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Walt Disney Co (DIS)

VALUEx Vail

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The Strength of Advice®

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Please refer to slide 19 of this presentation for detailed disclosure and certification information

Summary

As of 6/28/2018			TTM	10-Year Avg
Price ($)	104.77	ROIC	14.0%	11.7%
Market Cap ($B)	147.9	ROIIC (Rolling 3Y)	23.1%	20.8%
EV ($B)	181.7	ROE	20.8%	15.3%
P/E (Last FY*)	17.3	Gross Margin	40.0%	28.7%
P/E (Next FY Est)	14.6	EBIT Margin	25.1%	21.1%
P/FCF (TTM)	14.8	Net Margin	16.3%	13.5%
P/S (TTM)	2.8			
EV/EBITDA (TTM)	10.1			
Dividend Yield	1.6%			
Net Debt-to-EBITDA (TTM)	1.20			
Debt-to-Total Capital	35%			
Rating	Buy/Add			
Price Target (12-18 Month)	$130			

The Walt Disney Company

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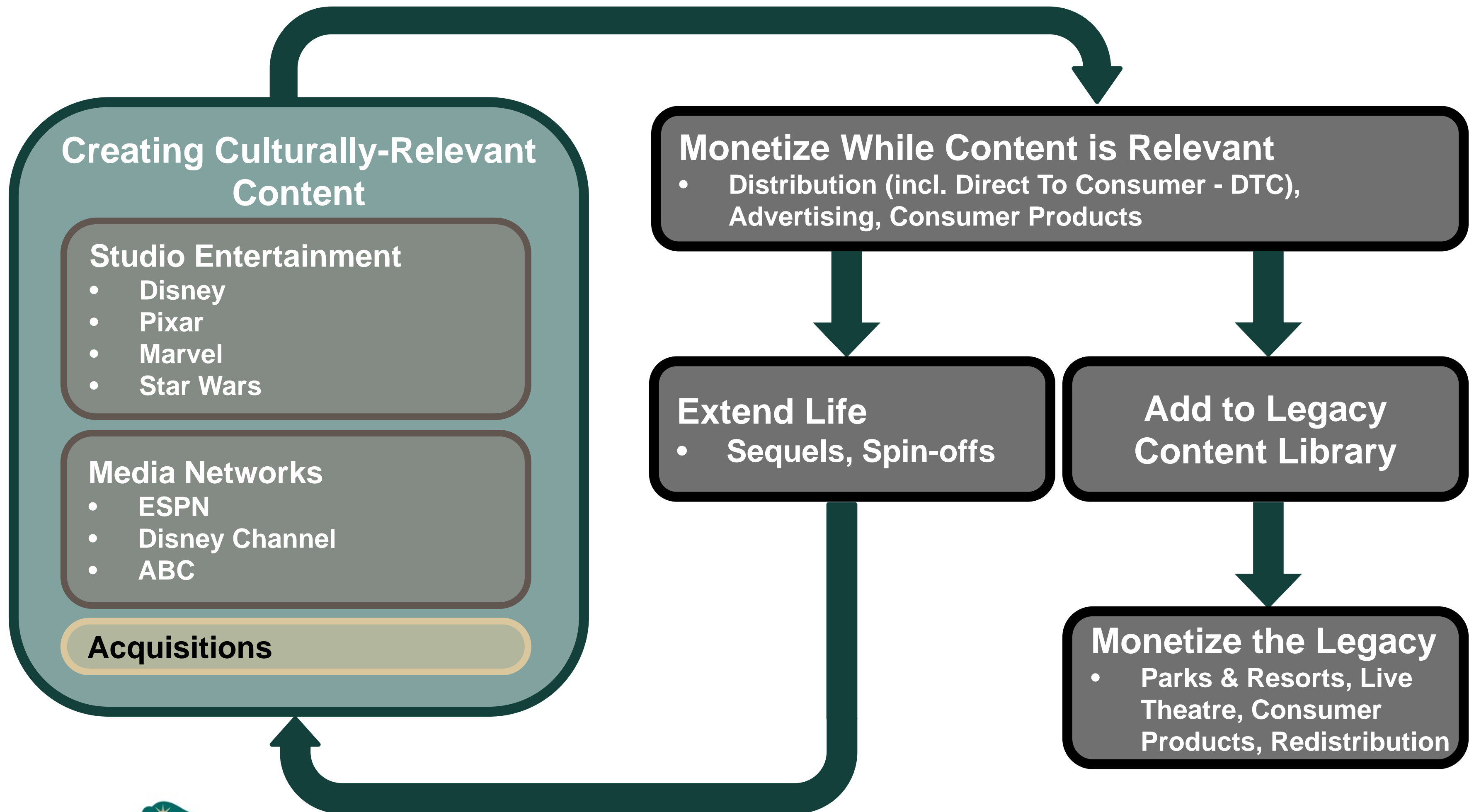
Source: D.A. Davidson; SEC filings; FactSet
* DIS fiscal year ends in September

Disney's Business Model



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Business Overview

DIS FY2017 Segment* Revenue ($B)

Segment	Revenue	Operating Income
Media Networks	23,510	6,902
Parks and Resorts	18,415	3,774
Studio Entertainment	8,379	2,355
Consumer Products & Interactive	4,833	1,744
Corporate/Other		

Y-axis: 60,000; 50,000; 40,000; 30,000; 20,000; 10,000; -; (10,000)

Sources: SEC filings; D.A. Davidson; FactSet

* DIS has announced a reorganization of its reporting segments and will transition its financial reporting beginning in FY2019

Why We Think DIS is a Great Business

- Repeatable, scalable process for developing and monetizing new studio content
  - Reputation as a good steward of brands makes DIS the destination of choice for content creators when looking to sell (the BRK of content)
- Unmatched library of legacy content (strengthened by FOXA acquisition)
- Leading portfolio of live sports rights

Key competitive advantage in DTC

- Ability to further monetize legacy content through parks and consumer products

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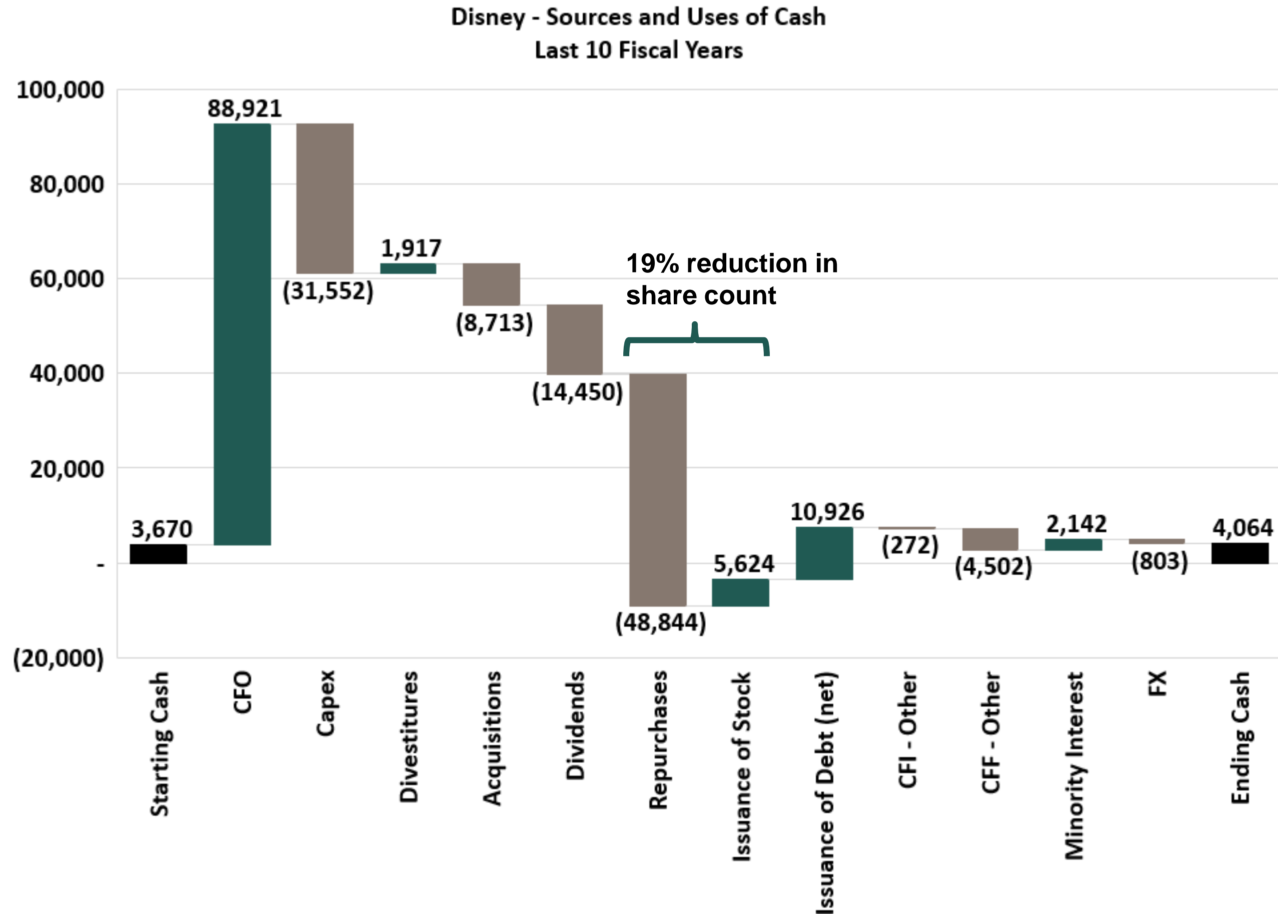
Sources and Uses of Cash

FY2008 – FY2017



Sources: FactSet; SEC filings

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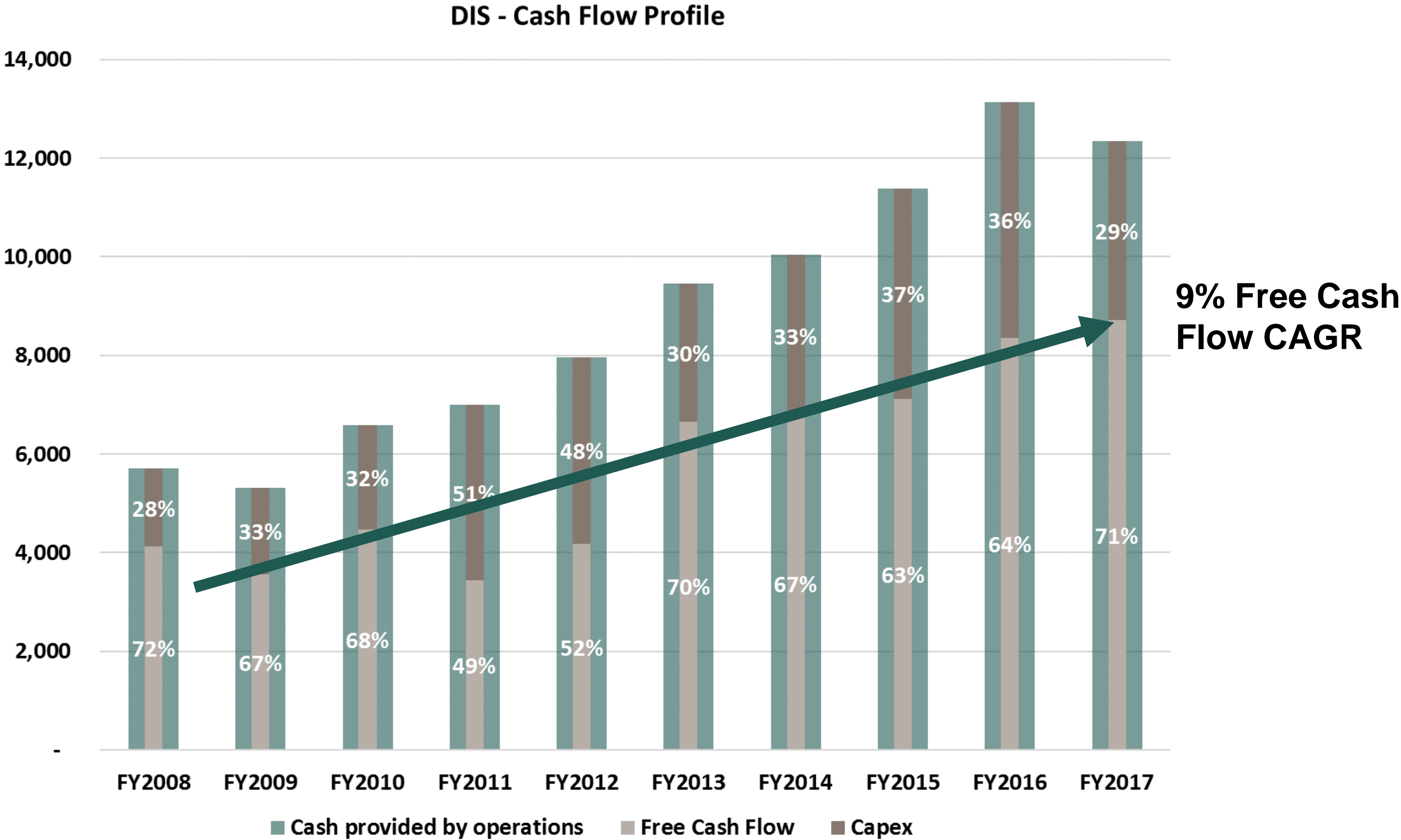
Free Cash Flow

FY2008 – FY2017



Source: FactSet; SEC filings

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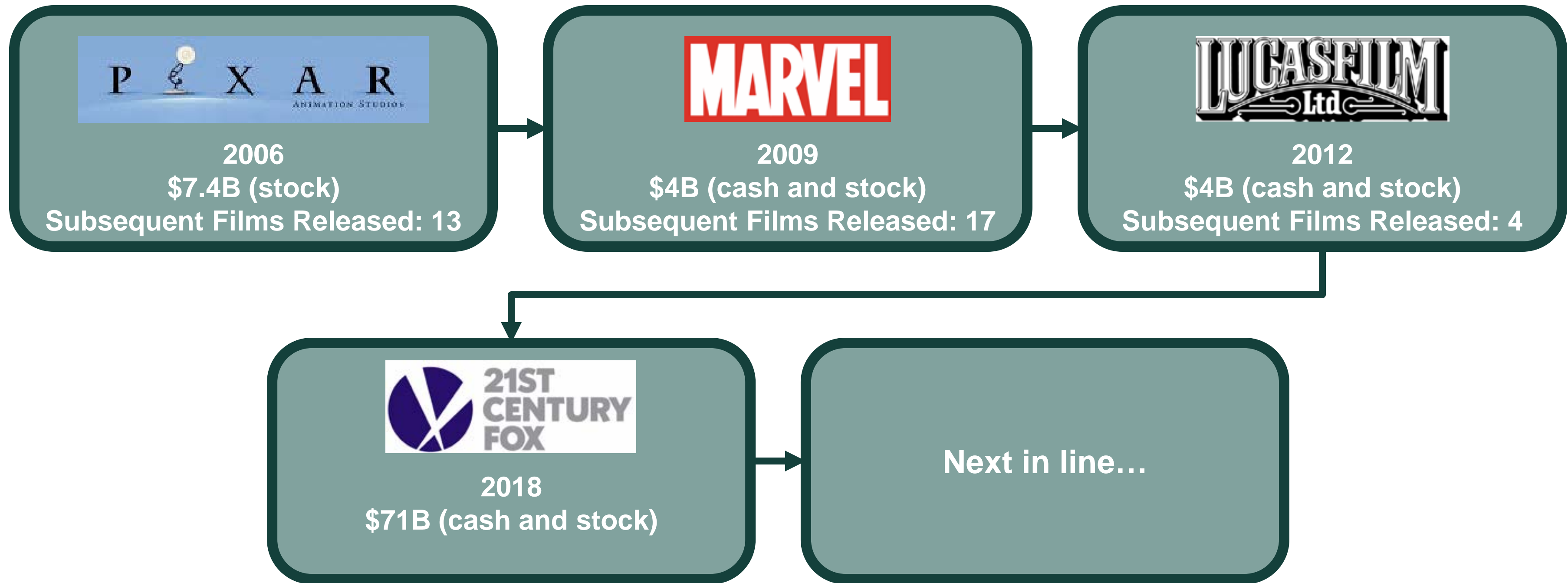
Repeatable, Scalable Content Generation

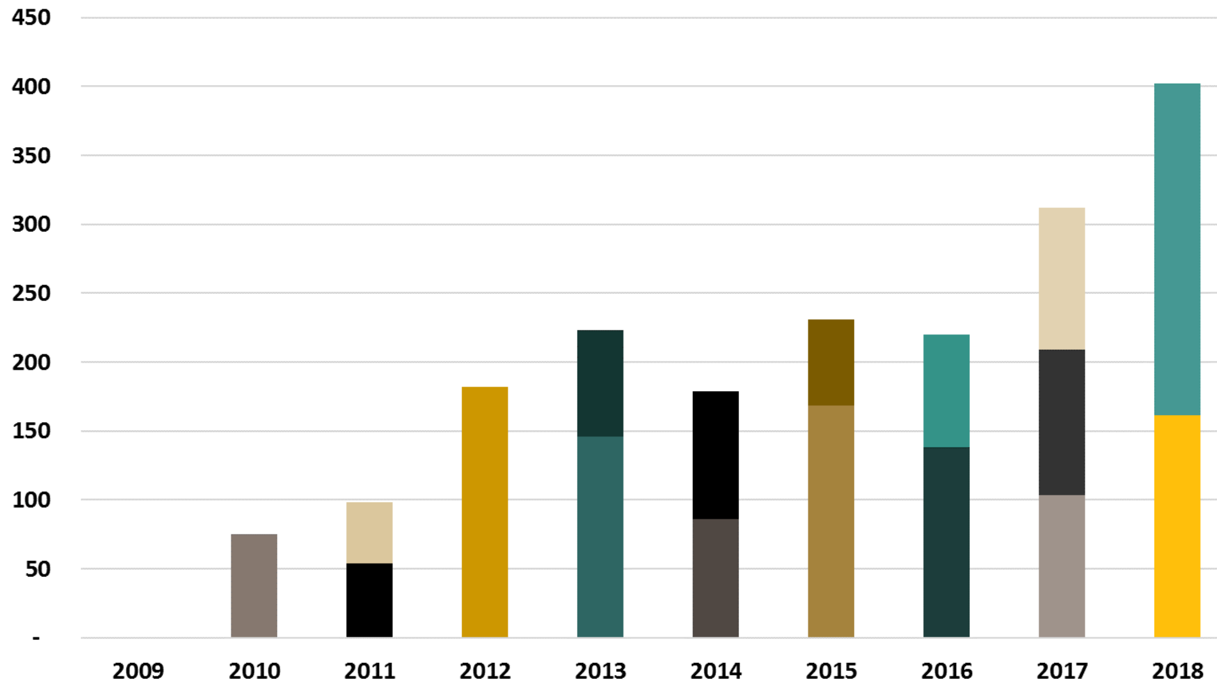
History of Brand Stewardship

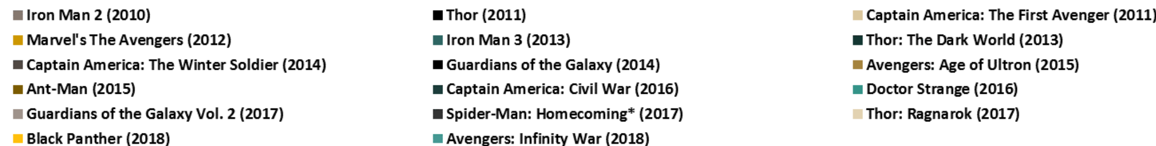


- All recent targets have accepted stock as part of the consideration, indicating the Disney brand gives it a competitive advantage when bidding for content
  - FOXA's board accepted DIS' initial offer despite a bid from CMCSA which was $12B higher
- DIS has a track record of strong execution, using the acquired content platforms to deliver strong financial results with increasing returns on capital and improved margin profile

Repeatable, Scalable Content Generation

Example: Marvel





- DIS acquired Marvel in 2009 for $4B
- Looking only at the movie titles released, we estimate DIS has generated an IRR of ~9.5% on the acquisition[1]
- This does not include additional methods of monetization, such as TV, parks, consumer products, and games

Sources: D.A. Davidson; Box Office Mojo; Deadline; Observer

* *Spider-Man: Homecoming* was released by Sony Pictures under a 1998 agreement; DIS does not directly profit from this release

[1]Assumptions: 12% segment operating margin, 25% segment EBITDA margin, and terminal value calculated using three-year average EBITDA and 11.5x EV/EBITDA multiple (5-year average multiple for the S&P 500 Movies & Entertainment GICS sub-industry), no debt on Marvel

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FOXA Acquisition

- Benefits
  - Immediately enhances legacy content library for upcoming Disney-branded DTC service launch
  - International sports rights acquired make DTC sports services more attractive to subscribers
  - Distribution and DTC assets acquired (Hulu, Sky, hotstar) open up more avenues for organic growth when combined with DIS' legacy content
  - Increases DIS' global footprint

- Key Risks
  - Significant increase in leverage following updated offer
  - Clash of cultures at production studios leading to talent exodus and/or development of poorly-received studio content
  - Complications due to CMCSA's outstanding bid for Sky

Sources: SEC filings, D.A. Davidson

Legacy Content Brings Value to DTC

- “We ultimately need to take back control of our content, to license it in effect to ourselves and to build that business…both by taking products that are made for other platforms like motion picture, theatrical release, but also by using the capability that we have…and creating products specifically for those services.”
  - Bob Iger, DIS Investor Meeting, December 14th 2017

- DTC service content includes
  - 400 to 500 films (pre-FOXA)
  - 7,000 episodes of Disney-branded TV
  - Disney short-form content
  - Plus original films and television content

- “We believe in full ownership and full control forever because of the way we mine these properties across all of [our] businesses…”
  - Bob Iger, Goldman Sachs Communicopia Conference 2016

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Sources: FactSet

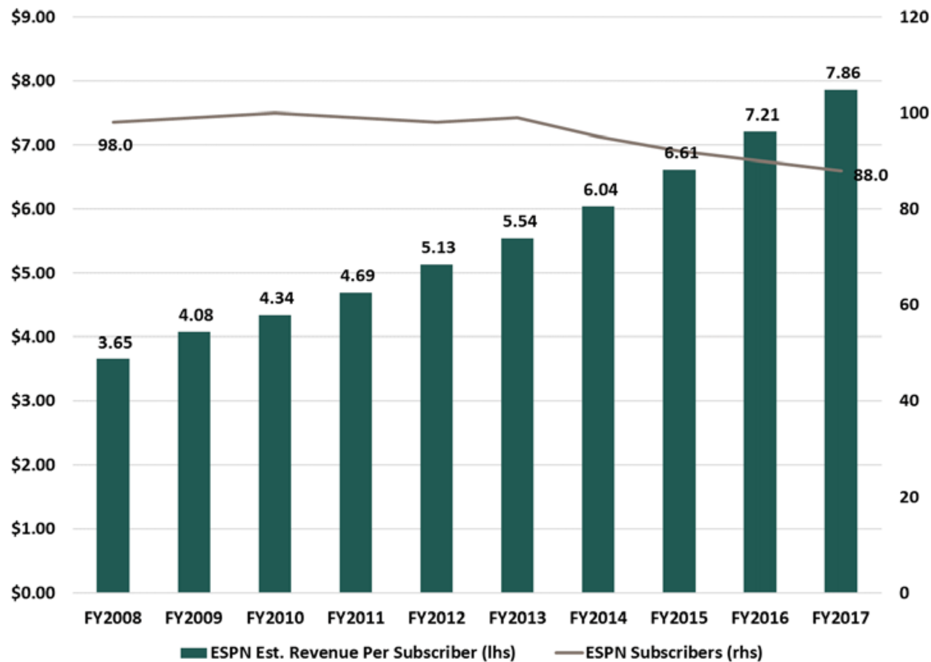
Conversion of Legacy Content to Subscription

Studio Entertainment Segment – Home Entertainment and TV/SVOD Distribution)			
	FY2017 Est	DTC Scenario 1	DTC Scenario 2
Revenue (Est.)	4,107	4,040	8,420
Monthly Charge	N/A	7.99	9.99
Market Share	N/A	30%	50%
Operating Income			
at DIS Segment Op Margin	1,150	1,131	2,357
at NFLX Domestic Op Margin		1,495	3,115
Impact to EPS			
at DIS Segment Op Margin		-$0.01	0.77
at NFLX Domestic Op Margin		$0.22	1.25

- Over the past ten years, we estimate DIS' revenue from Home Entertainment and TV/SVOD Distribution (legacy content) to be ~$27 per North American household per year
- A Disney-branded DTC service priced at $7.99 per month with ~30% penetration would replace all existing legacy content revenue
  - NFLX average monthly revenue per North American subscription in 2017 was $9.36
  - DIS' ownership of legacy content is a competitive advantage versus other DTCs that need to license content or build a library
  - Original film franchises and strong content library would attract subscribers
- Better monetization of DIS legacy content has to potential to make a meaningful impact on future earnings while helping to mitigate disruption from the transition to DTC in the Media Networks segment

Sources: D.A. Davidson, SEC filings; FactSet

Pricing Power Remains at Legacy ESPN



- ESPN has a portfolio of distribution rights in virtually every major professional and amateur sport in the U.S.
  - Exceptions: NHL, Olympics, auto racing
- ESPN has been forward-thinking in licensing emerging sports, such as MMA and eSports
- Since 2008, ESPN has consistently increased its pricing annually at a CAGR of 9% despite recent subscriber losses and lower ratings
- Acquisition of international sports rights via FOXA should help to preserve this pricing power

- "ESPN… when it licenses sports from the various leagues and schools…in almost all cases, buys both traditional media rights and digital media rights. So ESPN has a treasure trove of digital rights for 99% of the sports that it covers, that it is not fully exploiting on new platforms, and it fully intends, ultimately, to do that.
  - Bob Iger, Goldman Sachs Communicopia Conference 2016

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Sources: SNL Kagan via Variety, Business Insider, The Wrap, Forbes, Bloomberg, Sports Business Daily; SEC filings, FactSet

ESPN Conversion to DTC is Challenging…

ESPN Domestic Affiliate Fee Only			
	FY2017 Est	DTC Scenario 1	DTC Scenario 2
Revenue (Est.)	8,300	4,539	7,566
Monthly Charge		9.99	9.99
Market Share		30%	50%
ESPN+		47	79
Total Revenue		4,587	7,645
Operating Income			
at DIS Operating Margin	3,933	2,151	3,585
at NFLX Domestic Op Margin		1,680	2,799
Impact to EPS			
at DIS Operating Margin		-$1.14	-$0.22
at NFLX Domestic Op Margin		-$1.44	-$0.72

- Whereas conversion to DTC is a tailwind to operating profit for legacy content, it is a headwind for ESPN domestically
- ESPN as a standalone service likely requires too high of a price to offset lost revenue from the current affiliate fee model
- DTC sports is a different (and superior) product to linear ESPN
- Growth internationally could help to offset this earnings headwind
  - Sports content has more economies of scale as localization needs are minimal
- This does not include the impact of items that would potentially positively impact operating profit under an DTC model
  - More effective targeting of advertising
  - Reduced cost of generating timely live programming required to fill a 24 hour day on linear TV

Sources: D.A. Davidson, SEC filings, FactSet

…But the Combination of Both Services is Powerful

DTC Scenario 3 - Combined Disney and ESPN			
	Legacy Content	ESPN	Combined
Revenue (Est.)	6,734	9,080	15,814
Monthly Charge	7.99	11.99	19.98
Market Share	50%	50%	50%
Combined Impact to EPS			
at DIS Operating Margin	$0.47	$0.24	$0.70
at NFLX Domestic Op Margin	$0.86	-$0.37	$0.49

- A combined plan priced to generate an average of $20 per month with 50% penetration would increase EPS, even if ESPN margins decline to levels comparable to NFLX's domestic streaming business
- Underpriced legacy content has the potential to more than offset overpriced linear ESPN
- Upside remains from taking share domestically and global expansion
  - With 88MM subscribers (ESPN's current domestic level), EPS could increase between $2.00 and $2.30

Sources: D.A. Davidson, SEC filings

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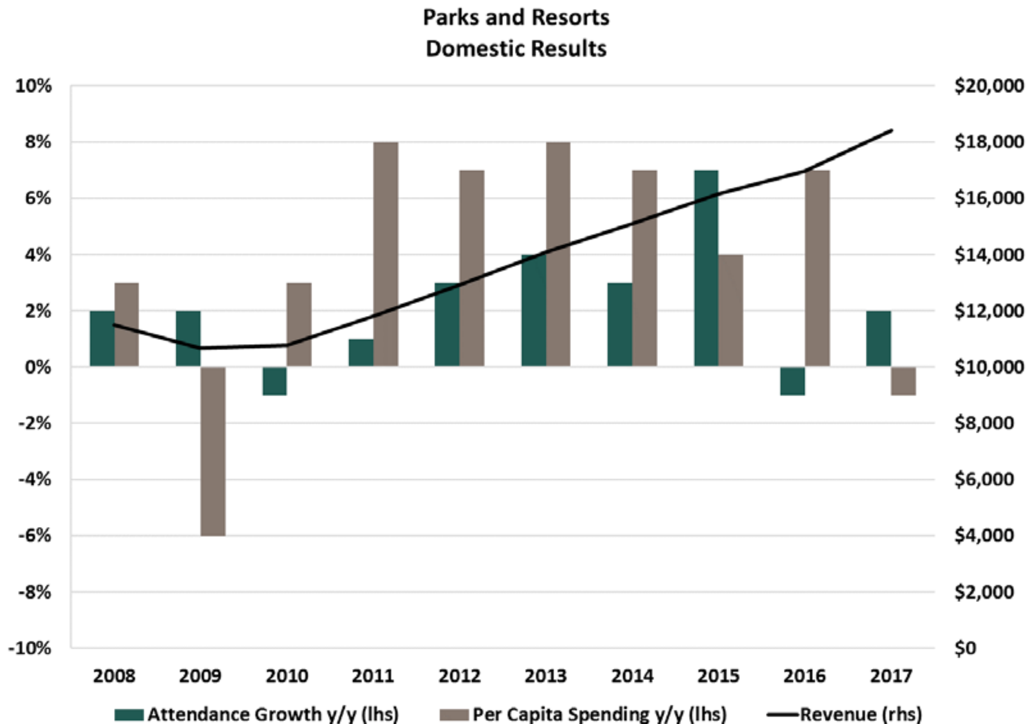
Pricing Power at Parks and Resorts



- Ticket prices at Disneyland Resort have increased consistently from $43 in 2000 to $135 in 2018
- "Now, many Disney fans are hoping that this latest price increase will become the one that finally does push a significant number of Disneyland visitors to say 'no' and stop coming to the parks. The trouble is we all are hoping that it's someone else who bails, so we can enjoy lighter crowds while we keep visiting."
  - Orange County Register, following Disneyland's 2018 price increase

Sources: SEC filings; https://www.ocregister.com/2018/02/12/has-disneyland-finally-passed-the-limit-for-price-increases/

Key Risks

- Increased financial risk due to FOXA debt
  - Reduces margin for error when converting legacy businesses to DTC
  - DIS will be less able to absorb the impact from poorly-performing movie and television franchises
- Cost of sports rights increase at a greater rate than revenue, leading to continued margin compression in Media Networks, its most profitable segment
- Technology risk of DTC migration
- Spending and traffic at Parks & Resorts becomes less resilient to economic slowdown
- Succession plan for Iger unclear (if not tumultuous)

Sources: SEC filings, D.A. Davidson

Summary

- DIS is a high quality business with sustainable competitive advantages
  - Strong studio that is a favored acquirer for content owners
  - Legacy content library
  - Exclusive live sports rights
  - Ability to monetize content through parks and consumer products
- DIS' management team has historically allocated capital well and delivered strong returns for investors
- Multiple drivers for future earnings growth
  - Continuing to acquire strategic content platforms
  - FOXA integration
  - Conversion of legacy content library and ESPN to DTC model
  - Global expansion
  - Pricing power in Parks and Resorts
- Investor worries about near-term results as DIS transitions its cable and legacy content businesses to a DTC model create opportunity to buy a great business at an attractive price

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WM Research Rating & Price Target History for Walt Disney Company (DIS) as of June 26, 2018

B/A = Buy/Add NEU = Neutral S/R = Sell/Reduce UP = Upgrade DN = Downgrade I = Initiation

The Walt Disney Co. was added to the D.A. Davidson WM Research Focus List on January 11, 2018.

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RATINGS INFORMATION

Buy/Add - Security appears undervalued based on our current view of valuation measures, expectations, and its risk profile.
Neutral - Security appears fairly valued based on our current view of valuation measures, expectations, and its risk profile.
Sell/Reduce - Security appears over-valued based on our current view of valuation measures, expectations, and its risk profile.

Rating Distribution (as of 3/31/2018)	Coverage Universe Distribution			Investment Banking Distribution		
	IR	WMR	Combined	IR	WMR	Combined
BUY/ADD (Buy)	53%	84%	55%	12%	3%	11%
NEUTRAL (Hold)	46%	16%	44%	7%	0%	6%
SELL/REDUCE (Sell)	1%	0%	1%	0%	0%	0%

WMR denotes Wealth Management Research; IR denotes Institutional Research whose rating scale is Buy, Neutral, Underperform.
Investment Banking Distribution denotes companies from whom D.A. Davidson & Co. has received compensation in the last 12 months.

Price targets are an evaluation of price potential over the next 12-18 months based upon assessment of future earnings and cash flow, comparable company valuations, growth prospects and other financial criteria. Certain risks may impede achievement of these price targets including, but not limited to, broader market and macroeconomic fluctuations and unforeseen changes in the subject company's fundamentals or business trends.

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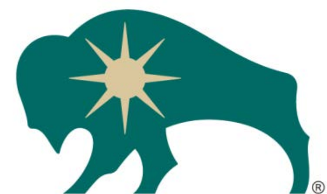

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