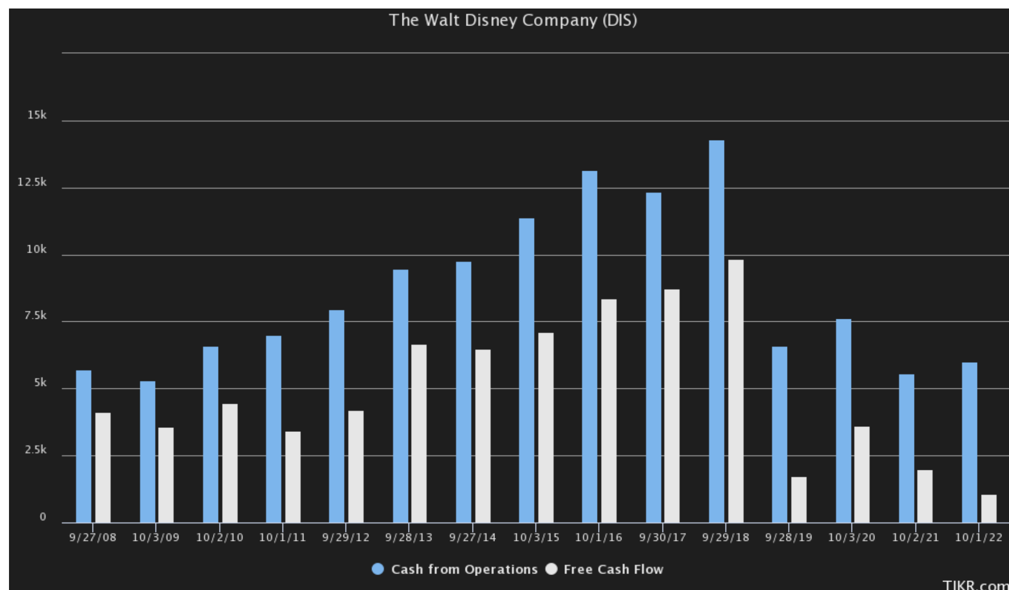
TITAN CAPITAL MANAGEMENT RESEARCH REPORT FOR: **TCM PRESIDENT'S SCHOLARS**

Analyst(s): Israel Nazari Date: December 12, 2022

COMPANY/TICKER: **THE WALT DISNEY COMPANY (DIS)** **Stock** **SELL**

EXECUTIVE SUMMARY

We recommend a SELL rating for The Walt Disney Company (DIS) because there seems to be a mismatch between the company's stock price and profitability. The impacts of Covid-19 disrupted the company's continuity as its present free cash flow numbers are still well below that of its golden years – as illustrated by the charts below. Disney's recent stats continue to disappoint as its fourth-quarter earnings report delivered lower-than-expected revenue and profit, widening losses in streaming, and unexpected warning signs from the parks.



Our recommendation is based on the following drivers:

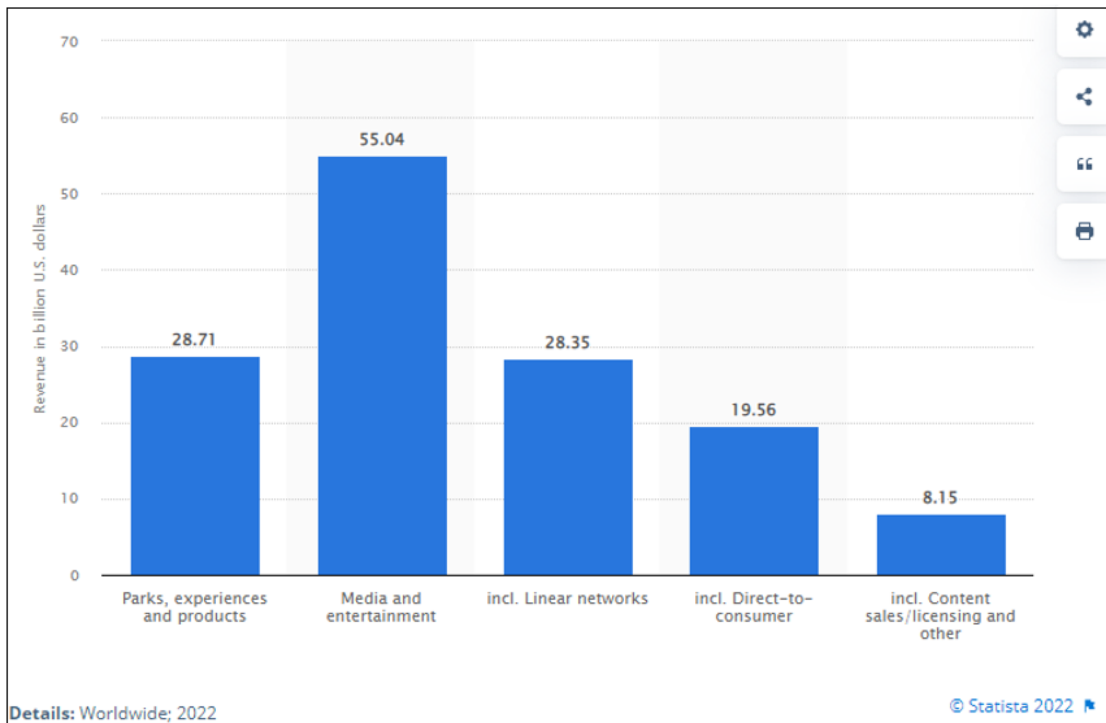
1) The company continues to burn money on Disney+ unprofitably. Despite Media and Entertainment being the leading business segment by revenue, Disney's streaming business has lost more than $8 billion since the launch of Disney+ three years ago; **2)** Overly priced Disney theme parks raise concerns amid a softening economy; **3)** A lack of confidence on Iger being able to turn the company around in a short-to-medium term.

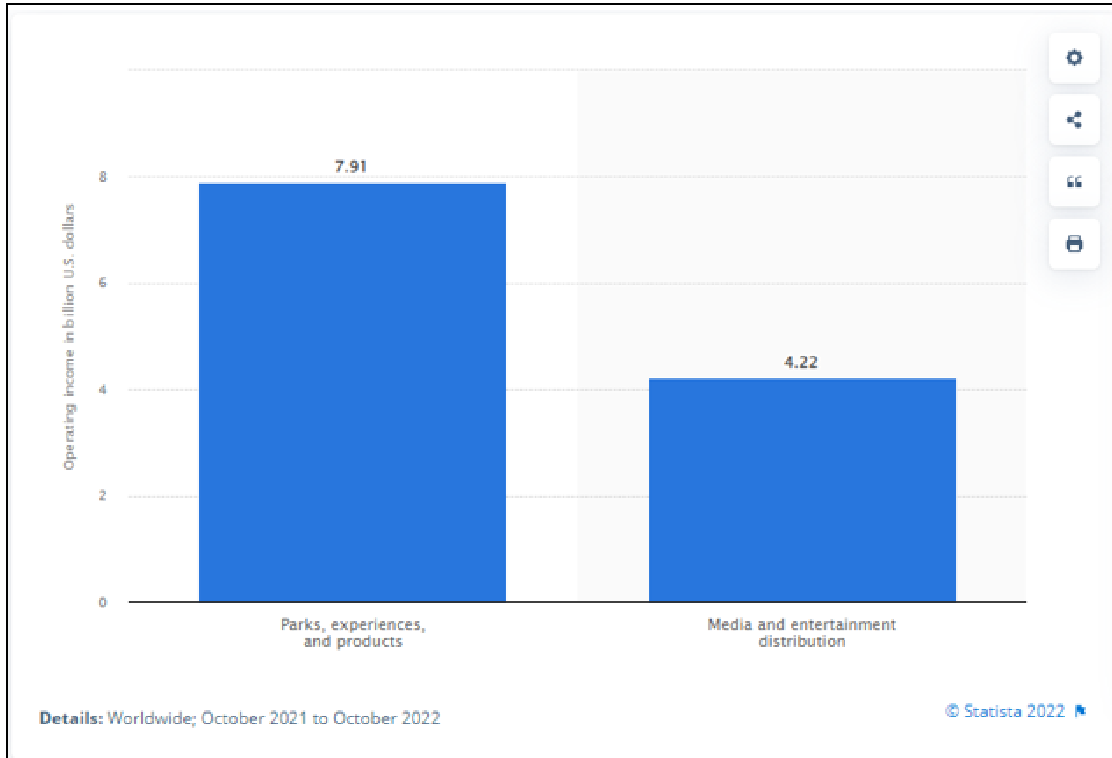
Additionally, the President's Scholars portfolio cannot benefit from any income generated through corporate profits since Disney halted their dividend payments in 2020. The Walt Disney Company also has a high Price-to-Earnings ratio, pushing the portfolio out of compliance with the investment policy statement (IPS).

COMPANY OVERVIEW

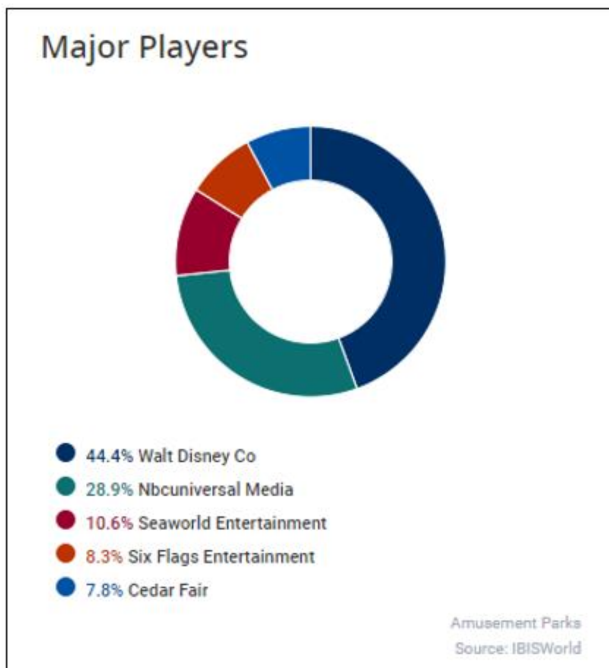
The Walt Disney Company runs a global entertainment business with its subsidiaries Disney Media and Entertainment Distribution and Disney Parks, Experiences and Products. The company operates television broadcast networks under the ABC, Disney, ESPN, Freeform, FX, Fox, National Geographic, and Star brands in addition to studios to make motion pictures under the Walt Disney Pictures, Twentieth Century Studios, Marvel, Lucasfilm, Pixar, and Searchlight Pictures banners. It also produces and distributes films and episodic television content. Disney provides theatrical, home entertainment, and music distribution services as well as direct-to-consumer streaming via Disney+, ESPN+, Hulu, and Star+; the sale and licensing of film and television content to third-party television and subscription video-on-demand services of live entertainment.

The business also runs theme parks and resorts such as Walt Disney World Resort in Florida, Disneyland Resort in California, Disneyland Paris, Hong Kong Disneyland Resort, and Shanghai Disney Resort, as well as Disney Cruise Line, Disney Vacation Club, National Geographic Expeditions, and Adventures by Disney, and Aulani, a Disney resort and spa in Hawaii.





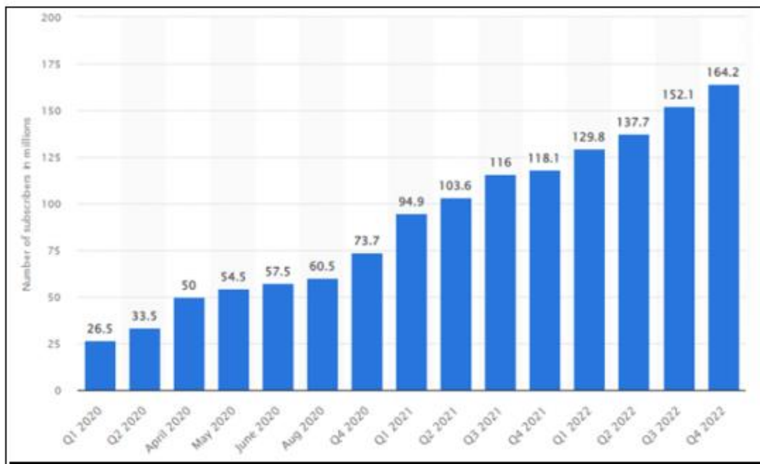
INDUSTRY OVERVIEW *(IBISWorld 'Industry at a Glance August 2022)*



IBISWorld characterizes the Amusement Parks industry as highly concentrated, dominated by five major players. The five major players are: The Walt Disney Company (parks make up about 35% of DIS total revenue), Universal Parks & Resorts, SeaWorld Entertainment Inc., Six Flags Entertainment Corporation, and Cedars Fair LP. Thus, the industry is highly competitive, and the major operators have used intellectual property rights to use film franchises and entertainment to attract consumers. However, it is projected that it will be challenging to considerably increase attendance and income over the next five years because the industry has already attained a very high population penetration rate and solid customer base in the domestic market. Moving forward, the industry will most likely offer more alluring deals and packages to encourage attendance. The central theme parks in the sector will benefit most from all-inclusive packages that include resort lodging and park admittance to retain visitors.

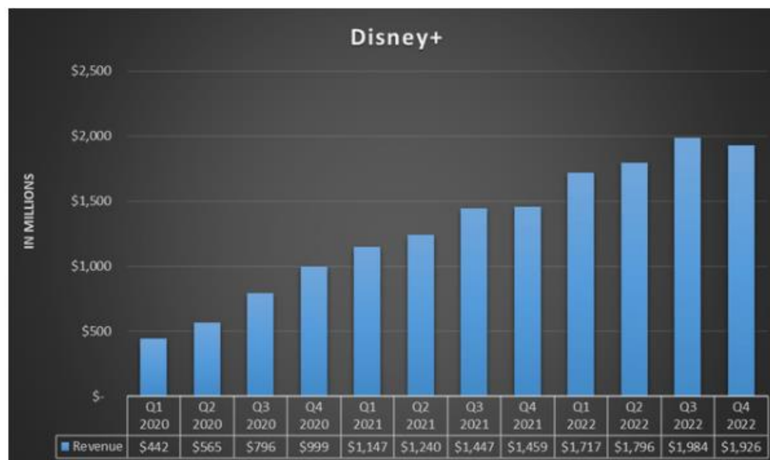
SELL DRIVERS

Disney+ Keeps Burning Money



During the pandemic, when amusement parks were forced to close, former Walt Disney CEO Bob Chapek focused most of his time on advancing the streaming platform, Disney+. In a short period, the platform gained momentum, and in less than three years, it reached 164.2 million subscribers ranking third after Netflix and Amazon Prime. (see chart) However, despite its rising popularity, Disney+ has not become profitable.

As shown in the chart below, Disney+ revenues in fiscal years 2020, 2021, and 2022 were $2.80 billion, $5.20 billion, and $7.40 billion, respectively. Despite this growth, Disney+ operating costs continued to outpace revenues, decreasing operating income. Since the launch of Disney+, Disney's streaming business has lost more than $8 billion. After Disney reported peak losses of $1.47 billion during their fourth quarter of this year, 38% wider than what analysts polled by FactSet had predicted, the company announced its intent to cut the marketing and content budget for streaming.



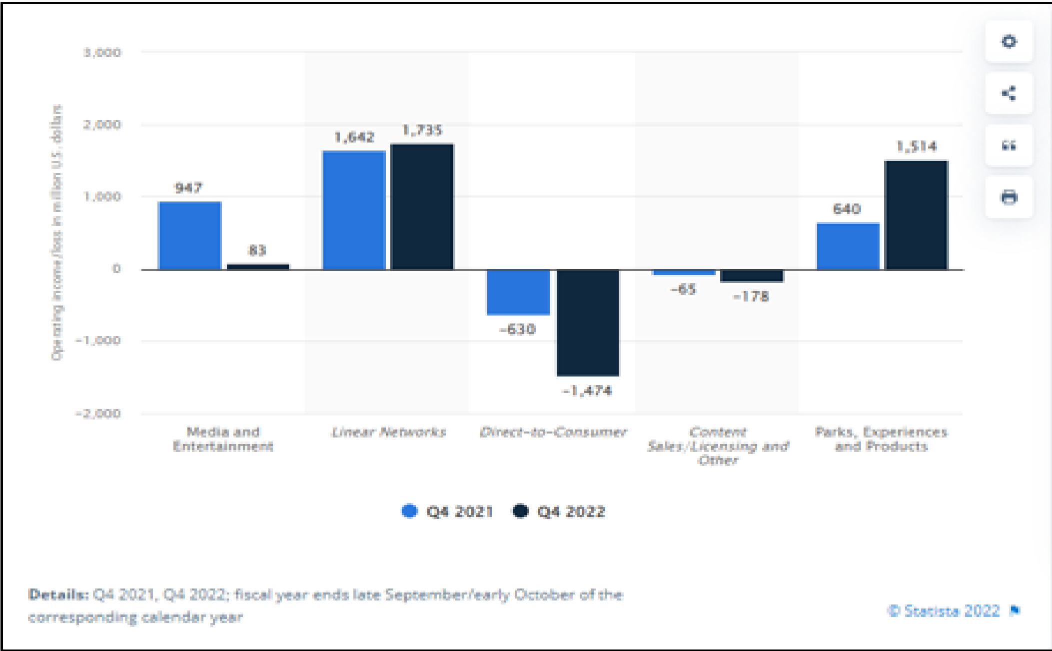
	Quarter Ended			Year Ended		
	October 1, 2022	October 2, 2021	Change	October 1, 2022	October 2, 2021	Change
Revenues:						
Linear Networks	$ 6,335	$ 6,698	(5) %	$ 28,346	$ 28,093	1 %
Direct-to-Consumer	4,907	4,560	8 %	19,558	16,319	20 %
Content Sales/Licensing and Other	1,736	2,047	(15) %	8,146	7,346	11 %
Elimination of Intrasegment Revenue[1]	(253)	(221)	(14) %	(1,010)	(892)	(13) %
	$ 12,725	$ 13,084	(3) %	$ 55,040	$ 50,866	8 %
Operating income (loss):						
Linear Networks	$ 1,735	$ 1,642	6 %	$ 8,518	$ 8,407	1 %
Direct-to-Consumer	(1,474)	(630)	>(100) %	(4,015)	(1,679)	>(100) %
Content Sales/Licensing and Other	(178)	(65)	>(100) %	(287)	567	nm
	$ 83	$ 947	(91) %	$ 4,216	$ 7,295	(42) %

As noted in the table above, despite a 20% increase in revenues, the direct-to-consumer segment – which comprises Disney+, Hulu, and ESPN+ – experienced a more considerable operating loss in the fiscal year 2022 than in 2021. An element that reports an operational loss of $4 billion despite generating $19.55 billion in revenues tells the story: Disney is losing money as Disney+ continues to expand, making it an unsustainable business model in the long run.

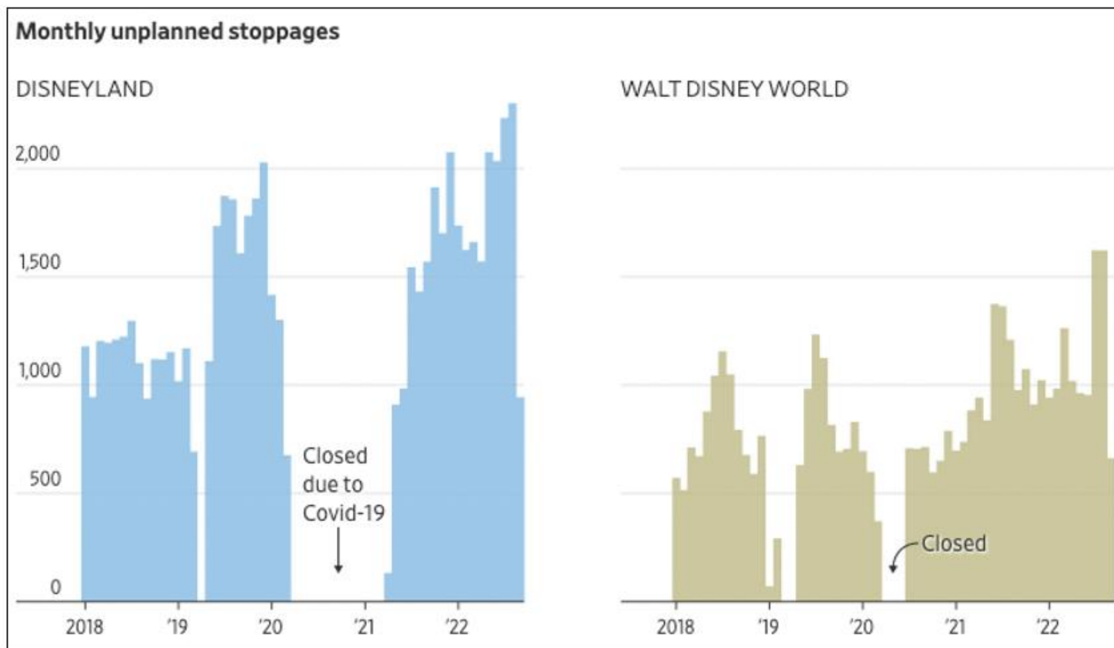
Disney Parks Overpriced

Disney parks are overpriced, and the expense of the experience itself has increased along with ticket prices. The fact that 2022 was a record year for vacations is mostly because Covid-19 restricted people's ability to travel in the preceding two years. 2022 was a success for the parks from a revenue standpoint; however, the parks' high prices have disappointed fans' expectations. The average American family cannot afford to visit Disney theme parks and the parks' shrinking margins make them a sore spot for investors, too. For consumers, the park's enchantment has been ruined by its high prices. Many feel that unless they upgrade to Genie+ (a smartphone app that allows guests to pay extra to skip certain lines) or buy more tickets to Lightning Lane (a queue available at selected attractions to save time in line), they won't receive the entire Walt Disney experience (Whelan, 2022). Guests feel they are being nickel-and-dimed and that unless they shell out a fortune, they will often have a bad time at Disney Parks.

In addition to price increases, the current macroeconomic environment should be considered. To combat inflation, major central banks worldwide have raised interest rates to restrict access to credit and slow down the economy. Amid a softening economy, vacations are not a priority, and pricy parks like Disney have become a luxury. Earlier in November, Disney's Q4 earnings report showed widening losses in streaming and unexpected warning signs from their parks. The domestic parks and experiences division of Disney, which also operates cruise ships, saw a decline in profit margins of roughly 16 percentage points from the previous quarter, falling short of analyst estimates of about 20%. The parks division's operating income came in at $1.5 billion, approximately 18% less than what JPMorgan Chase had anticipated for the quarter ($1.85 billion). This raises questions about how long the theme parks can sustain the profitability required to help cover streaming losses.

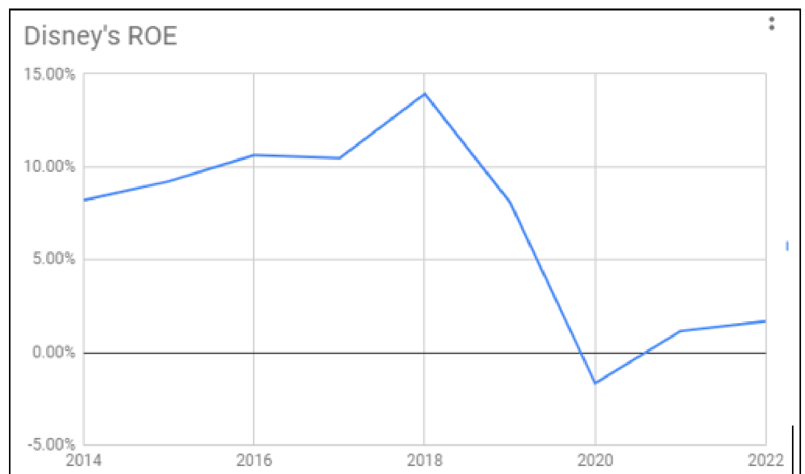


On top of that, Disney parks have been experiencing an increase in ride breakdowns. According to a Wall Street Journal analysis of statistics from three amusement-park data providers, unscheduled ride interruptions and wait times are rising at Walt Disney's theme parks. According to WDS Stats, a website that monitors the state of rides at Disney parks and reports how lengthy unplanned ride stoppages last, the average monthly number of ride stoppages increased by 42% at Walt Disney World and 58% at Disneyland during the same period between 2018 and 2022 as of late September. This is frustrating for visitors who paid more to secure a good place in line for their preferred rides.



Bob Iger's Return

Everyone enjoys a good comeback story, especially when things look bleak. The board of Disney rehired the late CEO, Bog Iger, to steer the company in the right direction. Unfortunately, there is little Iger can do to turn the company around in the next year or two.



Disney's return on equity has taken a nosedive since 2018 and is lower than it was in 2014. The two leading detractors are the purchase of 21st Century Fox, which significantly raised stockholders' equity, and the switch to streaming that has decreased net income. The fall in cable has not yet considerably impacted return on equity, according to Iger, who previously stated that traditional TV is approaching a cliff. If Iger is correct, it will dramatically drag profitability over the next five to ten years. A significant increase in return on equity will be necessary to improve the stock's long-term performance.

Even if there's an improvement in return on equity under Iger, Disney's ROE is unlikely to rise above 22%, which is the current S&P 500 industry average. Even the historical average of 10.5% return on equity for the S&P 500 may be difficult for Disney to achieve. If Iger wants to counteract the demise of linear networks, he has to create a $60 billion streaming company (doing twice what legacy networks will earn in 2022). That's triple Disney's current direct-to-consumer (DTC) revenue. It is reasonable to say that won't occur in the following two years.

On top of that, Iger will need to decide how to handle ESPN moving forward and justify the price paid for 21st Century Fox. Iger left shareholders with $4 billion in DTC losses just in 2022 after spending $71 billion to acquire 21st Century Fox, and despite the merger being announced in 2017, the stock is down. The long-term issue for Iger will be to maximize the acquisition. It will be crucial to sue the valuable IP he acquired through the transaction (Avatar, X-Men, National Geographic, etc.). But if Disney stockholders are to profit from the collection of distinctive assets the business has, Iger will also need to work on generating larger margins than streaming competitors.

RELATIVE VALUATION

Unattractive Financial Comparison

1. VALUATION Factors (1- best, 6 - worst: low is better except for FCF/Share)

									RANK						
Company Name	**P/E (NTM)**	**P/B (NTM)**	**EV/Sales (NTM)**	**EV/ EBITDA**	**BV/Shr (NTM)**	**FCF/Shr (NTM)**	**Price**	**Price Target**	**P/E Rank**	**P/B Rank**	**EV/Sales**	**EV/ EBITDA**	**FCF/Share (NTM)**	**Avg. Rank**	***Evaluation***
Walt Disney	**22.52x**	**1.77x**	**2.36x**	**19.73x**	**56.18**	**-89.71**	**$99.43**	**$120.00**	3	3	4	5	3	**3.6**	***High Price***
Comcast A	9.55x	1.80x	2.03x	6.73x	19.89	67.09	$35.86	$40.25	1	4	3	1	1	2.0	***Low Price***
Warner Bros. Discov	-	0.59x	1.58x	18.70x	19.59	-76.64	$11.55	$19.83		2	2	4	2	2.5	***Fair Price***
Paramount Global B	14.68x	0.47x	0.84x	8.77x	42.99	-138.23	$20.38	$19.07	2	1	1	3	4	2.2	***Low Price***
Netflix	30.51x	5.99x	4.43x	7.71x	53.52	-	$320.41	$292.97	4	5	5	2		4.0	***High Price***
Average	*19.31x*	*2.12x*	*2.25x*	*12.33x*	*38.43*	*-59.37*	*$97.53*	*$63.19*							

Walt Disney is highly-priced in comparison to its peers. Its high price-to-earnings ratio makes it an unsuitable position for the TCM President's Scholars portfolio. Disney's best businesses (parks and movie theaters) are cyclical and don't justify high multiples. Additionally, Disney missed earnings in Q4 by $1.28 billion.

3. LIQUIDITY, LEVERAGE, YIELD (1 - best, 6 - worst: high is better for current ratio, EBITDA/Int. Exp, and yield; low is better for debt ratios and beta)

									RANK							
Company Name	**Curr Ratio**	**EBITDA / Int. Exp**	**Net Debt / EBITDA**	**LT Debt/ Ttl Capital**	**FCF Yield**	**Dividend Yield**	**Beta**	**Diluted Shares**	**Curr Ratio**	**EBITDA / Int. Exp**	**Net Debt / EBITDA**	**LT Debt/ Capital**	**Dividend Yield**	**FCF Yield**	**Debt Rank**	**Yield Rank**
Walt Disney	**0.94**	**7.70x**	**3.41x**	**32.96**	**0.61**	**0.00**	**1.05**	**1,826.0**	3	3	3	1	3	4	**2.5**	**3.5**
Comcast A	0.84	9.41x	2.49x	53.72	8.53	1.99	0.81	4,377.0	5	2	2	5	2	2	3.5	2.0
Warner Bros. Discov	0.86	3.06x	11.82x	50.79	15.42	0.00	1.10	2,428.0	4	5	5	4	3	1	4.5	2.0
Paramount Global B	1.31	3.42x	4.44x	42.42	3.03	3.18	1.34	650.0	1	4	4	2	1	3	2.8	2.0
Netflix	1.14	27.37x	0.52x	43.55	-0.05	0.00	1.12	450.3	2	1	1	3	3	5	1.8	4.0
Average	*1.02*	*10.19x*	*4.54x*	*44.69*	*5.51*	*1.03*	*1.08*									

Regarding liquidity, leverage, and yield, Disney ranks in the middle compared to its peers. Its current ratio of less than one raises questions regarding the company's liquidity and ability to pay short-term obligations. Also, the company stopped its dividend payment in 2020, bringing its dividend yield to zero.

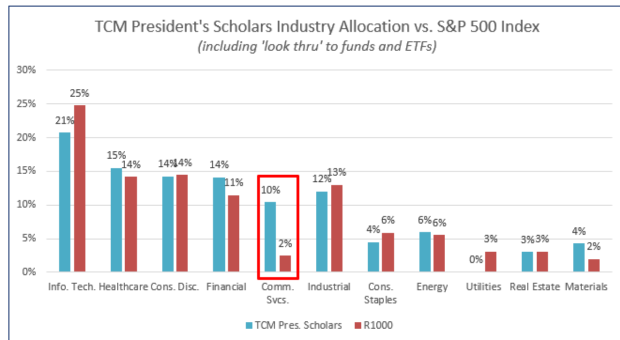
2. PROFITABILITY Factors (1 - best, 6 - worst: high is better except Total Debt)															
									RANK						
Company Name	Sales Growth (3 yr.)	Gross Margin (NTM)	EBIT Margin (NTM)	ROIC (NTM)	ROE (NTM)	Sales	EBITDA	Total Debt	Sales Growth	Gross Margin	EBIT Margin	ROIC	ROE	Avg. Rank	*Evaluation*
Walt Disney	**19.15**	**34.36**	**14.91**	**2.25**	**7.86**	**$82,580**	**$11,929**	**$51,602**	**4**	**3**	**3**	**4**	**3**	**3.5**	***Less Profitable***
Comcast A	11.83	67.57	18.82	2.90	18.88	$121,211	$36,845	$92,451	5	1	1	3	2	2.5	***More Profitable***
Warner Bros. Discov	134.85	-	1.44	-8.26	-0.90	$25,998	$4,309	$49,869	1		5	5	5	3.7	***Less Profitable***
Paramount Global B	96.29	-	7.14	7.35	3.23	$30,023	$3,219	$15,834	2		4	2	4	2.7	***Profitable***
Netflix	66.74	40.35	18.02	14.63	19.62	$31,473	$19,845	$13,887	3	2	2	1	1	2.0	***More Profitable***
Average	*65.77*	*47.43*	*12.07*	*3.77*	*9.74*	*$58,257*	*$15,229*	*$44,729*							

Overall, Walt Disney is high priced, less profitable, and has less yield than its peers, making it an unattractive investment. It would be prudent to steer away from the company given that Disney needs to control costs, reduce debt, and perhaps focus more on profitability than growth to improve the stock value to shareholders going forward.

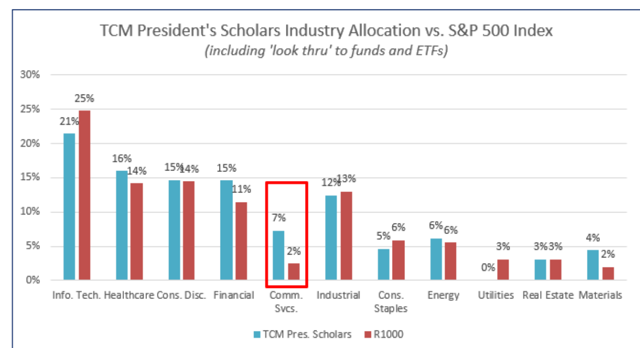
PORTFOLIO IMPACT AND SUMMARY

We recommend selling the entire 3.3% equity position in Walt Disney to fund future trades. Disney suspended their dividend payments in 2020 to conserve cash and ensure the company's viability. As a result, the President's Scholars portfolio cannot benefit from any income generated through corporate profits, making it unsuitable for our income objective. Additionally, Disney's trailing P/E ratio of 64 times contributes to the President's Scholars portfolio violation of the IPS guideline to maintain P/E equal to or below the index. Selling our Disney position provide cash for more stable income generating stocks while helping bring down the P/E ratio and decreasing our significant overweight in Communication Services.

Sector Allocation Pre-Trade



Sector Allocation Post-Trade



Compliance pre-trade

Compliance Report - Stocks		
	P/E <= the index	Violation
Pres. Scholars	*Russell 1000*	*Difference*
35.65	20.20	15.45
	Dividend yield > = the index	OK
Pres. Scholars	*Russell 1000*	*Difference*
1.87%	1.68%	0.19%

Compliance pre-trade

Compliance Report - Stocks		
	P/E <= the index	Violation
Pres. Scholars	*Russell 1000*	*Difference*
34.66	20.20	14.46
	Dividend yield > = the index	OK
Pres. Scholars	*Russell 1000*	*Difference*
1.94%	1.68%	0.26%

APPENDIX

https://seekingalpha.com/article/4560335-disney-2-biggest-problems-bob-iger-solve

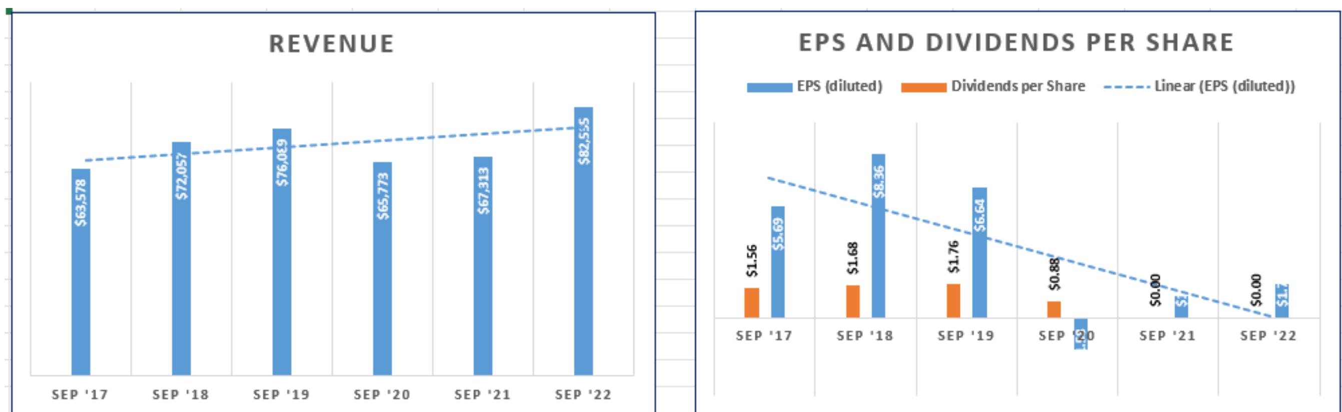
https://digital.fidelity.com/prgw/digital/research/quote/dashboard/summary?symbol=DIS

https://my-ibisworld-com.lib-proxy.fullerton.edu/us/en/industry/71311/industry-at-a-glance

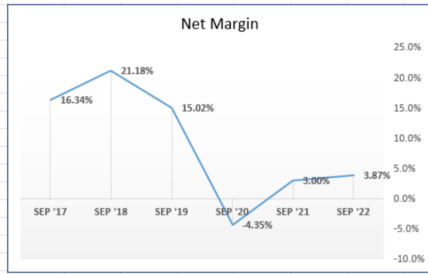
https://www-statista-com.lib-proxy.fullerton.edu/statistics/193150/operating-income-of-the-walt-disney-company-by-segment/

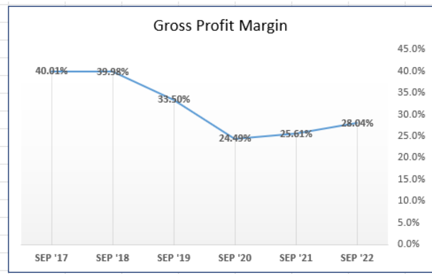
https://www.wsj.com/articles/disneys-theme-parks-are-sore-spot-for-investors-too-11669613538?mod=Searchresults_pos1&page=1

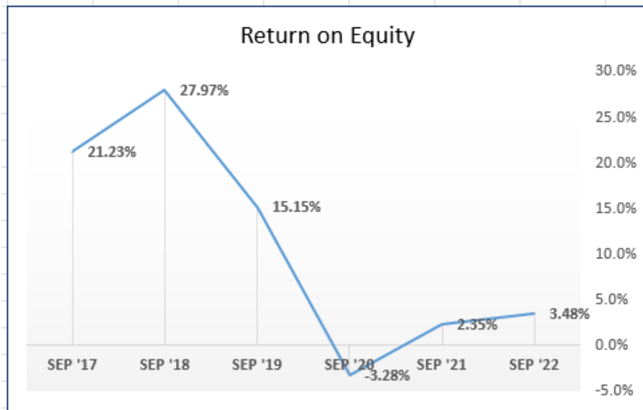
https://www.wsj.com/articles/disney-parks-ride-stoppages-and-wait-times-grow-as-ticket-prices-rise-11668833084

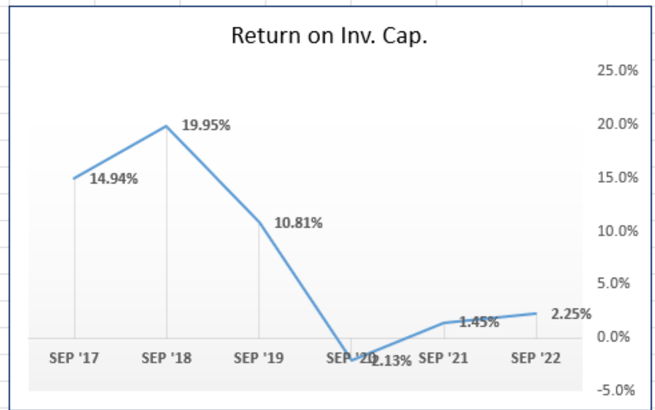


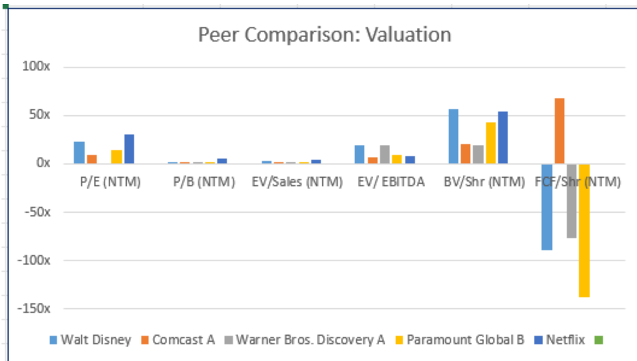
Operating Margin
25.13%
25.08%
16.87%
5.49%
5.55%
8.19%
SEP '17
SEP '18
SEP '19
SEP '20
SEP '21
SEP '22

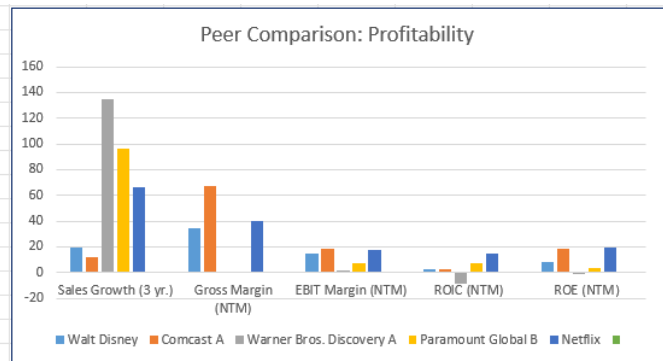

Net Margin
16.34%
21.18%
15.02%
-4.35%
3.00%
3.87%
SEP '17
SEP '18
SEP '19
SEP '20
SEP '21
SEP '22

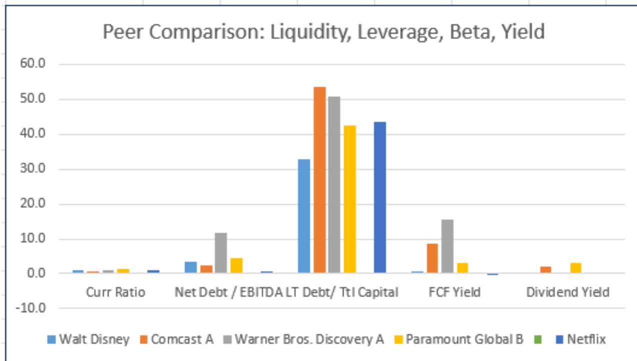

Gross Profit Margin
40.01%
39.98%
33.50%
24.49%
25.61%
28.04%
SEP '17
SEP '18
SEP '19
SEP '20
SEP '21
SEP '22

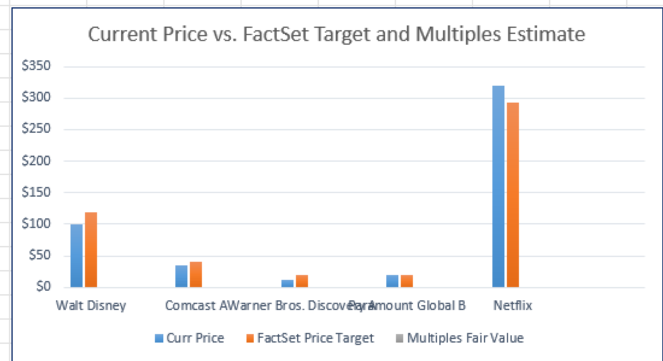

Return on Equity
21.23%
27.97%
15.15%
-3.28%
2.35%
3.48%
SEP '17
SEP '18
SEP '19
SEP '20
SEP '21
SEP '22


Return on Inv. Cap.
14.94%
19.95%
10.81%
-2.13%
1.45%
2.25%
SEP '17
SEP '18
SEP '19
SEP '20
SEP '21
SEP '22


Peer Comparison: Valuation
P/E (NTM)
P/B (NTM)
EV/Sales (NTM)
EV/ EBITDA
BV/Shr (NTM)
FCF/Shr (NTM)
Walt Disney
Comcast A
Warner Bros. Discovery A
Paramount Global B
Netflix


Peer Comparison: Profitability
Sales Growth (3 yr.)
Gross Margin (NTM)
EBIT Margin (NTM)
ROIC (NTM)
ROE (NTM)
Walt Disney
Comcast A
Warner Bros. Discovery A
Paramount Global B
Netflix


Peer Comparison: Liquidity, Leverage, Beta, Yield
Curr Ratio
Net Debt / EBITDA
LT Debt/ Ttl Capital
FCF Yield
Dividend Yield
Walt Disney
Comcast A
Warner Bros. Discovery A
Paramount Global B
Netflix


Current Price vs. FactSet Target and Multiples Estimate
Walt Disney
Comcast A
Warner Bros. Discovery A
Paramount Global B
Netflix
Curr Price
FactSet Price Target
Multiples Fair Value