CarteretGroup

CORPORATE FINANCE - MARKET INTELLIGENCE - Q4 2021

4 possible concerns and 2 strong positives for football finance over the next three months

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As 2021 nears an end, it is useful to assess the state of the football finance market as the sector seeks to recover following the Covid-19 lockdowns (and absence of crowds at stadia). Whilst there are continuing challenges posed by Covid-19, and potential new challenges (such as football regulation proposals), there is some positivity in the market with potential new entrants and more flexibility on funding periods and quantum levels.

The Possible Concerns...

1. Base rates, cost of money and unreliable boyfriends

Bloomberg described Andrew Bailey, the Governor of the Bank of England, as an "**unreliable boyfriend**" following the decision of the Monetary Policy Committee (MPC) to keep base rates at 0.1% in **November 2021**. Much of the speculation to that point had been for an increase in rates, and many of the funders considered that Bailey had given 'signals' that rates would rise.

The markets had also been 'fooled', and consequently the cost of money to the funders had increased during the three months to November.

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The question is, with the MPC scheduled to meet again on **16 December 2021**, whether or not the Bank of England will increase base rates at that meeting? The consensus among analysts is that the **Omicron** variant of coronavirus has increased the likelihood that the Bank of England will keep interest rates on hold again in December 2021. **However, the thing about an unreliable boyfriend is that he could be unreliable in both directions!**

Our discussions with all the key Fund Managers in the market has drawn a similar response - if the Bank of England increases base rates, then all funders are likely to increase their rates in-line with the size of the increase in base rates.

"...if there is no increase in base rates in December 2021 then there is a divergence in views amongst the leading Fund Managers...some will raise rates in any event to hedge future rises, others will take it on the chin."

However, if there is no increase in base rates in **December 2021** then there is a divergence in views amongst the leading Fund Managers. Some feel that base rates will inevitably rise over the typical course of funding to football clubs (e.g. accelerating deferred transfer fees or central distributions), and they will hedge the impact that this might have on future cost of money (including any currency movements) by increasing their pricing in the next three months.

Nevertheless, two of the leading Fund Managers consider that the cost of money has already increased over the last few months in anticipation of a base rate rise, and will simply lock-in financing rates at the point that any football finance transaction is drawn down (and "take any future increases in base rates over the course of the financing on the chin").

Key Takeaway:
If there is any possible interest in accelerating central distributions, or accelerating deferred transfer fees in the upcoming January transfer window, it might be sensible to seek to lock-in finance rates sooner rather than later. Also, be careful to choose a funder that will take any future increases in base rates on the chin!

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2. Covid-19: will football be hit by a 'fourth wave'?

Just when you thought it might be safe to go back in the water... a new variant of Coronavirus, **Omicron**, has been identified. It appears to be a particularly virulent strain, and what is still unclear, at this early stage at least, is the severity of the illness caused by the variant.

What *is* clear, however, is that this introduces a new level of uncertainty for football clubs, and for funders. Indeed, the uncertainty is magnified because many of the potential responses to try to deal with a new virulent strain of Covid-19 are out of the hands of football clubs and funders.

"It is important to note that none of the Fund Managers indicated that they would exit the market, but rates, terms and speed would all be impacted negatively by another ban on supporters attending stadia."

Football clubs have undoubtedly learned much from the Covid-19 lockdowns, and from the suspension of football leagues in the early stages of Covid-19. **Whilst football clubs could adapt structurally to a ban on supporters attending stadia, if this were to happen again then the financial impact could be huge** - especially when a number of clubs are still dealing with the financial consequences from the previous ban.

<u>The challenge for football clubs and funders is that a decision on whether to implement a new ban on supporters attending stadia is out of their hands</u>. There is a possibility that the UK government could introduce a new ban over the next three months, and the question is what might be the practical impact on the finance markets for football clubs?

The general picture from the Fund Managers is that a ban on supporters attending stadia over the next three months could:

- **i. reduce quantum in terms of the amount to be advanced to clubs;**
- **ii. require more detailed management information from the borrowing club;**
- **iii. in the case of financing deferred transfer fees, require an early understanding of the financial position of the <u>buying club</u>;**
- **iv. in the case of financing Premier League central distributions, get an understanding of any impact on media payments from national and international broadcasters - and the knock-on effect this might have on the distributions to individual clubs; and**
- **v. lead to more intensive scrutiny by credit committees in the context of a potential (and significant) macroeconomic shock to both football and the wider economy, and is likely to also result in a reduction in transactions approved by certain funders.**

Key Takeaway:
Football clubs will be attempting, right now, to calculate the probability of a future ban on supporters attending stadia, and the threat that this might pose to finances. For both the reason of the potential direct threat to the club's finances, and the probability that there would be a negative impact on financing rates, terms and speed, it is sensible to at least consider implementing any finance requirements ASAP in Q1 2022.

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3. The KYC/AML 'sniff test' is getting increasingly sniffy

In **Q4 2021** there has been a continuation of the more tentative approach adopted by most of the funders in the market in relation to Know Your Client and Anti-Money Laundering requirements adopted over the last three or four quarters. Indeed, one particular funder has now established a '**Reputational Risk Committee**'.

The KYC/AML considerations continue to centre on the domicile of the ultimate beneficial owners (**UBO**) of the borrowing club, as well as more detailed diligence on any corporate structures that include trusts or legal entities that are based in certain *off-shore* jurisdictions.

"However, reputational risk extends beyond just corporate structures, and there is clearly a heightened focus on the media reporting surrounding individual clubs."

This focus has not only been prompted by media reports within the football sector, but also from reflected concerns impacting the funder itself. For instance, the recent insolvency of Arena Television dragged a large number of funders into a limelight that felt uncomfortable and that they would want to avoid in the future in all sectors - including the football sector (which is itself, of course, a very high profile sector).

Key Takeaway:
There is a diverse range of approaches by individual funders to *reputational risks*. All funders have improved front-end risk assessment during the course of 2021, but significant time and money can be wasted if clubs are not aware of the individual approaches of each funder. This is a real-world example of *horses for courses* and it is important to take KYC/AML 'sniff tests' into account at the outset.

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4. "*Some pretty radical*" football regulation proposals

The fan-led review of English football, chaired by Tracey Crouch, has created debate within football clubs and their respective leagues during **Q4 2021**.

"We have to be careful not to damage the Premier League and English football. We agree with the thrust [of the review] but there are some pretty radical proposals there that need to be thought about."
Richard Masters, Premier League CEO

A meeting of the Premier League on 3 December 2021 voiced concerns - that had also been expressed by a number of club owners and Chief Executives since it was published in late November 2021 - in respect of a number of the proposals.

The two principal concerns of the Premier League clubs are:

- i. **The possibility of appointing an independent regulator; and**
- ii. **A possible transfer tax.**

The government has indicated that it will "proceed at pace" in acting on the Crouch review. This would appear to include a full government response "in the new year", and Nigel Huddleston (Sports Minister) seemed to go further with comments suggesting that the government believes that *football requires a strong independent regulator, with the ability to monitor the finances of football clubs in real time*.

So what do we know about timing? Well, it is thought that "new year" for the government response is likely to be **Spring 2022**, and Tracey Crouch has stated that she hopes an independent regulator will be fully operational by the **start of the 2023/24 season** (with a shadow regulator in place in advance of that date).

"There is no doubt that the proposals create uncertainty in the market, and Fund Managers have all said that they are keeping a watching brief."

The impact on football financing in Q4 2021 and Q1 2022 is likely to be minimal, but it is Q2 2022, when the government is scheduled to provide its response, that could bring some more significant changes in approach by the funders in the market.

Key Takeaway:
The generally accepted principle is that markets like certainty - funders want to know the 'SWOT' for a transaction, and then look to gain a competitive advantage at the margins: on price, terms and quantum. On that basis, the uncertainty caused by the football regulation proposals is a concern. This concern may escalate in Q2 2022 and Q3 2022 as the government responds to the proposals. Nevertheless, uncertainty can also provide opportunities for new financing products, services and new entrants to the market that might better align to the [new] requirements of football clubs.

Some Positives...

1. Funding over longer periods, and higher quantum

"Some of the football financing products provided by funders in the market have taken the same form for over five years. The market has evolved [considerably] in that time."

For example, a number of the funders are able to provide competitive pricing for accelerating deferred transfer fees over a term of up to two years, but if the deferred term is three years (or longer) then the pricing (from that funder) can become incredibly uncompetitive in the market.

Again, it is picking the *right horses for the right courses*. The good news in **Q4 2021** is that there are now funders who are molding their products to make them more representative of the way the player transfer market is now operating. **The key point to note is that the funder that has written the most business over the last two years, is not necessarily the best option right now in relation to individual football club requirements on the period of funding, quantum, pricing, or the lightest touch on security.**

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In addition to a number of funders extending the period of funding for certain types of transactions, the quantum available to clubs is also increasing.

Facility sums of **£20m or £25m were prevalent until recently** - and some funders are still restricted to that level of quantum - but the typical transaction size, especially for acceleration of FAPL central distributions, is **now in the range of £30m-£45m**. Some funders will go higher still, particularly if they syndicate part of the transaction.

Key Takeaway:
Our discussions with all the Fund Managers in the sector indicate that none of the funders are seeking to reduce the quantum on offer over the next three months, which is positive. The key, as with all other considerations when seeking a finance facility, is to be smart to find the funder that offers the best combination of quantum, rates and terms - and this is not always (or often) the funder that has written the most business in the past.

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2. New movers and shakers in the market

Irrespective of the challenges in the football finance market - many of which are actually caused by macroeconomic factors - **new funders are still considering entering the market**.

This is a positive sign, and reflects a wider interest in the football sector at present. **Private equity firms** are dueling over media rights for league competitions, other funders are seeking to provide **debt finance for leagues** to distribute to participant clubs, and **club M&A** activity is as buoyant as it has been over the last three years.

We have spoken to three Financial Institutions in the last few months who are actively considering entry into the football finance market. Combined with the increased value recently negotiated for Premier League international media rights, this indicates a positive medium-term for the Premier League.

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More funders provides for greater competition, of course, by virtue of an additional quantity of institutions; but, with increased interest from private equity and strong M&A activity, and increased media rights, the level (and quantum) of competition between clubs will also increase.

To compete, clubs will want to use every opportunity to find value in every market in which they compete including, of course, the player transfer market where they can utilise proprietary insights from firms such as **Carteret Analytics** (Ed: cheap plug!) to identify players that are undervalued by the market; as well as in the football finance market.

Key Takeaway:
New entrants to any financial market is often a good sign. Entrants into a sophisticated market, such as the football finance market, are often smart enough to

understand that an expanding market is not usually expanding in a linear fashion, i.e. that the new entrant is able to simply offer the same product as current market participants and expect to win business. The prospective new entrants to the football finance market believe that they can offer something that is more attractive to 'buyers' than the current products, and that has got to be good for football clubs.

Carteret Group

Carteret Group is an independent advisory firm specialising in *front office* investment banking services within the sports sector. It has three principal divisions - Debt Finance, Equity Investment (M&A) and Management Consultancy.

The authors would be very pleased to provide further information on any of the topics outlined in this *Market Intelligence Bulletin*. Likewise, they would be delighted to discuss the wider services of Carteret Group (including equity investment and management consultancy services), as well as the activities of other Carteret companies - including the quantitative analysis provided in the football sector by Carteret Analytics, or the corporate research services of Granta Research.

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