THE WALT DISNEY COMPANY'S STOCK: BUY, HOLD, OR SELL?

Gestão de Empresas e Empreendedorismo (GEE)
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INTRODUCTION

This case study departs from the work of Antonia Crowley, a portfolio manager at Century 23 Investment Company, as she reviewed the, at that time, recently released earnings report of The Walt Disney Company.

With the previous information, in addition to the company's stock performance, Crowley, having felt that it was time to update her investment thesis on the stock, set out to answer the following questions: What long-term trends were expected to play out in the industry? In the short term, what success or failures might Netflix challengers face in the streaming services? Were current global economic conditions a concern? Could an analysis of recent financial performance coupled with expectations of future performance provide any clues as to the suitability of current investments? Ultimately, she needed to know whether **the Century 23 Global Fund should hold its current position in Disney's stock, buy more or sell and whether there were better options to consider, such as buying stocks from Disney's competitors?**

QUESTION 01

Consider the strategy used by Century 23 Global Fund. What key criteria should Crowley apply when making her investment decisions?

- The strategy used by Century 23 Global Fund is known as growth at a reasonable price (GARP)
- GARP establishes that *'a firm's price-to-earnings (P/E) ratio, calculated as the stock price divided by the earnings per share, should roughly equate expected earnings growth (G).'* => **P/E ≈ G**
- Promising GARP candidates tend to be those with PEG ratios below 1.0.

PEG RATIO	2018	2019	AVERAGE
DISNEY	0.29	-1.08	-0.39
NETFLIX	0.65	5.27	2.96
COMCAST	0.24	2.47	1.36
VIACOM	-0.88	-0.57	-0.73

QUESTION 02

Size up the economy, as well as the media and entertainment industry. What are the growth prospects, competitive position, and key success factors?

- **The revenues from the global media and entertainment industry are expected to grow steadily in the years to come**, as are those from media networks, parks and resorts and studio entertainment:
    - Within media networks, video streaming will continue to grow as a sector as TV subscription revenue is projected to decrease;
    - Following a boom in the experience economy, driven by millenials, the spending on parks and resorts has been increasing;
    - Subsequent to numerous blockbusters, the studio entertainment revenue was predicted to increase;

- **The US economy** has recovered from the financial crisis of 2008-09 and **is now in a stable phase.** While global economic activity has been affected in recent years by geopolitical tensions, it has seen the emergence of new leading markets;

QUESTION 02

NETFLIX

- Operates mainly in the streaming industry;
- Leads the video on demand industry in the United States;
- Has started to finance original content, such as series and films;

VIACOM

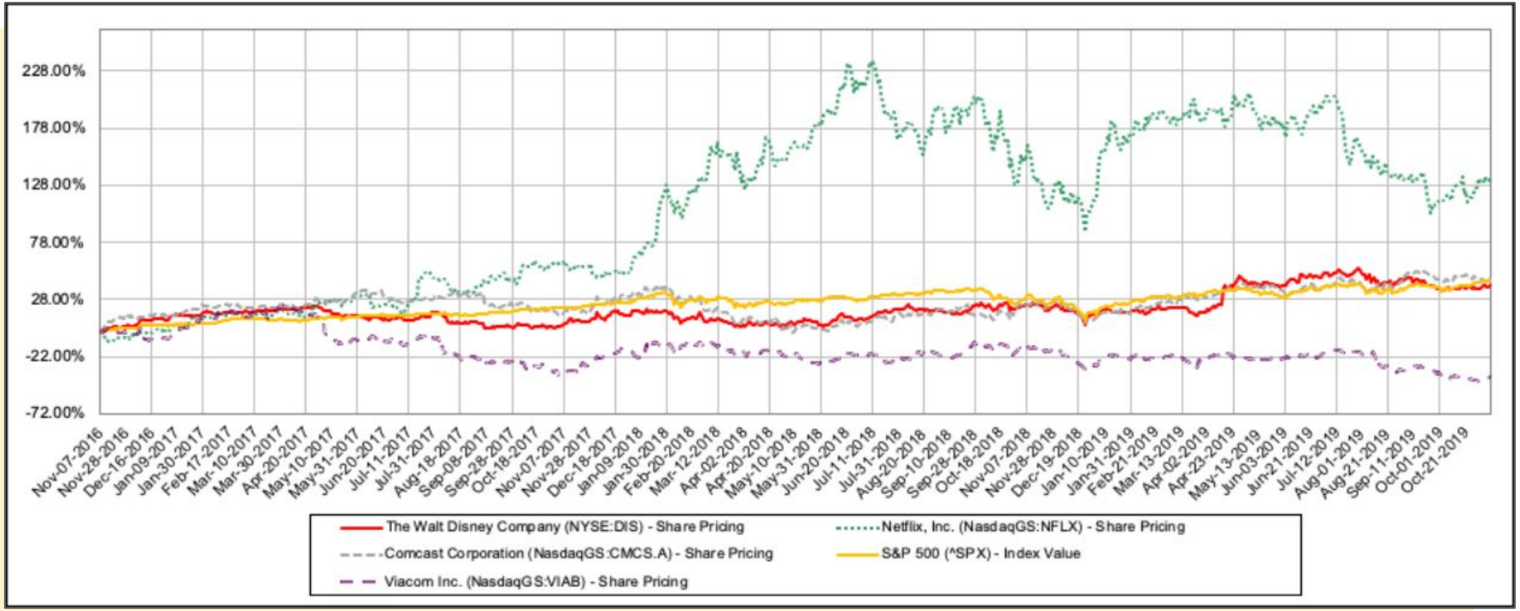
- Focuses its business on media networks and filmed entertainment, the first being the only profitable sector across the company;
- Following a merger with CBS, it garnered the largest viewership share in the US, in front of both Comcast and Disney;

COMCAST

- Its largest sector is cable communications;
- It also operates in cable networks, broadcast TV, filmed entertainment and theme parks;
- The theme park business has seen an increase in revenue in recent years, following industry growth;

QUESTION 02

- Disney’s stock, while underperforming Netflix, outperformed Viacom, and performed similarly to Comcast, registering some periods in which it had a higher stock performance than the aforementioned company.



QUESTION 02

- **Recent investment in movie production** has resulted in an array of blockbusters, having the widely successful Marvel franchise recently produced the all-time highest-grossing film, *Avengers: Endgame*.
- **Parks and resorts revenue increase follows the growth reported in the domestic industry and merchandise licensing**. The opening of a new *Star Wars*-themed park is set to capitalize on these trends furthermore.
- **Direct-to-consumer and international revenue also have seen growth**, mainly because of the consolidation of the streaming service Hulu and the ongoing investment in sports streaming service ESPN+.
- Launching a direct-to-consumer streaming service, Disney+, that made available content from various well-established studios, is a secure and promising way to compete with leading companies in the streaming industry. The initial monthly subscription cost of the service is also lower than that of Netflix.

QUESTION 03

How would you evaluate Disney's financial performance, both on an absolute basis and relative to its peers?

- **Disney appears to have a solid strategy financially**:
  - Its total assets and equity doubled in a year; liabilities also doubled, however at a lower rate, which is positive since it indicates that the investments in the company are being successful.
  - The income profits are increasing at a slow pace, but growing nonetheless, which is in part a result of the investments and other expenses that the company has done.

- **Comparatively to competitors, Disney also displays positive signs**:
  - The only company with a higher asset value is Comcast, however equity wise none of the competitors are keeping up.
  - Only Comcast has a net income on the same order of magnitude as Disney. Even so, by looking at the total revenue of both these companies, Disney's efficiency is better, as a 6 times lower revenue turns into the same income.
  - $10659 is coming from other investing activities, while the other companies are either losing or breaking even.
  - Disney and Netflix are also the only candidates with a positive net change in cash.

- These are all good indicators that Disney is effectively solidifying its market presence.

LIQUIDITY RATIOS	• The current ratio is higher than 1 and above the industry's standard. This means **Disney can cover short-term obligations using its assets**.
EFFICIENCY	• The number of days of inventory has increased in the last year for Disney, indicating a higher inefficiency in sales performance and inventory management. The days of accounts receivables have also increased meaning that customers are taking longer to pay. • The days of accounts payable has more than doubled in 2019, becoming the highest in comparison with the other companies, the second highest being Comcast, with almost 50 days less than Disney's, which means **Disney can keep cash for a month and a half longer than any competitor**. This cash, if used for short-term investing activities, can provide a valuable source of income. • First year of the negative cash conversion cycle, which implies that **Disney's suppliers are now sufficient to finance its operations**, there is no need for operating cash to stimulate growth.
CAPACITY	• Lowest debt to total assets ratio (0.2) among competitors. **The debt is low and this provides higher financial flexibility**. It also means that a higher percentage of assets ownership belongs to shareholders rather than the institutions Disney has borrowed money from. • Doubled interest-bearing debt/EBITDA in 2019, which would be concerning but it is still the lowest value compared with competitors. • Highest EBITDA/interest and EBIT/interest ratio amongst competitors, Disney is profitable enough to pay off its interest expenses using its pre-tax income and still has plenty left.

PROFITABILITY	● Return on common equity used to be the highest but halved in 2019, becoming the lowest amidst competitors in 2019. For investors, this means that the ratio of money spent in an initial investment compared to the money acquired by becoming a shareholder is lower (smaller profit margin). ● Return on assets more than halved in 2019 but still on par with the market's average.
GROWTH (OVER PRIOR YEAR)	● Revenue increase from 8% to 17% ● Operating Income and Net income became negative in 2019, with a tremendous drop from 40% to negative 12%
ROE DECOMPOSITION	● Profit margin has decreased since last year but is still the highest in the industry. ● Almost halved asset turnover, becoming the lowest in the industry in 2019. This means the effectiveness of the usage of assets applied to sales generation has been reduced. ● Stable financial leverage throughout the years, maintaining the lowest financial leverage amongst contenders. We can deduce that Disney has a very low risk of failure due to its lower amounts of debt.

QUESTION 3

- Share price steadily going up with a highly accentuated from 2018 to 2019, competitors like Netflix and Viacom had their share price fall in 2019. Indicator of good prospects.

- Decrease in 2019 of earnings per share. It is still however the highest in the industry, which means Disney makes more money than any competitor for each share of its stock.

- Became the best company in multiple factors relative to equity and share price amongst contenders, such as the market value of equity, the book value of equity and the book value per share.

- Market to book ratio has been gradually decreasing, now at a value of 2.8, meaning that investments can be made for cheaper.

- Huge increase in total enterprise value, almost surpassing the enterprise value of its biggest competitor Comcast.

- Price/Earnings (P/E) increased to 22.1 and investors are willing to pay a higher share price due to superior growth predictions for the future. This is the second-highest value in the industry, with Netflix in the number 1 spot at 85.1 in 2019. Netflix P/E has been decreasing from the previous value of 205.1 in 2017.

QUESTION 04

How would you assess Disney's prospects compared with the consensus analysts' forecasted revenue and profits?
How would you assess the future performance of its peers?

- Overall, it seems that Disney's forecasted revenue is going to increase, year to year, at a higher rate than all its competitors, maintaining an overall higher revenue than the average of the rest of the companies.

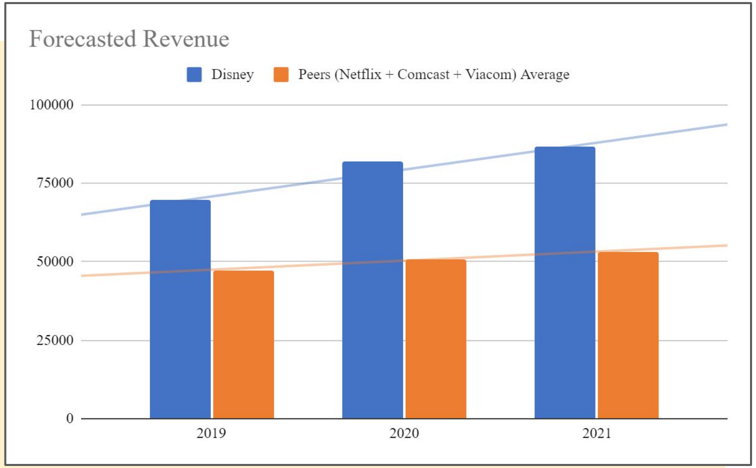
- It also seems probable that Disney's stocks keep being profitable, as they maintain their Price/Earnings ratio stable. It is also important to note the decline predicted for these metrics for Netflix, the leading competitor.

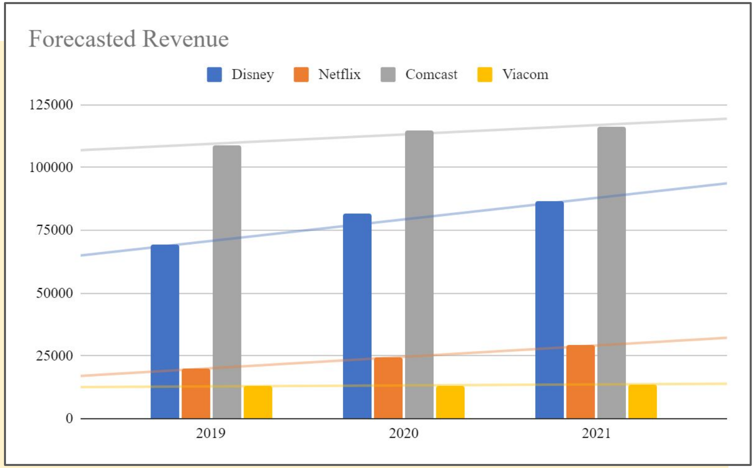
- Despite having a decrease, Disney forecasted net income is still at a higher level than its competitors. Individually, Comcast has the best ratio in this aspect.

- All companies will have a better Enterprise Value/Revenue in the upcoming years, with Disney getting values in the recommended range (between 1x and 3x).

QUESTION 04

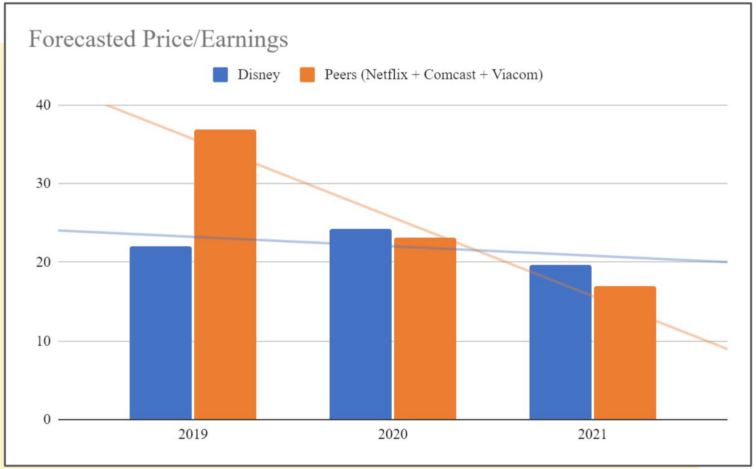
- Disney has the biggest forecasted increase in revenue both from 2019 to 2020 (12 196) and from 2020 to 2021 (4 957) among all considered companies.
- The company is also projected to lead most of its competition in revenue, only behind Comcast, and widening its difference from the average of its competitors every year.

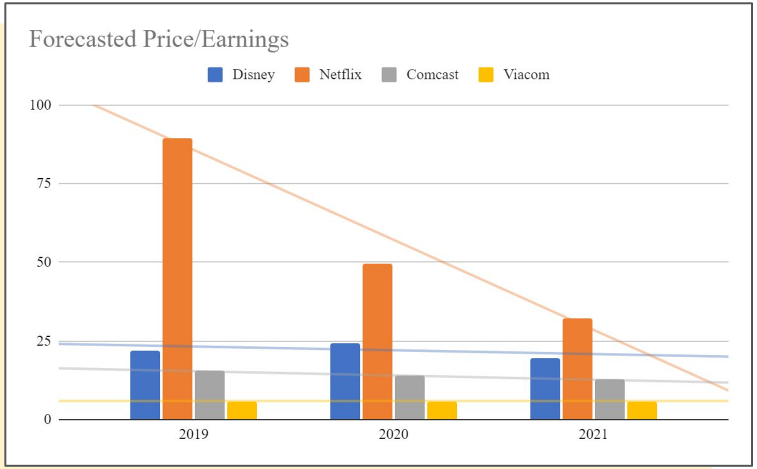




QUESTION 04

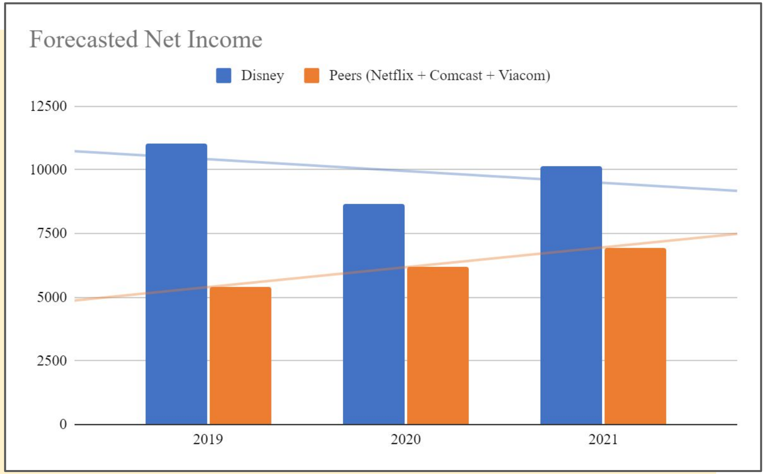
- While Disney's forecasted Price/Earnings ratio is expected to maintain stability in the next few years, its competitors' is expected to reduce at a high rate, mainly due to Netflix.
- In 2021, Disney's stocks are predicted to outperform the average of the rest of the considered companies.

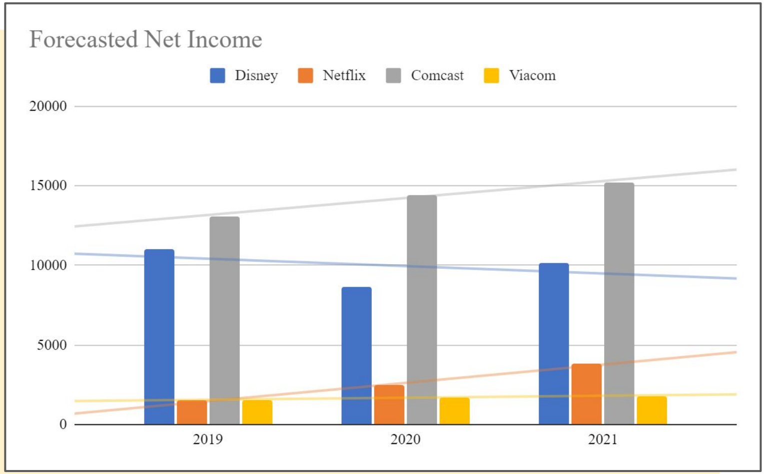




QUESTION 04

- Disney's net income is projected to suffer a decrease in the next few years going against the competition trend.
- This might be related to the fact that Disney increased sales, expenses and depreciation and amortization values, perhaps associated with the recent large-scale investments into new and ongoing businesses.





QUESTION 05

In the place of Crowley in December 2019, what action, if any, would you take with respect to the Century 23 Global Fund's position regarding Disney's stock?

- Disney seems to be in a good position in the various industries it has businesses in. Recent investments in new theme parks and video streaming services seem to take advantage of the growth of these sectors;
- The launching of the new streaming service Disney+ may not be a success:
  - Netflix is a clear industry leader, holding most of the video streaming sector in the US. Additionally, there are already many other well-established services.
- Both the analysts' predictions and the statistics from previous years are generally positive.
- Disney's stocks are still expected to keep making a profit for shareholders.

Based on our research our final decision would be to **hold the stocks on Disney**.

THE WALT DISNEY'S COMPANY STOCK: BUY, HOLD OR SELL? ***HOLD***

THANKS!

Does anyone have any questions?

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