

>: Are You Ready for Some Football?

Monday, September 10, 2007 / Ben Schott

When I die and go to heaven, I really hope it looks something like this past weekend: four NFL games going at once, split-screen on the high def, free flowing beer (well, wine), and half of Frito-Lay's annual sales spread out before me.

There's so much stress during the week ? between work and investments ? I absolutely love football season ... it gives aging wanna-be jocks like me a tacit excuse to veg on the couch and recover their strength.

Heck, it beats home improvement projects.

But if you're like me, you can never really get business completely out of your mind. So as I lay sprawled across the couch with crumbs on my shirt and empty bottles covering the coffee table, I started thinking about the BUSINESS of the NFL.

Now I'm no expert on the business side of the NFL (my knowledge is limited to what I've read in a few articles, to be honest), and I did sit down to write this article when there were a shocking number of empty bottles in front of me, but it seems to me that there are some great lessons that companies of all stripes would be wise to learn from the National Football League.

Lesson #1: Share the Wealth

In the words of Art Modell (the franchise owner who took his team from Cleveland to Baltimore) the NFL team owners are "32 fat-cat Republicans who vote socialist" on football.

Here's the deal: approximately 70% of all revenues that any given team brings in is distributed around the league.

At first glance this might seem like bad news for the league's big-market teams (the New York teams, Chicago, etc.) and good news for the smaller-market ones (i.e. Jacksonville, Buffalo, Baltimore, etc.).

But the end result of revenue-sharing has been that ? unlike with the other major sports here in the U.S. ? the NFL enjoys a level of parity that keeps 90% of the teams competitive from year to year (in other words, all the teams are keeping butts in their stadiums' seats ... think Tampa Bay Devil Rays in baseball for a comparison).

Granted, it's a little more complicated than that (the NFL's salary cap system is also the best in professional sports and keeps up the quality of competition), but the whole "share the wealth" concept has paid dividends in football.

The lesson for owners and executives in other businesses is that, while your organization most certainly has cost centers, profit centers, and everything in between, when you peg the success of any one individual/ department largely to the success or failure of the firm as a whole, the entire organization benefits.

Lesson #2: Incentivize Individual Business Units

Here's where I will seemingly contradict myself.

Granted, most of the revenue that individual NFL teams bring in is shared among all the teams in the league.

But the NFL did something really smart: they left a few income streams alone, allowing each team to keep 100% of what they earn in these areas.

An example of this is luxury box sales. You know, those fancy enclosed seating areas right above the lower deck that come equipped with plasma screen TVs, dedicated serving staff, and reclining leather seats.

The NFL decided that they would let each team keep all of the revenue earned off luxury box sales, as opposed to sharing it with the entire league.

Why?

The NFL figured that if they gave individual owners an incentive to fill their seats, the owners ? who, contrary to Mr. Modell's quote are quite the capitalists ? will do everything in their power to improve the quality of the "product" they put on the field.

Additionally, they also have a clear-cut incentive to build fancy new stadiums. And, if you take a look at a few of the newest stadiums in the league,

you'll notice one thing: all of the new designs incorporate MORE luxury boxes.

Lesson #3: Don't Seek Customers, Seek Evangelists

Imagine this:

You're at your local movie theater, the kids are home with the babysitter, and as is the norm at these kinds of places these days, you're feeling a little old.

All the "cool" high school age kids have congregated out front. And half of them have Xerox, Intel, Proctor and Gamble, and Burlington Northern T-shirts on.

Wait a minute. That would be insanity. But a dream come true for companies the world over.

That dream is a reality for the National Football League. Nobody thinks twice at the sight of someone wearing a 49ers or a Patriots jersey. But the fact that these brands are identified with and proudly worn is no mistake.

Think about it: the Holy Grail of any consumer-oriented company is the customer evangelist. This person doesn't just buy their products - they show them off proudly for all to see, in effect creating free advertising. In other words, they aren't merely customers, they're evangelists.

I've seen plenty of people who are such die-hard fans of their teams that they've had the logo or the number of their favorite player tattooed on their bodies. Imagine that, IBM!

Outside of the NFL and a few other sports organizations, I can't think of many other businesses that have mastered this concept - except perhaps Apple (Nasdaq: AAPL) and Harley-Davidson (NYSE: H



Any Other NFL Lessons?



As I said at the start, I'm by no means an expert on the business of the NFL.

But I imagine there are a few among you who've done m



What are some other lessons that businesses could learn from the NFL? How about lessons that the NFL can take from other organizations? Or would you prefer not to mix your football and your bi



Oh, and before I go ... here are a few ideas I put together for you for a tattoo:



(First one to actually get tattooed with one of our logos and send in a picture gets a free sandwich!)

Ben Schott

Ben Schott
Chief Investment Officer

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Monday, September 10

15:00 - *Consumer Credit (for July): Consensus \$9.5B*

Big Picture: Consumer credit includes household non-mortgage loans. Tax cuts and cash out mortgage refinancing provided consumer funding in past years as 6% yoy income growth and weakening equity gains now provide the means outside of credit. Credit cards (revolving credit) make up 37% of total consumer credit, which stands at \$2.5 trillion. Nonrevolving credit helps finance auto purchases, tuition, vacations and other forms of consumer borrowing. Annual growth of 5% has shown acceleration from the 3.4% yoy decade low of a year ago.

Implications: This monthly measure of consumer debt is volatile and subject to massive revisions. It is also released well after every other consumer spending indicator, including weekly chain store sales, auto sales, consumer confidence, retail sales, and personal consumption. For these reasons, the market almost never reacts to the consumer credit report. Consumer credit is broken down into three categories: auto, revolving (ie, credit card), and other. Since we already have indications on total consumer spending well before this release, there is little to be gained from learning what portion of spending was financed through acquisition of debt. Periods of strong spending can be accompanied by relatively weak credit growth and vice versa, so this measure fails even as a coincident or lagging indicator.

Tuesday, September 11

8:30 - *Trade Balance (for July): Consensus -\$59.0B*

Big Picture: The August 2006 deficit reached a record high -\$68.6 bln as lower energy prices provided the initial fall. The weak dollar and strong global growth now provide a strong upward trend for exports. From a year ago, exports have risen 11% as imports have risen just 4%. Import growth carries a larger effect as they are about 50% larger than exports. The massive size of the deficit is eyed for effects on the dollar and interest rates. The trade deficit demands an equal but opposite investment inflow from abroad as current foreign demand remains exceedingly strong given the return of petrodollars and Asian demand.

Implications: The trade report is most widely watched for trends in the overall trade balance. But trends in both exports and imports of goods and services bear watching as well. The export data in particular are

important to watch for indications that a strengthening competitive position at home and/or strengthening economies overseas are boosting U.S. growth. Imports provide an indication of domestic demand, but given the severe lag of this report relative to other consumption indicators, it is not particularly valuable for this purpose.

Thursday, September 13

14:00 - Treasury Budget (for August): Consensus -\$85.0B

Big Picture: Strong tax receipt growth continues to lead a path toward lower deficits given the strong (ex-housing) economy, profits and income growth. Spending remains stronger than desired as fiscal discipline is needed. The FY05 improvement sliced away a quarter of the record \$413 bln FY04 deficit as FY06 sliced away another \$71 bln. FY07 has already sliced \$82 bln through July as the last two months of the fiscal year may leave a smaller FY deficit than the current 12 month total of \$166 bln.

Implications: The monthly Treasury budget data follow strong seasonal patterns which produce huge month-to-month fluctuations in the deficit. These fluctuations tell us little about long term budget trends. To the extent that the market analyses the monthly Treasury data, the focus is on year/year changes in receipts and outlays, since the data are not seasonally adjusted. Only in April, the most important month for tax inflows to the Treasury, does the market pay any attention to this report. The data can be predicted with reasonable accuracy by using daily data in the Daily Treasury Statement.

Friday, September 14

8:30 - Export Prices-ex ag. (for August): Consensus NA, Import Prices-ex oil (for August): Consensus NA

Big Picture: Core import and export prices show the same 2.8% yoy gains, as the price movement in the volatile components provide stronger annual growth in export prices than import prices. The strong 18% yoy rise in agricultural export prices reflect the increased demand for grains that are now being increasingly used as alternative fuels. Petroleum prices are just 4% yoy given the high prices of a year ago.

Implications: Though not a market-moving release, export/import prices are a useful indication of inflation pressures created by changes in foreign exchange rates. For example, when the dollar is strong, import prices tend to be under downward pressure. If an item in Japan costs 500 yen and the exchange rate is 100 yen to the dollar, the US\$ price \$5. If the dollar then strengthens to Y120, the US\$ price falls to \$4.17. Because US exports must compete with foreign goods, there is also downward pressure on export prices when the dollar is strong. Economists typically look at import prices excluding oil and export prices excluding agricultural. In each case, the category in question is excluded because prices for those items are volatile and the swings are unrelated to foreign exchange rates. Oil prices tend to swing in response to OPEC decisions, and agricultural prices are often affected by weather, neither of which say much about long-term trends in traded goods prices.

8:30 - Retail Sales (for August): Consensus 0.5%, Retail Sales-ex auto (for August): Consensus 0.2%

Big Picture: Retail sales are slowing under the weight of a high Fed policy rate, as high gas prices drag alternative sales. The housing recession further drags consumer durable goods (e.g. furniture, building equipment, appliances) as auto sales have been surprisingly weak. Stronger retail sales growth had been fueled by low interest rates, vehicle discounting and mortgage refinancing as those forces faded in late 2005 and 2006. Despite the improved employment and income growth, the Fed tightening and high energy prices have had a deflating effect on consumer spending and big ticket durable goods purchases particularly. Strong income growth and the low unemployment provides support and is the best read on the future sales pace.

Implications: The retail sales report is a measure of the total receipts of retail stores. The changes in retail sales are widely followed as the most timely indicator of broad consumer spending patterns. Retail sales are often viewed ex-autos, as auto sales can move sharply from month-to-month. It is also important to keep an eye on the gas and food components, where changes in sales are often a result of price changes rather than shifting consumer demand.

9:15 - Industrial Production (for August): Consensus 0.3%, Capacity Utilization (for August): Consensus 82.0%

Big Picture: Industrial production is showing a significant lift after the weakening in late 2006. Annualized 6 month growth is more than twice the 12 month gain. Factory orders are back on the rise and drive production. The stall from autos, construction and business investment is past and leading to stronger growth ahead. Capacity use stands at 81.9% -- still below the level historically consistent with inflationary pressures -- as manufacturing reflects some excess capacity at 80.7%. The outlook may be turning south again given the plunge in August manufacturing employment.

Implications: The index of Industrial Production is a fixed-weight measure of the physical output of the nation's factories, mines, and utilities. Manufacturing production, the largest component of the total, can be accurately predicted using total manufacturing hours worked from the employment report. One of the bigger wildcards in this report is utility production, which can be quite volatile due to swings in the weather. Severe hot or cold spells can boost production as increased heating/cooling needs drive utility production up. In addition to production, this monthly report also provides a measure of capacity utilization. Though the rate of capacity utilization is seen as a critical gauge of the slack available in the economy, the market does not completely trust this measure. Capacity is very difficult to measure, and the Fed essentially assumes that growth in capacity in any given year follows a straight line. One can therefore predict the capacity utilization rate quite accurately based on the assumption for production growth. The 85% mark is seen as a key barrier over which inflationary pressures are generated, but given revisions to these data and the difficulties with capacity measurement, the 85% mark should be viewed cautiously. It would be appropriate to look for corroborating inflation indications from commodity prices and vendor deliveries.

10:00 - Business Inventories (for July): Consensus 0.3%

Big Picture: The inventory to sales ratio stands at 1.27 months just above the record low 1.25 months in January 2006. The inventory draw down in late 2006 and early 2007 is now past. The long trend toward smaller I/S ratios and the tighter range leaves less of a resulting effect on economic growth as the draw-downs or restocking takes place over a quarter or two. The large inventory drag on GDP in Q4 and Q1 turned to a

gain in Q2 2007.

Implications: The business inventories report includes sales and inventory statistics from all three stages of the manufacturing process (manufacturing, wholesale, and retail). But by the time it is released all three of its sales components and two of its inventory components have already been reported. Because retail inventory is the only new piece of information it contains, the market usually ignores the business inventories report.

10:00 - Mich. Sentiment-Preliminary (for September): Consensus 83.5

Big Picture: The push to a two year high in January was largely tied to the drop in gasoline prices. Plunging equity prices and economic fears have pushed the index down -14% since. The University of Michigan survey is significantly smaller (500 phone calls, just 250 in preliminary) than the Conference Board's, includes a longer outlook (for expectations) as questions are focused on the household compared to the business heavy CB survey. The index far better tracks the consumers' mood than spending habits better indicated through interest rates and income growth.

Implications: The Michigan index is almost identical to the Conference Board Consumer Confidence index, though there are two monthly releases, a preliminary and final reading. Like the Conference Board index, it has two subindexes -- expectations and current conditions. The expectations index is a component of the Conference Board's Leading Indicators index.

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