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Here you go. Slade will bring color copies. Thanks. Gerry

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The Sonics Challenge

Why A Poisoned Well Affords A Unique Opportunity

The Big Three Challenges of U.S. Sports Team Ownership

- Scarcity: They are hard to come by
- Economics: They are hard to operate profitably
- Reputation: They are hard on the owner's reputation

The Big Three Challenges of U.S. Sports Team Ownership

- Scarcity
  - Monopoly conditions, devoted fan bases, media-friendly content make them scarce and valued = expensive
  - League ownership rules in the "big four" leagues (NFL, MLB, NBA, NHL) add a meaningful barrier to entry beyond cost
  - Odds of a particular franchise becoming available to a particular region at a particular time are poor (for example, big four franchises have been available for sale in Seattle market 11 times in their combined 100 years of operation) (Mariners 4/30; Sonics 4/40; Seahawks 3/30)

The Big Three Challenges of U.S. Sports Team Ownership

- Economics
  - With the exception of the NFL, many professional sports teams struggle to make money (for example, about half the NBA operates at a profit in any given year, and it is the larger markets that tend to be consistently profitable)
  - Entry price and appreciation prospects are critical, especially as returns from operations can be volatile (meaning that effective due diligence requires understanding the league as well as the franchise) (see Goldman Sachs pages 11-14)
  - Critical to most operations' financial prospects is a partnership with the local community to provide a sound facility (see review of other arena financials)

The Big Three Challenges of U.S. Sports Team Ownership

- Reputation
  - Few sports team owners are loved (or even just not reviled) by the local community
  - Franchises can be seen as "rich boy toys," subsidized by public
  - Communities often feel passionate sense of ownership of team (a passionate fan base is a good thing!), but anything less than winning is viewed as a betrayal: the fault of a cheap and/or unwise ownership
  - Huge media sector preys on this passion and lives off of the (usually negative) energy of this phenomenon

Seattle's Current NBA Situation Mitigates All Three Challenges

- Scarcity
  - Current ownership faces bleak prospects and may be pushed to sell
- Economics
  - The Mayor is now willing to lead efforts to create a viable facility/lease at KeyArena
- Reputation
  - History shows that late-arriving local owners can potentially be viewed as white knights and, managed properly, can retain this reputation for some time
- The balance of this presentation explains these beliefs and outlines a campaign to capture them

Seattle's Current NBA Situation Mitigates All Three Challenges

- Scarcity
  - Current ownership faces bleak prospects and may be pushed to sell
    - It has poisoned its relationship with the fan base, likely diminishing a key revenue source – it went from break-even in 2005-06 to operating losses of $17 million in 2006-07
    - It has changed the composition of the team in a way that makes competitiveness unlikely in the near-term, further diminishing fan interest/ticket revenue
    - It faces a lease fight with the City* which proposes to force it either to absorb significant costs if it leaves early, or endure the unfavorable lease economics with a weakening fan base for three more years

* See "lawyering up" and related articles

Seattle's Current NBA Situation Mitigates All Three Challenges

- Scarcity (cont.)
  - The owners, while in a fraternity that generally protects its own, risk pressure from the NBA to accommodate a Seattle-based solution:
    - The league has a history of success in Seattle, and would rather stay; NBA's over-riding concern is the need for a competitive facility
    - Departure would double (from 1 to 2) the number of top 20 DMAs in which NBA is absent (today the NBA is only absent from #12 Tampa-St Pete. Seattle is #14 2006 DMA; Oklahoma City is #45)
    - The league has other franchises in flux which may provide a way to satisfy multiple interests

Top 20 Designated Market Areas (2006)

	DMA Rank	Percentage of U.S. Average Disposable Income (EBI)*	Number of Big 4 Teams	NFL	MLB	NBA	NHL
NYC	1	119 (3)	9	✓✓	✓✓	✓✓	✓✓✓
Los Angeles	2	108	6		✓✓	✓✓	✓✓
Chicago	3	116 (5)	5	✓	✓✓	✓	✓
Philadelphia	4	109	4	✓	✓	✓	✓
San Francisco/Oakland	5	142 (1)	6	✓✓	✓✓	✓	✓
Dallas/Fort Worth	6	113 (7)	4	✓	✓	✓	✓
Boston	7	118 (4)	4	✓	✓	✓	✓
Washington, DC	8	132 (2)	4	✓	✓	✓	✓
Atlanta	9	109	4	✓	✓	✓	✓
Houston	10	110 (+.9)	3	✓	✓	✓	
Detroit	11	110 (+.9)	4	✓	✓	✓	✓
Tampa/St. Petersburg	12	95	3	✓	✓		✓
Phoenix	13	103	4	✓	✓	✓	✓
Seattle	14	112 (8)	3?	✓	✓	?	
Minneapolis/St. Paul	15	108	4	✓	✓	✓	✓
Miami/Fort Lauderdale	16	101	4	✓	✓	✓	✓
Cleveland/Akron	17	94	3	✓	✓	✓	
Denver	18	115 (6)	4	✓	✓	✓	✓
Orlando	19	96	1			✓	
Sacramento/Stockton	20	99	1			✓	

FYI → Oklahoma City #45/83

*Effective Buying Income.

Seattle's Current NBA Situation Mitigates All Three Challenges

- Economics
  - There are three levels of economics to consider
    - Purchase price
    - Prospects for appreciation
    - Operating economics/prospects
- Two of the three, price and operating economics, are affected by the current situation

Seattle's Current NBA Situation Mitigates All Three Challenges

- Economics (cont.)
  - Purchase Price
    - It is reasonable to believe that the $350 million established as the price for the Sonics by the 2006 Goldman auction is a reasonable price for it to trade again. One could argue value has been diminished, but local ownership stability creates powerful positive momentum. This has been the case with both Seahawks and Mariners.
    - A franchise that is free to move (i.e. New Orleans), may command a premium if other markets were permitted to bid
    - This would leave current owners out their first year losses of $17 million, but avoids the continuing losses they face through the end of the KeyArena lease
      - There may, however, be ways to address this, such as the league orchestrating a sale of another franchise (say, New Orleans) to the Oklahoma City owners at an offsetting cost

Seattle's Current NBA Situation Mitigates All Three Challenges

- Economics (cont.)
  - Appreciation
    - The Sonics franchise has traded 4 times

Sonics Franchise Appreciation			
Year	**Buyer**	**Price**	**CAGR**
1966	Schulman	$1.75 mm	15.74%
1983	Ackerley	$21 mm	13.34%
2001	Schultz	$200 mm	12.10%
2006	Bennett	$354 mm	NA

Seattle's Current NBA Situation Mitigates All Three Challenges

- Economics (Appreciation cont.)
  - Examples of recent NBA transactions:

Recent NBA Sales			
Year	**Franchise**	**Price**	**Revenue Multiple**
2001	Sonics	$200 mm	2.7x
2002	Celtics	$360 mm	4.0x
2004	Nets	$360 mm	3.8x
2004	Suns	$401 mm	3.7x
2005	Cavaliers	$374 mm	3.6x
2006	Sonics	$354 mm	4.1x

  - Much of the value is tied to the league's future prospects

Seattle's Current NBA Situation Mitigates All Three Challenges

- Economics (Appreciation cont.)
  - As one of a limited number of media content franchises that still attracts the attention of demographically desirable consumers, and with rapidly growing interests overseas (especially in China), and unfilled markets in the U.S., the league's economic prospects remain very strong
  - Not greatly affected by this transaction, though losing a presence in the 14th largest DMA is not helpful especially when it has the 8th highest disposable income in top 20 DMAs

Seattle's Current NBA Situation Mitigates All Three Challenges

- Operating Economics
  - This is where the greatest necessity/opportunity exists for change (post 2010 -- $30-$40 million positive swing)
    - Gradual improvement possible in interim through franchise stability and management; lease modifications; and capital investment in facility
    - To be made reasonable to operate in Seattle, KeyArena must be overhauled, and its revenue streams redirected to the Sonics
    - Mayor has offered to redirect revenues in new lease
    - This makes possible a $30-$40 million revenue annual pick-up from break-even 2005-06 operations (see chart on next slide)
    - As the following pages illustrate, if these issues are addressed, the franchise, with proper cost controls, can be run profitably and with a payroll that would allow for a competitive product

Seattle's Current NBA Situation Mitigates All Three Challenges

Incremental Revenue Due to Arena Improvements and Normalized Lease		
	2006(a)	2011(e)
Tickets	$27,643	$41,000[1]
Sponsorship	$17,122	$29,000[2]
Suites	$1,424	$8,500[3]
Concessions & Retail	$1,982	$3,500[4]

1. Reflects enhanced amenities/access and the Sonics retaining 100% of ticket revenue. Still only approximates NBA average.
2. Includes improved local media rights, arena naming rights and unencumbered sponsorship categories (e.g., financial institutions).
3. Remodel creates better customized suite/loge seating options. Sonics retain 100% of suite revenue.
4. Sonics control all event retail/concessions. Enhanced concourse space.

Seattle's Current NBA Situation Mitigates All Three Challenges

- Operating Economics (cont.)
  - Franchise Stability and Management
    - The dominant controllable levers in a team's operating profit and loss are ticket revenues (heavily influenced -- more than 50% -- by high end customers) and somewhat influenced by competitiveness, as related to payroll -- especially player costs
    - Sonics have proven that payroll is not necessarily correlated to competitiveness -- from 1999-2006, Sonics were 8th in NBA dollars spent per win (lower being better), and above .500 in wins over the period, with 3 trips to playoffs
    - Payroll has management opportunities
    - Payroll is at an all-time high: $64 million in 2007-08
      - But low-hanging fruit for active management, due to K. Thomas and Sczerbiak contracts