In this course, we will discuss financial economic, financial accounting, and valuation issues that pertain to the entertainment, media, and technology (EMT) industries. It is useful to analyze the EMT industries together because they exhibit common characteristics and are jointly evolving and in some respects converging because of digital technology. Digital technology has had and will continue to have a profound effect on the production, distribution, and consumption of the services provided by EMT firms.

The EMT industries exhibit the following common characteristics, among others:

1) complex cost structures:
   i) large up-front fixed or sunk costs
   ii) complementarities among various types of costs
2) highly uncertain or skewed demand
3) complicated contractual (e.g., compensation and financing) arrangements to share risks, provide incentives, etc...
4) investments are real options in that they:
   i) pay off big with low probabilities,
   ii) are made over time and yield information about subsequent payoffs, and
   iii) are specialized and irreversible.
5) path dependencies that cause demand to depend on:
   i) random events,
   ii) technological lock-in, and
   iii) other consumers’ choices.
6) subscriber bases that churn or grow,
7) libraries with multiple revenue streams, and
8) largely intangible economic assets.

Because of these characteristics, accounting—while distinctly limited—is richly tied to the operations and valuation of EMT firms. In this course, we will explore this richness, focusing on salient, generalizable examples of EMT firms. A primary goal of the course is to adapt standard methods of financial analysis to the analysis of EMT firms, either by adjusting accounting numbers or by supplementing accounting numbers with non-financial measures.
Readings and Non-Graded Assignments: There is no assigned text for the course. I will hand out class notes for each session and other materials such as articles, problems, and cases. All material should be read and thought about prior to the class session.


Grading: There will be two take-home exams that will each determine 40% of your grade. These exams will be handed out after the end of the sessions on subscribers and accounting-based valuation. Assuming I stay on schedule (by no means a sure thing), these exams will be handed out in class on 3/29 and 4/26 and will be due on 4/5 and 5/6, respectively. You may discuss these exams among yourselves, but they should be completed individually, with no exchange of written work in any form.

The remainder of your grade will be based on class participation. I emphasize that productive participation does not require being either an expert or correct; for example, asking good questions is sufficient. I also emphasize that high volume participation need not be productive. For the more significant cases we will discuss, I will assign particular responsibility for each case to five or so individuals. If you have interest in a particular topic, let me know and I will attempt to assign you to that topic. Otherwise I will make these assignments randomly (without replacement). I will begin this practice in the session on financing arrangements.

Web Access to Materials/Blackboard: While I will hand out all materials needed for the course in class, the materials that are in electronic form will be available on Blackboard. I do not use Blackboard for any other purpose.
Tentative Outline of Sessions
(readings for sessions after compensation contracts are from last year and will be updated)

2/7 (1st half) Organizational Session and Overview

Read: Class Notes

Articles on the history of competition in the EMT industries:

“The Technology Sector’s Rise and Fall is a Tale as American as the Model T”, New York Times, December 14, 2000

Articles on media companies and digital technology:

“King Content,” The Economist, January 21, 2006
“Old Mogul, New Media,” The Economist, January 21, 2006
“The War of the Wires,” The Economist, July 30, 2005
“A Fuzzy Picture,” The Economist, January 7, 2006

Articles on intellectual property and digital technology:

“In Praise of P2P”, The Economist, October 30, 2004
Part I: Financial Economic Issues and Discounted Cash Flow Valuation

2/7 (2nd half)-2/14 (1st half)  Large Fixed Costs and Complementarities Between Fixed and Variable Costs

Read:  Class Notes

Various industries:

Theater:
“Now Playing on Broadway, the Money Pit,” New York Times, June 4, 2005
“Picking up a Broadway Tab,” New York Times, February 27, 2005
“Off Broadway, Success Grows Costly and Rare”, New York Times, February 1, 2005

Film:
“Gambling on a Film Fantasy”, New York Times, December 12, 2001
“Movie Theaters Build Themselves into a Corner”, New York Times, September 4, 2000
Television:
“Following HBO, Networks Test Short-Run Series”, *New York Times*, January 2004
“Smaller Video Producers Seek Audiences on Net,” *New York Times*, October 6, 2005

Music:

Radio:

Sports:
“$53 Million for Pedro? How Do You Figure?”, *New York Times*, December 19, 2004

Book Publishing:

Telecommunications:

Prepare: Evolving Cost Complementarities in Theater Problem
Up-front Costs, Efficiency, Option Value, and Risk Problem
CG Animation Profitability Problem
Fixed Costs Problem (optional)
Read: Class Notes

Read at least one of the following 2 lengthy articles (the article by Weinstein has a more complete historical treatment of profit-sharing contracts while the article by Goldberg has a more interesting conceptual edge)


“H’W’D at War with Piece-niks”, Weekly Variety, November 25-December 1, 2002
“Studios Take a Beating on the Backend,” Variety.com, January 22, 2006
“’Rings’ Bling Ding”, Variety.com, March 1, 2005
“Columbia Pictures to Share Movie Profits with Writers”, New York Times, February 6, 1999
“Music Royalties Rise, Even as CD Sales Fall”, New York Times, January 26, 2004
“No Compensation without Cost,” The Economist, October 29, 2005

Prepare: Work through the “Is Net Really Better than Gross?” problem. Also think about the various exercises in the class notes, especially those marked with an asterisk.
Financing Agreements and the Sharing of Risk and Ownership Rights

Read: Class Notes

Film:
“Hollywood gets warm and runny for...Other People's Money”, Weekly Variety, February 17-23, 1997
“Warners Works B.O. Wizardry”, Weekly Variety, December 6-12, 2004
“Brit Channels Euros to H'wood”, Weekly Variety, October, 18-24, 2004
“Rupe’s BSkyB Plays Hard Ball”, Weekly Variety, March 2, 2003
“`River King’ Redux”, Weekly Variety, October 25-31, 2004
“Tax Season”, Weekly Variety, November 1-7, 2004
“Credit, What Credit?”, Weekly Variety, January 24-30, 2005

Television:
“TV Networks Favor Pilots They’ve Made”, New York Times, April 1, 2002
“Cable Reruns Ramp Up”, Weekly Variety, January 24-30, 2005

Media:
“Vivendi Universal, with its Complex Balance Sheet...”, February 11, 2002
“Murdoch Moves to Avoid a Friendly Fight for Control”, New York Times, November 17, 2004
Euro Disney:
“The Overleveraged Disneyland: Will Disney Take Losses in France?”, *New York Times*, March 26, 2004
“Euro Disney to Raise Cash with Low-Priced Stock Offer”, *New York Times*, January 22, 2005

Technology:
“As Web Sites Seek an Attractive Mix of Content, a New Type of Business is Providing the Right Stuff”, *New York Times*, September 25, 2000
“Behind ‘Name Your Own Price’ Lies a Mesh of Partners”, *New York Times*, March 29, 2000
“AT&T Takes Full Control of At Home Cable Venture”, *New York Times*, March 30, 2000
“AT&T Faces Hard Choices over its Debt”, *New York Times*, November 20, 2000
“AOL in Deal to Regain All of Large Unit”, *New York Times*, August 21, 2002

Securitization:
“Securitization: Who its Right for, and When”, *Billboard*, April 27, 2002

*Prepare carefully*: Fox Entertainment Group IPO Case, Part I

*Prepare*: Rupert’s Convertible Bonds
Pixar v. Disney
Dreamworks’ Distribution Agreement
3/7-3/21 (1st half) Real Options and Path Dependence: Implications for Optimal Investment Timing and Industry Convergence

Read: Class Notes

Path Dependence:
“Lock and Key”, The Economist, September 18, 1999
“Knowledge is Power”, The Economist, September 23, 2000

Microsoft Vs. World:
“Microsoft is Set to be Top Foe of Free Code”, New York Times, May 3, 2001
“Microsoft Must Turn to New Set of Hurdles”, New York Times, November 4, 2002
“In the Battle of the Browses ’04, Firefox Aims at Microsoft”, New York Times, November 15, 2004
“Apple’s Success with iPod May Presage the Ascendence of Hardware over Software”, New York Times, January 19, 2004

Standards, Patents, and Copyrights:
“ Untangling Ultrawideband”, The Economist, September 19, 2004
“A Fine Balance: How Much Copyright Protection does the Internet Need?”, The Economist, January 25, 2003

Optimal Investment Timing:
“Beyond the Bubble”, The Economist, October 11, 2003
“A Report Indicates that Companies See Little Reason to Move Quickly into Buying Over the Internet”, New York Times, March 5, 2001

Industry Convergence:
“How to Manage a Dream Factory”, The Economist, January 18, 2003
“Dropping the Ball”, Weekly Variety, February 9-15, 2004
“Rupert’s World”, Business Week, January 19, 2004
“The Complete Home Entertainer?” The Economist, March 1, 2003
“From Pipes to Services”, The Economist, October 11, 2003

Prepare: Optimal Investment Problem
Fixed Costs, Path Dependence, Option Value, and Risk problem
Optimal Investment Timing in e-Commerce problem (with attached articles)
Mark Cuban’s Bet on Digital Projectors Problem (with attached article)
Discounted Cash Flow Valuation 1: Subscriber Bases and Churn

Read: Class Notes
“Broadband Gains Should Boost Earthlink Shares”, Barrons, March 15, 2002
(article goes with Earthlink’s Subscribers’ Value problem)
“Case of the Disappearing Eyeballs”, Weekly Variety, November 3-9, 2003
“Cable’s Rivals Lure Customers with Packages”, New York Times, November 22, 2004
“Cox Parent to Buy out Public Shareholders”, New York Times, October 20, 2004
“Sky is the Limit for Birds”, Weekly Variety, December 13-19, 2004
“Paper Trail”, Economist, August 14, 2004

Prepare: Do enough of the following spread-sheet-based problems to be comfortable with the mechanics involved:
- Cable Valuation problem
- Subscribers and Market Penetration problem
- Subscriber Tenure and Churn problem
- Cost Complementarities and the Value of Sticky Subscribers problem
- Discounted Cash Flow Valuation in the Digital Music Industry
- Earthlink’s Subscribers’ Value problem

First take-home exam handed out at the end of the class above and due one week later
Read: Class Notes

“Par Parenting Rowdy Offspring”, Weekly Variety, October 21-27, 2002
“Afterlife Spawns Horror Boutiques”, Weekly Variety, 15-21, 2004
“Mining the 3rd Dimension for Bigger Profits”, March 14, 2005
“Auds Take a Pass on Theatrical Hits”, Weekly Variety, November 18-24, 2002
“DVD Action Adds Video Traction”, Weekly Variety, December 2-8, 2002
“Studios Go in Opposite Directions after Oscar Nominations”, New York Times, February 10, 2004
“Indies Throw Cash at Pix Stash”, Weekly Variety, October 5, 1998
“Indies Form Powerhouse”, Weekly Variety, November 3-9, 2003
Various tables from Vogel, Entertainment Industry Economics
“Pushing Publishing Profits”, Billboard, March 8, 2003
“Can Oldies Save Slipped Discs?”, Weekly Variety, December 3-9, 2001
Various stories related to Beatles’ Song Catalog from www.nme.com

Prepare: “Libraries as Subscriber Bases” problem
Part II: Financial Accounting Issues and Accounting-Based Valuation

Intangible Assets

Read: Class Notes

List of intangible assets that are recognizable in an acquisition under FAS 141
Excerpts about intangible assets from Time Warner’s 2003 Form 10-K filing
Excerpts (paragraphs 33-40) from AICPA Statement of Position 93-7 on accounting for direct response advertising costs

Prepare: “America Online: Online or Off-Track” case, Brown and Stickney, 1998
Revenue Recognition and Expense Matching

Read: Class Notes

film:
“For Sony, Too Little Information Proved to Be a Dangerous Thing”, New York Times, August 6, 1998

theater:
“Gambling on a Trip from ‘Ragtime’ to Riches”, New York Times, 2/19/98

internet:
“Presto Chango! Sales are Huge!”, Fortune, March 20, 2000
“AOL’s Inventive Barter Deals Draw Scrutiny of Investigators”, New York Times, August 8, 2002
“A Sales Deal with Bertelsmann Restores AOL to the Unwanted Attention of Regulators”, New York Times, April 1, 2003
“Yahoo, Google, and Internet Math”, Wall Street Journal, May 10, 2004

telecommunications:

software:
“PeopleShell?”, Forbes, January 21, 2002
Prepare: “Orion Pictures Corporation: Silence of the Accountants” case, Abarbanell, 1997, which includes


Google’s Gross Revenue Recognition case

MicroStrategy Revenue Recognition case, which includes

“MicroStrategy’s Curious Success”, Forbes, March 6, 2000
Excerpts from CFRA Reports on MicroStrategy
Read: Class Notes

“Behind a Closed Door”, *New York Times*, July 1, 2001
“Qwest Plans $34.8 Billion Write-Down of its Assets”, *New York Times*, October 29, 2002
“Big Blue Haze”, *Barrons*, December 23, 1996
“The Valuation of Acquired R&D”, Zhen Deng and Baruch Lev, April 1998

Prepare: Valuation of and Accounting for Purchased Research and Development Technology: IBM’s Acquisition of Lotus Case, Francis, 1996
Netscape-Excite Marketing Agreement Case
Disney’s One-Time Items problem and answers
AT&T problem from White, Sondhi, Fried, *The Analysis and Use of Financial Statements*
4/25  Accounting-Based Valuation, Alternative Measures of Book Value and Income (EBITDA)

Read:  Class Notes

“The Ebitda Folly”, Forbes, March 17, 2003

Prepare:  Time Warner’s Segments Case

Second take-home exam handed out at the end of the above class and due May 6 at 6 pm.

5/2  The Limitations of Financial Accounting; Rethinking Financial Analysis

Read:  Class Notes

“How Much Are Your Eyeballs Worth?”, Fortune, February 21, 2000
“What’s it Worth?” business2.com, December 9, 1998
“Fox Sweeps Away Competish”, Weekly Variety, March 3-9, 2003
“Rating Agency Says it Erred in Measuring Web Site Use”, February 24, 2003
“How Good is Google?”, The Economist, November 1, 2003

Prepare:  Non-Financial Measures and Valuation: Yahoo vs. Lycos Case