



The Economics of Football...

The economic downturn has clearly had a significant impact upon the developed economies of the U.S., U.K. and Eurozone which are all experiencing negative growth along with rising unemployment levels. The latest figures show the U.S., U.K. and Eurozone economies contracting by 2.5%, 4.9% and 4.9% respectively in the second quarter of 2009 and each region has record high unemployment levels ranging from 7.2%-9.5%. With employers around the world cutting staff to reduce costs, one has to wonder, how is it the Spanish football club Real Madrid can afford to pay out £56 million for the Brazilian playmaker Kaka and £80 million for striker Cristiano Ronaldo within a matter of days.

In an analysis done by Deloitte, Real Madrid ranked number one among twenty of the largest football clubs in the world. In the 2007/8 season, Real earned €366 million, €41 million more than Manchester United and €57 million more than FC Barcelona which hold the second and third place positions respectively. Real has been able to maintain its number one spot for the past four years based on three main components of income: matchday revenue, broadcast revenue and commercial revenue. Matchday revenue, as the name implies, is mainly generated from gate receipts which include season tickets and memberships. Broadcast revenue includes revenue from domestic and international competitions while commercial revenue includes sponsorship and merchandising revenues.

The largest revenue generator for Real has been the club's ability to increase commercial revenue. Despite lower shirt sponsorship following the 2006 bankruptcy of BenQ Mobile, (a German mobile phone manufacturer), the club still generated 35% of its total revenues from this component. They have since had new shirt front sponsors Bwin, step in, in the 2007/8 season for an initial three year period. Meanwhile the club's kit sponsorship with Adidas which began in 1998, runs until 2011/12. For the first time in the past four years as the top revenue earner, Real's broadcast revenue surpassed its commercial revenue as the highest revenue component in 2007/8, bringing in 37% of the total revenue. This was mainly attributed to the second season seven year contract of Real's broadcast rights with Spanish film and TV Company, Mediapro. This contract guarantees the club more than €1.1 billion (approx. £870 million) until 2012/13. Matchday revenue brought in 28% of the club's revenue and has been the largest growth area for the club in 2007/8 given the restructuring of some parts of its home stadium, Bernabeu, to increase corporate hospitality and as a result, its revenue.

The question remains though whether Real Madrid, (or all football clubs for that matter) can maintain the high levels of gross revenue and sponsorship that they have grown accustomed to and continue to pay out record high transfer fees for players in light of the economic downturn. One effect noted by Deloitte is the impact the depreciation of the British pound against the Euro, from June 2007 to June 2008, has had on English clubs. From June 2007 to June 2008 the pound sterling fell by approximately 15% against the Euro which lowered the ranking of the English clubs against the Spanish

clubs when brought to one currency, the Euro, for comparison. If exchange rates were to remain relatively stable at 2007 levels, studies show the British club Manchester United would be at the top of the ranking instead of Real Madrid as the highest earning club for the 2007/8 season.

Matchday revenue is one component that can be highly influenced by the economic downturn given such high unemployment levels and individuals opting to save more. This brings us back to the basic economics - demand theory and utility which measures the want-satisfying power of a good or service. Some may argue that the demand to see Real Madrid play, especially with the new additions of Kaka and Ronaldo, will be highly inelastic and defy the theory of diminishing marginal utility. The desire and love for football by some are so strong that some may view this as a necessity good as opposed to a luxury good. This may mean that the costs of other aspects of an individual's life for example eating out, going on vacation, will easily be forgone to purchase season tickets for the game securing his/her spot in newly restructured stadia across the world. Clubs continue to invest billions into their venues to accommodate more people, boost corporate hospitality and add non-matchday aspects which will all generate increased revenue.

Broadcast revenue, in the writer's opinion, is one of the least exposed components to the economic downturn. The various multi-year contracts to TV companies that are signed by clubs secure a steady stream of income and are expected to remain one of the main drivers of revenue growth to football clubs.

The same cannot be said for commercial revenue which looks at sponsorship deals (shirt front and kit) and retail revenue. During times of economic uncertainty, companies look to cut back as much costs as possible to at least breakeven. This may mean sponsorship and marketing expenses will not be top priority for some companies during these uncertain times. One example of this was the bailout of Manchester United's shirt sponsor, AIG, an insurance company, by the U.S. Federal Reserve when the company was at risk of failing during the global financial crisis. Since its bailout in September 2008, AIG has said that it will not renew its shirt sponsorship when it expires in 2009/10. Some may argue that a top tier club like Man U will easily secure another sponsor to replace AIG. Here we see a classic example of investors choosing to invest in 'quality assets' with the intent of reaping the rewards of such exposure to a high profile club. However, it may be more challenging for smaller clubs who may find difficulty in renewing their commercial deals.

We cannot speak of revenues and expenses without bringing in the 'D' word, debt. According to Deloitte, debt may not always be a bad thing for clubs 'as long as it is manageable within the club's existing operations then it is sustainable and repayable'. Debt financing structures vary between clubs in different countries. Some clubs' stadium ownership and investments are not always held by the club but instead by external parties, whereas some clubs incur debt to invest in their facilities. The traditional method of financing clubs is through the benefactor type model which depends on the performance of the wider portfolio of the benefactor's investments.

All in all, the 'football market' is a thriving business and deals with large sums of money generated from various components. These components are all exposed to the ups and downs of the typical business cycle. A loyal fan base, broadcasting deals and the attraction to commercial partners are listed as the core elements to top tier clubs and can keep the clubs afloat during turbulent economic times. To go so far as to say that the football industry will be immune to the recession is a long stretch and even with inelastic demand from football fans we can expect to see some adjustments to revenue and expenditure in the near future. The top four highest transfer fees ever recorded were all payouts made by

Real Madrid starting with Cristiano Ronaldo at the top (£80.0 million in 2009), followed by Kaka (£56.1 million in 2009), Zinedine Zidane (£45.0 million in 2001) and Luis Figo (£37.0 million in 2000). Whether such high sums in pay-outs will be sustainable during these times will be dependent on revenue growth for the 2009/10 season which will be a direct reflection of the impact the economic downturn has had on the football industry.

FINANCIAL & ECONOMIC INDICATORS

As at 9 July, 2009

<u>Exchange Rate/US\$</u>	<u>Closing Value</u>	<u>Previous Week</u>
Yen	92.99	95.94
Euro	1.40	1.40
Jamaica	89.07	88.83
Guyana	203.70	205.20

<u>Commodity Prices</u>	<u>Closing Value</u>	<u>Previous Week</u>
Crude oil (US\$/bbl)	60.41	66.73
Natural Gas (US\$/mmbtu)	3.35	3.50
Gold (US\$/Troy Ounce)	912.35	929.80

Eurobond Indices (As at 9-July-09)

Lehman Brothers Global Aggregate Index (Return % YTD)	2.52
JP Morgan EMBI+ (Basis points)	445
JP Morgan Central America and Caribbean Index (CACI) (YTD return %)	20.20

<u>Policy Interest Rates (%)</u>	<u>Closing Value</u>	<u>Previous Week</u>
United States	0.15	0.09
Euro Zone	1.00	1.00
Japan	0.10	0.10
Brazil	9.25	9.25
Trinidad	7.50	8.00
Jamaica	17.00	17.00
Barbados	3.00	3.00

<u>Market Interest Rates (%)</u>	<u>Closing Value</u>	<u>Previous Week</u>
US 90-day T-Bill	0.18	0.16
US 10-Yr Treasury	3.41	3.50
3-month UK Libor	1.06	1.16
Japan 90-day T-Bill	0.33	0.33
Brazil 90-day T-Bill	8.70	9.19
TT 90-day T-Bill	2.57	2.60
Jamaica 90-day T-Bill	19.58	19.21
Barbados 90-day T-Bill	3.85	3.96

Sources: Bloomberg, CMMB, Central Bank of Trinidad and Tobago, Bank of Jamaica, Central Bank of Barbados, www.lehman.com

DISCLAIMER

The information contained in this documentation is for your information only. All information contained in this documentation has been obtained from and is based on sources, including but not limited to, newspaper and magazine articles that CMMB believes to be accurate and reliable. However such information, facts, calculations, methodology, assumptions and estimates contained in this documentation have not been verified by us. All opinions and estimates constitute the Author's judgment as of the date of the documentation which are subject to change; however neither its accuracy and completeness nor the opinions based thereon are guaranteed. As such, no warranty, express or implied, as to the accuracy, timeliness or completeness of this documentation is given or made by CMMB in any form whatsoever. Consequently, CMMB assumes no liability for the accompanying information, which is being provided to you solely for general information.