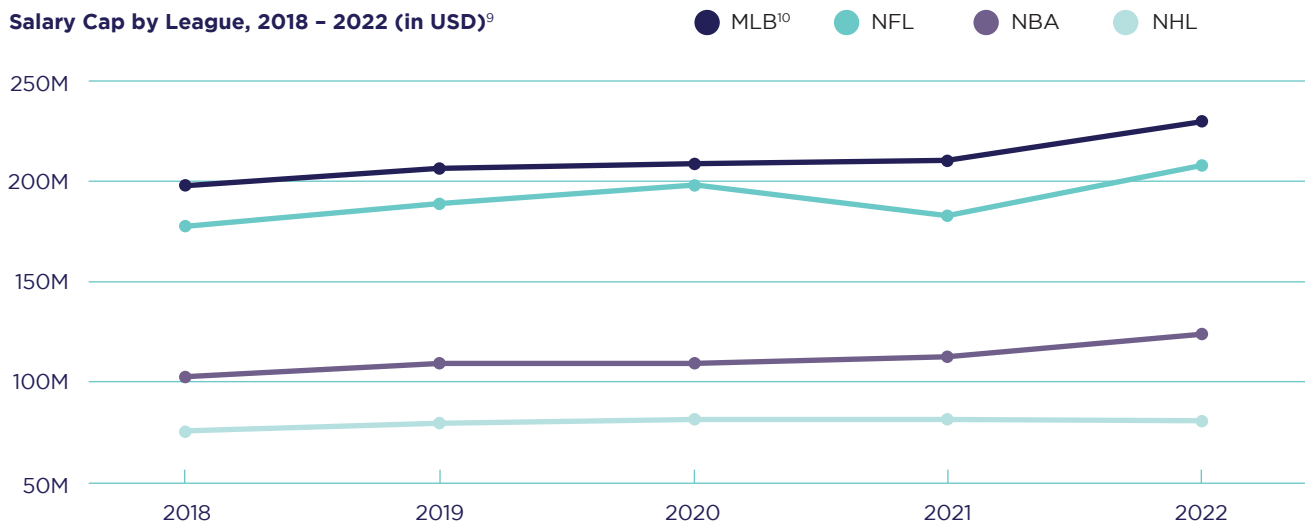


EXPENSES

The expenses for sports organizations are generally comprised of two major categories: team expenses and business expenses.

Team expenses typically constitute the largest portion of total expenses, as they include the annual amounts of the contracts paid out to players. In most North American leagues, a league-wide salary cap sets the ceiling for the total annual player-related expenses⁸, while in other leagues, organizations must use discretion and optimize their decisions to field the most competitive, but fiscally responsible roster of players.

Salary Cap by League, 2018 - 2022 (in USD)⁹



We can look to publicly traded sports franchises, most of which play in top-tier European soccer leagues, to get a sense of how much teams are generally willing to spend on their players. We highlight, however, that most European soccer leagues do not implement a direct salary cap, and as such, these values may not be comparable relative to those observed in North American sports leagues.

Select Player-Related Expenses by Team, as at June 30, 2022 (USD)¹¹

TEAM	ANNUAL PLAYER-RELATED EXPENSES	% OF TOTAL REVENUE
Manchester United	\$401.8M	65.7%
Juventus	\$326.0M	71.3%
Borussia Dortmund	\$242.5M	55.9%
Ajax	\$114.7M	57.8%
Benfica	\$118.1M	66.5%

While player salaries comprise the largest component of team expenses, a major business expense for sports franchises is venue cost. Most professional sports franchises will either own or lease their arena / stadium venue. This is a key distinction that not only affects the related expenses, but also impacts the fee structure of certain revenue streams.

Additionally, there are further considerations, such as staffing levels during game days, insurance and health benefit requirements for players, travel and lodging expenses, and administrative staff required for the operations of the organization. Certain organizations may have minimum requirements as mandated by the league, or a collective bargaining agreement.



CASH FLOW ADJUSTMENTS

Given that many sports organizations sell tickets in advance, working capital adjustments may be required depending on the valuation date.

The impact of capital expenditures for most sports organizations will be determined by their venue ownership strategy. To the extent that franchises lease their venues or investments have recently been made to stadium / arena infrastructure, capital expenditures may be minimal.

DISCOUNT RATE

While there is always subjectivity when it comes to estimating an appropriate discount rate to apply in a DCF-based valuation, forecasting cash flow for major sports franchises is fairly straightforward. Excluding potentially large and unpredictable swings in broadcasting and sponsorship revenues, most other key assumptions can be supported by historical analysis. While fledgling leagues and organizations will likely have more difficulty attracting fans and viewers in their early years; this emphasizes the importance of conducting adequate due diligence in advance of investing in and understanding the pathway to profitability for the team.

EXIT MULTIPLE

For major sports franchises, the true difficulty in applying an income approach analysis is determining an appropriate exit multiple. Generally, the practice in the industry is to assume the sale of an organization within 10 - 15 years, rather than apply a constant rate of growth, such as is done with the Gordon Growth Model.¹²





Concluding Thoughts

With so many tailwinds in respect of sports investment trends, whether it be the rise of women's sports, sports betting, the proliferation of sports-focused private equity funds, or others, the valuation of sports franchises will continue to be a hot topic. Stakeholders may require a robust valuation for a variety of different reasons, which can range from tax, financial reporting or M&A purposes. As a result, and keeping in mind the nuances and considerations that are unique to the sports industry, sector-specific knowledge is vital in order to provide accurate insights needed to arrive at a robust and sensible valuation conclusion.

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2. Data is based on valuations conducted annually by Forbes and represents the average of the five most valuable franchises as at each date. Team values are enterprise values (equity plus net debt) and include the economics of the team's stadium (but exclude the value of the real estate itself), based on comparable transactions.
3. Fair Market Value is defined in the International Valuation Glossary as the price, expressed in terms of cash equivalents, at which property would change hands between a hypothetical willing and able buyer and a hypothetical willing and able seller, each acting at arms-length in an open and unrestricted market, when neither is under compulsion to buy or to sell and when both have reasonable knowledge of relevant facts. (International Valuation Glossary - Business Valuation, updated February 24, 2022 p. 5: https://cbvinstitute.com/wp-content/uploads/2021/11/International-Valuation-Glossary-Business-Valuation_EN.pdf).
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8. We highlight that the salary cap does not equate to the cash payroll paid by a team. A contract's impact on the salary cap is calculated by dividing the total value over the length (average annual value, or "AAV"), while the payment structure itself may be different (i.e., front-loaded, etc.).
9. Source: www.spotrac.com.
10. The MLB does not have a salary cap. The numbers presented in this table represent the luxury tax threshold.
11. Source: Capital IQ; financial statements of companies. Figures have been converted based on the exchange rates as at June 30, 2022 of €1.0000:\$1.0489, and GBP1.0000:\$1.2159
12. The Gordon Growth Model is a formula used to determine the value of a stock based on a future series of cash flows that grow at a constant rate, and is typically used to estimate a terminal multiple.