Diamonds in the Rough

Minor league baseball is afraid of becoming a victim of its own success.

Tim Reason, CFO Magazine
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Matt White, CFO of the Pawtucket Red Sox, began his career in baseball as a college student, flipping burgers all summer at McCoy Stadium. "I just loved the place," says White, who returned to work in the ticket office after graduation. What's not to love? Minor league baseball is the great American pastime with a small-town-America feel--easy autograph fishing for the kids, a hot dog and a beer for less than five bucks, and a seat close enough to hear the dugout chatter.

After a year in the ticket office, though, White set aside the field of his dreams for a more conventional finance track: a graduate degree in accounting and a job with Arthur Andersen auditing high-tech firms. Then, in 1999, the renovation of McCoy opened up a new need for finance talent in the front office, and White jumped at the chance. Promoted to CFO that same year, he reports to work each day at the ballpark that groomed such baseball greats as Jim Rice, Roger Clemens, and Nomar Garciaparra.

Last season, with only two rainouts and a record attendance of 647,928, says White, "we had a truly unbelievable year." That's true of most of Minor League Baseball. Last year's centennial was testimony to the spiritual and physical renaissance of small-town baseball--almost 39 million fans attended games in 2001, the most since 1949 (when there were three times as many teams). Thanks to that support, more than half the teams in the minors now play in stadiums that, like McCoy, were built or completely renovated since 1990.

There should be joy in Mudville. But, like a pitcher working on a no-hitter, Minor League executives seem afraid to jinx their success by enjoying it. At their winter meetings in December, Minor League Baseball president Mike Moore warned his colleagues that "this industry is headed down a road of potential self-destruction if changes are not made."

"We see warning signs across the board, from the Rookie leagues up through triple-A," echoed Pat O'Conner, COO of Minor League Baseball. "Cash calls, reorganizations, and distress-type sales are not signs of a stable situation." Even given professional baseball's notorious penchant for crying poverty (see "A League of their Own."), O'Conner and Moore are throwing some pretty high heat.

Perhaps what has them spooked are the inevitable growing pains that have accompanied the success of such a tightly controlled and insular group of small businesses. Indeed, the success of the 160 teams affiliated with Major League clubs (and known officially as Minor League Baseball) has given rise in the last five years to some 50 teams in five independent leagues that receive no direct support from the Majors. The popularity of the minor leagues has introduced new owners, more-complex financing, and a new level of risk that the traditional world of baseball views with a mix of awe and concern.

Cinema or Sandlot?

Over the past decade, those financial changes have gone hand-in-glove with cultural changes to the game itself, as minor league baseball stumbled onto a family entertainment market that was starving for a place to spend money. "You don't go to minor league baseball just to watch baseball," declares Lexington Legends CFO Stacy Martin. The Legends's Applebee's Park features a merry-go-round, a speed-pitch machine, and a kids' section complete with playground. During the game, putt-putt contests, face-painting, and other activities compete for the attention of younger fans.

"Fifteen to 20 years ago, your average minor league fan was a crusty old guy who loved baseball and wanted to see new talent moving up through the system," says Chris Dunlavey, president of Washington, D.C.-based Brailsford & Dunlavey, which has been involved in building 15 minor league stadiums over the past 10 years.

That purist didn't mind the dilapidated condition of most ballparks. "Today," he says, "the average fans are a family of four with two kids who don't want to spend 150 to 200 bucks on an evening out."

"We are competing with the movies or the zoo," states White of the Pawtucket Red Sox, whose general admission seats cost $5. Dunlavey agrees: market studies by his firm peg the cineplex as a ballpark's primary competition. That's not to say fans don't get good baseball for their money. Back in 1981, in fact, PawSox fans were treated to the longest game in professional baseball history--33 innings with the Rochester Red Wings that tested the endurance of such future big leaguers as Wade Boggs and Cal Ripken Jr. (the PawSox eventually won 3-2). But serving their changing audience has put the Minor League at a crossroads, forcing their simple and conservative business model to absorb debt and new expenses.

The Business of Baseball

Finances vary widely among triple-, double-, and single-A teams, notes O'Conner, but of the 27 triple-A teams reporting in 2001, the average gross revenue for the top 9 teams was $5.5 million. For the middle and bottom 9, gross revenues were $2.94 million and $1.72 million, respectively. Across the board, those numbers represent an annual growth rate of 13 percent. O'Conner is quick to note, however, that they "illustrate the disparity within the triple-A class," adding that under the Professional Baseball Agreement (PBA) that controls their relationship with their Major League affiliates, "teams in the bottom 9 have the same obligations as teams in the top 9."

"For every club that is profitable, there is probably a club that isn't making money," declares Marv Goldklang, a part owner of the New York Yankees who heads up a group of minor league baseball investors (including actor Bill Murray and singer Jimmy Buffet) known as the Goldklang Group. The group owns three affiliated teams and two independent teams, and provides consulting for three others. To truly understand baseball's economics, says Goldklang, discount the top and bottom 20 percent of clubs. In the middle 60 percent that remains, he says, "the margin of difference between operating profit and operating loss is not all that substantial, and may depend as much on how effectively you control your costs as on how much revenue you generate."

At first glance, controlling costs wouldn't seem too tough. Running a ball club, quite frankly, is cheap. "People in a lot of industries would die for our [operating] margins," admits O'Conner. From 1993 to 2000, he says, leaguewide gross margins have increased 10 percent, to the 60 to 70 percent range. Although considered the antithesis of big-money Major League baseball, the affiliated Minor League teams enjoy those margins primarily because their main attraction is heavily subsidized by the Show. Major League teams pay for the salaries and benefits of Minor League players, as well as per diem when the players are on the road. The Majors even pick up most of the cost of bats and balls. Ballparks, meanwhile, are usually leased to the teams by local city or county governments, which traditionally have viewed them as a public amenity worthy of subsidization. "The day-to-day operation of a minor league team is not capital-intensive," explains Goldklang.

But the devil is in the operating details. "We scrutinize every item; it is not important whether it is a $500 item or a $10,000 item," declares Goldklang. The budget for his Hudson Valley Renegades, for example, contains more than 100 cost categories, from insurance to security to scoreboard operators and mascots.

While running a team doesn't require a lot of capital, buying one does. The success of the minors has significantly raised the capital requirements for acquiring a team. In his nine years with the league, says O'Conner, franchise prices have skyrocketed. A triple-A team, for example, costs $8 million to $12 million. To ensure the financial viability of Minor League teams, the 1990 PBA requires owners to maintain a 55 percent equity stake in their ball clubs. Yet last year saw the highest number of PBA (debt/equity) ratio failures ever, he says.

In fact, throughout the affiliated Minor Leagues, debt service costs have risen 51 percent over the last three fiscal years. "In the last reporting cycle alone," he adds, "debt held on Minor League franchises increased by 77 percent, to a total of $25-plus million." Given the minimal financial reporting required under the PBA, says O'Conner, "I can't differentiate between short- and long-term debt." Next year, he says, it will be clear whether this increase in debt is a leaguewide trend or an anomaly driven by recent start-ups.

In addition to funding team acquisitions, much of this debt-financing goes to renovating or building stadiums . "It is clear that taxpayers are getting less willing to fund these types of things," observes Lexington Legends owner Alan Stein, who privately funded his stadium's construction by securitizing his first three years' worth of revenue streams (see "Build It and They Will Come," below). Often a local government will use its bonding authority to raise funds for construction or renovation, but the payback comes out of ticket sales and lease agreements. "Long-term, high-priced lease requirements are straining profit-and-loss statements at alarming rates and with troublesome intensity," warns O'Conner.

Pitching Control

The new price of admission to the owner's box has caused a dramatic change in baseball management. "The mom-and-pop operators are a dying breed," says Goldklang. "Because the value of a franchise is escalating," adds Dunlavey, "we are seeing some sophisticated financiers getting involved, and they are leveraging themselves more successfully than owners used to."

O'Conner agrees. "In the last 8 to 10 years, financial management has gotten more sophisticated," he says. But these new owners are often naïve about the need for baseball's traditional fiscal conservatism. Expenses can easily wipe out margins, the honeymoon between new teams and fans can end, and, of course, there's always the danger of bad weather. The 31-year-old White says the conservative philosophy of legendary PawSox owner Ben Mondor, 77, who eschews debt whenever possible, has rubbed off on him. "Younger guys coming to the minors from other industries know all the available ways to raise money, but we are open for only 72 days a year," says White. "Five rainouts wipe out 7 percent of your season. Ben has lived through years with 14 or 15 rainouts."

Moreover, as in other industries, start-up efforts often ignore basic financial controls. "We knew we needed a CFO," says the Legends's Stein. "We had inadequate controls and systems."

No kidding, says CFO Martin. When he came on board a year and a half after the freewheeling start-up of the team, he says, fixing the mess he found "was not a fun job." In the team's eagerness to get paying contracts that could be used as collateral with lenders, he says, "no one thought about years two, three, and four." Checking accounts had gone unreconciled for nine months, the chart of accounts had ballooned to 30 pages, and Martin had to build an accounting system from scratch. "They couldn't have gone on like that much longer," he says. Fortunately, the phenomenal success of the Legends's first year--which included the league championship and record attendance--gave Martin the breathing room he needed to fix the finances.

The Portland Beavers weren't so lucky. Even with $33 million in stadium renovation funds from the city of Portland, their management team lost $10 million in their first year (see "Behind in the Count," above). A KPMG report commissioned by peeved city officials found poor accounts payables, inadequate debt reserves, and a failure to make financial reports to lenders.

Even among some newcomers, stories like that seem to reinforce baseball's prejudice against debt--a reminder that minor league teams are still small, privately owned businesses with a very conservative approach. Despite the Legends's success, says Martin, "our goal is to get this debt paid off as quickly as we can. We are not doing any profit disbursements to owners until we are fully out of debt."

"We don't have a penny of debt on our books," echoes Goldklang, himself something of a mix between traditional "baseball people" and the new breed of financially savvy operator. "I understand financial leverage, but in the business of minor league baseball, when you never know how tight your operating margins are going to be, it is just not suitable to be carrying a lot of debt."

In fact, Goldklang regrets the exodus of the mom-and-pop operators. "You could say mom-and-pop operators weren't able to generate as much profit, but I would say they understood far better than many of us today how much they could afford to spend. They didn't have a balance sheet, so they couldn't borrow." Moreover, he adds, "the industry may have lost a little something by losing people who were involved in the game because they loved baseball and loved bringing professional baseball to the community where they lived."

Fortunately, that feeling isn't completely lost on the new generation. Although he gets a generous share of the team's financial success, PawSox CFO White admits he could be making better money in the finance career he abandoned. "But," he says, "I would rather trade out some of the financial side to work here--people are in really good moods and it's energizing to see the kids' eyes light up when they come to the ballpark." Like the rest of the office staff, White sees plenty of fans of all ages--he pitches in wherever necessary on game day, pulling the tarp off the field, taking tickets, manning the concession stand. And yes, he says, "every once in a while I still find myself flipping burgers."

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Sidebar: Coming Soon to a Sandlot Near You

Ballparks opened since 1999 or scheduled to open by the 2002 season.

Facility	City/Team (State)	Capacity*	Cost
Alexian Field	Schaumburg Flyers (Ill.)	7,048	$16 million
Blair County Ballpark	Altoona Curve (Pa.)	6,126	$12 million
Riverfront Stadium	Newark Bears (N.J.)	6,000	$30 million
Coastal Federal Field	Myrtle Beach Pelicans (S.C.)	4,500	$13 million
Cafaro Field	Mahoning Valley Scrappers (Ohio)	6,000	$8.5 million
Louisville Slugger Field	Louisville RiverBats (Ky.)	12,000	$26.3 million
AutoZone Park	Memphis Redbirds (Tenn.)	14,320	$80.5 million
Dell Diamond	Round Rock Express (Tex.)	9,816	$25 million
EAB Park	Long Island Ducks (N.Y.)	6,013	$14 million
Smokies Park	Tennessee Smokies (Tenn.)	6,000	$20 million
Raley Field	Sacramento RiverCats (Calif.)	13,000	$40.5 million
Fifth Third Field	Dayton Dragons (Ohio)	9,300	$22.7 million
BellSouth Park	Chattanooga Lookouts (Tenn.)	6,000	$10 million
Campbell's Field	Camden Riversharks (N.J.)	6,425	$20.5 million
PGE Park	Portland Beavers (Ore.)	23,000	$38.5 million
GPU Energy Park	Lakewood BlueClaws (N.J.)	6,588	$20 million
Applebee's Park	Lexington Legends (Ky.)	6,994	$13.5 million
Richmond County Bank Ballpark	Staten Island Yankees (N.Y.)	6,886	$34 million
KeySpan Park	Brooklyn Cyclones (N.Y.)	7,500	NA
Ripken Stadium	Aberdeen Arsenals (Md.)	6,000	$25 million
Fresno Stadium	Fresno Grizzlies (Calif.)	12,500	$24 million

*Some figures include lawn seating

Source: Brailsford & Dunlavey

Sidebar: Build It and They Will Come

Alan Stein spent 14 years trying to convince city officials to help build a minor league stadium in Lexington, Kentucky. Although home to devoted fans of the University of Kentucky Wildcats football and basketball teams, Lexington had no summer sports. "There's nothing to do here," says former restaurateur and radio magnate Stein, a Lexington native. "If you'll pardon the pun, our research said baseball would be a home run."

So, in 1998, when city officials failed to act on a $10 million stadium commitment from the state legislature, Stein had had enough. "We realized the only way to make this project happen would be if we could do it on a fully private basis," he recalls.

Stein's Lexington Professional Baseball Co., which only a few months earlier had been little more than an advocacy group, raised $8 million in private funds. To get banks to cough up an additional $12 million, he says, "we did something unusual that most do not have the courage to do. We had no choice." Anyone buying stadium advertising, corporate suites (about $30,000 for three years), the concession franchise, or season tickets ($497 to $1,065) was required to sign a minimum three-year contract. "The long-term value of those contracts--a guaranteed revenue stream of $21 million--became collateral for our lenders," explains Stein.

It turned out to be solid collateral. In 2001, its first year of operation, the Lexington Legends broke the previous South Atlantic League attendance record while only halfway through the season, operating at an average 104 percent of the stadium's 6,033-seat capacity.

To this day, says Stein, the city has provided no financial assistance, not even tax abatements, and midway through the first year, it stopped providing game-day traffic control. Indeed, when it came to zoning changes and construction approvals, he says, "the city made it very difficult for us because we were private." But with the only wholly-owned, unsubsidized stadium in professional baseball, he says, "we control 100 percent of our revenue stream, and everything that goes on in our facility does so without politics or interference." Indeed, the city has turned out to be a good customer, frequently using the stadium for public events. "We charge them full price," adds Stein. *--T.R.*

Behind in the Count

Portland Family Entertainment, owners of the start-up Portland Beavers, had a rough rookie year.

- Bank Loans: $23 million
- Private Financing: $5.5 million up front, $6 million midyear
- Municipal Funds Provided for Stadium Renovation: $33 mill.
- Annual Lease Payment to City of Portland: $908,000
- Additional Considerations to the City: 10 percent of ticket sales, 18.8 percent of gross revenues over $10.7 million, 25 percent of distributable cash at year-end, 35 cents per ticket for public transportation subsidy, $40,000 payment to the parks department
- Gross Revenues from 2001 Operations: $11 million
- Operating Loss from 2001: $10 million

Source: Portland Family Entertainment