QUARTERLY REPORT #25: PERIOD TO 30 SEPTEMBER 2022[1]

Performance and net asset value[2]

Quarterly gross portfolio return: -5.7%

The sharp turn in global central bank monetary policy, has rapidly raised short term rates and also withdrawn liquidity from longer term bonds. As a consequence, 10year bond yields have risen, despite increased fears of recession, and resulted in another quarter of wild bond and equity markets. After a stunning 8.9% rally in July, the S&P500 saw declines in both August (4.2%) and September (9.3%) to see the key global index some 5.3% lower at quarter-end against June 2022. The index is now back to mid-November 2020 levels.

With 10year US bonds above 3.8% and S&P500 earnings expectations for CY2023 now starting to be cut, our postulation in QR#24 (June 2022) of a bottom in the US market in the 3200 – 3300 range – around 9% below the end June level - continues to gain plausibility. The level of fearsome bearishness amongst investors, as measured by surveys, is leading us to be a little more constructive on certain names. We are cognisant that this extreme bearishness has more recently produced aggressive rallies (eg. July) which get snuffed out quickly.

As UK investors have postulated, in the wake of a piece of brain-dead fiscal policy, there are increased fears that economic downturn will lead to a serious credit based version, as seen in 2008. Indeed, the biggest deterrent to investment is a group of global politicians, the like of which we haven't seen for numerous generations: a bunch of totalitarians opposed by a group of inept opponents. Add in some of the worst central bankers, who fancy themselves as bond traders and introduce extreme volatility to perceived safe assets, and there is little wonder investors are petrified.

The good news: in that type of environment, opportunity abounds, but we know the bear is not done yet.

Over the quarter, we exited a number of larger investments, most notably:

- Tassal after the enhanced takeover offer from Cooke Inc.,
- Regeneron after some excellent results with long dated dosing regimens for their aflibercept 8mg drug saw the share price jump 22% in two days adding close to US$15billion to equity capitalisation;
- Namoi Cotton after it became clear that our investment thesis regarding capital return was being turned on its head by board decisions we profoundly disagreed with; the good news is we were able to exit at advantageous prices and made an excellent return, especially given the subscription to placement and SPP in May 2021;
- E-L Corporation, where we tendered our shares into the Dutch Auction buyback at C$965/share; within two days, partly due to market volatility, we had the potential to repurchase at over C$100/share lower.

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1 Readers are referred to footnotes 2 and 28 - 33 explaining the derivation of the numbers. All returns are pre-tax unless stated otherwise. At the current level of net assets, cost imposition is estimated at 1% per month over the course of a full year (excluding capital raising related expenses) and is fully accrued monthly according to the best estimates of management. Readers are explicitly referred to the disclaimer on page 19.

2 Month by month tabulation of investment return and exposures is given on page 18, along with exposure metrics.

E72's top twenty long positions in alphabetical order as at 30 September 2022 are:

Alphabet (A and C class)	HAL Trust
Agency Group	IWG plc
Amerco	Liberty Broadband (tracker stock)
Brunswick Corporation	Lend Lease Corporation
Citigroup	Manchester United PLC
CK Hutchison	Porsche Automobil Holding SE
Deterra Royalties	UBS
Dexus Property Group	Virtu Financial
Exor NV	Volkswagen Group AG
Goldman Sachs	Yellow Brick Road Limited

Over the quarter, we benefitted from the divested stocks mentioned above, and also from our significant S&P500 hedge. Conversely, we saw a detraction from having a geared portfolio, and notable declines in the price of CK Hutchison, in a very weak Hong Kong market (which fell 21% over the quarter) Liberty Broadband and Virtu Financial, despite the apparent resolution of the "payment for order flow" issue and increased equity and other asset volatility.

One of the issues we find increasingly interesting, which occurred in 2008 and early 2009, was the disparity between the prices of listed equity exposure to real assets and the markedly different valuations being applied to privately held (or in Australia, major superannuation fund held) equivalent real assets. This is NOT the usual public-private arbitrage where the expensive public vehicle buys the cheap private asset. It's the reverse, because emotional equity markets do the valuations, not a highly paid valuer - with a large drinks bill.

Private-public arbitrage

To give a clue about 2008/9, my favourite example was the formerly listed Australian Infrastructure Fund (ASX: AIX), a vehicle investing in minority stakes in airports mainly in Australia – biggest monetary exposures were the widely held (by super funds) Perth and Melbourne Airports, but with a significant $400million investment in Hochtief's AirPort Capital group (Athens, Dusseldorf, Hamburg, Sydney). In December 2008, AIX's results showed their NTA/share to be A$3.24, with the shares at A$1.90. By June 2009, the price of the 381m shares had fallen to A$1.57; the fund had net debt/working capital deficit of A$136m for an enterprise value of A$734million. The on-balance sheet value of the airport assets: A$1,411million – a 48% discount.

If that was bad enough, AIX decided to issue new equity in mid-June 2009 at A$1.10/share in a 1-2 rights issue. Unravel the balance sheet, the equivalent enterprise value for the assets was A$555million – a stunning 60% discount to their private carrying values.

We are now seeing similar situations in other areas – office property, for instance. Australia's largest office property REIT – Dexus (ASX: DXS) – is a far more sophisticated entity than was AIX. It has a ~A$44billion funds management platform when the AMP Capital acquisition is completed, and ~A$18billion or so of on balance sheet assets, with strong exposure to premium office assets. DXS has around A$4.6billion of net debt.

DXS equity has collapsed in price and now trades at A$7.72 – down from $11.38 at end December 2021 (32%) and standing at a 37% discount to NTA which attributes effectively zero to the funds management business. Re-engineering these figures to look through to the assets sees investors paying ~A$13billion for A$17.75billion of real assets and related investments – a 27% discount, with no value for the funds management business. Moreover, the investments – property JV's - are essentially debt free. If Blackstone or Brookfield aren't looking, they should be.

Want a happy ending? If you held AIX at A$1.57 a share in June 2009, and took up the rights issue, over the next three years you received $0.39/share in dividends and a capital return equivalent of $3.20 by August 2012 – two and a half times your money or ~37% compound per annum return.

There is another – more esoteric area - where the private market for assets stands at a massive **premium** to the public market and where there is significant growth, even in the prevailing environment: trophy assets, most notably, sports teams.

Trophy assets: publicly listed sports teams trade at huge discounts to private

Second guessing even selected parts of the US economy at present is difficult. Housing has moved from ebullient to almost depressed in the space of months; prices in San Francisco are subdued, but rents and prices in New York are effervescent. A common feature between Australian and US economies is that interest rate sensitivities moving from ZIRP to "something" especially with other spending constraints such as in higher inflation – have been rather greater than many expected. There is a strong argument that prevailing economic and financial market conditions – perhaps strangely - favour "trophy assets" as investments.

There are clear signs that inflation in USA and Australia – but not necessarily Europe – is abating; it is measured year over year and many cost push elements are falling, but this does not necessarily mean CPIΔ will move back to the desired range of respective central banks. Further, the longer CPIΔ remains above desired levels, it will continue to accentuate economic inequality. The present bout of inflation – as we noted in QR#24 (June 2022) – is unusual in that overall CPIΔ is around 4%pa ahead of "core" CPIΔ which excludes food and energy and other volatile items. But folks with lower income spend more on these "volatile items". So in current conditions, the rich get richer and the Gini index[3] rises.

In such environments, for a consumer pressured by higher mortgage repayments and other accelerating prices, little things matter. Past experience – the early 1990's are a good example – show historically resilient performances from movie theatres. Cinema's, especially mall based megaplexes provide cheap entertainment and dining options – especially on a Tuesday evening.....

[3] The Gini index is an econometric measurement devised by the Italian statistician Corrado Gini in 1912 which measures a curve of income distribution away from a straight line of perfect equality (everyone earns the same so Gini = 0). The higher the number towards 100 (where one person earns everything) , the greater the inequality. USA Gini has risen from ~35 in 1979 to the current 41.5. South Africa is >60.

There is also the vaunted "Lipstick Effect"[4] – a female discretionary purchase that doesn't cost the earth but provides emotional uplift. The obvious item: lipstick – affordable luxury[5]. For many, what matters in tough times is sport.

Sport can be as cheap as you want it to be. Free-to-air games with chips and beer on the sofa or live at the game in the nose-bleed seats. It's escapism, offering another world of multi-million dollar salaries, glamour and it's passionate; 24/7 news, gossip, rumour, innuendo and increasingly nerdy stats (xG – expected goals in football)[6].

Sports team ownership, in many countries, since the 1920's, have been the asset that shows "you've made it". Not just buying the local team when your small business burgeons. But as any crusty Eastern European official from the 1950's to 1990's will tell you, it's also the desire of the Government, Army and Secret Service to run the most successful teams[7]. Look at the corporate ownership of sports teams across Asia, notably in Japanese football and baseball, Korean baseball and football, and football in China.

Over recent years, high net worth American individuals who have created significant wealth from buoyant financial markets have parlayed that – in ever increasing amounts – into sports teams. The recent zenith – the August 2022 sale of NFL team Denver Broncos for the highest transaction value of $4.65billion to one of the Walmart Walton family beneficiaries, compares to the last estimates "Forbes" value of the club in 2021 of $3.75billion. This 24% premium is not out of whack with past transactions in other sports, as we will discuss. "Forbes" estimated in 2021 that the aggregate value of NFL teams had risen 14% over the year; double-digit percentage increases in sport team values in the USA are par for the course. The aggregate value of the 29 surviving NBA basketball teams over the 24 years from 1998 to 2022 – according to "Forbes" - has risen from $4.85billion in 1998 to $72.9billion for 2022. That's 12% per annum across the league.

Why? In our opinion, two reasons: scarcity and demography.

Across the major organized leagues of the four key professional sports of gridiron, baseball, basketball and ice-hockey, there are 124 professional franchises: 32 each in American football and hockey, 30 apiece in the two b'balls. Of the 124 franchises, 9 are in Canada, 7 of which are in ice-hockey with each of the b'balls having a team in Toronto. These are franchises, which subject to league approval, are transferrable. If your team doesn't work in Baltimore, you shift it to Indianapolis. If it doesn't work in Oakland, it moves to LA, then Las Vegas. The New York Jets are not going to be relegated to NFL2, even if they should be.

US demography plays a major role. There are only **nine** incorporated cities in the US with a population over 1,000,000 out of a total of 330million folks. So there are very few mega markets where multiple franchises within a sport can thrive. Realistically only two: NYC and LA. Hence, the roughly 30 teams per sport have local monopolies, passionate "one-town-team" support

[4] "Forbes" 1 June 2022 "With recession threatening, the Lipstick Effect kicks in" provides a thorough and historic explanation of the phenomenon

[5] Readers wondering why Revlon Inc (REV) entered Chapter 11 bankruptcy protection in June 2022 might analyse the ongoing sales increases of its core "Revlon" color cosmetics brand but reflect upon the performance of its other branded product groups (Elizabeth Arden), its US$3.95billion of net debt and 86% equity ownership by the Perelman family holding company, MacAndrews and Forbes

[6] From the book "Expected Goals Philosophy: A Game-Changing way of analysing Football" by James Tippett (2019) showing a metric of how professional gamblers assess games

[7] Check out the history of Dynamo Moscow, Steaua Bucuresti (now FCSB), and BFC Dynamo (Berlin)

Of relevance to our English Premier League discussion, is the facet of "less is more" and global interest. US media contracts for each sport are increasingly difficult to track given streaming rights, and for three of the sports (not NFL) the large number of games per season and hence regional TV coverage. As best we can ascertain, the following table captures an interesting dynamic for the four US leagues and EPL:

US$million	teams	Games/ season	Media pa	Team value ($bn)	Value/media revenue	Revenue/ Game
NFL	32	272	10,000	132.5	13.3x	36.76
NBA	30	1315†	2,600	74.4	28.6x	1.98
MLB	30	2480†	3,000	60.9	20.3x	1.21
NHL	32	1397†	1,400	27.7	19.7x	1.00
EPL††	20	380	7,000	n/a	n/a	18.42

† assumes mid-point play-off season length †† translated at £1=US$1.16

Over very recent years, high net worth Americans have been discovering what wealthy Asians, the Stasi and Russian oligarchs knew years ago: for all the hoopla about US sports, one game – association football – is ubiquitous. So, now the Americans aren't just coming – they are invading.

In our opinion, whilst some would point at increasing values for sports businesses as signs of an asset bubble, the analysis above (and below) suggests some degree of subtlety is required. Has NFL peaked given the inherent dangers in the game? There's a clear observation that if you can get your sport to go "global" – there are opportunities everywhere in merchandising as well as media/streaming rights. Of the four key US sports, one - NBA – has by far the biggest global potential. On that score, it looks the most interesting and has a new media deal upcoming.

We are not saying that individual ego driven entrepreneurs will not go mad and burn their money – there are many prior examples in English football due to the gargantuan gaps between tiers of the pyramid (and probably one current one – Chelsea). But increasingly, today's franchise/club owner is more a hard-bitten business person. Check out this season's EPL surprise packet: Brighton & Hove Albion. Billy Beane and Michael Lewis have a lot to answer for.

The Sports

Across the globe, there are few publicly listed company avenues to investing in sports and sports teams. By and large, these types of companies have been extremely poor stock market performers, because they have been "value traps"[8]; one of the most dangerous, yet sometimes desirous attributes in sports/team ownership is ego. Virtually every publicly listed sport/sports team/franchise – and certainly the main entities of interest - is controlled either by an individual/family or a related sports "club".

If it wasn't obvious from the foregoing, if you could invest in anything, you would invest in the sport/sports league itself. UEFA, which controls football in Europe, generates €3.5billion pa alone from three competitions: European Champions League, Europa League, Europa Development League and a one-off "Super Cup" game between the winners of the first two. Before it sets aside ANY money for development, it has an effective 91% margin. Less than 10% is absorbed in costs.

[8] We define a value trap as a security trading at a large discount to its intrinsic value but where access to that value is denied by controlling shareholder with other motives or some other unfriendly obstacle eg executing a long lease on a desirable building which has significant redevelopment capacity.

However, without any teams there would be no competitions, and so significant proportions need to be delivered to the participants and winners. These payments are crucial to ensure there are no challenges to the "league" or establishment of alternative competitions to which participants defect[9].

There are two listed SPORTS, both of which have suffered pressures in this respect over past years: World Wrestling Entertainment (WWE) and Formula 1 motor racing (via Liberty Formula 1 tracker stock: FWONA/FWONB/FWONK). We have owned both in the past, most recently WWE, but have no current exposures. A very brief analysis of each is instructive in understanding where and why we do have exposures.

WWE emerged from the mid 1950's as the pre-eminent wrestling competition in the USA, against other regionally based tournaments; driven by the McMahon family, WWE (as it is now known) eventually won over against the competing Monday night fixture WCW (founded by Ted Turner) and acquired WCW in 2002. WWE is under some pressure at present from ECW (Elite Championship Wrestling), but has exhibited real strategic smarts over the past three years by moving away from owning its own content broadcaster to using WWE as prime content for others notably Fox, USA Network and Peacock.

Recent governance issues surrounding President Vince McMahon seeing him step away from the board, and strong suggestions McMahon's controlling stake in WWE is for sale have seen the shares rise strongly over the past four months.

As with virtually all sport(ing) franchises, McMahon's control is via super-voting shares with his ~39% economic ownership extending to 87% voting power. At the current $70.17 stock price, WWE's 74.3mn shares have an equity capitalisation of US$5.216billion; adding in debt to give an EV of $5.42billion reflects a multiple of 14.4x company guidance for CY2022 of $377million of OIBDA[10].

Formula 1 is now virtually unchallenged in its dominance of high end motor sport – the biggest circus on earth. It has a monopoly from FIA on the "World Championship" through to end-2110 Having morphed from a series of races controlled by the teams, then the "legendary" entrepreneur, Bernie Ecclestone, the organisation was acquired by Liberty Media in late 2016. This acquisition has coincided with a rebirth in the sport, with the 7th and 8th "Concorde" Agreements cementing in place the incentives for the major teams to stay in the sport and not attempt a breakaway series.

The Concorde pays 50% of TV dollars to the teams on a sliding scale accord to their success in the Constructors Championship as well as other prize money; in addition, with only 10 teams, there is a required US$200million payment for any new team wishing to enter.

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[9] The most definitive documentary of a challenger league is the ESPN "30 for 30" film "Small Potatoes: Who killed the USFL" about the fledgling challenger to the NFL which played after the conclusion to the NFL season from February through July. The film deals with the arguments about staying that way or competing head on with the NFL, as suggested by the owner of the New Jersey Generals, Donald J. Trump. The league folded after three seasons, though produced some outstanding players who went on to be NFL stars such as Sam Mills, Jim Kelly and Herschel Walker.

[10] Operating income before depreciation and amortisation

Formula 1's revenue is driven by broadcasting (40% in a normal year), fees from race promotors across the 25 events per annum (a notable increase in recent years) accounting for a further ~30% with 15% or so coming from corporate sponsorship and the remainder from ancillary services and support races. other commercial add-ons.

Liberty has brilliantly increased the profile of the drivers over a period when there has been increased competition between teams and star drivers; F1 became boring because te same team/driver won every year and was unchallengeable, but moreover, the drivers had no commercial rights to their profiles. After the Netflix series, Formula 1: Drive to Survive, first aired in 2018, the sport has been transformed, with greater driver access, gossip and fan following.

On most grounds, Liberty Formula 1 is the highest quality listed exposure in sport, with strong backing of the participants, 88 year remaining franchise, and only 25 (or so) times a year to "see the game"

Using the price of Liberty Formula 1's tracker non-voting stock (FWONK: $58.50) – the most liquid of the three – prices the equity at just over US$13.6billion; adding in debt gives the enterprise a value of ~$14.9billion. Analysts forecasts of EBITDA of $616million for FY22 look on the high side but based on a more conservative forecast around $570million, the shares trade at EV/EBITDA of around 26x EV/EBITDA. Whilst this has come down from peaks in the mid 30's, in our opinion, it reflects a view that F1 can continue to grow in the US, a market in which it has traditionally struggled. It is worth contrasting tis with the other "high multiples" of individual franchises within sports which are much more freely transferrable. F1 is not.

The US sports teams: we hold Madison Square Garden Sports

Liberty Media also control the Atlanta Braves baseball team (BATRK) via the super-voting structure and 11% cross shareholding between FWON and BATR. We have no holding in BATR due to the complexity of the tracker stock entity and lack of real discount. With 62million shares at $27.50, BATR has an equity capitalisation of $1.7billion; allowing for net debt and other assets, the enterprise value of $2.1billion is in line with the recent Forbes valuation.

In May 2019, in an investment presentation[11], we espoused the virtues of what was then called Madison Square Garden Company. In the intervening three plus years, MSG has split into two pieces – the sport teams (MSGS: NY Knicks and NY Rangers) + MSGS, being the arena itself and associated other assets, Tao Group Hospitality, and the controversial "Spheres" project in Las Vegas. In July 2021, MSGE completed the re-acquisition of MSG Networks, the broadcaster, which had previously been spun out.

A potted history of MSG

NY Rangers were founded in 1926 as an initiative of the then owner of MSG, Tex Rickard, who observed the popularity of the ice-hockey team then playing at MSG; by founding his own team (Tex's Rangers) he intrinsically connected the team with the arena virtually ever since. When the Knicks were formed in 1946, the eleven basketball franchises forming the new Basketball Association of America were required to have common ownership between team and arena, thus cementing MSG's ownership of its two major sports teams.

[11] "Climbing Cranes: Risky Behaviour" May 2019 http://east72.com.au/wp-content/uploads/2019/06/E72-Investment-Presentation-May-2019_Optimize.pdf

Madison Square Garden is in its fourth incarnation[12], the original having been built in 1879[13]. The genesis of the current building above Penn Station goes back to Irving Mitchell Felt, who in the late 1940's and early 1950's took control of Graham-Paige (G-P), previously an automotive manufacturer. G-P was redirected into real estate (and stock) investment and having acquired the Roosevelt Raceway harness track on Long Island, in 1959 acquired 40% of Madison Square Garden for $4million.

G-P changed its name to Madison Square Garden in 1962 as the (old) Madison Square Garden had redeemed a further 36% of its shares – later the subject of a complex tax case – to give G-P over an 80% stake, which it moved to 100% via an issue of preference shares.

Felt was the driving force behind relocating MSG to its present location, constantly attempting to gain tax breaks from the City of New York, but finally overseeing the erection of the present arena which opened on 14 February 1968.

A year later, Gulf + Western (G+W) – a conglomerate run by Charles Bluhdorn, which started when he acquired Michigan Bumper Company in 1956, and which expanded into media through the acquisition of Paramount in 1966 – started acquiring MSG shares. The process of acquiring the company ran a full eight years until an acrimonious meeting on 19 August 1977 when G+W squeezed out the remaining 19% of shareholders at an implied valuation of $48million (plus $130m of assumed debt).

G+W were in turn acquired by Viacom in 1994; as part of the emphasis on media, Viacom sold MSG (and related assets) to a 50-50 venture of ITT and Cablevision for $1billion; in 1997, Cablevision acquired ITT's stake for $600million giving it full ownership.

Cablevision was one of the great media success stories of the 1970's and 1980's, founded in 1973 by Charles Dolan (still living today at 95yo and who also created Home Box Office) to provide cable television subscriptions to Long Islanders, but expanding over the years supplying subscriptions to 3million NY area cable customers. Cablevision publicly floated in 1986 and span off two businesses – Madison Square Garden Company in February 2010 and AMC Networks in July 2011. The residual Cablevision business was acquired by Altice in 2015 for $17billion (including debt).

In September 2015, Madison Square Garden Company span off the venue (+ associated assets) and the two teams into a new company, with the old company being renamed MSG Networks. The new MSG Company perpetrated another spin in August 2020 with the venue assets once again moving to a new company (MSG Entertainment - MSGE) and the continuing company housing the two sports teams as MSGS.

All of the Dolan entities have split voting structures of single vote "A" common shares entitled to elect 25% of the respective company board and "B" common shares with ten votes entitled to elect 75% of the board of directors. The Dolan family own all of the "B" shares in the respective entities.

[12] https://allsportshistory.com/2020/11/27/madison-square-garden-a-super-quick-history/
[13] MSG 1 & 2: 5th Avenue & 23rd St; MSG 3: 8th Avenue & 50th St; MSG 4 (current); 7th Avenue & 33rd St

Why are we revisiting "MSG"?

In May 2019, the old MSG (now MSGS) traded at $302 a share. The combination of the MSGE "SpinCo" at $44.09 and MSGS at $136.66 adds to $180.75, a decline of 40%. But there is no plausible way the sports team valuations have declined over the past three and a half years, despite COVID, and there are moves afoot to enhance the value of the "arena company".

The arena company will undergo another spin, this time of the arena itself, and MSG Networks, leaving the $2billion "MSG Sphere" project at the Venetian in Las Vegas and Tao Hospitality in the erstwhile parent. As MSGE has mulled this restructure over, the Mayor of New York, Eric Adams, has reopened the possibility of relocating Madison Square Garden for a fifth time, given the constraints it enforces Penn Station below it.

The whole collection of assets is valued by the equity market at ~$3.2billion[14] including debt but before full completion of MSG Sphere. Considering that MSGE also owns the air-rights above Madison Square Garden, this appears to us to be extremely cheap, especially looking out to mid 2023. Despite an initially positive reaction to the spin-out proposal the shares have been very weak of late, in line with rising bond yields, which have impacted other property related exposures around the world.

NBA team valuations

The following tabulates the latest (2022) "Forbes" valuations, together with operating metrics from 2019 – the last full season with crowds where numbers are fully available - plus the internal rate of return from the last (major) sale transaction to now and a revenue multiple:

	Value ($mn)	2019 revenue ($mn)	2019 operating π	Last sale price ($mn)	Last major tranche sold	IRR from last sale	Valuation/$ revenue
New York Knicks	5800	$472	$157	1100	Aug-97	7.1%	$12.29
Golden State Warr	5600	$440	$109	450	Jul-10	25.1%	$12.73
Los Angeles Lakers	5500	$434	$178	67	Jun-79	11.0%	$12.67
Chicago Bulls	3650	$301	$103	16	Jun-85	16.1%	$12.13
Boston Celtics	3550	$304	$88	360	Sep-02	12.7%	$11.68
Los Angeles Clippers	3300	$282	$70	2000	Apr-14	6.9%	$11.70
Brooklyn Nets	3200	$304	$42	3200	Aug-19	0.0%	$10.53
Houston Rockets	2750	$348	$110	2200	Sep-17	5.6%	$7.90
Dallas Mavericks	2700	$307	$105	285	Jan-00	10.9%	$8.79
Toronto Raptors	2480	$334	$79	400	Dec-11	20.4%	$7.43
Philadelphia 76ers	2450	$300	$90	287	Oct-11	23.9%	$8.17
Miami Heat	2300	$294	$58	150	Jun-95	10.9%	$7.82
Portland Trail Blazers	2050	$287	$51	70	Jun-88	10.7%	$7.14
Sacramento Kings	2000	$286	$81	534	May-13	17.0%	$6.99
San Antonio Spurs	1980	$285	$66	75	Jun-93	12.2%	$6.95
Washington Wizards	1930	$269	$55	310	Jun-10	17.5%	$7.17
Milwaukee Bucks	1900	$283	$69	550	Apr-14	18.0%	$6.71
Phoenix Suns	1800	$246	$42	401	Apr-04	9.0%	$7.32
Utah Jazz	1750	$258	$63	1700	Dec-20	3.5%	$6.78
Denver Nuggets	1730	$252	$52	250	Apr-00	9.4%	$6.87

[14] 34.3million shares at $44 plus net debt, minority capital and a significant working capital deficit.

	Value ($mn)	2019 revenue ($mn)	2019 operating π	Last sale price ($mn)	Last major tranche sold	IRR from last sale	Valuation/$ revenue
Atlanta Hawks	1680	$251	$78	850	Apr-15	11.0%	$6.69
Indiana Pacers	1670	$243	$55	11	Apr-83	13.9%	$6.87
Cleveland Cavaliers	1650	$300	$39	375	Jun-05	9.5%	$5.50
Orlando Magic	1640	$244	$70	85	Sep-91	10.3%	$6.72
Oklahoma City Thund	1630	$258	($23)	325	Jan-05	10.1%	$6.32
Detroit Pistons	1580	$255	$52	325	Jun-11	16.5%	$6.20
Charlotte Hornets	1575	$240	$39	275	Mar-10	16.2%	$6.56
Minnesota T'wolves	1550	$234	$46	89	Jun-95	11.5%	$6.62
New Orleans Pelicans	1530	$224	$49	338	Jun-12	17.5%	$6.83
Memphis Grizzlies	1500	$224	$24	350	Jun-12	16.9%	$6.70
TOTAL	**$74,425**	**$8,759**	**$2,097**			**12.7%**	**$8.16**

The table suggests the NBA's 30 teams are collectively worth around $75billion or roughly 8x revenue and 35x operating income. That's a bit more than FWONK and reflects the fact it is a "sum of tradeable parts", plus the sheer attraction of NBA to grow from here (below). These franchises seem like good investments – from the last sale price to now, they have generated average IRR of 12.7% per annum.

So how good are these "Forbes" valuations? Not bad as it turns out – indeed **<u>under</u>**stated. Of the seven most recent sales, none were below the prior "Forbes" valuation, and the average premium, excluding the two outliers is around 40% (cf the Denver Broncos/Walton sale at 24%)

	Sale price	Prior Forbes valn	Variance	When
Houston Rockets	2200	1650	+33%	Sep 17
LA Clippers	2000	575	+248%	Apr 14
Milwaukee Bucks	550	400	+36%	Apr 14
Atlanta Hawks	850	825	+3%	Apr 15
Sacramento Kings	534	300	+78%	May 13
Utah Jazz	1700	1425	+19%	Dec20
Brooklyn Nets	3200	2350	+36%	Aug 19

The above table only includes valuation transactions where control of the team changed. Over the past 18months, five teams saw significant minority stakes change hands as private equity – notably Arctos Sports Partners and Dyal Home Court - have bought out other minority owners in Golden State, Phoenix, Atlanta, San Antonio and Sacramento.

In mid September, the listed private equity group, Ares Management announced the close of a $3.7billion fund in "Sports, Media and Entertainment Capital".

We are intrinsically more attracted to basketball than the other three major US sports. It has a wide global diversity of star players against the three other majors, is deliberately targeting global audiences and players, and has little of the concussion issues afflicting NFL. The global aspect is especially important, as we see in the English Premier League. No need to tell you about the ability of NBA stars to sell merch": you all know the story[15]. ,

[15] Air Jordan

Moreover, NBA has an upcoming renewal of the national TV rights package currently held by ESPN and Turner Sports which pays an estimated US$2.6billion a year; team values are clearly anticipating a significant lift in this number, given the current contract was negotiated in 2014 for commencement in 2016[16]. Hello streaming! Just assessing the three other major sports renegotiated deals over recent times suggests at least a doubling of the contract, but we also see scope for much more lucrative money from global deals, which US analysts don't seem to factor in.

So where does this leave the publicly traded MSGS? As we discuss with Manchester United (US: MANU below), whilst underpinned by positive economics, owning stock in the team is held back by a family controlled structure and past erratic attitudes towards the team(s). To some extent, the main (only?) investment thesis is a sale of the teams – a factor reflected in the share prices.

MSGS has only 24.77m shares issued trading at $136.66. As we discuss with MANU below, accounting in sports teams is arcane due to deferred revenues sat on the balance sheet often leading to upfront cash and hefty seasonality. Whilst MSGS net debt at $160million is low, on our estimates there is around $320m of negative working capital. Hence, the enterprise value for the two teams is around $3.8billion ($3.3bn equity + $480m "liabilities").

The combined Forbes valuations of the Knicks and Rangers is $7.8billion; if we take our liability figure off this, the debt free figure would be around $7.3billion. With "the Garden" separated, there may be a further discount, **but the Forbes values lay 92% above the equity markets' view**. We have a small exposure, bought at very recent prices.

The Biggest Gorilla in Europe. A Stateside invasion of the EPL.

At current exchange rates, and using 2019 revenues (pre COVID), NONE of the NBA franchises – in revenue terms – comes close to the largest football teams in Europe. In 2019, Barcelona's €841million revenue was over twice the equivalent of the NY Knicks. Barca have since degenerated due to club politics and the problem of retaining three mega-stars in the one team (2016: Messi, Neymar Jr and Suarez).

Whilst there are huge football clubs spread across Europe - of which eleven[17] are listed companies- there are two dominating factors: the proportion of TV revenue gleaned by the English Premier League and the money garnered for qualifying for and progressing through the European Champions League.

How does the EPL work for the (big) clubs?
In 2021-22 season, each EPL team received £79million of broadcast deal money and an equal £5.6million of EPL's commercial revenue – so £84.6million of "guaranteed". The inequalities start from "merit" payments which relate to the position on the EPL table which provides additional share of TV money. Finally each team receives "facility" fees which are related to how many of their games are broadcast live.

[16] Note the seemingly inflated value/media revenue numbers in the table on page xx
[17] Benfica, Sporting, FC Porto (all Portugal), (Glasgow) Celtic, Ajax Amsterdam, Lazio, AS Roma and Juventus (Italy), Borussia Dortmund (Germany) Olympique Lyonnais (France) and Manchester United.

According to @sportingintel[18] the league winning Manchester City would have received around £164m in 2021-22; bottom placed Norwich, who were relegated, were the only team not to break £100mn in payments (£98.6m) – their facility fees were less than half of those of Manchester City, but merit payments were <£3mn against the Sheikh's owned Mancs £53million.

As a guide, the first EPL season saw the 22 teams (there are now only 20) share £35million; the last season was up over 74fold from there at over £2.6billion – a CAGR of 13.1%.

Aside from central pool/broadcast and winning domestically, the biggest teams are further advantaged in three respects:

- Bigger matchday revenues through more tickets at higher prices and corporate hospitaility; as a guide Manchester United (MANU) 26 home games in 2018-2019 (pre COVID) brought in £4.26million a game in matchday revenue, excluding merchandise;
- Bigger deals with global companies for shirt/shorts/sleeve sponsorships + other "partnering" opportunities – normalised, this is MANU's biggest source of revenue at ~ £260million a year;
- Europe, especially European Champions League (ECL) where UEFA dole out €2.73billion (£2.4billion)[19] across the three competitions, but in accordance with inequities everywhere else in football, over €2billion is for the Champions League (as opposed to Europa or Europa Conference Leagues). Crudely, each of the 32 qualifiers for the "group stage" gets €15.6million, €2.8million a win, €9.6million for getting out of the group, and various payments up to winning. With the assorted bonuses, if you win all six of your group games in the ECL and go on to win the trophy, it's worth €85million. That's not available to the Norwich's of the world.

So for MANU, the last full season (2021/22) saw revenues split 44/37/19 commercial/broadcast and matchday – very similar to 2019. It becomes clear why the Glazers sign 36year old Christiano Ronaldo again. He sells a bucketload of "7" shirts.

So everywhere you look, the big must get bigger. This is the backdrop to the aborted European Super League pushed by Juventus Chair Andrea Agnelli in 2020, which was wildly howled down by UK fans (and Boris Johnson). Like it or not, it's not going away for the obvious reason that to maximise revenues and team values, the biggest clubs must morph into franchises. No threat of relegation, and where there are more high quality games.

As a guide, relegation from the EPL isn't a disaster – it's an existential threat. Parachute payments for the three clubs relegated from the EPL give the club 55% of equivalent EPL broadcast revenue in year 1, 45% in year 2 and 20% in year 3. So the minimum £79million falls to £45million in year 1. A £35million hole. It is why clubs have tended to yo-yo between the Championship and EPL in recent years because the broadcast revenue for a Championship club not relegated from the EPL is.......£8million. As a guide, the EPL's highest paid player, Mohammed Salah, the Egyptian goal scoring machine for Liverpool[20], earns over £18m a year.

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[18] c/- Nick Harris
[19] https://editorial.uefa.com/resources/0277-158b0bea495a-ba6c18158cd3-1000/20220704_circular_2022_47_en.pdf
[20] At the time of writing Mr. Salah's goal scoring machine appears to have been unplugged with production of only two in 7 EPL games.

Who owns the clubs? Where are the Americans?

Whilst a disaster for the aficionado, franchising would be an extremely appealing prospect for the alpha males, sheikhs, and the smart who own certain of the teams. So who are these folks? The major owners of the 20 EPL clubs can be categorised as follows – only 6 are controlled by locals:

Smart Brits from gaming/trading	2	Brentford, Brighton
Brits or dual citizenship Brits	4	Bournemouth, Everton, Spurs, West Ham
Chinese	1	Wolves
Thai	1	Leicester
Serbian (majority)	1	Southampton
Egyptian/USA	1	Aston Villa
Italian/USA	1	Leeds United
USA majority	5	Arsenal, Chelsea, Crystal Palace, Fulham, Liverpool
Greek	1	Nottingham Forest
Middle East Sovereign Wealth	2	Manchester City, Newcastle
PUBLICLY LISTED (USA)	1	Manchester United

There is increased fear about the American invasion on two fronts: Firstly, Americans are used to leagues with no relegation. They operate in sports competitions which are franchises, and which can be moved from city to city, if the local populace don't show up, or the local mayor won't build a new stadium. Where are the "Raiders" this week? Secondly, more of the money is of a private equity nature. One can only conclude that Alan Pace and ALK who bought Burnley FC (relegated from the EPL last season) on borrowed money, had a brain fade. They are having to gut the club to keep it alive, but will be praying its Championship form continues.

So who are the Americans still in the EPL? Their clubs and other sports connections are tabulated below:

American	**EPL team ownership**	**US sports participation**
Wes Edens	Aston Villa (smaller co-owner)	Milwaukee Bucks (NBA)
Stan Kroenke	Arsenal (100%)	LA Rams (NFL), Denver Nuggets (NBA), Colorado Avalanche (NHL)
Todd Boehly	Chelsea (managing owner)	LA Dodgers (MLB)
John Textor	Crystal Palace (40%)	other non US soccer teams
David Blitzer	Crystal Palace (18%)	
Joshua Harris	Crystal Palace (18%)	
Shahid Khan	Fulham (100%)	Jacksonville Jaguars (NFL)
Denise DeBartolo York/John York (49ers Enterprises)	Leeds United (44%)†	San Francisco 49ers (NFL)
John Henry/Tom Werner (Fenway Sports Group)	Liverpool (100%)	Boston RedSox (MLB), Pittsburgh Penguins (NHL)
Silver Lake	Manchester City (10%)††	
Glazer Family	Manchester United (67% economic)	Tampa Bay Buccaneers (NFL)

† option to buy 100% from Andrea Radrizzani valuing Leeds at £715million

†† City Football Group which also includes NY City FC, Melbourne City, Mumbai City, Sinchaun Jiuniu, Girona, Montevideo City Torque, Yokohama F. Marinos (20%), Palermo. Silver Lake invested $500m for the stake valuing CFG at US$5bn (£4.3billion). Silver Lake also own 33% of Australia's A-League

Is there an investment case for soccer teams?

Yes …and no. The more you look at football clubs – as opposed to NBA – the clearer it becomes that these entities belong in the private market, and not be publicly listed. That comes down to the make- up and structure of the sport. Despite FIFA's "Football Fair Play" rules, which in a complex manner attempt to prevent teams losing money year after year by paying exorbitant transfer fees and wages to stars, owners skirt them by capitalising loans to equity and other ruses. Hence, teams are subject to the ego and discipline of the main owners; when two of the main EPL owners are not ultra-high net worth individuals but sovereign wealth funds of Middle East oil countries, it's hardly a level playing field.

As we've said, football clubs are not franchises (yet) – they can be relegated, and the sport is moving to the big getting much bigger. So if you are going to play, you either have to be very smart, or be with the giants.

The other aspect is football club accounting – it's not a sector you put the analytical intern onto. There are four key complexities within the balance sheet and its translation to profit (utterly meaningless!) and cash flow:

- Players – the players contracts are classed as intangible assets and amortised appropriately. So if Manchester United sign Brown Jr. for £15m on a three year contract, effectively they will amortise £5million per annum, given that if the contract runs its full course, Brown Jr can leave of his own volition and no fee will be payable. Of course, if Brown Jr scores 20 goals a season, then MUFC will hope to lengthen his contract after year 2 for a further 3 years and can thus reduce the amortisation charges;

- Player "profits" – when players are transferred, by and large, clubs record a profit on disposal of intangible assets; in the case of "big" clubs the profit is usually a realistic loss because of the aggressive amortization of the player contract. However, Manchester City are the kings of developing "junior" players who never play for the first team, but end up being sold for genuine profits to other Premier League or Championship teams[21]. Occasionally, the mega-European (usually Spanish) teams pay to acquire an existing superstar; Real Madrid signed Christiano Ronaldo from Manchester United for £80 (€94m in July 2009);

- Deferred revenues – clubs sell corporate boxes and season tickets with upfront payments at the start of the season (August). Hence, the balance sheet at that time contains significant quantums of cash with the deferred revenue being "amortised" week by week across the season as the tickets/boxes are used on a game by game basis – similar to annual media subscriptions. Hence, trying to estimate appropriate levels of net debt needs to take account of such numbers.

[21] For Australian readers, Socceroo Aaron Mooy (currently with Celtic FC) is a prime example, signing for MCFC from their Australian affiliate Melbourne City for a notional fee, then sold to Huddersfield Town after a successful loan spell for £10million.

- Stadia – unlike some US sporting teams who have local authorities build stadia for them (under threat of moving away) UK football teams usually own their stadia[22]; as a consequence, there are required upgrades and changes as the environment around the ground evolves or capacity increases are required. In Liverpool, Liverpool FC have struggled on reworking Anfield amidst tight terraced housing whereas their rivals, Everton, have succumbed to the housing issue around them (and the inability to demolish a church in one corner) and are building a new stadium on a disused dock. The stadia cost £400-500mn+ but have limited alternative uses.

Hence, the asset values move up and down in a more volatile manner than a diversified equity portfolio, but they have two (expensive) legs, get very moody, are overly influenced by agents who are extraordinarily greedy. Not the sort of stuff you can analyse. What IS much easier to focus on is operating cash flow with appropriate deductions for player transfers (on a cash basis) in and out.

So why would you own shares in a publicly listed soccer club?

The Manchester United (MANU) investment thesis

The Reds are the ONLY way to participate in the riches of the English Premier League, which we have discussed, emanate from broadcasters, sponsorship, merchandising and European success. But to do so means you HAVE to enter a value trap, because MANU is controlled by the Glazer family. It is clear they see MANU as a (lucrative) financial asset, and have done relatively little – apart from pay excessive transfer fees for the wrong players and appoint the wrong managers since Sir Alex Ferguson[23] retired – to satiate the desires of the hardcore MANU fan. Against this backdrop, and with eyes wide open, we have a small position in MANU, since the upside on a sale is significant. The probability of a sale, from every angle, is increasing. This is an asset not immune from, but less impacted by global events for reasons discussed previously.

To be “stuck” in MANU shares is unlikely to be a good investment. MANU were floated seven years ago (August 2015) at US$14 per share – not far off the price today. There have been no stock splits, but the Glazer Family, which started with 124million “B” shares (10votes) out of 164million total shares, have watered this down to 110million through sales (B shares revert to “A” shares on sale). The shares peaked in June 2018 at $27 and recently touched a low just below $11.

[22] Only West Ham United (London Legacy/Newham Council), Manchester City (Manchester City Council) and Newcastle United (Newcastle City Council) in the EPL don’t own their stadiums. How ironic the two sovereign wealth fund clubs don’t own their grounds!

[23] Sir Alex Ferguson was the subject of a detailed Harvard Business School piece in 2013, the year of his retirement, on his management style and decision making

As other clubs are now being acquired by far larger entities than was previously the case – viz the Noisy Neighbours[24] and Newcastle – even the wealthy Glazers are starting to rethink the logic of controlling MANU. In our opinion, the process of divesting their controlling stake has begun, because we are probably getting close to peak mania, and they can take an egregious amount of money off the table. Anyone buying MANU would on our thesis require full 100% control of cash flow, not just equity.

The most rumoured buyer is Jim Ratcliffe[25] Britain's richest man and chair of Ineos, the specialty chemical (mainly ethylene) company. Certainly another potentate[26] would not want to leave stock with pesky individual investors.

So what's United worth? Basically what the Glazers will sell it for. We don't usually get our financial news from the (UK) "Daily Mirror" (formerly owned by the "Bouncing Czech")[27] but the morning edition of 5 September 2022, suggested "The Glazer family have slapped a minimum £3.75billion price tag on Manchester United amid increasing pressure to sell the club".

To gain an idea on the issues with football club accounting, whilst the Glazers have loaded MANU with £492million of net debt, the balance sheet at end June 2022 also has £147million of "deferred revenue" – effectively sponsorships and corporate and season tickets for which the "service" has not yet been provided, along with a net £274million of trade creditors and payable. All up, £913million of liabilities.

Taking a conservative view of the "Daily Mirror" price leak, excluding these liabilities suggests an equity price of around £2.85billion or US$19.50 a share - subject to fx rates - versus the current level of $13.27.

Is the price realistic? Somewhat surprisingly, probably yes. The Silver Lake investment into City Football Group valuing it at $5billion (£4.4billion) is a reasonable lead, as is the equity value purchase of Chelsea in mid-2022 by the Todd Boehly consortium of £2.5billion plus required investment of £1.75billion in "infrastructure" mandated by UK Government, given the selling shareholder was Roman Abramovitch.

An equity value of £2.85billion equates to 4.9x revenues in the latest season of 2021-2022 (6.5x including debt) which is below the average noted for NBA teams.

At the current share price, MANU trades at 26.6x guided EBITDA for FY23 (ends June). However, the key to the business' sustainability is cash flow. MANU generated gross cash from operations of £122million in FY22, down £16m on the prior year; but the Glazer's gearing means >£20m of that went in interest payments. So operating cash flow after interest was £101million.

[24] In September 2009, Manchester United beat the rapidly improving, big spending Manchester City 4-3 with the winning goal scored by Michael Owen six minutes into injury time ("Fergie-time"). Sir Alex Ferguson gave this unforgettable quote in a post-match interview "Sometimes you have a noisy neighbour. You cannot do anything about that. They will always be noisy. You just have to get on with your life".

[25] Mr Ratcliffe owns 62% of privately held Ineos Limited which generated revenue in 2021 of over €18.8billion, a bottom line of €2.1billion; he hails from Failsworth, 6 miles NE of Old Trafford and Bloomberg estimates his net worth to be US$28billion.

[26] Paris St-Germain are owned by Qatar Sports Investments

[27] "Private Eye", the UK satirical magazine's nickname for Robert Maxwell, father of Ghislaine Maxwell

But the lousy on pitch performances and past transfer market debacles resulting in a further need to strengthen the team, saw United spend a net £80m on new players in FY22. With another £8million on "plant", free cash flow was a lousy £9m pre-tax. But the Glazers need money – so they borrowed £40million to pay £33m in dividends, of which they received £22million.

It is clear, on a financial analysis, and an emotional one, that this clown show should be getting closer to its end game. The Glazers can't keep financially levering up United, especially if they don't qualify for the ECL. Whilst the Glazers may lose the "kudos" of controlling arguably the most famous football club in the world, effectively they have no "kudos" because the fan base generally despises them. In the current times, there are potential buyers aplenty for EPL assets – with reason because of TV, merch and "franchise" growth - and this is the jewel in the crown.

Our exposures to trophy assets

Our portfolio has assorted exposures to "trophy assets" – assets, or their manufacturers, where the "value" is in the eye of the beholder rather than a discounted value of future cash flows. Offsetting this apparent indiscipline is a reasoned understanding of history, and why these scarce assets and products are especially valuable.

Our exposures are to Porsche (vehicles) via both Volkswagen AG and Porsche Automobil Holdings, Madison Square Garden Entertainment (venues) and Madison Square Garden Sports (the teams), Ferrari, indirectly through its controlling shareholder Exor NV which also controls 60% of Juventus, the Italian champion football team, and at the riskier end of the spectrum – and a small position, Manchester United PLC.

Our strategy

Our overall exposure has come down progressively over the quarter as a result of the sales mentioned at the start of this report and increased hedging after the strong July month in markets. We are now carrying net exposure of $1.38 for every dollar of equity. We have retained a strong hedge against the S&P500 (in A$, not US$) and have had some benefit from the decline in Australian dollar against US$. Our portfolio remains esoteric, with a strong emphasis on valuation, from either an earnings or asset perspective. We are cognisant of the tightened monetary environment and fears of credit risks within financial markets, but also the opportunities this situation brings forth.

For further information:

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STATISTICAL APPENDIX: QUARTER & FYTD TO 30 SEPTEMBER 2022

1. Monthly performance, exposure and NAV

	Investment return[28]	Cost imposition[29]	Net Return[30]	R12 Return	NAV/share pre tax (c)	Gross Exposure[31]	Net Exposure[32]
30 Jun 17				46.6%	35.5	276%	-6%
30 Jun 18				-18.8%	29.0	278%	81%
30 Jun 19				-25.8%	21.6	395%	0%
30 Jun 20				-68.0%	7.0	185%	122%
30 Jun 21				+20.3%	7.3	297%	67%
30 Jun 22				-34.0%			
				R12 return			
31 Oct 21	(1.2%)	(0.8%)	(2.0%)	11.0%	7.2	429%	56%
30 Nov 21	14.2%	(0.8%)	13.4%	12.4%	8.1	400%	41%
31 Dec 21	(1.7%)	(0.6%)	(2.3%)	8.3%	7.9	259%	183%
31 Jan 22	4.2%	(0.7%)	3.6%	15.8%	8.2	251%	229%
28 Feb 22	(15.7%)	(0.7%)	(16.3%)	(8.9%)	6.9	224%	224%
31 Mar 22	0.7%	(0.8%)	0.0%	(14.0%)	6.8	309%	133%
30 Apr 22	-14.8%	(0.9%)	-15.7%	(22.1%)	5.8	322%	202%
31 May 22	5.5%	(1.4%)	4.1%	(22.0%)	6.0	268%	207%
30 Jun 22	-19.0%	(0.8%)	-19.7%	(34.0%)	4.8	290%	226%
31 Jul 22	11.3%	(1.1%)	10.2%	(26.3%)	5.3	303%	196%
31 Aug 22	-5.4%	(1.0%)	-6.4%	(27.6%)	5.0	345%	174%
30 Sep 22	-10.5%	(1.1%)	-11.6%	(39.7%)	4.4	336%	138%

2. Equity exposure as at 30 September 2022[33]
(as % month end pre-tax shareholders funds):

	percent	exposures
LONG	237%	24
SHORT	-	0
FUTURES/INDEX DERIVATIVES	(99%)	
TOTAL	336%	24
NET	138%	

[28] Change in market value of all investments – cash and derivatives – after interest charges, dividends receivable, dividends and fees paid away divided by opening period net asset value and time weighted for equity raisings
[29] All accrued expenses for company administration (eg. listing fees, audit, registry) divided by opening period net asset value and time weighted for equity raisings
[30] Calculated as 2 (above) minus 3 (above)
[31] Calculated as total gross exposures being nominal exposure of all long and short positions (cash and derivative) divided by end month pre tax net asset value – assumes index ∂ of 1
[32] Calculated as total net exposures being nominal exposure of all long minus short positions (cash and derivative) divided by end month pre tax net asset value – assumes index ∂ of 1
[33] Figures may not sum due to rounding

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