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Generations Winter 2021 - A Winning Play: New Investment Opportunities Emerge Amid Continually Rising Sports Franchise Valuations

An ownership stake in a professional sports franchise has historically presented a unique investment opportunity that has consistently performed at a championship level—even if the particular team itself has not achieved the same success on the field. The valuation of sports franchises and their revered brands continues to climb year after year, thanks in part to new and varied revenue streams. This has helped spur innovative paths to team ownership, including specialized funds offered by private equity firms, which are bringing on sports industry leaders (such as Theo Epstein) for guidance and providing more opportunities for individuals and family offices to invest in sports franchises.

Why Do Investors Pursue Ownership of Professional Sports Franchises?

While there is no one-size-fits-all explanation, there are several reasons why investors pursue ownership of professional sports franchises. Professional sports teams are a relatively scarce resource. There are a limited number of franchises, and thus ownership provides an access card to an exclusive club. Historically, this was the primary driver for pursuing ownership, as it was seen as a trophy asset that came with perks like ownership suites. Moreover, professional sports franchises represented a diversified asset that provided inverse protection to stock market behavior. Ownership also includes custody of incredibly well-recognized, historic and revered brands and the goodwill that accompanies them. Some owners use their position to build their own brands and use those platforms to engage in philanthropy and promote social change. They can also become thought partners for leagues and other owners in an effort to evolve their respective sports.

As valuations have continued to grow, ownership stakes have become an even more valuable asset class, albeit one that has traditionally been highly illiquid and held long term. Ownership stakes have historically performed powerfully and resiliently, including during the pandemic. Ownership has offered valuation growth and a recurring and forecastable revenue stream that has outpaced public market indices in both performance and volatility.

Varied Revenue Streams Keep Franchise Valuations Rising

One reason sports franchise ownership has offered consistent valuation growth is the uniqueness of the sports industry and the variety of revenue streams within it.

An example is the value of media and broadcasting rights—in an "on demand" world, live sporting events remain appointment viewing and as a result are incredibly valuable to league and team advertisers, sponsors, and media partners. There is an insatiable demand for live sports content, as sports fans seek a connection to their favorite teams and everything their brands represent. This will allow live sports to continue to stand out among the competition for consumers' attention. Digital platforms (Amazon, YouTube, DAZN, etc.) have recently joined traditional broadcasters in bidding for these rights, increasing the competition for them. As these new platforms disrupt the traditional broadcasting market, the overall value of the rights on all platforms should continue to increase, compensating for any loss of value in traditional linear broadcasting rights. Amid this backdrop of competition for broadcast rights, some team owners have sought ownership of media properties. This, along with acquiring physical property such as stadiums, related venues and local real estate, also generates value and new revenue.

Additionally, there has been an increased focus on virtual fan engagement, alongside a continued desire to improve the in-stadium experience for ticketholders. Sports franchises and their partners are leveraging virtual reality and augmented reality technologies, including in broadcasts (with on-screen graphics and advertisements) and within social media platforms. Teams are also investing in esports and video games, either through outright ownership or through a partnership with an esports team, and most leagues have virtual apps or video games where fans can compete as their favorite players. With all these emerging technologies, teams and owners are able to further monetize intangible assets, such as through licensing of team logos and other intellectual property.

Another revenue stream still in its relative infancy is sports betting, which is now legal and operational in more than 15 states. This will be a brand-new, instant and significant source of revenue for leagues and teams. In just one example, teams have begun collaborating with sportsbooks to install betting kiosks in arenas. The integration of sports betting creates new in-arena and at-home viewing experiences and appeals to an entirely new fan demographic.

Finally, sports is experiencing a technological revolution, and data has become an incredibly valuable resource. From tracking biometric data of athletes to the collection of fan data, teams are using data to improve player performance and fan engagement and ultimately increase revenues. Several franchises have also created in-house sports data analytics companies that offer services to other teams and businesses in the industry.

New Ways to Invest

As franchise valuations continue to surge, some owners are struggling to find individual buyers with enough wealth to acquire minority shares that come without much control or influence on operations. At the same time, leagues are now allowing more institutional investors into the ownership ranks. For example, the National Basketball Association (NBA) on January 26, 2021, voted to change its rules to allow private equity funds and other institutional investors to own as much as a 20 percent stake in up to five different franchises. Previously, in a similar move, Major League Baseball (MLB) in October 2019 changed its rules to allow investment funds to own minority interests in multiple teams.

In response to these rule changes, several private equity firms have created new funds that acquire passive/noncontrolling minority ownership stakes in franchises. These firms are also turning to sports industry professionals to provide guidance and help them obtain opportunities in the industry. For example, on February 2, 2021, Epstein announced he was joining Arctos Sports Partners to advise both Arctos and the portfolio of teams in which it invests on leadership, culture and other business matters. Going forward, these types of partnerships will provide investors in these funds with the benefit of a prominent and successful sports executive guiding the team in which they have invested and help firms source and secure even more investment opportunities.

These types of funds provide a creative option for investors seeking to reduce the downside of illiquidity. While ownership in general has been an incredibly resilient and well-performing asset, ownership of minority shares has traditionally been a highly illiquid, long-term play due to the lack of a market for these ownership interests. These new funds are filling this gap by creating a pool of liquidity as they buy and hold minority ownership shares.

Ultimately, these new funds provide a novel way for individual investors and family offices to invest in ownership stakes in professional sports franchises, which have proven to be a well-performing asset powered by diverse revenue streams.

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