THE INVESTMENT PITCH

PRIVATE EQUITY IN SPORT

THE SPORTS CONSULTANCY

BDO

CONTENTS

INTRODUCTION

> *“Success is where preparation and opportunity meet.”*

BOBBY UNSER

RACING CAR DRIVER AND BROADCASTER

THE SPORTS OPPORTUNITY

The theory surrounding private equity has traditionally been skewed towards entrepreneurial businesses. Private equity (PE) is often a catalyst for professionalisation, transformation and accelerated growth, and in many ways PE allows the entrepreneur to be more entrepreneurial.

While the above theory is true, PE should not only be seen as the go-to for entrepreneurs, but also as a partner for those who want to embark on the next phase of growth, with the ambition and resilience for transformational change over a relatively short period of time.

Where there is a need and appetite for commercialisation, there is an argument for PE investment, irrespective of the history of an organisation, the breadth of the stakeholders, or the depth of the social responsibility.

In the last decade, examples of private equity investment in sport have been relatively sporadic and isolated. Aside from the largest and most notable sports properties and brands, the sector has been viewed with caution by investors; likewise, leaders of sports businesses, attempting to balance the desire to grow their sport with the need to respect the idiosyncrasies of the game, have been wary of external investment.

Over the last 18 months, however, there has been a notable shift in activity and appetite on both sides of the field: investors and sports entities are increasingly looking for innovative ways to partner and accelerate towards transformative growth. In recent months, this activity has grown as both sides identify opportunities to both weather the shorter-term challenges posed by the pandemic and to position themselves to enter the "new normal" stronger.

So, the Sports-PE challenge is whether sports organisations are able to navigate their traditions, governance structures and political landscapes in such a way as to find a seat at the table for PE. And, if they can, whether the PE experience can deliver sufficient and stable incremental returns, for all stakeholders, in what PE considers to be an acceptable investment lifecycle, together with an exit mechanism that preserves the integrity of the organisation.

It is in this context that we are delighted to release this joint paper examining the relationship between PE and sport. Drawing on the experience of The Sports Consultancy and BDO of advising leaders in sport and investment, we address the three key questions for either party when approaching an investment:

- **WHY IS NOW THE RIGHT TIME FOR PE AND SPORT TO TEAM UP?**
- **WHAT ARE THE PECULIARITIES OF THE SPORTS INDUSTRY TO BE AWARE OF AND WHAT ARE THE FUNDAMENTALS THAT NEED TO BE IN PLACE FOR A SUCCESSFUL INVESTMENT?**
- **HOW SHOULD DEALS BE STRUCTURED TO ACHIEVE THE OBJECTIVES OF BOTH SIDES?**

Some adjustments may be required on both sides, but this may only be evolutionary change, fuelled by the promise of untapped market opportunities. Success will be where PE is prepared to actively invest their capital, time and experience in the opportunities that sports rights holders are presenting.

WHY NOW?

To understand the history and potential future of investment in sport, it is necessary to understand the perceived historical dichotomy in goals between the two parties and how this perception may be changing to create new opportunities.

In order to make a return, investors need to either buy well, sell well, grow earnings or hope that earnings multiples increase over time as the asset class increases its appeal, or a mixture of all these.

Two interesting questions to ask on behalf of PE firms are therefore:

- **WHY INVEST IN SPORT NOW?**
- **WHY HAVE PE NOT INVESTED IN SPORT PREVIOUSLY?**

Taking these two questions together, this section examines the following key drivers of what is spurring the interest of PE now when previously there may have been a reluctance:

- SEPARATION OF REGULATORY AND COMMERCIAL ASPECTS
- EMERGING SPORTS ON AN UPWARD TREND
- SPORT'S UNIQUE BRAND LOYALTY
- PREDICTABLE AND GROWING REVENUES FOR ESTABLISHED SPORTS
- NEW OPPORTUNITIES WITHIN EXISTING SPORTS
- MAXIMISING THE VALUE OF PARTICIPATION
- LEVERAGING NEW PARTNERSHIPS
- SPORTS PRIMED FOR COMMERCIAL EXPERTISE
- SPORT'S ABILITY TO ADAPT AND INNOVATE
- RECESSION PROOF

SEPARATION OF REGULATORY AND COMMERCIAL ASPECTS

Perhaps the biggest factor that has prevented interest in the past, and may continue to do so, is that sport as an industry is different because of the number of external stakeholders involved. It is that sense of being a custodian as well as being an owner. This adds a different dimension, as the owner has a responsibility not only to the business but the sport as well, which is not something that PE has been comfortable with in the past.

The public nature of sport, as well as the level of public funding within some sports, means they are required to be run as quasi-regulated businesses, meaning a higher level of governance than businesses PE would typically invest in. This presents challenges to both the running of the portfolio company and the potential profits to be made, as well as asking the question of whether PE firms are willing to flex their modus operandi during their period of ownership.

The custodian vs owner issue also presents a challenge upon exit. It is not just a case of generating financial value and making a profit on sale, but also ensuring that the custodian leaves the sport or organisation better equipped for the future on exit than it was on entry.

Recent examples, from CVC's investment in Premiership Rugby to the International Table Tennis Federation's creation of a separate World Table Tennis commercial arm, have shown, however, that the regulatory and commercial responsibilities can be split, allowing investors to focus on commercial aspects. And this joining of expertise may create additional synergies to drive the sport even further forward.

EMERGING SPORTS ON AN UPWARD TREND

Certain areas of sport, particularly e-sports and women's sport, are seeing exceptional growth in participation, leading to greater media coverage, revenues and prize money.

E-sports used to be the playground of venture capital, but over the last two years it has seen a dramatic increase in income, projected at over $1bn at the end of 2019, mainstream media coverage, as well as improved governance and regulation, followed by a spike in investment from PE. It has even seen investment from football clubs, which see e-sports as an opportunity to reach new markets, a younger fan demographic, and additional sponsorship opportunities.

The increased profile of women's sport (both through traditional broadcasting and social media) means that certain sports are well positioned for investment. In football, for example, the growth in popularity of the women's game was highlighted by last year's FIFA Women's World Cup, where the global audience was estimated to have exceeded one billion for the first time. Likewise, in 2019 the FA and Barclays announced a record-breaking partnership for the Women's Super League, which is now the subject of investment approaches from PE.

The high growth nature of these sports, and the attraction of new media and commercial partners, means that PE's interest in this space should continue.

1BN

GLOBAL VIEWERSHIP 2019
FIFA WOMEN'S WORLD CUP

BRAND LOYALTY

Brands are key drivers of business value. Strong brands have powerful emotional connections with their customers. Customers adopt brands which are an extension of their own personality, style and identity. These deep relationships go beyond the consumption of any single product or service and endure over time. A strong brand, properly managed, can generate significant and consistent revenue over time. In no industry is the relationship between business and consumer stronger than in sport. Sport possesses some of the most powerful brands on the globe, that have an authenticity and heritage that few other industries can match. While, for sports fans, their following is a lifetime engagement like no other. Put simply, there is no substitute to the club you support. Through the lowest lows to the highest highs, the loyalty that clubs command over their supporters is unrivalled in every regard.

While technology and changing consumer behaviour is shortening the life span of many established brands - particularly highlighted during this Covid crisis, as industry giants in the retail and airline world for instance, have seen their consumer base dissipate - sports brands have an enduring shelf life that spans lifetimes and family generations. Investing in sport gives PE the opportunity to acquire brands with an infinite life - brands which have global presence and unbreakable ties to its fan base who religiously follow and engage with that brand on a daily basis. The value these fans drive is immense, through not only direct revenue involved in activities such as ticket and merchandise sales, but also as the core sales case for attracting other commercial partners. Sponsors and media platforms sign up to multi-million pound deals in order to partner with sports to gain access to their loyal fan base, who consistently engage with the product. It is this unique relationship between the fan and sport that offers demonstrable revenue and growth opportunities that few industries can.

CITY FOOTBALL GROUP

City football

Ferran Soriano, Chief Executive of City Football Group, has pioneered the club's expansion into global markets around the world through the purchase and investment of other football clubs. The City Football Group currently has significant investments in eight football clubs, including Manchester City (UK), New York City FC (USA) and Melbourne City FC (AUS) as the club seeks to solidify its position as one of the world's largest sports brands.

Yet, the idea of becoming the world's biggest club is not just a vanity project: rather, the Group, and Soriano in particular, have realised the untapped potential of the City brand globally and its ability to capture a global audience to generate significant additional revenue.

As Soriano realised when he was Chief Executive of Barcelona, despite the global presence of these mega football brands, the businesses themselves were small in comparison as a significant proportion of the club's fanbase were not able to directly interact with the club on a regular basis. He believed that a franchise model, that exported the core club brand and put it into different clubs around the world would give overseas fans direct access to the club.

This vision has been realised at City Football Group, who have invested in clubs in China, Japan, Australia, America, Spain, Uruguay and India that has expanded the reach and capability of the club and meant they have been able to capitalise on the power of the brand and their fan loyalty to increase revenue potential exponentially.

FERRARI AND FORMULA 1

As a rights holder, Formula 1 recognises the integral value brand loyalty holds in their business and the importance of keeping its biggest global brands a part of their Championship to maintain and grow its overall value. To that end, Formula 1 pay Scuderia Ferrari, the only team to compete in every F1 World Championships since inception and a global brand in its own right, a "long standing team" payment and provide them the power to veto regulation changes in order to keep the team a valuable member of the F1 community.

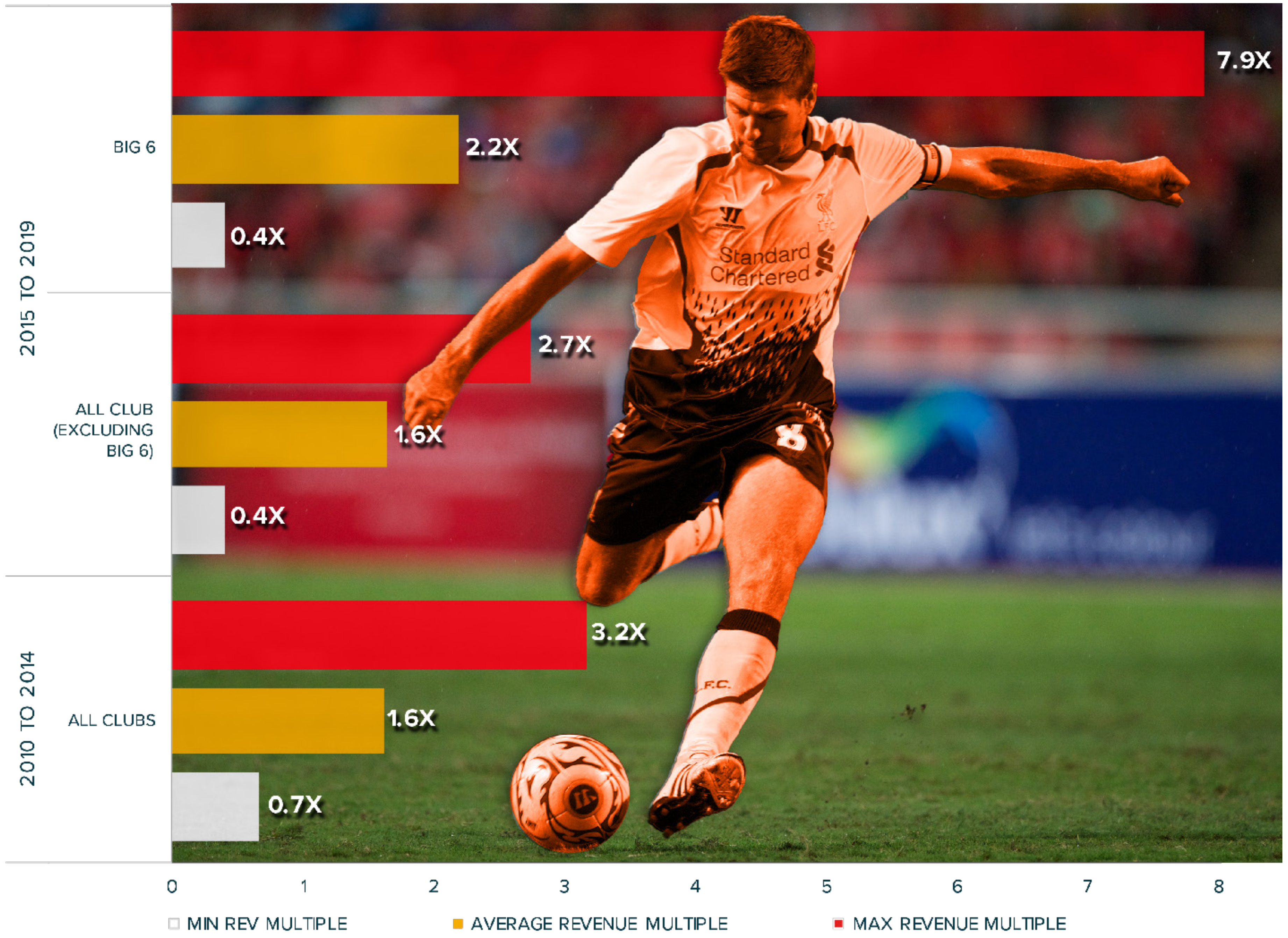
Formula 1 understands the unique pull the prancing horse logo has and the support it commands with fans worldwide. This is showcased through the Tifosi, who turn up in their thousands to every race weekend in their Ferrari livery to catch a glimpse of the famous red car. As such Formula 1 deem it necessary to recognise Ferrari's position in the sport through increased payments and voting powers to ensure the brand maintains its relationship with the sport.

PREDICTABLE AND GROWING REVENUES FOR ESTABLISHED SPORTS

Whilst there is a degree of uncertainty around when fans can return to stadiums, this is only in the short term, and investors tend to take a longer-term view in sports.

The perception of investment in sport has changed. While sport still lends itself to passion projects, investors are now looking for sizeable financial return on investments, and not just a “trophy asset”. PE demands high returns, and traditionally these have not been seen to be available within sport. These days, however, certain sports, such as football, have much more predictable and lucrative recurring revenue streams. For example, looking at Manchester United, Liverpool, Everton, Tottenham Hotspur, Chelsea and Arsenal, these clubs have never been relegated from the Premier League which provides a high predictability of revenue.

Sport is a price-inelastic product; consuming sport is not a luxury but a necessity for many viewers. The emotional connection with a club is a lasting loyalty that many other brands across the world could only dream of replicating. Within football, the value of a club often sits between one and two times revenue, increasing for higher revenue clubs who have over £250m annual revenue. These are seen as relegation-proof or having more diverse revenue streams (e.g. overseas joint ventures) and other angles to their deals such as real estate development and e-sports. With the exception of the traditional Big Six clubs, where recent multiples have been well over four times, multiples have not changed a great deal over time but there is an opportunity to find an underutilised brand/support base and expand it to increase value. For instance, Nottingham Forest is an example of a club with a large fan base and extensive honours list where promotion to the Premier League could provide a significant acceleration of revenue and value growth.



SOURCE: BDO BENCHMARKING DATA

Min, max and average revenue multiples (versus enterprise value) 2010 to 2019. Outside of the Big Six clubs, revenue multiples have remained broadly consistent on average over the last ten years, yet the Big Six clubs have earned significant premiums in recent years

NEW OPPORTUNITIES IN EXISTING SPORTS

The creation of new competitions is not limited to sports which have historically struggled to generate revenues, either in the UK, or worldwide. As sports try to attract bigger, wider and more diverse audiences, new formats represent a good opportunity. This has been seen recently with the new look Davis Cup in tennis, following investment from Kosmos, The Hundred in cricket which was due to start this summer but has been delayed until 2021, and the International Swimming League which introduced city franchises to swimming.

Not only are sports fans being treated to exciting new versions of sports they already watch, but the variety of television channels and digital platforms available today mean that a wider array of sports are beamed into the homes of fans across the globe. American sports have become almost mainstream in the UK, with NBA and NFL in particular receiving a heavy focus. Women’s sport is also highly in focus on television, with football, netball, golf and cricket all widely accessible.

Along with a higher profile and increased access to women’s sport, perhaps the biggest change in recent times has been the coverage of e-sports. These have long been available to stream on the internet, via sites such as Twitch and YouTube, but over the last few months, viewers have been able to watch certain e-sports on the BBC, such as the League of Legends UK Championship. The long and short of it is that as different sports grow in popularity, media coverage will continue to evolve.

MAXIMISING THE VALUE OF PARTICIPATION

There is not always a correlation between the most popular sports for public participation and revenue. In the UK, some of the most popular sports that have not been fully monetised with significant latent potential include running, swimming, basketball and netball. Basketball in the UK provides a prime example of a sport that has been unable to move away from a publicly subsidised model despite being the 2nd largest participation team sport in the UK. Over 1.2 million people play basketball currently, which is only second to football in terms of participation as a team sport, and yet Basketball England, the national governing body for the sport, is almost entirely funded through Sport England (Sport England provided £4.73m to Basketball England over the period 2017-2021). They have been unable to articulate the value of their audience to commercial partners and therefore are vulnerable to public sector cuts.

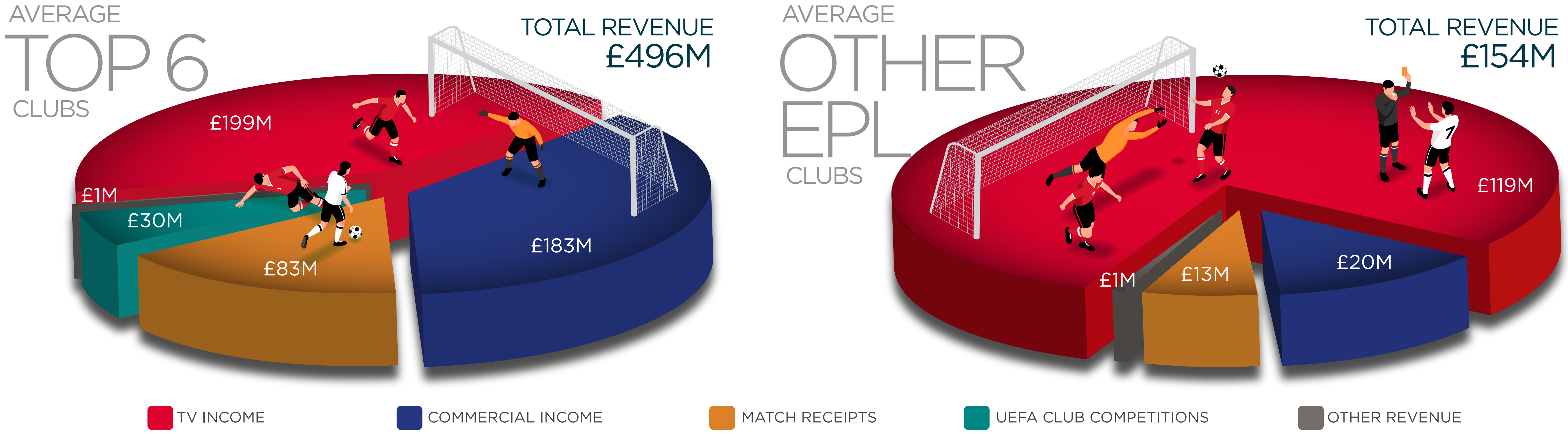
This has been laid to bare during the Covid-19 crisis, as sports including netball, basketball and badminton have called on the UK government to provide funding to help them stay afloat, amid fears that up to 50% of their playing demographic are unable to access the sport currently and they do not have the resources internally to support.

Even the majority of football could be regarded as heavily underutilised. The Big Six clubs have successfully managed to leverage their brands, creating additional revenue streams and monetising worldwide fan engagement. But outside of the Big Six and looking down to the Championship, there still remains significant opportunities for clubs to graduate to this more elite commercial level.

Splitting revenue into three broad categories - TV income (central distributions), match day receipts and commercial and advertising income - the Big Six English Premier League (EPL) clubs have been able to generate close to 40% (£183m) on average of their revenue from sponsorship. Clubs outside of the Big Six have, however, been much more reliant on TV income, only generating 13% (£20m) of income on average from commercial and advertising.

This is one of the main reasons US sports franchises, often alongside US PE, are currently so interested in UK sports. US franchises make hundreds of millions from fan engagement strategies with highly sophisticated teams, and are able to utilise their expertise, technology and commercial connections to capitalise on the underinvestment of UK sports brands and broaden their revenue streams.

AVERAGE SPLIT OF PREMIER LEAGUE REVENUES – 2019



Outside of the Big Six clubs, commercial revenues are a relatively small proportion of total revenue.

LEVERAGING NEW PARTNERSHIPS

There is also significant potential, across sports, to partner with hosts cities and nations as one of the largest sources of revenue in the industry. In the first half of this decade alone, the largest five events in the world by visitor numbers/spectators (World Expo 2020, Winter Olympics 2022 and Summer Olympics 2021 and 2024, UEFA European Championships 2021 and 2024 and the FIFA World Cup 2022) will, by our estimates, generate over $244bn in public sector investment on capital and operational expenditure. The reason public sector stakeholders are prepared to invest so heavily into these major, global events is because they deliver significant return on investment through economic impact and global destination marketing, as well as generating lasting infrastructure and social legacies that help achieve macro-strategic objectives. By comparison, those events will earn an estimated $25bn in broadcast and sponsorship revenue in respect of the same period.

Before a large increase in broadcast revenues in 2019, the principle revenue source of the world's most valuable global sports series, Formula 1, was host government investment. In 2018, revenue from host investment was $617m (34% of total revenue) as compared to broadcast revenues of $604m (33%). In 2019/20, host investment still makes up 30% percent of the organisation's total revenue, double the revenues generated from sponsorship.

SPORTS PRIMED FOR COMMERCIAL EXPERTISE

Sports organisations tend to need investment for one of two reasons: to implement expansion plans or to pay back debt. From the viewpoint of PE, both represent opportunities.

Netball is a good example of a sport which is on the rise, but is still heavily reliant on government funding. Last year it was announced that England Netball is still 64% funded by government-backed Sport England, with the goal being to swap the ratio to 64% self-funded in the next two or three years.

PE can not only provide the investment that sports are looking for, but can couple this with financial and commercial expertise which can reshape organisations and help them take advantage of opportunities that were previously either out of reach or not even on the radar.

RECESSION PROOF

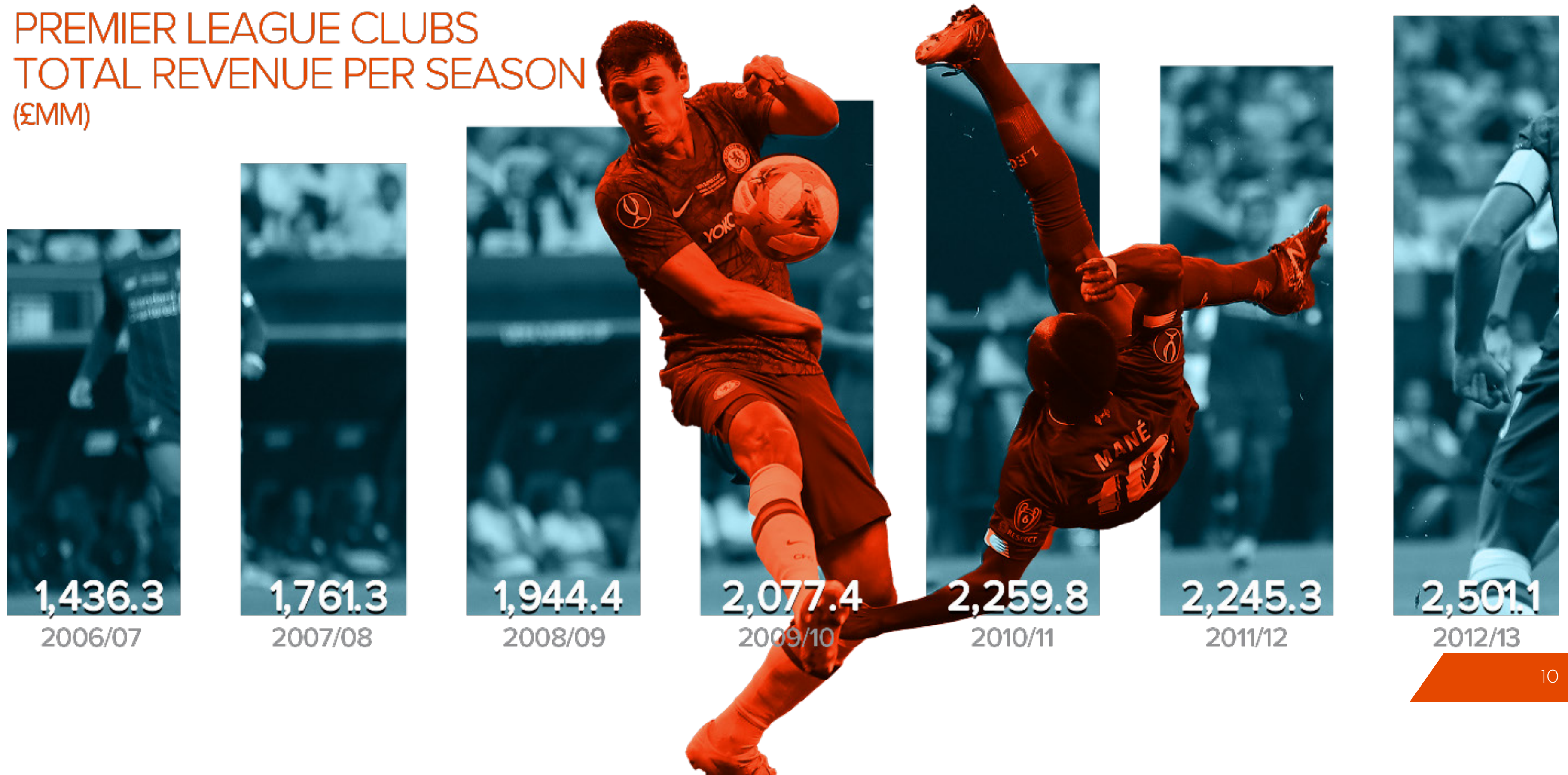
Whilst the current situation that regulatory bodies and professional sports teams are facing is unprecedented, at least in post-War times, with complete cessation and a resumption with no crowds, sport has shown an incredible ability to survive periods of recession in the past.

During the financial crisis of 2008 and the following recession, Premier League football clubs showed that not only could they hold onto revenue, but they could actually grow. During this period, total Premier League revenue grew substantially, almost doubling from 2006/07 to 2012/13.

Whilst other sports do not have the financial power of the Premier League, and there has been the need for redundancies and cutbacks in many sports over the last few months, compared to many other sectors, sport remains strong and, as shown during lockdown, will ensure that they can deliver return on investment for their key stakeholders – broadcasters, sponsors and the fans.

Many sports, especially those that have put a focus on maintaining or enhancing the viewer experience, have actually seen an increase in viewing figures during lockdown, demonstrating the enduring demand for sport. WWE, Bundesliga and cricket all experienced record breaking viewing figures since the return to sport in June. Not only is sport more resilient to the downturn, it is also quick to bounce back, taking advantage of the appetite of fans and other stakeholders. Whilst other sectors may be slow to bounce back after such periods of downturn, sport draws people back in quickly.

We have not yet seen the return of fans to stadiums on a large scale, but one senses that once the gates open, sport will not experience the social reluctance that other sectors are feeling. In fact, to a greater extent than ever before, sports events will have a huge role to play in our recovery in economic stimulation and boosting tourism, encouraging and inspiring physical activity and improvements to health and, as sport and entertainment has always done, providing diversion. Or even, at its at its most basic level, providing the thing we miss most at our darkest moments of 'lockdown': social interaction on a mass scale.



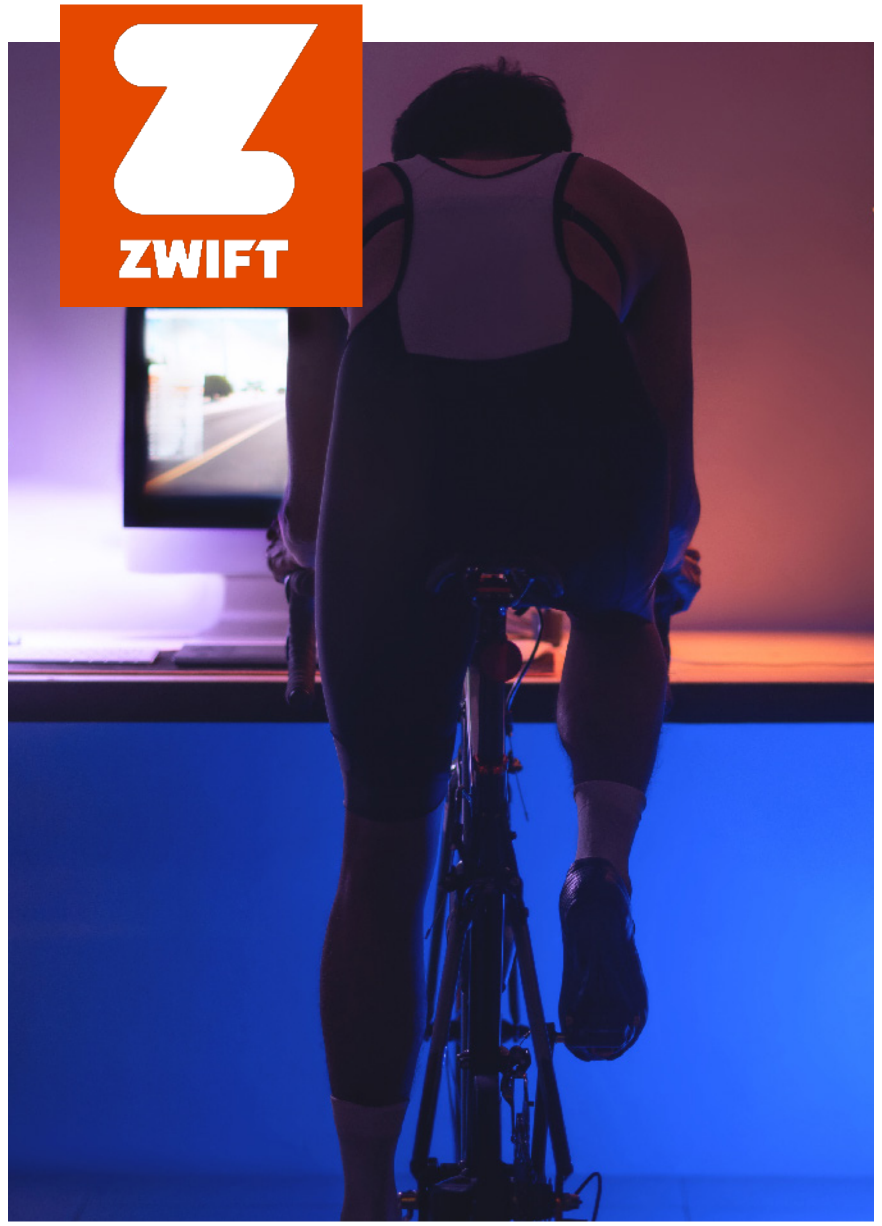
SPORT'S ABILITY TO ADAPT AND INNOVATE

The recent pandemic has highlighted many things to the sporting world, presenting numerous issues such as fan-attendance and the revenue this generates in a socially distanced world. This may present an issue going forward if a level of social reluctance does present itself when social distancing measures are removed. But the lack of fans presents new opportunities for sports that are naturally socially distanced or that can present themselves digitally, and or engage with fans in new, innovative ways.

Even in sports where ticket revenue generation is crucial to the commercial ecosystem, rights holders have demonstrated their ability to adapt to unprecedented situations and still deliver content and meet the demands of its broad stakeholder base:

ZWIFT

The online multiplayer cycling and running training programme has welcomed an unprecedented number of new users onto their platform during lockdown. The innovative platform allows users to easily train in solo or group rides from the comfort of their homes. Following the immense success over the last six months, Zwift has raised over $450m worth of investment from various funds.



UFC FIGHT ISLAND

Abu Dhabi's Yas Island has become the innovative new home of UFC since the outbreak of the pandemic. At first it was a temporary solution for UFC 251 in July (originally scheduled to be held in Perth), Yas Island, one of the Emirates most popular leisure, shopping and entertainment destinations, has been re-branded to UFC Fight Island and will host a further five events running through to October, including two pay-per-view shows in UFC 253 and UFC 254.

MATCHROOM FIGHT CAMP

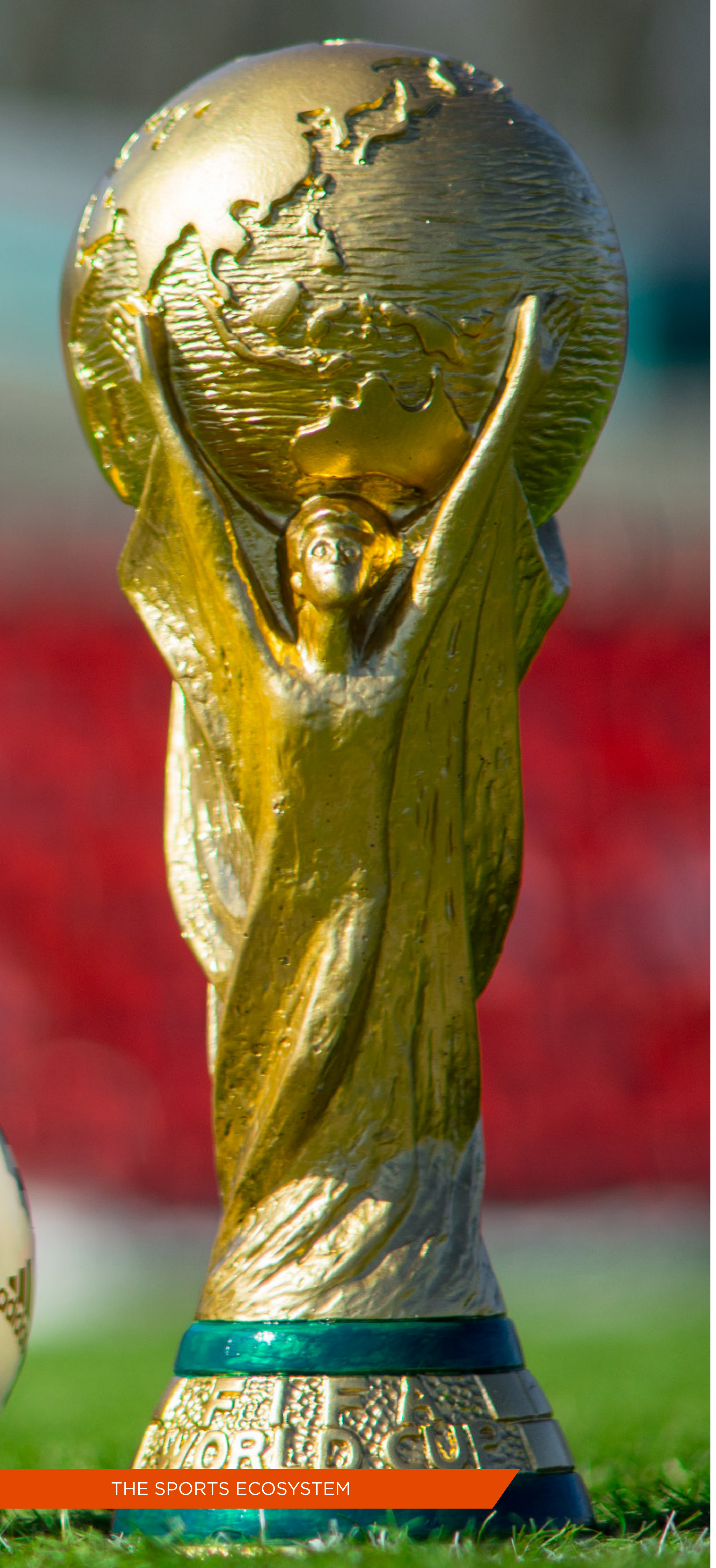
After several months without live boxing, and faced with the prospect of no live spectator events for the rest of 2020, Matchroom Boxing created their own 'Fight Camp'. Located in the garden of Matchroom's head office in Essex, 'Fight Camp' hosted four live shows including headlines of Dilllian Whyte vs. Alexander Povetkin and undisputed women's lightweight champion Katie Taylor.

THE SPORTS ECOSYSTEM

For all of the opportunities that sports properties can bring, they can also present unique challenges to investors unfamiliar with the landscape. Sports organisations are rarely established as purely commercial vehicles as they will typically have a role to play in the regulation of competitions and growing grassroots participation. For example, there will be pressures or regulations which may restrict growth or profit generation which do not exist in other industries. Sport's peculiarities and complexities also often dictate the corporate structure and governance of its organisations, meaning that they will look unfamiliar when compared to other investments.

In this section, we map out sport's idiosyncrasies that PE need to navigate, as well as the challenges and risks associated with investment into the sports ecosystem.

- SPORTS IDIOSYNCRASIES:
  - STAKEHOLDERS
  - FANS
  - INTERNAL AND EXTERNAL POLITICS
  - GUARDIANSHIP
  - COMMERCIAL IMPERATIVES
  - OWNERSHIP/MEMBERSHIP STRUCTURES
- CHALLENGES AND RISKS:
  - CORPORATE GOVERNANCE
  - REVENUE DISTRIBUTION
  - OTHER INTERESTED PARTIES
  - STABILITY OF THE SPORTS ORGANISATION
  - EXISTING PARTNERSHIPS
  - PLAYER POWER
  - SPENDING CONTROLS
  - OWNERSHIP REGULATIONS
  - REPORTING RESPONSIBILITIES
  - INTEGRITY CONCERNS



SPORT'S IDIOSYNCRASIES

1. STAKEHOLDERS

The hierarchy and network of commercial partners and related parties within a sport can be extremely complex. This ecosystem is bound together by a web of bilateral or multi-party contractual arrangements that form the basis of sporting regulation, membership, event sanctioning, participation, commercial partnerships, disciplinary and other key functions.

OLYMPIC SPORTS
IOC, IFS, NOC, NGBS, COMPETITIONS/ LEAGUES, ATHLETES

FOOTBALL
FIFA, CONTINENTAL ASSOCIATIONS, NATIONAL ASSOCIATIONS, LEAGUES/COMPETITIONS, TEAMS, PLAYERS

PARTNERS
THERE ARE ALSO A NUMBER OF OTHER RELATED STAKEHOLDERS, EACH PLAYING THEIR PART IN THIS ECOSYSTEM:

- SPONSORS *(EXCLUSIVE CATEGORIES AND REGIONS)*
- BROADCAST PARTNERS
- HOST CITIES
- FANS

Understanding the roles of each of these stakeholders, where ultimate authority and commercial rights sit and how they flow down the stakeholder chain, will be key for an investor to ensure that it is able to implement its plans to grow a target organisation.

2. FANS

Sports fans are different to ordinary consumers of goods or services. A sport or sports team can be part of the social structure of a city or country. Fans are important stakeholders and will often be wary of 'outsiders' coming into the sport. If fans' interests are not considered, and if they are not managed through a carefully-planned communications strategy, this can also significantly impact the long-term value of a sports property.

3. INTERNAL AND EXTERNAL POLITICS

The politics within a sport's organisation, in terms of individual personalities as well as relationships between member bodies, can impact how easy it is for key decisions regarding investment in commercial strategy to be approved. Various National Federations within an International Federation structure are likely to have different priorities in terms of revenue distribution within the sport. The social impact of sport and the platform it presents for important issues such as sustainability, gender and racial diversity, also means that sports will often be subject to increased government scrutiny. Recent months have also shown how rights can be affected through widespread broadcast piracy with apparent geopolitical motivations. Public policy and regulation can have a positive impact, for example greater investment in sports participation or hosting major events. However, there can also be restrictive elements, for example Listed Events, advertising, gambling regulations which effect an investor's plans. Therefore, the prevailing political context needs to be considered when identifying and progressing with an investment opportunity.

4. GUARDIANSHIP

For sport, maintaining the 'rules of the game' and its sporting integrity are sacred. Sports organisations and their stakeholders will want to ensure that full control and decision-making regarding these aspects is maintained within the sport and unaffected by investment.

5. COMMERCIAL IMPERATIVES

Historically, sports organisations have typically not been run as commercial entities or businesses. Many organisations have only generated revenues for the purpose of paying participants funding prize money, sustaining its sporting assets and to reinvest in growing participation. Whilst some sports, such as professional football, have seen significant growth in commerciality, many International Olympic Federations are still not structured in a way to optimise commercial returns. As the need for cash reserves has become highlighted even more in the current COVID-19 crisis, this will become more of a focus for many organisations.

6. OWNERSHIP/MEMBERSHIP STRUCTURES

Many sports bodies have evolved from small, non-commercial member organisations, operated for the benefit of their members. Key decisions including investment or important strategic initiatives may require a two-thirds majority, or even unanimous approval from an entire membership in order to be passed. As an example the unanimous approval issue has been a major issue in recent years for F1 for example trying to bring in the cost-cap

CHALLENGES AND RISKS

This unique nature of sport presents a number of factors that may not be immediately apparent, but which can significantly impact the viability and profitability of a sports property as an investment. For this reason, it is essential that sports-specific due diligence is carried out alongside the typical corporate and legal due diligence which would be a part of any investment transaction. These challenges include:

1. CORPORATE GOVERNANCE

For many of the reasons set out above, corporate governance structures within sports organisations will often look very different to typical commercial entities in other industries. The governance of member organisations in particular can cause perceived inefficiencies which may hinder the realisation of commercial opportunities. Kosmos' 25-year, $3bn investment into the ITF's Davis Cup, required a charm offensive over a number of months in order to secure the required two-thirds majority approval of the ITF's 140 Member Federations. Beyond approval of the deal itself, the ability to modernise governance structures to allow for greater commercial freedom may well be an important consideration for an investor.

2. REVENUE DISTRIBUTION

There may appear to be an inherent conflict between a sports organisation's duties to redistribute revenues amongst its members and providing a return to external investors. Similarly, there may be conflict between the long-term growth of the sport at certain levels or specific regions and an investor's plans for income production or building capital value. However, a commercial strategy which balances these interests and works within (or expands) the parameters of the unique sporting framework, can still allow investments to thrive.

3. OTHER INTERESTED PARTIES

Commercial opportunities such as the ability to create and exploit new event assets may well be subject to sanction or approval from a related governing body or commercial partner. It is therefore important to be clear on any restrictions such as calendar limitations or conflicting commercial arrangements that may impact on any plans an investor may have. Again, fans need to be considered when developing commercial strategies, particularly in relation to ticketing, media rights, moving from free-to-air to pay TV and event format changes.

4. STABILITY OF THE SPORTS ORGANISATION

The value of a sports property derives from its ability to exploit the commercial rights relating to the properties it controls. Threats of breakaway competitions or member defection can drastically affect the value of a sports property overnight.

5. EXISTING PARTNERSHIPS

Due diligence through a sports lens should address some important questions here, such as, are existing partnerships valuable? Are they at risk? Is the organisation free to exploit the opportunities that the investor has identified?

CHALLENGES AND RISKS

6. PLAYER POWER

Players are important assets. Their ability to engage directly with fans through social media and other channels, and the value of this to rights holders and their commercial partners, has grown exponentially over the last decade. With increasing player power, an investor will want to ensure that it is free to maximise the value and opportunities that they bring.

7. SPENDING CONTROLS

Sports are increasingly seeking ways to increase competition and making participation more financially sustainable. This can restrict opportunities to accelerate growth through external financial investment. Financial Fair Play rules, salary caps and luxury taxes all have to be considered.

8. OWNERSHIP REGULATIONS

Many sports have other specific rules and regulations which may impact the ability to invest. For example, the Owners and Directors Test (or "fit and proper person test" as it is also known), applies certain restrictions on who is able to invest in the ownership of English football clubs.

9. REPORTING RESPONSIBILITIES

In the UK, the Code for Sports Governance places further governance obligations and restrictions such as term limits and diversity quotas for Board membership for any sport receiving public funding. Differing levels of government regulation of sports organisations are observed internationally, whilst sporting regulations through the IOC or World Anti-Doping Agency (WADA) imply further obligations and restrictions to take into account.

10. INTEGRITY CONCERNS

Possibly the most significant risk to the value of a sports property is the issue of integrity. Can fans trust that what they see in the sporting arena is genuine? The sport of cycling still faces challenges in attracting sponsorship following the fallout of a number of high-profile doping incidents in recent years.

MAKING THE CASE

As PE becomes increasingly active in the sports sector, it is essential for a rights holder seeking external investment to have a clear understanding of what an investor is looking for, what they will scrutinise and what their objectives are.

In this section, we set out what rights holders need to know about investors and what they need to demonstrate in order to persuade PE to invest capital and expertise into their organisation. Firstly, we examine what investors objectives are and the typical characteristics they look for in businesses they want to invest in. Secondly, we identify what rights holders need to demonstrate to potential investors to put them in the best position possible to secure the maximum level of investment from the market.

- **WHAT ARE INVESTORS LOOKING FOR?**
  - **OBJECTIVES**
  - **BUSINESS CHARACTERISTICS**
- **WHAT DO YOU NEED TO SHOW?**
  - **PREPARATION FOR SALE**
  - **BUSINESS PLAN DEVELOPMENT**
  - **MITIGATING VALUE EROSION**

WHAT ARE INVESTORS LOOKING FOR?

OBJECTIVES

There is no "one size fits all" approach for PE firms. They raise funds typically over a ten year timeframe to invest in businesses and then sell them over this time period. But the investment strategy objectives, return targets and exit strategies can vary widely. They can range from a more traditional three to five year investment and sale model to longer term investments – CVC's 11-year holding of Formula 1 being the prime example which was tied to increasing the commercial profitability of the sport and potentially adding value to existing portfolio assets in the sector.

CVC X F1

CVC F1 INVESTMENT
2006
$965.6M
(PART OF **$2BN** PURCHASE WITH OTHER **$1BN** A LOAN FROM RBS)

RETURNS DURING OWNERSHIP
2006-2017
$4.3BN

EXIT VALUE RECEIVED
2017
$1.5BN
(CASH AND SHARE-FOR-SHARE EXCHANGE)

BUSINESS CHARACTERISTICS

Against a backdrop of increasing disruption, sport is becoming more attractive to investors for its ongoing ability to capture the world's attention and to engender loyalty and passion from valuable target demographics. Investors are looking for sports properties with strong fundamentals: secure, regular income streams and opportunities to diversify and grow these streams. They are also looking for like-minded rights holders that share their ambition to rapidly accelerate growth and increase value through their connection with their fans, their ability to leverage those relationships with commercial partners and the opportunities to create additional value.

- **RECURRING REVENUES**
  e.g. game day income
- **CONTRACTED REVENUES**
  e.g. partnerships broadcast, sponsorship & host cities
- **DISRUPTORS**
  e.g. social media investment
- **INTELLECTUAL PROPERTY**
  e.g. chain of control across key IP
- **GROWTH**
  e.g. revenue growth
- **CASH GENERATION**
  e.g. positive cash flow over the investment period
- **STRONG MANAGEMENT TEAMS**
  e.g. skills, experience, vision
- **SCALABILITY AND LATENT POTENTIAL**
  e.g. new fan markets
- **BRAND LOYALTY**
  e.g. season ticket sales/retention

WHAT DO YOU NEED TO SHOW?

PREPARATION FOR SALE

Preparation is vital, and the business needs to be focused both on presenting the best possible face to the market and ensuring its house is in order.

For the former, the business needs to be able to articulate a strategy for how it would use the investment to create additional value, captured in a robust business plan and information memorandum. For the latter, everything underpinning the business plan, from management accounts to contracts, tax to governance, needs to be ready for the scrutiny that will come when investors come to due diligence.

MITIGATING VALUE EROSION

Value is based on trust. Trust that the business plan is achievable and that the management team has the commercial mindset to deliver it, that revenue streams are as secure as possible, and that risks have been identified and have been mitigated against. As with any relationship, surprises and sins of omission undermine that trust, and therefore the valuation of the business.

To avoid any surprises, it is therefore essential to be open and transparent in the business plan around past failures and the learnings management has taken from those for future projects. Likewise, accounts need to be ready for a due diligence data room and the existing contracts need to support the ambitions for the business. Discovering in due diligence, for example, that global commercial rights are in fact subject to various exclusivities and existing partnerships would represent a significant risk to the assumptions underpinning the valuation.

BUSINESS PLAN DEVELOPMENT

The business plan needs to be a clear articulation of the vision for the business that has robust financials and a solid bedrock of professionalism that stands up to scrutiny. That means four things:

VALUE DRIVERS

It needs to identify all the existing and potential drivers of revenue and EBITDA growth for the business: this could be opportunities to expand internationally, premium-ise rights, unify a fragmented landscape, or leverage existing assets to create additional, predictable revenues. Each of these will require independent, reasoned valuation forecasts that stands up to the scrutiny an investor will apply. In normal times, the business plan should always identify, account for and mitigate against potential downside risk, for example a drop-off in performance leading to relegation. In a post-Covid era, where many of sport's revenue fundamentals have come under exceptional strain, this is all the more important.

GROWTH STRATEGY

It needs to include your strategy for how external investment will enable you to create additional value in the areas you have identified: what are the initiatives, enablers and partnerships needed to deliver the strategy?

TRACK RECORD

It needs to demonstrate to investors the track record: this includes the capabilities of the management team to deliver on the strategy, and effective governance structures to hold them to account. Historically, investors have been wary of sport due to concerns about the capabilities of management teams. Therefore, demonstrating that leaders in the business share the same commercial mindset as a PE suitor can help to overcome this barrier.

GOVERNANCE

It needs to address the specifics of the sport's governance and politics: for example, this could include creating a separate commercial entity from "laws of the game" and regulatory functions, ring-fencing commercial assets for investment, without an investor having any influence on regulation of the sport itself. It could also cover voting rights, where investors will rightly want a degree of say over all aspects relating to the commercialisation of the sports organisation such as those aspects which allow the investor to 'move the dial' in respect of their return on investment (e.g. promotion/relegation, event qualifying criteria, event formats and host city arrangements).

THE ART OF THE DEAL

There are a number of different types of investments, each with its own nuances and complexities to consider. Often the most crucial and complicated part of any transaction lifecycle, this section seeks to provide a simplification of the three broad types of investment and explains the differences between each one to demonstrate that there are multiple approaches to structuring a deal and ultimately forming the foundation for a mutually beneficial partnership.

- HOW TO STRUCTURE A DEAL
  - EQUITY INVESTMENT
  - ASSET PURCHASE
  - JV PARTNERSHIP
- HOW TO CHOOSE THE RIGHT PARTNER
  - ALIGNING OBJECTIVES
  - EXIT STRATEGY CLARITY

HOW TO STRUCTURE A RELATIONSHIP

When considering an investment, and structuring the deal, it is important to consider what it is the investor actually wants to buy and what the rights holder actually wants to sell, and this will differ on a case-by-case basis.

There are three broad types of investment, with differences:

EQUITY INVESTMENT

INVESTOR ACQUIRES SHARES IN THE COMPANY
(E.G. CVC'S INVESTMENT IN PREMIERSHIP RUGBY)

ASSET PURCHASE

INVESTOR PURCHASES AN ASSET USED FOR SPORT
(E.G. THE ACQUISITION OF THE OCEAN RACE'S ASSETS FROM VOLVO'S COMPANIES)

PARTNERSHIPS

THE INVESTOR WORKS WITH THE EXISTING RIGHTSHOLDER TO DEVELOP A NEW PROPERTY. THIS COULD BE IN THE FORM OF A CONTRACTUAL RELATIONSHIP OR A JOINT VENTURE
(E.G. ITF'S 25-YEAR LICENCE TO KOSMOS IN RESPECT OF THE DAVIS CUP RIGHTS)

Equity investments are the most common type of investment, but these do not always involve purchasing 100% of the company, and where this is the case, it is important to ascertain exactly what it is that the investor wants.

Investors want to make a return on their investment, so want to invest in the aspect of the business that will make them the most money. They may not want to get overly involved in the running of the sport, as such, the separation of commercial rights from the operation of the sport represents a good way forward for investment.

Where this is the case, the different aspects of the business will need to be determined to work out how much of the overall business is being purchased. Or the investment will need to be executed through the creation of a separate commercial vehicle. Sports deals should follow typical completion mechanics (cash free, debt free, normal working capital) but historically this level of sophistication has been rare. As PE has entered the market, this has changed, as deals are structured in a way they are familiar with.

Debt of sports businesses is often different from that in other sectors, and takes many forms, including commitments, contingencies, receivables factoring, pre-sold revenue streams, up-front cash for sponsorship, off balance sheet financing, and shareholder loans. All this needs to be considered in the completion mechanics.

Taking investment in a football club as an example, as it has a long history of investment from the private sector, the availability of bank debt will be restricted by the operating cash flows and the cash flow available for debt service at the club, which until recently was often negative for football clubs. Clubs therefore commonly look to receivables financing and advanced funding against broadcasting distributions which, outside of Covid-19 conditions, were (and should continue be) seen as relatively secure cash flows by lenders. Failing this, they typically fall back on shareholders for funding.

The common challenge for potential investors in football is how to structure the acquisition around significant shareholder debt balances, which has tax structuring consequences.

However, for the best run organisations, relatively cheap debt financing is available for big capital projects. In September 2019, Tottenham Hotspur converted £525m into bonds, issued to US private investors, with staggered maturity of between 15-30 years. Tottenham Chairman Daniel Levy said the Tottenham bond issue was "significantly oversubscribed".

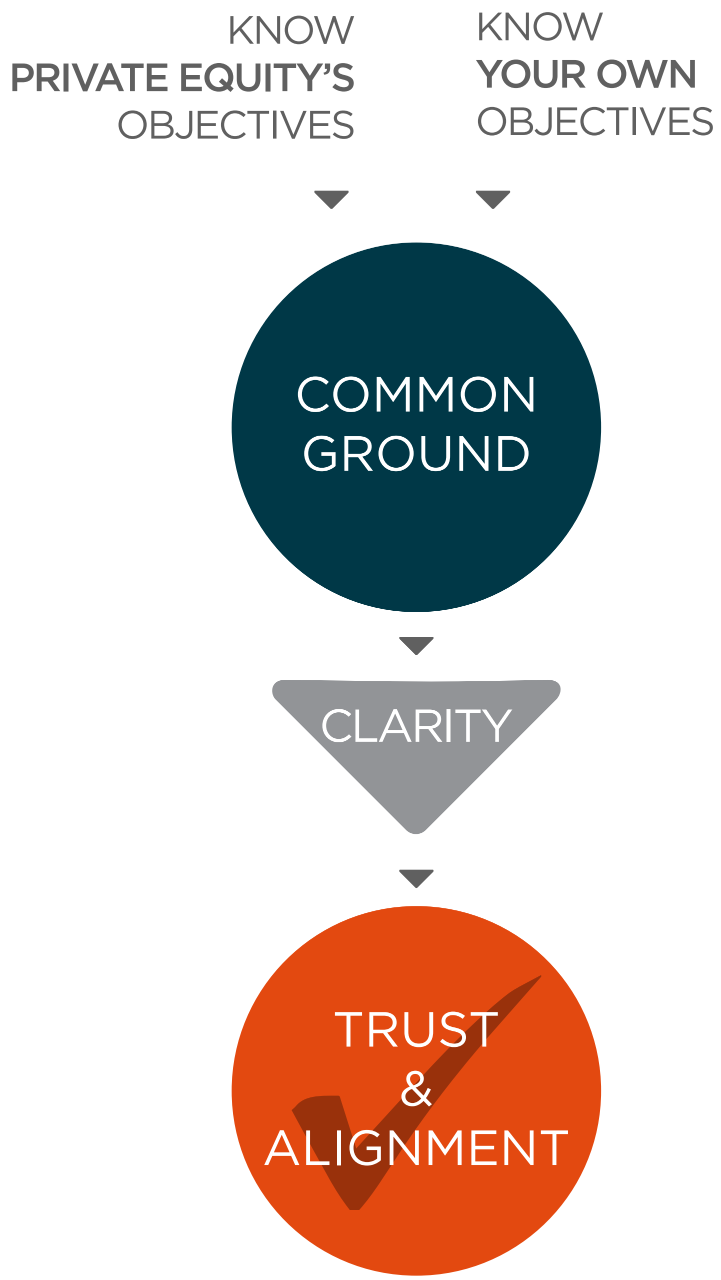
With debt and completion mechanics in mind, another key consideration in any investment is tax structuring. It is important for investors and rightsholders to understand the tax implications of any potential deal structure. Finding the right structure to accommodate the most relevant tax reliefs and incentives can be complex, but structuring the business as effectively as possible at an early stage can help maximise growth, attract diverse further investment and ensure that as much value is retained as possible on sale.

Earn outs and deferred consideration are common where sellers expect compensation for future successes, for example promotions or retention of league status within football. Careful forecasting is required to weigh up the cost/benefit of this for both buyers and sellers. As described above with sophistication of transactions increasing, W&I insurance will become an increasingly important feature of PE deals. This has historically been rare and expensive for sports transactions.

HOW TO CHOOSE THE RIGHT PARTNER

Most entrepreneurial management teams are well aware of the importance of agenda alignment amongst the leaders of the business. This comes into sharp focus when a PE investor joins the board. The investor agenda is likely to be simply to drive value. Altruistic objectives of management may not be shared by investors.

Real success in a relationship with PE comes where there is significant alignment, and non-aligned factors can be clearly de-prioritised.



In our experience, it is important for a rights holder to have absolute clarity about their own objectives and those of their team. Questions rights holders should ask themselves include:

- **WHAT IS YOUR DEFINITION OF SUCCESS FOR YOURSELF OVER THE MEDIUM & LONG TERM?**
- **WHAT IS YOUR DEFINITION OF SUCCESS FOR YOUR BUSINESS OVER THE SAME PERIOD?**
- **WHAT ARE YOU LOOKING FOR FROM PE? HOW MUCH DO YOU REALLY KNOW?**
- **WHAT ALTERNATIVES ARE THERE?**
- **WHAT ARE YOUR 'NON-NEGOTIABLES'?**
- **HOW COULD YOUR BUSINESS (SAFELY) GROW FASTER?**
- **COULD YOU COPE WITH SHARING CONTROL OF YOUR BUSINESS?**
- **WHO WILL YOU EVENTUALLY HAND THE BUSINESS OVER TO?**

It is also imperative that rights holders understand that while they are looking to increase the value of the business, the end goal of PE will be to exit, and so the rights holder will be dealing with another investor further down the line.

ABOUT THE AUTHORS

THE SPORTS CONSULTANCY

THE SPORTS CONSULTANCY is a London-based agency that works with the world's largest events, host nations and sponsors of sport. We have built a reputation as the world's leading agency specialising in all aspects of the relationship between international major event owners, their host cities and partners. We have worked with some of the leading rights holders in sport and entertainment, helping them optimise the value of their assets across events and sponsorship. Given our unique work in this space, we are also in the fortunate position of advising investors on maximising value and unlocking commercial potential, and have a strong understanding and experience of working on the 'buy-side' of a transaction as well as the 'sell-side'.

We are able to advise through the lifecycle of a third-party investment transaction, from preparing for market and throughout the transaction and post-transaction in realising commercial returns. Where a transaction requires additional professional services support (such as tax structuring, financial due diligence or other M&A advisory), we work with relevant best-in-class providers.

CONTACT:
ROBERT DATNOW, *Managing Director and Co-Founder,*
robert@thesportsconsultancy.com

BDO

BDO UK provides tax, audit and assurance, advisory and business outsourcing services to companies across all sectors of the economy. We take the time and effort to understand our clients' businesses and markets. Our partners and staff are specialists in their fields and have a proactive, flexible approach to helping clients overcoming the challenges they face. We aim to be as innovative and entrepreneurial as our clients.

Our Professional Sports Group provides you with a tailored service to meet your unique needs and challenges. We bring to bear our extensive experience of working with sports operators, associations, governing bodies, support industries and various other stakeholder groups. You will benefit from our practical advice and insights. Our market-leading assurance, tax and advisory disciplines work together and share knowledge to provide you with the accountancy and business services that will make a difference to your whole business.

Alignment with other BDO sectors such as technology & media, real estate, leisure & hospitality and betting & gaming – all of which are typically relevant to sports businesses - supports our commitment to providing a complete holistic response to your challenges. We operate from 17 locations, covering all major business centres, so that we can be close to our clients. We employ 5,000 people who are allowed to be themselves: taking responsibility for their work and their relationships with clients. All our people share core values that underpin both our culture and the value that we bring to our clients.

The firms have representation in 162 countries, with 80,000 people working out of over 1,600 offices. Being a member of the BDO global network allows us to meet the needs of clients who are growing and trading internationally.

CONTACT:
IAN CLAYDEN, *Partner - Head of BDO Professional Sports*
ian.clayden@bdo.co.uk