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Golden State Warriors: A New Beginning

Joe Lacob, Silicon Valley veteran and venture capitalist, sat on the mid-century couch in his hotel room in Athens, Greece reading through the latest deal points on his iPad. It was approaching 6 AM, but sleep was immaterial to him in this race against the clock. Joe had been working non-stop for 3 days to try and close a deal to purchase the Golden State Warriors of the NBA from current owner Chris Cohan. Joe had been notified that he was a finalist, but Larry Ellison, founder of software giant Oracle, was a finalist as well.

Through the summer of 2010, Joe worked to finalize his purchase of the Warriors, and the deal was now in its final stages. He was in Greece with his family, and an impending transportation strike threatened to derail his plans to leave Athens the following morning. If Joe didn't take off before noon, he would be grounded in Athens for at least two days. However, if he didn't close the deal before taking off, Larry Ellison could steal the Warriors purchase. In anticipation of closing the deal, Joe instructed his lawyers to hunker down in a conference room in New York with the lawyers representing Chris Cohan.

Joe carefully thought through his decision to purchase the Warriors one last time. He always wanted to own a sports team, and he now had the opportunity to purchase one of his favorite NBA teams. Furthermore, as a venture capitalist at Kleiner Perkins Caufield & Byers (KPCB), Joe loved the thrill of a deal. The opportunity to take on risk, build something from scratch, and succeed at the highest level made him tick. Owning a sports team is the ultimate form of this gratification — teams are measured by wins and losses each night and only one winner is crowned each year. However, owning a team would be unlike any other investment Joe had made through KPCB. It would thrust him into the public sphere and put him under the microscope of the media.

Due to the uncertainty of his travel and the shadow of Larry Ellison, Joe knew the deal had to be completed within the next 6 hours, but he also wanted to ensure he was making the right decision. Should he move ahead with the deal? What would be his final offer?

The National Basketball Association

The league was founded in New York City in 1946 as the Basketball Association of America (BAA). The BAA merged with its rival, the National Basketball League (NBL), in 1949 to form the National Basketball Association (NBA). Maurice Podoloff, the first commissioner, oversaw the 8 founding teams, all of which were located in the Northeast region of the United States. One of these teams, the Philadelphia Warriors, won the inaugural league championship in 1947.

Initially, professional basketball was less popular than college basketball and other major professional sports in the United States. A few events in the 1980s catalyzed the NBA's surge in popularity. First, a rivalry between former college stars Magic Johnson and Larry Bird, who played for the LA Lakers and Boston Celtics, respectively, culminated in their first NBA Finals showdown. This rivalry brought star power to two of the NBA's most historic franchises. Further, major cable networks toyed with live broadcasts of NBA games, especially the NBA finals, but it wasn't until 1984 that TV ratings backed up this investment. Between the 1984 Finals and the launch of the All Star Weekend that year, the league was entering a new era.

The NBA's popularity further grew in the 90s as the sport attracted mainstream audiences. Michael Jordan became an international celebrity when Nike made him the face of its shoe line. The sport truly went global when Jordan became the face of Gatorade and McDonald's and led the "Dream Team" to a gold medal in the 1992 Barcelona Olympics.

In the late 90s, NBA superstars started capitalizing on the league's success. Michael Jordan signed a deal to be paid more than $30 million in one season. Shortly thereafter, Kevin Garnett signed a 7 year, $126 million deal with the Minnesota Timberwolves. After these signings, the NBA suspended play in an effort to rewrite the Collective Bargaining Agreement (CBA), which is a document that dictates the rules of player contracts, revenue distribution, and the salary cap, among other things. This marked a seminal moment that would change the business of the league. There was now a more concrete compensation system that included a soft salary cap and a maximum player salary. This set forth all of the mechanisms for team building and salary structure for the next decade just as media rights deals were being renegotiated and exponentially increasing in value. With these changes, there was a lot of money to be shared between the players and the owners.

By 2002, the league grew to 30 teams, and basketball had become a staple international sport. As a result, the value of teams skyrocketed. In 2002, the Boston Celtics was purchased for $360 million by a syndicate including Joe Lacob as a minority investor. The price paid was nearly double what any team had previously been sold for. Then, in 2004, the Phoenix Suns sold for a record $401 million. Due to increasing popularity, league revenue sharing from national TV rights paid out a record high $900 million in 2010, and some local TV deals exceeded $20 million per year.

The popularity of the game had never been stronger, but a majority of teams were still unprofitable despite strong league revenue sharing and increasing revenue from ticket sales, local TV rights, and sponsorships. The league was moving towards another CBA negotiation in the summer of 2011. The current agreement required players to receive 57% of all Basketball Related Income (BRI). Joe's team projected that any new deal would result in the players' share of BRI dropping from 57% to 50%. While that would yield a positive impact on profitability for all teams, the negotiation came with uncertainty about the future labor agreement as well as another lockout during the 2011-12 season.

The Golden State Warriors

Historically, NBA teams were owned by families for generations. Abe Pollin, a successful construction contractor, purchased the Baltimore Bullets in 1964 and held on to them for the next 46 years. Jerry Buss, a real estate investor, bought the Los Angeles Lakers in 1979. His family still owns the franchise today. Bill Davidson, former CEO of Guardian Industries, bought the Detroit Pistons in 1974 for $6 million. As teams became more expensive, ownership groups began to form with a majority stakeholder leading a group of investors. Owners serve on the NBA Board of Governors and guide the league through all decision making processes.

In 1946, the Warriors started in Philadelphia as a founding member of the BAA. The team won the inaugural championship and followed up with another title in 1956. Despite this success, the team moved to San Francisco in 1962 under the new ownership of Franklin Mieuli, who bought the Warriors for $850,000. In 1971, the team changed their name to the Golden State Warriors and played games in Oakland and San Diego. In 1972, they began to play exclusively at the Oakland Arena and won their next championship in 1975.

In the 1980s, the team went through a downturn and in 1986 was sold to Jim Fitzgerald and Dan Finnane for a rumored price of less than $20 million. In the 1980s, the team put together a short period of exciting play, dubbed run TMC. However, after an ugly season in which the team was forced to trade franchise cornerstone Chris Webber, the team endured many losing seasons. In 1994, Chris Cohan purchased the team for $119 million with the hope of turning them around. However, in 1997, star player Latrell Spreewell was suspended for an entire seasons after choking coach PJ Carlesimo. The team made the playoffs only once between 1994 and 2010. The 2007 Warriors playoff team captured the nation's attention as the ultimate underdog and provided one of the biggest upsets in playoff history when they beat the top-seeded Dallas Mavericks. However, the team quickly slid back to sub-mediocrity after losing star player Baron Davis to free agency. In the 16 seasons under Chris Cohan's ownership, the Warriors had the 2nd worst aggregate record in the NBA and had lost franchise cornerstones every time momentum appeared to be building.

Despite facing losses and embarrassment, the Warriors managed to draw fans at about the league average and counted a dedicated fan base among its assets. During the 2007 playoff run, Oracle Arena became known as the "Roaracle" when fans set arena decibel records. The team resided in a top 10 media market that boasted two baseball teams, two football teams, but only one basketball team. Its local TV deal with Comcast Sports Net earned the team about $10 million per season, which was well below the league average of $17 million, but expired after the 2011-12 season. Ticket sales hovered around the league average at $35 million per season despite being located in one of the largest and wealthiest media markets.

In the most recent season (2009-10) the team went 26-56. In the previous 5 seasons, the team had a 45.6% win percentage. However, the team had a young, promising core, which included star player Monta Ellis and 2009 first round pick Stephen Curry. However, the Warriors were not profitable and had a history of losing potential star players. Despite this, the Warriors were still valued at approximately $325 million in 2010.

Joe Lacob's Decision

Joe Lacob had always wanted to own a sports team. As a child growing up in Massachusetts, he had fallen in love with the Red Sox and great Celtics of the 60s. In his teenage years, his family moved to Anaheim, where he sold peanuts at Angels Stadium to help pay for school and later watched the birth of a Lakers dynasty in the early 80s. Now a 25-year resident of Silicon Valley, he was an avid Bay Area sports fan with love for the Oakland A's and Golden State Warriors.

As an undergrad, Joe Lacob attended UC Irvine and majored in Biological Sciences. He had plans to attend medical school, but was not accepted to any programs. He spent the next year at a Masters program in Epidemiology at UCLA and then worked in the healthcare industry for two years. He then decided to attend the Stanford Graduate School of Business. After graduating, he started a healthcare company but was instead asked to join his investors, Kleiner Perkins Caufield & Byers. After 25 years at KPCB, he had worked on major investments across healthcare, biotechnology, and tech, including Align Technology, NeuroPace, Autotrader.com and SportsLine. Joe's previous experiences in academics and industry shaped his approach to investing. He was an opportunistic investor who deeply understood the strategy of investing. Lastly, he was always patient, clearheaded, and rational.

The Warriors presented a unique opportunity. Media and TV money in sports was growing rapidly, leading to large increases in revenue for teams. The Warriors had 2 more years on its local TV contract, and the NBA had 6 more years on its national TV deal. Therefore, the Warriors TV revenue was locked in for at least 2 more years. Since the Warriors consistently underperformed for so long, there was inherent upside to improve the franchise. However, Joe wondered how he could measure the potential of a franchise that had been performing poorly for such a long time. The "We Believe" playoff run in 2007 painted a picture of what things could be like if the team performed well, but it was a small sample size over a short period of time. Would improved on court performance really change what had been a league average performing business? If not, the financial losses would remain substantial and likely continue for some time.

In addition to franchise related risks, the league had lost a collective $370 million in the 2009-10 season. Further, the league's CBA was set to expire in 2011. Rumors were starting to surface that there would be a lockout, and some even feared the entire 2011-12 season could be lost, which would mean an entire year of lost revenue. The new CBA could improve the economics of the NBA by reducing player salary costs. Or it could permanently damage the league in the eyes of its fans due to another long lockout. This would give Joe Lacob just one year to assess a new team and start making his imprint. Could Joe build on this promising team he has currently and assemble a winning team?

Conclusion

As Joe sat in his hotel room, he recapped the potential opportunity. Sports teams were unique investment opportunities — very few of them were available at any given time and as a result were difficult to value. The Warriors, in particular, did not have great on-court or financial performance, so Joe would be betting on a turnaround. If he could recruit a great team and build the Warriors like the many successful startups that he had funded as a venture investor, there would be clear paths to improving both the on-court and overall business performance of the franchise. Plus, several looming changes to the Warriors' TV contract and the CBA could really be game changers for the investment opportunity. However, with a potential lockout looming, he knew a lost season would be costly and potentially threaten the viability of the entire investment.

As his email buzzed with updates from his legal team in NY and the clock continued ticking on the Greek transport strike, Joe knew he had to decide. Should he move ahead with this deal? What would be his final offer?

Exhibits

Exhibit 1: Last 6 NBA Team Purchases

Team	Year	Purchase Price	Last 5 Seasons Win Pct.	Metro Area Population	Other Professional Sports Teams in Metro Area
Brooklyn Nets	2010	$365M	0.414	20,092,883	Knicks (NBA), Jets (NFL), Giants (NFL), Yankees (MLB), Mets (MLB), Rangers (NHL), Devils (NHL)
Washington Wizards*	2010	$551M	0.417	6,033,737	Redskins (NFL), Nationals (MLB), Capitals (NHL)
Charlotte Hornets	2010	$175M	0.414	2,223,635	Panthers (NFL)
Oklahoma City Thunder	2006	$325M	0.509	1,322,459	N/A
Cleveland Cavaliers	2005	$375M	0.373	2,077,240	Browns (NFL), Indians (MLB)
Phoenix Suns	2004	$404M	0.519	3,715,360	Cardinals (NFL), Diamondbacks (MLB), Coyotes (NHL)

Note: *Purchase price includes team and arena

Exhibit 2: Golden State Warriors Financials — 2005-2010

Revenue	2005-06 Actual	2006-07 Actual	2007-08 Actual	2008-09 Actual	2009-10 Forecast
Ticket Sales	33,235	40,430	49,859	53,596	41,600
NBA Revenues	30,416	31,391	31,502	33,332	35,471
Local TV	7,750	8,850	8,560	9,250	9,750
Local Radio	460	918	1,569	1,118	830
Corporate Sponsorships	6,573	8,751	11,392	11,158	10,859
Luxury Suites	6,589	7,774	7,789	7,159	6,776
Concessions & Parking	3,235	3,756	4,428	3,771	2,564
Merchandising	1,390	2,142	2,685	1,571	1,179
Playoffs		8,022			
Other	1,357	1,280	1,893	2,073	1,203
Total Revenue	91,004	113,314	119,678	123,028	110,232
Expense					
Player Compensation	57,565	65,161	59,749	58,411	59,669
NBA Escrow & Luxury Tax	(7,509)	(6,450)	(8,530)	(9,743)	(8,819)
Basketball Staff	5,526	11,496	7,885	7,991	7,471
Scouting	1,443	1,369	1,237	1,213	1,100
Other team expense	13,059	16,226	15,229	16,768	11,553
Arena Rent & Debt Service	8,500	8,087	8,574	7,982	6,135
Game Day expenses	1,298	1,248	1,601	1,479	1,452
Business Operations	20,110	20,510	25,599	26,677	26,518
Playoffs		6,162			
Total Expense	99,993	123,810	111,344	110,778	105,079
EBITDA	(8,988)	(10,496)	8,334	12,249	5,153

Exhibit 3: Local TV Contract

Fiscal Year	Yearly Contract Value ($'s 000)
FY 2008	$9,250
FY 2009	$9,750
FY 2010	$10,250
FY 2011	$10,750

Note: The current local TV deal is signed through FY 2011 (2011/12 season). The NBA average for local team contracts is approximately $17 million per year. Team in similar sized markets, such as Detroit, Philadelphia, and Boston, have deals in the $20 million-$25 million per year range.