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Marketplace

Baseball Superstar's Megacontract Is Impressive, but Less Than It Seems

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Will Alex Rodriguez really cost his new employer a quarter of a billion dollars? Not if the currency in question is "baseball dollars."

A bit of background: The slugging shortstop, considered by some to be the best player in baseball, signed a contract this month with the Texas Rangers reported to be the richest ever in professional sports. Columnists, gasping at its size, vilified the Rangers for breaking baseball's bank and setting a course for sports ruin. Sandy Alderson, an official in the Major League Baseball commissioner's office, said he was "stupefied" and the sport was "in a crisis situation."

Baseball Weekly magazine noted that Rangers owner Tom Hicks paid \$250 million for the franchise, about the same as the gross value of the new contract. But Mr. Hicks, who was stung by the outcry over the contract, insists that he can make money on the deal.



AP Photo/Donna McWilliam

Alex Rodriguez in Texas Rangers gear says.

That is where the baseball dollars come in. In baseball-contract announcements, all the money to be paid a player over the years is added up as if it were to be handed over in one lump sum today -- a calculation that pads a player's ego and titillates fans but is fundamentally flawed.

In Mr. Rodriguez's case, the term of the contract is 10 years. But Mr. Hicks believes his 25-year-old superstar will almost certainly work somewhere else after 2007. Mr. Rodriguez, nicknamed A-Rod, can opt out of the last three years if another baseball player is earning more than his \$27-million-a-year salary. With a few players already earning around \$20 million a year, "we really believe it will be a seven-year deal," Mr. Hicks

Over the seven years, Mr. Rodriguez is due to get \$128 million in paychecks. He also will get a \$10 million signing bonus spread equally over five years. Another \$33 million in pay will be deferred, starting with \$5 million deferred next year. He will get 3% annual interest on his deferred money and it will be paid out between 2011 and 2020. Mr. Hicks estimates he could set aside \$4 million today and have it grow enough to pay out next year's \$5 million deferred payment.

What it boils down to is that the present value of a lump sum of money is greater than the value of that

same sum divided and paid over a period of time. "It's not really \$252 million if you're making payments 20 years from now and it's only appreciating 3%. That's a significant discount," says Edward Freher, an executive compensation expert at consultant William M. Mercer. "But everyone likes headlines."

Looked at another way, if Mr. Rodriguez were a corporate executive signing a 10-year, \$252 million contract, and his employer filed a proxy statement detailing the deal, a more realistic valuation would be about \$165 million, to be paid in pieces over two decades.

To be sure, even with that valuation, the contract would top most chief executive officers' compensation packages. A Mercer survey of 350 corporations found the median annual package at about \$5 million for chief executives. But Mr. Rodriguez won't get the tax benefits executives get from receiving stock options or other forms of equity.

"No CEO worth his salt would make a deal like this because of the tax implications," says Steve Unger, managing partner for media, entertainment and interactive content at Heidrick & Struggles International, an executive-recruiting firm.

Neither Mr. Rodriguez nor his agent, Scott Boras, could be reached for comment.

Mr. Hicks, a financier who also owns the Dallas Stars of the National Hockey League, says he tries to keep his team payrolls at about 50% to 55% of team revenue. If he keeps that ratio constant, he can earn operating profit of 10% to 15% from the franchises, he says.

For this coming season, the Rangers were counting on revenue of between \$150 million and \$155 million before the signing. With Mr. Rodriguez generating extra sales of tickets, beer, T-shirts and other items, the team now expects revenue of about \$160 million.

With room for \$80 million to \$88 million in player salaries, Mr. Hicks went into the free-agent signing season this winter with only \$49 million committed. Spending aggressively, he signed a designated hitter, a third baseman and a relief pitcher. Mr. Rodriguez will receive \$16 million in cash for his first season with the team, plus \$2 million of his signing bonus. In all, the Rangers have agreed to pay about \$80 million in salary this year -- well in line with Mr. Hicks's budget.

Down the road, as Mr. Rodriguez's annual salary steps up to \$23 million in year seven, the Rangers' cable-TV contract with Fox Sports also jumps sharply. Mr. Hicks signed a 10-year, \$250 million deal with Fox. Rates for Ranger games doubled under the new deal to \$150,000 per game, and will double again to \$300,000 per game in eight years. What's more, Mr. Hicks has boosted cooperate sponsorship revenue by packaging his baseball and hockey businesses together, making it a more attractive buy for advertisers. "There's a real synergy to having two teams in a market," he says.

Mr. Hicks says the Rangers should have the third- or fourth-highest revenue in baseball, and only about the sixth-highest payroll. The team will pay its three outfielders less than \$1 million combined next season. And it will have two starting pitchers making \$250,000 apiece.

While the disparity in salaries on the field can be huge, the biggest problem in baseball is the disparity in revenue between the big-city and small-market teams. Some teams will have annual revenue of only about \$60 million while on the highest end, the New York Yankees bring in more than \$230 million. So the Boston Red Sox can afford to sign outfielder Manny Ramirez to an eight-year contract paying \$20 million a year, but the Minnesota Twins' entire payroll was just \$15.8 million last season. "The system has to be changed, and it will be changed," baseball Commissioner Allan H. "Bud" Selig said shortly

after the Rodriguez signing.

Even though the Rangers say they can afford Mr. Rodriguez, the team probably won't make money on the deal -- unless it reaches the World Series.

Mr. Hicks estimates additional revenue next year of only \$6 million to \$8 million as a result of Mr. Rodriguez. Reaching the playoffs would generate considerable extra sales. But the World Series seems like a long shot for the Rangers, who won only 71 of 162 games last year with a pitching staff that has the worst earned-run average among the 30 major-league teams.

Mr. Hicks says Mr. Rodriguez, who brings sharp defensive skills, a potent bat and strong leadership to the club, can carry the team to baseball's championship -- and be a moneymaker. "If he takes us to where we want to go, he'll be cost-effective," Mr. Hicks says. "We believe he'll make us a winning team, at a price we can afford."

Besides, Mr. Hicks is getting a bit back from Mr. Rodriguez. He has sold his new player a luxury box at the arena being built for the Stars and a luxury suite at the Rangers home, the Ballpark in Arlington. Mr. Rodriguez will pay about \$450,000 a year for the box and the suite -- the full retail rates.

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