

### *The era of the option*

Few sectors have reflected [the reality of change at increasing speed] more directly than Media and Telecom...

In his autobiography, Henry Adams commented on what he perceived to be the accelerating nature of history, and the inadequacy of an education in rapidly changing times. He formulated this perspective in the context of his own life experience, which spanned the youth of our nation into an industrial revolution and civil war and the scientific discoveries of the early twentieth century, leaving the old man to wonder if the learning he had picked up in his lifetime could really have prepared him for the times ahead. If he only knew! Leaving aside unprecedented global events that were to follow, succeeding one another at narrower and narrower intervals, the pace of technical evolution alone would have dazzled even this expectant prophet. Whether changes in living standards and public opinions and tastes have been the cause or the result of this accelerating history can be the subject of much debate, but change at increasing speed seems to be a robust enough truth, and one that can be relied upon to continue. Few sectors have reflected this reality more directly than Media and Telecom, and few aspects of this broad industry segment will be as completely affected by accelerating change as those related to finance, valuation, and successful investment.

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Many have already described and opined upon the shifts in communication modes and consumer behavior at length, so we will skip past these preliminaries. Besides, the revolutionary changes are evident at every turn for all to see, as newspapers become Internet blogs which become wireless tweets, which will undoubtedly seem as old-fashioned as a payphone soon enough. It may be just as interesting, especially to investors and other capital providers, to determine the impact of such change on valuation metrics and financial opportunity. If equity value (and by extension, enterprise value) can be reduced to two components – one, the inherent business, and, two, option value – which is not an inadequate analytic approach, then an environment of rapid change would speak to each separately, and in different ways.

All things equal, change is threatening to an established business, as we have seen in the case of traditional Media and Telecom operations, and rapid change can be gravely threatening. The fundamental valuation impact of instability will be some degree of magnitude negative, in direct relation to the gravity of the threat

(i.e., the change that is taking place). In terms analogous to the education of Henry Adams, the traditional development of an established order will not prepare it for changes and tumult that follow, and may in fact be a hindrance to the extent that future flexibility is stifled.

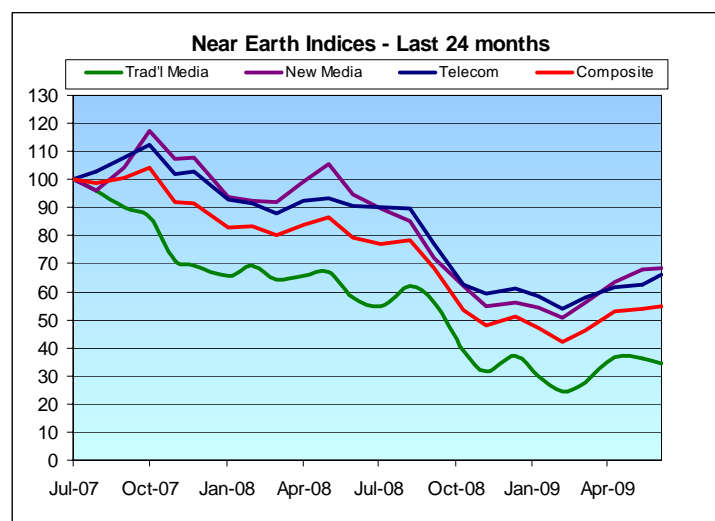
The fundamental valuation impact of instability will be negative... Option value, on the other hand, thrives...

Option value, on the other hand, thrives on tumult and directly benefits from change. Black-Scholes technicalities aside, the notion can be observed practically every day. From a competitive perspective, volatility enables new entrants to compete when a solid and stable environment would have kept new entrants out. From a financial perspective, volatility leads to the wild swings which may cause substantial upside opportunity. And option value emerges when choices can be made... to change or stay the course, to pursue or drop a business plan, to buy or sell an asset, or not to do either... all of which choices are presented with greater velocity and repercussions in a high volatility environment.

As options, however, are just that and nothing more, the financial value of an option will ordinarily not be as high as that of the underlying business to which it is related, and the composition of optionality versus inherent business value in a given equity scenario will be a matter of proportion, magnitude, and timing. In the present time, marked by economic weakness and diminishing profits on one hand, (i.e., deterioration of business fundamentals), and increased volatility on the other, (i.e., threat to the established order, and enhanced optionality), equity values have fallen to a point where option value probably constitutes a greater percentage of the whole than has been previously the case. In the Media and Telecom sectors

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particularly, composite indices had started to fall long before the more general equities markets collapse last year, which is not surprising in light of the tremendous volatility experienced by the sector. In both cases, (i.e., the



broad market index and the specific industry sector), one may look at the valuation decline and see this as a descent tending towards pure option value.

... the earlier in its life-cycle and the more unproven a business concept, the more its value will reflect pure option value...

While the economic weakness will eventually cease and while profits will at some level find their equilibrium, the pace of technological change and shifts of consumer patterns are unlikely to slow. Henry Adams would in fact argue that this pace will continue to accelerate, and he will quite possibly be proven right for a long time to come. In such an era, regardless of individual business fundamentals, the optionality ingredient is thus likely to remain an increasingly important aspect of overall valuation. Whether it is the only value in a given circumstance, or whether there are also other aspects, will depend on the circumstance itself. It is safe to say that the earlier in its life-cycle and the more unproven a business concept, the more its value will reflect pure option value. It is increasingly safe to say, particularly in the world of Media and Telecom, that the phenomenal rate of change we are experiencing is making start-ups even out of companies that had unwittingly considered themselves mature.

From a financial perspective, whether as buyer/investor or seller/issuer, a thesis based on realities described may thus include the following ingredients:

...the phenomenal rate of change we are experiencing is making start-ups even out of companies that had unwittingly considered themselves mature.

- valuation targets/expectations reflecting sector volatility
- small investment size to reduce risk exposure, and the less capital intensity the better
- quick time-to-market targets for new projects or products... for strategics, buying may be better than building... for entrepreneurs, short lead times on new products
- exit/liquidity flexibility within short timeframe, ideally with multiple alternatives, but preparedness to hold if necessary
- portfolio/product diversification for both investors and sector competitors

While this recipe may not fit every circumstance, it should at the very least be worthy of consideration, and especially so in an environment marked by continuing acceleration. On this July 4, let us remember that visionary Adams, great grandson of John and grandson of John Quincy, who saw his times and the times to come with clarity, and who, in his own way, understood the value of the option.



**SPECIALISTS IN SATELLITE, MEDIA AND TELECOM INVESTMENT BANKING**

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By Dan Ramsden  
Near Earth LLC



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