

ARSENAL HOLDINGS PLC

Commentary on INTERIM ACCOUNTS for the six months ending 30 November 2009 by Nigel Phillips

“Debts destroying football!” – “Monstrous wages out of control!” – “Pound cripples English clubs!” – “Football Bubble Bursts!” – “Pompey in administration” – “Fans to buyout clubs!”

Sensationalist headlines or the mother of all hard landings in the madhouse of football finances in the English Premier League (EPL)?

Arsenal Overview .

- Drowning in debt?* No, manageable and under control
- Swimming in cash?* No, but £35m available to spend on transfers and wages
- Football income?* In balance with football costs
- Finances and facilities the envy of all?* You bet!
- Revenue growth potential?* In commercial / sponsorship only
- Property cash upside?* In sight at last! (Perhaps £45m)

As Arsenal climb to fifth in the Deloitte World Football Rich List (ranked by income) what is the financial reality at the club? In match day (gate receipts) and broadcast/TV income Arsenal are firmly in the top five whilst **commercial / sponsorship income** lags way behind competitors. If this third leg of club revenues matched peers then Arsenal could flex serious financial muscle in its bid to move that final step to the very top level.

- Arsenal's high position in the league relates almost exclusively to the new stadium financing (long term mortgage style payments) and is not due to ongoing operating losses (spending more than it earns) or unsustainable acquisition-related debt. Encouragingly **property development loans have been almost fully repaid and should be by summer 2010.**
- **Wages and other football costs** (stadium running costs, team expenses, scouting, youth development, etc) account for all football income, **a delicate balance** that needs to be maintained, as Wenger's remarkable consistency at making money from player trading can not be relied upon as a top up forever.
- Wages of c£120m pa, **a reasonable 55% of total income**, are in the same league as other perennial Champions League (CL) qualifiers from the EPL, but are double, treble and even more of those in the chasing pack. Continued upward movement in wages of players who compare "take home pay+with" salaries in countries with far lower tax rates can only be accommodated by:
 - Increasing commercial revenues
 - Developing new revenue streams
 - Reducing non-wage football costs
 - Spreading the wage spend more efficiently across the playing squad
- The harsh economic landscape has resulted in both **commercial and retail revenues dipping slightly**. Attendance on a sold seats basis remains strong although actual stadium attendance continues to be an estimated 3,000-4,000 below the sold level. Keeping sold seats at full is important.

The Arsenal Football Business . **Football turnover** increased by 2% to £100.2m (£98.4m) due to extra revenue from the Champions League pool. This more than compensated for match day income falling £3m to £41.4m, due to one fewer game. The **football operating profit (before debt service costs)**, excluding player sales and the cost of writing down the squad (basically depreciation of intangible assets . a non-cash cost) was £18m (£23.5m).

Arsenal's football income comprised four separately identified revenue streams:

Match day	£41.4m (£44.4m)	41% (45%) of football revenue
Broadcasting	£35.4m (£28.9m)	35% (30%) of football revenue
Commercial	£15.9m (£16.3m)	16% (17%) of football revenue
Retail	£7.5m (£8.0m)	8% (8%) of football revenue

Broadcast income is set to increase by c£7.5m pa as the new overseas three year TV deal comes into effect next season. **Football costs** jumped by a significant 15% to £82.1m from £74.1m, almost exclusively due to wage increases for the 17 players whose contracts have been extended over the past 12 months. This £8.5m six month wage increase is net of wages not paid to high earning players who have left the club (Adebayor and Toure) and reflects a major financial commitment to the current squad. As ever **“non-wage football costs”** are remarkably high to this observer. More explanation from the club would be welcome. It is unclear if

there is scope for downward pressure on this figure by applying some efficiency measures. These non-wage football costs exceed the total income of eight EPL teams.

Cash balances increased to £101m (£75.7m), which included £22.5m (£22.6m) held in specific debt service reserve accounts related to the new stadium financing. This acts as security for lenders that future interest and principal payments can be made on due dates. I estimate that £25m is held in the Transfer Proceeds Account (TPA) related to the inflow from the summer transfer activity. With Highbury Square now fully funded, of the remaining £53.5m I expect at least £35m of this to be season ticket money received in advance and earmarked to cover second half football costs. **This leaves £18.5m “free cash” which added to the TPA monies gives £34m for additional “squad spend”** after taking into account the probable £9.5m still to pay on players already on the books (see below).

The **new stadium debt** continues to fall in line with expectations, now £236.6m (£242.1m) and due for final repayment by 2031. Interest costs are either fixed contractually or by interest rate swap agreements at about £15m pa. Total annual costs of this debt, including principal reductions, are c£20m pa. The £26.3m (£25.9m) of supporter held debentures (A, B, C and D bonds) increased due to rolled up interest on C and D bonds.

“Accruals and deferred income” (revenue received in advance of the accounting period to which it relates . essentially season ticket, Diamond Club, club level, box and commercial monies) remain high but fell to £134m (£151m).

Player trading again proved a very profitable activity generating a surplus of £34m (£18.5m) with sales to Manchester City offset by the residual value of players sold. These high value sales have taken the **five year net transfer spend into surplus**, an incredible feat of fiscal prudence whilst maintaining high levels of performance in the CL. Money payable in the future on players fell to £20.7m (£23.5m) of which £9.5m (£10.9m) is described as probable based on the expected future first team appearances.

The Arsenal Property Business – Sales progress at Highbury Square is described as remarkable and it is hard to disagree. The outstanding loan on this development was £35.7m (£135m) at end of November 2009 and was down to £12.9m as at the end of February 2010. This loan has to be fully repaid by end of 2010 but is likely to be cleared by this summer. This will be a significant milestone as Arsenal will be left with about 90 apartments to sell (plus 25 still unbuilt) with all future sale proceeds potentially available to spend on projects and infrastructure. This figure could be £30m although the exact amount and timing is unknown (no need to do discounted sales to repay debt) and the nature of projects and infrastructure is unknown.

Following the sale of the social housing element of the **Queensland Road** site to Newlon Housing Trust (with planning permission for 700-apartments plus sports centre; 350 affordable housing / 350 market priced units) the only remaining debt on the Club's property development business is the £13m left on Highbury Square. Arsenal owns the remaining units in Highbury Square, permission for 350 market priced units at Queensland Road plus two other sites, all of which are for sale and hoped to be cleared within two years. Whilst dangerous to speculate on values, and the club do not for obvious reasons, **it is feasible to anticipate a possible cash surplus of up to £45m in the next two years.**

Summary . Football finances have never been under such scrutiny and the much talked about UEFA **“financial fair play concept”** suits Arsenal's model of **self sustainability and paying its own way**. This six year plan is designed to introduce more discipline and rationality in club finances, the like of which Arsenal have demonstrated since the new stadium was first mooted. But can Arsenal currently compete at the highest level? The wage bill says yes, but maybe the spend can be more efficient in first team squad emphasis. Other costs remain stubbornly high. The difference between tickets sold and real attendance is a trend that needs watching regarding future ticket sales. A full-ish stadium (55,000) is financially important as is continued CL qualification. Also 9,000 premium priced seats generate 35% of match day income and weakness here is expected. The only realistic prospect of meaningful revenue growth comes from commercial and sponsorship opportunities, where the club is locked into long term deals on the two most lucrative assets: kit manufacture and shirt sponsorship. The **long term commercial deals** with Emirates (shirts until 2014/15, stadium naming rights 2020/21) and Nike, who recently exercised an option to extend for three more years until 2013/14, are secure but generate progressively less cash value due to the stadium-induced front loading of these contracts. The annual cash foregone is now about £7.5m and opportunity cost compared to fair market value is closer to £20m pa. **Overall: comfortable, conservative yet revenue growth is needed to match rising costs.**

As an Arsenal Supporters' Trust member, if you have any comments on the financial accounts please contact us at info@arsenaltrust.org or on 07775 671345