Stern School of Business
Entertainment, Media and Technology (EMT) Program
New York University

B10.3355.30: Accounting and Valuation Issues in the EMT Industries
Spring 2008
Professor Stephen Ryan (10-73 KMC, 998-0020, Fax 995-4004, sryan@stern.nyu.edu)
Office Hours: TW 4:00-6:00 and by appointment
Classroom: KMC 5-75, T 6:00-9:00

Description: 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 following common characteristics, among others:

1) complex cost structures:
   i) large up-front fixed and possibly sunk costs
   ii) complementarities among various types of costs
2) highly uncertain and skewed demand
3) 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.
4) path dependencies that cause demand to depend on:
   i) random events,
   ii) technological lock-in, and
   iii) other consumers’ choices.
5) complicated contractual (e.g., compensation and financing) arrangements to share risks, provide incentives, etc...
6) largely intangible economic assets.

Because of these and other 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. So as not to violate copyright laws, all of the articles I hand out are available to NYU students at http://library.nyu.edu/collections/databases.html, on ProQuest Newspapers (e.g., New York Times and Wall Street Journal) or ProQuest Research (e.g., Business Week, The Economist, Forbes, Fortune, Hollywood Reporter, and Variety), or are free online (e.g., businessweek.com and variety.com). All material assigned for a session should be read and thought about prior to class.


For students who want a deeper understanding of the effects of path dependence on the competitive dynamics of markets for information goods, a number of worthwhile books cover this topic, e.g., Information Rules, Carl Shapiro and Hal Varian (HBS Press, 1999).

Grading: Your grade will be based on a take-home exam (40%), a group project (40%), and class participation (20%).

- The take-home exam will be handed out after the end of the session on financing arrangements (i.e., the end of Part II of the course as indicated in the course outline). The exam will probably be due one week later, although I may decide two weeks are warranted if the exam is particularly long. Assuming I stay on schedule (by no means a sure thing), the exam will be handed out on 3/25 and due on 4/1. You may discuss the exam among yourselves, but it should be completed individually, with no exchange of written work in any form. In this regard, the Stern Honor Code applies, as stated at http://w4.stern.nyu.edu/scorp/committee.cfm?doc_id=4797.

- The group project may be completed in groups of from 1 to 5 students. It should examine a specific accounting or valuation issue affecting one or more EMT firms or industries (i.e., any topic that corresponds to topical coverage of Sections III or IV of the course as indicated in the course outline). Flexibility is encouraged in both the choice and treatment of the topic. You should not pick a topic that is covered in detail in class, however, unless you bring a decidedly different perspective to it. The treatment could be a case study, industry analysis, or other report. I recommend that you start thinking about topics immediately and maintain a file of potential topics as you perform the work for
class, read the newspaper, etc... I recommend that groups have a brief discussion with me about their topic before they expend substantial effort. The project write-up should be 5-10 double-spaced, 12 point font, 1 inch margin pages. In addition, if you identify relevant readings (e.g., articles from the popular press or academic journals, contracts, and financial statements) please attach them, as they may be useful in subsequent iterations of this course.

- My evaluation of your class participation will reflect your overall contribution to class discussion throughout the course, especially on the cases. I emphasize that productive participation does not require you to be either an expert or correct; for example, asking good questions is a highly useful form of participation. I also emphasize that high volume participation need not be productive.

**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. These materials include class notes, some but not all of the problems and cases, class presentation slides (which I do not hand out in class), and links to files for streaming videos of each class (for those who miss class). I do not use Blackboard for any other purpose.
Tentative Outline of Sessions
(sessions after financing arrangements have not been updated from last year)

2/12 (1st half) Organizational Session and Overview

Read: Class Notes

Part I: Economic Background

2/12 (2nd half)-2/19 (1st half) Large Fixed Costs and Complementarities between Fixed and Variable Costs

Read: Class Notes

Theater:

Film:

Television:
“NBC Chief Out to Shake up TV,” Financial Times, January 21, 2008

Music:
Radio:

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

Telecommunications:
“Verizon`s Big Bet Starts to Pay Off,” BusinessWeek.com, January 30, 2007

Prepare:
The exercise on p. 6 of the class notes
Evolving Cost Complementarities in Theater Problem, with attached article “Off B`way Pumps up Prices”, Weekly Variety, February 19-25, 2001
Up-front Costs, Efficiency, Option Value, and Risk Problem, with attached article “Gambling on a Film Fantasy”, New York Times, December 12, 2001
CG Animation Profitability Problem

Optional (Recommended if Unfamiliar with the Effect of Diversification on Risk): Work through Fixed Cost Problem with attached answers
Real Options and Path Dependence: Implications for Optimal Investment Timing and EMT Industry Convergence

Read: Class Notes

Real Options:

Path Dependence (Networks and Lock-in):
“Google’s Shadow Payroll is not Such a Secret Anymore,” New York Times, February 16, 2006
“Social Graph-iti,” The Economist, October 10, 2007

Standards, Copyrights, and Patents:
“In the DVD War over High Definition, Most Buyers are Sitting it Out,” New York Times, December 31, 2007

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 Browsers ’04, Firefox Aims at Microsoft”, New York Times, November 15, 2004
“You’ve Heard this Song Before,” The Economist, November 11, 2006
“Way Beyond the PC,” The Economist, November 26, 2005
“Pressuring Microsoft, PC Makers Team up with its Software Rivals,” Wall Street Journal, February 7, 2006

Optimal Investment Timing:

Industry Convergence:

Prepare: Optimal Investment Problem with attached answers.
Microsoft vs. World exercise on p. 8 of the class notes
MySpace’s Restrictions on Users’ Behavior problem with attached article
Fixed Costs, Path Dependence, Option Value, and Risk problem with attached answers
Part II: Contracts and Associated Accounting Issues

3/4 Compensation Contracts and Contractual Definitions of Gross and Net Profits

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)


“Studios Take a Beating on the Backend,” Variety.com, January 22, 2006
“Scenes from Next Week,” Wall Street Journal, November 1, 2007
“No Compensation without Cost,” The Economist, October 29, 2005

Prepare: “Is Net Really Better than Gross?” problem, with attached articles
“Experiments in Compensation Arrangements” problem, with attached articles
The exercises in the class notes that I indicate we will discuss in class.
3/11-3/25 (1\textsuperscript{st} half) Financing Agreements and their Portrayal in Financial Reports

Film:
“Hollywood gets warm and runny for...Other People's Money”, \textit{Weekly Variety}, February 17-23, 1997
“New Faces, Old Script,” thedeal.com, June 8, 2007

Television:

Theater:

Technology:

Pixar v. Disney, with attached article “Escaping the Shark?” \textit{Barrons}, February 2, 2004
Dreamworks’ Distribution Agreement (this case overlaps with Pixar v. Disney)
Marvel’s Film Financing Facility

\textbf{First take-home exam handed out at the end of the class above and due one week later}
Part III: Discounted Cash Flow Valuation

3/25 (2nd half)-4/1 (1st half)  Subscriber Bases, Market Penetration, and Churn

Read:  Class Notes
“Broadband Gains Should Boost Earthlink Shares”, Barrons, March 15, 2002 (article goes with Earthlink’s Subscribers’ Value problem)
“Trying to Wean Internet Users from Free,” New York Times, November 12, 2005
“Yes, T-Mobile is Profitable, But What to Do with It? New York Times, July 11, 2005
“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
“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
as well as
  XM vs. Sirius
  NetFlix Subscriber Valuation
Read: Class Notes
“Afterlife Spawns Horror Boutiques”, Weekly Variety, 15-21, 2004
“Auds Take a Pass on Theatrical Hits”, Weekly Variety, November 18-24, 2002
“Indies Form Powerhouse”, Weekly Variety, November 3-9, 2003
Various tables from Vogel, Entertainment Industry Economics
Table on film library transfers from MPA, US Entertainment Industry: 2004 MPA Statistics
“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 IV: Financial Accounting and Accounting-Based Valuation

4/8-4/15 (1st half) The Costs of Intangible Assets: Capitalization versus Expensing; Write-offs

Read: Class Notes

Intangible Assets:
List of intangible assets that are recognizable in an acquisition under FAS 141
Excerpts about intangible assets from Time Warner’s 2005 Form 10-K filing

AOL:
“America Online Plans $385 Million Charge”, Wall Street Journal, October 31, 1996

Prepare: “America Online: Online or Off-Track” case, Brown and Stickney, 1998
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
Read: Class Notes

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

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

internet:
“AOL’s Inventive Barter Deals Draw Scrutiny of Investigators”, New York Times, August 8, 2002
“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 Revenue Recognition case, which includes excerpts from its 2004 annual report
MicroStrategy Revenue Recognition case, which includes
   “MicroStrategy’s Curious Success”, *Forbes*, March 6, 2000
Excerpts from CFRA Reports on MicroStrategy

Qualcomm Revenue Recognition Case

Oracle Revenue Recognition Case

4/29  Accounting-Based Valuation, Alternative Measures of Book Value and Income
     (EBITDA)

*Read:* Class Notes

*Prepare:* Time Warner’s Segments Case
5/6 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