Niyati Maheshwari, 2021A1PS2962G The Walt Disney Co.

1) Industry analysis, Competitive strategy analysis and Corporate strategy analysis

Introduction

Walt Disney is a historic and large company founded by founder Walt Disney in 1923 and listed on the U.S. Stock Exchange in 1957.Walt Disney is as a global conglomerate with two primary divisions: Disney Media & Entertainment Distribution and Disney Parks, Experiences & Products. Within its media sphere, the company encompasses renowned networks such as ABC, ESPN, Disney Channel, National Geographic, and FX Networks, while its film production arm includes distinguished entities like Walt Disney Pictures, Pixar, Marvel, Lucasfilm, and 20th Century Studios. Operating iconic theme parks across the globe, including Disneyland Resort and Walt Disney World Resort, Disney further extends its reach through consumer goods featuring its beloved characters. In response to the evolving digital landscape, Disney has strategically entered the streaming market with Disney+, Hulu, and ESPN+, aiming to solidify its position amidst industry flux.

1. Porter's Five Forces Analysis

(1) Threat of new entrants: The analysis of the threat posed by potential entrants to both the audio-visual and theme park sectors suggests a **low level of threat**. In the audio-visual domain, established companies wield significant advantages, including extensive libraries of film and television content, as well as sophisticated streaming platforms. These assets create high barriers to entry for new competitors, limiting their ability to effectively challenge established players. The theme park industry presents challenges for new entrants due to the capital investment required for park development.
(2) Competitive rivalry: The degree of competition is **intense**, especially in the audio-visual and theme park sectors where Disney operates. In audio-visual entertainment, Netflix emerges as a major rival to Disney+. Netflix offers a larger selection of movies and original content compared to Disney+, posing a challenge. In the theme park industry, Universal Studios is Disney's primary competitor. Universal's innovative attractions and recent expansion into Beijing highlight its strong market presence.
(3) Supplier power: The bargaining power of suppliers is **significant** for Disney due to the uniqueness of its products, which are often only available from a limited number of vendors. Switching suppliers can be costly for Disney because it require setting up new production lines, resulting in higher expenses. This gives suppliers leverage in negotiations, as Disney may be hesitant to change suppliers due to the associated costs and potential disruptions to its operations.
(4) Buyer Power: The bargaining power of buyers is **low**, given its dominant position and unique offerings in the market. Disney holds a virtual monopoly, particularly in theme parks and entertainment. Its globally renowned theme parks boast unmatched scale and popularity. Additionally, Disney's iconic animation and movie characters are irreplaceable, leaving buyers with limited alternative options. This lack of substitutes further diminishes buyer bargaining power.
(5) Threat of substitution: The degree of threat from substitutes for Disney **varies by business segment**. In Media and entertainment distribution, there are **moderate alternatives**. In audio-visual entertainment, Netflix poses a **significant** challenge to Disney's streaming service, Disney+. However, for Disney's theme parks, where its offerings are unique, the **threat of substitutes is low**. Disney's iconic characters, are exclusive to the company, making them irreplaceable. In the theme park industry only Universal Studios stands as Disney's primary competitor. **Overall**, the threat of substitutes is **moderate** for Disney.

2. Competitive Strategy analysis

Differentiation: Disney's strength lies in its diversification across multiple business segments, allowing it to differentiate its products from competitors. This strategy is complemented by intensive growth strategies focused on developing new products tailored to global market trends and preferences. By offering a wide range of products targeting different segments, such as adults and children, Disney can expand its customer base and increase revenues.

- **Superior product quality/variety**: Disney's growth is fuelled by innovation and creativity, enabling it to compete effectively against larger firms and maintain its position as a global leader. High-quality creations, particularly in films, resonate across generations, fostering emotional connections and attracting both existing and new customers. This commitment to excellence is evident in Disney's numerous accolades, including many Oscar Awards since 1932, across various categories. This dedication to quality extends across all business segments, ensuring that Disney consistently delivers exceptional experiences and products to its customers.

- **Premium customer experience:** The services and the customer experience provided in the amusement parks owned by Disney is extremely premium. This is also reflected in the company's other domain like media and entertainment in the production of movies.

Cost leadership Strategy: Disney has strategically crafted its pricing strategies for both Disney+ and Disneyland tickets to align with market demands and its own competitive advantages. By recognizing its position relative to streaming leader Netflix, Disney adjusted the subscription fee for Disney+ to be more competitive, leveraging its size, brand recognition, and diversified profit model to sustainably offer lower prices.
The tiered pricing structure for Disneyland tickets caters to different consumer segments, such as students, adults, and seniors, making it appealing for various demographics. This strategic pricing, coupled with Disney's extensive marketing efforts, positions it favourably against competitors like Universal Studios. With four parks compared to Universal's two, Disney's offering stands out as a more comprehensive and popular choice for visitors.

- **Acquisitions:** Disney has shifted its strategy to incorporate acquisitions of firms such as Pixar, Marvel, and Lucasfilm. This allows Disney to leverage the intellectual capital of these companies, diversifying its product offerings while minimizing investment in research and development.
- **Economies of Scale and Scope**: Disney capitalizes on economies of scale and scope due to its diversified business portfolio. High production levels in industries with significant fixed costs, such as movie studios and theme parks, enable cost reductions per unit produced. Furthermore, synergies between Disney's various divisions provide cost advantages, with resources from one segment benefiting others, enhancing overall efficiency and profitability.

3. Corporate Analysis

1**. Allocation of Resources**

- Disney's allocation of resources is evident in its investments in its theme parks and resorts division. For instance, the company allocated $5.5 billion for the construction of Shanghai Disney Resort, which opened in 2016. This investment demonstrates Disney's capitalizing on the growing demand for themed entertainment experiences, Another example is Disney's strategic investment in content creation and acquisition. The acquisition of Pixar Animation Studios in 2006 for $7.4 billion enabled Disney to bolster its animation capabilities and gain access to popular franchises like "Toy Story" and "Finding Nemo."

2. Organizational Design:

- Within the media networks division, separate units oversee ABC Television Network, ESPN, and Disney Channels Worldwide, enabling focused management attention on each network's specific needs and challenges.
- Additionally, Disney's acquisition of 21st Century Fox in 2019 necessitated a reorganization of its organizational structure to integrate Fox's assets seamlessly. Disney established a new segment, Direct-to-Consumer & International, to oversee its streaming services, including Disney+ and Hulu, reflecting the evolving landscape of the media and entertainment industry.

3. **Portfolio Management:**

- Disney's portfolio management strategy involves periodically evaluating its assets and making strategic decisions to enhance its overall portfolio. An example of this is Disney's divestiture of its interactive gaming division, Disney Interactive Studios, in 2016. Despite initial investments in video game development, Disney decided to exit the gaming business to focus on its core strengths in content creation and distribution.
- Conversely, Disney's acquisition of Lucasfilm in 2012 for approximately $4 billion exemplifies its proactive approach to portfolio management. The acquisition not only added iconic franchises like "Star Wars" to Disney's portfolio but also provided opportunities for cross-promotion and expansion into new markets, such as merchandise and theme park attractions.

4. Strategic Tradeoffs:

- Disney faces strategic tradeoffs in balancing investment in new content creation with leveraging existing intellectual property. For example, while Disney continues to produce original content, it also capitalizes on its extensive library of intellectual property by remaking classic animated films into live-action adaptations. These adaptations, such as "The Lion King" and "Aladdin," leverage existing fan bases while introducing the stories to new audiences.
- Additionally, Disney's decision to launch Disney+ required significant upfront investment in content production and technology infrastructure. While this impacted short-term profitability, Disney recognized the long-term

potential of direct-to-consumer streaming services and strategically positioned itself to compete with digital disruptors like Netflix and Amazon Prime Video.

BCG Matrix

Stars	Question Marks
• Disney+ • MCU (Marvel Cinematic Universe) • Disney Parks, Experiences and Products	• Disney+ Hotstar • Hulu • Disney Cruise Line
Cash Cow	**Dogs**
• Disneyland • Disney Cruise Line • Disney Channel • The Walt Disney Studios	• Hulu • FX Networks • National Geographic

(5)

- Disney's streaming platform, Disney+, boasts an impressive 116 million global subscribers and $16 billion in revenue. The Marvel Cinematic Universe (MCU) reigns supreme in the superhero genre, grossing over $23 billion worldwide. Despite pandemic challenges, Disney Parks, Experiences, and Products generated over $16 billion and announced exciting expansions.
- Cash cows include Disney Cruise Line, dominating with over 70% market share and $2.8 billion revenue, Disney Channel with $1.65 billion revenue, and The Walt Disney Studios, raking in $11 billion from blockbuster franchises.
- In the Question Marks category, Disney+ Hotstar reports 46 million subscribers, mainly from India, presenting growth potential. Hulu's diverse content and live TV offerings position it as a promising contender for expansion.
- Dogs in Disney's portfolio include FX Networks and National Geographic, each generating around $1 billion in revenue but facing challenges in market share and growth compared to competitors.

2) Performance Analysis of the firm using ROE decomposition

Major financial values required for ROE decomposition

In $ Million	2023	2022	2021	2020	2019
Net Revenue	88898	82722	67418	65388	69607
Net Expenses	-79906	-75952	-63759	-61594	-57777
Avg Total Assets	204605	203620	202579	197767	146291
Avg Shareholders' Equity	97142.5	95945	90637	86230	68825
Net Income	8992	6770	3659	3794	11830

*Taken from the Annual Reports of Walt Disney Co.

- ### Net Profit Margin
  Net profit margin indicates how much profit a company makes per dollar of revenue. A higher net profit margin indicates that a company is more efficient at converting revenue into profit, which is generally seen as a positive sign by investors and stakeholders. Conversely, a lower net profit margin may suggest that a company has higher expenses relative to its revenue, which could be a cause for concern.
  Net profit margin (ROS) = Net Income / Revenue.
  For FY2023, Net profit margin = 8992/88898 = **10.11%**

- ### Asset Turnover Ratio
  The asset turnover ratio essentially tells us how much revenue a company generates for each dollar invested in assets. A higher asset turnover ratio indicates that a company is more efficient at using its assets to generate sales, which is generally viewed favorably because it implies better utilization of resources. Conversely, a lower asset turnover ratio suggests that a company may not be utilizing its assets efficiently to generate revenue.

  Asset turnover ratio = Net Revenue / Average Total Assets

Average Total Asset = ($Asset_i$ + $Asset_{i+1}$)/2
For FY2023, Asset turnover ratio = 88898/204605 = **0.43**

- ## Returns on Asset

ROA provides insights into how efficiently a company's management team is using its assets to generate profit. A higher ROA indicates that a company is generating more profit per dollar of assets, which is generally seen as favorable. Conversely, a lower ROA suggests that the company may not be using its assets as efficiently to generate profit.

Return on asset = ROS * Asset Turnover
For FY2023, ROA = 4.39%

- ## Financial Leverage

Financial leverage provides insight into how effectively a firm is leveraging shareholder equity by utilizing its assets. It aids in assessing the structure of solvency. When we observe that Total Assets outweigh total equity in the firm, it implies that the firm is in a favorable position from a solvency standpoint and is effectively leveraging equity

Financial Leverage = Average Total Assets / Average Total Equity
For FY2023, Financial leverage = **2.11**

- ## Return on Equity

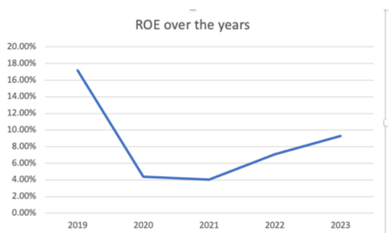
ROE measures the efficiency with which a company generates profits from the capital invested by its shareholders. A higher ROE indicates that a company is generating more profit per dollar of shareholder equity, which is generally viewed positively by investors. Conversely, a lower ROE suggests that the company may not be effectively utilizing shareholder equity to generate returns.

ROE = ROS * Asset Turnover Ratio * Financial leverage
For FY2023, ROE = **9.26%**

ROE Decomposition for last 5 years

RATIO/YEARS	2023	2022	2021	2020	2019
Net Profit Margin	10.11%	8.18%	5.43%	5.80%	17.00%
Asset Turnover ratio	0.43	0.41	0.33	0.33	0.48
Return on Assets	4.39%	3.32%	1.81%	1.92%	8.09%
Financial Leverage	2.11	2.12	2.24	2.29	2.13
Return on equity	9.26%	7.06%	4.04%	4.40	17.19%

- The company initially had a solid ROS of 17% but due to pandemic we can observe a sharp dip in ROS.
- Similarly, we can observe the same pattern in other financial ratios as well.
- In the last two years it is observed the company to be back on track as it has started to get to the pre pandemic numbers which is shown in the graph.



3) Valuation of the company using DCF techniques

Model Selection

- DCF valuation can be done in three ways- Dividend Discount Model, FCFF and FCFE. The company does not pay regular dividends and hence it is not possible to use DDM. We have used FCFF way of valuation as the D/E ratio of the company was found to be unstable in a 10 years period and hence FCFE was used.

Estimation of variables

Risk free rate: Risk free rate was calculated by taking the 10 years US treasury rate which was averaged out at **4.25%** [(1)]**.**

Market rate: S&P 500 index was used to proxy the market rate by taking the yearly average return of the last 10 years which was found out to be **9.555%** [(2)]

Beta: To calculate the beta, we have used the formula

Beta = Covariance (R_m, R_i)/ Var (R_m), where R_m is the monthly return of the S&P 500 index and R_i is the monthly return of the Walt Disney's stock return.

Beta was found out to be **1.328**.

Cost of Equity

K_e (Cost of equity) = R_f + beta * (R_m - R_f)

*Country risk premium is assumed to be zero as the company is US- based

which gives K_e = 4.25 + 1.328 * (9.555-4.25) = **11.3%.**

Cost of Debt

K_d (Cost of debt) = before-cost cost of debt * (1 – Tax rate)

= (R_f + default spread of company) * (1 – Tax rate)

The Walt Disney Co. has a default rating of A- by Fitch Ranking [(3)] which corresponds to a default spread of 1.50%.

*Country risk premium is assumed to be zero as the company is US- based

K_d = (4.25 + 1.15) * (1 – 0.2890) = **3.84%.**

Data required for further calculation:

We will need:

- Net income = 3,390
- Depreciation = 5,639
- Capital expenditure = 4,969
- Change in NWC = 1,599
- Equity = 99,277

*All figures are in $ Millions of FY23[(4)].

Reinvestment rate

Reinvestment rate = {(capital expenditure – depreciation) + change in non-cash working capital)}/ (EBIT * (1 – Tax Rate))

Putting values from the table,

Reinvestment rate = **-37.73%**

ROC

ROC = {EBIT(1-t)} ÷ {BV of debt + BV of equity}
ROC = **2.56%**

Growth rate (long term)
Growth rate = ROC * Reinvestment rate
Growth rate = **-0.968%**

WACC
WACC = W_e*Ke + W_d*Kd
WACC = **9.07%**

After this, now we need to calculate the second phase stable variables to find the terminal value using the formula:
{$EBIT_{n+1}$ * (1-t) * (1-Reinvestment rate)} ÷ ($WACC_n$ – stable growth rate}

Calculations for stable growth time period:

Growth rate for the stable period can be assumed to be of the risk-free rate of 4.25% as Walt Disney is the one the biggest firm in its sector and could be assumed to have stable growth after some financial stress.
Growth rate (stable) = 4.25%

Cost of Equity (stable) = R_f + beta * (R_m – R_f)
Assuming that beta will tend to 1 in stable growth period zone as the companies returns will be expected to follow the market returns,
K_e (stable) = 4.25 + 1*(9.555-4.25) = **9.555%**

Cost of Debt (stable) is expected to be the same as the tax rate and the default spread of the company is assumed to be same in stable growth,
hence K_d (stable) = **3.84%.**

WACC (stable) = 7.85%
ROC (stable) is assumed to be the same as **WACC (stable), ROC = 7.52%**
Reinvestment rate = Growth rate / ROC = 4.25/7.52 = 54.12%

Calculation in the high growth period

$EBIT_{i+1}$ = $EBIT_i$ * (1 + growth rate (high growth))
$FCFF_i$ = $EBIT_i$ (1- Reinvestment rate)
PV of $FCFF_i$ = $FCFF_i/(1+WACC_{high})^i$

Year	EBIT	EBIT*(1-Tax Rate)	Reinvestment rate	FCFF	PV of FCFF
1	5050.65	3591.01	-37.73%	4945.78	4534.49
2	5001.78	3556.27	-37.73%	4897.92	4897.92
3	4953.38	3521.85	-37.73%	4850.53	4850.53

4	4905.45	3487.78	-37.73%	4803.59	4803.59
5	4857.99	3454.03	-37.73%	4757.11	4757.11

Sum of Present Value of FCFF = **$23843.64 million**
FCFF after 1 year of high growth = **$4711.08 million**
Terminal value = 4711.08/ (7.52%-4.25%) = **$130756.23 million**
PV of Terminal value =124771.63/ $(1+7.52)^5$ = **$89598.81 million**
Value of equity in operating assets = **$113442.45 million**
Cash and Marketable Security = **$14,182 million**
No. of Shares = **1,830,315,921 (from AR2023)**

Value of equity per share = $(113442.45 + 14,182) million / 1830315921 = $69.73
Current market price of Walt Disney Stock = $111.99
This means that the stock of Walt Disney is overvalued.

This result is consistent with the chart shown below where the stock price is beginning to correct as the stock is highly overvalued.

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