EDISON

Borussia Dortmund

Company reappraisal

Winning ways

Travel & leisure

Borussia Dortmund appears headed for record pre-transfer EBITDA in the current year, suggesting that the Wembley-led comparative was not as good as it gets. Underlying profit progression marks the management's positive development of the company's powerful brand on a platform of continued playing success. The market's lack of recognition of the creation of a sustainable business contrasts with the apparently high ratings accorded to major privately-owned football clubs.

Year end	Revenue* (€m)	EBITDA* (€m)	PBT** (€m)	EPS** (€)	DPS (€)	EV/EBITDA (x)
06/12	189.1	36.8	45.1	0.55	0.06	8.8
06/13	253.4	42.1	71.6	0.99	0.10	7.4
06/14e	254.0	45.0	36.5	0.50	0.06	6.6
06/15e	251.0	46.0	34.0	0.47	0.06	6.7

Note: *Before player transfer income. **PBT and EPS are normalised, excluding intangible amortisation, exceptional items and share-based payments.

Resilient earnings

The current year could see an increase in underlying EBITDA despite not matching the Champions League heroics of 2013. Such progress is yet more impressive in the face of materially lower UEFA distribution as runners-up in the Bundesliga in 2012/13 (champions in the previous year) and persistent high costs associated with player signings, key contract renewals, merchandise expansion and stadium refurbishment. FY15 should see further progress and may surprise as we have not allowed for Champions League beyond the Round of 16 (estimated additional c €4m EBITDA in FY14). The acquisitions of last season's Serie A top scorer Ciro Immobile and fourth highest Bundesliga scorer Adrián Ramos may allay concern at the loss of Robert Lewandowski. Finances remain strong even after this investment (FY15e net debt/EBITDA of 1.1x).

Proven strategy

This management has transformed the company's fortunes since near-bankruptcy in 2005. It is successfully pursuing a well-defined strategy centred on developing core revenue sources such as broadcasting, advertising, match operations and merchandising. It is maximising success on the field without taking on new debt, while achieving a balance between financial and sporting interests.

Undervalued

Despite a lack of comparable peers, we feel that an EV/EBITDA (pre-transfer) of 6.7x FY15e does not reflect the long-term potential of strong brand development, valuable media rights and sustainable cash flow, backed by freehold property and substantial subscription revenue, and hidden reserves from player development. EV against resilient and growing revenue is only 1.2x prospective. A free cash flow yield of 7% (now 7.8%) would imply a share price of €4.65.

6 June 2014

Price	**€4.20**
Market cap	**€258m**

Net debt (€m) at March 2014	62.7
Shares in issue	61.4m
Free float	76%
Code	BVB
Primary exchange	Frankfurt
Secondary exchange	N/A

Share price performance

%	1m	3m	12m
Abs	(2.3)	0.9	15.4
Rel (local)	(2.4)	(1.4)	(0.8)
52-week high/low		€4.08	€2.90

Business description

The group operates Borussia Dortmund, a leading German football club, recent back-to-back champions of the Bundesliga and quarter-finalist in 2013/14 UEFA Champions League (finalist in 2012/13).

Next events

Edison roadshow	12 June 2014
Full-year results	Late August 2014

Analysts

Richard Finch	+44 (0)20 3077 5700
Neil Shah	+44 (0)20 3077 5715

consumer@edisongroup.com

Edison profile page

Borussia Dortmund is a client of Edison Investment Research Limited

Investment summary: Winning ways

Company description: A leading German football club

Borussia Dortmund has been a major force in German football for decades. Second only to Bayern Munich in terms of Bundesliga titles over the last 20 years, it was the first German club to win a European competition (the European Cup Winners' Cup in 1966) and the Champions League in 1997. In the past two seasons it has finished second in the Bundesliga and gone deep in the Champions League. The club's fabled stadium (the Westfalenstadion, now formally SIGNAL IDUNA PARK) has long enjoyed the highest average attendance (over 80,000) in the country and indeed in Europe. Borussia Dortmund was formed as Ballspielverein Borussia 09 e.V. Dortmund in 1909 (hence the BVB 09 logo) and was listed on the Frankfurt Stock Exchange in 2000.

Undervalued

Despite a lack of comparability with peers, Borussia Dortmund is rated among the lowest. However, we prefer to focus on the company's success in creating value in a sustainable business. Its EV/EBITDA (before transfers) rating of 6.7x FY15e does not, in our view, reflect the long-term potential of powerful brand development, valuable media rights and sustainable positive cash flow, backed by freehold property, substantial subscription revenue, and hidden reserves from player investment. EV as a share of resilient and growing revenue is only 1.2x prospective. Free cash flow generation has been strong and sustained and current free cash flow yield is 7.8%. Assuming a more moderate 7% FCF yield implies a share price of €4.65. The company's transfer policy continues to generate significant hidden reserves in player values. Despite a neutral balance of transfers since 2009 the surplus of market value, estimated by www.transfermarkt.de, to net player assets (excluding Lewandowski, as leaving on a free transfer) at March 2014 is over €200m.

Sensitivities

The company's business operations are dependent on the success of the football club. Participation in lucrative UEFA competitions cannot be relied upon although the club has qualified comfortably in recent seasons. While serious player injuries cannot be foreseen, the club maintains a strong squad and minimises the risk of poor investment by intensive scouting and medical examinations. The company competes for a share of disposable consumer income, which may be eroded by economic downturn, but home attendance remains buoyant. Borussia Dortmund is reliant on the strength of its brand. Key agreements may not be renewed but the company has long-term contracts with major sponsors. The club is subject to external governing bodies, which may change the structure of German and European football; in terms of finances the company is in tune with a market subject to growing regulation. Negotiation of key media contracts is outside the company's control. The club is obliged to pay players and coaching staff in line with competitors; its wages/revenue ratio is relatively low. Aware of potentially conflicting sporting and financial aims, management seeks to ensure that cash flows stabilise at a positive level on a lasting basis.

Financials

After its financial troubles under previous management Dortmund has successfully implemented a clear strategy focused on developing core revenue sources such as advertising, merchandising, match operations and broadcasting. Management is similarly intent on maximising success on the field without taking on new debt, while achieving a balance between financial and sporting interests.

The current year is headed for record EBITDA before transfers despite not matching the Champions League success of FY13.

The company reports quarterly, with preliminary results for the full year due in late August.

Company description: A leading German football club

Fine pedigree: Since its formation in 1909 Borussia Dortmund has become one of Germany's most successful football clubs, having won eight national championships, three German Cups and five German Supercups as well as the Champions League in 1997 and the European Cup Winners' Cup in 1966.

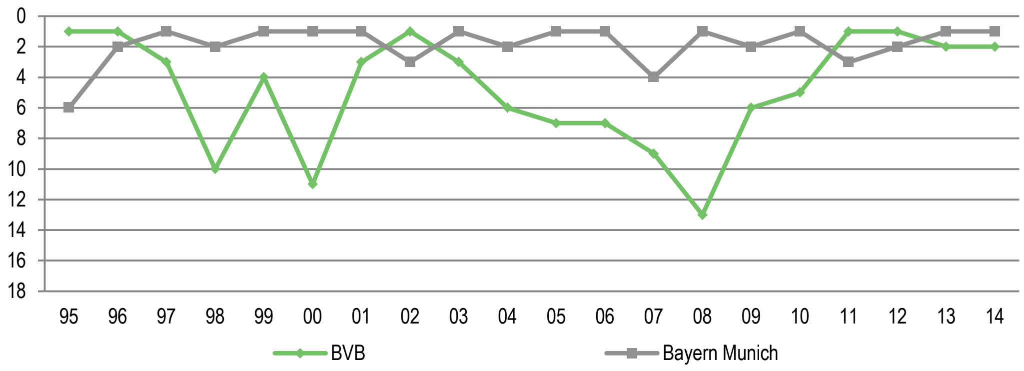
Exhibit 1: Club honours

German championship*	1956, 1957, 1963, 1995, 1996, 2002, 2011 and 2012
DFB Cup	1965, 1989 and 2012
German Supercup	1989, 1995, 1996, 2008** and 2013
UEFA Champions League	1997 (defeated Juventus 3-1 in final)
European Cup Winners' Cup	1966 (defeated Liverpool 2-1 in final)
Intercontinental Cup	1997 (defeated Cruzeiro 2-0 in final)

Source: Bundesliga. Note: *Bundesliga from 1964. **Unofficial.

During the 51 years of the Bundesliga the club has achieved top six status (the current benchmark for UEFA competition qualification) on 21 occasions (including the recent season when it was second) in addition to its five titles. Indeed more recently, as shown in Exhibit 2, Dortmund's performance in the Bundesliga has been second only to dominant Bayern Munich as the only other club to have won multiple titles in the last 20 years. The prolonged decline between 2003 and 2008 reflects financial troubles under the club's previous management.

Exhibit 2: Bundesliga ranking over the last 20 years



Source: Bundesliga

Head coach: Jürgen Klopp. Before his appointment in 2008 he was coach of Mainz for seven years, guiding the club to promotion from the second division in 2004 and 11th place in the Bundesliga the following year. As a player for Mainz, he holds the club appearance record and is the second highest goalscorer. He is 46 and his contract at Dortmund runs until 2018.

Sporting director – Michael Zorc has spent his whole career at Dortmund, first as player for 17 years (Bundesliga appearance record), culminating in the Bundesliga and Champions League success of the mid 90s and then as sports director since 1998. His contract was recently extended to 2019.

Exhibit 3: Squad participation in 2013-14 season (50 matches: 34 Bundesliga; 10 CL; and 6 German Cup)

	Nationality	Age**	At BVB since	From	Contract expiry	Matches started	Goals
Goalkeepers							
Roman Weidenfeller	Ger*	33	2002	Kaiserslautern	2016	42	-
Mitchell Langerak	Aus*	24	2010	Melbourne Victory	2016	8	-
Defenders							
Sokratis	**Gre***	**25**	**2013**	**Werder Bremen**	**2018**	**35**	**1**
Mats Hummels	Ger*	24	2008	Bayern München	2017	34	2
Marcel Schmelzer	Ger*	25	2005	Magdeburg	2017	26	1
Lukasz Piszczek	Pol*	28	2010	Hertha Berlin	2017	22	3
Erik Durm	Ger	21	2012	Mainz	2017	22	-
Marian Sarr	Ger	18	2013	Bayer Leverkusen	2017	3	-
Neven Subotic	Srb*	24	2008	Mainz	2016	15	-
Manuel Friedrich	**Ger**	**33**	**2013**	**Bayer Leverkusen**	**2014**	**12**	**1**
Midfield							
Jakub Blaszczykowski	Pol*	27	2007	Wisla Krakau	2018	17	3
Milos Jojic	**Srb**	**21**	**2014**	**Partizan Belgrade**	**2018**	**7**	**4**
Jonas Hofmann	Ger	21	2011	TSG Hoffenheim	2018	5	3
Henrikh Mkhitaryan	**Arm***	**24**	**2013**	**Shakhtar Donetsk**	**2017**	**44**	**13**
Nuri Sahin	Tur*	24	2013	Real Madrid	2017***	44	2
Marco Reus	Ger*	24	2012	Borussia M'gladbach	2017¶	39	21
Sven Bender	Ger*	24	2009	TSV 1860 Munich	2017	24	1
Kevin Großkreutz	Ger*	25	2009	Rot Weiss Ahlen	2016	47	3
Oliver Kirch	Ger	30	2012	Kaiserslautern	2016	6	1
Ilkay Gündogan	Ger*	22	2011	Nuremberg	2016	2	-
Sebastian Kehl	Ger	33	2002	Freiburg	2015	21	2
Forwards							
Pierre-Emerick Aubameyang	**Gab***	**24**	**2013**	**St Etienne**	**2018**	**27**	**16**
Marvin Ducksch	Ger	19	2002	-	2018	1	1
Julian Schieber	Ger	24	2012	VfB Stuttgart	2016	2	1
Robert Lewandowski	Pol*	24	2010	Lech Poznan	2014§	45	28¥

Source: Bundesliga, Borussia Dortmund. Note: *Current full international. **Age at start of season. ***On loan in season. § Joins Bayern Munich next season. ¥ 2013/14 Bundesliga top scorer with 20 goals. 2013/14 Bundesliga Player of the Season. **Bold** = acquisitions for season.

Continuing riches: The first-team squad has an average age of 25, which is typical for the Bundesliga, and includes at least 16 current full internationals. While Kehl and Weidenfeller provide valuable experience, the likes of Hummels, Schmelzer, Bender and Großkreutz have been successfully developed into the first-team and younger players such as Durm and Hofmann are being introduced. Mkhitaryan, Aubameyang and Sokratis arrived in 2013/14 following Götze's move to Bayern. The team is praised for its vibrant attacking style in keeping with the well-known enthusiasm and passion of its head coach. It failed to score on only two occasions in the Bundesliga last season (15 goals in its last five away fixtures). Most key players and coach Klopp are contracted until 2017 or beyond.

The club was again very successful in 2013/14: second in the Bundesliga (71points was its third highest total and would have won the title in 2007, 2009 and 2010), quarter-finalist in the Champions League (losing to winners Real Madrid) and finalist in the DFB Cup (losing to Bayern). It won the German Supercup against Bayern on the eve of the season. This was all the more creditable in view of an unprecedented spate of injuries to key players. As shown in Exhibit 3, Hummels, Schmelzer, Piszczek, Subotic, Blaszczykowski, Bender and Gündogan played a combined average of just 20 games out of a possible 50, which is barely half that in the previous season. Their expected return in 2014/15 should mark a significant strengthening of the team, even before transfer activity, and help to offset the loss of Lewandowski. In this regard the club has signed last season's Serie A leading scorer Ciro Immobile from Torino and Adrián Ramos (fourth with Reus in the 2013/14 Bundesliga goals table) from Hertha Berlin.

Coherent strategy

After its financial troubles (see page 9) Borussia Dortmund has successfully pursued a well-defined strategy centred on developing core revenue sources such as broadcasting, advertising, match operations and merchandising. Management is similarly intent on maximising success on the field without taking on new debt, while achieving a balance between financial and sporting interests.

- **Squad development:** Exhibit 3 shows that the company is adhering effectively to its aim of putting together a competitive team with a focus on promising young players and "under a cost-optimised budget." Under coach Klopp transfer activity (Exhibit 4) has been restrained with the only "trophy" signing being that of Marco Reus, which is rather "the return of the lost son to his spiritual home" (BVB website) as he played his youth football for BVB. Robert Lewandowski proved a bargain at under €5m as consistently a leading scorer in the Bundesliga and Champions League. Last season's "windfall" proceeds from the departure of Mario Götze to Bayern Munich explain the relative buying spree in summer 2013. Similarly, the recent acquisition of Immobile and Ramos does not mark an abandonment of the company's investment policy, rather it is well within its resources and may of course be offset by disposals. Identification of up-and-coming players at minimal cost (even free) and their development at the new "BVB Academy" are to the fore, underpinning a healthy potential surplus to book value, as estimated by www.transfermarkt.de (see below). On disposals, management is aware of the potential conflict between financial and sporting interests and looks to have achieved a good balance with considered sales, notably Sahin (later returned on loan from Real Madrid) and Nagawa.

Exhibit 4: Significant player transactions by coach Jürgen Klopp since 2009

In	Date	Age at signing	Transfer fee (€m)	Current value (est) (€m)	Contract expiry
Hummels	2009	20	4.2	26	2017
Bender	2009	20	Free	18	2017
Großkreutz	2009	20	Free	10	2016
Piszczek	2010	25	Free	15	2017
Lewandowski	2010	21	4.7	50	2014*
Gündogan	2011	20	5.5	27	2016
Reus	2012	23	17.1	30	2017
Mikhitaryan	2013	24	27.5	26	2017
Aubameyang	2013	24	13.0	17	2018
Sokratis	2013	25	9.5	15	2018
Effective 2014/15					
Adrián Ramos	2014	28	9.7	11	2018
Nuri Sahin	2014	25	7.0	12	2017
Ciro Immobile	2014	24	19.4	12	2019
Total estimated current value surplus to cost c €151m*					
OUT	Date	Age at signing	Cost (€m)	Transfer fee (€m)	Buyer
Nuri Sahin	2011	22	Free (BVB)	10.0	Real Madrid
Shinji Kagawa	2012	23	0.3 (2010)	16.0	Man United
Lucas Barrios	2012	27	4.2 (2009)	8.5	Guangzhou
Mario Götze	2013	20	Free (BVB)	37.0	Bayern Munich
Ivan Perisic	2013	23	5.5 (2011)	7.5	Wolfsburg
Total estimated realised surplus to cost c €69m					

Source: www.transfermarkt.de. Note: *Including c €45m, which is unrealisable owing to expiry of contract (free transfer to Bayern Munich).

Dortmund's positive reconciliation of conflicting interests is further highlighted by the disparity in its recent net transfer balance (amount received less paid) with those of its fellow Champions League quarter-finalists, with the notable exception of Atlético Madrid although this seems primarily to be a function of the latter's difficult finances. Exhibit 5 shows the last five seasons when coach Klopp was fully into his stride. The comparison with Bayern is telling as Bundesliga performance is also taken into account. Although the last two seasons have shown a clear points inferiority, Dortmund has achieved second place and Champions League football at a fraction of Bayern's net spend.

Exhibit 5: Net transfer balances in last five seasons of 2013/14 Champions League quarter-finalists

€m	2009/10	2010/11	2011/12	2012/13	2013/14	Cumulative since 2009/10 Net balance	Bundesliga rank (points)
Borussia Dortmund	-5 (5)	-2 (1)	+1 (1)	+7 (2)	-5 (2)	-4	2 (347)
Bayern Munich	-52 (1)	-7 (3)	-39 (2)	-70 (1)	-22 (1)	-190	1 (390)
Atlético Madrid	+1	-10	+10	+15	+44	+60	-
Manchester United	+77	-11	-42	-61	-77	-114	-
Barcelona	-88	-20	-13	-32	-39	-192	-
Chelsea	-26	-110	-73	-90	-56	-355	-
Paris Saint-Germain	-9	-2	-96	-144	-109	-360	-
Real Madrid	-170	-83	-47	-	-67	-367	-

Source: www.transfermarkt.de. Note: Bundesliga rank in brackets.

- **Brand development:** The “Borussia Dortmund” brand is a prime asset. It has just been ranked by Brand Finance as the ninth most valuable football brand, with a trebling in value since 2010 thanks to Champions League exposure. According to SPORTFIVE, Germany’s leading sports media rights agency, the club has one of the largest fan bases with 37m supporters in Germany and 6.6m fans and over 550 fan clubs worldwide. Average Bundesliga home match attendance of c 80,000 is consistently the highest in Europe. Reflecting the longstanding devotion of the club’s Westphalia heartland and epitomised by the fervent atmosphere of the “Gelbe Wand” (“Yellow Wall”) at the “Südtribüne,” the largest stadium standing area in the world, BVB’s brand image is one of intensity and loyalty, which is a strong platform for advertising.

  Management aims to monetise this, as follows:

  - **Advertising (28% of FY14e revenue):** Typically long-term contracts with leading regional and international companies with a proven ability to renew at higher prices or market new opportunities. Principal sponsors are EVONIK (shirt, extended to 2016), SIGNAL IDUNA (stadium, extended to 2021) and PUMA (kit, until 2020). There are currently 12 “BVBChampionPartners” as well as about 40 lower-tier sponsors. This activity is outsourced to SPORTFIVE, which receives commission on revenue generated.
  - **Merchandising (14% of FY14e revenue):** The award of licences and revenue from the sale of team merchandise. In addition to partners’ wholesale distribution channels, sales are made via branded stores (FanShops), an e-commerce platform (www.shop.bvb.de) and a truck that attends all away matches. No overseas sales offices are planned.
  - **New media:** New fans are being attracted via Facebook (9m “likes” on the official fan page, up fourfold in the last year) and Twitter (c 1m followers, also up x4). However, both are small compared with Chelsea and Arsenal, which have respectively 30m and 24m Facebook “likes” and nearly 4m Twitter followers, which indicates scope for Dortmund. Mobile phone apps and games enjoy strong growth, as does the web portal “meinBVB.de.”
  - **Pay TV:** In 2011 the company was the first Bundesliga club to offer its own TV package in co-operation with Deutsche Telekom. “BVB Total” shows all club Bundesliga matches “live” and matches in other competitions via delayed streaming. A sponsored talk show and an English-language “round-up” programme for international markets have also been devised.
  - **Matchday operations (17% of FY14e revenue):** Management regards SIGNAL IDUNA PARK, Germany’s largest stadium, as its most valuable asset apart from the team. With home matches sold out and a policy of inflation pricing as a community club, the scope for ticketing revenue growth is limited. Apparent underachievement with the likes of Arsenal and Manchester United, where ticketing was 38% and 30% respectively of FY13 revenue, is thus unfair; Bayern Munich’s 22% revenue share (FY13) is a better comparative. Two-thirds of capacity is pre-sold as season tickets, which brings significant revenue visibility, and an annual footfall of 1.4m spectators at Bundesliga games alone gives potential for ancillary income from merchandising and catering. The stadium is not multi-functional.

- **Broadcasting (32% of FY14e revenue):** Marketing of media rights is conducted centrally by the Bundesliga and UEFA, hence outside company control. However, the system of revenue distribution to clubs is defined well in advance, with the Bundesliga agreeing in 2012 the sale of rights for four seasons from 2013/14 and UEFA selling rights on a three-year basis. The current Bundesliga deal is worth an extra 45%.. As for average attendance, the Bundesliga is much higher than the Premier League, La Liga and Serie A. UEFA raised Champions League distribution by 20% from the start of the 2012/15 rights cycle and 2015/18 distribution should be buoyed by a more than doubling in the sales value of rights for the UK TV market (BT Sport).

Management

The company's senior management (see below) is backed by highly experienced management of the non-sports businesses and coaching staff.

- **Chief Executive: Hans-Joachim Watzke**. Before his appointment in 2005 Mr Watzke was treasurer of the football club. His contract runs to end 2016. He is also the owner-founder of Watex, a leading manufacturer of protective clothing for industrial workers and firefighters.
- **Chief Financial Officer: Thomas Treß** was appointed second managing director in 2005 and has been responsible for finance since 2006. His contract runs to mid-2016. He was previously a partner at RölfsPartner, one of the leading business consultancies in Germany. He was awarded "CFO of the year 2013" by the German *FINANCE-Magazine*.

Sensitivities

- The company's business operations are dependent on footballing success. Weak performance on the field could cause revenue to fall and affect the ability to attract and retain players and coaches. Participation in lucrative UEFA competitions cannot be relied upon, although the club has again qualified comfortably for the Champions League next season.
- While serious player injuries cannot be foreseen, the club has a strong team squad and minimises the risk of poor investment in players by intensive scouting and medical examination.
- The company competes for a share of disposable consumer income, which may be eroded by economic downturn. However, attendance at home matches is resilient (much the highest in the Bundesliga) and ticket prices are lower than those of leading competitors. The increasing popularity of the Bundesliga is evident in a sharp rise in the value of future broadcast rights.
- Borussia Dortmund is reliant on the strength of its brand. While damage may impair its ability to attract sponsors and partners, the company invests heavily to deliver consistent quality. Long-term contracts with major sponsors give security independent of sporting performance.
- Dortmund is subject to external governing bodies, eg the Bundesliga, DFB, UEFA and FIFA, which may change the structure of German and European football. In terms of finances, the company is in tune with a market subject to growing regulation, notably the new break-even requirement for participation in UEFA competitions.
- Negotiation and pricing of key media contracts are outside the company's control and those contracts may change, as last year with regard to Bundesliga TV rights from 2013/14.
- The company's digital media strategy is unproven. Piracy and illegal live streaming may adversely affect its broadcasting and new media and mobile revenue.
- The club is obliged to pay players and coaching staff in line with competitors. Labour costs in FY13 accounted for 42% of its revenue excluding transfers, which is lower than key peers.

- Interest rate risk is minimised by the significant fixed element of borrowings and by interest-rate swap transactions. The company's long-term debt is substantially in place until 2020-26.
- Aware of a potential conflict between sporting objectives and financial requirements, management aims to ensure that cash flows stabilise at a positive level on a lasting basis.

Valuation

Among major listed peers, there is limited comparability with Dortmund in terms of valuation indicators. By far the largest by capitalisation, Manchester United and Arsenal offer very limited free float, while Juventus, although with similar market value to Dortmund, has a majority shareholder and expects a lower outturn this year owing to earlier elimination from the Champions League than in FY13. This also applies to Celtic, whose historic multiple is thus flattering. Olympique Lyonnais continues to find the going tough during restructuring with a further EBITDA loss in H114 and a subsequent narrow failure to qualify for the Champions League. Against available peer numbers (forecasts are not available for most) Dortmund is rated among the lowest.

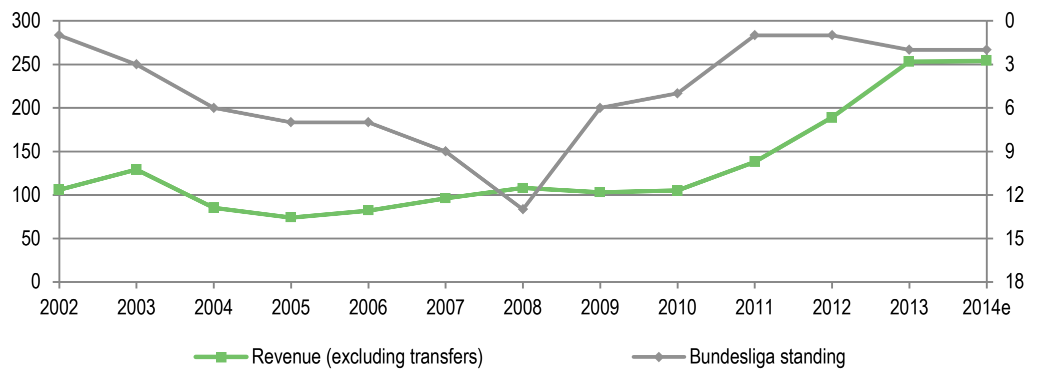
Exhibit 6: Valuation comparison with major listed peers

Prospective	EV	EBITDA*	Revenue	EV/EBITDA	EV/revenue
Borussia Dortmund	€277m	€45m	€254m	6.2	1.1
Manchester United	$3.19bn**	£130m***	£425m**	14.9	4.6
Historic					
Borussia Dortmund	€285m	€42.1m	€253m	6.8	1.1
Arsenal	£1.04bn	£29.6m	£283m	35.1	3.7
Juventus	€390m	€47.7m	€272m	8.2	1.4
Celtic	£71m	£14.9m	£76m	4.8	0.9
Olympique Lyonnais	€57m	(€13.5m)	€101m	-	0.6

Source: Company accounts. Note: *Before player transfer income. **$1.65/£. ***Mid-point of guidance at May 2014. Year-end June for all except Arsenal (May). **Prices as at 2 June 2014.**

This low valuation is highlighted by two recent investments in privately owned Bundesliga clubs. The acquisition by Allianz of 8% of Bayern Munich for €110m suggests multiples of c 20x FY13 EBITDA and over 3x revenue, while KKR's purchase of 10% of Hertha Berlin for c €60m points to a total valuation that dwarfs that of the much more successful Dortmund. Although its listed status and large free float militate against such a high rating, we believe that the sustainability of Dortmund's model and scope for value creation deserve better recognition in valuations. In terms of pre-transfer EV/EBITDA (net debt including finance leases), the low rating of 6.7x FY15e does not reflect the long-term potential of strong brand development, valuable media rights and positive cash flow, backed by substantial season ticket sales and hidden reserves from player investment.

Exhibit 7: Revenue (excluding transfers) and Bundesliga performance since 2002



Source: BVB accounts, Bundesliga

It also appears undervalued in respect of the strength of its non-transfer revenue. Exhibit 7 shows resilience during a dip in playing fortunes, reflecting the longer-term nature of most of its income. The EV/non-transfer revenue multiple is just 1.2x prospective.

Value creation is emphasised by the company's transfer policy, which is generating substantial hidden reserves in player values. The past five years under coach Klopp have seen average capital gains of €18m and the scope for further gains is high. Despite a neutral balance of transfer income and expenditure the surplus of market value, estimated by www.transfermarkt.de, to net player assets at March 2014 is c €207m (excludes Lewandowski, who leaves on a free transfer at end FY14). That surplus is reassuring, even though it is to be treated with caution, as it is notional and because company policy is for disposal only in special cases. There is security also in the freehold value of the stadium (at June 2013 €121m or €1.98 NAV), while Brand Finance has newly accorded Dortmund a brand value of $260m, up 15% in 2013.

Free cash flow (see Exhibit 9) is running at €20m before player acquisitions and disposals (with upside), implying a free cash flow yield of c 7.8%. Assuming a more moderate 7% FCF yield implies a share price of €4.65.

We feel Dortmund should be rewarded for its disciplined model at a time of increasing regulation. Unsustainable spend on wages and transfers is being penalised by new UEFA Financial Fair Play requirements. Nine clubs, including Paris Saint-Germain and Manchester City, were recently found to be non-compliant and face sanctions such as fines and a cap on wages and squad size.

Investor sentiment may be helped by Dortmund's admission to the "Prime Standard" of the Frankfurt Stock Exchange in recognition of compliance with international transparency standards. It will be included in the SDAX index from 23 June.

Financials

Borussia Dortmund's turnaround has been remarkable. The company was at risk of bankruptcy in 2005, broadly attributed to extravagance, notably on foreign players, after Bundesliga success. New management (the current CEO and CFO) implemented a reorganisation programme, which included the restructuring of liabilities through a long-term fixed-interest loan from Morgan Stanley, cost-cutting and a strategy of revenue development and sustainable investment in players (see above). Key initiatives included the repurchase of the stadium, eliminating high rental costs, and early repayment of the loan via a long-term agreement with marketing partner SPORTFIVE, while early extension of flagship contracts endorsed the advertising strategy. Jürgen Klopp's appointment as coach was in tune with management's approach to player investment. Financial recovery was not boosted by European participation until 2011 and was in the teeth of economic downturn.

FY14: The nine months to March saw almost a double-digit rise in revenue, which is creditable, given lower UEFA Champions League distribution (we estimate down 10% or c €4m) for having finished as runners-up in the Bundesliga in 2012/13, compared with being champions in FY12. While advertising and merchandising were again to the fore (+9% and +22% respectively), there was an initial strong boost from the newly-increased Bundesliga broadcasting contract (estimated +29% or c +€6m as not disclosed by the company). However, success has come at a price as costs remained an issue, especially labour (+16% or + c €11m), reflecting player signings and key contract renewals. This led to an 11% reduction in EBITDA before transfers.

Full-year: We are raising our revenue forecast by €12m owing to top-line buoyancy but holding EBITDA owing to cost pressures. We believe that the aforementioned shortfall in EBITDA can be recouped in Q4 as the comparative period was depressed by exceptional costs associated with the Champions League Final (eg player bonuses, advertising agency commissions, administration and match operations) and the Götze exit. Q413 EBITDA margin was just 7% against 21% in the preceding nine months and 17% in the year to date. We assume labour costs down 25% in Q4. Our estimate of €9m UEFA revenue in the quarter comprises €4m from the quarter-finals and €5m from the market pool. There should be a higher contribution from the DFB Cup on reaching the final.

FY15: We are now assuming Champions League progress to the Round of 16 rather than exit at the group stage, which appears reasonable, given last season's continued success and annual player labour costs of c €100m. Revenue and EBITDA are raised by €15m and €5m respectively from our March report. This is one round less than last year, hence the expected fall in income from UEFA broadcasting, match operations and performance bonuses. However, this could well be made up by buoyant advertising and merchandising. Likely constrained operating costs after the step change in recent years could allow improved EBITDA despite slightly reduced playing success.

Exhibit 8: Revenue and profit analysis

Year end June (€m)	H113	Q313	Q413	FY13	H114	Q314	Q414e	FY14e	2015e
Home matches									▲
Bundesliga	8	5	4	17	9	5	3	17	17
Champions League*	3	1	2	6	3	1	1	5	4
DFB Cup	1	-	-	1	-	-	1	1	2
Away Matches:									
Champions League*	3	1	2+Final	6+Final	3	1	1	5	4
DFB Cup	2	1	-	3	3	1	Final	4+Final	2
Revenue									
Match operations:									
Bundesliga	11.4e	7.4e	6.8	25.6	13.0e	7.7e	5.6	26.3	27.1
Champions League	5.9e	2.2e	8.1e	16.2	6.1e	2.3e	4.2	12.6	8.9
DFB Cup	1.5e	0.9e	-	2.4	0.4e	0.3e	2.8	3.5	3.0
Other (Supercup, internationals)	0.3e	0.1e	0.2e	0.6	1.3e	0.1e	0.2	1.6	3.0
Total	**19.1**	**10.6**	**15.1**	**44.8**	**20.8**	**10.4**	**12.8**	**44.0**	**42.0**
Broadcasting:									
Bundesliga	13.4e	7.6e	8.7e	29.7	17.4e	9.7e	11.9	39.0	43.0
Champions League	32.5e	4.0e	18.9e	55.4	28.4e	4.0e	5.6	38.0	33.0
DFB Cup	1.0e	1.5e	-	2.5	0.9e	1.0e	3.6	5.5	3.0
Total	**46.9**	**13.1**	**27.6**	**87.6**	**46.7**	**14.7**	**21.1**	**82.5**	**79.0**
Advertising	31.7	15.2	22.4	69.3	33.8	17.3	19.9	71.0	72.0
Merchandising	17.8	5.4	8.8	32.0	22.6	5.8	6.6	35.0	36.0
Catering / other	8.2	3.9	4.4	16.5	10.5	4.7	2.8	18.0	19.0
Release fees	1.8	-	1.4	3.2	0.6	0.8	2.1	3.5	3.0
Total	**125.5**	**48.3**	**79.6**	**253.4**	**135.0**	**53.8**	**65.2**	**254.0**	**251.0**
Other operating income	1.7	0.6	0.5	2.8	2.6	1.1	0.8	4.5	4.0
Labour costs	(44.5)	(22.9)	(38.8)	(106.2)	(52.2)	(25.9)	(28.9)	(107.0)	(106.0)
Share of revenue	35%	47%	49%	42%	39%	48%	44%	42%	42%
Material costs	(9.9)	(2.9)	(4.7)	(17.5)	(12.3)	(3.5)	(3.2)	(19.0)	(19.5)
Other operating costs	(42.4)	(17.1)	(30.9)	(90.4)	(47.9)	(18.5)	(21.1)	(87.5)	(83.5)
EBITDA before transfers	**30.4**	**6.0**	**5.7**	**42.1**	**25.2**	**7.0**	**12.8**	**45.0**	**46.0**
Margin	**24%**	**12%**	**7%**	**17%**	**19%**	**13%**	**20%**	**18%**	**18%**
Profit on disposal of players	**Neg.**	**3.2**	**42.2§**	**45.4**	**1.5e**	**2.0e**	**-**	**3.5**	**-**
Transfer income	0.4	7.3	43.9	51.6	1.6	2.6	-	4.2	-
Less: Carrying value	0.4	4.1	1.7	6.2	0.1	0.6	-	0.7.	-

Source: Edison Investment Research. Note: ▲Assuming exit from Champions League in Round of 16 § Gain on disposal of Götze.

Cash flow: The company has achieved c €20m positive free cash flow before transfers in each of the last three years and we expect a similar outturn in FY14. A likely €2m net inflow from transfers (notably last summer's aforementioned high-profile signings set against proceeds from disposals, mainly of Götze) should make up for a forecast €2m higher dividend payment, suggesting an overall cut of c €16m in net bank debt, ie to €17m at June 2014. We assume a similar level of season ticket sales (deferred income) to last year. The unpredictability and potential size of transfers and season ticket sales makes forecasting of year-end net bank debt hazardous. There is also c €22m liability from finance leases. In FY15 free cash flow may be yet more positive (estimated €30m) owing to likely lower capex and tax payable. However, this could be more than matched by an estimated €36m negative transfer balance (payments for Immobile, Ramos and Sahin), slightly offset by a €2m lower dividend payment. Dortmund finances are in any case robust (FY15e net debt/EBITDA of 1.1x).

Exhibit 9: Financial summary

€'000s	2012	2013	2014e	2015e
June	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS				
Revenue	189,100	253,400	254,000	251,000
EBITDA	36,800	42,100	45,000	46,000
Player transfers	23,200	45,400	3,500	0
Operating Profit (before amort. and except.)	49,900	76,700	40,500	38,000
Intangible Amortisation	(8,500)	(11,600)	(22,000)	(28,000)
Exceptionals	0	0	0	0
Other	0	0	0	0
Operating Profit	41,400	65,100	18,500	10,000
Net Interest	(4,800)	(5,100)	(4,000)	(4,000)
Profit Before Tax (norm)	45,100	71,600	36,500	34,000
Profit Before Tax (FRS 3)	36,600	60,000	14,500	6,000
Tax	(9,100)	(8,800)	(2,200)	(900)
Profit After Tax (norm)	36,000	62,800	34,300	33,100
Profit After Tax (FRS 3)	27,500	51,200	12,300	5,100
Average Number of Shares Outstanding (m)	61.4	61.4	61.4	61.4
EPS - normalised (c)	55.0	99.2	50.5	47.1
EPS - (IFRS) (c)	44.8	83.4	20.0	8.3
Dividend per share (c)	6.0	10.0	6.0	6.0
EBITDA Margin (%)	19.5	16.6	17.7	18.3
Operating Margin (before GW and except.) (%)	26.4	30.3	15.9	15.1
BALANCE SHEET				
Fixed Assets	210,400	212,200	248,000	261,000
Intangible Assets	25,700	28,400	60,000	70,000
Tangible Assets	182,600	178,400	184,000	187,000
Investments	2,100	5,400	4,000	4,000
Current Assets	38,300	90,200	56,000	45,000
Stocks	5,800	7,600	7,000	7,000
Debtors	24,500	65,900	20,000	21,000
Cash	5,300	12,500	24,000	12,000
Other	2,700	4,200	5,000	5,000
Current Liabilities	(60,600)	(73,000)	(66,500)	(66,000)
Creditors	(54,600)	(68,500)	(62,500)	(61,000)
Short term borrowings	(6,000)	(4,500)	(4,000)	(5,000)
Long Term Liabilities	(93,300)	(87,300)	(87,400)	(88,400)
Long term borrowings	(41,300)	(40,800)	(37,000)	(35,000)
Finance leases	(21,100)	(19,700)	(20,400)	(20,400)
Other long term liabilities	(30,900)	(26,800)	(30,000)	(33,000)
Net Assets	94,800	142,100	150,100	151,600
CASH FLOW				
Operating Cash Flow	32,700	40,700	42,000	43,000
Net Interest	(4,900)	(5,000)	(4,000)	(4,000)
Tax	(1,100)	(8,800)	(8,000)	(3,000)
Capex	(7,300)	(6,500)	(10,100)	(7,300)
Acquisitions/disposals	(1,500)	(7,600)	2,000	(36,000)
Financing	0	0	0	0
Dividends	100	(3,600)	(6,100)	(3,700)
Net Cash Flow	18,000	9,200	15,800	(11,000)
Opening net debt/(cash)	69,900	64,400	53,900	39,000
HP finance leases initiated	(12,500)	1,300	(900)	0
Other	0	0	0	0
Closing net debt/(cash)	64,400	53,900	39,000	50,000

Source: Company accounts, Edison Investment Research

EDISON

Contact details	Revenue by geography
Rheinlanddamm 207-209 D-44137 Dortmund Germany +49 (0) 231 90 20 745 www.bvb.de/aktie	N/A

CAGR metrics		Profitability metrics		Balance sheet metrics		Sensitivities evaluation	
EPS 2011-15e	19.9%	ROCE 2014e	22.4%	Gearing 2014e	25.5%	Litigation/regulatory	◖
EPS 2013-15e	N/A	Avg ROCE 11-15e	29.2%	Interest cover 2014e	10.1	Pensions	○
EBITDA 11.15e	20.7%	ROE 2014e	20.7%	CA/CL 2014e	0.8	Currency	○
EBITDA 13-15e	4.5%	Gross margin 2014e	N/A	Stock days 2014e	10.1	Stock overhang	○
Sales 11.15e	16.0%	Operating margin 2014e	15.9%	Debtor days 2014e	28.7	Interest rates	○
Sales 13-15e	N/A	Gr mgn / Op mgn	N/A	Creditor days 2014e	84.8	Oil/commodity prices	○

Management team

Chief Executive: Hans-Joachim Watzke

Before his appointment in 2005, Mr Watzke had been treasurer of the football club for four years. His contract as CEO has been extended to the end of 2016. He is also the owner-founder of Watex, a leading manufacturer of protective clothing for industrial workers and firefighters.

Chief Financial Officer: Thomas Treß

Thomas Treß was appointed second managing director in 2005 and has been responsible for finance since the start of 2006. His contract has been extended to mid-2016. He was previously a partner at RölfsPartner, one of the leading business consultancies in Germany. He was awarded “CFO of the year 2013” by the German *FINANCE-Magazine*.

Principal shareholders	(%)
Bernd Geske	11.9
Borussia Dortmund	7.2
Odey Asset Management	5.1

Companies named in this report

Bayern Munich, Real Madrid, Arsenal, Manchester United, Olympique Lyonnais, Juventus, Celtic, Mainz, Atlético Madrid, Chelsea, PUMA, EVONIK, SIGNAL IDUNA, SPORTFIVE