The Walt Disney Company

The University of Connecticut
Student Managed Fund
2019 Analyst Report

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The Walt Disney Company (NYSE, DIS)
Sector: Communication Services
Recommendation: Buy

Report Highlights

Target Price	Current Price	52 Week High	52 Week Low	P/E	Market Cap
$139.02	$116.24	$117.90	$96.80	17.45	$172,877.1M

We recommend a buy rating for Walt Disney based off our analysis with a target price of $139.02 per share, allowing for a 19.6% margin of safety based off the close price on October 2nd, 2018.

Basis for Recommendation

1. Unique business model- The Walt Disney Company has four interconnected business segments through which the company can effectively utilize its branded entertainment. For example, a character or storyline created in Disney's studio entertainment can be showcased on one of Disney's media networks, and the character's toys and products can be sold throughout Disney stores. This provides Disney with a steady and reusable revenue stream.

2. An unparalleled Disney experience- Disney is arguably one of the strongest recognizable brands in the US. The company has the ability to reach children and families throughout the country, providing a magical experience through its parks and resorts. This, matched with a rewards program that promotes annual Disney vacations, creates an environment for low price sensitivity. Disney's loyal customer base is one of the strongest factors in its ability to grow and sustain growth in economic downturns.

3. 2019 planned direct-to-consumer launch- In today's environment, streaming services have become an increasingly popular form of entertainment consumption. Disney's planned launch of its own 2019 direct-to-consumer platform will help the company compete with Netflix and Amazon services, and it has the technology resources and content necessary to effectively compete through recent acquisitions of BAMTech and Twenty-First Century Fox.

BUSINESS DESCRIPTION

The Walt Disney Company is a diversified mass media and entertainment conglomerate. Founded in 1923, it has grown into a company with four major business segments: Media Networks, Parks and Resorts, Studio Entertainment, and Products and Interactive. The current CEO and Chairman is Robert Iger, with Christine McCarthy as CFO.

Media Networks is the primary unit of Disney and consists of domestic broadcast televisions networks and stations (ABC, ESPN, and Disney Channel cable network), television production and distribution operations, domestic broadcast radio networks and stations (ESPN radio and Radio Disney Networks), and streaming services and innovative technology. Revenue is generated from affiliate fees, the sale to advertisers, and license fees to use television programming. Media Networks is also the largest segment, generating 43% of revenue in 2018.

Parks and Resorts includes domestic and international theme parks and resorts (the Walt Disney World Resort in Florida, the Disneyland Resort in California, Disneyland Paris, Hong Kong Disneyland Resort, Shanghai Disney Resort, and Tokyo Disney Resort), and the Disney Cruise line. The businesses in this segment principally generate revenues from the sale of theme parks admission, sales of food, beverage and merchandise, charges for resort and vacation packages; while the remaining revenues are from sponsorships and co-branding opportunities, real estate rent and sales, and royalties from Tokyo Disney Resort.

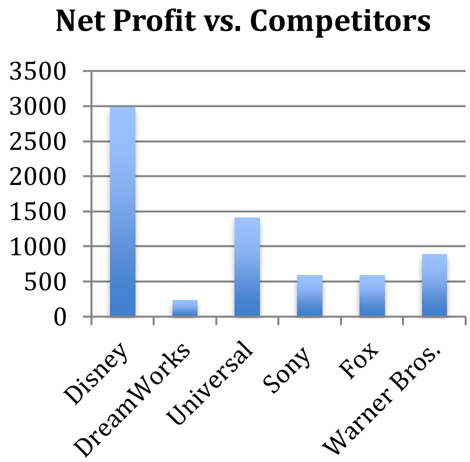
Studio Entertainment produces and acquires live-action, animated motion pictures, direct-to-video content, musical recording, and live stage plays. This business segment consists of the Walt Disney Pictures, Pixar, Marvel, Lucasfilm, and Touchstone banners. Revenue is generated from the distribution of films, stage play ticket sales, music distribution and licensing of Company intellectual property for use in live entertainment production.

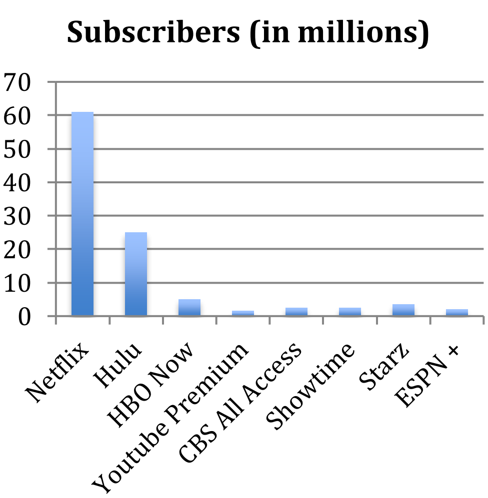
Products and Interactive is the smallest segment that sells merchandise, games and books through its own retail stores, online, and wholesalers, and advertising in online video content. Revenue is generated from licensing character and content; selling merchandise, games, books, and advertising; and charging tuition at English language centers in China.

21st Century Fox Acquisition

Disney's shareholders voted to approve the Fox acquisition in July of 2018. Disney would finance the $71.3 billion deal with $52.4 billion in stock and $18.9 billion in debt. Fox's assets were one of the main reasons for the acquisition: Disney now owns a 60% controlling stake in Hulu and a 39% stake in Sky, which was then sold to Comcast for $15.31 billion and used in part to finance the Fox deal. As part of the Justice Department's requirements, Disney has also agreed to sell Fox's 22 regional sports networks. One of the major implications of this acquisition was the ability for Fox's assets to strengthen Disney's direct-to-consume platform, improving the company's competitive position in the streaming space. In addition, the acquisition will accelerate Disney's international growth with an increasing presence of 350 new channels in 170 countries. Lastly, there is expected to be about $2 billion in cost synergies by 2021.

INDUSTRY OVERVIEW





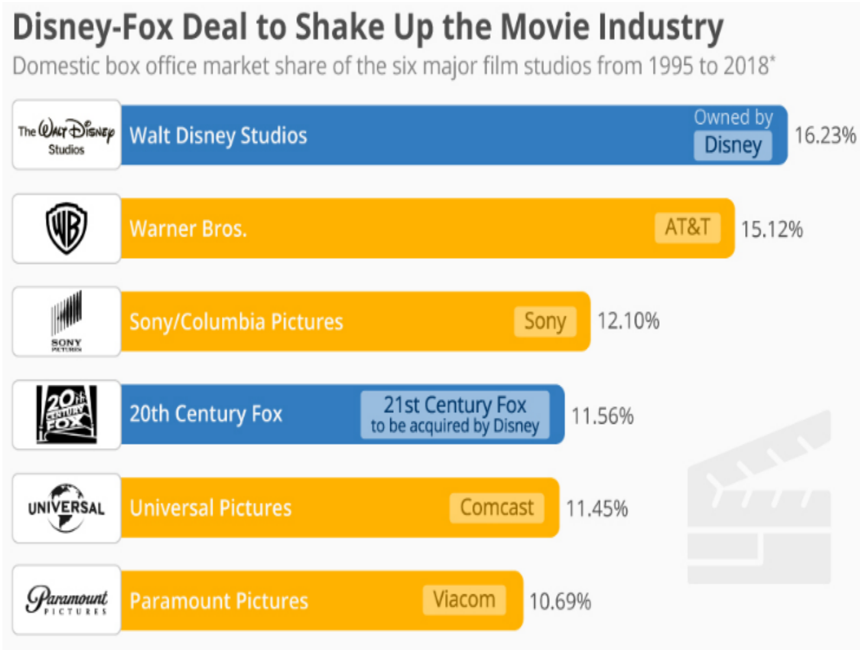
Some of the positive factors that may affect the communication services sector are increasing wireless demand with the rollout of 5G technology, and solid advertising demand through better ability to target consumers. In terms of negative factors, slowing revenue growth, rising expenses, and regulatory risk toward the collection of personal data may affect this sector.

Competitors

Disney faces competition across all four business segments. The company's main competitors include Comcast, Viacom, CBS, and Sony Corporation. For Media Network and Studio Entertainment, the main competitors are Twenty-First Century Fox (Acquired), CBS, Viacom, and Netflix. For Parks and Resorts, the competitors are Universal Studios and Comcast, Cedar Fair, Six Flags and Entertainment, etc. For Studio Entertainment, the competitors are Comcast, and Sony Corp., etc. For Consumer Products and Interactive Media, the competitors are Mattel, Hasbro, and DC Comics, etc. However, no competitor has the capability to compete against Disney in all four business segments, because of its diversification, strong brand image and customer loyalty.

Competitive Analysis

Disney's main competitive advantage is the strong brand and experience associated with the company's products. They provide a unique experience through their branded entertainment and parks, and there is a low threat of substitutes, allowing for price changes to not have an effect on demand. In addition, with the acquisition of Fox, Disney will have a large content base for their direct-to-consumer streaming services and a higher market share, giving them a competitive advantage against other direct-to-consumer models. This acquisition will allow Disney to grow internationally as well, with over 350 new channels reaching 170 countries.



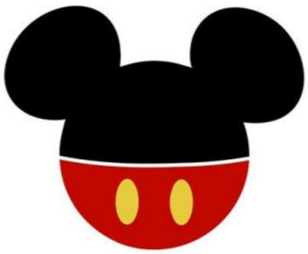
The chart to the left shows the domestic box office market share of Disney's major competitors: Disney's studio entertainment division occupies the top market share at 16.23%, followed closely by Warner Brothers and Sony Pictures with 15.12% and 12.10% respectively. With the acquisition of 21st Century Fox, Disney's market share will greatly pass competitors.

INVESTMENT THESIS

The Walt Disney Company has been an industry leader for decades, with a strong positioning to be dominant in the next ten years. Disney will provide sustainable long-term growth through its interconnected business model, strong brand loyalty, and direct-to-consumer launch.

Disney has the unique advantage of four interconnected business segments

Media Networks, Parks and Resorts, Studio Entertainment, and Products and Interactive business segments all work together in a seamless unit to create value and bring Disney's concepts to life. Many of the company's storylines and characters are used throughout each segment. For example, when Disney's Animation Studios launched the popular children's movie *Frozen*, the plot and characters generated revenue across all four segments: *Frozen* led to box office as the number one seller in its first year. In addition, it was aired on Disney's television network, bringing new viewers and increasing subscription and ad revenue. The characters became members of the cast at Disney's theme parks, allowing children to relive the storyline and meet Ana and Elsa. Finally, all of the characters were made into dolls, stuffed animals, storybooks, and many more merchandise to be sold in Disney stores in the parks and across the country.



Disney's strong brand loyalty is fostered from an unparalleled experience to bring families together

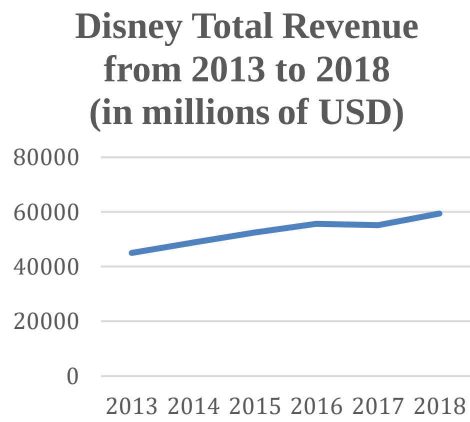
Each year, Disney's parks, resorts, and cruise lines bring in a steady stream of revenue from loyal customers who choose Disney as their vacation spot every year. The parks are designed specifically to create a magical atmosphere, catering to both kids and their parents to serve as the perfect family destination. The innovative content produced by Disney's studios is targeted at children to hook them into Disney's brand, which they grow to love. Most importantly, families can trust that the content and storylines created by Disney will be appropriate for all ages and even usually involve life lessons, making the brand voted parent's top choice for their family entertainment. Finally, Disney's loyal customer base can attest to the strong emotional connection they have to the brand, as most consumers have grown up watching Disney movies and visiting Disney theme parks. This generation of fans is likely to perpetuate the cycle with their own kids, making the brand everlasting.

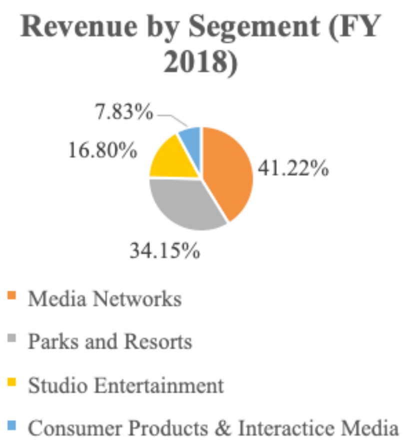
The planned launch of Disney's streaming service will position the company to be a greater competitive force in this up and coming space

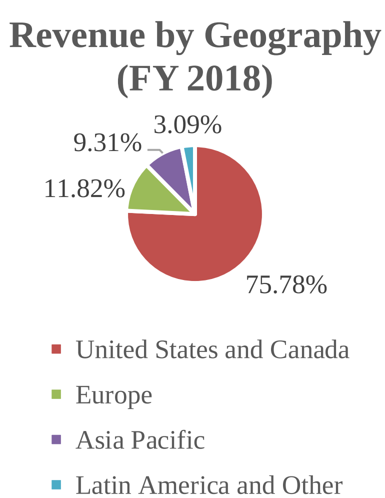
Disney's ESPN+ streaming service is already gaining popularity, and it plans to launch its own direct-to-consumer platform in early 2019. Disney has been smart in preparing for this launch: it recently acquired the technology necessary for the platform through BAMTech, and increased its content two-fold with the acquisition of Fox. Disney will become a direct competitor with Netflix and Amazon streaming services, providing the opportunity to grow revenue substantially and increase the company's competitive market share. Disney's large customer base will be a factor in new adoption of its platform over existing competitors.

The acquisition of 21st Century Fox will position Disney well in today's competitive digital environment

Disney's battle with Comcast over the control of Fox's assets shows just how important gaining market share in the streaming space is becoming for major companies. Disney's 60% stake in Hulu, along with the addition of Fox's assets to its streaming platform's portfolio, will provide it with a significant competitive advantage to compete with larger companies such as Netflix and Amazon.







From 2013 to 2018, Disney's revenue had been growing steadily. Specifically, for fiscal 2018, revenues increased 8%, net income increased $3.6 billion, and diluted earnings per share increased to $8.37.

In terms of segments, Media Networks operating income declined 4% resulted from ongoing investment in BAMTech (associated with ESPN+) and lower advertising revenues on cable stations, partially offset by an increase in income from ESPN due to strong affiliate revenues and an increase at the Disney Channels; Parks and Resorts operating income increased 18% benefiting from the company's strategy of balancing attendance throughout the year, additionally, 27% higher volumes and 4% higher average guest spending at international operations, and 3% higher average guest spending and increase in average ticket and food, beverage prices at domestic operations; Studio Entertainment operating income increased 27% benefiting from higher international growth and increased in theatrical distribution results; Consumers Products and Interactive Media operating income decreased 6% due to lower comparable retail stores sales and lower income from licensing activities. Generally, Disney's revenue is highly concentrated in Media Networks and heavily reliant on the United States and Canada.

Moving Forward, Disney is expected to launch its new direct-to-consumer service, Disney +, on November 12 of this year in the United States and scheduled to roll out in Europe and Asia starting next year. Further, management expects a total of 60 million to 90 million subscribers by 2024. This new service offering along with the fox acquisition will benefit Disney by expanding its already dominant portfolio of content and provide fuel for growth in other business segments.

VALUATION

Discounted Cash Flow Model

Disney was purchased on two occasions, the first on October 9th, 2018 at a price of $117.3 per share. 700 shares were bought at a cost basis of $81,921. On December 26th, 2018 an additional 135 shares were bought at a price of $105.83, lowering the average purchase price to $114. This move was made in order to capitalize on a low point in the market, as nothing had fundamentally changed within the company.

We valued Disney at an implied share price of $139.02 with a 19.6% margin of safety. The model assumes a steady 7% growth in revenue over the next five years, along with a steady, incremental adoption of Disney's new direct-to-consumer streaming platform. In addition, Disney is expected to improve margins by 25 basis points each year, which is also reflected in the model. We used a 9.9% WACC, reflective of a 10.5% CAPM and a 2.0% cost of debt. In addition, we used a 3.5% terminal FCF growth rate which accounts for both the domestic and global economies Disney operates in.

Implied Equity Value and Share Price	
PV of Cash Flows	$ 97,722.4
PV of Terminal Value	$ 126,694.2
Enterprise Value	$ 224,416.6
Less: Total Debt	21,286.0
Less: Preferred Securities	
Less: Noncontrolling Interest	386.0
Plus: Cash and Cash Equivalents	4,017.0
Implied Equity Value	**$ 206,761.6**
Fully Diluted Shares Outstanding	1487.2
Implied Share Price	**$ 139.02**
Current Stock Price	$ 116.24
Margin of Safety	19.6%

Implied Perpetuity Growth Rate	
Terminal Year Free Cash Flow	$ 20,136.0
WACC	9.9%
Terminal Value	$ 325,637.0
Implied Perpetuity Growth Rate	3.5%

Sensitivity Analysis of Implied Share Price						
		WACC				
		7.9%	8.9%	9.9%	10.9%	11.9%
Growth Rate	2.5%	$ 148.27	$ 133.38	$ 122.52	$ 114.25	$ 107.73
	3.0%	$ 161.50	$ 143.18	$ 130.18	$ 120.46	$ 112.93
	3.5%	$ 177.75	$ 154.80	$ 139.02	$ 127.51	$ 118.74
	4.0%	$ 198.15	$ 168.78	$ 149.37	$ 135.59	$ 125.29
	4.5%	$ 224.55	$ 185.94	$ 161.64	$ 144.92	$ 132.73

RISKS AND MITIGATORS

Changes in the United States or Global economic conditions have an impact on consumer spending

A decline in economic activity in the United States and other regions of the world would adversely affect demand of any of Disney Businesses, with Parks and Resorts, and Consumer Products experience the highest sensitivity. Since the Parks and Resorts is the largest segment by revenue, then a decline in economic condition could significantly reduce attendance at parks and resorts, thus reducing the revenue and earnings. For consumer products, the consumer could become more reluctant to make the purchase during such declines in economic activity. However, this risk could be offset by strong brand loyalty, and unique experience that Disney provides to customers.

Success of studio entertainment and direct-to-consumer content dependent on consumer tastes and preferences

As consumer tastes and preferences are difficult to predict, and there is significant competition in the direct-to-consumer streaming space; Netflix was first to market, with Amazon and Apple following closely behind. In this situation, Disney is already late to the market, but this risk could be offset by upcoming Disney +, ESPN +, and Hulu.

Reduction in consumer demand for some Media Network content, specifically decline in cable TV popularity among younger generations and households

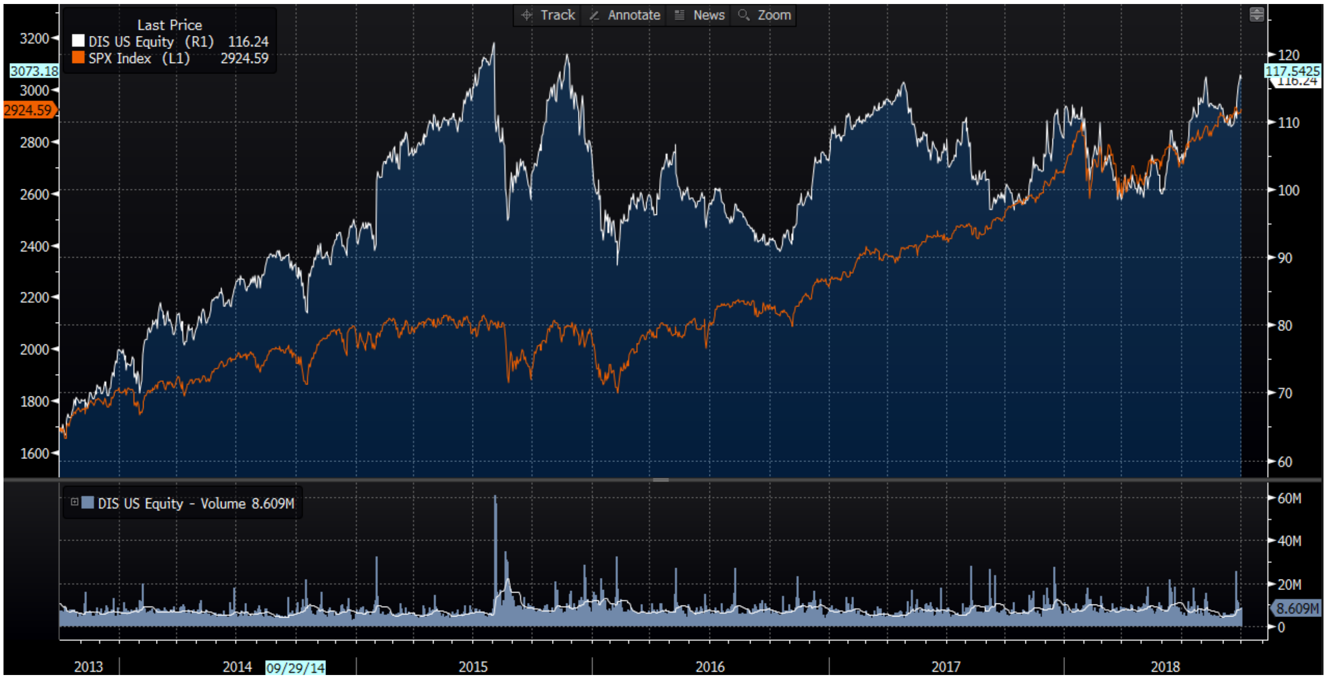
The success for some of Media Network content depends on the ability to adapt to changing patterns of content consumption and technology changes. In recent years, Disney has experienced a decline in cable TV consumption, because an increasing number of consumers are shifting toward video streaming service, a cheaper alternative to cable and satellite for TV shows, movies, and other streaming media. This risk is not just a threat to Disney, as well as its main competitor (Comcast), that is why Disney is trying to enter the direct-to-consumer market.

CONCLUSION

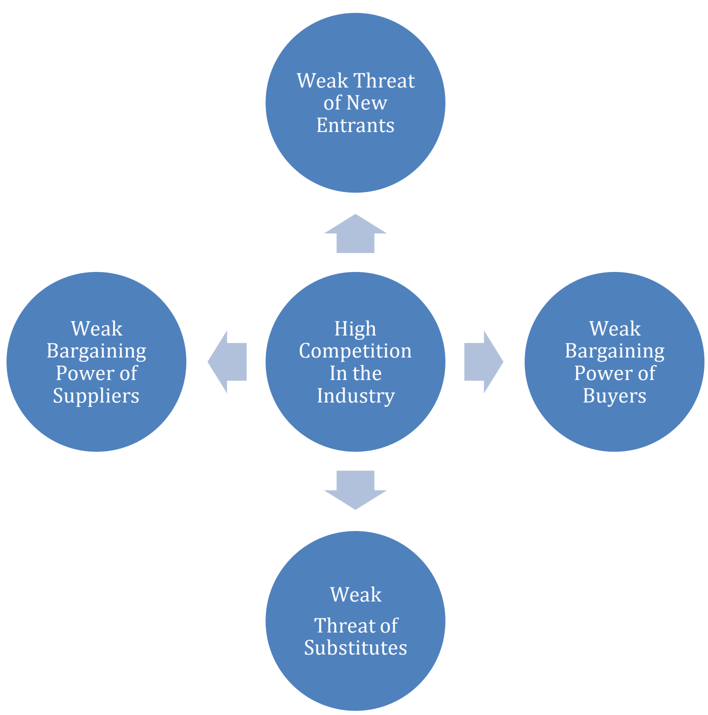
In conclusion, we recommend a **buy** rating for Disney at a target price of $139.02, allowing for a 19.6% margin of safety based off of the price on October 2nd, 2018 of $166.24. It will be an important upcoming year for the company, with the launch of its direct-to-consumer streaming platform and the global expansion of theme parks into new territories. This, along with the company's unique experience and strong brand loyalty, will be catalysts for growth in the five-year time horizon.

APPENDIX

APPENDIX A: 5-YEAR STOCK PERFORMANCE



APPENDIX B: PORTER'S FIVE FORCES



APPENDIX C: COPORATE SOCIAL RESPONSIBILITY

APPENDIX D: MANAGEMENT

Robert A. Iger, Chairman and CEO

- Appointed as President and CEO in 2005
- Started his career at ABC in 1974
- Board member at Apple since 2011

Christine M.McCarthy, CFO

- Appointed as CFO in 2015
- Former Executive Vice President and CFO of Imperial Bancorp from 1997 to 2000

Alan Braverman – General Counsel and Secretary
Jayne Parker – Chief Human Resources Officer
Kevin Mayer – Chairman of Direct – to – Consumer and International

APPENDIX E: DISCOUNTED CASH FLOW MODEL

(In millions of USD)	Historical Period					Projection Period				
Discounted Cash Flow Analysis	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Revenue	**$ 45,041.00**	**$ 48,813.00**	**$ 52,465.00**	**$ 55,632.00**	**$ 55,137.00**	**$ 58,996.59**	**$ 62,300.73**	**$ 66,661.78**	**$ 71,661.42**	**$ 77,394.33**
% growth		8.4%	7.5%	6.0%	-0.9%	7.0%	5.6%	7.0%	7.5%	8.0%
Cost of Revenue	25,034.00	26,420.00	28,364.00	29,993.00	30,306.00	31,915.03	33,612.56	35,869.26	38,456.05	41,420.87
Gross Margin	**$ 20,007.00**	**$ 22,393.00**	**$ 24,101.00**	**$ 25,639.00**	**$ 24,831.00**	**$ 27,081.56**	**$ 28,688.17**	**$ 30,792.53**	**$ 33,205.36**	**$ 35,973.46**
Gross Margin %	44.4%	45.9%	45.9%	46.1%	45.0%	45.9%	46.0%	46.2%	46.3%	46.5%
SG&A	8,365.00	8,565.00	8,523.00	8,754.00	8,176.00	9,784.90	10,332.91	11,056.22	11,885.43	12,836.27
% margin	18.6%	17.5%	16.2%	15.7%	14.8%	16.6%	16.6%	16.6%	16.6%	16.6%
Other Operating Expenses	0	-6	-32	203	0	95.7	116.6	137.5	158.4	179.3
Total Operating Expenses	**$ 8,365.0**	**$ 8,559.0**	**$ 8,491.0**	**$ 8,957.0**	**$ 8,176.0**	**$ 9,880.6**	**$ 10,449.5**	**$ 11,193.7**	**$ 12,043.8**	**$ 13,015.6**
% margin	18.6%	17.5%	16.2%	16.1%	14.8%	16.7%	16.8%	16.8%	16.8%	16.8%
EBITDA	**$ 11,642.00**	**$ 13,834.00**	**$ 15,610.00**	**$ 16,682.00**	**$ 16,655.00**	**$ 20,055.26**	**$ 21,234.86**	**$ 22,736.91**	**$ 24,441.53**	**$ 26,379.79**
% margin	25.8%	28.3%	29.8%	30.0%	30.2%	34.0%	34.1%	34.1%	34.1%	34.1%
Depreciation & Amortization	2192.0	2288.0	2354.0	2527.0	2782.0	2854.3	2996.2	3138.1	3280	3421.9
% growth		4.4%	2.9%	7.3%	10.1%	2.6%	5.0%	4.7%	4.5%	4.3%
EBIT	**$ 9,450.00**	**$ 11,546.00**	**$ 13,256.00**	**$ 14,155.00**	**$ 13,873.00**	**$ 17,200.96**	**$ 18,238.66**	**$ 19,598.81**	**$ 21,161.53**	**$ 22,957.89**
% margin	21.0%	23.7%	25.3%	25.4%	25.2%	29.2%	29.3%	29.4%	29.5%	29.7%
Taxes	2,984.00	4,242.00	5,016.00	5,078.00	4,422.00	2,680.37	3,263.88	3,320.36	3,314.69	3,266.21
Pretax Income	9,958.00	12,423.00	13,953.00	14,821.00	13,808.00	12,992.60	13,599.52	13,834.82	13,811.19	13,609.23
Effective Tax Rate	30.0%	34.1%	35.9%	34.3%	32.0%	20.6%	24.0%	24.0%	24.0%	24.0%
EBIAT	**$ 6,466.00**	**$ 7,304.00**	**$ 8,240.00**	**$ 9,077.00**	**$ 9,451.00**	**$ 14,520.59**	**$ 14,974.78**	**$ 16,278.45**	**$ 17,846.85**	**$ 19,691.68**
Plus: Depreciation & Amortization	2192.0	2288.0	2354.0	2527.0	2782.0	2854.3	2996.2	3138.1	3280	3421.9
Less: Capital Expenditures	2796.0	3311.0	4265.0	4773.0	3623.0	4688.4	5000	5311.6	5623.2	5934.8
Less: Increase in Net Working Capital	2405	1877	424	124	-3706	224.8	224.8	224.8	224.8	224.8
Plus: Other Operating Adjustments	-	-	-	-	-	-	-	-	-	-
Free Cash Flow	**$ 3,457.00**	**$ 4,404.00**	**$ 5,905.00**	**$ 6,707.00**	**$ 12,316.00**	**$ 12,461.69**	**$ 12,746.18**	**$ 13,880.15**	**$ 15,278.85**	**$ 16,953.98**
% growth		27.4%	34.1%	13.6%	83.6%	1.2%	2.3%	8.9%	10.1%	11.0%
WACC	**9.90%**									
Discount Period						1	2	3	4	5
Discount Factor						0.91	0.83	0.75	0.69	0.62
Present Value of Free Cash Flow						**$ 11,339.11**	**$ 10,553.21**	**$ 10,456.86**	**$ 10,473.69**	**$ 10,575.07**