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MOAG & COMPANY

industry ANALYSIS

Analysis and Reporting on Emerging Financial Trends and Developments in the Sports Industry

MOAG & COMPANY

MAJOR LEAGUE BASEBALL: TWO STRIKES AND YOU'RE OUT?

Opening Day, 2002

To Our Clients and Friends:

A year ago, we wrote,

> *"Despite the doom and gloom predicted for baseball based on an ever-widening economic disparity of its teams and an out-of-control player compensation system, we have a positive outlook. Why? MLB owners finally have given Commissioner Selig the power and tools he needs to take corrective action. Additionally, the relationship between the Commissioner and the leader of the Players Association appears to be positive and both men seem inclined not to repeat the strike of 1994-95. While we may not see a salary cap, we believe the almost-suicidal salary spiral will be brought under control and greater revenue sharing will be required for the franchises."*

At that time, Management (the "League") and the Major League Baseball Players Association (MLBPA; the "Players") seemed to be involved in informal, personal and positive discussions on the upcoming labor contract. Neither Management nor the Players would comment on those discussions, and both sides assiduously avoided any type of public rhetoric. We took this as a sign that both sides understood how damaging the strike of 1994-95 had been and were seeking to avoid a repeat that might just send fans over the edge. It appears now that we were wrong.

After a highly successful World Series, the League's announcement that it was targeting two teams for contraction received a decidedly unmixed, negative reaction from the Players, as well as from fans and from the U.S. Congress. A highly relevant and important industry issue suddenly became a seemingly unplanned confrontation with politicians and the localities that were targeted for contraction. Needless to say, the Players were unhappy with the timing, substance and unilateral nature of the announcement.

Later in the off-season, the League's chief negotiator, Paul Beeston, who had developed a good working relationship with the Players' savvy leader Don Fehr, left the League and was replaced by a new negotiating team.

Most recently, a "clarified" interpretation of the League's rule regarding franchise debt (the "60/40 Rule") was correctly interpreted as a backdoor attempt to ratchet down player costs without confronting the issue directly. With as many as two-thirds of MLB franchises out of compliance, it begs the questions as to how teams can realistically comply and what will happen if they don't.

The real issue at hand is the flawed economic architecture of Major League Baseball. In a nutshell, the failings of baseball are escalating player costs and the fact that only a small minority of franchises can afford to lure and/or retain the best players. Consequently, the sport itself is becoming more predictable and less interesting. Baseball fans cannot reasonably expect a competitive team year in and year out unless they reside in one of the larger media markets – even a new stadium no longer guarantees a competitive team.

In his testimony before Congress, Commissioner Selig claimed that, as a whole, MLB teams lost more than $230 million in 2001 (and that is before interest payments on team debt), which equates to nearly $8 million per team. However, given that roughly one-third of MLB teams made money, that spreads an even greater amount of losses over the other two-thirds.

The bottom line of any business – and sports is no exception – is directly impacted by either increasing revenues and/or controlling costs. The fans and media markets that generate revenue for the League have done so increasingly at a rate of 13% per year. However, fans and local cable companies cannot and will not close the broadening gap between revenues and expenses on their own. Increased revenue sharing does not increase revenues, it simply redistributes them (though it could be argued that increased revenue sharing leads to more competitive teams in more markets, which increases revenues in those markets and thus overall). As for costs, the only cost of any consequence is player payroll.

The debate between Management and the Players with regard to controlling costs has reached a critical juncture for the sport. It is no longer simply entertaining and interesting to watch the League and the Players deal with these issues; it is now getting close to the point of threatening our ability to enjoy Major League Baseball.

Very serious questions loom on the Major League Baseball horizon: Can baseball survive a second work stoppage in less than a decade, or will fans and sponsors permanently tune out? Further, can baseball avoid such a work stoppage while at the same time making meaningful, long-term changes to its economic structure?

So now, as the 2002 MLB season opens, we offer this sobering analysis of America's grand old game.

Best regards,

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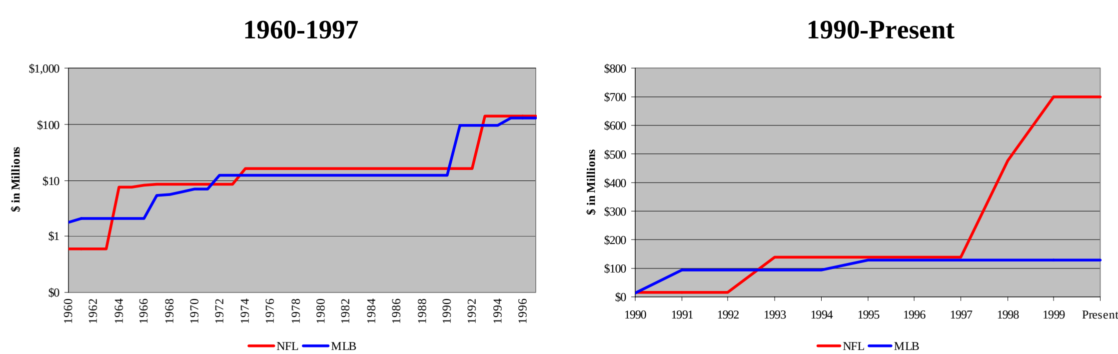
PART I: MAJOR LEAGUE BASEBALL FRANCHISE VALUATIONS

Once upon a time, baseball was the true national pastime, and its franchise values reflected that fact – trading at a premium to the values of franchises in other leagues. The last 10 years, however, have seen the NFL overtake MLB as the king of sports. The lead change can be seen clearly by looking at the expansion fees and transaction values of the two leagues.

Expansion Fees

From 1960 to 1997, MLB and the NFL added a similar number of expansion teams, who each paid very comparable expansion fees (See left-hand graph in Exhibit 1). Particularly in the 1970s and 1980s, expansion fees in the two leagues seemed to mirror each other. And in the early 1990s, MLB expansion fees seemed to set the bar for subsequent NFL fees. Since 1997, however, a dramatic divergence has occurred (See right-hand graph in Exhibit 1). Whereas the NFL has completed two rounds of expansion at increasingly higher values (Cleveland paid $476 million in 1998 and Houston paid $700 million in 1999), MLB has not only seen its expansion fees flat-line, but it is in fact considering contraction.

Exhibit 1
MLB and NFL Expansion Fees Since 1960



Source: Moag & Company Research.

Transaction Values

Likewise, recent transactions clearly demonstrate that a divergence in MLB and NFL franchise values has occurred. From 1992 to 1994, seven MLB teams were sold at values ranging from $82 million to $173 million. From 1991 to 1994, five NFL teams were sold at values ranging from $102 million to $183 million. While the NFL values are slightly higher, the ranges effectively overlap.

The average value of MLB transactions since 1995 has reached $182 million. The average value of NFL transactions over the same period has reached $439 million. Exhibit 2 details the disproportional growth in franchise transaction values since 1995.

Exhibit 2
MLB and NFL Transaction Values Since 1995

Year	MLB Franchise	Transaction Value ($M)		Revenues ($M)	Revenue Multiple
1995	A's	$ 85.0		$ 44.5	1.9x
1995	Cardinals	150.0		66.2	2.3x
1996	Pirates	90.0		40.7	2.2x
1996	Angels	120.0		49.0	2.4x
1998	Angels	147.0		83.2	1.8x
1998	Dodgers	311.0	(a)	100.1	3.1x
1998	Rangers	250.0		100.8	2.5x
1999	Marlins	150.0		73.0	2.1x
1999	Reds	183.0		68.4	2.7x
1999	Indians	323.0		136.8	2.4x
2000	Royals	96.0		63.6	1.5x
2000	Blue Jays	137.0		73.8	1.9x
2002	Red Sox	375.0	(b)	160.5	2.3x
2002	Marlins	158.5		79.1	2.0x
2002	Expos	120.0		62.7	1.9x
2002	D'Backs	218.5	(c)	120.7	1.8x
	Average	**$ 182.1**		**$ 82.7**	**2.2x**
	Range				1.5x to 3.1x

Year	NFL Franchise	Transaction Value ($M)		Revenues ($M)	Revenue Multiple
1995	Buccaneers	$ 192.0		$ 65.7	2.9x
1995	Rams	$ 200.0		77.0	2.6x
1997	Seahawks	$ 200.0		72.9	2.7x
1998	Vikings	$ 246.0		71.4	3.4x
1998	Browns	$ 530.0	(a)	132.0	4.0x
1998	Redskins	$ 800.0	(a)	134.9	5.9x
2000	Ravens	$ 600.0		119.3	5.0x
2000	Jets	$ 635.0		103.4	6.1x
2002	Falcons	$ 545.0		113.0	4.8x
	Average	**$ 438.7**		**$ 98.8**	**4.2x**
	Range				2.6x to 6.1x

(a) *Transaction value includes stadium.*
(b) *Transaction value is estimated. Total transaction was $700 million and included 80% of the New England Sports Network, the stadium and other real estate.*
(c) *Transaction is estimated. Total transaction is $16 million per year for 10 years for 49.5% ownership. Estimate assumes a 10% discount rate.*

Source: MLB; MLB Blue Ribbon Report; Team Marketing Report; Moag & Company Research.

As is shown in Exhibit 2, NFL teams have traded at a higher multiple of revenues, 4.2x on average, than have MLB teams – 2.2x (of note is that Commissioner Selig has picked 2.0x to determine compliance with the 60/40 Rule). When applying these multiples to the average revenues for each league, the disparity between the two leagues is very evident. Applying the 4.2x multiple to average NFL team revenues (the average in 2000, the last full year of data available, was $127.0 million) yields an average franchise valuation of approximately $533 million. Applying the 2.2x multiple to average MLB team revenues (the average in 2001 was $118.3 million) yields an average franchise valuation of only $260 million. In other words, the average NFL franchise is now worth more than twice as much as the average MLB franchise.

Why the divergence?

The disparity between NFL and MLB franchise values has developed and become exacerbated based on the two leagues' relative success in the fundamentals – balancing revenues and expenses. The NFL has been able to capitalize on a sound economic structure that has led to increasing revenues (primarily television revenues) and controls on player salaries. Highlighted throughout the remainder of this newsletter are the factors that have had the greatest negative impact on MLB franchise values – namely, the overall unhealthy economic condition of baseball and unsettled labor issues.

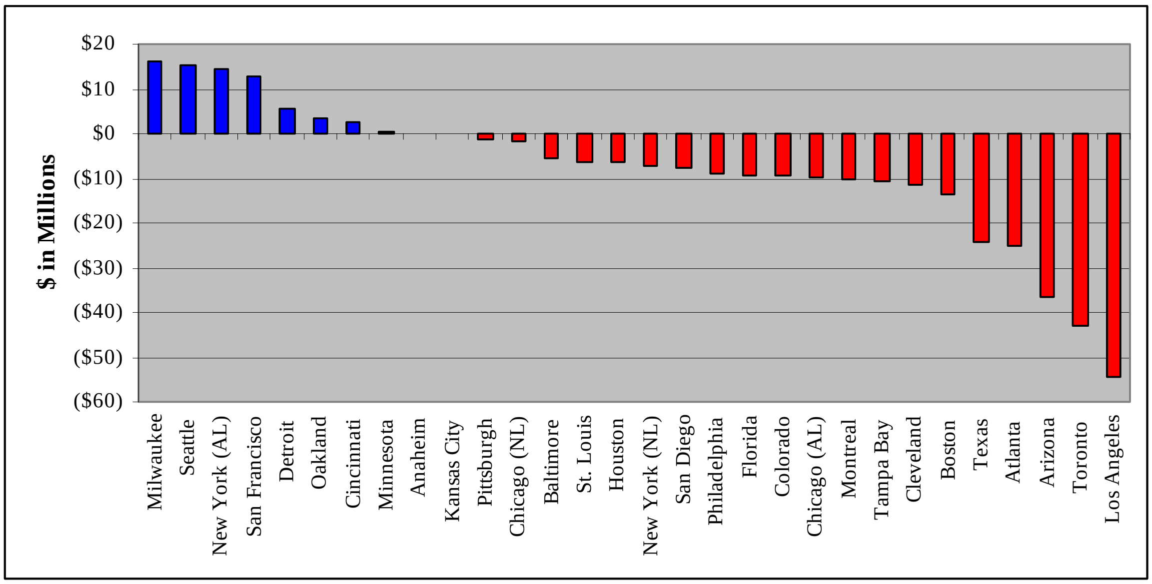
PART II: OVERALL ECONOMIC CONDITION OF BASEBALL

MLB Bottom Line

As was mentioned in the Introduction to this newsletter, in his testimony before Congress during this past off-season, Commissioner Selig revealed that MLB teams incurred more than $230 million in operating losses in 2001. When added to the losses reported for the previous six seasons, the Major League Baseball industry has lost nearly $1.5 billion since 1995. On a per team basis, this figure equates to more than $7 million in losses per year.

In 2001, only nine of 30 teams could claim to have operated at breakeven or better (of which four did so only because of revenue sharing). Cumulatively since 1995, only two teams have been profitable (New York Yankees and Cleveland, though the Indians in fact lost more than $11 million in 2001). Exhibit 3 details operating income by team for 2001.

Exhibit 3
MLB 2001 Operating Income by Team

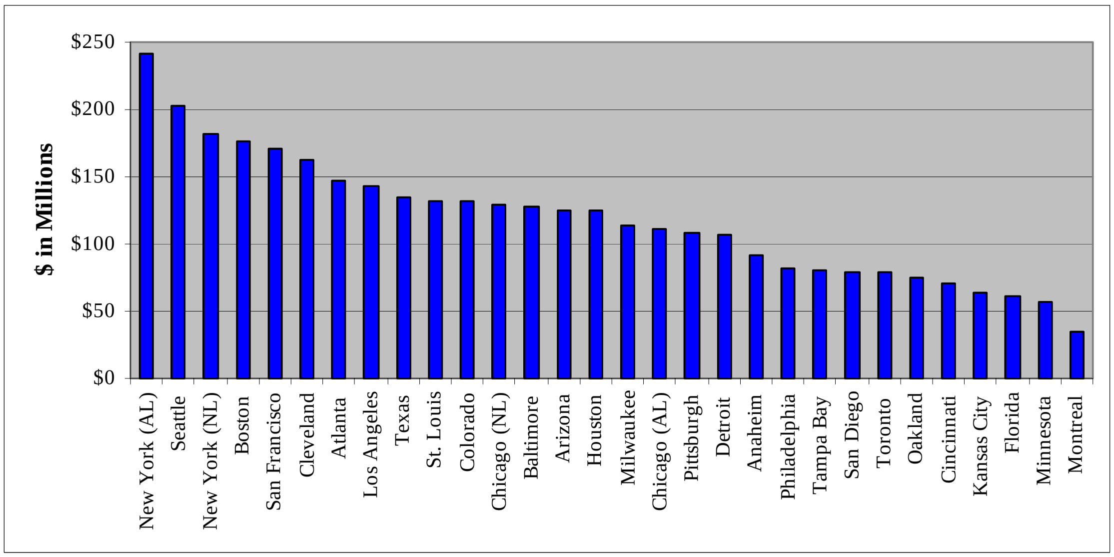


Source: MLB.

MLB Revenue Disparity

More than $1 billion in operating losses notwithstanding, in the years following the 1994-95 MLB Players' strike, the industry has seen substantial revenue gains. Per club revenues have grown by roughly 86%, or 13% per year, since 1996 (over the same period, the average MLB team payroll increased by 113%). The average team revenue in 2001 approached $120 million. Exhibit 4 details revenue by team for 2001.

Exhibit 4
MLB 2001 Revenue by Team

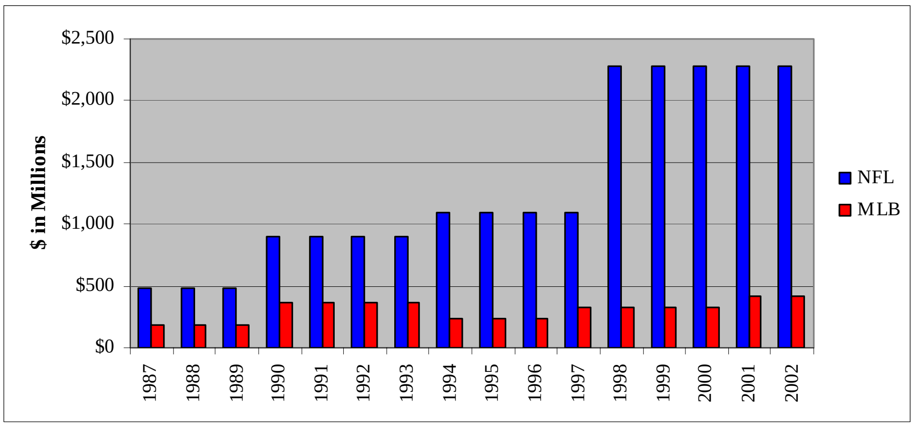


Source: MLB.

Team revenues come primarily from three sources: (i) Central Fund revenues, which are generated by industry-wide contracts, such as national television contracts and licensing arrangements, and historically have been distributed evenly by MLB to all clubs; (ii) local revenues, including ticket sales, local television, radio and cable rights, ballpark concessions, parking and team sponsorships; and (iii) revenue sharing, introduced in 1996, which transfers locally generated money from high-revenue clubs to low-revenue clubs.

National Revenues
The largest component of Central Fund revenues, or national revenues, is MLB's national television revenue. Television rights fees are shared equally among the 30 teams. Whereas NFL television rights fees have increased tremendously since 1987, with its current eight-year contract worth $17.6 billion, MLB rights fees have not experienced such growth. The current MLB television contract is for six years and is worth a total of $2.5 billion, approximately 1/7th the size of the NFL contract. Exhibit 5 details the annual value of NFL and MLB television rights contracts since 1987.

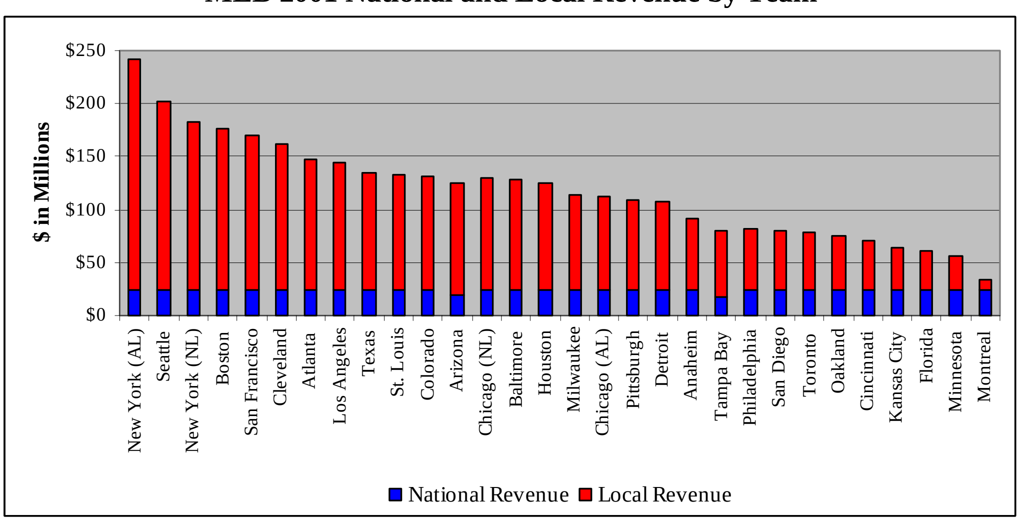
Exhibit 5
MLB and NFL National Television Rights Fees by Year



Source: Moag & Company Research.

Local Revenues
Given MLB's relatively low level of national revenues, local revenues have become the largest component of revenues for most MLB franchises. For the 2001 season, MLB teams averaged $94.3 million in local revenues, compared to $49.6 million in 1996, an increase of 90%, or 14% per year. On average, local revenues constituted 80% of a team's total revenues in 2001. Exhibit 6 illustrates by team the portion of total revenues that is comprised by local revenues.

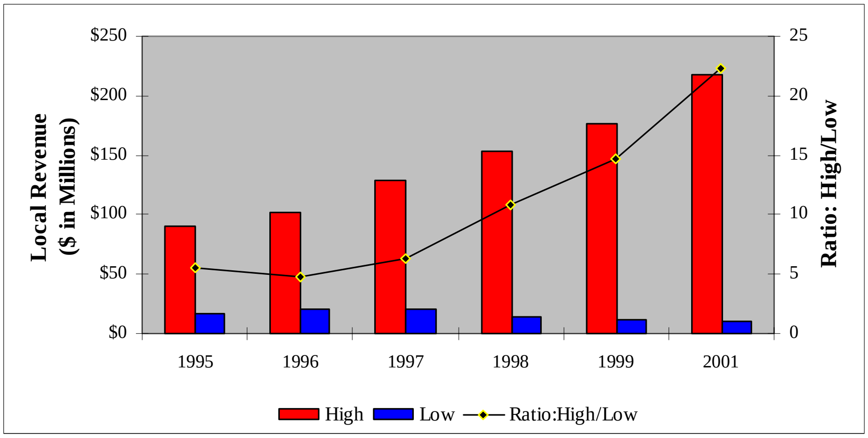
Exhibit 6
MLB 2001 National and Local Revenue by Team



Source: MLB.

Since 1995, the gap in local revenues between the highest and lowest clubs has quadrupled. In 2001, as shown in Exhibit 7, the highest club (New York Yankees, $217.8 million) had local revenues that were more than 22 times greater than the lowest club (Montreal, $9.8 million).

Exhibit 7
MLB Local Revenue Gap

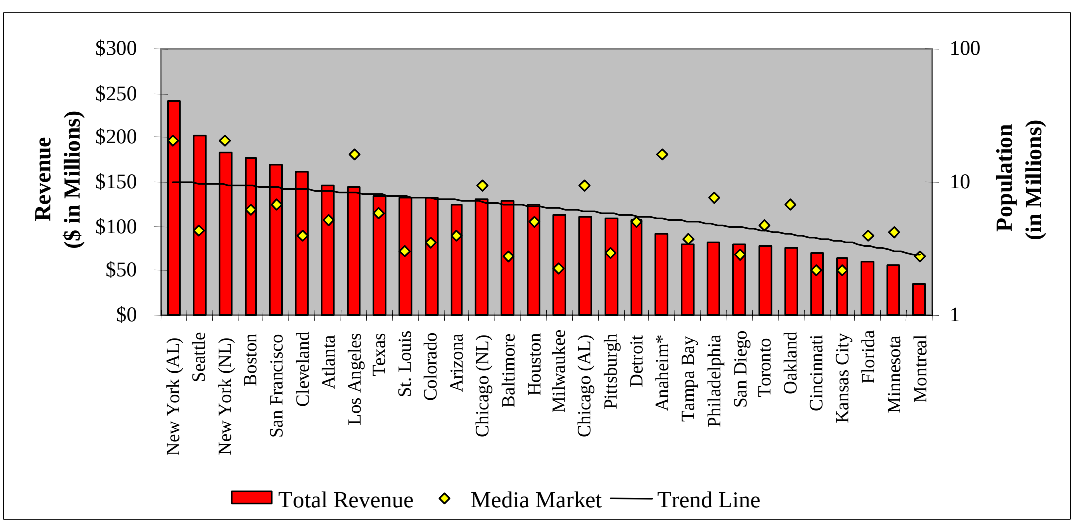


Source: MLB Blue Ribbon Report; MLB.

This disparity is reflective of Major League Baseball's revenue polarization in general. Since 1996, average local revenues for the top quartile teams have grown at an annual rate of 23%, compared to 5% for the bottom quartile teams.

Market Size Constraints
Local revenues, and thus total revenues, are driven primarily by market size, though there is evidence that a mid-market MLB team can be competitive in a new ballpark (for example, Seattle and Cleveland each ranked among the top six in terms of revenues in 2001). Exhibit 8 demonstrates that the top revenue teams are, generally speaking, located in the largest markets.

Exhibit 8
MLB 2001 Revenue vs. Market Size



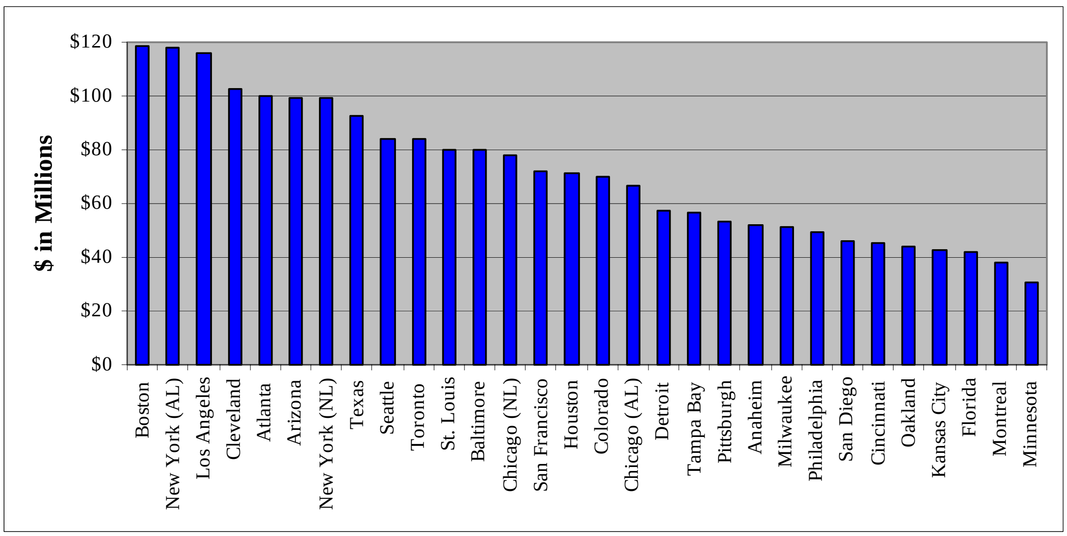
Source: Sales & Marketing Management; MLB.
** Anaheim is part of the Los Angeles media market.*

MLB Payroll Disparity

Revenues drive player payroll. From 1996 to 2001, the average MLB team payroll increased by $37.9 million, or 113%, from $33.5 million to $71.4 million. While payrolls have grown, payroll disparity has grown faster. The payroll difference between the average top and bottom quartile teams was $64.9 million in 2001, as compared to $19.3 million in 1996. Said another way, top quartile teams are growing payroll at 20% per year compared to 11% for bottom quartile teams.

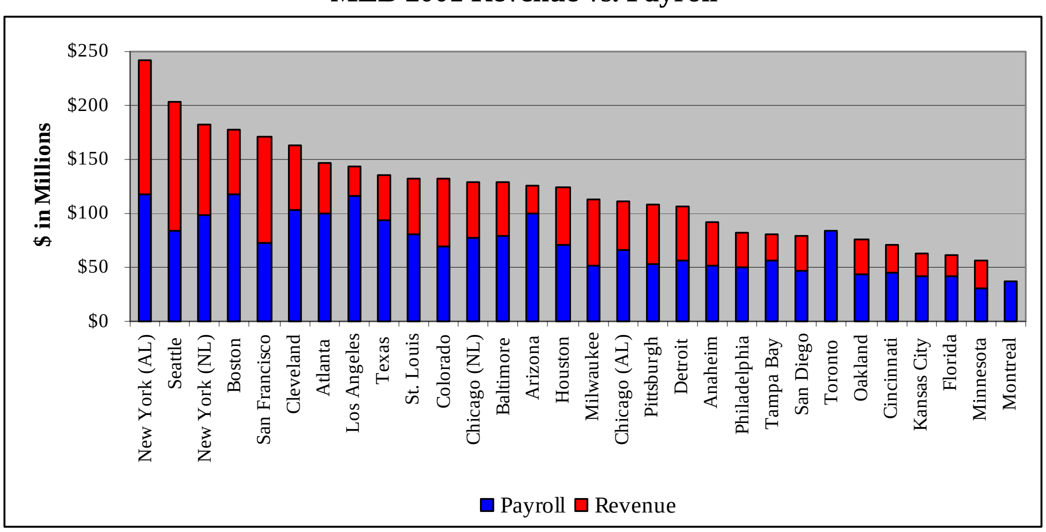
Exhibit 9 shows 2001 payrolls for the 30 MLB franchises. The Red Sox led the league with a payroll of $118.5 million, while the Twins had the lowest payroll at $30.5 million. Exhibit 10 illustrates by team the portion of revenue that is allocated to player payroll.

Exhibit 9
MLB 2001 Payrolls by Team



Source: MLB.

Exhibit 10
MLB 2001 Revenue vs. Payroll



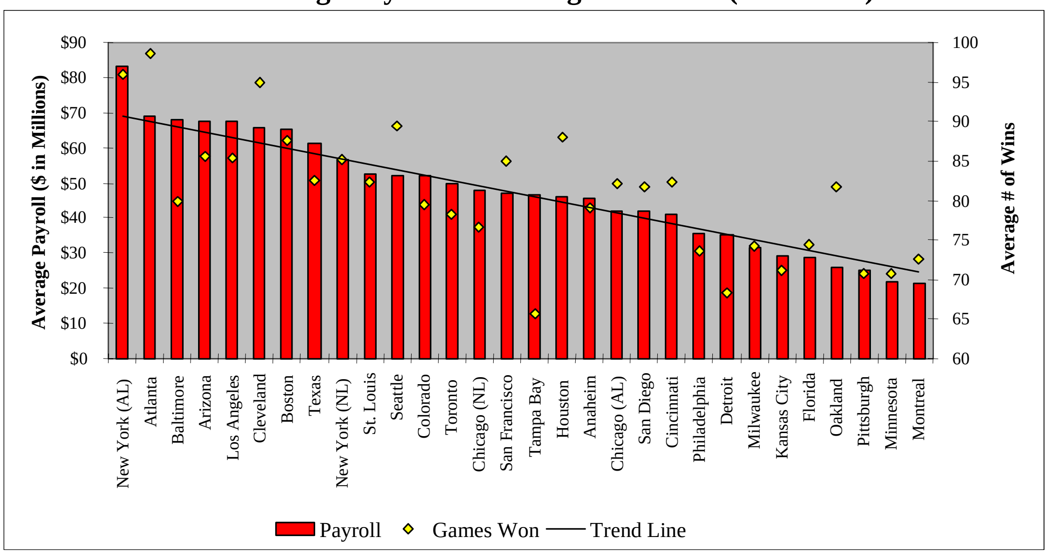
Source: MLB.

For many teams faced with slower-growing or even declining local revenues, the MLB payroll disparity situation has forced a choice. Given relatively fixed national revenues and non-player payroll expenses, these teams in large part have elected to further reduce their payroll rather than operate at an even greater loss. Not surprisingly, these payroll reductions have led to less and less success on the field.

Lack of Competitiveness

In general, payroll drives on-field success. While team chemistry, player evaluation and management also contribute, it is evident that a club's payroll is an increasingly important element. Exhibit 11 plots average payroll versus the average number of wins for each MLB team since 1995. Exhibit 12 examines the average payroll for clubs that qualified for the playoffs from 1996 to 2001 versus those that did not (omits 1995 because it was a strike-shortened season).

Exhibit 11
MLB Average Payroll vs. Average # of Wins (1995-2001)*



** 1995 wins based on that season's winning percentage projected out for a 162-game schedule.*
Source: MLB; MLB Blue Ribbon Report; CNNSI.com; Moag & Company Research.

Exhibit 12
MLB Payroll: Playoff vs. Non-Playoff Teams

($ in Millions)	1996	1997	1998	1999	2000	2001
Average Payroll of Playoff Teams	$ 46.1	$ 53.3	$ 58.1	$ 75.4	$ 75.5	$ 77.7
Average Payroll of Other Teams	28.5	34.5	36.7	40.3	61.6	59.6

Source: MLB; MLB Blue Ribbon Report; CNNSI.com; Moag & Company Research.

From 1995 to 2001, a total of 224 postseason games were played. During this period, clubs with payrolls less than the league average won five postseason games, clubs not in the top quartile in terms of payroll won zero World Series games, and no club with a payroll less than the league average even appeared in a World Series.

PART III: MAJOR LEAGUE BASEBALL'S ATTEMPTS TO GROW REVENUES AND CUT COSTS

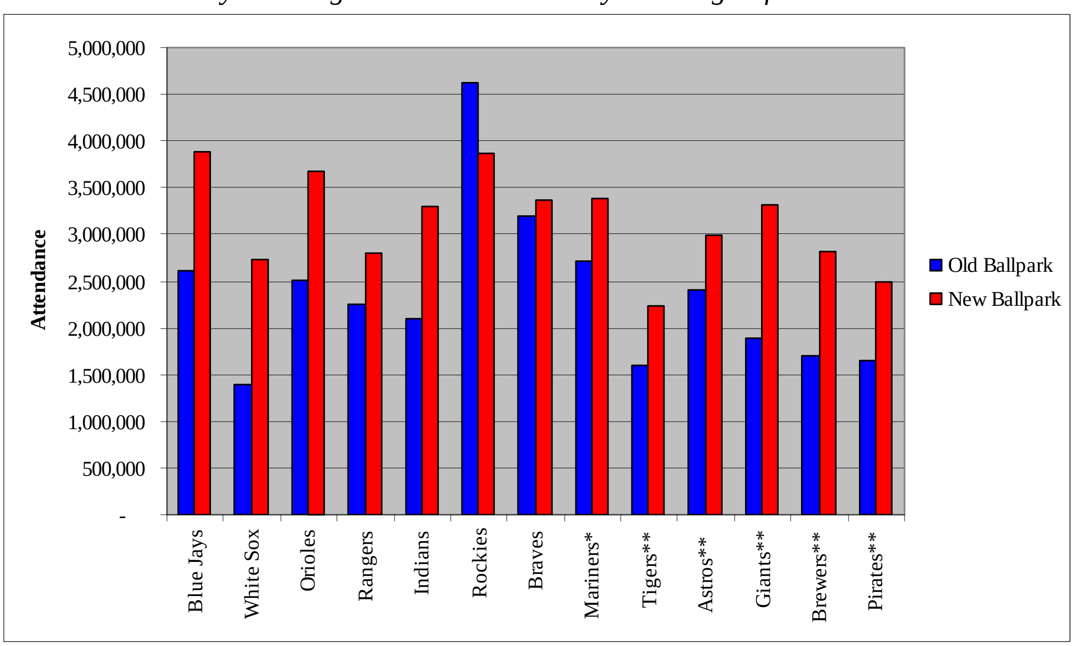
To address the fact that upwards of 20 MLB teams lose money on an annual basis, that total industry losses have averaged more than $200 million per year since 1995, and that average salaries have increased faster than average revenues over the same period, Major League Baseball and its member clubs have embarked upon a number of initiatives designed to increase revenues or reduce costs. Four of these initiatives – two deemed proactive and two deemed reactive – are detailed below.

Proactive – New Ballparks

Early Examples

From 1989 to 1999, eight new ballparks were built for non-expansion teams. Following the Sky Dome in Toronto were Comiskey Park in Chicago, Camden Yards in Baltimore, Jacobs Field in Cleveland, The Ballpark at Arlington in Texas, Coors Field in Denver, Turner Field in Atlanta, and Safeco Field in Seattle. Exhibit 13 displays the average total attendance for these teams for the three seasons prior to moving compared to the first three seasons in their new ballpark. With the exception of the Rockies, who moved into a smaller ballpark, each team experienced a significant increase in attendance. In fact, only the White Sox, who nonetheless doubled attendance, and the Rangers, who suffered from post-strike repercussions, failed to average more than 3 million fans in their first three years in their new parks.

Exhibit 13
MLB Attendance Increase in New Ballparks
3-yr. Average Prior to Move vs. 3-yr. Average After Move



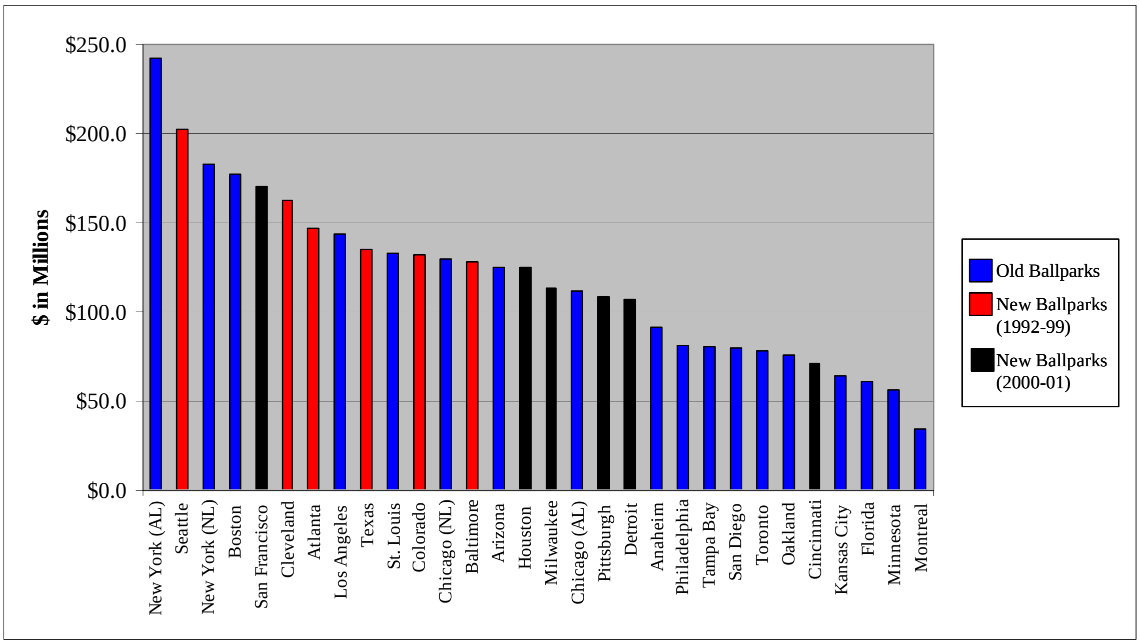
Source: Moag & Company Research.

* *Mariners played 42 games at Safeco Field in 1999; total attendance used for that season is implied total attendance for 81 games at Safeco.*

** *Tigers, Astros and Giants new stadium averages are 2-year averages; Brewers and Pirates new stadium averages are 1-year averages.*

Exhibit 14 displays the 2001 revenue figures for all MLB franchises. The six teams that built new ballparks between 1992 and 1999 each ranked among the top 13 in terms of 2001 total revenue, even though some of these teams are located in relatively small markets. Revenue increases allowed these teams to spend more on payroll and become or remain competitive on the field. In fact, each of these teams has made at least one playoff appearance since moving into their new home, highlighted by the Braves, who have won five division titles in five years at Turner Field, the Indians, who have won six division titles in eight years at Jacobs Field, and the Mariners, who set a major league record for wins in their second full season at Safeco Field.

Exhibit 14
MLB 2001 Revenues: Old Ballparks vs. New Ballparks



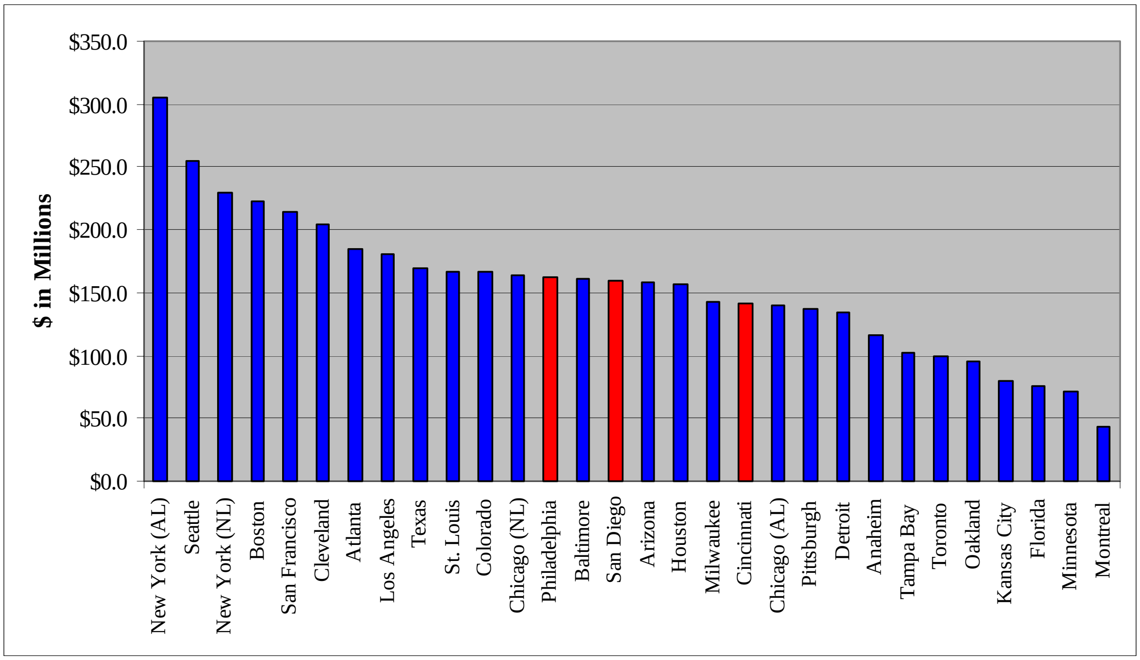
Source: MLB.

Later Examples
Given the handful of large-market teams and the number of teams already in new ballparks, a new ballpark no longer guarantees a place among MLB's high-revenue teams. In 2000, new ballparks opened in Detroit, Houston and San Francisco. In 2001, the Brewers and Pirates moved into new homes. Again, Exhibit 13 provides a before-and-after summary of attendance for these teams. Note that while all but two teams from the earlier phase of new parks averaged more than 3 million fans, only the Giants have averaged more than 3 million fans in the more recent phase.

Exhibit 14 shows that these teams, with the exception of the Giants, did not excel from a revenue standpoint in 2001, especially compared to teams that built ballparks from 1992-1999. Teams are finding that even a large increase in attendance does not translate into a position among the top revenue teams, but rather allows them simply to "catch up" with the other teams in new ballparks. With the newest ballparks serving only to move teams from the bottom of the revenue pack to the middle, combined with ballpark deals that involve increasing private contributions (in other words, increased team debt), these teams have not been able to have the same on-field success as the teams that built parks in the 1990s. Of the latter group, only the Astros and Giants have made the playoffs since moving.

The trend of new stadiums allowing teams to move only to the middle of the pack should continue into the foreseeable future. The Reds, Phillies and Padres all expect to move into new ballparks by 2004. Exhibit 15 displays a projected revenue chart for the 2004 season, assuming new ballparks for these three franchises. To arrive at the revenue figures, 2001 revenue for the other 27 teams was increased annually by 8%, while 2004 revenue for the Phillies, Padres and Reds represents a 100% increase over 2001. Even with revenue doubling, the Phillies, Padres and Reds would only move into 13th, 15th and 19th place, respectively, in total revenue, and the teams' increased ballpark debt may mitigate even these gains.

Exhibit 15
MLB 2004 Projected Revenues
Assumes Phillies, Padres and Reds Move into New Ballparks



Source: Moag & Company Research.

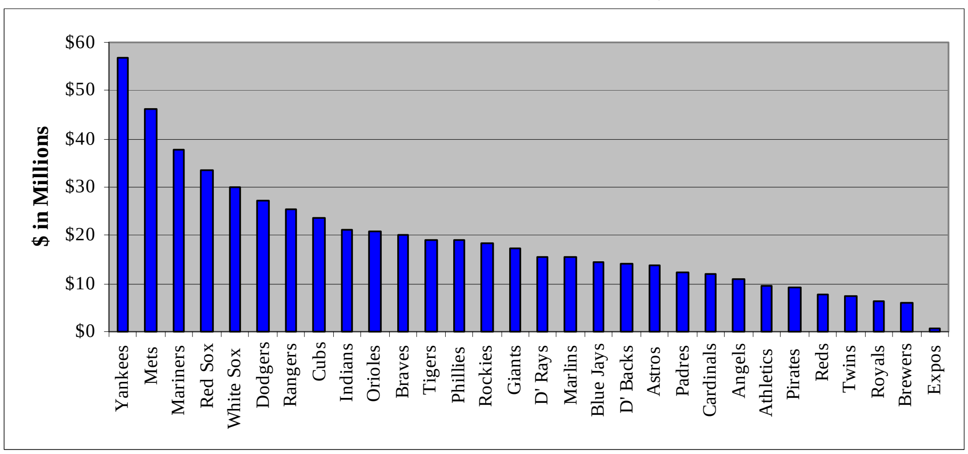
Proactive – Local Cable Television

The sale of the Boston Red Sox for the record price of $700 million included an 80% stake in the New England Sports Network (NESN), clearly showing the importance of local media to the value of a franchise.

Local media has also grown in importance relative to a team's bottom line, as local media revenues represented 20% of total MLB local revenues in 2001. As Exhibit 16 demonstrates, however, local media revenue has served only to exacerbate the revenue disparity between large- and small-market teams. Franchises in larger, more densely populated markets are able to command higher rights fees – on the order of six to ten times higher – than their smaller market brethren. For instance, teams in Milwaukee, Pittsburgh, Anaheim, Oakland, Cincinnati, Kansas City and Minnesota generated as much in the way of local media revenues collectively as did the New York Yankees on their own.

A further development that will only contribute to this disparity (if not to the debate regarding the accuracy of the numbers reported by MLB clubs) is the formation of franchise-owned television networks like NESN. The most prominent example, the Yankees Entertainment and Sports (YES!) Network in New York, is 60% owned by YankeeNets (the parent company of the New York Yankees, the NBA New Jersey Nets and NHL New Jersey Devils), and is expected to double the local television revenue received by the Yankees, which is already the highest in baseball. The network will also control a meaningful segment of the New York region's sports content.

Exhibit 16
MLB 2001 Local Media Revenue by Team



Source: MLB.

Reactive – Contraction

Less than 48 hours after the Diamondbacks defeated the Yankees in one of the most dramatic World Series ever, Commissioner Selig announced to baseball fans that,

> *"After long and arduous study, we have determined that there is no other acceptable current solution but to contract two teams. It makes no sense for Major League Baseball to be in markets that generate insufficient local revenues to justify the investment in the franchise. The teams to be contracted had a long record of failing to generate enough revenues to operate a viable Major League franchise."*

Major League Baseball's owners voted overwhelmingly (28 to 2) to authorize Selig to begin the process of contracting two teams (that would turn out to be Minnesota and Montreal) prior to the start of the 2002 season, and many within the League favored extending contraction to include four teams.

The rationale for contraction, at least from the League's point of view, is clear. Contraction would make good on Selig's threats to relocate or contract franchises that have not secured new, revenue-producing ballparks, and it would create an open market where other struggling franchises could move (or for expansion). In other words, if a team was unable to gain support for a new, publicly-financed ballpark, the League would be able to threaten to move the team to the once-spurned/now-open market, where officials and fans would be willing to spend significant sums of money to attract a new team.

The Players have insisted that contraction is subject to collective bargaining. The Players do not want 50 of their jobs eliminated and have said that the owners must negotiate contraction. The owners, on the other hand, have said that the Players have no say in the matter. This disagreement between the League and the Players was sufficient to delay any action regarding contraction until after the 2002 season. Nonetheless, Commissioner Selig reaffirmed that Major League Baseball is fully committed to contraction of at least two teams and will continue with the contraction process, even though that process will not be completed until the 2003 season.

Economics of Contraction

The cost of contraction is only partially known. Major League Baseball bought the Montreal Expos from owner Jeffrey Loria for $120 million, or roughly 2x revenues. Presuming for sake of this discussion that Minnesota was also contracted, and applying a similar revenue multiple, the cost to buy the Twins from owner Carl Pohlad would be approximately $150 million. Then, in addition to the $270 million required to buy out the two major league clubs, the League would also likely have to buy out all of their minor league franchises and any long-term contracts that either the major or minor league teams have. Estimates of the total cost run as high as $500 million or more.

The benefits of contraction are somewhat simpler to quantify. Contracting the Expos eliminates baseball's foremost money pit – the Expos rank last in attendance and effectively every revenue category, have virtually no hope of improving their situation in Montreal and, at $28.5 million, were the largest recipients of revenue sharing dollars in 2001. Not surprisingly, Minnesota was the second largest beneficiary of Major League Baseball revenue sharing ($19.1 million). Collectively, the contraction of those two teams represents $47.6 million that can be distributed to the remaining 28 teams (this assumes that the League does not move to increase revenue sharing, which would surely increase that amount). In 2001, the League also would have had an additional $48.8 million – the amount of national television and licensing revenue received by the Expos and Twins – to share among the other 28 teams. Finally, after paying the owners of the eliminated teams, and making up at least a portion of that money by saving on revenue sharing and collecting those teams' shares of national revenues over a number of years, baseball would have a chance to extract a large check for an expansion franchise.

Alternative: Relocation
Given the logistical nightmares associated with contracting only one team (for instance, one team would always be 'off'), a new ballpark in Minnesota, for example, would likely mean a reprieve for both the Twins and the Expos, though it is very unlikely the Expos franchise would remain north of the border when relatively fertile markets such as Washington, D.C./Northern Virginia, Portland, Sacramento, Indianapolis and Charlotte are without Major League Baseball. If an ownership group in one of these markets could afford to pay an 'expansion fee' and build a new ballpark, it would affect the same revenue sharing savings as would be realized by contracting the Expos. Commissioner Selig has stated that MLB "will continue to review relocation as a long-term solution as we work to stabilize the industry's economics."

Reactive – Controlling Payroll through the 60/40 Rule

What is it?
When initially reported that Commissioner Selig sent a letter to the 30 MLB clubs spelling out the terms of the "60/40 Rule", it was inferred that the motivation was Selig's fear that mounting debt could force one or more teams into bankruptcy. After all, even the World Series Champion Arizona Diamondbacks had made repeated capital calls just to stay afloat. It has quickly become apparent, however, that Selig instead had his eye on team payrolls and the ongoing discussions with the Players.

The "60/40 Rule", written by then-Milwaukee Brewers owner Selig some 27 years ago, stipulates that a club must maintain a ratio of 60% assets to 40% liabilities. Enforcement of the rule has been lax for a decade or more, as baseball attempted to rebuild itself after the 1994-95 Players' strike, and underwent a building boom characterized by significant stadium debt. In addition to signaling his intention to begin progressive enforcement of the rule, however, Selig also redefined liabilities to include stadium-related debt and long-term player contracts.

Selig told the owners that they have until June to comply with the rule or face possible fines, the loss of payments of national revenues and the threat of being put in trusteeship. Selig also told teams that they would be valued at 2x revenues for purposes of this calculation.

What are the ramifications?
On one hand, the announcement of the "60/40 Rule" can be viewed as a somewhat innocent negotiating ploy, as it will certainly now take its place among the items being negotiated between the League and the Players. The Players believe that clubs could be deterred from signing players to lucrative long-term contracts if those contracts could take the teams out of compliance with the rule, and are thus opposed to its unilateral enforcement.

On the other hand, Selig himself has said that the 30 MLB franchises are carrying more than $3 billion in debt, or more than $100 million per team. Given that average franchise revenues were $118.3 million in 2001, and based on the 2x revenue multiple, it follows that the average MLB franchise is already out of compliance ($237 million/$100 million = 58%/42%). Particularly hard hit will be those teams that, with Selig's full support, have incurred debt in the proactive pursuit of the construction of a new ballpark.

In fact, when factoring in long-term player contracts, even the most solvent franchises exceed the debt ratio limit. It is likely that the biggest violators of the debt ratio for the foreseeable future will be relatively well-healed teams like Colorado ($344 million committed beyond this season), Texas ($241 million to ARod alone) and the New York Yankees ($630 million).

Given the number and names of the teams that are out of compliance, it is unlikely that enforcement of the “60/40 Rule” will ever rise to a level such that it has the desired effect of significantly reducing player salaries.

PART IV: MAJOR LEAGUE BASEBALL'S ATTEMPTS TO RESTORE FINANCIAL AND COMPETITIVE BALANCE

In addition to the measures designed to increase revenues and reduce costs, Major League Baseball also has made an effort to address its financial and competitive balance issues. Two of those efforts, limited revenue sharing and the luxury tax, are detailed below.

Limited Revenue Sharing

What is the current system?
In an effort to rectify the large revenue disparity and restore competitive balance among its teams, Major League Baseball introduced its current revenue sharing system in 1996. The system is designed to help balance local revenues among the 30 MLB clubs by shifting such revenues from high-revenue to low-revenue teams.

Currently, MLB uses a split pool revenue sharing plan. Under the plan, each team contributes 20% of its net local revenue to a common pool. The pool is distributed as follows: (i) 75% of the money is distributed equally to all teams and (ii) the remaining 25% is distributed among the teams that fall below the league average in local revenue.

Is it working?
MLB's revenue sharing plan has allowed low-revenue teams to become more financially competitive; however, the plan has flaws that have prevented MLB from achieving a competitive balance on the field.

One issue with the current system is the amount of local revenue that is contributed to the pool. A 20% contribution from each team may not be sufficient to close the large gap in local revenue that exists between teams. Given that 75% of the contributions are redistributed evenly among the 30 teams, there is little remaining for the low-revenue teams. Essentially, after the initial distributions are made to all the teams, the low-revenue teams are splitting 5% of the league's total local revenue.

A second point of contention with the current plan is the use of the split pool system, which allows low-revenue teams to receive a disproportionate amount of the pooled revenue. The split pool system has been criticized for turning revenue sharing into charity – allowing low-revenue teams to turn a profit but not incentivizing them to invest in their product. The alternative is the straight pool system, which calls for an even distribution among all teams.

Overall, results on the field indicate that revenue sharing has been ineffective in creating a competitive balance.

Luxury Tax

What was tried?
MLB's most recent Collective Bargaining Agreement included a luxury tax for the 1997, 1998 and 1999 seasons. The threshold for the tax was set at the midpoint between the fifth and sixth highest payrolls in the league. The teams with the five highest payrolls paid a tax on the difference between their payroll and the designated threshold. The tax rate was 35% for the 1997 and 1998 seasons and decreased to 34% for the 1999 season.

During the three seasons the tax was in place, a total of $30.6 million was paid. The Orioles and Yankees paid the most, with totals of $10.6 million and $9.9 million, respectively.

Why didn't it work?
Baseball's luxury tax experiment failed in its attempt to keep payrolls at reasonable levels and also failed to close the gap between low and high payrolls. With the threshold adjusting yearly based on team payrolls, teams on the upper end of the payroll scale had little incentive to take cost-controlling measures with respect to their payrolls. As payrolls increased, the threshold adjusted upward, so the taxable portion of payrolls did not fluctuate greatly. Similar to revenue sharing, baseball's luxury tax also failed to incentivize lower payroll teams to increase their spending.

Baseball's luxury tax did not lead to its intended results. Low-revenue teams kept their payroll down while receiving financial benefits from the luxury tax. High-revenue teams did not feel pressure to keep their payroll levels down because the adjustable threshold meant little variation in the amount of tax paid. In the end, the payroll gap did not close, but rather widened.

PART V: WHAT IS AT STAKE?

Recent History

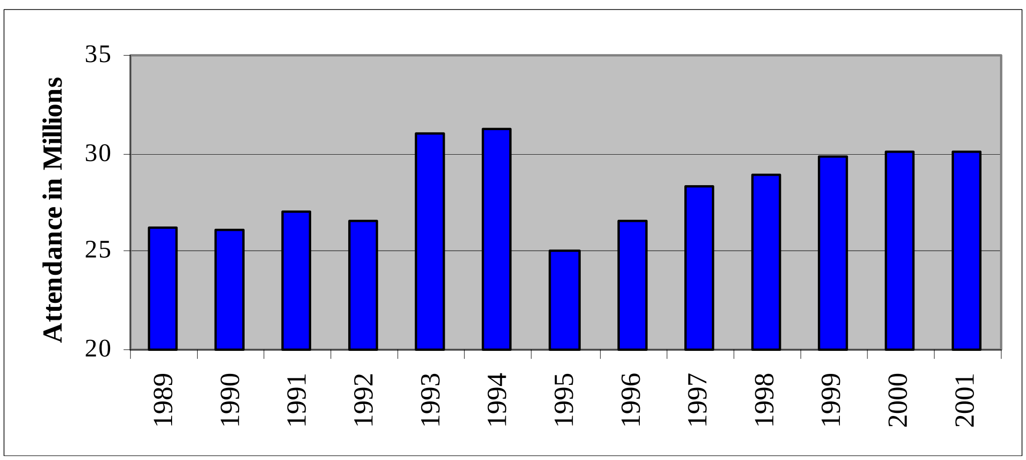
The Players' strike that cut short the 1994 season was the 8th work stoppage in baseball since 1972 and the longest ever in professional sports history. It was the only strike to cause the cancellation of the playoffs and World Series and it delayed the start of the 1995 baseball season. The strike also halted years of unprecedented growth within the league. The work stoppage resulted in a tremendous amount of indifference among fans, reduced national media revenues and caused hundreds of millions of dollars in losses for the team owners. The looming question is whether baseball can survive a second work stoppage in less than a decade.

Lessons from 1994-95 Work Stoppage

Attendance

Fan reaction to the 1994-95 strike demonstrates the danger a work stoppage poses to MLB. The 1994-95 strike canceled a World Series for the first time in almost a century and resulted in a dramatic decline in attendance. Given its current levels of operating losses, MLB can ill-afford another similar drop-off in attendance and the resultant loss of revenues. Exhibit 17 shows total attendance for MLB leading up to and following the most recent strike.

Exhibit 17
MLB Annual Attendance

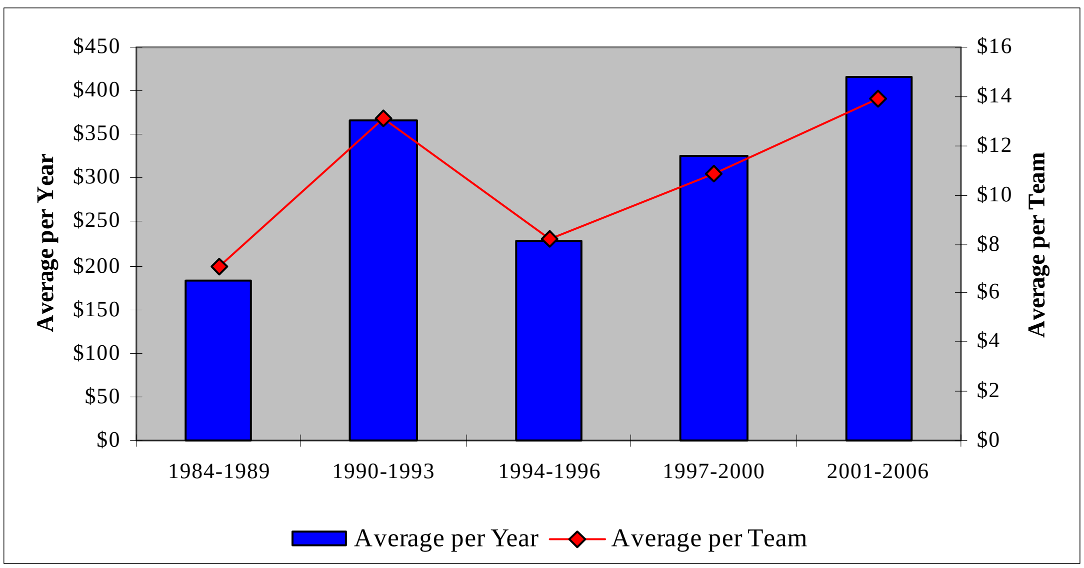


Source: Moag & Company Research.

Television Contracts
Exhibit 18 displays historical annual values for MLB's national television contracts. The deal covering the 1994 season through the 1996 season was significantly lower than the deal that preceded it, due in large part to the threat of a strike that eventually ensued. The deal covering 1997 through 2000 was also lower than the deal that preceded the contract signed under the threat of a strike.

MLB recently signed a six-year, $2.5 billion national television deal that runs through the 2006 season, so while a work stoppage would not immediately impact the value of the league's TV contracts at the national level, it would impact the timing of payments received under these contracts, as the networks would undoubtedly withhold payments during the work stoppage. Given that the 1994-95 strike negatively impacted the league in television negotiations, it is reasonable to believe a work stoppage or threat of a work stoppage now would negatively impact teams as they negotiate local media deals.

Exhibit 18
MLB National Media Rights Fees
($ in millions)



Source: Moag & Company Research.

Current Situation

Many of the issues that resulted in the 1994-95 MLB work stoppage figure prominently among the issues facing MLB today. The most recent MLB collective bargaining agreement expired after the World Series in November 2001. Thus, entering the 2002 season, the Players are operating (willingly) under an expired agreement and both sides are braced for another work stoppage if a new labor agreement cannot be reached.

In addition to a post-strike decline in attendance and a negative impact on TV contract negotiations, a work stoppage would have more basic ramifications. Specifically, teams would not generate revenues, the Players would not get paid, and fans and sponsors would seek alternative outlets. On a macro level, the municipalities that in many cases have helped fund the construction of new venues will suffer the effects of vacant ballparks and the resulting slowdown in economic activity in surrounding areas.

Part VI: Current Recommendations and Proposals

Given the relative ineffectiveness of its previous efforts, Major League Baseball is reviewing a handful of new options that emerged as recommendations of the Commissioner's Blue Ribbon Panel. These options are detailed below and are followed by a hypothetical compromise solution.

Revenue Sharing

Blue Ribbon Report Recommendation
The Blue Ribbon Report concluded that, in order to achieve competitive balance, MLB needed to increase revenue sharing to 40-50% of each team's local revenues. The report also concluded that the League should switch to a straight pool plan, under which the pooled revenues would be split evenly among the 30 teams.

League Position
League officials have stated that they favor a straight pool revenue sharing plan with an increased contribution from each team, similar to the recommendations of the Blue Ribbon Report. Commissioner Selig has indicated that he would like revenue sharing equal to 50% of local revenue, with deductions for ballpark expenses.

Players Position
The Players favor a much smaller increase in revenue sharing. The MLBPA's latest proposal includes an increase in local revenue sharing from 20% per team to 22.5%. The Players also favor maintaining the split pool system, where low-revenue teams receive a disproportionate amount of the pooled local revenues.

Luxury Tax in lieu of a Salary Cap

Blue Ribbon Report Recommendation
The Blue Ribbon Report also suggests the use of a 50% luxury tax, which it refers to as a "competitive balance tax." Although not a formal salary cap, the luxury tax would serve a similar purpose. The Report recommends a fixed tax threshold of $84 million.

League Position
The League would like to implement a luxury tax on payrolls greater than $98 million. Any team with a payroll greater than this amount would be taxed on the excess portion at a rate of 50%.

Players Position
The luxury tax is clearly unfavorable from the Players' standpoint because it could potentially cause large-market teams to spend more judiciously in the free agent market. The Players want teams to be able to spend as much as they are capable of spending on payroll without the threat of being heavily taxed.

Salary "Floor"

Blue Ribbon Report Recommendation
To ensure that low-revenue teams make an effort to be competitive on the field, rather than reducing payroll and relying on revenue sharing to remain profitable, the Blue Ribbon Report recommends a salary floor of $40 million.

Neither the League nor the Players has formally proposed a salary floor.

Compromise?

Rather than debating the absolute level of local revenue sharing or the use of a split versus straight pool, a different approach may be required to bridge both the gap between the League and the Players and the one between the League's member clubs. We would like to conclude this newsletter with an unsolicited proposal.

BALANCE AMONG TEAMS THROUGH ECONOMIC RESTRUCTURING (BATTER)[1]

Instead of "tithing" to the poor teams, taxes on high-payroll teams and salary caps or floors, we propose giving the franchises and the Players "ownership stakes" in baseball's various revenue streams. We believe that any resolution of the industry's economic issues requires all parties involved – the League, the owners, the Players and the fans – to have a direct and vested interest in the economic success of the enterprise. On that premise, we make the following qualifying statements around which we build a possible new economic model for Major League Baseball:

- Most importantly, fan attendance and ticket purchases should have a tangible effect on the product on the field. We propose that 100% of all gate receipts go directly to the home team's player payroll. This would establish a more permanent and meaningful link between the fans and the players and teams they support. Fans will know their support of the team has consequence, and players will know their salaries are a function of their collective on-field performance.

- National revenues are currently shared equally among the 30 teams. We believe that a percentage should be earmarked for the Players. Designate 65% for player compensation, and let the owners share the remaining 35%.

- Local television revenues, as much as any other factor, are responsible for the growing disparity between baseball's "haves" and the "have-nots". Given that any team's local television revenues are valuable only because there is an opponent for the local 'nine', sharing a larger percentage of these revenues equally among the 30 teams can be justified. As they are the feature presentation, the Players should also share in these television revenues. To accomplish this, allocate 50% of local television revenues directly to Players.

- As for other local revenues, the relative ability of each franchise to deliver quality baseball in an enjoyable environment, as well as to develop its respective market should be rewarded and/or punished at the bottom line. As such, allowing teams to budget 100% of other local revenues against non-player payroll expenses will provide an incentive for all teams – high- and low-revenue alike – to maximize existing, and aggressively pursue potential revenue opportunities while, at the same time, keeping an eye on costs.

[1] Pardon the acronym – we couldn't help ourselves! Admittedly, the mechanics involved in implementing our Balance Among Teams Through Economic Restructuring Unsolicited Proposal (BATTER UP) are more complicated in real-life than on a spreadsheet. Our intent is solely to describe a potential framework for constructive discussion.

In short, this model provides:

- To fans, the benefit of knowing that the dollars they spend on increasingly expensive ticket prices are being plowed back into the product they are paying to see. They will know that they can influence the home team's success by choosing to attend games.

- To Players, Payroll determined as follows:
  - 100% of Game Receipts
  - 65% of National Revenues
  - 50% of Local Media Revenues

- To Team Owners, retained revenues as follows:
  - 35% of National Revenues
  - 50% of Local Media Revenues
  - 100% of Other Local Revenues

This model should result in across-the-board increases in income for both owners and players. It should also result in more balanced competition as player payroll will be tied to dedicated sources that are largely shared equally among the 30 teams. The lone variable involved in determining player payroll will be gate receipts – the greater a team's support from its fans, the higher the team's payroll.

This model effectively guarantees annual payroll increases for the players, so long as MLB revenues continue to increase. Over the next seven years, for example, the average team payroll will increase by 11% per year, from $71 million to $145 million. For the owners, this model will improve operating income for two-thirds of MLB teams by 2004, and by 2008, 25 teams will turn an operating profit (compared to nine in 2001). Of the five holdouts, Pittsburgh effectively breaks even, leaving four teams – Florida, Kansas City, Minnesota and Oakland – who represent baseball's short list for clubs that require new ballparks or new markets.

Exhibit 19 quantifies the impact of this model.

Exhibit 19
Potential Revenue Sharing Scenario

	2001 Actual	2001 Pro Forma	2004 Pro Forma	2006 Pro Forma	2008 Pro Forma
Team Revenues: **Average** **Range**	$118 million $63M - $216M	$118 million $44M - $212M	$166 million $83M - $282M	$200 million $101M - $341M	$242 million $122M - $413M
Team Payroll: **Average** **Range**	$71 million $30M - $118M	$71 million $32M - $123M	$99 million $56M - $164M	$120 million $68M - $199M	$145 million $82M - $241M
MLB Income from Baseball Operations	($232 million)	($232 million)	$54 million	$275 million	$564 million
Change from 2001	- -	*unchanged*	*+ $286 million*	*+ $507 million*	*+ $796 million*
Total Player Compensation	$2.1 billion	$2.1 billion	$3.0 billion	$3.6 billion	$4.3 billion
Change from 2001	- -	*unchanged*	*+ 38% overall* *+ 11% per year*	*+ 68% overall* *+ 11% per year*	*+ 103% overall* *+ 11% per year*
# Teams Improved	- -	13 of 30	21 of 30	23 of 30	25 of 30

Notes:
1. Pro Forma columns are based on the Revenue Sharing and Player Payroll assumptions listed above Exhibit 19.
2. Team Revenues are net of Revenue Sharing.
3. Operating Income calculations assume all revenue items grow by 10% per year and non-player payroll expenses grow by 5% per year.
4. # Teams Improved represents the number of teams whose operating income improves relative to 2001 Actual.
5. Montreal is assumed to relocate in 2003. Cincinnati, Philadelphia and San Diego are assumed to move into new ballparks in 2004.

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