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US PRIVATE EQUITY INVESTMENTS IN EUROPEAN FOOTBALL

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European football clubs, once viewed as trophy assets held by wealthy individuals, are now firmly on the radar of US financial sponsors who have identified untapped commercial opportunities in the sports industry. Clearlake Capital's $5.3 billion acquisition of Chelsea Football Club and Elliott Management's takeover of AC Milan brought private equity's involvement in European football firmly into the spotlight. Yet, headline-grabbing buyout deals are only the tip of the iceberg. A significant number of private equity investments in the sector are structured as minority investments, with the private equity firm taking a non-controlling stake in the target football club or in a more specific asset of the club (such as its media rights or similar revenue streams). Notable examples include Silver Lake's acquisition of a 10% stake in City Football Group (which includes Manchester City, amongst others), Oaktree Capital's acquisition of a 31% stake in Inter Milan and Ares Management's acquisition of a 34% stake in Atlético Madrid.

In this article, we set out the various commercial factors that are driving US private equity investors' growing interest in European football and also explore the strategic considerations that make minority investments attractive. We also provide an overview of the key structural and legal considerations which underpin these transactions.

Why are US private equity investors interested in European football?

US private equity's interest in European football clubs has grown as a result of a variety of factors. Most fundamentally, the sector has seen a steady growth in asset valuation. According to the Football Benchmark 2023 Football Clubs' Valuation report, the aggregate enterprise value of the 32 most prominent European football clubs has increased by 96% in the seven-year period from 2016 to 2023, a performance that outpaces the FTSE 100 Index.

A primary factor driving this growth are the projections for key revenue streams such as media rights and sponsorships. In particular, the media rights associated with sports assets are expected to continue to grow in value, as streaming services such as Amazon and Apple join traditional broadcasters in competing to broadcast live sporting events. In addition, though sports betting has long been legal in Europe, European clubs are likely to benefit from the legalization of gambling in the United States, which represents the world's largest sports market.

European clubs are often perceived by US investors as offering greater growth opportunities than similar investments in the US. US sports franchises have historically been more successful than their European counterparts in developing their revenue streams (particularly in commercializing media rights) and, as a result, are generally viewed as more mature businesses. European football clubs are viewed as attractive investment opportunities because a similar development of their revenue streams represents "low-hanging fruit" that can be quickly realized, particularly with the help of a private equity investor with the appropriate experience and the right vision for growth. This is compounded by the fact that each of the major US sports leagues has imposed rules to limit the scope of private equity investment, including rules against private equity investors obtaining any control rights with respect to franchises. There are fewer such restrictions among European sports governing bodies, and there are several examples of private equity investors obtaining board seats or veto rights in connection with their investment into European clubs.

Global macroeconomic trends have also added to the appeal of European assets for US investors. The growing strength of the dollar against both the pound and the euro over the past two years has allowed US private equity to make investments into European clubs at a relative discount.

In the most successful of these types of investments, private equity sponsors are able to provide value to the club not only as a financial partner, but also by improving management functions and contributing applicable cross-industry expertise. Modern sports clubs have diverse revenue streams that can span across various industries, including technology and media, hospitality, food and beverage, and real property. A private equity investor with relevant experience in these industries can often act as a partner with the club through a minority investment in order to optimize one or more of these revenue streams, thereby unlocking value.

The appeal of a minority position

Compared with majority ownership stakes, minority investments – whether in a club or in specific club revenue streams – appeal to private equity investors due to various factors. Firstly, they offer investors a more accessible way to participate in this increasingly attractive asset class. The opportunities to purchase a controlling interest in a club can be rare, are typically highly competitive and often come with lofty valuations. However, club owners are often more open to taking on new minority investors due to a need for liquidity, for a fresh capital injection or for access to a new business plan and markets (though competition for such stakes has also increased). Notably, during COVID-19, clubs looking for much-needed capital found that selling minority stakes was typically a financially more attractive option than obtaining debt financing. The sale of equity stakes also represents an opportunity to raise cash within financial fair play rules.

Additionally, the size of minority investments makes them relatively easy to finance compared with controlling positions, particularly in an environment in which rising interest rates have made transaction financing challenging. This is magnified by a trend of leagues considering rules to restrict change of control transactions relying on debt financing; notably, England's Premier League recently announced a prohibition of fully-leveraged buyouts. As a result, minority investments can offer a more achievable path for private equity sponsors to invest in the sector.

A further consideration is that the public interest in football clubs can put majority owners under intense scrutiny.For some private equity investors who are concerned that this type of scrutiny could adversely impact their broader business, a minority stake presents an attractive option, as the controlling owner is typically the primary focus of public and media attention. As a result, a minority investment can provide a way to invest in the sector in a meaningful way, while avoiding being predominantly responsible for the operations and on-pitch success of the club.

Legal and structural considerations

Club minority investments

The most familiar structure for these types of investments is an investment into the club itself, whereby the investor obtains shares in a holding company, which in turn owns subsidiaries that house the club's various assets.

Such investments involve typical legal issues related to minority investments including diligencing the contracts underpinning the club's various revenue streams, reviewing corporate governing documents and shareholder rights, and negotiating appropriate contractual protections related to the investment, such as negative covenants, board rights, tag-along rights, and rights of first refusal.

In addition, potential investors should be aware of the rules and regulations related to ownership of football clubs in the relevant jurisdiction and league. For example, England's Premier League has established rules regarding the fitness of a potential owner, which apply to owners of 30% or more of the voting rights of a club. These rules require, among other things, that such owners (i) are not involved in another Premier League or English Football League club, (ii) have sufficient funds for the investment into and subsequent operation of the club, and (iii) have not been convicted of certain criminal offenses. As a result, completion of such checks is typically included as a condition to the closing of any investment transaction. Other leagues have restrictions around ownership structure, such as Germany's Bundesliga's "50+1" rule, which requires that club members maintain a majority interest in the voting rights of the entities that operate a professional club, limiting private investment to minority investments. There are also particular regulatory risks to football clubs arising from player transfers and significant tax risk, with tax authorities across Europe recouping hundreds of millions of dollars from clubs in recent years.

European governments are now considering increasing regulation over the ownership and operation of football clubs. For example, on February 23, 2023, the UK's Department for Culture, Media and Sport published a white paper proposing a new independent regulator to oversee football clubs operating in the UK that will impose certain operational standards and a more exacting owners' test.

Particular attention should be paid to these types of restrictions to the extent that an investor is considering a "multi-club" ownership model, under which the investor groups multiple football club investments (and perhaps other sports industry investments) into a single portfolio. This model has the obvious advantages of economies of scale and risk diversification, and in particular, can be an effective way to reduce the financial risk related to the possibility that a club underperforms and is relegated. However, it also adds additional complexity, given the various governing bodies' ownership rules. In addition to owners' tests at the league and government levels, participation in competitions governed by the Union of European Football Associations (UEFA) is also conditioned on its own ownership rules, which prohibit a single individual or legal entity from having control or decisive influence over more than one club participating in a UEFA competition.

These restrictions have gained increased attention recently due to the potential sale of Manchester United, with reported interest from Qatari and Saudi Arabian sovereign wealth funds, which already own Paris Saint-Germain and Newcastle United, respectively. In 2017, UEFA allowed RB Leipzig and FC Red Bull Salzburg to compete in the Champions League despite ownership of both clubs by Red Bull, finding that Red Bull did not have a decisive influence over both clubs after Salzburg made various changes to its corporate structure and certain commercial arrangements with Red Bull to reduce Red Bull's involvement. However, given recent comments from UEFA warning that "multi-club investment has the potential to pose a material threat to the integrity of European club competitions", it may reach a different conclusion should a similar scenario arise in the future. To the extent that an investor is interested in pursuing a multi-club ownership strategy, properly structured minority investments can be a viable solution for an investor to avoid these issues.

Revenue stream investments

An alternative structure for private equity sponsors seeking to invest in a football club is an investment into a specific club revenue stream, such as media rights or stadium operations, through an equity stake in an entity holding the applicable rights. Generally, this entity will be separated from football operations within the club structure, with the club retaining exclusive control over sporting decisions. While not yet as common as traditional investments into clubs, investments targeting specific revenue streams can be advantageous in avoiding many of the regulatory challenges of club ownership (including those described above), while giving the investor exposure to an attractive revenue stream within the club's portfolio.

Such an investment requires careful diligence of the scope of the rights and of the existing contracts supporting those rights. For investments into media rights, an investor should specifically confirm the nature of the rights held by the club, and (if the applicable league negotiates an umbrella media deal on behalf of participating clubs) how payments are made by the league. In addition, an investor may consider trying to negotiate for additional contractual protections aimed at mitigating risks that could undermine club revenue streams, considering the investor's lack of visibility into football operations as a result of the investment structure. Such protections may include an earnout mechanism to tie a portion of the consideration to a benchmark year-over-year growth rate, a right to renegotiate deal terms in the event of certain major changes undermining the value of the applicable rights, or a right to receive a portion of the parachute payments due to the club in the event of relegation. In media rights deals in particular, it is crucial that the rights acquired are technology-agnostic, such that any changes to the technology by which content is delivered will not affect the rights held by the investor.

Given the continued interest from private equity investors in European football clubs and the regulatory challenges that accompany club ownership, revenue stream investments can be an effective way for investors to gain exposure to the sector, while avoiding the complications of onerous ownership rules at various levels.

What's next?

US private equity investors have already recognized the opportunity presented by investment in European football clubs. As investment in the sector continues, minority investments will continue to be deployed by these sponsors, including investments into both club operating companies and specific club revenue streams. When properly structured, such investments can provide a number of commercial and legal advantages that allow the investor to accomplish its objectives.

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