March 15, 2007

Sports Franchise Valuation: The Chicago Cubs

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AEG Working Paper 2007-03

I. Sports Team Values

Estimating the value of a sports franchise is as much art as science. Despite the common perception that there is a known "value" for professional sports franchises, the market value is rarely observed. As we wrote in a recent extensive review of sports franchise valuation:

> Most sports franchises are not publicly traded companies; they are closely-held entities. However, while the clubs themselves are private businesses, they occupy a place in American society quite close to public institutions. This place has earned them civic institution status, access to direct and indirect taxpayers subsidies, and even a *de facto* exemption from the major antitrust laws.
>
> The value of a private business typically cannot be estimated directly from sales transaction data. Most privately-held businesses—and the overwhelming majority of US business organizations are privately-held businesses—have infrequent ownership transactions. Thus, to estimate the value of such a firm, an analyst usually takes an "income approach" to estimating the market value. Standard references on valuation of private firms describe this approach, which relies on examining industry and economic conditions, the organization itself, past financial performance, projected future performance, and other factors, in an effort to predict the future earnings to an owner.[1]

Anderson Economic Group has developed methods of estimating the value of businesses that takes into account the unique characteristics of such businesses, such as the importance of the brand, the sales or market territory, and other factors.[2] We have applied this methodology in industries such as automotive retail, rental car agencies, general retailers, beer & wine wholesalers, and sports franchises. Recently, we reviewed the particular valuation challenge posed by professional sports franchises, and analyzed data on publicly traded firms in Europe as well as more familiar US franchises.

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ESTIMATES: FORBES "VALUES"

There are two well-known publications that have published estimates of sports franchise values on a regular basis in the U.S.: *Financial World* and *Forbes* magazines. The reports in these publications, which appear to have been prepared by researcher Michael K. Ozanian, have become public benchmarks of "value." However, it is important to note that they are not market values, and in some cases rely on data that are hotly disputed by both the owners of the specific teams and the leagues. This is particularly the case with Major League Baseball, which has sharply criticized the Ozanian estimates.[3] Ozanian, return, has accused the league of "crying poor month."[4]

The *Forbes* estimates are accompanied by some data, but not by a specific methodology. It appears that the author's judgement is a significant part, if not the most significant part, of the valuation method. However, judgement is an unavoidable part of estimating the value of any company, especially when complete financial and operational information are not available. Thus, the *Forbes* estimates should be accorded some respect as a consistently presented effort to systematically estimate values, with at least a selection of supporting data and commentary.

TRANSACTION VALUES

Our previous research included a comparison of actual transaction values with estimates prepared by *Forbes* and *Financial World.* This information is reprinted in Table 1, "Transaction Value and Forbes Estimates," on page 3.

1. This section is based on Ilhan Geckil and Patrick Anderson, "Sports Franchise Valuation and the Contender Factor," AEG Working Paper 2007-1, available at: http://www.andersoneconomicgroup.com. Content is excerpted with permission.

   Cited valuation references include: Abrams, Jay B. 2001. *Quantitative Business Valuation: A mathematical approach for today's professionals*; Anderson, Patrick L. 2004b. *Business Economics and Finance: Using Matlab, Simulation Models, and GIS*. CRC Press; Damadoran, Aswath 2002. *Investment Valuation*. New York: Wiley.; and Pratt, Shannon, Robert F. Reilly., and Robert P. Schweihs. 1996. *Valuing a Business, 3d ed.* McGraw-Hill.

2. For a discussion of the particular franchise valuation issues, see Anderson, Patrick L. 2004b. *Business Economics and Finance,* CRC Press, chapter 10; "Valuation of Franchised Industries," AEG working paper ***
3. See, e.g., Edward Colby, "Someone is Lying. Is it Forbes or Baseball Owners?" *Columbia Journalism Review,* April 27, 2006; found at CJRDaily web site, at: http://www.cjrdaily.org/the_audit/someone_is_lying_is_it_forbes.php.
4. For example:

   > A casual reader might think the owners of most sports teams were all headed for Chapter 11. Baseball owners say most of their teams are in the red. By some accounts, as many as 20 hockey teams are losing money.
   >
   > Even as they pocket an $18 billion TV deal, many football team owners cry poor mouth.

   "Selective Accounting," *Forbes,* Dec. 14, 1998; found at Forbes.com archives: https://www.keepmedia.com/Auth.do?extId=10022&uri=/archive/forbes/1998/1214/6213124a.html.

Table 1. Transaction Value and *Forbes* Estimates

Sports Team	League	Buyer	Year	FW Value (in million)	Forbes Value (in million)	Average of FWM and Forbes (in million)	Actual Transaction Value (in million)	% Difference between Estimated Value and Real Transaction Value
Los Angeles Dodgers	MLB	Murdoch, News Corp.	1998	$180	$236	$208	$311	**49.5%**
Washington Redskins	NFL	Dan Snyder	1999	$348*	$607	$478	$800	**67.4%**
Cleveland Indians	MLB	Larry Dolan	2000	n/a	$364	n/a	$323	**-11.3%**
Cleveland Cavaliers	NBA	Dan Gilbert	2005	n/a	$356	n/a	$375	**5.3%**
Manchester United	English Premier League	Malcolm Glazer	2005	n/a	$1,186	n/a	$1,470**	**65.3%**

source: AEG Research; *Financial World; Forbes*

** Applying a 32% growth over the 1997 value of $200 million for the years 1998 and 1999, as FW increased the value between 1995 and 1997.*
*** Three quarters of the Manchester United shares.*

MISSING FACTORS

As Table 1 shows above, the actual transaction values are often much higher than the estimates presented in two prominent financial magazines. In "Sports Franchise Valuation and the Contender Factor," we identified two factors often missing in traditional "discounted cash flow" valuation methods for sports franchises: the contender factor and the ego factor. We believe these factors account for much, if not all, of the large observed discrepancy between past valuation estimates and the actual transaction values.

II. The Chicago Cubs

Value History

Between 1995 and 2005, Cubs had only 5 winning seasons, qualifying for the playoffs twice, and playing in one ignominious division final. This is not a very strong performance for a team with high expenditure figures like Chicago Cubs. See "Baseball Teams Financial Data" on page 10, in the Appendix.

According to the most recent *Forbes* study, the value of Cubs franchise was $448 million in 2005. Given that the Forbes' valuation was based on the key factors in DCF valuation methodology, we will rely on that estimate as the starting point for this valuation analysis. Since it has only been less than two years since that valuation, we would not normally expect a substantial change in the Cubs value in 2007.

Comment from a Cubs Fan Perspective

For the author that bleeds "Cubby blue" it is painful to revisit recent performance. In 2006, the Cubs finished 66-96. This not only put them last in their division, they were last in the National League. Only two teams in all of baseball were worse, the Tampa Bay Devil Rays with 61 wins and the Kansas City Royals with 62 wins.

It is difficult for any baseball fan to have to compare their team to the Rays. Tampa Bay has occupied the bottom of the standings since they joined Major League Baseball in 1998. It is even difficult for Devil Ray fans. Tampa Bay finished last in attendance as well in 2006.

For the Cubs, the end of the 2006 season was unfortunately reminiscent of the end of the 2003 and 2004 seasons. In 2003, the Cubs were five outs from the World Series. After they lost, some of the players had the temerity to suggest that a play by a fan—off the playing field—impacted their ability to get to the World Series.

The finger pointing continued in 2004. At that time, long-time Cubs announcer Steve Stone, who many feel is one of the best commentators in the game, resigned after twenty years with the Cubs. During that season, Stone had criticized manager Dusty Baker and his players on the air as Chicago lost seven of nine, blew a lead in the wild-card race and missed the playoffs. Stone's comments angered Baker and several players, including one who was even allowed to call the broadcast booth during a game to complain.

After the 2006 season the Cubs began making changes to try to see improvement. Although, as poorly as the team performed, it would almost be difficult to not see improvement even as "regression to the mean." But the Cubs get credit for effort.

In October, the Tribune (owner of the Cubs) did not renew the contracts of Cubs President Andy MacPhail and Manager Dusty Baker. MacPhail elaborated on the past performance, saying that going to the playoffs only twice in twelve years was not good enough.

Why Value the Business Now?

Management changes make a new valuation of a business relevant. When the top two executives are removed from any business, the value of that business is in flux. Aside from that, suffering Cubs fans have to do something to dispel the memories of ’06. They say your problems get better if you talk about them.

So we are combining our vocation and our avocation to quantify the age-old Cub-fan query: what *will* happen next year?

Recent Events

The recent efforts by the Cubs are noteworthy. Cubs General Manager Jim Hendry completed so many deals that he worked himself into the hospital. And even that did not stop him. He closed one deal forty-five minutes from having an angioplasty.

The acquisitions were fast and furious, and expensive. The Cubs replaced Baker with Lou Pinella. Then they re-signed third baseman Aramis Ramirez to a five year, $73 million deal and Alphonso Soriano to an eight year, $136 million contract. Including convincing Jeff Samardzija, a pretty good wide receiver from Notre Dame, to forgo his likely place in the April NFL draft and commit exclusively to baseball, the Cubs made acquisitions in excess of $300 million. This set an MLB record for off-season spending.

Factors Affecting the Value of the Cubs

But do the acquisitions add to the value of the business? When using any financially rigorous methodology to value a business, one must consider change in revenue streams.

Gate and Advertising Revenue. Even with the poor record in 2006, the Cubs achieved their second highest attendance ever, drawing over 3 million fans. They were second in the league in attendance, selling 95% of their tickets. Furthermore, good television ratings on WGN (Tribune’s superstation) and the local cable sports channel, Comcast Sports Net, demonstrate continued fan interest. As economists and financial analysts, we might term this “downside inelasticity.” In particular, advertising revenue holds steady during losing seasons.

We expect that elasticity will flip, however, when the team does well. Advertising revenue can, and does, rise when the team is in contention.

Ballpark Considerations. Though a recognizable and newsworthy landmark, Wrigley Field is the second oldest ballpark in baseball. Compared to newer ballparks, Wrigley Field puts the Cubs at a competitive disadvantage, primarily because of reduced signage opportunities. This gap continues to widen because twenty-three of the thirty teams have either built new stadiums in the last twelve years or have a new stadium planned.

Since the last valuation, however, the club has added new revenue streams. They have made the outfield doors available as ad space. This opportunity presented such a distinct placement opportunity that it never even hit the public market. It has already been sold at a three-year exclusive to exercise gear maker UnderArmour. After the 2005 valuation, the Cubs added nearly 1,800 seats to the bleachers increasing the capacity to just over 41,000.

The Cubs also offer signage behind home plate that is visible during games broadcast on WGN or Comcast Sports Net. A multipurpose building housing a themed restaurant and batting and pitching cages for players is planned for the west side of Wrigley Field. According to the Cubs, the addition of lights in 1998, sky boxes, last year's bleacher expansion and the rotating advertising sign behind home plate have provided millions of dollars. These changes slightly increase the value of the business.

Interested Buyers and Sellers?

It is obvious that no business would be sold unless there is an interested buyer and seller. Since hitting its high in February 2004, Tribune stock price had decreased about 50%. In 2006, this deterioration of market capitalization led the Chandler Trusts, the largest shareholder, to pressure the Tribune to increase the stock price, even if it meant selling the company or its parts.

On March 6, 2007, Tribune announced that it had agreed to sell its two southern Connecticut newspapers, The Advocate and Greenwich Time, to Gannett for $73 million. (The authors are not sure if it is a coincidence that this price matches the cost of the Aramis Ramirez acquisition.) Dennis FitzSimons, Tribune chairman and chief executive stated that with this transaction, Tribune exceeded its goal of selling $500 million in non-core assets as part of the 2006 performance improvement plan. Since they exceeded their goals, Tribune doesn't have plans to sell any more properties.

Regardless of the current stock price, spring time (and spring training) could lead to “acquisition-al exuberance.” All the interest and discussion of possibly buying the Cubs has chummed the water, catching the attention of potential buyers who would have even remote interest in acquiring the strong brand.

Most recently, billionaire real estate mogul and noted “grave dancer” Sam Zell put forth a plan to acquire Tribune Co. Since Zell sold his Equity Office Properties Trust in February for $39 billion, in the biggest leveraged buyout in Wall Street history, he may have some time and spare cash on his hands. A special committee of Tribune board members is reportedly taking the Zell offer seriously.[5]

Valuation

With the changes in the executive suite and subsequent acquisitions, the Cubs became more aggressive and more interesting than they had been. But how does this impact the value of the Cubs? The Cubs report that they no longer “have” to sell the team. However, all the discussion has chummed the water for potential buyers.

The Cubs obligated themselves to $300 million in contracts, the longest and largest of which runs eight years. While this leads to quite a bit of potential, what is required to convert that potential into kinetic revenue? The bar is not as high as one might think. To increase ad revenue, the Cubs only have to be a contender. With a fan base that grows even during a season such as 2006, all the fans (thus advertisers) need from the Cubs is

5. Seeyle, Katharine Q. and Andrew R. Sorkin, “Tribune Considering Late Offer From Real Estate Magnate,” *New York Times* Business Section, February 26, 2007.

to contend for the league championship once every three or four years for interest to remain high enough to provide significant incremental revenue.

Additional revenue sources slightly increase the value. The potential improvement in playing performance—leading to higher ad revenue, fan interest, and other earnings—significantly increases the value. Finally, an unmotivated seller with a motivated buying community leads to a higher value. The Cubs could be at their highest value since Tribune's urgency has gone.

Given these considerations, we believe the value of the Cubs franchise has increased a substantial amount, which we estimate as to be a 34% increase to $600 million. This would place the Cubs as one of the most valuable sports franchises in the country, behind the probable first-place New York Yankees, but well ahead of other clubs in major cities with better records.

III. Comparison Valuation: Major League Baseball and the 2006 Detroit Tigers[6]

A CASE STUDY: 2006 DETROIT TIGERS

The Detroit Tigers' 2006 season proved successful far beyond expectations. With manager Jim Leyland setting the tone, and veteran players like Ivan "Pudge" Rodriguiez, Kenny Rogers, and Magglio Ordoniez helping to develop the team's young talent, the Tigers' went from dismal 119-loss season just three years ago, to an unforeseen World Series run this year. 2006 marked the team's first playoff appearance since 1997, and their first World Series appearance since they claimed the championship in 1984.

Tigers' improved performance not only resulted in more wins; it also renewed the interest of baseball fans throughout Michigan. During the course of the 2006 season, attendance at Comerica Park increased by some 7,500 fans per game, and every playoff game was sold out, with standing room only crowds far exceeding the stadiums official capacity of 42,000 fans. Even fans without tickets came into downtown Detroit to watch games at bars and restaurants, or from outside the stadium and atop nearby parking garages and buildings. The increasing interest in the Detroit Tigers, combined with brisk sales of Tigers' licensed products and wide-spread national media attention, certainly had positive impacts on the region's economy and the value of Mr. Illitch's team.

Prior to the 2006 playoffs, Scott D. Watkins and Alex L. Rosaen of Anderson Economic Group released "Economic Impacts from 2006 Detroit Tigers' Game Attendance."[7] This report included estimates of fan expenditures related to playoff games. Although the focus of that report was the economic impact on the community, we have used some

6. This section is reprinted from Ilhan Geckil and Patrick Anderson, "Sports Franchise Valuation and the Contender Factor," AEG Working Paper 2007-1, available at: http://www.andersoneconomicgroup.com. Content is excerpted with permission.
7. Please see AEG Working Paper 2006-09 #2, available on http://www.AndersonEconomicGroup.com.

of their estimates of fan expenditures on tickets and merchandise in this analysis of firm value.

This increase in value was based on two factors: the increased revenue (in excess of increased costs) that the franchise expected due to larger attendance, and the reputation the team had earned that established an expectation of future winning seasons and playoff berths. This “contender” factor supports increased merchandise sales across the country, as well as continued fan interest.The “contender” factor creates a value premium for teams like the Yankees and the Tigers, for whom an expectation of future winning seasons encourages ticket and merchandise sales above those expected for a typical franchise in the same league.

We conclude that the team, which had languished in the bottom half of the league for several years, increased its franchise value significantly in two successive years of improved performance. In the second year, in which the team won the American League pennant and played in the World Series, we estimate the team’s franchise value grew by 25%. This increase in value was based on two factors: the increased revenue (in excess of increased costs) that the franchise expected due to larger attendance, and the reputation the team had earned that established an expectation of future winning seasons and playoff berths. This “contender” factor supports increased merchandise sales across the country, as well as continued fan interest.The “contender” factor creates a value premium for teams like the Yankees and the Tigers, for whom an expectation of future winning seasons encourages ticket and merchandise sales above those expected for a typical franchise in the same league.

Our analysis shows that the performance of the Detroit Tigers in 2006 increased the value of the franchise by 25%. If we take Forbes’ assessment of the Detroit Tigers’ value of $292 million in 2005 as a basis, the value of the Tigers franchise increased by $73 million to $365 million, after the 2006 season. See Table 2, “Estimated Franchise Value, Detroit Tigers,” on page 8.

Table 2. Estimated Franchise Value, Detroit Tigers

Year	Value (in millions of USD)	Change (in millions of USD)	Change (%)
2000	200	48	32%
2001	290	90	45%
2002	262	-28	-10%
2003	237	-25	-10%
2004	239	2	1%
2005	292	53	22%
2006	**365**	**73**	**25%**

Sources: Forbes; Anderson Economic Group

IV. Appendix: Baseball Team Data

The data in this appendix are excerpted from Ilhan Geckil and Patrick Anderson, "Sports Franchise Valuation and the Contender Factor," AEG Working Paper 2007-1, available at: http://www.andersoneconomicgroup.com. Content is excerpted with permission.

As discussed in "Estimates: Forbes "Values"" on page 2, the "value" figures here are estimates, not actual transaction values. Similarly, figure for operating earnings and other internal financial data are also estimates.

The AEG analysis in the tables relies on these estimates because they are the best available consistently-prepared data.

Table A-1. Baseball Teams Financial Data, 2005

	Revenues (1) in millions of USD	Gate Receipts (2) in millions of USD	Player Expenses in millions of USD	Operating Income (1), (3) in millions of USD	Estimated Team Value (1) in millions of USD	Estimated Stadium Value in millions of USD	Value/Rev. Ratio	Value (Excluding Stadium Value)/Rev. Ratio
New York Yankees	$ 277	$ 145	$ 223	(50.0)	$ 1,026	$ 178	**3.70**	**3.06**
Boston Red Sox	206	136	154	(18.5)	617	131	**3.00**	**2.36**
New York Mets	195	69	131	(16.1)	604	117	**3.10**	**2.50**
Los Angeles Dodgers	189	71	111	13.4	482	121	**2.55**	**1.91**
Chicago Cubs	179	89	117	7.9	448	90	**2.50**	**2.00**
Washington Nationals	145	54	69	27.9	440	90	**3.03**	**2.41**
St Louis Cardinals	165	84	101	7.9	429	114	**2.60**	**1.91**
Seattle Mariners	179	69	109	7.3	428	97	**2.39**	**1.85**
Philadelphia Philies	176	72	104	14.8	424	117	**2.41**	**1.74**
Houston Astros	173	74	87	30.2	416	96	**2.40**	**1.85**
San Francisco Giants	171	80	98	11.2	410	122	**2.40**	**1.68**
Atlanta Braves	172	46	91	27.6	405	77	**2.35**	**1.91**
Los Angeles Angels of Anaheim	167	65	111	(2.6)	368	98	**2.20**	**1.62**
Baltimore Orioles	156	60	83	21.0	359	84	**2.30**	**1.76**
San Diego Padres	158	67	86	13.0	354	102	**2.24**	**1.59**
Texas Rangers	153	39	73	24.7	353	99	**2.31**	**1.66**
Cleveland Indians	150	39	58	34.6	352	78	**2.35**	**1.83**
Chicago White Sox	157	51	86	21.7	315	75	**2.01**	**1.53**
Arizona Diamondbacks	145	43	68	21.8	305	68	**2.10**	**1.63**
Colorado Rockies	145	32	70	16.3	298	61	**2.06**	**1.63**
Detroit Tigers	146	35	91	3.5	292	55	**2.00**	**1.62**
Toronto Blue Jays	136	31	61	29.7	286	58	**2.10**	**1.68**
Cincinnati Reds	137	40	72	17.9	274	60	**2.00**	**1.56**
Pittsburgh Pirates	125	29	49	21.9	250	49	**2.00**	**1.61**
Kansas City Royals	117	19	53	20.8	239	38	**2.04**	**1.72**
Milwaukee Brewers	131	36	57	22.4	235	47	**1.79**	**1.44**
Oakland Athletics	134	35	75	16.0	234	43	**1.75**	**1.43**
Florida Marlins	119	24	91	(11.9)	226	29	**1.90**	**1.66**
Minnesota Twins	114	30	73	7.0	216	33	**1.89**	**1.61**
Tampa Bay Devil Rays	116	16	50	20.3	209	35	**1.80**	**1.50**
							(Blue: Above Average;	
TOTAL	**4,733**	**1,680**	**2,702**	**362**	**11,294**	**2,462**	**Yellow: Below Average)**	
Average	***158***	***56***	***90***	***12***	***376***	***82***	***2.31***	***1.81***

(1) Revenues and operating income are for 2005 season. Estimated value of team based on current arena deal (unless new arena is pending) without deduction for debt (other than arena debt).
(2) Includes club seats.
(3) EBITDA: Earnings before interest, taxes, depreciation and amortization.

Data Source: Forbes
Analysis: Anderson Economic Group