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An Unlevel Playing Field

DLA Piper's Charles Baker discusses some of the vagaries of trying to buy a professional sports team

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The sports world, like most sectors, has faced its share of turmoil in recent years, and more questions loom as the major domestic sports leagues are all facing possible labor unrest in the coming years. In spite of the cloudy picture, deal activity has been robust, and valuations in some cases have soared far beyond expectations.

In May of this year, law firm DLA Piper became an instant player on the sports business and entertainment landscape, when the law firm poached a team of lawyers from Nixon Peabody. Charles Baker was among those joining DLA Piper's corporate and finance group as a partner, focusing on M&A, restructurings, private equity, and corporate finance, with a concentration on sports, media, entertainment and the consumer sectors. Recently, he has worked on deals involving the Chicago Cubs and Miami Dolphins and also served counsel for multiple stadium financings, including new homes for the New York Yankees and New York Mets.

Baker spoke with *Mergers & Acquisitions* in July to breakdown what is driving deal activity across the realm of professional sports.

Mergers & Acquisitions: *There has been a lot going on when it comes to sports M&A these days. What tends to drive dealflow in this area? The segment seems like it tends to operate outside of the normal M&A cycles.*

Baker: From a transaction perspective chaos breeds opportunity. There are a lot of teams still carrying significant debt loads or ownership groups that are funding operating losses. You have to ask, 'how



Charles Baker

long can that continue?'

That alone, presents a lot of opportunities for buyers, but you also have uncertainty created by the expiring collective bargaining agreements. Each of the four major leagues are affected. The NFL and the NBA are facing new labor agreements at the end of next season, while the NHL and Major League Baseball will have to deal with new collective bargaining agreements in 2012.

All of this serves to create more uncertainty, which drives M&A, generally.

Mergers & Acquisitions: *Amid this uncertainty, the Golden State Warriors were still able to fetch around \$450 million – a record price for an NBA team that rarely wins. Are acquirers just looking for 'trophy' properties or is there a true thesis behind these investments that justify the prices being paid?*

Baker: Sports teams will always be considered trophy properties, which is why they tend to price higher than other assets when you compare the multiples. With that said, these are viable businesses, and you don't see a lot of sales in which the seller doesn't get more for a property than they originally paid. Up until the sale of the [NBA's Charlotte] Bobcats earlier this year, I don't think there was a single case in which that happened in the NBA.

If you look at Steve Ross's acquisition of the [NFL's] Miami Dolphins, I guarantee he isn't planning to lose money. In fact, if you look at that market, an NFL franchise in Miami has to be considered a cash cow.

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These deals are attracting savvy investors; investors who have typically built a track record of being able to spot value. In the case of the Warriors, the team is in a great market and has a great fan base, so that probably overshadows the recent performance of the team to some degree.

Mergers & Acquisitions: *The Golden State sale was also interesting because the highest bidder didn't even win. Larry Ellison came out publicly after the deal saying that he had the highest bid and still lost. If you consider other similar situations in the NFL and MLB, it seems to underscore that there's more to an auction than just the valuation.*

Baker: No two examples are ever the same. That's going to be a wildcard when you're buying into any league. The commissioner of each league, at the end of the day, has always had the power to do what's in the best interests of their league. The NBA and other leagues have been quite active in that regard.

Mergers & Acquisitions: *Is there a typical deal structure when it comes to buying a sports franchise?*

Baker: Each league has their own set of rules relating to transfers, but by and large the rules govern, among other things, the amount of leverage a buyer can take on to fund a purchase. In the NBA, for instance, you can't borrow more than a certain amount of debt if it's secured against an owner's interest in the team. If it's unsecured, buyers can borrow slightly more. When you count the arena, there is an even higher debt limit. In the other leagues, you'll see some variation of this formula.

The leagues will also scrutinize the makeup of the ownership group. To go back to the NBA, for each ownership group, there needs to be at least one person who owns a minimum percentage of the acquiring entity.

The leagues will perform a pretty thorough exam in connection with the sale. For example, if you have an auction with a dozen bidders, a seller and its advisors can narrow it down to a half dozen pretty quickly just by determining who can fund their bids and who can't. Naturally, the league will perform diligence on any prospective owner or owners as well.

Mergers & Acquisitions: *How would you characterize the demand from lenders to back these deals? Is this an area where there might be some skepticism on the part of Wall Street? Or does that \$200 million secured by the NBA last year from JPMorgan and Bank of America signal an underlying appetite?*

Baker: The banks, before the crisis, were pretty eager to back these assets. If you look at some of the credit arrangements in Europe, for the football clubs there, you could argue that things got as aggressive as they did for many other sectors during the credit bubble. The economic crisis and recession have forced banks to become a bit more conservative, but the demand is still there.

Mergers & Acquisitions: *How do the banks view the situation going on with the Texas Rangers, in which the Bankruptcy Court had to step in to block a sale to Nolan Ryan's ownership group, citing that the MLB turned away higher offers?*

Baker: The banks watched that one with interest. I'd just say generally that all sides have played the game with the Rangers pretty aggressively.

Mergers & Acquisitions: *What are the differentiators between an 'A' property and everything else when you're talking about a sports franchise?*

Baker: Television is huge in all of the leagues. Most national, league-wide revenue contracts are split between the teams, but local revenue stays with the team, so the team's local market is crucial. The real estate can also be important. A lot of these teams are sitting on undeveloped parcels of land or control real estate that can be turned into something better. A municipality that can afford to help, where you have taxpayer assistance in financing new stadiums, may also be a consideration for potential purchasers.

Mergers & Acquisitions: *As a fan, it can be frustrating to watch an ownership group cry poor when it comes to talent. Does winning run counter to profit generation?*

Baker: I would disagree with that premise. It is very difficult to have a poorly performing team and make a lot of money in this business. If you talk to Danny Meyer about restaurants, he'll tell you that it all starts with the quality of

the food and the overall customer experience, or the "hospitality." The same is true in sports. It begins with the product on the field.

Mergers & Acquisitions: *The sports story of the summer has to be LeBron's defection from the Cleveland Cavaliers. I've seen estimates range from \$100 million to \$200 million in terms of the impact on the Cavaliers' valuation.*

Baker: Those aren't easy estimates to make. Anecdotally, though, if you go to Cleveland you will see a 'LeBron effect.' Some of the "experts" coming up with those numbers seem to be pulling things out of the air based on the spread, but in a place like Cleveland, where he was the primary draw for that basketball team, you'll see an affect on ticket sales, local restaurants, parking garages, et cetera. There will be an impact, and it will be pretty huge.

Consider what he'll do for Miami if he turns the Heat into a winner. All of a sudden they're filling all of the seats; they're potentially playing 14 additional games, eight of which could be home games if he takes them to the finals. Each game generates revenue for the franchise and the city. If you consider the merchandise sales and everything else that goes with it, there is clearly a significant economic impact.

Mergers & Acquisitions: *In the past, we'd see a lot of corporate entities own teams, whether it was Disney or the Tribune Co. These days, corporate ownership has dwindled, and interest from financial buyers has yet to materialize in any meaningful way. What is the hangup precluding institutional capital from really making a bigger splash in this segment?*

Baker: I'm actually chairing a seminar on this subject in the Fall. Private equity has invested in the segment before. Boston Ventures bought into Richard Petty Motor Sports, TowerBrook [Capital Partners] backed Dave Checketts when he bought the [NHL's] St. Louis Blues, and I know Falconhead Capital has an endurance sports platform, which operates endurance running road races and other events. These are just a few of the investments. So private equity has dipped their toes in the segment; the problem is that team ownership, if you're looking to make a quick profit, doesn't necessarily fit into a five to seven year holding period. Also, these assets don't lend themselves to a traditional PE model, where

you can squeeze costs or pursue add-ons to create scale and enhance value.

With that said, there are a ton of individual PE professionals who have either looked at these assets or bought in -- Tom Hicks, Ted Forstmann with IMG, and the Celtics ownership group, to name just a few.

Mergers & Acquisitions: *When it comes to*

creating value, which team owners provide the best model for others to follow?

Baker: I think George Steinbrenner would be a great example. He cared more about winning, even if it meant overpaying for talent. Some will argue with his tactics, but he created incredible value for that franchise and he did it by focusing first on the

team and its performance.

I think Bob Kraft is a great owner; Mark Cuban, despite his theatrics, cares immensely about that team and that helped create a loyal fanbase.

Presence is important for owners; putting a quality team on the field is paramount, and paying attention to the fans, beyond what's happening on the field, is the third piece to the puzzle. **MA**