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Private Market PlayBook

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OPEN SEASON

Hard-hit sports world finds its newest fans: PE firms

By Andrew Woodman

CVC Capital Partners, Bain Capital and Cinven are among the private equity investors that have been circling Serie A, Italy's top-flight soccer league, for a possible stake in recent months. The promise of new capital couldn't arrive at a better time.

Serie A canceled months' worth of matches due to the coronavirus and has been feeling the pinch. Its revenue for the season is expected to drop to €2.1 billion (around $2.4 billion) from €2.5 billion the previous year, according to a forecast by Deloitte analysts. Even larger declines are expected across other top leagues in Europe, including England's Premier League, which expects to see revenue plummet from €5.9 billion to €4.9 billion.

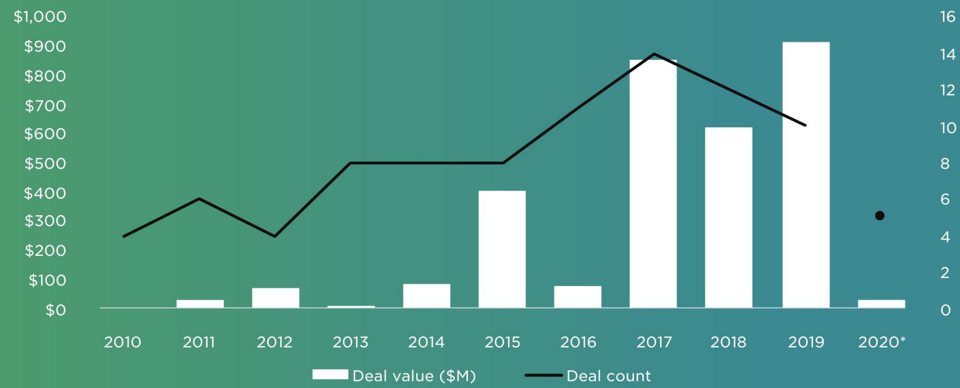
Serie A is just one of the world's many pandemic-plagued sports leagues forging new links to private equity. After playing out most noticeably in Europe, the trend has also taken hold across the Atlantic as the coronavirus ravages the finances of professional sports everywhere.

"COVID-19 has left leagues across the world—and their stakeholders—with significant revenue shortfalls and working capital needs, and third-party capital can fill this gap," said Andrew Umbers, a partner with UK sports-focused consultancy Oakwell, which advised Luxembourg-based CVC on its bid to buy a 14.5% stake in the Six Nations Rugby tournament.

In terms of total deal value, PitchBook data shows that 2019 was a record year for PE investment in Europe's sports market, with around $911 million injected across 10 deals—more than half of that representing Silicon Valley-based Silver Lake's $500 million purchase of a 10% stake in the vaunted English soccer club Manchester City.

Taking the field

PE deal activity in sports



Source: PitchBook | Geography: Europe
*As of September 1, 2020

New players

After decades of barring PE firms from taking stakes in franchises in many top leagues, the field is starting to open up. In the US, where $1.2 billion was invested across eight deals in 2019, Major League Baseball ruled last October that funds would be allowed to hold positions in multiple teams. Earlier this year, in a watershed moment for investors, Major League Soccer followed suit with plans to allow private equity to invest in teams, many of which have lost money during the pandemic.

The shift is significant because many sports have traditionally been closed to institutional investors, reflecting long-standing fears that third-party providers of capital could have undue influence. For many years, those rules may not have mattered because investments in the space were generally not as lucrative as they are today. Team ownership was typically the province of high-net-worth individuals drawn in more by the prestige of the asset than its profitability.

Joseph DaGrosa, chairman of the recently formed Kapital Football Group, said historically many leagues have appeared, in some respects, like an old boys' club, unwilling to open to a larger universe of investors that can cut far bigger checks than any individual. Now there is a paradigm shift. He said, "There's a recognition that capital is needed, and the only way that capital can come in, is in large doses through the institutional marketplace."

Adam Sommerfeld, managing partner at Certus Capital Partners, which advises several Premier League teams, said the fact that multiple established funds are already investing in pro sports is more likely to attract new investors. He points to examples such as CVC, which helped set the trend as far back as 2006 when it bought a stake in motor sports league Formula One. More recently, the firm is expanding its influence in rugby, augmenting its Six Nations deal in May with the purchase of a stake in the Pro14 league. That same month, CVC and Silver Lake were said to be in talks with New Zealand Rugby, a rugby union governing body.

"You're seeing a base that is very well-regarded, with respected investors making a statement of intent that others are looking to circle behind," Sommerfeld said. "It provides a comfort blanket."

Another big factor that has driven the need for new capital in sport is technology, which is opening up new growth areas. It is no coincidence, for example, that Silver Lake, one of the most well-known technology-focused PE investors, is backing a Premier League team.

"[Technology] is connecting every element of the sports value chain," explained Peter Hanton, a lawyer with Clifford Chance in London, which has advised several sporting bodies. "Whether it's on the pitch and using live data analysis around your players and training to assess how performance improvements can be enhanced, or using data analytics around your fan engagement."

"Content is king"

Broadcasters, generally the top source of sports income, have been upended by the arrival of streaming platforms such as Amazon and YouTube. And fans, who increasingly consume media on mobile devices, are changing the way they engage with sports teams. New capital is needed to take advantage of these opportunities.

DaGrosa said private equity groups are treating sports as a proxy for content at a time when demand is soaring. "Private equity firms see that content is king and clubs provide that content," he said.

He added that the likes of Amazon and Netflix, partly due to lockdowns during the pandemic, are running out of fresh content. So while these businesses have seen their customer base grow in recent months, the rate at which they are able to produce new shows to meet growing demand is likely to hit a wall.

"The only way you keep subscribers happy is with new content, and sports provides new content all time," DaGrosa said. "There are only so many times you can see a movie, but there's an infinite number of times you can watch your favorite team play."

Pandemics aside, there are still risks associated with investing in sports, and these vary both from deal

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> Managing Partner, Certus Capital Partners

to deal and by region. For example, in Europe, the lowest-performing soccer teams face relegation, which may impact the long-term value of an investment. Performance can also dictate a team's entry into international competitions—and thus access to additional sponsorship deals. Governing sports bodies can also hold sway over the success of an investment.

In one recent case, the Union of European Football Associations hit Silver Lake-backed Manchester City with a €30 million fine and a two-year ban from European club competitions after it was accused of masking equity funds as sponsorship revenue. This would have put the team in breach of financial fair-play rules barring clubs from spending more than they earn.

The ban was later overturned and the fine reduced to €10 million by the Court of Arbitration for Sport. But regulatory oversight isn't necessarily a bad thing for investors. DaGrosa pointed out that sport regulations, such as financial rules that stop teams from spending unlimited amounts on players, give investors comfort that everyone has to play by the same rules and there are consequences for breaking them.

"Uncertainty scares investors," he said. "The more certainty you have—even if you don't like the certainty—the more comfortable you are."

For this reason, investors are increasingly attracted to US leagues such as MLS, which is far younger than its counterparts and has developed differently. The structure is more centralized. MLS operates as a single entity that centrally owns the teams and the player contracts, and shares the broadcasting rights. Unlike in Europe, teams do not face the risk of relegation, offering investors a more controlled environment where losses are limited. Match-day revenues are also greater for MLS in a country where fans are willing to pay more for an average ticket, DaGrosa said.

"On balance it certainly justifies paying a higher multiple of revenues for an MLS team relative to a European football team," he added.

However, sports investors on both sides of the Atlantic still face the risk of a COVID-19 resurgence and more lockdowns. The concern is significant enough that CVC is said to have added a coronavirus clause to its Six Nations deal, allowing the firm to withhold capital—to be paid in a series of installments—should further disruption occur.

Many aspects of pro sports remain appealing to traditional private equity investors. Sports leagues make most of their money from broadcasting rights, and many are locked into two- to five-year contracts, roughly corresponding to portfolio company holding periods. In addition, there are income streams from sponsorship, match-day revenue such as ticket sales and increasing digital revenue from things such as advertising on online content.

Oakwell's Umbers said more institutional investors, such as PE firms, are interested in backing sports. However, he stressed the importance of finding the right firm that both understands the sport in question and can align its interests with other stakeholders.

"Sports needs to be very careful who it chooses as its financial partner. There are multiple sources of capital, and private equity is just one of them," he said. "There are significant differences in culture sometimes, which won't always fit a particular sport to third-party capital."

Nevertheless, private equity investment in sports is only expected to grow. In April, Oakwell issued a report advising that the English Cricket Board consider opening up to funds. Certus' Sommerfeld, meanwhile, said investors are now expressing interest in even more diverse categories of sports—including swimming.

"I think people are realizing that the commercial, major opportunities around sports are growing far more than they ever have," he said. "Even COVID-19 has shown just how reliant people are on live content and having live sports to watch."

ESPORTS: A LEAGUE OF THEIR OWN

By Andrew Woodman

Kyle Giersdorf, a 16-year-old professional video game player, made headlines last year when he won $3 million in the inaugural World Cup tournament playing the popular shooter game Fortnite.

That prize was on par with the £2.35 million (about $3.1 million at today's conversion rate) won by tennis champion Novak Djokovic in his 2019 Wimbledon men's singles victory, showcasing the big-money heights attained by the once-fringe esports market.

"That has piqued people's interest in esports as a serious business, and the viewer numbers are increasing," said James Cranston, a lawyer with Clifford Chance who advises the sports and esports industries. "It is something that [investors] can get into early, and therefore reasonably cheaply, and by doing so can assist with setting the regulatory makeup around it."

Fortnite developer Epic Games—which private investors recently valued at $17 billion—had a prize pool totaling $100 million for last year's tournament. And it's widely expected to match that amount for future competitions.

Since esports leagues came on the scene around 20 years ago, the business has been dominated by game developers who use tournaments as an additional revenue stream—and as an effective way to boost their marketing profiles. Now, traditional sports brands are getting in on the act.

English soccer clubs such as Manchester United and Arsenal have teams dedicated to esports. The ePremier League, which launched in October 2018, is now into its second season and offering a £20,000 grand prize. It also ran the inaugural ePL Invitational, inviting Premier League soccer players on hiatus from lockdown to compete in a knockout tournament playing EA Sports FIFA 20. The event attracted more than 150 million viewers across platforms such as Facebook, YouTube and Twitch, and it was carried on TV by Sky Sports.

"For clubs, it's a great platform through which they engage with a younger fan base and cross-sell their digital content and existing products," explained Gregory Scott, a private equity lawyer with Clifford Chance.

Despite their virtual existence, esports haven't been totally immune to the impact of lockdown. Some major competitions take place in large stadiums where crowds gather to watch their favorite players compete across giant screens. For example, the 2019-2020 season ePL finals that had originally been set to take place at Gfinity Arena in London were postponed from March to August. The 2020 Fortnite World Cup was canceled altogether.

Nevertheless, if a second wave of coronavirus breaks out, esports will likely be better insulated than conventional sports. Epic Games has already decided to take its remaining tournaments online. For Wimbledon, meanwhile, an entirely virtual alternative isn't an option—yet.