

## **Arsenal's Financial Performance**

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### **Abstract**

The football industry is a good study in the basics of finance. The economics of the football industry, and the financial statements of football clubs, are fairly simple. But football is a famously difficult business to make money in – the value is mostly captured by the employees.

In 2000 Arsenal Football Club faced a strategic challenge. Its legendary Highbury Stadium was too small for one of the world's top 10 football clubs. But the cost of replacing it was potentially onerous and would leave Arsenal little to spend on players for a few seasons, posing an equal threat to Arsenal's survival. The case examines how this choice between people and infrastructure affected financial performance.

This case was prepared by Professor Chris Higson with assistance from Julie Conder. The case study was prepared in 2008 from publicly available information, and revised in 2009, as a basis for class discussion rather than to illustrate either the effective or ineffective handling of an administrative situation.

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### Football's financial model

In financial terms, a big football club is a straightforward business. You need a stadium in which to play, and a training ground. You need a squad of perhaps fifty players and a few hundred other people to coach and manage the team, care for the ground and run the business. Your revenue has three legs: matchday revenues, broadcasting revenues, and commercialization.

'Matchday' revenues, principally ticket sales and hospitality, are the traditional source of any sports club's income. The big football clubs also now share in the proceeds from the global broadcasting rights. They also use this media profile to build a global brand and to profit from selling replica shirts and other merchandise. Exhibit 1 reports the 2008 revenues of the world's ten biggest clubs; the data are taken from accounting-firm Deloitte's annual football survey. In 2008, these clubs had revenues in the range €170m to €370m, with Real Madrid at the front of the pack by some margin, and Arsenal in sixth place.

**Exhibit 1 The largest clubs in 2008, in terms of revenue (figures in €m)**

	Revenue 2007/08	Attendance Average 2007/8	Capacity	Capacity Used %
Real Madrid	366	76,200	80,000	95%
Manchester United	325	75,700	76,200	99%
FC Barcelona	309	67,300	98,800	68%
Bayern Munich	295	69,000	69,000	100%
Chelsea	269	41,400	41,800	99%
Arsenal	264	60,100	60,400	100%
Liverpool	211	43,500	45,400	96%
AC Milan	210	55,900	80,100	70%
AS Roma	175	36,200	72,700	50%
Internazionale	173	51,400	80,100	64%

**Note:** English club revenues for each year have been converted from sterling to euros using the exchange rate as at 30 June 2008. Sterling had depreciated by 15% against the euro over the previous 12 months – converted at the June 2007 rate, Manchester United would have been the biggest club, with revenues of €382.

**Source:** Deloitte 2009 Football Money League

Although the financial model of big-club football may be simple, what is far from straightforward is making a good return for investors. The 'economic rent' to football tends to be captured by the players. While the big football clubs have seen big increases in all three sources of revenue in recent years, a lot of this finished up in the pockets of the players, whose salaries increased by 65% between 2000 and 2005 according to Deloitte.

Top football stars may be paid €5m to €10m a year. These people possess unique talents; they are immensely valuable 'intangible assets' to the clubs they play for and there is intense international competition for their services.

What is harder to explain is the income of journeyman players in professional football. There are perhaps 700 professionals playing for the 20 teams in the UK Premiership. According to The Guardian (April 11, 2006) the average Premiership footballer earned a basic salary of £676,000 (€880,000) with almost 30% earning over £1m (€1.3m<sup>1</sup>). In addition he would receive another 60% to 100% in bonuses – appearance money, win bonuses, signing-on fees, cup bonuses, goal bonuses and an end-of-season performance bonus. In the Championship, which is the second-tier league in the UK and employs perhaps 500 footballers, the average basic wage was £195,750. In the third-tier 'League One' it was £67,850, and in League Two around £50,000. There was a proposal to limit clubs from spending more than 75% of their income on wages.

<sup>1</sup> Assuming a £1: €1.3 exchange rate

### **Arsenal's challenge**

Under its French coach, Arsene Wenger, London's Arsenal FC has become one of the world's most admired big football clubs. Wenger is an astute operator in the market for footballing talent with an excellent network of contacts and talent scouts, especially in the French-speaking countries. He has a reputation for putting out teams that play elegant football.

Europe's biggest football ground is Barcelona's Camp Nou, which holds 98,772; Barcelona's long-term success must have been due, in part, to its early decision to build Camp Nou, in 1957. At the turn of the millenium, Arsenal faced a strategic challenge. The iconic Highbury Stadium in north London, where Arsenal had played for a century, was both out of date and far too small. Its capacity was 38,400 – the smallest of any of Arsenal's international peers. In the financially demanding world of big-club football this was a source of weakness, seriously limiting matchday income. One consequence was that Arsenal had more than 20,000 people on a waiting list for season tickets.

The approach of Manchester United had been to develop and enlarge the existing Old Trafford stadium to its current 76,000. But this was not an option for Arsenal. Highbury sat on a cramped urban site, hemmed in by roads and housing, and part of it was a historic building under a preservation order. After a lengthy search, Arsenal found an old industrial estate as a site for the new stadium, just 500 metres from Highbury. Planning, financing and construction delays meant that it took seven years between the announcement of the new stadium in November 1999 and its final commissioning in summer 2006. The new stadium would still only seat 60,000 spectators, but would contain a lot more executive and corporate accommodation.

The challenge would be paying for the stadium. Building from scratch on a new site was more costly than developing an existing stadium. And, whereas most big football clubs were owned by super-wealthy individuals with deep pockets, Arsenal remained a fairly democratic setup with shares traded on the stock market. So Arsenal had to borrow the money to pay for the stadium. The danger was that, for a few years at least, this would restrict expenditure on players.

Arsene Wenger was not one to understate the burden. He told the News of the World, the UK's leading Sunday tabloid newspaper, on 6th July, 2008, that Arsenal would probably have to sell their star players every year for nearly another two decades. *"The strategy of the club is to sell every year and to buy less expensive players. ... We manage at Arsenal to maintain all our football ambitions, national and European, while having to free up for 17 more years an annual surplus of £24 million to pay for our stadium."*

### **Financing the new stadium**

After a long search, Arsenal eventually chose an industrial estate at Ashburton Grove, just five hundred metres from Highbury, as the site for the new stadium. The plan was announced in November 1999, with a scheduled opening in August 2003 though this subsequently slipped three years. The stadium opened in July 2006. It had cost £430 million, though not all of this was for the stadium itself.

Work ceased shortly after commencement and only restarted when a £260m loan was raised from a consortium of banks, led by the Royal Bank of Scotland. On 13 July 2006, the club issued the first publicly-marketed, asset-backed bonds by a European club, replacing the bank debt with an issue of £210m of 13.5 year bonds at 0.52% over UK government bonds, and £50m of 7.1 year bonds at 0.22% over LIBOR.

Arsenal had a particularly wealthy London following and a high demand for tickets. The new stadium was designed to exploit this. The seating capacity was 60,355. 51071 was standard seating in two tiers. For the first season, adult ticket prices ranged from £32 to £66 for most matches, but £46 to £94 against top sides. Season ticket prices were between £885 and £1,825. The middle tier, the 'Club Level', has 7,139 seats, sold on licences lasting from one to four years and costing from £2,500 to £4,750 per season. These were sold out immediately. Another 2,222 spectators were housed in boxes of 10, 12 and 15 seats; the box prices started at £65,000 per year. The most exclusive area was the 'Diamond Club' which was invitation only and cost an initial £25,000, plus £25,000 a year. Tickets included use of a private lounge, a free restaurant and bar, valet parking and concierge service, and the opportunity to travel to games on the players' aeroplane.

In October 2004 Arsenal announced a £100m sponsorship deal with Emirates Airline, involving a naming deal for the stadium for the first 15 years and an eight-year shirt sponsorship starting in the 2006–07 season. Delaware North, which had a 20-year contract to run the stadium's catering operation, contributed £15m towards the capital costs of the catering facilities.

The spare ground around the new stadium was being developed as housing and Highbury itself was being converted into apartments, most of which had been presold. In total, more than 2,000 homes were to be built at three sites and the club expected the proceeds from these developments to significantly offset the costs of the new stadium in due course.

### Accounting review

Arsenal's 2007-2008 financial statements report the two year's results after the move to the new stadium. Some extracts accompany this case. Arsenal's financial year end is 31 May.

The *balance sheet* is a company's fundamental financial document. It lists the assets, and where the money came from to pay for them. The problem is, it can be an incomplete account of the assets and liabilities. And by default it carries the assets at what they cost, which may not be their value now. The company's *income statement* describes its revenues and costs, and thus its profit in the year.

Reviewing Arsenal's financial performance, we might have the following questions:

- *Property, plant and equipment (PPE)*. The biggest item by far in Arsenal's balance sheet is real estate. What does this relate to and how is it valued?
- *Development properties*. How much do the accounts tell us about the value of Arsenal's development properties?
- *People*. Football clubs are the only companies that put 'people' in the balance sheet. How much does Arsenal have on its balance sheet for players? Does this measure what the players are actually worth?
- *Borrowing*. How much was Arsenal borrowing by the end of financial year 2008?
- *Revenues*. What were Arsenal's sources of revenue in 2008, and how did this compare to the previous year?
- *Costs*. What did Arsenal spend on wages, and on interest payments, in 2008? Do they disclose the pay of individual players, or indeed of the footballers as opposed to other staff?

Table 1 summarizes Arsenal's financial statements for years 2000 to 2008.

#### *Property, plant and equipment (PPE)*

The biggest item by far in Arsenal's balance sheet is real estate, and the largest item of PPE is the new Emirates stadium. The costs of this – land, construction, and related costs – had been capitalised as 'Assets in course of construction'. When the stadium was brought into use, these costs (£327k) were transferred partly into 'Freehold properties' and partly into 'Plant and equipment' (Accounts 2007). Freehold land is not depreciated but the stadium is depreciated at 2% per annum, commencing with the date it became ready for use.

#### *Development properties*

The development property is included in Stocks, valued at the lower of cost and net realisable value. There was a net transfer from PPE to Stocks of £20.66m in the 2007 Accounts in respect of development property.

There is a bit more information in the Directors' Report:

*Revenue in the property segment fell to £15.3 million (2007 - £23.8 million) as sales activity was limited to the granting of certain leasehold interests and contracting work within the social housing element of the Highbury Square development. Profit from this Highbury Square sales activity was balanced by the carrying costs of our development site at Queensland Road.*

*We have now secured all of the land interests in the Queensland Road site, which lies to the south of Emirates Stadium, and we continue to progress the design of an appropriate redevelopment scheme and detailed planning permission for the site. This is proving to be a complex process - blending a mix of residential, commercial and regenerative elements - and we will not be able to finalise an on-sale of the site until it is complete.*

*Construction work at the Group's main development site, Highbury Square, has continued at an intensive level throughout the year and remains very much on a schedule which will see the completion of the majority of the residential units over the next year. ... we remain confident that Highbury Square represents a genuinely unique residential scheme in an excellent location. This view is supported by the sales position to date which continues to be positive. We have so far marketed 655 of the development's 680 private residential apartments and 598 of these are the subject of exchanged sale contracts. The first wave of 65 finished apartments in the South Stand was released at the end of July and sales have so far completed on apartments having a revenue value of £18.7 million. Sales as achieved will be included in the Group's 2008/09 financial results.*

### *People*

The Balance Sheet records the cost of player registrations, and this is amortized to income over the term of the player's contract. Provision is made in 'Other creditors' and 'Provisions' for additional fees that may become payable, contingent on the number of appearances the player makes. This figure based on historic costs and thus does not reflect the current market value of players signed to the club. It also does not record any 'home-grown' players the club employs.

### *Borrowing*

By the end of the financial year 2007 Arsenal had borrowings (bonds, bank loans, debentures) totalling £340m, partially offset by a cash balance of £74m. These borrowings were made to finance both the Emirates Stadium and the property developments. As expected, the borrowings rose further during 2008 for construction at the Highbury site, before sales of apartments came on stream. The equivalent figures at the end of 2008 were: debt £411.3m and cash £93.3m.

The Emirates stadium borrowings were refinanced during 2007, replacing the previous project loan with a fixed interest rate bond. Although this resulted in an exceptional charge to the Profit and Loss Account of £21.4m for the costs of the re-financing (and including a write-off of £11m of previously capitalised finance costs), annual debt service costs were reduced from £32m to £20m. To allay any fears supporters might have that the capital expenditure would hamper the Club in the transfer market, the Chairman insisted that "Significant funds were available to the manager during the summer transfer window... we were able to secure all his main targets".

### *Revenues*

In 2005, Arsenal's chief executive predicted the new stadium would increase Arsenal's revenue from £115 million to around £170 million. But the 2007 accounts showed Arsenal's revenue increasing to £200.8m, 46% more than the previous year and operating profits jumped to £41.6m, 268% more than 2006. In 2008 the increase is not so marked but is still significant: revenue is now £223m and operating profits £48m. Another significant figure on the Balance Sheet is 'Deferred income', which is income received in advance, including season tickets, executive boxes, sponsorship income, and the pre-sale of residential properties.

### *Costs*

Expenditure on wages and salaries in 2008 was £88.3m, with total staff costs (including social security and pension costs) amounting to £101.3m. The accounts do not disclose the pay of individual players however, nor is there any split of costs between playing and non-playing staff. In 2007 Earnings after tax dipped because of substantial interest expenses: financing costs relating to the construction of the Emirates Stadium that had previously been capitalised were now written off on the completion and refinancing of the project. In 2008 this figure shoots up, from £2.8m to £25.7m.

## **Arsenal's financial performance**

Table 2 calculates Arsenal's performance and gearing metrics.

Arsenal's earnings have fluctuated over the years, from a substantial profit of £24.3m in 2001, followed by a loss of £20.5m in 2002, then small profits leading up to £2.8m in 2007, and Arsenal has not paid a dividend. The difficult year in 2001/2 was attributed by the Chairman to a jump in the wages bill caused by an increase in the number of players, new contracts for both players and management, and payment of bonuses for winning the Premier League and FA Cup 'Double'.

EBIT (Earnings Before Interest and Tax) can be derived quite straight forwardly from Arsenal's published accounts as 'Profit on ordinary activities before finance charges'. EBIT in 2008 was £53,660k. Capital employed is measured as net debt, which is debt less cash and equivalents plus equity shareholders' funds. In 2008 capital employed was  $((142835+268502) - 93264 + 159100 = 318073 + 159100 =) £477,173k$ . Capital employed in 2007 was  $((4122+336090) - 73857 + 133374 =) £399,729k$ , so average capital employed in 2008 was  $((399729+477173)/2 =) £438,451$ .

ROCE (Return on Capital Employed) relates EBIT to average capital employed; in 2008 it was  $(53660/438451 =) 12.2\%$ . Arsenal's fluctuating returns have an upward trend; in 2008 ROCE rose from 10.7% in 2007 and 4.7% in 2006. However Arsenal has not quite achieved the return of 2001 when ROCE was 13.9%. At that time Arsenal had a net cash balance; by 2008 it had large loans and a gearing ratio of 66.7

Arsenal's shares are traded on the 'Plus' market, which is a 'junior' electronic market for infrequently traded shares – according to Plus, the price of transactions in early 2008 would have given Arsenal a market capitalisation of £525m, though this has dropped to £470m in the current stock market conditions of early 2009.

**Table 1 Arsenal financial statements (figures in £000, year end 31 May)**

**ARSENAL INCOME STATEMENT**

	2000	2001	2002	2003	2004	2005	2006	2007	2008
<b>SALES</b>	<b>61,260</b>	<b>62,911</b>	<b>90,967</b>	<b>117,831</b>	<b>156,887</b>	<b>138,395</b>	<b>137,237</b>	<b>200,843</b>	<b>222,970</b>
Operating expenses	-52,320	-64,267	-98,881	-95,012	-120,225	-105,764	-125,775	-158,685	-174,480
Amortisation of players	-10,172	-15,145	-17,681	-18,774	-26,406	-14,993	-15,401	-18,782	-21,757
Profit on disposal of players	22,216	25,121	2,873	1,370	2,282	2,894	19,150	18,467	26,458
Share of joint venture	0	-834	-512	-165	-67	204	499	435	469
Exceptional (disposal of intangible)		20,000							
<b>EBIT</b>	<b>20,984</b>	<b>27,786</b>	<b>-23,234</b>	<b>5,250</b>	<b>12,471</b>	<b>20,736</b>	<b>15,710</b>	<b>42,278</b>	<b>53,660</b>
Net interest	231	1,615	891	-721	-1,894	-1,471	175	-36,705	-16,992
Tax	-7,105	-5,145	1,781	-521	-2,425	-10,972	-7,983	-2,757	-10,942
<b>EARNINGS</b>	<b>14,110</b>	<b>24,256</b>	<b>-20,562</b>	<b>4,008</b>	<b>8,152</b>	<b>8,293</b>	<b>7,902</b>	<b>2,816</b>	<b>25,726</b>

**ARSENAL BALANCE SHEET**

	2000	2001	2002	2003	2004	2005	2006	2007	2008
Cash	7,261	42,502	14,680	1,351	26,003	71,629	35,598	73,857	93,264
Other Current Assets	22,168	40,032	39,575	58,264	70,055	63,764	93,939	137,391	235,461
<b>CURRENT ASSETS</b>	<b>29,429</b>	<b>82,534</b>	<b>54,255</b>	<b>59,615</b>	<b>96,058</b>	<b>135,393</b>	<b>129,537</b>	<b>211,248</b>	<b>328,725</b>
PPE	36,491	42,024	46,430	124,770	209,615	314,822	451,501	455,300	449,517
Player registrations	38,832	45,111	53,060	39,396	34,989	28,983	66,555	64,671	55,665
Investments & Other	0	0	0	0	0	0	0	76	406
<b>LONG-TERM ASSETS</b>	<b>75,323</b>	<b>87,135</b>	<b>99,490</b>	<b>164,166</b>	<b>244,604</b>	<b>343,805</b>	<b>518,056</b>	<b>520,047</b>	<b>505,588</b>
<b>TOTAL ASSETS</b>	<b>104,752</b>	<b>169,669</b>	<b>153,745</b>	<b>223,781</b>	<b>340,662</b>	<b>479,198</b>	<b>647,593</b>	<b>731,295</b>	<b>834,313</b>
Debt	0	0	0	47,180	23,715	19,572	22,816	4,122	142,835
Trade creditors	740	839	5,728	29,317	6,843	9,491	15,747	15,723	7,844
Accruals, deferred income, other	33,255	51,773	52,822	49,132	72,979	78,181	129,140	130,172	183,573
<b>CURRENT LIABILITIES</b>	<b>33,995</b>	<b>52,612</b>	<b>58,550</b>	<b>125,629</b>	<b>103,537</b>	<b>107,244</b>	<b>167,703</b>	<b>150,017</b>	<b>334,252</b>
Debt	14,438	14,438	14,438	14,438	143,556	205,388	274,926	336,090	268,502
Deferred income	1,851	3,906	2,051	815	2,439	27,739	35,471	68,680	31,782
Provisions, other	13,390	6,914	6,503	6,688	6,767	16,171	38,935	43,134	40,677
<b>LONG-TERM LIABILITIES</b>	<b>29,679</b>	<b>25,258</b>	<b>22,992</b>	<b>21,941</b>	<b>152,762</b>	<b>249,298</b>	<b>349,332</b>	<b>447,904</b>	<b>340,961</b>
Paid-in share capital	293	26,758	59	59	59	30,059	30,059	30,059	30,059
Retained earnings	40,785	65,041	45,445	49,453	57,605	65,898	73,800	76,616	102,342
Other reserves	0	0	26,699	26,699	26,699	26,699	26,699	26,699	26,699
<b>SHAREHOLDERS' FUNDS</b>	<b>41,078</b>	<b>91,799</b>	<b>72,203</b>	<b>76,211</b>	<b>84,363</b>	<b>122,656</b>	<b>130,558</b>	<b>133,374</b>	<b>159,100</b>
<b>TOTAL LIABILITIES&amp;S.FUNDS</b>	<b>104,752</b>	<b>169,669</b>	<b>153,745</b>	<b>223,781</b>	<b>340,662</b>	<b>479,198</b>	<b>647,593</b>	<b>731,295</b>	<b>834,313</b>

**Table 2 Arsenal financial performance**

	2000	2001	2002	2003	2004	2005	2006	2007	2008
<i>Revenues:</i>									
Gate & other match day	20,334	20,494	24,553	27,907	33,765	37,397	44,099	90,613	94,580
Broadcasting	35,935	37,337	45,342	51,802	59,780	48,594	54,870	44,312	68,360
Retail	4,991	5,080	4,940	8,534	6,885	8,389	10,218	12,064	13,052
Commercial			15,767	15,558	14,132	20,703	22,796	29,518	31,259
Property development			365	14,030	41,825	23,312	5,115	23,792	15,247
Player trading					500	0	139	544	472
<b>SALES</b>	<b>61,260</b>	<b>62,911</b>	<b>90,967</b>	<b>117,831</b>	<b>156,887</b>	<b>138,395</b>	<b>137,237</b>	<b>200,843</b>	<b>222,970</b>
Players	57	63	71	71	72	61	49	52	54
Total employees	188	218	239	256	271	293	312	374	379
<b>STAFF COSTS</b>	<b>33,970</b>	<b>40,651</b>	<b>61,453</b>	<b>60,569</b>	<b>69,889</b>	<b>66,012</b>	<b>82,965</b>	<b>89,703</b>	<b>101,302</b>
<b>EBIT</b>	<b>20,984</b>	<b>27,786</b>	<b>-23,234</b>	<b>5,250</b>	<b>12,471</b>	<b>20,736</b>	<b>15,710</b>	<b>42,278</b>	<b>53,660</b>
EBIAT (assuming 30% tax)	13,948	23,126	-21,186	4,513	9,478	9,323	7,780	28,510	37,620
Debt	14,438	14,438	14,438	61,618	167,271	224,960	297,742	340,212	411,337
less Cash	-7,261	-42,502	-14,680	-1,351	-26,003	-71,629	-35,598	-73,857	-93,264
Equity	41,078	91,799	72,203	76,211	84,363	122,656	130,558	133,374	159,100
<b>CAPITAL EMPLOYED</b>	<b>48,255</b>	<b>63,735</b>	<b>71,961</b>	<b>136,478</b>	<b>225,631</b>	<b>275,987</b>	<b>392,702</b>	<b>399,729</b>	<b>477,173</b>
Average equity		66,439	82,001	74,207	80,287	103,510	126,607	131,966	146,237
Average capital employed		55,995	67,848	104,220	181,055	250,809	334,345	396,216	438,451
<b>METRICS</b>									
Return on Capital Empl.	<b>cost of capital</b>	49.6%	-34.2%	5.0%	6.9%	8.3%	4.7%	10.7%	12.2%
Return on Capital Empl., after tax	<b>8.0%</b>	41.3%	-31.2%	4.3%	5.2%	3.7%	2.3%	7.2%	8.6%
Return on Equity	<b>10.0%</b>	36.5%	-25.1%	5.4%	10.2%	8.0%	6.2%	2.1%	17.6%
Economic Profit		18,646	-26,614	-3,825	-5,007	-10,742	-18,968	-3,188	2,544
Gearing		-44.0%	-0.3%	44.2%	62.6%	55.6%	66.8%	66.6%	66.7%