Sporting chance

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When Portugal decided to put itself forward as a candidate to host the European Football Championship in 2004 (Euro 2004) there were not enough stadiums in the country that could fulfil the requirements for a competition on this scale.

With one and a half years until the event, work is far advanced on the ten stadiums selected for the competition. Of those, some are being newly built and others are being refurbished. Only the four major Portuguese clubs ? Benfica, Sporting, Porto and Boavista ? are directly responsible for the construction of their new stadiums. The remaining stadiums are being paid for by local municipalities.

After a long and intensive period of negotiations, the new Sporting stadium was the first project for Euro 2004 to reach financial close using a limited recourse structure, where the debt service is based mainly on the revenue streams from the project.

1) Structuring a stadium project sponsored by a football club ? the main difficulties and key factors

The financial difficulties that football clubs are currently facing in Europe have been publicly noted and widely discussed. Despite some few honourable exceptions, it is clear that, driven by the increasingly large costs of professional football teams, clubs tend to accumulate unbearably high liabilities. The inevitable consequences have arrived, as some cases of bankruptcy have already been announced. Although on a relatively minor scale, when compared with the European top leagues (Italy, Spain, England and Germany), the Portuguese clubs are not living in easy times, either.

The first difficulty concerns the equity requirement. Unlike many project finance deals, a high degree of leverage would not be accepted on this kind of project since the robustness of the funding structure plays a critical role in the success of the deal. This means that, facing a particularly difficult financial environment, the club needs to find the necessary sources of funds in order to achieve a substantial non-debt sum ? never less than 50% of the total sources of funding. The possible solutions are government subsidies and local municipality support (in various forms); potential income from real estate development on the old stadium site; presales of seats and corporate boxes for the new stadium; engagement of sponsorship entities and other present or future (discountable) sources of funds that the club might transfer to the project.

Even though the football element will always be present in the project, lenders usually demand that ?football risk? be mitigated as much as possible, either by means of the existence of revenue streams from independent activities within the stadium area (such as health clubs, commercial and entertainment areas, etc.) or through some possible form of cash flow protection that might be provided by the sponsors. In other words, lenders will expect that the project be structured in such a way that it will be able to generate enough cash flow to service debt and to show comfortable financial ratios without direct reliance on the club's performance. As such, the establishment of a special purpose vehicle will be required so that all rights and obligations can be clearly defined and allocated and therefore the project's risk might be properly modelled and assessed.

Last, but not least, the degree of confidence that the club's management may be able to provide to the project in terms of organization, qualified resources and commitment will no doubt play critical roles that may be the final elements in closing the deal.

2) Sporting's decision to build a new stadium and the club's restructuring process

Although Euro 2004 provided a particularly favourable environment for some clubs to build their new stadiums, namely through the possibility of getting government subsidies, Sporting had already decided to go ahead with this project since its old stadium was no longer complying with standards for safety and comfort. In fact, Sporting's decision to build a new stadium was taken as part of a wider process of restructuring that the club started about five years ago.

Sporting Clube de Portugal (the club itself) is now the head of Grupo Sporting and keeps running directly all the non-professional sporting activities, such as the junior football teams, handball, athletics, swimming, and others. Next in this new structure comes ?Sporting SGPS?, which is the holding company controlling the various companies, such as ?Sporting SAD? ? for the premier/professional football team (already listed in the Lisbon's stock exchange), ?Sporting Comércio e Serviços? ? for the merchandising of all products carrying the Sporting brand and ?NEJA? ? for the design, build, finance and operation of the new stadium.

The two main objectives that this new model of organization was meant to achieve are: 1) to establish a completely new corporate philosophy based on specific business focus for each company and on professional management skills; and 2) to create the conditions necessary to attract investor interest and to make projects bankable on their own merits which otherwise would be much more difficult to assess, monitor and control.

3) The new Sporting stadium ? concept, contractual structure, sources of funding and revenue

The new Sporting stadium is being built next to the old one on adjacent land owned by the club. With a total investment of Eu150 million, the stadium will have a capacity of 50,000 and will be the centre of a complex with facilities that include a commercial area of 15,000 m2 with several shops and restaurants, a heath club, a medical centre, an entertainment centre (including several cinema theatres), a Sporting megastore, parking areas and a seven-storey office building. The concept behind NEJA is to create a versatile leisure site, which should be translated into a profitable and self sustained project, instead of a facility that is simply used for matches (as it is right now).

As owner of the land, Sporting is formally managing construction, although in its capacity as project company NEJA is effectively overseeing the work and raising part of the funding. The reason why Sporting kept this arrangement is that there are existing agreements between the club and the public authorities for Euro 2004 regarding the granting of government subsidies. Under this condition, Sporting directly funds the project through the use of the following sources: an upfront equity payment, government subsidies and income from the real estate development on adjacent land owned by the club, being all the remaining funding needs fulfilled by NEJA.

During the construction phase the contractual link that connects NEJA to the project is a promissory agreement that it entered into with Sporting for the acquisition of the surface rights over the new stadium. Under this promissory agreement Sporting commits to transfer to NEJA, once construction is completed (scheduled completion date is July 2003), the surface rights over the new stadium for a period of 25 years. On the other hand, NEJA agrees to fund the project during construction in the form of advance payments for the acquisition of the surface rights. These payments will be made against the use of the debt facilities that NEJA raised for the project and from other sources of funds. Additionally, after construction an annual rent will be due to Sporting, although these payments are subordinated to the debt repayment.

The other sources of funds that NEJA was responsible for are the so called ?founding members? and the television rights. The founding members are a group of entities that entered into individual agreements with NEJA whereby they acquired certain rights in the new stadium, such as advertising, exclusivity to sell a certain range of products and a corporate box for a certain period of years against a payment of a certain amount. The television rights in relation to a certain number of seasons are an important souurce of future and discountable receivables that have been transferred from Sporting SAD to NEJA in order to enhance the robustness of the project's funding profile. This transfer was made on the basis that NEJA will reimburse Sporting SAD using revenues that NEJA manages to obtain from the pre-selling of seats (a completely innovative concept in Portugal) and corporate boxes to the extent that after each repayment the annual debt service cover ratio is not less than 1.5.

The transfer of television rights to NEJA was seen as an important sign of commitment from Grupo Sporting to the project, since they represent one of the main assets of Sporting SAD, which assumes in this way the commercial risks of pre-selling of seat and corporate boxes.

In summary, the sources of funds made up of the upfront equity payment, the income from the real estate development, government subsidies, founding members and television rights amounted to 60% of the total funding needs of the project and complied with lender requirements in terms of funding structure/maximum leverage.

As mentioned before, the project's revenues will come from several activities that will be carried out within the stadium facilities. Of those, an important portion (30% of the total revenues) will derive from a monthly rent that Sporting SAD will pay for the utilization of the new stadium by the professional football team. Because of the direct link between this important source of revenue and football risk, Sporting and Sporting SAD agreed on the use of the monthly dues from the club's members to secure the effectiveness of the rent payment by Sporting SAD. This was also seen as a very positive sign of commitment to the project, taking into account not only the value of these receivables (nearly the same amount of the rent that will be due by Sporting SAD) but also its high level of stability that has been observed in historical terms (even during a recent period of many consecutive years in which Sporting was not capable of winning any relevant competition).

On a global perspective the project's base case evidences an annual debt service coverage ratio always above 1.5 and a loan life cover ratio of 2.0 for a maximum debt maturity of 15 years.

4) A template for other forthcoming stadium projects

When the process started, the financial structuring of NEJA seemed to be an almost impossible task, especially taking into account the particularly adverse context in which the project was planned. After financial close was reached in February, 2002, NEJA might well be seen now as an example in many aspects to other similar forthcoming projects.

The adequate grounding that has been established for the development of the project through the recent restructuring at Grupo Sporting, and the strong signs of commitment to the project that have progressively been given by the club and its management, constituted the main reasons for the success of the deal.

Although this a sector in which volatility is a principal feature, there are reasons to believe that NEJA might confirm the assertion that, just as projects can go wrong in sectors where there are apparently favourable conditions at the outset, there can also be successful projects in more challenging sectors. n

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