A Case Study on Additional Fund Needed & Sustainable Growth

Case

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This case was written by Avijit Bakshi (CMS BUSINESS SCHOOL). It is intended to be used as the basis for class discussion rather than to illustrate either effective or ineffective handling of a management situation. The case was compiled from generalised experience.

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Abstract

The Indian Premier League (IPL) becomes the world's second most lucrative sporting property. The average value of the eight franchises was $67 million in 2009, a year after the IPL tournament launched. Now when the league has been extended to ten teams, that average value becomes $1.04 billion at an annualized growth rate of 24%. Mr. Arjun Ganguly, CEO of Altrus Ltd., is very impressed with the revenue model and valuation of IPL franchisees and wanted to take part in the auction of franchisees. He convinced the company's CFO, Mrs. Nira Gautam, about the potential of making money by acquiring an IPL team. He was ready to infuse additional equity if the situation demanded it. However, as the company's CFO, Nira's concern was the amount of additional funds needed to realize the CEO's dream. However, she does not want to compromise on the finances that are required to support existing and regular commitments. She spoke with lenders and instructed her team to compute the additional funds required to support the existing commitments and the additional funds required to buy an IPL team, along with supporting current obligations. She also wanted to know what the growth rate of the company would be if no external financing was available.

Keywords: IPL, Additional Fund Needed, SSGR, Self-Sustainable Growth Rate, External funding

Mr. Arjun Ganguly, CEO of Altrus Ltd., is very excited about the prospects of the Indian Premier League (IPL). He has been working hard for the last two months on his dream project: "owning an IPL team." He has done lots of research about the potential for making money after investing several thousand crores in the IPL's bidding process. Now he is convinced about the prospects of the IPL. The Board of Control for Cricket in India (BCCI) hinted at increasing the number of IPL teams from next season (2023) and the auctioning of teams will start in mid-December. Mr. Ganguly is very thrilled after hearing this news from the media. But he has to convince the CFO of Altrus, a long-term friend of Arjun, Mrs. Nira Gautam, and the board of directors. Nira is also passionate about cricket, especially the IPL, but where monetary decisions are involved, she put the company's interests ahead of everything. Mr. Arjun knows unless Nira is fully satisfied with the potential of making money, she will never give a green signal.

On June 15, Arjun called Nira to the boardroom for a brainstorming session. He briefed Nira about the project.

Arjun: "I may invest a few crores for passion, but surely not thousands of crores for passion. Second, what I eventually have to pay to the BCCI is the difference between what I get from them by way of broadcast rights, etc., and what I have to pay to them by way of licence fees.

He concluded by saying…

"The bid amount for the IPL team isn't just for passion, but I think over the next 10 years it's going to prove a good buy."

The discussions continued for 4 hours, which helped to remove doubts from Nira's mind. Arjun felt that half of his job was done as he successfully convinced Nira with numbers. Both agreed to take part in the auctioning of the IPL teams.

But what was the maximum amount they should bid for, and what about funding that amount? That is an area of concern and should be looked into by them.

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BACKGROUND

The Indian Premier League has been proven to be a gold mine for investors.

Forbes published its first valuations of the premier league teams in 2009. It registered the average value of the eight franchises at $67 million. Now, that the league has been extended to ten teams, the average value has increased by an annualized growth rate of 24% to $1.04 billion.

However, for teams in the National Football League and the National Basketball Association, the average growth rates in values between 2009 and 2022 were 10% and 16%, respectively. The Mumbai Indians, the most valuable franchise in the IPL, are now worth $1.3 billion, surpassing the values of all the franchises in the National Hockey League (NHL), Major League Soccer (MLS), and six Major League Baseball (MLB) teams. [1]

“The IPL is the most prominent cricket league in the world to attract sponsors and media rights. The founders of the IPL deserve a lot of credit for adapting concepts from the National Basketball Association (NBA) and European soccer leagues. “They benefited from solid governance on the part of the BCCI, which made team finance transparent and ensured the competition continued during the COVID era,” says Ajimon Francis, managing director of Brand Finance India, a brand valuation and strategy consultancy.

In October 2021, the IPL sold two new franchises. The CVC Capital bought the Gujarat Titans for around $750 million, and Mr. Sanjiv Goenka purchased the Lucknow Super Giants for about $950 million.

There are two reasons for the hike in IPL valuations.

First, the IPL lured a massive audience on television. In the last concluded season 2022, 400 million people watched matches on television, and another 260 million watched streamed matches. The Disney Star retained their Indian subcontinent TV rights for a figure of Rs 23,575 crore (Rs. 57.5 crore/game), and the digital rights deal was acquired by the Reliance-backed Viacom18 for Rs 20,500 crore. This is one of the biggest broadcast deals in the sport’s history, which fetched Rs. 48,390 crores, ($6.20 billion) through selling IPL media rights for the next five years, starting in 2024. [2]

Second, the IPL’s economic model virtually ensures that every team is profitable. For example, in 2021, the average revenue for the eight teams was $35 million, with an operating income of $9 million.

The main source of revenue for the IPL teams is media rights. BCCI sells the media rights to the broadcasters or channels and shares the revenue earned from media rights among teams after deducting their share from it.

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[1] https://www.forbes.com/sites/mikeozanian/2022/04/26/indian-premier-league-valuations-cricket-now-has-a-place-among-worlds-most-valuable-sports-teams/?sh=438ec41e3951

[2] Star India, Viacom18, Times Internet win IPL media rights; total value hits Rs. 48,390cr | Cricket News - Times of India (indiatimes.com)

According to Elara Capital's Taurani, 45% of the central revenue was shared equally among the IPL's eight teams in 2021. On the contrary, the NFL and the NBA equally share about 60% and 40% of their revenues, respectively. Besides this, 5% of the central revenue was distributed to the IPL's four playoff teams. The BCCI keeps the other 50% of the central revenue. Only about 20% of the revenue of the teams is contributed by tickets to matches, individual team sponsorships, and merchandise.

The team valuations are determined by market demographics and success rates in the tournament. The Mumbai Indians, the most valuable team, are worth $1.3 billion and have five IPL championships to their name. They represent the financial center of India and play in the second-most populous state in terms of total population (135.7 million).

The thinking here is that IPL team values are likely to see solid appreciation over the next several years as non-media revenue streams increase. Central sponsorship revenue, for example, is expected to increase more in the years to come. The analysts believe the NFT deals and a video game (both as part of central revenue) will push up sponsorship revenue even further, as it happened with U.S. teams.

Table 1

IPL'S MOST VALUABLE TEAMS 2022

Team	Owner	Value	Revenue	Operating Income
Mumbai Indians	Reliance Industries	$1.3 billion	$33 million	$5.5 million
Chennai Super Kings	India Cements	$1.15 billion	$41.2 million	$14.8 million
Kolkata Knight Rider	Shah Rukh Khan	$1.1 billion	$41.2 million	$14.1 million
Lucknow Super Giants	RP-Sanjiv Goenka Group	$1.075 billion	NA	NA
Delhi Capitals	GMR Group, JSW Group	$1.035 billion	$35.4 million	$8.3 million
Royal Challengers Bangalore	United Breweries	$1.025 billion	$36.4 million	$9.7 million
Rajasthan Royals	Emerging Media Ltd.	$1 billion	$31.7 million	$6.6 million
SunRisers Hyderabad	Sun TV Network	$970 million	$31.8 million	$3.2 million
Punjab Kings	Mohit Burman, Ness Wadia, PZNZ Media	$925 million	$31.2 million	$9.8 million
Gujarat Titans	CVC Capital Partners	$850 million	N/A	N/A

Source: https://www.forbes.com/sites/mikeozanian/2022/04/26/indian-premier-league-valuations-cricket-now-has-a-place-among-worlds-most-valuable-sports-teams/?sh=438ec41e3951

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Base Price of New Franchise

On June 17, the BCCI officially announced the release of the tender to own and operate two new teams to be added to the IPL in 2023. The IPL governing council has invited bids for the same, for which interested parties need to purchase the Invitation to Tender (ITT) for a non-refundable fee of Rs. 10 lakhs, which is available until December 5, 2022. They also announced Goa and Bhubaneshwar as the two new teams for the IPL 2024.

Arjun was enthusiastic about the Goa team.

"We do have operations there. We run a power distribution business in Goa. We run a retail store chain in Panaji. So, I am excited about the team," he said.

After deciding to add two new franchises to the T20 league at the 89th AGM, the BCCI hinted at the base price that potential suitors would have to bid to purchase a team. There was no doubt that the two new franchises would invite bids from multiple suitors.

"Nothing has been officially discussed about the base price as of yet." "But during the BCCI AGM, we discussed the matter informally." "Ownership of the IPL team is now a prized asset, and we feel the base price for the new IPL team will not be less than Rs. 1500 crore or probably more," the BCCI official told the media.

So, the expected cost of one franchise will be at least Rs. 1500 crore. While there was no doubt that a small bidding war will take place between the parties that are showing interest in owning IPL franchises, the final cost could soar keeping in mind the rising popularity and brand valuations of the IPL teams.

Additional Funds Needed for Arjun's Dream Project

On June 20, Nira and Arjun met again to discuss their next plan of action. Arjun shared the values and earnings of current IPL teams with Nira (table 1). Nira was impressed with the earning potentiality of the teams but was concerned about the below-mentioned points.

- how much amount Altrus should dedicate to ensure winning the bid? She wanted to be clear about the maximum amount they can bid for.
- the lump sum amount that will be required, how to fund it – by internal sources, external financing, or a combination of debt and equity?

Both continued to discuss the project.

Arjun: So, it's clear there will be a tough fight in the bidding. To participate in the growth story, we must own a franchise, and for that, a lump sum amount needs to be invested.

Nira: What does "lump sum" mean? How much are you expecting? I am also trying to understand that. Our core business should not be neglected because of the new project.

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Arjun: Agreed… Our core business should not be starved because of the fund. The base price is yet to be declared by the BCCI, but unofficially, it might be Rs. 1500 - 1600 crore.

Nira remained silent for a moment. She didn't expect this much. Arjun could read Nira's mental state.

Nira: But it is only the base price. How much do we require to ensure bagging a team?

Arjun: Very difficult question but in the circle, it is heard that there is expected to be a huge competition between 8 to 10 corporates for the franchises.

Nira: That number of competitors was important. So, if we consider that 10 corporates would compete, including us, and each corporate would be ready to go up to Rs. 1,000 crores over and above the last price bid, that means roughly we need Rs. 10,000 crores.

Arjun: Humm… But don't worry, Nira. As you know, the management is ready to infuse equity to the extent of Rs. 500 crores as of now. Is there any development in the discussions with lenders?

Nira: Yeah... deliberations have started just now. But now we need to recalculate from the beginning, as Rs. 10,000 crores were not in our estimation. Let me sit down with my finance team and compute how much additional finance is needed to fund Rs. 10,000 crore.

Arjun: Let me know if any additional equity is required over and above Rs. 500 crore.

Nira called senior executives of the finance department to a meeting to understand the present status of the company's finances and how much funding they require. She shared the plan of the CEO with all the executives who were present in the meeting and asked the senior finance manager, Mr. Mahesh, to express his view.

Mahesh: Mam, the CEO's dream project looks very promising, however, I think it should not be at the cost of the company's existing growth plan.

Nira: No... definitely not

Mahesh: The sales team has projected a sales growth of 25% in the coming year. So, while considering the plan for funding the bid amount, we should not forget to finance the increase in assets required to support the increased level of sales. In addition to this, the company is scheduled to repay its existing debt to the extent of Rs. 105 crore and incur a planned capex of Rs. 4,000 crore.

Nira: Sure….

Mahesh presented grossly the last year's financial data.

Total fixed assets: Rs. 15,000 crore Operating current assets: Rs. 9,000 crore Share capital: Rs. 8,500 crore Retained earnings: Rs. 5,900 crore Account payables: Rs. 7,500 crore Last year's sales: Rs. 45,000 crore. He also showed additional information:

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Pre-tax Profit Margin as a percentage of Sales: 9.5%, Average Tax Rate as a percentage of Pre-Tax Profit: 25%, and Dividend Pay-out Ratio: 40%.

Nira: Thanks Mahesh for the inputs… But let me share with you that the management has already planned to infuse equity to the extent of Rs. 500 crores initially, and deliberations have been started with several lenders, e.g., BNP Paribas, Citi, and JP Morgan, to raise a mix of overseas loans, mezzanine debt, and a stock-backed bridge loan to be repaid in 24 months. Take a rough estimate of the overall size of the debt of Rs. 8,000 crores and the bid amount of Rs. 10,000 crores.

Mahesh: Thanks for the update, ma'am.

Nira: "Ok, gentleman, Since I will have to sit down with lenders next Monday, I require answers to the following questions by Friday.

- What is the external funding required to support growth in sales only?
- What is the external funding required to support growth in sales and planned capex decisions?
- What is the external funding required to support growth in sales, planned capex decision, repaying existing debt, and investment in the IPL?
- What if the company will be able to raise fresh debt maximum amount of Rs. 8,000 cr.? What part of the external funding will be sourced through fresh debt and fresh equity? And lastly
- What would be the growth rate of our company in the current situation without considering the above changes and when no external finance is available to support growth?

Mahesh: "Sure mam."

Conclusion

The meeting ended on a positive note. The finance department has an enormous responsibility to provide proper input to the CFO. Based on their input, only the CFO will negotiate with lenders. All the executives returned to their departments. Now they need to work on building five different scenarios as instructed by the CFO based on what they just concluded from last year.

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