

ARSENAL HOLDINGS PLC

Commentary on STATEMENT OF ACCOUNTS & ANNUAL REPORT 2006 / 07 by Nigel Phillips

The Emirates Effect! When the Arsenal Holdings plc results for the year to 31st May 2007 were proudly announced they received much media coverage and comment. Maybe now we can glimpse what the future could hold after a journey of 7 years from when the Ashburton Grove site was first identified in late 1999.

Total revenue / turnover was up 46% to £200.8m from £137.2m although **profit before tax** actually fell to £5.6m (£15.9m). Discounting revenue from property sales (£23.8m from the sale of the development site at Drayton Park) **football related turnover** increased by 34% to £177m (£132m). **Player trading** [profit on player sales less the amortisation charge against the playing squad] was again profitable with a gain of £200k (£3.9m) reported. The profit figures were impacted by the exceptional finance charge of £21m, the cost of putting in place the long term debt in July 2006 for the stadium whilst replacing the project loans taken out for the construction of the stadium. **Operating profit from football** was £14.4m (£4.2m loss).

The football related income comprised four identified revenue streams, namely:

Match day	£90.6m (£44.1m in the prior year)	51%	(33%) of football revenue
Broadcasting	£44.3m (£54.9m)	25%	(42%)
Commercial	£29.5m (£22.8m)	17%	(17%)
Retail	£12.1m (£10.2m)	7%	(8%)

Match day revenue, at £3.1m per home game, is impressive and is about £50 per supporter per game. This only includes commission on catering / concession sales rather than the normally reported gross take (a feature of the 20 year exclusive catering deal signed with Delaware North). Broadcast income fell due to the reduced contribution from the UEFA Champions League pool. The exit at the first knockout stage compared to reaching the final in May 2006 had a £10m negative impact on these revenues.

The **total operating expenses** (costs) increased as well to £177.5m (£141m). Excluding the £14.7m (£2.7m) cost of property sales, total football costs were £15m lower (£6.4m higher) than football related income. **Wages / staff costs** were the principal cost component and increased by 8% to £89.7m (£83m) albeit with an increased number of employees (374 vs 312) relating to the larger scale of the new stadium operations. The key **wages / football revenue ratio** was a modest 51% (63%) and could fall below 50% in the present season as the wages of Henry and Ljunberg are unlikely to be matched by new joiners. The Managing Director, Keith Edelman, was the highest paid director at £1.16m (£1.04m) and at £22k per week is probably equivalent to an emerging first team player! No termination payment to David Dein had been agreed at the time the accounts were signed off in September 2007.

Reduced activities in the transfer market appear to have reduced **payments to agents** to £1.2m (£4.4m) – “expenses not deductible for tax purposes”. No detail is given on **“other operating (costs) charges”** of £44.7m (£33.7m) which represent 33% of cash costs. Further analysis would be welcome.

Whilst negligible it is interesting to note that the Arsenal Broadband Ltd joint venture with ITV plc had reduced profitability during the year (£435k vs £499k for Arsenal's 50% share). Arsenal's share of the net assets of the joint venture was £76k (£209k deficit). ITV are still in negotiation with Kroenke Sports Enterprises over the sale of its 50% stake in this business for £23m.

The final stadium project costs are quoted at £430m and the related long term fixed rate debt is £260m. The construction debt was refinanced in July 2006 and now consists of £210m of 23 year fixed rate bonds and a 25 year floating rate bond. Interest on this debt has been fixed at what are now very beneficial rates and the annual debt service costs (interest and annual repayments on the £210m) is c.£23m. Arsenal have a further £90m (£55m) of debt of which the Highbury Square development loan at the year end was £64.5m (£29.7m) with the remaining £25m being the A/B/C/D bonds/debentures owed to supporters. The **total gross debt** rose to

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£345.5m (£309.5m) but so did **cash balances** to £73.9m (£35.6m). It should be noted that £45.5m (£8.2m) of this cash is not available for direct use as it resides in accounts over which there are charges forming a part of the overall stadium debt security package. This secured cash relates to a 150% annual debt service charge plus other factors such as transfer proceeds received but not reinvested in new players.

Due to the large amount of monies paid in advance on the multi-year sales of executive boxes and Club seats and receipts from some commercial deals "**accruals and deferred income**" increased further to £170m (£135.5m). This is effectively money received in advance of the year to which it is related or actually due.

Property development activities are likely to remain an important part of the Arsenal finances for a further three seasons. Arsenal has fortuitously ridden the property wave for several years and we need this to continue for a few more years. It is reported that the Highbury Square development is progressing well with 91% of all 724 (703) units having been sold with completion due in Oct-Dec 2009. Combined with other developments at Queensland and Hornsey Road the successful completion of these properties is forecast to generate gross sales in excess of £300m and a **positive "net cash" of £90m** over the next three years. Surprisingly "only" £60m of this appears to be related to Highbury Square. Previous independent estimates have put this figure at over £100m. This conservatism and prudence may be related to the need to see sales converted into completions, the 65 so far unsold units (the remaining 9% of the 724 total) or the fact that there are several purchasers of multiple units with one buyer thought to have accounted for about 20% of all units sold in the development.

Summary and the Future – In the spirit of improved communication and transparency it is nice to see eight pen pics of the directors on page 2. From their looks football is clearly a serious business!

Much has been made of where the football revenues place Arsenal in the league table of the "world's richest clubs". Whilst one should not confuse revenue with profitability or wealth it is fair to say that Arsenal is now in the revenue big league!

Match day revenues are impressive. With the recently agreed extension to the Wenger contract (June 2011) continued "Wenger boys" football should give the Club confidence of repeating these £90m plus annual match day revenues from a full stadium. One should however be sensitive to how the ever increasing costs of watching Arsenal are permanently excluding many people and particularly the young [average age of Arsenal season ticket holder 44]. Domestic TV revenues this season will be c£16m higher than last and with a good Champions League performance broadcast revenues could exceed £65m come this time next year. The fixed rate debt deals look a very well timed and shrewd piece of business. Other football clubs seeking to fund new stadia or refinance existing debt can be heard shouting "Lucky Arsenal" as the debt markets take a turn for the worse! The Arsenal refinancing deal could not be done now on the same terms and conditions.

Commercial and retail income (24% of total football revenue), the directly controllable revenues, appear to need revitalising as the "historic" deals with Emirates and Nike increasingly look sub-optimal in relation to what the market now pays. [Arsenal receive £6m pa for its shirt sponsorship (7 years to run) vs £14m for MUFC (3 years to run)]

An interesting scenario for the Club over the next three years relates to the use of the potential cash generated from three remaining property developments. It is predicted that net debt could be as low as £76m in three years time. If this is the case and the £210m fixed rate loan is allowed to amortise on schedule then the Club could have about £165m of cash. Even if £50m may be subject to the debt security structure there could still be in excess of £100m of distributable cash burning a hole in someone's pocket. Would this "free cash" be attractive to any potential purchaser of the Club?

However Wenger's talent at operating on a "net nil" transfer policy (self-imposed now perhaps?) whilst still delivering Champions League football (just!) has been miraculous and is surely unsustainable in the long term. That anticipated cash may come in useful in the years ahead.

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