The Walt Disney Company

2016 SMF Analyst Report

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The Walt Disney Company (NYSE: DIS)

- **Sector:** Consumer Discretionary
- **Industry:** Media and Entertainment
- **Date:** April 20, 2016
- **Current Price:** 103.27
- **Target Price:** 116.98
- **Recommendation:** BUY

Key Financials

Market Cap: 168.49 B
52 Week High: 122.08
52 Week Low: 86.25
Dividend Yield: 1.81
Gross Margin: 45.9%

Profit Margin: 15.98%
P/E Ratio: 19.3
EPS: 4.9
FCF/Sh: 3.82
FCF Growth: 2.71%

FCF/Sales: 12.66%
ROE: 19.83%
ROIC: 13.9%
ROA: 9.93%
Beta: 1.47

DIS Performance vs. SPY

Business Summary

According to the 10k distributed by The Walt Disney Company, the company, together with its subsidiaries, is a diversified worldwide entertainment company with operations in five business segments: Media Networks, Parks and Resorts, Studio Entertainment, Consumer Products and Interactive.

Business Segments

Studio Entertainment

The Studio Entertainment segment produces and acquires live-action and animated motion pictures, direct-to-video content, musical recordings and live stage plays.

The businesses in the Studio Entertainment segment generate revenue from the distribution of films in the theatrical, home entertainment and television markets, stage play ticket sales, the distribution of recorded music and licensing revenues from live entertainment events. Significant operating expenses include film cost amortization, which consists of production cost and participations and residuals expense amortization, distribution expenses and costs of sales.

The Company distributes films primarily under the Walt Disney Pictures, Pixar, Marvel, Lucasfilm and Touchstone banners. The Company produces and distributes Indian movies through its UTV banner.

In August 2009, the Company entered into an agreement with DreamWorks Studios (DreamWorks) to distribute live-action motion pictures produced by DreamWorks for seven years under the Touchstone Pictures banner for which the Company receives a distribution fee. As of October 3, 2015, the Company has distributed eleven DreamWorks films. As part of the agreement, the Company provided loans to DreamWorks, which as of October 3, 2015 totaled $159 million. There is an additional $90 million available to DreamWorks.

Prior to the Company's acquisition of Marvel, Marvel had licensed the rights to third-party studios to produce and distribute feature films based on certain Marvel properties including Spider-Man, The Fantastic Four and X-Men. Under the licensing arrangements, the third-party studios incur the costs to produce and distribute the films and the Company retains the merchandise licensing rights. Under the licensing arrangement for Spider-Man, the Company pays the third-party studio a licensing fee based on each film's box office receipts, subject to specified limits. Under the licensing arrangements for The Fantastic Four and X-Men, the third-party studio pays the Company a licensing fee, and the third-party studio receives a share of the Company's merchandise revenue on these properties. The Company distributes all Marvel-produced films with the exception of *The Incredible Hulk*, which is distributed by a third-party studio.

Prior to the Company's acquisition of Lucasfilm, Lucasfilm produced six Star Wars films (Episodes 1 through 6). Lucasfilm retained the rights to consumer products related to all of those films and the rights related to television and electronic distribution formats for all of those films, with the exception of the rights for Episode 4, which are owned by a third-party studio. All of the films are distributed by a third-party studio in the theatrical and home entertainment markets. The theatrical and home entertainment distribution rights for these films revert back to Lucasfilm in May 2020 with the exception of Episode 4, for which these distribution rights are retained in perpetuity by the third-party studio.

Lucasfilm also includes Industrial Light & Magic and Skywalker Sound, which provide visual and audio effects and other post-production services to the Company and third-party producers.

Media Networks

The Media Networks segment includes cable and broadcast television networks, television production operations, television distribution, domestic television stations and radio networks and stations.

The businesses in the Media Networks segment generate revenue from fees charged to cable, satellite and telecommunications service providers (Multi-channel Video Programming Distributors or MVPDs) and television stations affiliated with our domestic broadcast television network for the right to deliver our programs to their customers/subscribers ("affiliate fees"), from the sale to advertisers of time in programs for commercial announcements ("ad sales") and from other sources such as the sale and distribution of television programming ("program sales"). Significant operating expenses include programming and production costs, participations and residuals expense, technical support costs, operating labor and distribution costs.

Consumer Products and Interactive

The Consumer Products segment engages with licensees, publishers and retailers throughout the world to design, develop, publish, promote and sell a wide variety of products based on the Company's intellectual property through its Merchandise Licensing, Publishing and Retail businesses. In addition to using the Company's film and television properties, Consumer Products also develops its own intellectual property, which can be used across the Company's businesses.
Consumer Products segment generates revenue from:

- Licensing characters from our film, television and other properties to third parties for use on consumer merchandise
- Publishing children's books and magazines and comic books
- Selling merchandise through our retail stores, internet shopping sites and wholesale business; and
- Charging tuition at our English language learning centers in China

Significant costs include costs of goods sold and distribution expenses, operating labor and retail occupancy costs.

The Interactive segment creates and delivers branded entertainment and lifestyle content across interactive media platforms. Interactive's primary operations include the production and global distribution of multi-platform games, the licensing of content for games and mobile devices, website management and design for other Company businesses and the development of branded online services.

The Interactive segment also manages Maker Studios, Inc. (Maker), a leading network of online video content. Maker results are allocated primarily to the Media Networks and Studio Entertainment segments.
Interactive segment generates revenue from:

- Selling of multi-platform games to retailers and distributors, the collection of fees through micro transactions in the games, and subscriptions
- Licensing content to third-party game publishers and for mobile devices
- Online advertising and sponsorships

Significant costs include cost of goods sold, product development, marketing expenses and distribution expenses.

Parks and Resorts

Parks and Resorts: The Company owns and operates the Walt Disney World Resort in Florida; the Disneyland Resort in California; Aulani, a Disney Resort & Spa in Hawaii; the Disney Vacation Club; the Disney Cruise Line; and Adventures by Disney. The Company manages and has effective ownership interests of 81% in Disneyland Paris (see recapitalization discussion below), 47% in Hong Kong Disneyland Resort and 43% in Shanghai Disney Resort, each of which is consolidated in our financial statements. The Company also licenses our intellectual property to a third party for the operations of the Tokyo Disney Resort in Japan. The Company's Walt Disney Imagineering unit designs and develops new theme park concepts and attractions as well as resort properties.

The businesses in the Parks and Resorts segment generate revenues from the sale of admissions to theme parks, sales of food, beverage and merchandise, charges for room nights at hotels, sales of cruise and other vacation packages and sales and rentals of vacation club properties. Significant costs include labor, infrastructure costs, depreciation, costs of merchandise, food and beverage sold, marketing and sales expense and cost of vacation club units. Infrastructure costs include repairs and maintenance, information systems expense, utilities, property taxes, insurance and transportation.

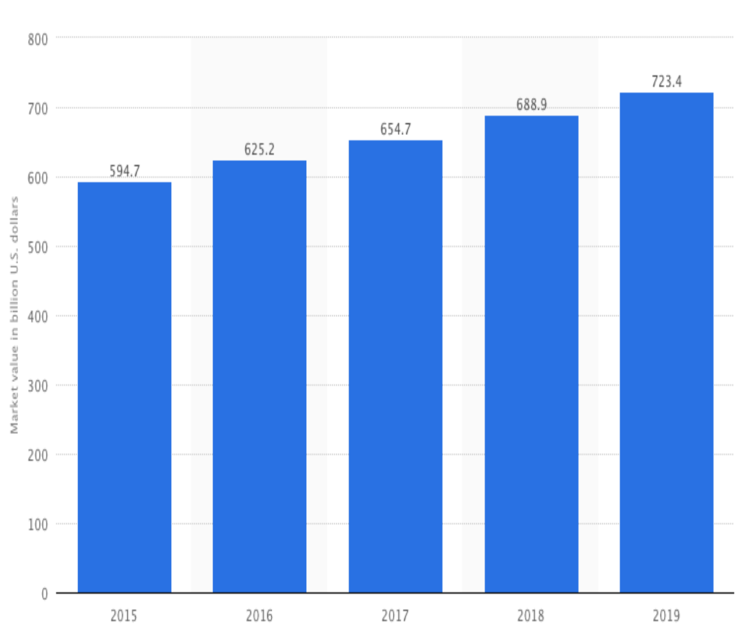
Sector Overview: Consumer Discretionary

The Walt Disney Company is considered part of the consumer discretionary sector. This division of the market is comprised of companies that produce goods or services that are considered nonessential such as media, retail, hotels, restaurants and leisure, textiles, apparel and luxury goods, household durables, automobiles, auto components, distributors, leisure equipment and products, and diversified consumer services. By definition, these organizations are not recession proof and feel the effects of any economic downturn. This causes the consumer discretionary sector to have a relatively high correlation to the market with a three-year beta of .98. The sector is tracked by the Spdr exchange traded fund XLY, of which Disney comprises 6.39%. The 3-year return of the fund is 16.74% and the 1-year return is 8.30%.

XLY Historical Performance vs. SPY

Industry Overview: Media and Entertainment

Projected Growth in M&E Sector:



The Media and Entertainment Industry includes film, TV, music, Internet, video games, advertising, and print. The U.S. Media and Entertainment market represents one third of global industry and is the largest market of its kind in the world. Industry forecasts predict worldwide expansion due to the growing opportunities in the digital media market. Globally the market is valued in the trillions. In 2014 the global markets were valued at an estimated 1.9 trillion U.S dollars, with the expectation that this value will rise to 2.3 trillion by 2018. Disney is one of the largest players in the global market and will likely be an integral part of the digital global expansion.

Opportunities

Disney's collection of branded franchises presents them with an opportunity for continued record-breaking performance, particularly within the Studio Entertainment segment. The Company has a myriad of motion pictures in the pipeline, including films from their increasingly popular Marvel and Star Wars franchises. As these franchise extensions continue to grow in popularity, Disney can further integrate them into their media ecosystem, particularly their Consumer Products and Interactive segments.

In addition, Disney has significant opportunity within their Parks and Resorts segment. In mid-June of this year, Disney will have its grand opening of Shanghai Disneyland. China is a great opportunity for Disney, as it is largely an untapped market. The opening of Shanghai Disneyland signifies Disney's expansion into less westernized markets, an effort they are committed to pursuing.

Risks

Although every segment of The Company faces risks and threats in some respect, Disney's largest challenges are within their Media Networks segment. One of Disney's most well known franchises is its cable network ESPN. As online advancements in media streaming and downloading continue to change the landscape of media consumption, a trend known as cord-cutting is gaining popularity. Cord-cutting is when cable and satellite customers replace their TV service providers with alternative sources of TV programming. This is a risk for The Company as ESPN is one of the main cable networks included on those traditional TV service plans.

To combat this, Disney is teaming up with TV service providers to have ESPN be included in lighter cable packages that cost less than traditional subscriptions. In addition to this, Disney is always analyzing new ways to convey their Media Networks content.

Competitive Environment

The Walt Disney Company is unlike any other in the industry. With their integrated business structure, ability cross sell products, and tendency to recycle creative material for each generation, Disney has been able to build a mass media conglomerate that dwarfs its closest rivals. Generally Disney has competitors in each business segment, but few can recreate the integrated business structure that Disney has mastered. Disney's market cap of $168.55 billion is the largest when compared to its closest competitors and more than twice the entertainment industry average.

Overall Disney's network, park, and studio entertainment businesses are either equal to or better than their closest rivals. ABC has produced several hits such as Scandal, How to Get Away with Murder, and Grey's Anatomy and ESPN is the most watched sports network. Star Wars, Pixar, Marvel and the coming Indiana Jones sagas all dominate the studio entertainment segment. The Disney theme parks are an added attraction and revenue source that the TeleCom companies do not have in their portfolio. For these reasons Disney stock has outperformed both Time Warner and Fox over the past few years.

Twenty-First Century Fox:

Twenty-First Century Fox Incorporated has four main business segments, Cable Network Programming, Television, Filmed Entertainment, and Direct Broadcast Satellite Television. The company generally competes with Disney in the media network business segment with the Fox Entertainment Group stations such as Fox News and Fox Sports rivaling Disney's ABC and ESPN. The stations do not draw nearly as many viewers, as Fox has only two primetime hits and ESPN is the top sports network. Twenty-First Century Fox has a market cap of $57.93 billion and employs approximately 20,000 people. The company has generated approximately $26.5 billion in annual revenue with $2.46 billion in net income.

Time Warner Cable:

Time Warner is the second largest U.S. cable company in terms of revenue. In 2015, the company generated over $28 billion in revenue with a net income of $3.78 billion. They compete with Disney's media network and studio entertainment segments. The rights to DC Comics are held by Time Warner and have been something of a cash cow for the company. Time Warner Cable has a market cap of $59.25 billion and employs nearly 25,000 people. Recently they have been the target of a few acquisition attempts. A deal made with Comcast fell through after regulatory scrutiny, however Charter has been working with Time Warner to solidify an agreement. The stock of the company has done well on the news of a potential acquisition.

Comcast Corporation:

Comcast is the largest in the U.S. in terms of revenue. Last year, the company received over $74.5 billion in revenues and earned $8.16 billion in net income. The businesses of Comcast compete with Disney's parks and resort segment as well as their studio entertainment business. The company owns both NBCUniversal, which includes television networks such as Sports Network and NBC, and the Universal theme parks. Comcast has also produced box offices hits like the Harry Potter Series. However, Disney's parks have attracted parks draw an annual 48.3 million visitors as compared to Universal's 10.1 million.

Valuation

	Historical Period				
	2011	**2012**	**2013**	**2014**	**2015**
Revenue	**$ 40,893.0**	**$ 42,278.0**	**$ 45,041.0**	**$ 48,813.0**	**$ 52,465.0**
% growth		*3.4%*	*6.5%*	*8.4%*	*7.5%*
Cost of Revenue	33,112.0	33,415.0	35,591.0	26,420.0	28,364.0
Gross Margin	**$ 7,781.0**	**$ 8,863.0**	**$ 9,450.0**	**$ 22,393.0**	**$ 24,101.0**
Gross Margin %	*19.0%*	*21.0%*	*21.0%*	*45.9%*	*45.9%*
SG&A	-	-	-	8,565.0	8,523.0
% margin	*0.0%*	*0.0%*	*0.0%*	*17.5%*	*16.2%*
Restructuring, merger and acquisition	55.0	100.0	214.0	140.0	-
% margin	*0.1%*	*0.2%*	*0.5%*	*0.3%*	*0.0%*
Other Operating Expenses	-	-	-	2,288.0	2,354.0
Total Operating Expenses	**55.0**	**100.0**	**214.0**	**10,993.0**	**10,877.0**
% margin	*0.1%*	*0.2%*	*0.5%*	*22.5%*	*20.7%*
EBITDA	**$ 10,319.0**	**$ 11,719.0**	**$ 12,161.0**	**$ 14,828.0**	**$ 16,487.0**
% margin	*25.2%*	*27.7%*	*27.0%*	*30.4%*	*31.4%*
Depreciation & Amortization	1,841.0	1,987.0	2,192.0	2,288.0	2,354.0
EBIT	**$ 7,726.0**	**$ 8,763.0**	**$ 9,236.0**	**$ 11,400.0**	**$ 13,224.0**
% margin	*18.9%*	*20.7%*	*20.5%*	*23.4%*	*25.2%*
Interest Expense	435.0	472.0	349.0	294.0	265.0
Other income (net)	752.0	969.0	733.0	1140.0	909.0
Taxes	2,785.0	3,087.0	2,984.0	4,242.0	5,016.0
% tax	*36.0%*	*35.2%*	*32.3%*	*37.2%*	*37.9%*
Net Income	**$ 5,258.0**	**$ 6,173.0**	**$ 6,636.0**	**$ 8,004.0**	**$ 8,852.0**
Plus: Depreciation & Amortization	1,841.0	1,987.0	2,192.0	2,288.0	2,354.0
Plus: Other Operating Adjustment	(7,805.3)	(6,787.0)	(5,933.0)	(7,123.0)	(6,519.0)
Plus: Change in Non-Cash Working Capital	(582.3)	(975.0)	965.0	(11.0)	(2,308.0)
Less: Capital Expenditures	(3,559.0)	(3,784.0)	(2,796.0)	(3,311.0)	(4,265.0)
Free Cash Flow	**$ 3,435.0**	**$ 4,182.0**	**$ 6,656.0**	**$ 6,469.0**	**$ 6,644.0**
% growth		*21.7%*	*59.2%*	*-2.8%*	*2.7%*
WACC	11.0%				
Discount Period					
Discount Factor					
Present Value of Free Cash Flow					

	Projection Period										CAGR
	2016	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**	**(2015-2025E)**
Revenue	**$ 56,216.7**	**$ 60,236.6**	**$ 64,544.0**	**$ 69,159.4**	**$ 74,104.8**	**$ 79,403.9**	**$ 85,081.8**	**$ 91,165.9**	**$ 97,684.9**	**$ 104,670.1**	*7.2%*
% growth	*7.2%*	*7.2%*	*7.2%*	*7.2%*	*7.2%*	*7.2%*	*7.2%*	*7.2%*	*7.2%*	*7.2%*	
Cost of Revenue	30,392.2	32,565.5	34,894.2	37,389.4	40,063.1	42,927.9	45,997.5	49,286.7	52,811.1	56,587.5	
Gross Margin	**$ 25,824.4**	**$ 27,671.1**	**$ 29,649.7**	**$ 31,769.9**	**$ 34,041.7**	**$ 36,476.0**	**$ 39,084.3**	**$ 41,879.1**	**$ 44,873.8**	**$ 48,082.6**	*7.2%*
Gross Margin %	*45.9%*	*45.9%*	*45.9%*	*45.9%*	*45.9%*	*45.9%*	*45.9%*	*45.9%*	*45.9%*	*45.9%*	
SG&A	9,498.3	10,177.5	10,905.2	11,685.1	12,520.6	13,415.9	14,375.3	15,403.2	16,504.7	17,684.9	
% margin	*16.9%*	*16.9%*	*16.9%*	*16.9%*	*16.9%*	*16.9%*	*16.9%*	*16.9%*	*16.9%*	*16.9%*	
Restructuring, merger and acquisition	101.8	101.8	101.8	101.8	101.8	101.8	101.8	101.8	101.8	101.8	
% margin	*0.2%*	*0.2%*	*0.2%*	*0.2%*	*0.2%*	*0.2%*	*0.2%*	*0.2%*	*0.2%*	*0.2%*	
Other Operating Expenses	-	-	-	-	-	-	-	-	-	-	
Total Operating Expenses	**9,600.1**	**10,279.3**	**11,007.0**	**11,786.9**	**12,622.4**	**13,517.7**	**14,477.1**	**15,505.0**	**16,606.5**	**17,786.7**	*5.0%*
% margin	*17.1%*	*17.1%*	*17.1%*	*17.0%*	*17.0%*	*17.0%*	*17.0%*	*17.0%*	*17.0%*	*17.0%*	
EBITDA	**$ 18,474.4**	**$ 20,701.4**	**$ 23,152.4**	**$ 25,848.1**	**$ 28,810.9**	**$ 30,871.1**	**$ 33,078.6**	**$ 35,444.0**	**$ 37,978.5**	**$ 40,694.3**	*9.5%*
% margin	*32.9%*	*34.4%*	*35.9%*	*37.4%*	*38.9%*	*38.9%*	*38.9%*	*38.9%*	*38.9%*	*38.9%*	
Depreciation & Amortization	2,530.5	2,663.2	2,795.9	2,928.6	3,061.3	3,194.0	3,326.7	3,459.4	3,592.1	3,724.8	
EBIT	**$ 14,792.1**	**$ 16,768.6**	**$ 18,952.1**	**$ 21,362.1**	**$ 24,019.8**	**$ 25,737.4**	**$ 27,577.9**	**$ 29,549.9**	**$ 31,663.0**	**$ 33,927.1**	*9.9%*
% margin	*26.3%*	*27.8%*	*29.4%*	*30.9%*	*32.4%*	*32.4%*	*32.4%*	*32.4%*	*32.4%*	*32.4%*	
Interest Expense	207.6	155.8	104	52.2	0.4	-51.4	-103.2	-155	-206.8	-258.6	
Other income (net)	900.6	900.6	900.6	900.6	900.6	900.6	900.6	900.6	900.6	900.6	
Taxes	5,610.8	6,360.5	7,188.7	8,102.9	9,111.0	9,762.5	10,460.6	11,208.6	12,010.1	12,868.9	
% tax	*37.9%*	*37.9%*	*37.9%*	*37.9%*	*37.9%*	*37.9%*	*37.9%*	*37.9%*	*37.9%*	*37.9%*	
Net Income	**$ 9,874.3**	**$ 11,152.9**	**$ 12,559.9**	**$ 14,107.6**	**$ 15,809.1**	**$ 16,927.0**	**$ 18,121.1**	**$ 19,396.9**	**$ 20,760.3**	**$ 22,217.4**	*9.6%*
Plus: Depreciation & Amortization	2,530.5	2,663.2	2,795.9	2,928.6	3,061.3	3,194.0	3,326.7	3,459.4	3,592.1	3,724.8	
Plus: Other Operating Adjustment	(6,833.5)	(6,833.5)	(6,833.5)	(6,833.5)	(6,833.5)	(6,833.5)	(6,833.5)	(6,833.5)	(6,833.5)	(6,833.5)	
Plus: Change in Non-Cash Working Capital	(582.3)	(582.3)	(582.3)	(582.3)	(582.3)	(582.3)	(582.3)	(582.3)	(582.3)	(582.3)	
Less: Capital Expenditures	(4,350.3)	(4,437.3)	(4,526.1)	(4,616.6)	(4,708.9)	(4,803.1)	(4,899.1)	(4,997.1)	(5,097.1)	(5,199.0)	
Free Cash Flow	**$ 9,339.4**	**$ 10,837.7**	**$ 12,466.2**	**$ 14,237.1**	**$ 16,163.6**	**$ 17,508.3**	**$ 18,931.2**	**$ 20,437.7**	**$ 22,033.7**	**$ 23,725.5**	*13.6%*
% growth	*40.6%*	*16.0%*	*15.0%*	*14.2%*	*13.5%*	*8.3%*	*8.1%*	*8.0%*	*7.8%*	*7.7%*	
WACC											
Discount Period	1	2	3	4	5	6	7	8	9	10	
Discount Factor	0.90	0.81	0.73	0.66	0.59	0.53	0.48	0.43	0.39	0.35	
Present Value of Free Cash Flow	**$ 8,413.9**	**$ 8,796.1**	**$ 9,115.2**	**$ 9,378.4**	**$ 9,592.3**	**$ 9,360.7**	**$ 9,118.4**	**$ 8,868.5**	**$ 8,613.5**	**$ 8,355.7**	

Implied Equity Value and Share Price

PV of Cash Flows	$ 89,612.58
PV of Terminal Value	$ 115,309.34
Enterprise Value	$ 204,921.92
Less: Total Debt	$ 17,336.00
Plus: Cash and Cash Equivalents	$ 4,269.00
Implied Equity Value	$ 191,854.92
Fully Diluted Shares Outstanding	$ 1,640.00
Implied Share Price	$ 116.98

Implied Perpetuity Growth Rate

Terminal Year Free Cash Flow	$ 23,725.5
WACC	11.0%
Terminal Value	$ 327,411.7
Implied Perpetuity Growth Rate	**3.5%**

Sensitivity Analysis of Implied Share Price

	WACC				
Growth Rate	9%	10%	11%	12%	13%
2.5%	$ 148.84	$ 125.70	$ 108.11	$ 94.33	$ 83.25
3.0%	$ 157.38	$ 131.54	$ 112.27	$ 97.38	$ 85.54
3.5%	$ 167.47	$ 138.28	$ 116.98	$ 100.79	$ 88.08
4.0%	$ 179.58	$ 146.15	$ 122.37	$ 104.62	$ 90.89
4.5%	$ 194.38	$ 155.44	$ 128.59	$ 108.97	$ 94.04