

**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

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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 background information, Entertainment Industry Economics: A Guide for Financial Analysis, Sixth Edition, Harold L. Vogel (Cambridge University Press, 2004) provides a broad but occasionally quite insightful introduction to the entertainment and media industries. In addition, [www.variety.com](http://www.variety.com) and [www.hollywoodreporter.com](http://www.hollywoodreporter.com) are good free sources of current information about those industries, especially the film industry.

For students who want a deeper understanding of the effects of highly uncertain and skewed returns, Hollywood Economics, Arthur De Vany (Routledge, 2004) provides an analytical yet accessible treatment of that topic focusing entirely on the film industry.

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](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 (1<sup>st</sup> half) Organizational Session and Overview

*Read:* Class Notes

Part I: Economic Background

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

*Read:* Class Notes

Theater:

"Why Neil Simon Decided to Turn His Back on Broadway", *New York Times*, November 21, 1994

Film:

"The \$75 Million Difference", *New York Times Magazine*, November 16, 1997

"A Big Star May Not a Profitable Movie Make," *New York Times*, August 8, 2006

"Going Deep for Digital", *New York Times*, September 26, 2005

"Even Blockbusters Find Fame Fleeting in a Multiplex Age", *New York Times*, August 13, 2001

"Direct to DVD Releases Shed Their Loser Label," *New York Times*, January 28, 2008

Television:

"New Serials: Now You See Them, Now You Don't," *New York Times*, January 10, 2007

"NBC to Pay Outsiders for Blocks of Programs," *New York Times*, December 3, 2007

"NBC Chief Out to Shake up TV," *Financial Times*, January 21, 2008

Music:

"No. 1 With a Bullet: Madonna Opens Big, and She'd Better", *New York Times*, May 11, 2003

"Music Industry is Trying Out New Releases as Digital Only", *New York Times*, November 22, 2004

Radio:

“Loaded with Personalities, Now Satellite Radio May Try a Merger,” *New York Times*, January 1, 2007

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

“Web War: Nothing Neutral About It,” *BusinessWeek.com*, January 29, 2007

“Two British Mobile Phone Operators Share Networks,” *New York Times*, December 31, 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

2/19 (second half)-2/26

Real Options and Path Dependence: Implications for Optimal Investment Timing and EMT Industry Convergence

*Read:* Class Notes

Real Options:

“The Accidental Innovator,” *The Economist*,” December 22, 2007

Path Dependence (Networks and Lock-in):

“Connect, Only Connect”, *New York Times*, January 25, 2003

“Google’s Shadow Payroll is not Such a Secret Anymore,” *New York Times*, February 16, 2006

“Broadway Weighs Plan to Reward Frequent Theatergoers,” *New York Times*, September 18, 2006

“Social Graph-iti,” *The Economist*, October 10, 2007

“Want an iPhone? Beware the iHandcuffs,” *New York Times*, January 14, 2007

“Slouching toward Digital,” *BusinessWeek.com*, January 7, 2008

Standards, Copyrights, and Patents:

“In the DVD War over High Definition, Most Buyers are Sitting it Out,” *New York Times*, December 31, 2007

“Warner Bros. Backs Blu-ray,” *Variety.com*, January 4, 2008

“Sales of HD DVD Players Plunge after Warner Move,” *New York Times*, January 28, 2008

“A Fine Balance: How Much Copyright Protection does the Internet Need?” *The Economist*, January 25, 2003

“Microsoft, AT&T Argue Software-Patent Case,” *Wall Street Journal*, February 22, 2007

“Patent Holder Grip Weakens,” *Wall Street Journal*, May 1, 2007

Microsoft vs. World:

“In Software Development, a True Ardor for Java”, *New York Times*, April 20, 1998

“Little-Known Project Developing Alternative Software to Windows”, *New York Times*, January 18, 1999

“Linux Backers Plan Assault on Microsoft”, *New York Times*, August 14, 2000

“Microsoft is Set to be Top Foe of Free Code”, *New York Times*, May 3, 2001

“Microsoft to Allow Partners to Alter Some Source Code”, *New York Times*, April 10, 2003

“Microsoft Eases Policy on Licensing its Technology”, *New York Times*, December 4, 2003

“2 Giants in a Deal over Linux,” *New York Times*, November 3, 2006

“Microsoft Must Turn to New Set of Hurdles”, *New York Times*, November 4, 2002

“Microsoft is Putting its Muscle Behind Web Programming Tools”, *New York Times*, February 13, 2002

“Competitors Shape Strategy to Gain Edge in Web Services”, *New York Times*, February 3, 2003

“In the Battle of the Browsers `04, Firefox Aims at Microsoft”, *New York Times*, November 15, 2004

“Digital Media Becomes Focus as Microsoft and AOL Settle”, *New York Times*, June 2, 2003

“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

“Clash of the Titans: Google Gets Ready to Rumble with Microsoft,” *New York Times*, December 16, 2007

“A Matter of Sovereignty,” *The Economist*, September 22, 2007

#### Optimal Investment Timing:

“Major League Baseball Steps out as Coach in the Game of Web Video,” *Wall Street Journal*, March 27, 2006

“Level 3 Regains Luster Amid Web-Video Boom,” *Wall Street Journal*, December 21, 2006

#### Industry Convergence:

“Bill Gates goes Vertical”, Gabler, *New York Times*, June 12, 1997

“A Test of Synergy”, *New York Times*, November 11, 2002

*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

“MySpace Restrictions Upset Some Users,” *New York Times*, March 20, 2007

Fixed Costs, Path Dependence, Option Value, and Risk problem with attached answers

Mark Cuban’s Bet on Digital Projectors Problem with attached article, “Theater Chain Buying Sony’s Digital Projectors,” *New York Times*, March 15, 2005

Real Options on Convergence with attached articles “The Small Picture,” *Wall Street Journal*, April 3, 2006, and “A Very Big Push for a Very Small Screen,” *Business Week*, April 2, 2006

## 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)

“Profit-Sharing Contracts in Hollywood: Evolution and Analysis”,  
Weinstein, *Journal of Legal Studies*, January 1998.

“The Net Profits Puzzle”, Goldberg, *Columbia Law Review*, March 1997

“Studios Take a Beating on the Backend,” *Variety.com*, January 22, 2006

“How Pixar Adds a New School of Thought to Disney,” *New York Times*,  
January 29, 2006

“Music Stars Complain about Stringent Contracts”, *New York Times*, September  
6, 2001

“Spit Out By the Star-Making Machinery”, *New York Times*, February 3, 2002

“Korn Sells a Stake in Itself,” *New York Times*, January 11, 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

“H’w’d at War with Piece-Niks,” *Weekly Variety*, November 25-December 1,  
2002 and “Pic Writedowns Prompt Meltdowns”, *Weekly Variety*, December 9-  
15, 2002

“Experiments in Compensation Arrangements” problem, with attached articles

“Scribe Plot Twist,” *Daily Variety*, March 19, 2007, and “Google Tests an Ad  
Idea: Pay Only for Results,” *New York Times*, March 21, 2007.

The exercises in the class notes that I indicate we will discuss in class.



3/11-3/25 (1<sup>st</sup> half)    Financing Agreements and their Portrayal in Financial Reports

Film:

“Hollywood gets warm and runny for...Other People's Money”, *Weekly Variety*, February 17-23, 1997

“New Faces, Old Script,” thedeal.com, June 8, 2007

“Sharing Pix is Risky Business”, *Weekly Variety*, November 17-23, 2003

Television:

“Digital Media Brings Profits (and Tensions) to TV Studios,” *New York Times*, May 14, 2006

“NBC to Sell TV Shows for Viewing on Apple Software,” *New York Times*, December 7, 2005

“Near Instant Pay Reruns Set for Shows on NBC and CBS,” *New York Times*, November 8, 2005

“Television’s Power Shift: Cable Pays for ‘Free’ Shows,” *New York Times*, February 5, 2007

Theater:

“Nonprofit Show, but Money’s Riding on It,” *New York Times*, March 18, 2007

Technology:

“Tech Titans Turn to Debt for Deals,” *Wall Street Journal*, February 7, 2006

“If Earnings Depend on Investing, Watch Out”, *New York Times*, January 21, 2001

*Prepare:* Fox Entertainment Group IPO Case, Part I, with attached articles “Titanic Task: Valuing Fox Offering,” *Weekly Variety*, November 9-15, 1998, “The

Rules

According to Rupert,” *Fortune*, October 26, 1998, “Sports and TV Start-Ups Limit News Corp. Earnings,” *New York Times*, February 11, 1999, “A Murdoch Spinoff of Fox Shares Has Been Better for Some than Others,” *New York Times*, August 21, 200, and “Fox Clocks Back in at Murdoch’s News Corp.” *Weekly Variety*, March 22, 2005

Pixar v. Disney, with attached article “Escaping the Shark?” *Barrons*, February 2, 2004

Dreamworks’ Distribution Agreement (this case overlaps with Pixar v. Disney)  
Marvel’s Film Financing Facility

**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 (2<sup>nd</sup> half)-4/1 (1<sup>st</sup> 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)

“A Man of Words is Still Partial to One: Loyalty”, *New York Times*, December 29, 1999

“Free or Paid? AOL Will Let its Two Halves Duke it Out”, *New York Times*, November 22, 2004

“Trying to Wean Internet Users from Free,” *New York Times*, November 12, 2005

“Online Music’s Elusive Bottom Line,” *New York Times*, November 21, 2005

“2 Largest U.S. Wireless Carriers Add Many Subscribers,” *New York Times*, January 25, 2006

“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

“Cablevision Loss Widens, Yet Stock Rises”, *New York Times*, February 24, 2005

“Cox Parent to Buy out Public Shareholders”, *New York Times*, October 20, 2004

“Adelphia Board’s Choices Complicate a Bidding Process”, *New York Times*, January 31, 2005

“A Bulk-Sales Initiative by AOL May Have Inflated Subscriptions”, *Wall Street Journal*, July 25, 2003

“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

4/1 (2<sup>nd</sup> half) Libraries and Primary versus Ancillary Revenues

*Read:* Class Notes

“In Warner Brothers’ Strategy, A Movie is Now a Product Line”, *New York Times*, February 11, 2002

“Blockbuster with a Joystick”, *New York Times*, February 7, 2005

“H’W’D Revels in Niche Riches”, *Weekly Variety*, February 24-March 2, 2003

“Afterlife Spawns Horror Boutiques”, *Weekly Variety*, 15-21, 2004

“Missed it in the Theater Today? See it on DVD Tonight,” *New York Times*, January 23, 2006

“Multimedia Launch of ‘Bubble’ Gets Mixed Response,” *Wall Street Journal*, January 30, 2006

“Auds Take a Pass on Theatrical Hits”, *Weekly Variety*, November 18-24, 2002

“Indies Form Powerhouse”, *Weekly Variety*, November 3-9, 2003

“Sony-Led Group Makes a Late Bid to Wrest MGM from Time Warner”, *New York Times*, September 14, 2004

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

“Berry Gordy Sells EMI a Stake in Catalogue of Motown Songs”, *New York Times*, July 2, 1997

Various stories related to Beatles’ Song Catalog from [www.nme.com](http://www.nme.com)

“For ‘CSI,’ Press A1,” *New York Times*, November 12, 2005

“Bombing on Broadway, Thriving on the Road”, *New York Times*, February 10, 2003

“Skype, Warner Reach Ringtone Deal,” *Wall Street Journal*, January 30, 2006

“Verizon Is to Add ‘O.C.’ to Multimedia Offerings,” *Wall Street Journal*, February 9, 2006

*Prepare:* “Libraries as Subscriber Bases” problem

Part IV: Financial Accounting and Accounting-Based Valuation

4/8-4/15 (1<sup>st</sup> 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  
"U.S. Moves to Allow Trading of Radio Spectrum Licenses", *New York Times*, May 16, 2003

AOL:

"America Online Plans \$385 Million Charge", *Wall Street Journal*, October 31, 1996  
"A Tale of Two Writeoffs: American Online & Allegiance", Jack Cieselski, *The Analyst's Accounting Observer*, November 21, 1996  
"America Online's Strategy Raises Eyebrows", *New York Times*, February 13, 1997  
"America Online's Triumvirate in Cyberspace", *New York Times*, February 16, 1998  
"AOL Pays a Fine to Settle a Charge that it Inflated Profits", *New York Times*, May 16, 2000  
"Internet Providers Look for Profit in Free Access", *New York Times*, March 6, 2000  
"AOL Reporting Further Losses; Turner Resigns", *New York Times*, January 30, 2003

*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:

“What’s the Problem with Film Industry Reporting?” Londoner, *Journal of Financial Statement Analysis*, Spring 1996

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

“How Dreamworks Misjudged DVD Sales of Its Monster Hit”, *Wall Street Journal*, May 31, 2005

theater:

“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

“S.E.C. Inquiry on Homestore Has Expanded to Cendant”, *New York Times*, November 25, 2002

“Yahoo, Google, and Internet Math”, *Wall Street Journal*, May 10, 2004

telecommunications:

“The Fiber Optic Fantasy Slips Away”, *New York Times*, February 17, 2002

SEC Press Release 2004-148, “SEC Charges Qwest Communications International Inc. with Multifaceted Accounting and Financial Reporting Fraud”

software:

“PeopleShell?”, *Forbes*, January 21, 2002

*Prepare:* “Orion Pictures Corporation: Silence of the Accountants” case, Abarbanell, 1997, which includes

“Orion Pictures Corporation: Lessons from its Demise”, Brown, *Corporate Controller*, May/June, 1992

“Hollywood Mystery: Woes at Orion Stayed Invisible for Years”, *Wall Street Journal*, October 16, 1991

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  
    “A Hard Fall as a Highflier Revises Figures”, *New York Times*, March 21, 2000  
    “Failed Audit: The Humiliation of PricewaterhouseCoopers”, *New York Times*, March 24, 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

    “AOL’s Need: A New Vision”, *New York Times*, February 2, 2003  
    “Deal Time?”, *Forbes*, March 3, 2003  
    “In Uncertain Times, Put Surprise to Work”, *New York Times*, December 1, 2001  
    “The Ebitda Folly”, *Forbes*, March 17, 2003  
    “Looking Glass on Earnings Just Got Darker”, *New York Times*, October 24, 2002

*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

“How Did They Value Stocks? Count the Absurd Ways”, *New York Times*, March 18, 2001

“Funny Business”, *New York Times Magazine*, December 19, 1999

“Fox Sweeps Away Competish”, *Weekly Variety*, March 3-9, 2003

“IBM Again Leads Businesses in Patents Awarded by U.S.”, *New York Times*, January 13, 2003

“Yahoo Charts the Spread of the News by E-Mail...”, *New York Times*, January 29, 2001

“Pop-Up Web Ads Pose a Measurement Puzzle”, *New York Times*, July 23, 2001

“Rating Agency Says it Erred in Measuring Web Site Use”, February 24, 2003

“Nielsen Offers More Details on Lost Viewers”, *New York Times*, November 25, 2003

“How Good is Google?”, *The Economist*, November 1, 2003

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