

Cost Analysis of Madison Square Garden Sports Corp

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ABSTRACT

Madison Square Garden Sports Corp. (NYSE: MSGS) is a mature company in the sports industry, especially in basketball and hockey. Despite the poor performance of the New York Knicks from 2013 to last year, the team has still been worth the highest value of all National Basketball Association (NBA) teams in the past years. Its home court, Madison Square Garden, is honored as "Mecca of basketball". Consequently, the team and the company draw the interest of many people. The purpose of this cost analysis is to set a reasonable budget and strategic plan for the corporation, so the cost analysis will extend organization-wide and be from the perspective of the business operators to determine whether modification or improvements can be applied to current operational decisions inside the company. After analyzing the cost structure of MSGS, the corporation is found to be actually promising despite its current operating loss. With the operating loss decreasing from \$93,866,000 last year to \$78,443,000 this year, the corporation is believed to recover from the serious COVID-19 situations last year and to progress for the better.

Keywords: MSGS, NBA&NHL (National Hockey League), Cost analysis, COVID-19.

1. INTRODUCTION

NBA popularity has been increasing significantly since the age of Michael Jordan not only within the states but also around the world: the informal cooperation between NBA and the CCTV in China began as early as 1982. This increase in enthusiasm has motivated ticket prices from almost free to a stunning record of the Golden State Warriors selling two seats to Game 4 of the NBA Finals for a total of \$101,015; also, it surged the contract of media rights to billions of dollars worth: the NBA is looking to sign a new broadcasting contract, and it projects to be a big one. The new deal, which would start in 2025, could be worth over \$75 billion total, and over \$8 billion annually, according to Jabari Young of CNBC. [1]. As a result, it would cost billions of dollars to purchase an NBA team. According to Forbes, the NBA teams still increased by four percent in 2021, to an astonishing \$2.2 billion, even though the COVID-19 situation in 2020 brought much damage to the businesses overall. While the value of these teams has been growing exponentially, little do people know about the finances and cost structures of these

teams. In this research, the author analyzes the cost structure of the MSGS corporation, the owner of the famous New York Knicks and one of the few public companies owning a sports team.

Basketball has frequently appeared in daily conversations of American people, and millions of people watch NBA games in the court and in front of TVs. When enthusiastic basketball fans cheer for their beloved teams, some also wonder regarding the cost structure of these basketball teams. Fortunately, the New York Knicks is owned by the Madison Square Garden Sports, Corp., which is a public company, originally Madison Squares Garden Corporation. Therefore, its annual reports, including the various financial statements can be accessed by the public. Also, the analytical process can build people a better understanding of the basketball industry as a whole: as the team enjoys the advantageous geographical location, the metropolis of New York City, most important factors in the market are available and can be analyzed here.

Consequently, this paper analyzes the cost-benefit structure of MSGS, specifically discussing

and calculating the total costs of MSGS in the fiscal year ending Jun 30, 2021. The reason for choosing this year is that the corporation have been experienced to handle the special situations under COVID-19 after the unstable fiscal year 2020 around the world, not only in the business world but also in the sports industry. It helps analyze the performance of the corporation in the past years, especially under the special situation of COVID-19, which can help offer a template for future cost distribution.

2. THE MADISON SQUARE GARDEN CORP

Madison Square Garden Sports Corp. (thus abbreviated as MSGS) is an American sports holding company based in New York City, originally established in 2010. The main responsibility of MSGS is to manage professional sports teams, including the NBA's New York Knicks and its NBA G League affiliates, the Westchester Knicks, and the NHL's New York Rangers and their AHL affiliate, the Hartford Wolf Packs. The management ranges from the trade and signing of players, the rental lease for the stadium, business cooperations, and other daily operational decisions. [2] [3]

The business model of MSGS is relatively obvious and straightforward. As MSGS manages numerous sports teams, and these teams would bring them abundant profits in their regular operations. The major components of income include ticket sales and advertisement contracts. The easiest approach to surge the income is to enhance the performance of players in the court, as much as possible: every additional series in the NBA or NHL playoffs means thousands more of tickets, thus millions of dollars of income. Moreover, a team with stable excellent performance can attract the eyes of not only audience but also sponsors and advertisements. Given the geographical advantages of MSGS teams, the contract would be highly profitable.

3. THE SPORTS INDUSTRY

Four main income sources compose the revenues of the sports industries: gate receipts (tickets), concessions, sponsorships, media broadcasting, respectively, and there's no exception for the NBA.

The necessities for the industries, including NBA, are mainly money, transportation, media

access, and densely populated area so that they can attract audience and advertisements, thus developing the businesses for profit.

Another important aspect is the approach of the association to sign contracts with laborers, which are the players. To start with, the sports leagues hold draft annually, allowing their member teams to pick young players with potential based on their previous observations, distinct need for each team, and luck occasionally. Those drafted rookies can thus sign contracts with the teams, and these contracts are usually predetermined and pay players millions of dollars per year (not that much in the league today even though the amount has been set a rookie limit). At the same time, those undrafted players naturally become free agents and can offer their services to the highest paying team. Players become free agents and can sign their next contract when previous contracts expire, or they might be traded to other team during the time period of their contract, which was detailedly regulated by the league. The maximum salary for NBA player has now reached over 40 million dollars a year.

In a broader picture, the two sports leagues act like a cartels, an illegal form of businesses in other industries. The associations themselves never need to show concern in potential competition simply because they are the only supplier for what they offer, namely monopoly. They also have strict rules with the number of teams in the league so that investors or business beginners would find it highly difficult to enter the industry. They need some luck to only buy an existing team in the league. The limited number of teams also leads to increasing ticket price and more profitable media broadcast contracts [4].

Just like all business industries, the NBA, along with its teams, also faces many opportunities and threats.

Opportunities include:

- The rapid expansion of NBA broadcast in densely populated Asian countries can bring enormous broadcast profits to the league. Before the pandemic COVID-19, the NBA organized numerous preseason games in India, attracting eyeballs of Indian audience; the cooperation between NBA and CCTV shifted smoothly to Tencent Sports in China, and membership fees are required to watch NBA games, another major source of income for the league in Asia.

- Besides TV broadcast and preseason games, the NBA also innovated to hold regular games outside the US to attract fans around the globe, especially countries where their players are actively playing in NBA teams. Before COVID-19, the association successfully organized games in Mexico and Europe, and it's highly potential that the association gains more popularity and opportunities of business cooperation with the rapid spread and favorable comments for these games.
- At the same time, the NBA took a giant leap in the gambling industry after Adam Silver became the Commissioner of NBA, signing contracts with MGM Resorts International, a successful company in the gambling industry, under the decision of Silver. This could contribute as a major source of income for the league in the foreseeable future.
- Moreover, the NBA board is considering and organizing votes regarding adding a mid-season cup in January and February so that more players can be more active with a prize of one million dollars offered, and more revenues can be earned with tickets and broadcast contracts. The NBA chairs, including the current commissioner Adam Silver, are striving to innovate and reform the NBA for more income, despite the opposition of many fans in social media.

Threats include:

- The cooperation between NBA and China broke in 2019 due to (when he was) General Manager of Houston Rockets Daryl Morey's sensitive comments on Hong Kong issues. The situation has been worsening recently, when Celtics Player Enes Kanter is spreading inappropriate speeches regarding the independence and integrity of China, and Tencent Sports stopped the broadcast of games of Celtics immediately.
- The COVID-19 pandemic forced the league to suspend the 2020-2021 season for several months, leading to significant losses in ticket sales and media broadcastings. Despite Adam Silver's decision to resume the season in social distancing (no or limited allowance of fans into the courts), the league still could hardly cover its loss, which would further lead to a plummet in the salary cups of each team.
- The NBA needs to compete with other professional sports leagues in the US, such

as baseball, hockey, and football. Even with their growing popularity, the NBA still can hardly be named the most popular league in the US, with NFL and Super Bowl attracting the eyes of almost every American.

- Currently, the NBA earns an annual revenue of \$8 billion, gradually recovering from COVID-19 and steadily increasing. The industry as a whole is healthy, yet it also needs to remain vigilant for unexpected incidents and active for further development, yet in a more rational approach. Not every reform can achieve the expected effect.

And for MSGS, the concentrations of risks are financial instruments that may potentially subject the Company to a concentration of credit risk consist primarily of cash and cash equivalents and accounts receivable. Cash and cash equivalents are invested in money market accounts and a time deposit. The Company monitors the financial institutions and money market funds where it invests its cash and cash equivalents with diversification among counterparties to mitigate exposure to any single financial institution.

4. THE COST ANALYSIS PROCESS

Product costs, period costs, and depreciation and amortization are the three most important categories of costs while conducting the cost analysis. In product costs, direct and indirect costs are then sub-divided. However, the annual report (10-K) OF MSGS does not follow the traditional categorization, so people can only grab the factors of cost in the financial statements one by one and determine which category they fall into.

In the consolidated statements of operations of MSGS, the direct product costs can be attributed to the section of direct operating expenses, which costs the corporation \$281,890,000 in the fiscal year. These costs include compensation expense for the Company's professional sports teams' players and certain other team personnel, as well as NBA luxury tax, if applicable, NBA and NHL revenue sharing (net of escrow) and league assessments for the Company, event costs related to the presentation and production of the Company's sporting events and other operating expenses, including expenses related to the Arena License Agreements which require the Company to pay arena license fees to MSG Entertainment in exchange for the right to use The Garden for games of the Knicks and the Rangers for a 35-year term.

Then, the indirect product costs include the selling, general and administrative expenses of \$206,700,000. It is mainly composed of League Assessments of NBA and NHL and Advertising expenses of the corporation. Total advertising costs, which were classified in selling, general and administrative expenses, were \$2,291,000, \$3,064,000, and \$4,381,000 for the years ended June 30, 2021, 2020 and 2019, respectively.

Depreciation and Amortization is \$5,574,000.

Income tax expenses (benefits) are also provided. Income taxes of MSGS are composed of current and deferred expenses, both including federal, state, and other taxes. The total income tax expenses in fiscal years 2021, 2020, and 2019 are - \$73,421,000, \$20,593,000, and \$12,619,000, respectively.

With the operating expenses listed above and given the revenue of \$415,721,000, the operating loss is \$78,443,000 [5]. And "Table 1" shows the results of the calculation.

Table 1. Results of cost calculation of MSGS

Direct operating expenses	selling, general and administrative expenses	Depreciation and Amortization	Revenue	Operating Loss
\$281,890,000	\$206,700,000	\$5,574,000	\$415,721,000	\$78,443,000

5. CONCLUSION

After analyzing the cost structure of MSGS, the author found the corporation to be actually promising with the following reasons, despite its current operating loss.

To start with, the major part of the costs falls into salaries of players and the personnel of team. Investigating the salaries of each individual players, one can be sure that they are worth the money: last season, the New York Knicks returned to the NBA playoffs for the first time since 2013 with the excellent performance of Julius Randle and Derrick Rose, and their new villain Trae Young of Atlanta Hawks will really help advertise the team for their game at Madison Square Garden Arena this Christmas [6].

To be followed, during the pandemic, the NBA and NHL suspended their season for some time and limited attendance at MSG Arena after the games resumed. Therefore, certain costs were cut regarding the lease of MSG Arena between MSGS and MSG Entertainment, which somehow alleviated the burden of the corporation during the pandemic.

Then, comparing the operating loss of MSGS in 2021 with the previous 2020 fiscal year, it can be seen that a sharp decline from a loss of \$93,866,000 to \$78,443,000. Things are recovering from the pandemic to previous levels [5].

Moreover, the stock price of MSGS stays healthy in the long run [7].

Combined with all these factors and comparison to other professional sports teams, it can be concluded that MSGS are improving.

Recommendations for the corporation: from the perspective of revenue, the professional teams at NYC still need superstars to attract more audience even though MSGS would have to pay more luxury tax. More stars lead to more topics and more revenues, and Trae Young, the villain of NYC would be an example. New York City never lacks the market: it needs topics for sale. From the perspective of costs, Madison Squares Garden Corp. existed for numerous years as a large company. The separation would definitely lead to shrink in resources available, but it would be a good chance for the directors of boards to think twice before every movement [8].

AUTHORS' CONTRIBUTIONS

This paper is independently completed by Jin'an Pan.

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