EXPERT COMMENTARY

With sports, media and entertainment developing into a compelling institutional asset class, Bobby Sharma, founder and managing partner of Bluestone Equity Partners, asks whether investors are running the right playbook

Investing in a league of its own

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The world is changing. From every standpoint – economic, geopolitical, technological and even cultural – we are in a rare moment where everything is in a state of major flux. Such instability can be unnerving to investors looking for grounded, stable growth as companies and their leaders must both perform and transform. This is especially true for institutional LPs looking for private equity returns on a typical fund horizon.

Get in the game

Few industries can claim immunity to (or even resilience from) such macro gale force winds. But the sports, media and entertainment industry (SME) has proven its growth, stability and durability for generations – weathering the storms of dot-com bubbles (in the plural), the Great Recession and, most recently, the covid-19 pandemic, delivering consistent returns with low or no correlation to equity markets and recession-resistance.

What could once be considered a collection of basic, static, parochial businesses often fueled by passion or drafting off trends, have turned into complex, dynamic, global enterprises, often fueled by innovation and technology. SME has gone from chasing the culture and economy, to shaping them. Sports, in particular, is the last great global gathering spot – live and virtually – the global town square in an ultra-fragmented and digital world, cutting across the lines of politics, socioeconomics, religion, creed, gender and generations. And that makes for good business.

In the last decade, SME has grown into a major global $2.7 trillion market – a mix of $1.1 trillion products, $0.8 trillion participation and $0.8 trillion top-tier leagues and teams. With strong fundamentals, and ripe with opportunity as the landscape continues to evolve with underlying tailwinds, SME has been driven by incessant innovation and the convergence of sports, media and entertainment – as otherwise historically distinct entities, in and of themselves.

Team chemistry

Major professional sports franchise valuations are a good proxy for SME – given their ability to capture value chains from across the industry – and revenues from top-tier leagues and teams have experienced positive historical growth since 2006. Indeed, from 2002 to 2023 the average valuations of NFL, NBA, MLB and NHL teams have outpaced the S&P 708 percent to 336 percent. Further, and front of mind for most institutional investors, such growth has occured with very low correlation to equity markets – eg <0.15 correlation to S&P 500 and US buyout PE performance between 2000 and 2022.

Eased franchise investment rules in North America since 2019, increased profile and access to elite European football clubs, and post-covid demand for uncorrelated returns have driven billions of highly institutional capital into these top-tier teams. With rapidly increasing demand and a static supply of such properties – eg just 124 franchises across NFL, NBA, MLB and NHL – the top 100 sports teams in the world by estimated revenue have recently been valued at over $2 billion each.

Such growth has primarily been driven by highly visible and long-term contractual revenue – specifically multi-year media rights, sponsorship and ticketing deals. In recent years, this revenue base has expanded further by opportunistically and intelligently navigating the evolution of culture and technology, including new media, licensing, gambling, data, real estate and internationalization. By investing in technologies and services that monetize and enhance the value of premier intellectual property, top-tier leagues and teams have broadened and deepened their connections with fans and improved their live and virtual experiences. Along the way, the growth has been stabilized by fandom, which provides a loyal and sticky customer base, with dedicated and price inelastic consumers, regardless of outcome.

Over time, the size, scope and trajectory of SME investment has evolved the industry into a de facto asset class for institutional investors, with strategies largely ranging initially from early-stage venture at the turn of the century, to multibillion-dollar buyouts in the last decade. But SME's intoxicating mix of passion, glamor, trend and good old-fashioned FOMO has increasingly blurred the lines even between those two diametric ends of the investment spectrum.

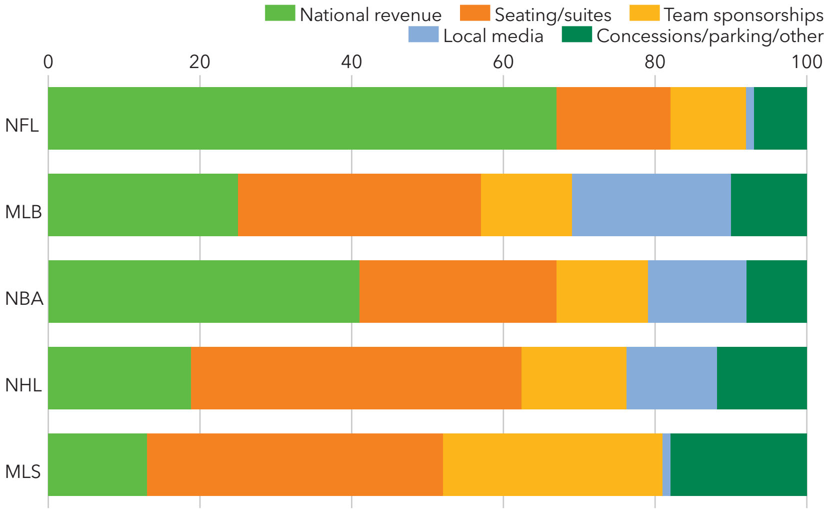
Out of position

Typical private capital sports investment today – and perhaps especially the headlines it generates – has placed a heavy emphasis around league and team targets. But upon closer examination, one may say a misplaced emphasis, creating an industry-wide misalignment with LP expectations in terms of valuation and growth, but also and especially in terms of actual asset management and liquidity. From 2019 to 2023, franchise valuations have grown 15.1 percent while attendant revenue has increased just 4.2 percent – a multiple of 3.6x. At the same time, the S&P 500's valuation has grown 10.2 percent while revenues 6.6 percent – a multiple of 1.5x. Further, an LP position with a top-tier property carries with it two major – often overlooked – liabilities: first, no governance rights (often even limited information rights) where GPs are expected to be adding value; and second, illiquidity (almost always with no control of outcome timings) where DPI is a contractual obligation within a fund term.

With respect to the latter, in North America such positions often have contractual lockups up to six years, only to be followed by multiple layers of approval rights, for inherently discounted (and therefore unfavorably precedent-setting) minority positions in a generally illiquid market. In European football, such restrictions are at the whim of controlling investors, in a volatile market fraught with the risk of relegation, and hence, potentially cratering revenue and valuation, for most clubs.

Perhaps even more challenging as an institutional investment matter are emerging league and team properties. These assets have ridden tailwinds of SME capital inflows to even loftier valuations, especially outsize relative

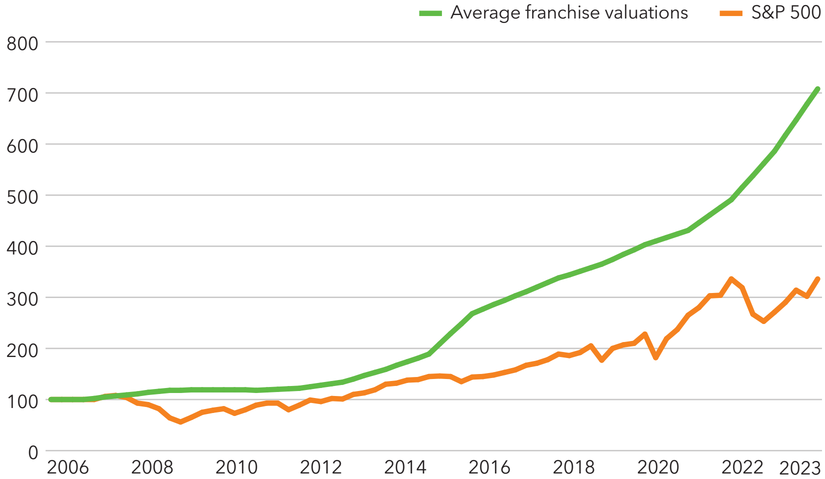
Revenue breakdown of US sports leagues (%)



Source: How NFL Teams and Owners Make Their Money (Sportico 2024) to present revenue realities, or even realistic projections. In an increasingly saturated market, the chances of establishing meaningful and sustainable growth are diminishing, and investors often take on venture risk at buyout valuations, with unprotected downsides to boot. This is to say nothing of the uncapped, unregulated player expenses in the eternally liquid – both in terms of teams and players (for sale: everything, everywhere, all at once) – European football market. While the top-tier global clubs have enjoyed unprecedented commercial success this generation, it has not been enough to establish either consistent profitability or operational stability, at any level, anywhere.

The realities of the modern football market have created a perpetual competitive race to the bottom, wherein almost every club chases the phantom – and at times conflicting – business models of promotion to a higher-tier league, major tournament qualification and/or player transfer fees (counter-intuitively, the sale of one's top players) to turn a profit and/or enhance valuations. All on the constant knife's edge of relegation.

Indexed franchise valuations vs S&P 500 (%)



Source: Global Sports Insights; The Business of Sports – industry revenues from 2023

$2.7trn

Total global sports assets revenues as of 2023, per Global Sports Insights

3.6x

Sports franchise valuations multiple increase between 2019-23, compared with a 1.5x value growth for the S&P 500

Stick to the playbook

But the underlying SME tailwinds remain, and if one looks beyond the headlines of high-profile teams, glamorous events and consumer trends, the broader SME ecosystem is indeed vibrant, dynamic, global and durable.

There exists an entire ecosystem of technology, services, media and entertainment companies that underpin and/or benefit from the growth of professional and amateur sports alike – from the grassroots (across youth and amateur sports), college (in the US, as it increasingly professionalizes) and international competition. And while the rise of experiential culture may have emanated from millennials and Gen Z, live and shared entertainment has captured the global zeitgeist across generations the world over.

As traditional revenue streams evolve, industry stakeholders are increasingly leveraging creative and innovative strategies to drive revenue, fostering long-term and sustainable value creation downstream – and at times even creating new streams. Operating businesses abound and are thriving as direct beneficiaries of the attractive fundamentals underpinning SME, as services, technology, media, entertainment or some combination thereof. For institutional investors, the broader SME landscape presents a compelling opportunity: capturing the upside of "ownership" while avoiding the structural drawbacks inherent in both established and emerging property rules and capital stacks. Businesses that provide solutions to leagues, teams and fans can benefit directly from SME's stable, long-term growth fundamentals without exposure to inflated valuations, governance restrictions or illiquidity. Yet, the heavy focus on team investing has led many to overlook the high-growth, scalable businesses that are driving the industry forward.

Ultimately, institutional investors need the vision, access, ability and flexibility to evaluate both league and team ownership, as well as the broader SME ecosystem, adapting to market conditions to capture risk-adjusted returns, with liquidity, on a specific investment timeline. While team stakes may have issues at this moment, SME continues to grow, and even those opportunities will evolve.

The key is to stay clear-eyed and grounded in substance, always investing with focus and discipline, to remain opportunistic, but always prioritizing diligence and governance to find businesses and deals that offer both growth and control. In an industry driven by shiny objects, but dictated by economics as any other, long-term success in SME belongs to those who invest strategically and without blinders. ■

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