

1.3 Valuation

Valuation, in its essence, tells you how much a company, a house, a team, an asset, a brand, an art piece, a baseball card, or anything else is worth. Valuation is a complex field with many professionals, certifications and designations, books, and a deep academic literature. It became a cornerstone course in many finance programs. The object that is being valued could be different depending on the purpose, i.e. the value of something for tax purposes may not necessarily be the same as its value under a litigation scenario. In a company setting, the stock value may be different for 1% of the company vs. 50%, whether the company is private or public, or whether the valuation is performed for common stock or preferred stock. There are many methods one can use. All these details are important but the underlying goal is always the same: Provide a good, reasonable estimate for what something is worth.

While not the only definition of value, a common definition is found by a hypothetical pair: a willing and able buyer and seller. If what we are valuing is not traded, then we must think of ways how we can estimate the price when our hypothetical buyer and seller meet, either of which is not under any obligation to make the trade. Markets make our job easier. Whenever there is a market for something, chances are there are already buyers and sellers. Moreover, when markets are regulated and the prices are transparent, like a stock or futures exchange, we do not only know the existence of buyers and sellers, but we also observe at which price they trade and how prices move. In essence, this is called price discovery and is an essential function of the markets. Price discovery is a process that may improve the reliability of the valuation exercise.

We discussed in 1.2 that sports teams are rarely traded on exchanges. This begs the question: If sports teams are not traded on the public exchanges, how do we know how much are they worth? We don't, until someone buys them and we read about it.

We are not entirely clueless though. There are currently two related efforts in the marketplace. Forbes, in its SportsMoney section, provides annual estimates of franchise valuations. The second effort is the SportsRiskIndex, which is a futures product currently in development and will be discussed in greater detail in Chapter 5. Before we do that, though, we must continue to put the building blocks together.