May 18, 2018

Dear clients and colleagues,

In the spirit of the upcoming World Cup in Russia, Global Alpha is going to take a look at soccer stocks this week and declare a champion!

Most soccer stocks are thinly traded and can be extremely volatile based on the intentions of the controlling shareholders. The classical model for a soccer club is to operate slightly above break-even, with the obvious reason being that most are privately controlled by extremely wealthy owners more concerned with trophies than profits. Revenue sources can generally be classified into one of three categories: match-day revenues, media revenues and commercial revenues. Most clubs use match-day and media revenues to cover operating expenses.

Match-day revenues include ticket sales, concession sales, parking and revenue from other events (sporting/music/entertainment) that are held at the club's stadium. Match-day revenues are largely limited by the number of seats in the stadium, so a team with an average attendance well above the league average can have a competitive advantage. Increasing seating capacity is limited due to considerable CapEx and OpEx implications as well as permitting complications. Increasing ticket prices is difficult to accomplish without a backlash about the traditional working class fan base being priced out. Match-day revenues should be considered stable and low growth. Media includes revenues from domestic and international competition broadcasts as well as other relevant revenue sources such as team websites, team television channels or even mobile carrier partnerships. In most countries, broadcast revenues are negotiated by the league and not individual teams, which means they are more equitably distributed. Increased broadcast revenues are usually redirected into player acquisitions and wages.

Commercial relates to various sponsorship deals the club may have in place. The most significant are typically shirt, kit (e.g. Nike, Adidas, Puma, etc.) and stadium sponsorships. Other sources of revenue include licensing, merchandising, retail and ecommerce. Given the complexity in increasing stadium sizes and the mostly shared nature of broadcast revenues, commercial revenues offer an opportunity for clubs to differentiate themselves and grow revenues.

On the other side of the equation, costs can generally be classified into employee benefits (wages, bonuses, etc. for players and club staff), depreciation of physical assets such as the stadium and training facilities, amortization of the capitalized costs associated with acquiring players and other operating expenses (e.g. catering, cleaning and policing on match days and costs associated with media and commercial revenues).

So, with some of the basics on how soccer clubs operate out of the way, let's see how the tournament played out — this time on paper and not on the pitch.

First a little word on the methodology. To qualify for this prestigious tournament, the participant must be a constituent of the STOXX Europe Football Index, which covers all football clubs that are listed on a stock exchange in Europe, Eastern Europe, Turkey or the EU-enlarged region. The participants are limited to one club per country and must be from a country participating in the 2018 World Cup, further highlighting this summer's suffering for Italian (Lazio) and Dutch (Ajax) fans who would otherwise have participated in this competition.

Finishing fourth, bowing out at the semi-final stage and losing the third/fourth place play-off game that nobody really wants to play anyway, is the ever-mercurial France, represented by Olympique Lyonnais, with an 5.3% return year to date (at time of writing). The team that dominated in France for much of the 2000s have now gone a decade without winning their league championship. With one game remaining this season, the club currently sits in third position, which guarantees their participation in the potentially more lucrative Champions League compared to last season when they finished fourth and participated in the Europa League. For example, 2017/18 commercial revenue to be distributed to clubs participating in the Champions League was estimated at €1.3B compared to €400M for the Europa League. Lyon's better performance has translated into a 16% increase in attendance compared to last season. Confirmation of Champions League qualification could be a catalyst for the stock. Media revenues in France include €726M/year in domestic television rights until 2020, evenly split between all clubs. Lyon will also benefit from being the stadium chosen to hold this week's Europa League final, a World Cup preparation match for the French national team, and other entertainment events this summer.

Equaling their performance in the 1994 World Cup with a third place finish is Sweden, which is represented by AIK, and with a 5.6% return year to date (YTD) just edges out France in a tightly contested affair that went to extra time and a penalty shoot-out. AIK currently sits second in their league, the same position they finished in last year. Optimism for this year must be high as attendance is up 34% compared to last year, contributing to increased match-day revenues. Domestic television rights in Sweden are worth €25M/year.

Falling at the final hurdle and failing to follow up on their victory at Euro 2016 is Portugal, represented by Benfica, with a 21.7% return YTD. Last year's Portuguese champions could not defend their title this year, finishing second, and this could be a contributing factor to attendance falling 5%. Still, Benfica are the best-supported club in Portugal, with average attendance 10,000 greater than the second best-supported team, and second place does ensure Champions League qualification. Benfica also has their own premium TV channel, the appropriately named Benfica TV, which markets and broadcasts their home matches. The television rights are owned by Portuguese media company NOS, which paid €400M for a three-year deal starting with the 2016/17 season. The deal can be extended up to a total of 10 seasons. Benfica, like other Portuguese teams, also do an excellent job scouting young talent in Latin America and parts of Africa, developing and then selling the most successful players to Europe's richer leagues. It is estimated that Portugal's top three teams have earned almost €1B over the past six years from the sale of players.

And the winner of the inaugural Global Alpha World Cup is….Denmark! Denmark is represented by Brondby and dominated the competition with a 169.2% return YTD. Brondby were the second club in the world to go public in 1987, and it is interesting that they are the only top performer currently leading in their home league, albeit by the slightest of margins. They are also on course to win their domestic cup competition. The good performance on the pitch has led to a 3% increase in average attendance. Danish domestic television rights are worth €54M/year and split between fewer teams (14) than most other major leagues. Could history repeat itself in Russia? Denmark scored a famous victory in Euro 92 when, at a week's notice, they returned from vacation and replaced Yugoslavia (disqualified due to the conflict) and went on to win the tournament. Now let's celebrate Denmark's victory with "probably" the best beer in the world.

What is going to happen in the real World Cup tournament? It really does feel wide open. Historically European teams win on home soil, with the only exception coming 60 years ago when Brazil won in Sweden. With Neymar's injury worry and Argentina's ability to play as less than the sum of its parts, it would seem this trend could well continue. France and Spain have the depth of talent to be contenders, while defending champions Germany look strong to add a fifth title and equal Brazil for the most World Cup victories. As someone once wisely said: "Football is a simple game; 22 men chase a ball for 90 minutes and at the end, the Germans win." Whatever the outcome, enjoy the spectacle.

Have a great weekend.

The Global Alpha team