The Walt Disney Company's Stock: Buy, Hold, or Sell?

GEE - First Case Study

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Case Study Introduction

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Antonia Crowley, a portfolio manager at Century 23, was responsible for managing the holdings of Century 23 Global Fund, whose strategy was to identify stocks that were showing consistent earnings growth while also trading at a reasonable price (GARP).

As Disney's stock was one of the major holdings of this fund, Antonia Crowley and her team were closely monitoring **The Walt Disney Company** and the performance of its stock.

Disney's stock performance had been strong in the last three years, outperforming media conglomerates Viacom and Comcast, although underperforming Netflix. Furthermore, the Walt Disney Company was involved in various businesses, including movie production, streaming, and parks and resorts development.

But was this enough? The **market competition in the entertainment industry was intense** and was expected to continue, particularly in the **streaming** area, which made Crowley feel that she should update her investment thesis and consider other factors in her analysis.

Problem Identification

This case study analysis aims to provide recommendations to Antonia Crowley and her team about the possible actions that could be taken regarding Disney's stock.

By understanding the economic environment and the entertainment industry, and through the analysis of recent financial performance and expectations of future performance of Disney and its competitors, we aim to help Antonia take an informed decision.

Should Century 23 Global Fund hold its current position in Disney's stock, buy more, or sell? Were there better options to consider, such as buying stocks from Disney's competitors?

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

Considering the GARP strategy (which combines growth and value investing attributes), in order to make her investment decisions, Crowley must perform a complete financial analysis, taking into account:

- **Macro environment:** analyse GDP growth, employment rate, inflation and trends that can influence the performance of the company;
- **Industry environment:** its evolution and the company's position in the industry, absolute and relative to the competitors;
- **Company status:** company's strengths and weaknesses, by analysing Income Statement, Balance Sheet, Cash-flow Statement and Ratios (profitability, efficiency, liquidity, leverage);
- **Stock values and risks:** analyse the evolution of the stock values and anticipate future risks that could affect its growth.

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

Positive aspects:

- US recovered from the financial crisis of 2008-09;
- GDP annual growth rate of 3.39% over the previous decade;
- Inflation rate steady around target (2%) for the next five years;
- Robust labour market with low rates of unemployment;
- Difference between 10-year and 3-month treasury yields result in a sloping upward curve, pointing to an economic expansion.

Negative aspects:

- Concerns about economic growth in recent years due to the persistent trade and tariff war with China and decreased corporate investment;
- Impact of trade and geopolitical tensions on the global economy, which have increased uncertainty about the future of the global trading system and international cooperation.

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

Media Networks:

- Mergers and Acquisitions (Disney acquired TFCF and Viacom merged with CBS Corporation);
- **TV subscription revenue expected to fall** by 2.9% annually, due to the **rise of video streaming**;
- Streaming stimulated investment in quality original content (series/films);
- **Global revenue forecast to increase** 4.2% annually, accounting for 16% of the digital media market in 2023 and the number of users will grow 5% annually.

Parks and Resorts:

- Explosion of the experience economy driven by millennials, since spending on theme parks had recently been increasing at an annual rate of 5% and **worldwide park attendance was expected to grow** at an annual rate of 3.8% through 2022;
- Many theme parks and resorts were being built or renovated worldwide.

Studio Entertainment:

- Global **film industry** revenue grew 3.8% in 2019 and **forecast to increase** at an annual rate of 9% in 2020;
- As distribution became simpler and more affordable, an increasing number of independent filmmakers entered the industry over the previous five years.

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

COMPETITIVE POSITION

1 Disney

- **Diversity of services:** media networks, parks & resorts, studio entertainment, and consumer products and interactive media;
- **Streaming** and **unique content** (Disney+);
- Movie production: **blockbusters**;
- **Expanding global presence** (diverse entertainment to meet consumer demand) with Twenty-First Century Fox acquisition;
- **Experience economy: parks & resorts** that attract families and millennials with **immersive environments** and **new technology.**

2 Netflix

- Pioneering and leading **streaming** service;
- Anticipating the **replacement of linear TV** by Internet entertainment.
- Invests on **original content** (series/films);

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

COMPETITIVE POSITION

3 Comcast

- **Diversity of services:** cable communication and networks, broadcast TV, filmed entertainment, themed parks, and media and telecommunications (Sky);
- Different sector: **telecommunications**;
- Video **subscribers declining** in the main sector, cable communications;
- **Experience economy:** investing in **new theme parks** and resorts to attract millennials.

4 Viacom

- Media networks and filmed entertainment;
- **Cutting-edge technology**: exploring the future of entertainment (5G technology, in-car entertainment);
- Only profitable sector was media networks;
- Huge growth potential: owning popular brands such as Nickelodeon and MTV;
- **Market capitalization dropped**;
- **Merger** with CBS to **battle TV audience decline**: still too small to compete with larger players.

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

COMPETITIVE POSITION

- “Online streaming services were engaged in a fierce battle with the traditional film industry.”
- “Consumers were shifting away from viewing traditional network and cable TV”

	Diversity of services	Streaming	Parks experience economy	Original films & series	Exploring new technology	Cable TV films & series
Disney	YES	YES (Disney+, ESPN+, Hulu)	YES	YES	YES	YES (TFCF)
Netflix	NO	YES	NO	YES	NO	NO
Comcast	YES	YES (Xfinity)	YES	NO	NO	YES (Xfinity, NBCUniversal)
Viacom	NO	NO	NO	NO	YES (5G,...)	YES (CBS)

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

KEY SUCCESS FACTORS

- **Resistance against independent filmmakers** and to the **rise of streaming** by:
  - producing personalised/**original content**;
  - launching **new services** or merge/acquire companies that complement/extend the current ones;
  - new **technology** that provides new experiences;
  - **investing in the streaming market**;
  - bet on diversity in the film industry: women as leading characters and actors with different ethnicities and sexual orientations.
- **Diversification** of the services and segments offered by the brand, in order to hit markets around the world;
- Build **stronger brand loyalty** - promote diversity but at the same time consistency (focus on the segments that are growing), understand and engage customers; favour loyal customers and attract new ones;
- Respond to the explosion of the experience economy, driven by millennials, and to the increasing park attendance: **new or improved theme parks** through the use of cutting-edge technology;

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

INCOME STATEMENT

Disney:

- **Cost of Goods Sold** increasing faster than revenues - consolidation of Twenty-First Century Fox and Hulu;
- **Total Revenue** is increasing more year after year;
- **Gross Profit** decreasing.
- **EBIT** decreased as **Selling, General & Administrative expenses** increased - consolidation of Hulu, investment in ESPN+, and launch preparation of Disney+;
- **Net Income** increased from 2017 to 2018 but decreased from 2018 to 2019.

Netflix:

- **Total Revenue** decreasing growth way lower than the competition.
- **Cost of Goods Sold** growth has been decreasing
- **Gross Profit** low, but increasing - Total revenue greater than COGS.
- **EBIT** and **Net Income** increased a lot from 2017 to 2018 and continued

to grow in 2019.

	Disney		Netflix	
Total Revenue	7.79%	17.05%	35.08%	19.51%
Costs of Goods Sold	8.40%	28.39%	24.08%	17.46%
Gross Profit	7.06%	3.16%	59.21%	23.02%
Selling General & Admin Expenses	8.37%	29.11%	60.65%	11.32%
Depreciation & Amortization	8.23%	38.16%	-	-
Operating Income (EBIT)	6.07%	(19.44%)	91.40%	47.11%
Net Interest Exp.	39.32%	70.73%	67.61%	34.78%
Other Non-Operating Income	0%	0.98%	(99.22%)	(18 100,00%)
Other Unusual Items	(625.93%)	441.16%	-	-
Income Tax Expense	(62.39%)	82.26%	(79.33%)	3 9623.24%
Net Income	40.29%	(12.26%)	194.21%	16.73%

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

INCOME STATEMENT

Comcast:

- **Total Revenue, Net Income** and **EBIT** increased sharply from 2017 to 2018 and kept a slow increase in 2019;
- **Gross Profit** increased 8% in 2018 and 14% in 2019.

Viacom:

- **Total Revenue, Net Income** and **EBIT** a lot bellow competition and seems stagnated;
- **Net Income** decreasing, which seems concerning.

	Comcast		Viacom	
Total Revenue	11,15%	14,69%	(2,41%)	(0,81%)
Costs of Goods Sold	17,11%	15,83%	(5,66%)	(1,72%)
Gross Profit	8,62%	14,17%	1,56%	0,21%
Selling General & Admin Expenses	8,83%	15,90%	1,70%	3,08%
Other Operating Expenses	23,47%	53,55%		
Operating Income (EBIT)	8,14%	8,92%	1,90%	(2,97%)
Net Interest Exp.	16,73%	34,51%	(9,39%)	(12,68%)
Other Non-Operating Income	(440,19%)	65,66%	(109,30%)	50,00%
Other Unusual Items	(143,53%)	(224,32%)	(5 075,00%)	(10,55%)
Income Tax Expense	(55,34%)	(2,43%)	(8,19%)	65,43%
Net Income to Company	52,39%	7,11%	(8,48%)	(9,72%)
Net Income	54,42%	5,75%	(8,27%)	(9,95%)

BALANCE SHEET

Disney:

- In 2019, **Total Assets** and **Total Liabilities increased** due to new investments. Assets were mainly influenced by acquisitions (Goodwill and Other Intangibles);
- As assets increased more than liabilities (absolute value), equity increased.

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

CASH-FLOW STATEMENT

Disney:

- Cash from financing and operations stable until big decrease in 2019;
- High expense in other operating and financing activities in 2019;
- Positive Net Change in cash in 2019, despite a decrease in cash from operation, due to a decrease in cash from financing (stoppage on repurchasing of Common Stock and decrease of debt).

Netflix:

- Consistently high negative values for cash from operations - not producing profit from their main operations;
- Positive Net Change in cash due to having old debt being paid;
- Not investing as much as other companies.

Viacom:

- Negative Cash Flow Balances due to their high investment;

Comcast:

- Very negative cash flow balances in 2019 due to their high investment.
- High Cash Acquisition value caused by the acquisition of Sky in 2018.

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

- In 2019 Disney's **Return on common equity** is below average because the Equity doubled (assets increased more than liabilities). New investments are yet to generate profits. However in previous years this value is above the average of the industry.
- **Return on Assets** is above market average but seems to be decreasing, which indicates that the company has made many investments that haven't yet produced revenue growth.
- Disney's **Return on common equity** influenced by the asset turnover and profit margin. **Asset Turnover** decreases in 2019 due to the **acquisition of TFCF** (Goodwill value in the balance sheet increases in 2019).
- **Profit Margin** is affected by increasing total revenue and decreasing net income. However, Disney's Profit Margin is still higher than the other companies.

Profitability	Disney			Industry		
	2017	2018	2019	2017	2018	2019
Return on common equity	21.7%	25.8%	12.4%	17.9%	20.9%	18.3%
Return on assets	9.4%	12.8%	5.7%	4.7%	5.5%	5.3%
Return on sales	25.37%	24.96%	17.18%	16.17%	17.29%	17.58%

Dupont Formula	Disney			Industry		
	2017	2018	2019	2017	2018	2019
Profit Margin	16.3%	21.2%	15.9%	8.9%	11.1%	10.3%
Asset turnover	0.58	0.60	0.36	0.54	0.51	0.53
Financial leverage	2.32	2.02	2.18	3.99	3.89	3.53

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

- Ideally, the **current** and **quick ratios** should be above 1, which does not always happen in the industry;
- This means that there is some general difficulty in the industry at **paying short-term obligations**;
- Disney's liquidity has shown a steady increase, having surpassed the industry values in 2019. In this last year, only the current ratios of Disney and Viacom are above the margin of 1, meeting their short-term obligations.
- Disney has a better **cash conversion cycle** than the industry average, with a negative number. This means that Disney does not need operating cash to grow and the business has great liquidity;
- Even though the days of accounts receivables increases, the days of accounts payables grows even more, resulting in a better Cash Conversion Cycle;
- Inventory grew in 2019 (x3 in comparison with the previous year), which justifies the increasing days of inventory.

Liquidity	Disney			Industry		
	2017	2018	2019	2017	2018	2019
Current Ratio	0.94	1.00	1.07	1.27	1.26	1.03
Quick Ratio	0.75	0.80	0.80	0.79	0.76	0.80

Efficiency	Disney			Industry		
	2017	2018	2019	2017	2018	2019
Cash Conversion Cycle	13.0	15.0	-20.4	13.9	10.4	14.8

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

- Disney's **percentage of business owned by creditors** is lower than the industry average (0.2 and 0.4, respectively), showing that Disney has a higher degree of financial flexibility compared to its competitors.
- Disney's **percentage of assets that are being financed** with debt is much lower than industry (0.5) but stable. This means that Disney is not using debt to generate profit as much as its competitors, but at the same time means it represents a much safer investment.
- When it comes to **Interest-bearing debt/EBITDA**, Disney's values are low compared to the industry average and all its competitors. This is a very good sign of strength and stability as it shows that Disney can very easily pay back its debts, which puts it in a very comfortable position, although this value increased very significatively from 2018 to 2019 while in the same time period, all other competitors decreased their values.
- Disney's **EBIT/interest** and **EBITDA/interest**, although rapidly decreasing in the last years, are much higher than industry average.

Capacity	Disney			Industry		
	2017	2018	2019	2017	2018	2019
Debt / Total Assets	0.2	0.2	0.2	0.4	0.4	0.4
Debt / Common equity	0.5	0.4	0.5	1.5	1.6	1.4
Interest-bearing debt / EBITDA	1.3	1.0	2.7	4.6	4.5	3.9
EBITDA / interest	40.7	31.1	16.4	5.9	6.0	5.8
EBIT / interest	34.0	25.8	12.2	4.8	5.1	5.0

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

- Disney's **revenue** is growing at a higher rate than the industry, which may reflect good investments.
- Disney's **operating income** was negative and a lot below industry's average owing to the consolidation of video streaming, although industry values also decreased in general. This also applies to **net income**.
- The USA's (country where Disney is based) GDP growth achieved values between 2% and 3% in both 2017 and 2018, which are considered healthy values.

Growth	Disney		Industry	
	2018	2019	2018	2019
Revenue	7.8%	17.1%	14.6%	11.1%
Operating Income	6.1%	(19.4%)	33.8%	17.7%
Net Income	40.3%	(12.3%)	80.1%	4.2%

- Both Disney and Comcast stock prices have been growing at a good and stable rate, particularly since april 2019. Viacom stock performance is the weakest, with a strong and stable decrease in value over approximately 2 years. Netflix's stock price is by far the one that has been growing the most, and, although at a very unstable rate, the growth values have been very high since january 2018.

4 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?

Disney's projections are more optimistic when compared with analysts forecasted revenue and profits. When it comes to **Revenue**, **EBIT** and **EBITDA** the values estimated by Disney's prospects are a little higher than the ones predicted by analysts, however both agree with an increase, which is good.

In 2020, the **Net Income** is expected to decrease due to new investments, particularly the launch of *Disney*+ and the increasing number of parks. However, a growth in Net Income is expected in 2021 as there are fewer scheduled expenses, therefore less money is being spent.

	Disney's Prospects		Analysts Prospects	
	2020	2021	2020	2021
Revenue	17.5%	6.1%	14.92%	5.72%
EBITDA	13.2%	7.7%	11.64%	7.15%
EBIT	27.5%	11.3%	21.59%	10.14%
Net Income	-21.4%	16.6%	-27.29%	14.23%

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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?

- **Netflix**: Consensus analysts predict an excellent future performance for Netflix, with a drastic increase in its revenues, EBIT and EBITDA and Net Income. Analysts are predicting that 2020 will be the year that Netflix will actually start generating revenue. However, this is a risky assumption, since this company doesn't have any profit until now.

- **Comcast**: Comcast shows a smaller and steady growth, since its market is already well defined and won't change too much in the coming years.

- **Viacom**: Forecasted revenue is almost even. However, a low **EBITDA** margin indicates that a business has profitability problems as well as issues with cash flow. On the other hand, a relatively high **EBITDA** margin means that the business earnings are stable, like we saw on the other three companies.

	Netflix				Comcast				Viacom			
	Disney's Prospects		Analysts Prospects		Disney's Prospects		Analysts Prospects		Disney's Prospects		Analysts Prospects	
	2020	2021	2020	2021	2020	2021	2020	2021	2020	2021	2020	2021
Revenue	21.8%	19.0%	17.93%	15.98%	5.3%	1.5%	5.03%	1.48%	3.4%	2.7%	3.29%	2.61%
EBITDA	45.8%	37.4%	31.43%	27.24%	6.7%	2.8%	6.28%	2.71%	0.6%	0.7%	0.61%	0.68%
EBIT	49.7%	39.7%	33.20%	28.44%	10.0%	3.2%	9.08%	3.06%	0.3%	1.2%	0.26%	1.17%
Net Income	63.3%	53.5%	38.76%	34.87%	9.8%	5.9%	8.95%	5.56%	10.6%	5.1%	9.57%	4.83%

5 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? Defend your position.

1 Disney

Has the advantage of **diversification** while Netflix is only focused on streaming;

However, Disney is **responding to the rise of streaming** by creating Disney+ and competing with Netflix.

2 Netflix

Netflix's cash flow is concerning, with **many operating expenses**;

Only streaming - **lacks diversity.**

3 Comcast

Comcast's main focus is cable communication, which may be a concern due to the rise of streaming services and due to the fact that **consumers are shifting away from traditional network** and cable TV.

4 Viacom

Viacom is **declining**, with revenues a lot below competition;

Viacom's merging CBS may be a bad sign and implies some risk.

5 Recommendations

Taking all of this into account, if we were Antonia Crowley, we would decide to **hold Disney's stock** and wait to see the evolution of Disney's financials in the forthcoming years.

The launch of Disney+ and the new acquisitions allowed Disney to expand her business and to explore new services, in particular to a new rising area, streaming. As forecasted by specialists, 2020 will still reflect the initial investments and the consolidation of these new services.

However, considering the financials from the past years, the diversity of services, the investments in segments and services with growing revenues, the stability of the stock value and the forecasts, keeping Disney's stock seems to be a great option as new investments will probably result in an increase in the stock value after 2020.