Investing in Sport: A Transatlantic Rivalry

As I sit here writing this piece, I am wrestling with the physical, mental and financial ramifications of my recent trip to Berlin to watch England lose the Euros Final to a deserving winner in Spain. Although the result was genuinely devastating, when I am asked (as I have been many times since) whether it was worth it, the answer is always an unequivocal “Yes”. This is because there is no ‘experience’ which comes close, at least for me, and many others, to generating such a wealth and spectrum of emotion. The prospect of watching your club or country in a final seems to render the concept of budgeting obsolete. A similar rationale underpins much of the ownership in this arena: owning a football, baseball, basketball team (etc…) has for a long time been the playground of the obscenely wealthy, splashing out on trophy assets to earn glory and the adulation of an adoring fan base, or fulfilling a childhood dream.

Of course, success on the pitch has brought money, and certain European football clubs have become global brands by that virtue. The advent of televisual media introduced additional revenue streams and as technology has advanced, so too has the prospect of reaching a global audience. Large tech streaming platforms, all eager to muscle into the mix, spending more (and for longer) on fixed contracts with sport leagues has further broadened their audience. Private equity sponsors have taken note and have become increasingly active and willing owners. Profit now looks to be overtaking passion as the prevailing reason for owning a sports team. Yet you need only take a look at Todd Boehly since his purchase of Chelsea FC in mid-2022, contorted in the director’s box as he cops yet more abuse from the Chelsea faithful, to understand the potential pitfalls of ownership in European football.

Which leads me to the central premise underpinning this piece. Although European football is arguably more competitive (and entertaining), it is commercially less attractive for reasons related to the structuring of European vs North American leagues.

Why is sport so attractive right now?

Sport in the US and Europe has exhibited broadly trending growth across the “Big Four” in the US (Major League Baseball, National Football League, National Basketball Association, Major League Hockey) and the “Big Five” Football leagues in Europe (Premier League, Serie A, Bundesliga, La Liga, Ligue 1). It is fair to say the US enjoys the relative advantage in this sphere due to certain structural factors which will be discussed in due course.

The following graphs demonstrate the relative performance of the respective US leagues relative to the S&P500, with the Ross-Arctos Sports Franchise Index providing real time information on aggregate franchise valuation growth, and the second graph breaking it down by league (although slightly more dated).

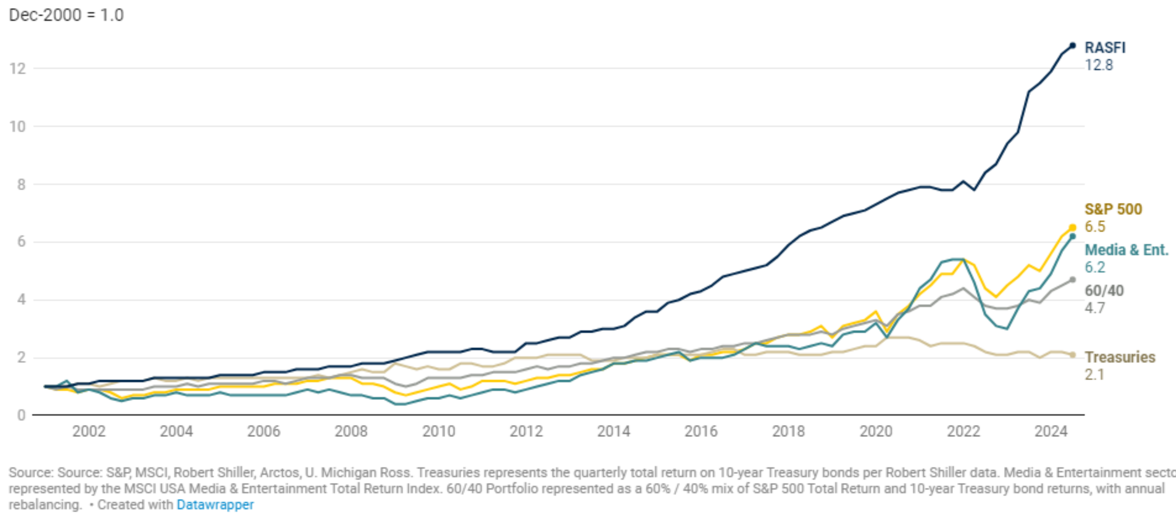


FIGURE 1: TWO DECADES OF RASFI RETURNS

FIGURE 2: TEV GROWTH – BIG FOUR LEAGUES (MLB, NBA, NFL, NHI) VS S&P 500
Source(s): Arctos Partners

It's a similar picture in Europe. Although some clubs are clearly struggling, total enterprise value continues to rise steadily among the elite clubs with the top 32 clubs exhibiting average TEV growth of 124% over the past 8yrs according to the most recent 2024 report from Football Benchmark on European football team valuations.

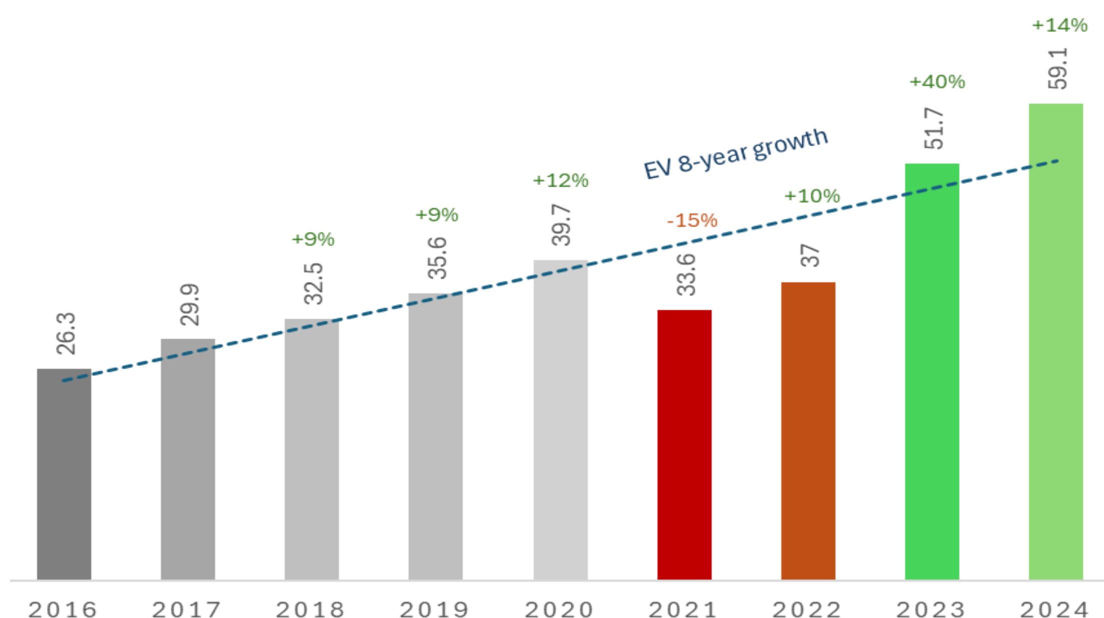


FIGURE 3: AGGREGATE EV OF TOP 32 CLUBS (2016-2024, EUR BILLION)
Source: Football Benchmark, The European Elite 2024

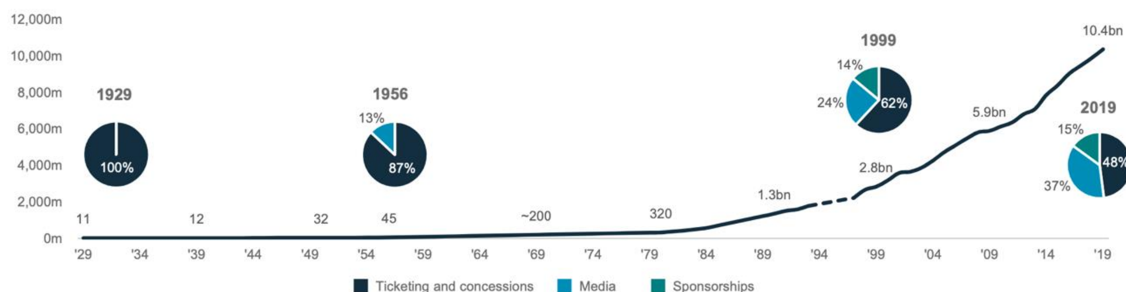
What is driving this growth?

Firstly, sport is in its own league when it comes to customer loyalty, and associated revenue retention. No other form of 'entertainment' can create the same attachment and provide the same level of fanatical, resilient, intergenerational devotion. This is especially true when one considers that the team need not even necessarily deliver or succeed to ensure the continuing support of the fan. I am both a Tottenham fan and I am English. I have never seen my team lift a trophy (aside from the Carling Cup in '08, and I was a bit young for that). I have, however, in that time, owned a season ticket for Spurs and travelled to every major tournament to support England. Am I an idiot? In most other walks of life this sustained failure would trigger a reassessment. For some reason, within this construct, my blind loyalty is applauded. My dad supported Spurs and I am hopeful my children will too.

It is this emotion which underpins the resilience and consistency of a large proportion of the revenue.

Over time, leagues have been able to extract revenue from different sources and now make money in 3 ways:

1. Ticketing concessions
2. Selling advertising space at the venue/sponsorship
3. Licensing content to traditional and digital media companies.



Source: Rodney Fort's database (1951 House Judiciary Committee Hearings, 1957 Congressional Hearings, Gerald W. Scully, The Business of Major League Baseball, University of Chicago Press, December 1989, Financial World Magazine), Forbes. Revenue data is available for the following years: 1929, 1933, 1939, 1943, 1946, 1952-1956, 1980, 1982, 1984, and 1990-2019. Remaining years are interpolated linearly in the chart. The years 1994 and 1995 were impacted by the MLB players strike (not shown). Revenue mix for 1999 and 2019 estimated from internal data

FIGURE 4: MAJOR LEAGUE BASEBALL ESTIMATED REVENUES AND REVENUE MIX
Source: Arctos Partners

The above graph is admittedly specific to Major League Baseball (MLB), however, given this is the oldest league in the world, it probably provides the most valuable insight into the evolution of the revenue mix. 'Ticketing concessions' has always been at the core although since the introduction of television and more recently streaming, that proportion has understandably diminished.

At its core however, the onset of televisual and then internet media consumption has broadened the audience first from local to regional, and now from national to global. Competition for these eyeballs has been fierce, with platforms vying for superior coverage over their rivals. This has precipitated a veritable explosion in revenues.

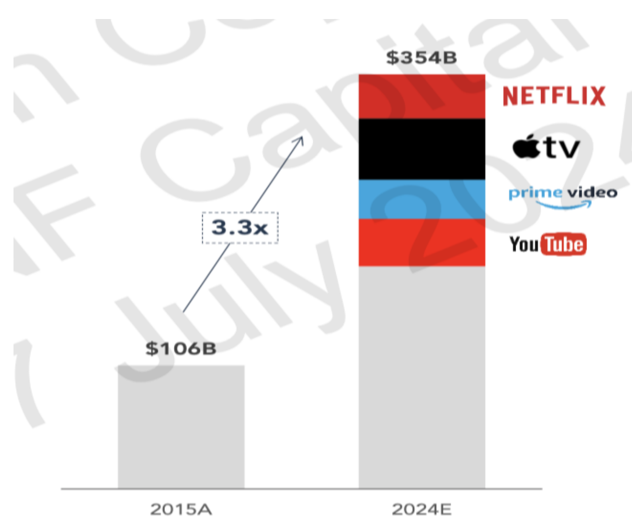


FIGURE 5: MEDIA REVENUE OF CURRENT/POTENTIAL SPORTS RIGHTS BUYER UNIVERSE VS BIG FIVE SPORTS RIGHTS
Source: Arctos Partners

Sports leagues are able to negotiate media rights pay packages on a semi-regular basis, and the recent renewals make for exceptionally interesting reading, particularly the disparity between Europe’s top offering, and those of our friends over the pond.

In the US, the NFL is currently the premium product and recently renewed their media rights in March 2021. They signed a series of 5 deals with NBC Sports, CBS Sports, Fox Sports, ESPN and Amazon, comprising a collective value of $110bn across 11 seasons, totalling roughly $10bn a year. Sources in the industry claim this represents a near doubling of the previous deal. The NFL even has an opt-out after 5yrs, to see if they can secure a better deal, on improved terms!

In July 2024, the NBA inked a new deal with Disney, Comcast and Amazon reported to be worth $76bn across 11 years. Their last deal was worth $24bn across 9 years. The deal before that was worth $7.4bn over 8yrs. This trend continues more or less across all US sports leagues.

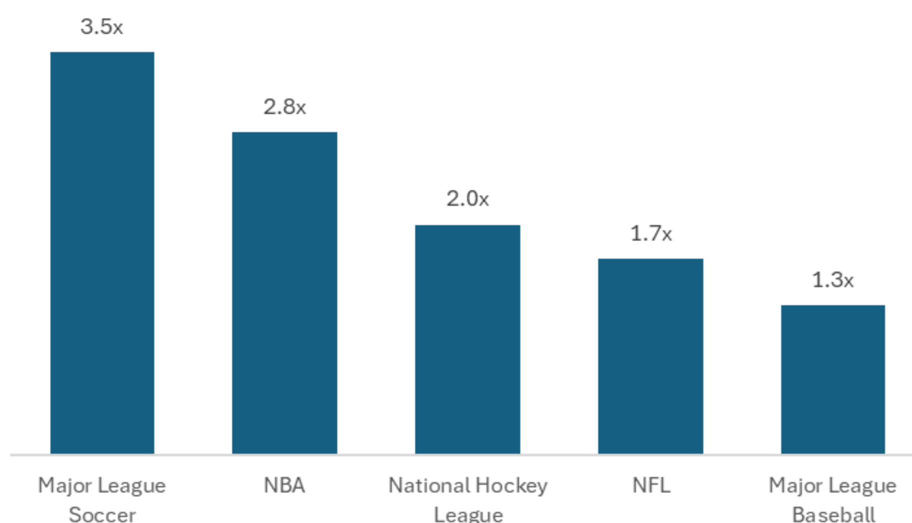


FIGURE 6: STEP UP IN ANNUAL REVENUES AT LAST TV RIGHTS RENEWAL
Source: Investing in US Sports – More Than a Game, Reji Vetasseri, DECALIA

What's different in Europe?

Europe is sadly a bit of a different story. Serie A and La Liga have experienced relatively stagnant renewals recently. The Bundesliga comes up for renewal fairly soon, and Ligue 1 is mired with issues following the departure of Kylian Mbappe. The Premier League, however, makes for an interesting and relevant comparison.

The Premier League is still proportionally the 800lbs gorilla in the room, with their newly inked domestic UK deal with SKY and TNT Sports worth £6.7bn over 4yrs. It must also be noted that the UK domestic market, given population size, is roughly 1/5th of the US, and so the value per consumer is roughly considered equivalent. Nevertheless, the increases per renewal for Europe's top offering do not match those in the US. The Premier League's last deal (2022/23 – 2024/25) was worth £5bn over 3yrs. On a per year basis, the old deal's £1.62bn per year is roughly equivalent to the new deal's £1.67bn per year.

We do also have to consider that the Premier League enjoys the benefit of a considerable market for their international rights given the global popularity of football. The Premier League is unique in that its international media rights revenue constitutes over 50% of the total revenue share, so we can foresee a renewal somewhere in the range of the domestic transaction on the horizon. To date, there is no other league which comes close, save for La Liga, powered predominantly by Real Madrid and Barcelona.

Despite this popularity, competition for Premier League sports media rights does not reach the fervour observed in the States. One argument for why is that the rights are already at a very high value -their market share, on a domestic and internationally combined basis - already around 50% of the total media revenue generated by European football. Although a fairly logical assumption, the price of these rights is simply a function of supply and demand; the issue here being that there are only 2-3 players who compete for the TV Rights (think SKY and TNT etc). This quasi-monopolistic structure serves to suppress their value, not the opposite.

Similarly, although there was a lot of talk about the big US streaming platforms coming into the UK/ Europe, and slugging it out for the sports rights, this development has not been as pronounced as envisaged. Amazon has been active however as they have been fully able to monetise the consumer through a dominant market position, monthly subscriptions, advertising and various ways to upsell to the consumer. This has made it worth it for them to bid for rights. Other large players in the US, such as Google (Youtube TV), have been unable to roll out subscription services in Europe due to various regulatory and financial obstacles. They would therefore be solely reliant on advertising revenues to recoup cash spent on rights. In their eyes, this trade-off is not worth the money.

An additional headache for streaming platforms has been that international markets are sold off on an individual country basis. It seems as if large streamers are hesitant to bite off chunks, instead opting for the whole meal in the US, where they can attempt to access an already competitive consumer market through one deal, driving up pricing.

Lastly, there is a far greater disparity between the end beneficiary of these rights in the US vs Europe. In Europe, the top teams in the league receive a far greater proportion of the media spoils than their American cousins.

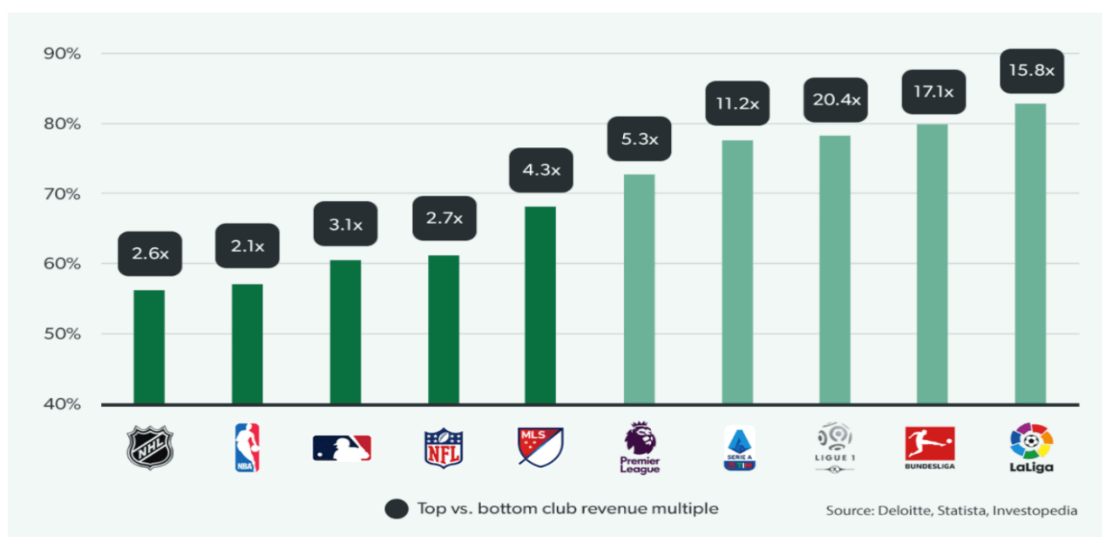


FIGURE 7: % OF REVENUES CONTROLLED BY TOP 50% OF TEAMS/MULTIPLE BETWEEN TOP AND BOTTOM CLUB REVENUES, SEASON ENDING 2019, EURM.
Source: Tifosy Capital and Advisory Insights

The reasons for this are structural and to a large extent strip out the major risks associated with owning a sport team.

In brief, American leagues are horizontal and effectively closed to new membership (as long as the existing teams are viable from a financial and operational standpoint). There is no relegation or promotion, and the clubs operate as franchises (or brands) within a league of which they can be broadly understood to have an ownership. Each club/franchise nominates a representative to an executive committee (normally the majority owner) which works to ensure that certain competitive and financial regulations are adhered to. These regulations are intended to maintain the overall financial health and competitivity of the league. This committee works to ensure more egalitarian distribution of media rights and merchandise revenue. Consequently, a far higher proportion of North American sports teams are profitable. In fact, 41 of the 50 world's most valuable sports teams are American (according to a 2021 article by Forbes). It is this economic security, or even equality, which serves to distinguish the US Leagues as a safer haven for investment.

This is not traditionally a principle espoused within a North American capitalist construct. Ordinarily, the weak would make way for the strong, and to the victor would go the spoils. This is how leagues operate in Europe, with the pyramid set-up ensuring that successful teams are promoted, and their less successful counterparts are relegated. Capital therefore flows to the top of the pyramid, with the idea being that it is the successful teams, and the quality of the entertainment that they produce, which creates an entertainment 'product' that cannot be replicated elsewhere. Conversely, the dogfight at the bottom of the league, as teams desperately scrap to avoid 'going down', creates some truly iconic sporting moments. So long as sufficient parity can be maintained to make sure that each game is sufficiently unpredictable, then the league will be exciting.

Clearly, this set up introduces some colossal risks (and rewards). Relegation can be a veritable death sentence, but dynastic periods of success can mint entities worth billions. It is this polarization of outcome, which contributes to the dynamism of the league, yet may give you cause for concern as a potential investor.

Why did it play out this way?

When researching this piece, I was so often confronted by the age-old adage that the Americans had done it this way so that they could make more money: it was rampant capitalism implemented at the expense of competition. In fact, as evidenced above, that argument doesn't really hold to bear. In fact, they organized their leagues as such out of necessity to engineer a sufficiently entertaining spectacle.

To ensure sufficient parity within the league (and to use the MLB as an example as it is the oldest and was created at a similar time to our English 'Premier League') the Americans had to professionalize before we did. Arguments around this are legion but I think the most compelling comes from two economic historians (Louis Cain and David Haddock) who put forth that in order to produce well-played games with uncertain outcomes, in the sparsely populated, relatively rail-poor United States, the National League restricted membership to one outstanding team in each of eight cities that spanned 1,207 miles (the North East). Average distances between the eight original baseball teams

were tenfold that of the twelve original football teams (595 miles vs 59 miles). American players had to travel for 2-3 days roundtrip to play a game. There's just no way they could hold down a job and accordingly they had to be compensated for their time. In addition, games which were played locally were often very uneven and boring to watch. Therefore, teams travelled long distances to play in front of largely home crowds. To ensure the crowds were sufficiently large to pay the players, the league introduced the concept of a territorial monopoly, meaning only one team had the rights to play and sell tickets/merchandise within a specific city or territory. It was just too risky to allow a local upstart to steal market share and upset attendance at games. It would mean the league couldn't pay players and it would detract from the overall quality of the match.

Why am I bothering to tell you this?

Aside from the fact that I found it very interesting, it rounds off the competitive moat that American Leagues have dug around themselves. They enjoy a rigid league composition wherein they cannot be relegated, and they have the sole right to merchandise themselves within their territories. This monopoly gives them the collective bargaining power to counteract their only remaining risk: namely, rampant player salaries. US sports teams have introduced salary caps and a draft system which allows the worst performing teams to pick the best young players coming through the college system. Of course, the best talent will still find its way to extraordinary salaries, but the league-imposed caps ensure no team can blow themselves up in the process. Although specific to the NFL, the sheer physicality of the sport leads to short careers. Players need to maximise their earnings within a 2–3-year time frame. They simply can't afford to be locked in a salary dispute with a long-term owner…

Teams in US sport leagues are therefore not victim to the exorbitant salary demands of certain players who can help them achieve their position at the top of the pyramid. US League franchises can more effectively position themselves in opposition to outlandish salary demands through their unified position, ensuring salary costs don't eat so vociferously into their profits.

Does this create a more or less entertaining spectacle? That is not necessarily the subject of this piece, however, does the gradual reset of player quality, ensuring a more even distribution of champions over time, sound more or less entertaining to you? I think I know where I stand and would argue Manchester City's recent total dominance of the Premier League renders the competition a less exciting spectacle.

So, we have in front of us two diametrically opposed structures providing sports entertainment to obliging fans. On the one hand we have the European system with its preference for excellence and commensurate profit. On the other, we have the US system, structured in such a way so as to promote a redistribution of profits sufficient to ensure competitivity from season to season.

In all honesty, as an avid fan of competitive sport, my heart leans towards my European brethren. My brain understands the appeal of the US system and is tempted by its mechanics. My money, however, would be on the US all day long.

So how can you get access?

Investing into US sports team has traditionally been difficult. Stringent measures concerning debt to equity ratios have ensured ownership is still privy to very well capitalized individuals; people heavily vetted by the leagues themselves to ensure no conflict of interest and the ultimate preservation of parity within the league. The result has been franchise capital stacks populated with wealthy local businessmen, usually just pleased to be involved.

As the industry has matured, and alternative forms of revenue have been introduced, the complexity around successfully operating a team has increased. At the same time, minority owners have, over time, encountered an increasing need for liquidity. As a result, US Leagues have started to adopt a more amenable stance to ulterior forms of ownership. Specially ordained private equity firms have now identified this opportunity and have begun to deploy capital into this arena. Their participation is predicated on their sophistication. More often than not, their capital is considered 'growth capital' and they are expected to help teams unearth additional steams of revenue; for example, improved stadia and surrounding real estate monetization.

Only a private equity partner who can demonstrate this proficiency will be welcomed into the fold; and crucially, there are myriad conflicts which restrict involvement from the incumbent and large private equity sponsors we would all recognise. We are therefore presented with a fresh opportunity, open to only a few parties.

Perhaps most telling of this development is the very recent (August 27th, 2024) decision by the NFL to allow minority ownership in teams by institutional investors (ie. private equity funds). The NFL was the final US sports league to make this decision, meaning all 5 major US Leagues are now accessible to (certain) PE Funds. For clarity, see the official statement from the NFL on the development:

The ground rules: *The NFL has been thinking about private equity for five years and got very serious about it in the last year, with the appointment of a special committee to delve into an asset class that other professional sports leagues were already in business with. The result is a measured first dip into the pool.*

A total of 10 percent of a team can be owned by private equity funds. The NFL has already vetted the private equity funds that will be allowed to do transactions with the teams. The list of permitted funds consists of Arctos Partners, LP; Ares Management Corporation; Sixth Street; and a consortium group including Blackstone, Carlyle, CVC, Dynasty Equity and Ludis (which is led by Hall of Fame running back Curtis Martin). Direct investment by sovereign wealth funds and pension funds is not allowed. Such funds are allowed to be investors in the overall private equity funds, but even then, their participation would be limited to a very small percentage share of ownership.

A team can sell stakes to multiple funds for a total of 10 percent of ownership, although each stake must be for at least 3 percent. And a fund can hold stakes in more than one team at the same time -- up to six teams. The league has set up parameters around information disclosure for funds that own stakes in multiple teams.

This is truly a passive investment. There is no voting power attached to the transaction. The rest of the NFL's strict ownership rules remain in place. The controlling owner must own 30 percent of the team. A franchise can have limited partners, but no team can have more than 25 owners total, including the controlling owner, other individuals and families, and now private equity funds.

And private equity funds that buy shares in teams are obligated to initially hold onto the investment for six years before they can sell; it is not going to be like flipping real estate.

"This won't change a thing," NFL Commissioner Roger Goodell told reporters on Tuesday. "This is 10 percent of a team. All it is, is a silent position that would allow access to capital for those teams that wish to offer 10 percent of their team. They will not be in any kind of decision-making influence in any way. It was very important when we began this that we strengthen the ownership. … We think the single-owner structure has been very valuable ... and this does not impact that at all."

Now the cynic in me would naturally pose the question: why would they let others into the party? The answer most likely stems from the success of the enterprise hitherto. For the reasons outlined above (team scarcity, no relegation, monopolistic territories), NFL teams are now very expensive. In fact, the median Premier League team is valued at 2.1x TEV / Revenue (vs. 7.0x for NFL teams and 5.7x for MLB teams). The last successful 2023 sale of the Washington Commanders to Josh Harris and a collection of limited partners that includes Magic Johnson broke the $6 billion mark. That is eye watering stuff, even for a billionaire. The NFL has taken the view, as has every other league, that permitting an influx of institutional PE capital satisfies legacy minority owner liquidity requirements and concomitantly promotes investment (and reinvestment) of capital into teams and their infrastructure. Similarly, many franchises are keen to engage with an institutional and knowledgeable operating partner, as they enter the next stage of the development.

Importantly, this is only open to a select few GPs who have consistently demonstrated an aptitude in sports investing, with Arctos Partners the only fund able to invest across all 5 major leagues.

It is our strong recommendation that investors spend time thinking about what is unfolding the US. Ultimately, we are presented with an opportunity to tap into a monopolistic structure benefitting from growing media rights revenues. European football teams have their appeal: status, history, and a more global product; but they are overbought and poorly run. Instead, the US offers a safer, albeit pricier, investment, supported by stronger media rights and a more equitable distribution of revenues…. Ironic, I know.