

## Valuing a trophy asset

It is almost a year since we last wrote about The Madison Square Garden Company and what a strange period it has been. At the time, we had recently purchased the shares, aiming to take advantage of the separation of the two main divisions and the unlocking of the conglomerate discount. We believed that a combination of events had led to the company trading at a significant discount to its intrinsic value, presenting an attractive opportunity with an upcoming catalyst. The spin-off was completed in April 2020 creating Madison Square Garden Sports (MSG Sports) and Madison Square Garden Entertainments.

MSG Sports is comprised of two sports teams, the New York Knicks basketball team and the New York Rangers ice hockey team. Sports teams represent a unique case which require different considerations when estimating value compared to almost any other asset class.

These trophy assets have historically been more valuable to billionaires as privately held investments than to shareholders of public corporations. The reasons for this are twofold.

Firstly, there is the prestige of owning a major team. Secondly, there are unique income tax advantages in the US, whereby the purchase price can be written off against the team's taxable income over 15 years. In addition, certain holding structures allow for the team's tax losses to flow through to an owner's personal tax returns, offsetting income from other sources. Well known billionaire owners include Steve Ballmer, former CEO of Microsoft, who owns the Los Angeles Clippers. Steve Cohen, the founder of hedge fund Point72 is buying the New York Mets and Mark Cuban owns the Dallas Mavericks.

Forbes provide estimated valuations for each team every year with the highest valuations ascribed to teams based in major cities, with the biggest fan bases and the most celebrated histories. The New York Knicks and Rangers are considered to be the most valuable franchises in the basketball and hockey leagues respectively. In actuality, these valuations have often proved conservative. For example, over the past decade the average premium paid above Forbes' valuations for NBA and NHL teams were approximately 35% and 43% respectively.

Moreover, the average team values for the NBA and NHL have increased consistently at low double digit and high single digit rates respectively. Historically, revenue from media rights and ticket prices has consistently outpaced inflation, driven by increasing demand from a growing population as compared to a fixed number of teams. We see no reason for this not to continue. Similarly, the number of billionaires who are potential buyers of teams has increased more than threefold in fifteen years and again, the number of teams is not increasing. Lastly, we believe that the likely legalisation of online sports betting in the state of New York over the next few years would provide a new source of revenue and boost fan engagement.

Obviously, since the last time Forbes' valuations were released the world has changed substantially for sports teams across the globe. With all major sporting events cancelled, the timing of the spin-off was hardly ideal. But who could have predicted what would transpire when it was approved in November 2019?

Although both the National Basketball Association and the National Hockey League have managed to complete their current seasons in 2020, it has to be assumed that a return to packed stadiums for the next season is unlikely. Continued restrictions on fan attendance will undoubtedly have an impact on the earnings of the teams. The market has not been blind to this fact and MSG Sports' shares are trading below their value at the date of the spin-off six months ago, and significantly below our estimate of their intrinsic value. Therefore, we must ask ourselves whether the current situation affects the long-term value of these assets.

Realistically, the value of sports teams has not been tied to the earnings potential, but rather is determined by the price that a potential buyer is willing to pay. It is our view that the reasons for purchasing a sports team are unaltered. Neither the prestige of the New York Knicks or the Rangers will be affected by a temporary reduction in fan attendance. In addition, the tax benefits of owning a sports team are unchanged. Therefore, the long-term value of these teams should be relatively unaffected by the current restrictions. Indeed, Steve Cohen's September 2020 agreement to purchase the New York Mets baseball team (i.e. during the COVID pandemic) was at a premium to the Forbes valuation and set a record amount for a North American sports team.

Despite the significant changes the world has undergone since the start of the year, sports teams are finding ways to adapt to the new normal. Fans will no doubt be eager to return to in person spectating but will be able to watch games on television in the meantime. The integral role that watching sports and supporting teams play in the lives of many will continue. Over the long term we remain convinced that the value of these under-appreciated but irreplaceable assets will be realised.

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