The Walt Disney Company

DISNEY – THE GREAT STORYTELLER

The Walt Disney Company (DIS.N, Market Capitalisation USD $257.32B)[1] is a global mass-media and entertainment powerhouse with strong brand equity and wide familiarity amongst consumers. Disney is fundamentally a branded storyteller. The company's business model revolves around leveraging its IP to drive revenue through the "Disney ecosystem" of integrated business segments. Disney is now in a transition period as it works to align the company's business model to the consumer shift away from the cable-TV media consumption model towards direct-to-consumer (DTC) streaming.

The media conglomerate reports through four business segments:

Media Networks - which earns affiliate fees for TV content, such as *Disney Channel, ESPN, National Geographic,* and *ABC.*
Studio Entertainment – the film-content creation arm which earns revenue through box office sales and licensing.
Parks, Experiences, & Consumer Products – merchandising, branded theme parks, cruise ships, and other such attractions.
Direct to Consumer & International – streaming (*Disney+, Hulu*, and *ESPN+)* and international media (*Hotstar*).

FOX ACQUISTION AND *DISNEY+* CHANGED THE NARRATIVE

In light of the ever-increasing pace of cord-cutting,[2] the company's stock had plateaued since mid-CY2015 as the market seemed singularly concerned about stagnation in the company's Media Networks segment which accounted for 41% of FY2018 revenue.[3] These concerns, coupled with uncertainty around the acquisition of 21st Century Fox, presented Elevation Capital with the opportunity to acquire shares in late 2018. In April 2019, the company unveiled its plans for launching and growing *Disney+*, its direct to consumer streaming platforms which will be packed with thousands of hours of *Marvel*, *Star Wars*, *Pixar*, *National Geographic, Fox*, and *Disney* content.

FOX MAKES DISNEY A BLOCKBUSTER POWERHOUSE

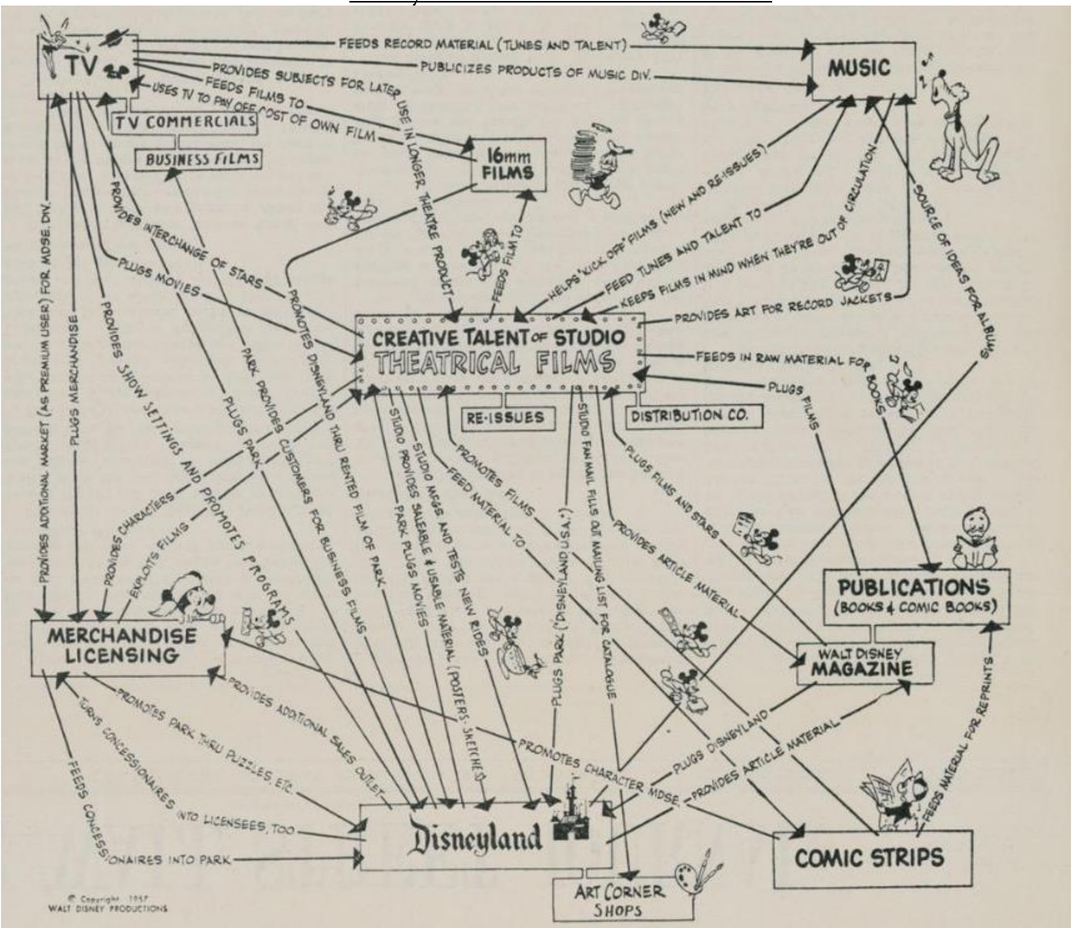
Disney is a blockbuster powerhouse. Disney produced seven of the highest grossing films in the ten years preceding 2019,[4] and six of the ten highest grossing films of all time.[5] The acquisition of *Twenty First Century Fox* expanded the pipeline dramatically with the film slate for 2019 being expanded from six releases to fourteen.[6] Disney's release of *Avengers: Endgame* in April this year attained the world record for the highest opening weekend with gross sales at over $1.2B, beating Disney's own previous record. Disney now owns rights to all characters from the Marvel Cinematic Universe which is the highest grossing film franchise of all time.[7] Disney's library of popular branded content, and the capability to create it, is the core driver of revenue through Disney's ecosystem.

←The merger may have been very little surprise for some at 20th Century Fox. The Simpsons predicted the acquisition of Fox by Disney back in November 1998.

DISNEY RECIPE FOR SUCESS UN-CHANGED

In the 1950's Walt and Roy Disney leveraged success in film creation to launch a TV channel and drive loyal fans to the company´s first theme park in Anaheim, California. They formed a business model based on leveraging their central asset, creative storytelling talent, to infuse value into a diverse array of complementary entertainment assets.

Disney business model chart from 1957



Source: Harvard Business Review[8]

While the company's portfolio of assets has changed significantly, the fundamental proposition has remained the same. The company has successfully built on this ecosystem over decades and compounded success in branded content creation to gain deep familiarity with consumers, allowing it to capture mind-space of each successive new generation. This integrated business model and strong brand equity provides the company with a wide economic moat which will ensure it thrives in the next generation of media consumption.

This is not a business which can easily be replicated.

"[Disney's business model is] not wedded to the [linear media] distribution model, what [it is] wedded to is creating great content that is branded." [9]

-Robert Iger, CEO

Walt Disney ANIMATION STUDIOS STAR WARS MARVEL PIXAR Walt Disney PICTURES

CONTENT IS KING

Premium media content gives Disney a powerful connection with the consumer, while reducing the risk of being intermediated by third-party streaming service such as Netflix. Disney CEO Robert Iger has acquired studio assets which vastly expanded and diversified Disney's IP portfolio, extending the powerful connection with the consumer, and predictably generating value for the business post-acquisition. The most recent and largest acquisition, of *Twenty First Century Fox,* gives the company access to a major film studio that will contribute strongly to Disney's IP library. In the context of shifting industry dynamics it is clear why Rupert Murdoch saw greater benefit in housing his capital with Disney over Fox's other prospective buyers.

"PLATFORM ECONOMICS 'TRUMP' LICENSING FEES"[10]

Instead of simply licensing content to third-party platforms such as Netflix in exchange for yearly fees, Disney has chosen to invest in reaching the consumer directly by building it own streaming platforms. While such actions may penalise the short-term cash flows of the company, Disney will ultimately create a more powerful, secure franchise in the long-run. Through direct subscriber relationships at the point of consumption Disney can collect data to tailor content creation in its Studio Entertainment segment and optimise offerings from Parks, Experiences, and Consumer Products. *Disney+* won't just be a *Netflix* that has thousands of hours of *Marvel*, *Star Wars*, *Pixar*, *Fox*, and *Disney* content. It will be an *Amazon* for *Marvel* action figures with *Groupon* deals for *Star Wars* roller-coasters and rooms at Disney hotels.[11]

"No matter how much technology changes….how people get their stories, we're still going to be relevant but only if we enable ourselves to be distributed and purchased by the consumer in a modern way, if we stick to the old that would be a recipe for extinction." – Robert Iger, CEO[12]

NOT A ZERO-SUM GAME

Disney has set a five-year target of 60M to 90M subscribers on *Disney+*, 40M to 60M on *Hulu*, and 8M on *ESPN+*. This is well short of Neflix's current ~139M subscribers.[13] Competing in the streaming market is not a zero-sum game. Deloitte estimates that streaming subscribers average three subscriptions per head in the US.[14] With a subscription price for *Disney+* lower than the standard or cheapest options for Netflix, Disney is betting on generating meaningful scale in the short-term by co-existing with the incumbent juggernaut as a "must have" add-on. Disney can leverage its blockbuster content and customer engagement in other business segments to achieve its targeted subscriber goals and operational profit if management plays its cards well. The company will quickly pick a lot of low-hanging fruit with its appeal to families alone.

"There's clearly room for two or three global providers in this space…I think Netflix will be very successful and I think Amazon obviously is going to be very successful and the question is who is going to be number three…I expect it to be Disney." - John Malone[15]

SUMMARY

Emerging technology shifts in consumer behaviour and the proliferation of streaming platforms represents a considerable threat to traditional media suppliers and distributors. As a content producer we believe Disney's strong brand equity, ability to create premier branded content, and scale in its established segments empower the company to transcend multiple content distribution channels mitigating risks. Increasing market confidence in Disney's streaming services and continued performance in its other core segments will result in attractive returns for those with patience to hold this blue-chip stock over the long term.

"No matter how much the marketplace is disrupted … a great story well told is going to succeed as an investment, as a financial proposition" – Bob Iger, CEO[16]

[1]As at 24/06/2019, when Share Price was $142.98.
[2] The cord-cutting trend broke a record in Q4 CY2018 when it reached the highest rate of decline in pay-TV subscriptions in the US; as reported by *Fortune* magazine on the 22nd February 2019. Accessed at this link:
http://fortune.com/2019/02/22/cord-cutting-record-netflix-comcast/
[3] The market's single-issue focus was reflected in August 2015 when the stock dropped over 9.2% the day after it was first revealed there were "modest sub-losses" in *ESPN*: Barrons *Working More Magic at Disney* by Jack Hough, accessed at this link:
https://www.barrons.com/articles/how-bob-iger-seeks-to-work-more-magic-at-disney-51546045063
[4] Data taken from Box Office Mojo. Accessed at this link:
https://www.boxofficemojo.com/yearly/?view2=worldwide&view=releasedate&p=.htm
[5] Data taken from Box Office Mojo. Accessed at this link:
https://www.boxofficemojo.com/alltime/world/
[6] As stated by the CEO Robert Iger in the Earnings Call for Quarter Two 2019 on 8 May 2019.
[7] The Marvel Cinematic Universe is the highest grossing film franchise of all time according to data provided by Box Office Mojo. Accessed at this link:
https://www.boxofficemojo.com/franchises/chart/?id=avengers.htm
[8] Harvard Business Review "*The Disney Recipe"* by Todd Zenger. Accessed at this link:
https://hbr.org/2013/05/what-makes-a-good-corporate-st
[9] Robert Iger in interview with David Fabier from CNBC on 12 April 2019. Accessed at this link:
https://www.cnbc.com/video/2019/04/12/disney-ceo-bob-iger-netflix-competitor.html
[10] See footnote 9.
[11] The Atlantic, *Disneyflix is Coming and Netflix should be Scared* by Derek Thompson. Accessed at this link:
https://www.theatlantic.com/magazine/archive/2018/05/disneyflix-netflix/556895/
[12] Seen footnote 9.
[13] Netflix reported having ~139M subscribers in its Form 10-K filing for 2018 with the SEC:
https://www.sec.gov/Archives/edgar/data/1065280/000106528019000043/form10k_q418.htm
[14] According to Deloitte's *13th Digital Media Trends Survey*. Accessed at the following link:
https://www2.deloitte.com/insights/us/en/industry/technology/digital-media-trends-consumption-habits-survey/summary.html
[15] John Malone in interview with David Fabier from CNBC on 15 November 2019. Accessed at this link:
https://www.cnbc.com/video/2018/11/14/watch-cnbcs-full-exclusive-interview-with-liberty-media-chairman-john-malone.html
[16] See footnote 6.

This summary report was written in July 2019.