The Walt Disney Co DIS (XNYS)

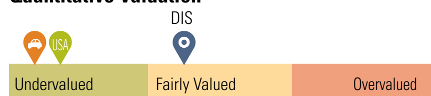
Morningstar Rating	Last Price	Fair Value Estimate	Price/Fair Value	Trailing Dividend Yield %	Forward Dividend Yield %	Market Cap (Bil)	Industry	Stewardship
★★★	132.04 USD	130.00 USD	1.02	1.30	1.33	237.63	Media - Diversified	Standard
31 May 2019 22:06, UTC	31 May 2019	08 Sep 2017 06:04, UTC		31 May 2019	31 May 2019	31 May 2019		

Morningstar Pillars

	Analyst	Quantitative
Economic Moat	Wide	Wide
Valuation	★★★	Fairly Valued
Uncertainty	Medium	Medium
Financial Health	—	Moderate

Source: Morningstar Equity Research

Quantitative Valuation



	Current	5-Yr Avg	Sector	Country
Price/Quant Fair Value	1.01	0.93	0.80	0.83
Price/Earnings	14.8	19.2	16.2	20.1
Forward P/E	19.7	—	12.3	13.9
Price/Cash Flow	14.7	14.6	10.2	13.1
Price/Free Cash Flow	22.8	22.3	17.7	19.5
Trailing Dividend Yield%	1.30	1.41	2.46	2.35

Source: Morningstar

Bulls Say

- The parks and resorts segment has rebounded strongly from the recession, and the opening of Disneyland Shanghai should provide additional momentum.
- The addition of the Star Wars franchise broadens the demographics that the company can address. Additionally, Disney's strong distribution and merchandising capabilities should help to speed the monetization of the Lucasfilm acquisition.
- Although making movies is a hit-or-miss business, Disney's large library of content with popular franchises and characters reduces this volatility over time.

Bears Say

- The business model for the media networks depends on the continued growth of retransmission and reverse compensation fees. Any slowdown in the growth of these fees, perhaps because the pay-television business begins to shrink, would hurt the profitability of this segment.
- Increases in the cost of popular programming such as sports events and television series could adversely affect margins at ESPN and ABC.
- Developing mass-market hit programs can be unpredictable, especially as media fragmentation continues.

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Comcast Gives Disney Control of Hulu for a Piece of the Upside; Firms Focused on Their DTC Efforts

Business Strategy and Outlook

Neil Macker, CFA, Analyst, 12 April 2019

We believe Disney is successfully transforming its business to deal with the ongoing evolution within the media industry.

ESPN remains the crown jewel of Disney's media networks segment, which now includes the recently acquired Fox cable entertainment channels like FX. ESPN dominates domestic sports television with its 24-hour programming on its growing number of networks. It profits from the highest affiliate fees per subscriber of any cable channel and generates revenue from advertisers interested in reaching adult males ages 18-49, a key demographic. The Disney Channel also benefits from attractive economics, as its programming consists of internally generated hits with Disney's vast library of feature films and animated characters. We expect the unique content on ESPN and Disney Channel will provide the firm with a softer landing than its peers as viewing transfers to an over-the-top world over the next decade.

Disney's other components rely on the world-class Disney brand, sought after by children and trusted by parents. Over the past decade, Disney has demonstrated its ability to monetize its characters and franchises across multiple platforms--movies, home video, merchandising, theme parks, and even musicals. This stable of animated franchises will continue to grow as more popular movies get released by the animated studio and Pixar. Disney has arranged the Marvel universe to create a series of interconnected films and product tie-ins. With the acquisition of Lucasfilm, the firm has positioned the Star Wars franchise in the same manner. Disney's theme parks and resorts are almost impossible to replicate, especially considering the tie-ins with its franchises and other business lines.

The firm's DTC efforts, Hulu, ESPN+, and Disney+, will benefit from the new content being created at Disney and Fox television and film studios as well as the deep libraries at the studios. We expect that Disney+ will leverage this content to again create a large, valuable subscriber base.

Analyst Note

Neil Macker, CFA, Analyst, 14 May 2019

Disney and Comcast have agreed on a unique and complex deal that immediately hands over operational control of Hulu to Disney while providing Comcast the ability to monetize some of the upside in Hulu. The deal will help Disney reach its goals for Hulu, which it views as the third leg in its direct-to-consumer efforts along with Disney+ and ESPN+. On the other side, Comcast can now fully focus on its NBCUniversal streaming service, which will launch in mid-2020. We are maintaining our wide moat ratings for both firms and our fair value estimates of $130 and $45 for Disney and Comcast, respectively.

Under the deal, Comcast gains a put option and Disney a call option on Comcast's 33% stake in Hulu. The options can be exercised as soon as January 2024, with the value of the total Hulu equity set to at least $27.5 billion. Recall that AT&T recently sold its 10% stake in the streaming service back to the firm at a total valuation of $15 billion, which implies roughly 13% annual compounded growth for Hulu's valuation over the next five years. The firms can also ask for an independent valuation of Hulu when the option is exercised, which could result in a higher valuation. Comcast also has the option to fund or not fund any future capital calls, which will be capped to $1.5 billion in equity funding with any additional capital required funded by non-diluting debt. Comcast's equity stake can not be diluted below 21% of Hulu, meaning that Comcast will receive at least $5.8 billion for its ownership stake.

Comcast also agreed to extend its NBCU content licensing agreement and Hulu Live carriage agreement for NBCU channels until late 2024, though oddly NBCU can also end most of these arrangements in three years. Comcast also gained the right to add programming that it has licensed exclusive to Hulu to its own streaming service a year from now, but Hulu would then pay a reduced license fee. The cable giant will also have the right to distribute Hulu on the X1 platform.

Economic Moat

Neil Macker, Analyst, 12 April 2019

We assign Walt Disney a wide economic moat rating. Its

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media networks segment and collection of Disney-branded businesses have demonstrated strong pricing power in the past decade. We believe that the addition of the entertainment assets from Twenty-first Century Fox should help the firm continue to generate excess returns on capital despite operating in the increasingly competitive media marketplace.

One of our guiding premises in media is that the value of content continues to increase even as the distribution markets mutate. Despite changes in distribution, pay-television penetration remains at above 75% of U.S. households. Even without a pay-television subscription, most cord-cutters still consume video content, and many use antennas to capture signals, providing content creators with an additional avenue to generate revenue from these viewers. Over-the-top providers like Netflix and Amazon Prime are creating their own content and other large media firms like Disney and WarnerMedia are going direct to consumer. However, these services require deep libraries to gain and retain subscribers and many of them are looking for third-party content to supplement their own original content. Given the ongoing demand for content, we believe content creation is not a zero-sum game, as high-quality content will always find an outlet.

The ESPN network is the dominant player in U.S. sports entertainment. Its position and brand strength empower it to charge the highest subscriber fees of any cable network, which in turn generate sustainable profits. ESPN uses these profits to reinforce its position by acquiring long-term sports programming rights, including the NFL, the NBA, and college football and basketball. The ESPN brand has been extended to create sister channels (ESPN2, ESPN Classic, and SEC Network), the pre-eminent sports news website (ESPN.com), and an OTT streaming service (ESPN+). While the decline in subscribers at traditional distributors has negatively affected revenue for ESPN, the channel is a core network for every major OTT pay-television distributor despite its high fees. Given the importance of live sports to the pay-television bundle, we expect that the main ESPN channels will remain key components of any pay-television offering.

Disney also owns ABC, one of four major U.S. national broadcast networks and affiliated TV stations in eight markets (including six of the top 10 markets). While network ratings have declined over the past decade, the broadcast networks are the only outlet to reach almost all of the 120 million households in the U.S. Network ratings still outpace cable ratings and provide advertisers with one of the only remaining methods for quickly reaching a large number of consumers at once.

The media network component also includes the Disney Channel, one of two dominant cable networks for children, which allows Disney to introduce and extend its strong content portfolio. With the purchase of the Fox entertainment assets, Disney has enhanced its pay-television network lineup by adding multiple channels with strong appeal to adults. FX and FXX have created a platform for critically acclaimed original scripted shows, most of which are generated and owned by the Fox television studios, which Disney now owns.

The studio side of Disney has been strengthened via the Fox acquisition, particularly on the television production side. The Fox television studios currently produce or co-produce 70% of the prime-time slate on Fox. The Fox studios have placed a number of their programs on other broadcast and cable networks, including Modern Family on ABC and Homeland on Showtime. The critical acclaim of its studio-produced content, along with the studio's willingness to sell shows to the right distributor, created a virtuous cycle in which the creators of its hit shows had an incentive to launch new shows with the studio, as strong ratings attract other creators to the platform. We believe this cycle will be enhanced by the addition of more in-house platforms, including Hulu and Disney+.

While the addition of Fox Searchlight should help Disney garner more Oscar nominations, the film side of the firm is already running full bore, as Disney was the top-grossing studio in the U.S. for the last three years, with over $3 billion in box office receipts in 2016 and 2018. As recently as 2010, the firm's success at the box office depended heavily on Pixar. However, Disney now has six studios (Marvel, Pixar, Lucasfilm, Disney Animation, Disney Live Action, and 20th Century Fox) with the ability to generate blockbuster films annually. With the addition of Fox, Disney now owns 12 of the top 20 films in terms of worldwide box office grosses, with nine of the movies released in last five years.

Disney has mastered the process of monetizing its world-renowned characters and franchises across multiple platforms. The company has moved beyond the historical view of a brand that children recognize and

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parents trust by acquiring and creating new franchises and intellectual property. Recent success with the Pixar and Marvel franchises has helped to create new opportunities with adults who may have outgrown their attraction to the company's traditional characters. The acquisition of Lucasfilm added another avenue to remain engaged with children and adults. Disney uses the success of its filmed entertainment not only to drive Disney+ subscriptions, but also to create new experiences at its parks and resorts, merchandising, TV programming, and even Broadway shows. Each new franchise deepens the Disney library, which will continue to generate value over the years.

Fair Value & Profit Drivers

Neil Macker, Analyst, 12 April 2019

Our fair value estimate for Disney is $130, which reflects the impact of the acquired Fox assets. This estimate implies a price of approximately 18 times our fiscal 2019 earnings per share forecast and an enterprise value of roughly 12 times estimated fiscal 2019 adjusted EBITDA. We expect average annual top-line growth of about 10% through fiscal 2023 with annual organic growth of 5% and 4% for the Disney and Fox assets, respectively.

We project average annual sales growth from the media networks to be 3% (4% for affiliate fees and flat for advertising), as the loss of subscribers at ESPN and other pay TV channels will be offset by per-sub affiliate fee increases domestically and international growth. We also expect new bundles to provide a boost to the segment. We project 5% average annual sales growth during the next five years for the new parks, experiences, and consumer products segment. Investments that required heavy capital expenditures over the past few years are now bearing fruit, including the launch of Shanghai Disneyland in fiscal 2016. We forecast operating margin for the segment to exceed 25% by fiscal 2023.

We have modeled 4% average annual growth for the studio segment due to the strong slate of Marvel movies over the next few years and the growth in television, subscription VOD, and other distribution outlets as Disney+ ramps up. Disney is now reporting revenue on a gross basis, meaning the growth in studio revenue from Disney+ will be eliminated on a consolidated basis.

We estimate 22% annual growth for the new DTC and international segment as we are modeling strong subscriber growth for Disney+. We expect the service to hit 55 million paid subscribers by the end of fiscal 2023. This growth assumes a strong international rollout and continued low prices for the service in the U.S and internationally. We do not project that the segment will be profitable by the end of our five-year projection.

We project Disney's overall operating margin will improve to 24% in fiscal 2023 from 23% in fiscal 2019 as the losses at the DTC segment are offset by margin improvements at the studio and parks segments.

Risk & Uncertainty

Neil Macker, Analyst, 12 April 2019

Disney’s results could suffer if the company cannot adapt to the changing media landscape. Basic pay-television service rates have continued to increase, which could cause consumers to cancel their subscriptions or reduce their level of service. ESPN garners the highest affiliate fees of any basic cable channel, and a decrease in pay-TV penetration would slow revenue growth. The cost of sports rights may continue to skyrocket, putting pressure on margins. The company's ad-supported broadcast networks, along with the theme parks and consumer products, will suffer if the economy weakens. Making movies is a hit-or-miss business, which could result in big swings in profitability for the filmed entertainment segment.

Stewardship

Neil Macker, Analyst, 12 April 2019

While we rate Disney's stewardship of shareholder capital as Standard, we believe the current management team is in the upper end of the tier of its direct peers. Chairman and CEO Bob Iger began his tenure as CEO in October 2005 and chairman in March 2012 and is now scheduled to serve until June 2021 due to the acquisition of the Fox entertainment assets. The resignation of COO Tom Staggs in April 2016, formerly viewed as the successor to Iger, had thrown the previous orderly succession plan out the window. While we had believed that the board would look outside the company for the next CEO, Disney reorganized the firm in March 2018 and effectively created another internal two-man race to succeed Iger. The two contestants are Kevin Mayer, former chief strategy officer and now head of the newly created direct-to-consumer and international segment, and Bob Chapek, the head of the combined parks & resorts and consumer products segment. We believe that Meyer is the current frontrunner

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due to both his role in acquiring many of the firm’s highly valued assets such as Pixar, Marvel Lucasfilm, and the Fox deal as well as his new position which places him at the forefront of helping the firm navigate the evolving media landscape.

After the loss of former CFO Jay Rasulo in 2015, the company drew on its deep executive bench to promote Christine McCarthy to CFO. McCarthy has a long tenure with the firm and significant experience in the finance function at Disney as the firm's treasurer.

Under Iger, Disney has embraced new technology and reinvigorated its commitment to high-quality content. He understood the importance of animation to the company early in his tenure, purchasing computer animation studio Pixar in 2006 and then resurrecting Disney's own studio. Iger also purchased two major content creators (Marvel and Lucasfilm) that expanded the demographics served by the company. Beyond Pixar, the company has made significant investment in new technology/distribution including buying Club Penguin (an MMO for children), Maker Studios (a network of YouTube channels), and its investment in BAMTech (a leader in online live-streaming). The Fox acquisition transforms the company by adding additional studios, international assets, and direct to consumer platforms. We believe Iger will remain on the lookout for M&A opportunities, specifically in new digital media, but we project that the deals will be on the smaller end of the spectrum.

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Analyst Notes Archive

Changes in Media Continue to Pressure Pay TV Bundle; Comcast and Disney Best Positioned to Adapt

Neil Macker, Analyst, 04 January 2019

The constantly evolving media ecosystem has put tremendous pressure on the traditional pay-television bundle model as people find new ways to consume content. Three years ago, we offered the view that the traditional pay-television bundle was broken but not dead. Since then, there have been a number of new entrants that use the Internet to distribute pay television, so-called over-the-top services. However, the pace of change within the pay-television delivery marketplace remains frustratingly slow and the price of the traditional bundle is stubbornly staying much higher than it needs to be. As a result, subscribers continue to flee the traditional delivery methods from cable, satellite, and telecom firms.

While the new OTT entrants have not forced traditional platforms to lower their pricing, these newer competitors have helped stabilize the overall pay-television market by signing up 7 million subscribers over the past few years. The subscriber growth at the new platforms has been driven by smaller households and "cord shavers," who value the bundle but not at the much higher price of traditional services. However, the growth at some of the largest OTT services has slowed down.

As we examine our coverage across media and cable, two firms, Walt Disney and Comcast, stand out as having both a wide moat and the ability to sustain their competitive position in the face of the ongoing changes across the pay-television landscape. Both firms are trading well under our fair value estimates of $130 for Disney and $42 for Comcast.

NBCUniversal Joins the Streaming Wars

Neil Macker, Analyst, 15 January 2019

Competition within the subscription video on demand, or SVOD, market in the U.S. continues to increase as Comcast's NBCUniversal announced its plans on Jan. 14 to launch a new streaming service in 2020. Comcast, like other traditional media firms, faces the challenge of establishing direct customer relationships without disrupting the highly-lucrative traditional pay-television ecosystem. However, we believe its SVOD proposed approach is superior to AT&T's plans for WarnerMedia. Unlike Comcast, AT&T's legacy consumer segment remains heavily dependent on profits from traditional television distribution without a strong Internet access business to fall back on. We aren't planning on any changes to our moat ratings or fair value estimates across the media and telecom spaces following Comcast's announcement.

In a unique move, the ad-supported version of Comcast's planned SVOD service will be free to pay-TV subscribers with an option to remove ads for a fee. For non-pay-TV subscribers, the service will reportedly cost $12 per month according to CNBC. Management at NBCU have publicly remarked in the past that the firm does not want to endanger the firm's current business model and that the economics around a streaming service are "challenging." By tying its product directly to pay-TV subscriptions, NBCU is attempting to solve both problems at once, as the link to pay television subscriptions should help the service quickly gain scale and allow NBCU to generate its target of $5 in ad revenue per month for each subscriber. However, by pricing the non-pay-TV subscriber version at $12, NBCU is effectively ceding the value spot for that market to Disney+, which we expect to launch at a price under $10, while also likely making the NBCU service unattractive to the vast majority of customers.

DTC and Fox Occupy Center Stage at Disney; Strong Start to Important Transitional Year

Neil Macker, Analyst, 05 February 2019

Disney began fiscal 2019 with a strong first quarter that provided insight into the direct-to-consumer business, which we found encouraging. The disclosed projected impact from not licensing its movies reinforces our belief that Disney is much better served by reserving its content for its DTC effort than by arming its competitors. The Fox media assets and the DTC efforts will continue to be the focus as Disney works through an important transitional year. We are maintaining both our wide moat rating and our fair value estimate of $130.

Revenue for the first quarter were flat year over year at $15.3 billion. The reorganized media networks segment grew revenue 7% due to growth at both cable networks and the broadcasting segment. Affiliate fee revenue was up 7% in the quarter as higher rates offset the 1% decline in subscribers. The rate of subscriber losses has decreased for six consecutive quarters, driven by the continued

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consumer uptake of the OTT TV services. Ad revenue at broadcast networks was up 6% as higher pricing and local political ad spending offset lower impressions due to ratings. ABC continued to see strong ad pricing growth in the current quarter, with scatter pricing running 40% above the upfront levels.

The new parks, experiences & consumer products segment posted 5% growth, as the park and resort business continues to report strong results. Domestic attendance was flat but per capita spending grew by 7% and per room spending improved by 5%. The increased admission pricing does not appear to have negatively impacted attendance or dampened in-park spending. Revenue at the studio fell 27% due to a weak theatrical slate and a difficult comp. Given the record-breaking 2018 box office performance, the studio business will face difficult comps throughout 2019. Segment operating margin for the firm fell by about 210 basis points to 23.9% as the revenue growth was more than offset by the increased programming costs and weaker studio results.

Apple TV+ Opens With a Thud; New Service Launches Into Very Competitive Market in Fall 2019

Neil Macker, Analyst, 25 March 2019

At its Show Time event on March 25, Apple unveiled its long-awaited video streaming service, Apple TV+, which will feature its original content. The service will launch this fall as an ad-free service in over 100 countries for a price to be disclosed later. While Apple has secured projects from several high-profile creators and actors, including Oprah Winfrey and Steven Spielberg, the amount of content available at launch appears paltry when compared with Netflix and Disney+. By waiting to launch until this fall, Apple will be competing against not only established services like Netflix and Hulu but also against other new services from media firms with much deeper content libraries like Disney and WarnerMedia. We maintain our wide moat rating and $130 fair value estimate for Disney along with our narrow moat ratings and fair value estimates of $200, $135, and $37 for Apple, Netflix, and AT&T, respectively.

After an overly long video about creativity, Apple essentially held a network upfront presentation with creators and actors coming onstage to discuss their respective shows. However, the presentations did not feature any clips from the shows, and Apple overall showed one brief montage video for the entire TV+ presentation. While the star power of the celebrities on stage was impressive, we found the lack of show clips disappointing.

Between the lack of clips and price point, we did not see any reason for either Netflix or the traditional media firms to be worried about Apple at this point. While Apple's entrance into the space will drive up the ever-increasing cost of producing content, we note that the estimated $3 billion in content spending by Apple prior to launch is equivalent to the combined annual spending by Discovery and Scripps as separate firms. While the two media firms focus on lower-cost unscripted content, we think the relatively low total spending by Apple highlights the lack of content that will be ready for the service's launch in the fall.

Disney Strikes Back With $6.99 Price for Disney+; Impressive Content Quality and Depth on Display

Neil Macker, Analyst, 12 April 2019

Disney came out swinging at its investor day with an aggressive price point for Disney+, which will launch Nov. 12 for $6.99 per month or $69.99 annually. Unlike the disappointing reveal for Apple TV+, Disney not only provided a firm launch date and price but also showed and outlined the amount and quality of content that will be available at launch. Management surprisingly offered guidance of 60 million-90 million subscribers by the end of fiscal 2024. We think the wide range reflects the uncertainty around the timing of launches in international markets, which are expected to account for two thirds of subscribers. We are maintaining our wide moat rating and $130 fair value estimate.

While the investor day touched on all the firm's direct-to-consumer services, the focus was on Disney+. Management is pursuing a very aggressive strategy, as it does not expect Disney+ to achieve operating income profitability until fiscal 2024, nearly five years after launch. Cash content spending on Disney+ originals will hit $2.5 billion in fiscal 2024 with licensed content spending, internally sourced from Disney's studios, hitting a similar level. While this number is well below $12 billion in cash spending at Netflix in 2018, Disney+ is essentially buying the pay-one window for Disney movies after they've shown in theaters, so the cost borne by Disney+ is much lower than the actual production cost.

At launch, we expect that the Disney+ service will be very

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The Walt Disney Co DIS (XNYS)

Morningstar Rating	Last Price	Fair Value Estimate	Price/Fair Value	Trailing Dividend Yield %	Forward Dividend Yield %	Market Cap (Bil)	Industry	Stewardship
★★★	132.04 USD	130.00 USD	1.02	1.30	1.33	237.63	Media - Diversified	Standard
31 May 2019 22:06, UTC	31 May 2019	08 Sep 2017 06:04, UTC		31 May 2019	31 May 2019	31 May 2019		

attractive to many consumers, given the low price point and deep content library. The service will cost just over 50% of the $12.99 monthly price of Netflix, while the annual price is only 45%. Disney+ will launch with 18 of the 21 released Pixar movies, over 35 Disney Animation movies, four Marvel films including Captain Marvel, eight of the 10 released Star Wars films, The Simpsons, and numerous TV episodes from Disney Channel and National Geographic. All content will be downloadable, a boon to parents.

Disney Sells Fox Sports Networks to Sinclair; Focus Remains on Integrating Fox Entertainment Assets

Neil Macker, Analyst, 06 May 2019

Walt Disney announced the sale of the 21 regional sports networks it acquired in the Twenty-First Century Fox transaction to Sinclair Broadcasting for $9.6 billion. Disney was required to sell the stations within 90 days of the closing of the Fox transaction as part of the consent decree with the U.S. Department of Justice. While the price of the deal is lower than we had expected, the difference does not change our positive view about the deal or the impact of the Fox entertainment assets on Disney. The focus at Disney will be squarely on the integration and monetization of the Fox assets. We are maintaining our wide moat rating and $130 fair value estimate.

We believe that the lack of bidding interest in the regional sports networks from a number of media firms is due to the structural issues with the networks. While the concept of a sports rights bubble for the major sports continues to float around the investor community, we think any bubble in local rights has been steadily deflating over the past couple of years. During the early part of the decade, cable companies bid excessively on a handful of rights deals, notably in Los Angeles and Houston, and subsequent performance has suffered as these networks struggled to get carriage deals.

While the Fox regional sports networks carry multiple sports, all RSNs depend on the performance of a small number of local teams. If the teams are not performing well, interest and ratings decline with larger sustained declines for teams with long-term performance issues. National sports broadcasters like ESPN also deal with ebbs and flows, but they benefit from the overall popularity of each sport and can weather any one team's demise. The national deals can also confer rights to leaguewide highlights or exclusive footage, which ESPN or Fox Sports 1 use to populate their news shows or league-specific programming.

Disney Beats 2Q Expectations; Disney+ Launch and Fox Integration Underpin Transformational 2019

Neil Macker, Analyst, 08 May 2019

Disney posted a slightly better than expected fiscal 2019 second quarter as both revenue and EBITDA beat consensus expectations. The firm continues to execute well which should help with the integration of the Fox entertainment assets and the launch of Disney+ later this calendar year. These two events are the key parts of a transformational year for the media giant as it jumps into the highly competitive direct-to-consumer market. We are maintaining both our wide moat rating and our fair value estimate of $130. With shares trading in 3-star territory, investors may want to wait for a pullback prior to investing.

Revenue for the second quarter was up 3% year over year at $14.9 billion. The media networks segment posted flat revenue growth as affiliate fee revenue growth was offset by lower advertising and distribution revenue. Affiliate fee revenue was up 4% in the quarter as the 7% higher rates more than offset the 2% decline in subscribers and the 1% negative impact of the new revenue recognition standard. Advertising revenue at broadcast networks was down over 3% as higher pricing was more than offset by lower impressions due to ratings. Ad revenue at the cable networks fell 2% as ESPN aired both college football playoff semi-final games last year versus none this year.

The parks, experiences & consumer products segment posted 5% year-over-year growth, as the parks and resorts business remains a key growth driver for Disney. Compared with last year, domestic attendance was up only 1% but per capita spending grew by 4% and per room spending improved by 1%. The increased admission pricing does not appear to have deterred park goers or dampened their in-park spending. Revenue at the studio fell 15% due to a difficult comp at the box office and home distribution. Segment operating margin for the firm fell to 25.6% from 29.1% as the revenue growth was more than offset by the increased programming costs and weaker studio results.

Comcast Gives Disney Control of Hulu for a Piece of the Upside; Firms Focused on Their DTC Efforts

Neil Macker, Analyst, 14 May 2019

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Disney and Comcast have agreed on a unique and complex deal that immediately hands over operational control of Hulu to Disney while providing Comcast the ability to monetize some of the upside in Hulu. The deal will help Disney reach its goals for Hulu, which it views as the third leg in its direct-to-consumer efforts along with Disney+ and ESPN+. On the other side, Comcast can now fully focus on its NBCUniversal streaming service, which will launch in mid-2020. We are maintaining our wide moat ratings for both firms and our fair value estimates of $130 and $45 for Disney and Comcast, respectively.

Under the deal, Comcast gains a put option and Disney a call option on Comcast's 33% stake in Hulu. The options can be exercised as soon as January 2024, with the value of the total Hulu equity set to at least $27.5 billion. Recall that AT&T recently sold its 10% stake in the streaming service back to the firm at a total valuation of $15 billion, which implies roughly 13% annual compounded growth for Hulu's valuation over the next five years. The firms can also ask for an independent valuation of Hulu when the option is exercised, which could result in a higher valuation. Comcast also has the option to fund or not fund any future capital calls, which will be capped to $1.5 billion in equity funding with any additional capital required funded by non-diluting debt. Comcast's equity stake can not be diluted below 21% of Hulu, meaning that Comcast will receive at least $5.8 billion for its ownership stake.

Comcast also agreed to extend its NBCU content licensing agreement and Hulu Live carriage agreement for NBCU channels until late 2024, though oddly NBCU can also end most of these arrangements in three years. Comcast also gained the right to add programming that it has licensed exclusive to Hulu to its own streaming service a year from now, but Hulu would then pay a reduced license fee. The cable giant will also have the right to distribute Hulu on the X1 platform.

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MORNINGSTAR

The Walt Disney Co DIS ★★★Q 01 Jun 2019 02:00 UTC

Last Close	Fair Value Q	Market Cap	Sector	Industry	Country of Domicile
31 May 2019	01 Jun 2019 02:00 UTC	31 May 2019			
132.04	130.88	237.6 Bil	Consumer Cyclical	Media - Diversified	USA United States

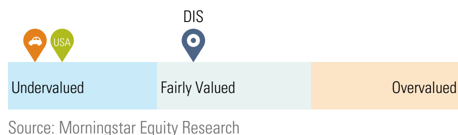
There is no one analyst in which a Quantitative Fair Value Estimate and Quantitative Star Rating are attributed to; however, Mr. Lee Davidson, Head of Quantitative Research for Morningstar, Inc., is responsible for overseeing the methodology that supports the quantitative fair value. As an employee of Morningstar, Inc., Mr. Davidson is guided by Morningstar, Inc.'s Code of Ethics and Personal Securities Trading Policy in carrying out his responsibilities. For information regarding Conflicts of Interests, visit http://global.morningstar.com/equitydisclosures

Company Profile

Walt Disney owns the rights to some of the most globally recognized characters, from Mickey Mouse to Luke Skywalker. These characters and others are featured in several Disney theme parks around the world. Disney makes live-action and animated films under studios such as Pixar, Marvel, and Lucasfilm, and also operates media networks including ESPN and several TV production studios. Disney recently reorganized into four segments with one new segment, direct-to-consumer and international. The new segment includes the

Quantitative Scores

		Scores All	Rel Sector	Rel Country
Quantitative Moat	Wide	100	100	100
Valuation	Fairly Valued	12	9	16
Quantitative Uncertainty	Medium	100	100	99
Financial Health	Moderate	84	68	84



Source: Morningstar Equity Research

Valuation

	Current	5-Yr Avg	Sector Median	Country Median
Price/Quant Fair Value	1.01	0.93	0.80	0.83
Price/Earnings	14.8	19.2	16.2	20.1
Forward P/E	19.7	—	12.3	13.9
Price/Cash Flow	14.7	14.6	10.2	13.1
Price/Free Cash Flow	22.8	22.3	17.7	19.5
Trailing Dividend Yield %	1.30	1.41	2.46	2.35
Price/Book	2.6	3.6	1.6	2.4
Price/Sales	3.3	3.2	0.9	2.4

Profitability

	Current	5-Yr Avg	Sector Median	Country Median
Return on Equity %	20.0	21.2	12.2	12.9
Return on Assets %	8.6	10.3	5.4	5.2
Revenue/Employee (K)	297.3	282.6	566.3	325.9

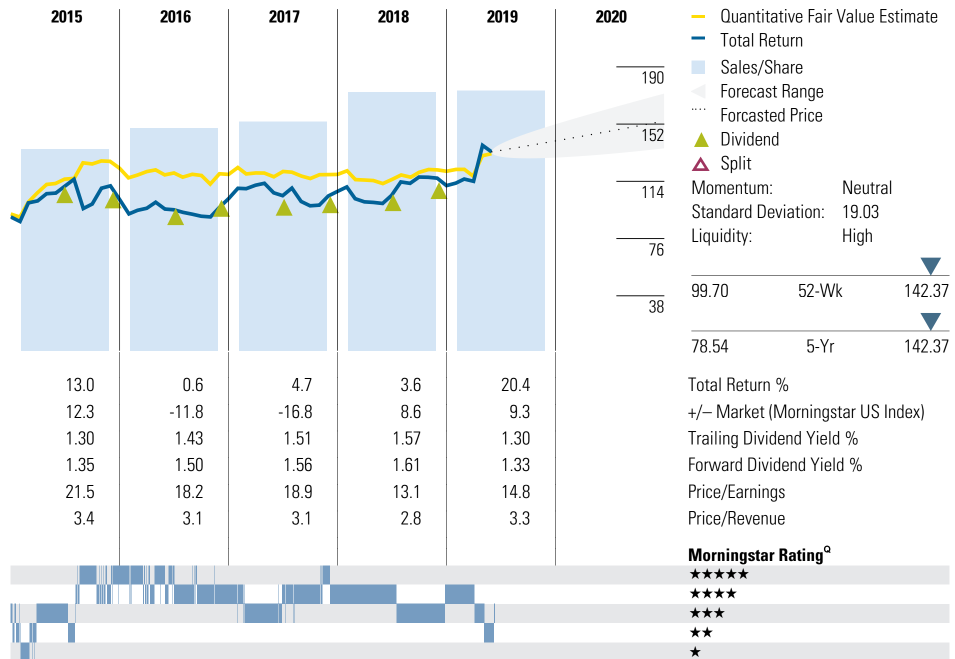
Financial Health

	Current	5-Yr Avg	Sector Median	Country Median
Distance to Default	0.7	0.7	0.6	0.5
Solvency Score	371.5	—	486.0	552.4
Assets/Equity	2.0	2.1	1.8	1.7
Long-Term Debt/Equity	0.4	0.4	0.2	0.4

Growth Per Share

	1-Year	3-Year	5-Year	10-Year
Revenue %	7.8	4.3	5.7	4.6
Operating Income %	7.0	3.9	9.4	7.1
Earnings %	46.9	19.5	19.9	13.9
Dividends %	7.7	-2.5	17.5	17.0
Book Value %	18.1	7.2	5.2	6.6
Stock Total Return %	34.5	11.3	10.7	19.4

Price vs. Quantitative Fair Value



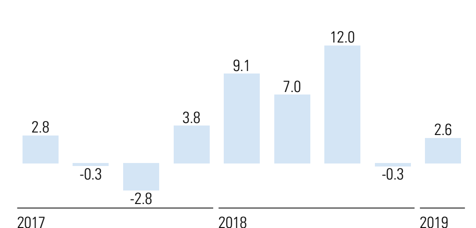
2015	2016	2017	2018	2019	2020	
13.0	0.6	4.7	3.6	20.4		Total Return %
12.3	-11.8	-16.8	8.6	9.3		+/– Market (Morningstar US Index)
1.30	1.43	1.51	1.57	1.30		Trailing Dividend Yield %
1.35	1.50	1.56	1.61	1.33		Forward Dividend Yield %
21.5	18.2	18.9	13.1	14.8		Price/Earnings
3.4	3.1	3.1	2.8	3.3		Price/Revenue

2014	2015	2016	2017	2018	TTM	Financials (Fiscal Year in Mil)
48,813	52,465	55,632	55,137	59,434	59,760	Revenue
8.4	7.5	6.0	-0.9	7.8	0.5	% Change
11,540	13,224	14,358	13,873	14,837	13,816	Operating Income
22.1	14.6	8.6	-3.4	6.9	-6.9	% Change
7,501	8,382	9,391	8,980	12,598	13,478	Net Income
9,780	10,909	13,213	12,343	14,295	13,546	Operating Cash Flow
-3,311	-4,265	-4,773	-3,623	-4,465	-4,811	Capital Spending
6,469	6,644	8,440	8,720	9,830	8,735	Free Cash Flow
13.3	12.7	15.2	15.8	16.5	14.6	% Sales
4.26	4.90	5.73	5.69	8.36	8.93	EPS
26.0	15.0	16.9	-0.7	46.9	6.8	% Change
3.48	3.82	4.71	5.40	6.48	5.79	Free Cash Flow/Share
0.86	1.81	1.42	1.56	1.68	1.72	Dividends/Share
26.78	27.56	27.50	28.35	30.73	49.97	Book Value/Share
1,700	1,653	1,600	1,500	1,500	1,800	Shares Outstanding (Mil)
						Profitability
16.6	18.7	21.4	21.2	28.0	20.0	Return on Equity %
9.1	9.7	10.4	9.6	13.0	8.6	Return on Assets %
15.4	16.0	16.9	16.3	21.2	22.6	Net Margin %
0.59	0.61	0.62	0.59	0.61	0.38	Asset Turnover
1.9	2.0	2.1	2.3	2.0	2.4	Financial Leverage
45.9	45.9	46.1	45.0	44.9	43.4	Gross Margin %
23.6	25.2	25.8	25.2	25.0	23.1	Operating Margin %
12,676	12,773	16,483	19,119	17,084	37,803	Long-Term Debt
44,958	44,525	43,265	41,315	48,773	89,938	Total Equity
2.1	2.2	2.1	2.0	2.1	2.0	Fixed Asset Turns

Quarterly Revenue & EPS

Revenue (Mil)	Dec	Mar	Jun	Sep	Total
2019	15,303.0	14,922.0	—	—	—
2018	15,351.0	14,548.0	15,228.0	14,307.0	59,434.0
2017	14,784.0	13,336.0	14,238.0	12,779.0	55,137.0
2016	15,244.0	12,969.0	14,277.0	13,142.0	55,632.0
Earnings Per Share ()					
2019	1.86	3.55	—	—	—
2018	2.91	1.95	1.95	1.55	8.36
2017	1.55	1.50	1.51	1.13	5.69
2016	1.73	1.30	1.59	1.10	5.73

Revenue Growth Year On Year %



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MORNINGSTAR

Research Methodology for Valuing Companies

Qualitative Equity Research Overview

At the heart of our valuation system is a detailed projection of a company's future cash flows, resulting from our analysts' research. Analysts create custom industry and company assumptions to feed income statement, balance sheet, and capital investment assumptions into our globally standardized, proprietary discounted cash flow, or DCF, modeling templates. We use scenario analysis, in-depth competitive advantage analysis, and a variety of other analytical tools to augment this process. We believe this bottom-up, long-term, fundamentally based approach allows our analysts to focus on long-term business drivers, which have the greatest valuation impact, rather than short-term market noise.

Morningstar's equity research group ("we," "our") believes that a company's intrinsic worth results from the future cash flows it can generate. The Morningstar Rating for stocks identifies stocks trading at an uncertainty-adjusted discount or premium to their intrinsic worth—or fair value estimate, in Morningstar terminology. Five-star stocks sell for the biggest risk-adjusted discount to their fair values whereas 1-star stocks trade at premiums to their intrinsic worth.

Four key components drive the Morningstar rating: (1) our assessment of the firm's economic moat, (2) our estimate of the stock's fair value, (3) our uncertainty around that fair value estimate and (4) the current market price. This process ultimately culminates in our single-point star rating.

1. Economic Moat

The concept of an economic moat plays a vital role not only in our qualitative assessment of a firm's long-term investment potential, but also in the actual calculation of our fair value estimates. An economic moat is a structural feature that allows a firm to sustain excess profits over a long period of time. We define excess economic profits as returns on invested capital (or ROIC) over and above our estimate of a firm's cost of capital, or weighted average cost of capital (or WACC). Without a moat, profits are more susceptible to competition. We have identified five sources of economic moats: intangible assets, switching costs, network effect, cost advantage, and efficient scale.

Companies with a narrow moat are those we believe are more likely than not to achieve normalized excess returns for at least the next 10 years. Wide-moat companies are those in which we have very high confidence that excess returns will remain for 10 years, with excess returns more likely than not to remain for at least 20 years. The longer a firm generates economic profits, the higher its intrinsic value. We believe low-quality no-moat companies will see their normalized returns gravitate toward the firm's cost of capital more quickly than companies with moats.

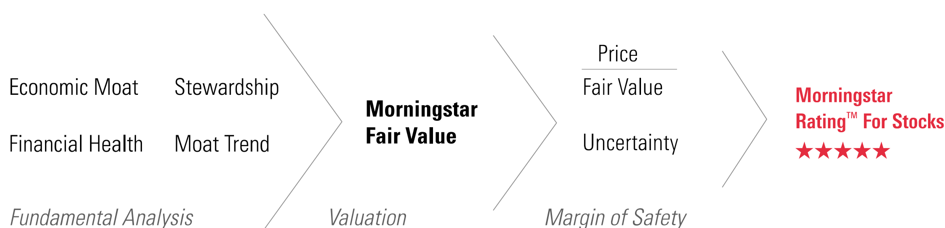
To assess the direction of the underlying competitive advantages, analysts perform ongoing assessments of the moat trend. A firm's moat trend is positive in cases where we think its sources of competitive advantage are growing stronger; stable where we don't anticipate changes to competitive advantages over the next several years; or negative when we see signs of deterioration.

All the moat and moat trend ratings undergo periodic review and any changes must be approved by the Morningstar Economic Moat Committee, comprised of senior members of Morningstar's equity research department.

2. Estimated Fair Value

Combining our analysts' financial forecasts with the firm's economic moat helps us assess how long returns on invested capital are likely to exceed the firm's cost of capital. Returns of firms with a wide economic moat rating are assumed to fade to the perpetuity period over a longer period of time than the returns of narrow-moat firms, and both will fade slower than no-moat firms, increasing our estimate of their intrinsic value.

Morningstar Research Methodology for Valuing Companies



Our model is divided into three distinct stages:

Stage I: Explicit Forecast

In this stage, which can last five to 10 years, analysts make full financial statement forecasts, including items such as revenue, profit margins, tax rates, changes in working-capital accounts, and capital spending. Based on these projections, we calculate earnings before interest, after taxes, or EBI, and the net new investment, or NNI, to derive our annual free cash flow forecast.

Stage II: Fade

The second stage of our model is the period it will take the company's return on new invested capital—the return on capital of the next dollar invested ("RONIC")—to decline (or rise) to its cost of capital. During the Stage II period, we use a formula to approximate cash flows in lieu of explicitly modeling the income statement, balance sheet, and cash flow statement as we do in Stage I. The length of the second stage depends on the strength of the company's economic moat. We forecast this period to last anywhere from one year (for companies with no economic moat) to 10–15 years or more (for wide-moat companies). During this period, cash flows are forecast using four assumptions: an average growth rate for EBI over the period, a normalized investment rate, average return on new invested capital, or RONIC, and the number of years until perpetuity, when excess returns cease. The investment rate and return on new invested capital decline until the perpetuity stage is reached. In the case of firms that do not earn their cost of capital, we assume marginal ROICs rise to the firm's cost of capital (usually attributable to less reinvestment), and we may truncate the second stage.

Stage III: Perpetuity

Once a company's marginal ROIC hits its cost of capital, we calculate a continuing value, using a standard perpetuity formula. At perpetuity, we assume that any growth or decline or investment in the business neither creates nor destroys value and that any new investment provides a return in line with estimated WACC.

Because a dollar earned today is worth more than a dollar earned tomorrow, we discount our projections of cash flows in stages I, II, and III to arrive at a total present value of expected future cash flows. Because we are modeling free cash flow to the firm—representing cash available to provide a return to all capital providers—we discount future cash flows using the WACC, which is a weighted average of the costs of equity, debt, and preferred stock (and any other funding sources), using expected future proportionate long-term market-value weights.

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3. Uncertainty Around That Fair Value Estimate

Morningstar's Uncertainty Rating captures a range of likely potential intrinsic values for a company and uses it to assign the margin of safety required before investing, which in turn explicitly drives our stock star rating system. The Uncertainty Rating represents the analysts' ability to bound the estimated value of the shares in a company around the fair value estimate, based on the characteristics of the business underlying the stock, including operating and financial leverage, sales sensitivity to the overall economy, product concentration, pricing power, and other company-specific factors.

Analysts consider at least two scenarios in addition to their base case: a bull case and a bear case. Assumptions are chosen such that the analyst believes there is a 25% probability that the company will perform better than the bull case, and a 25% probability that the company will perform worse than the bear case. The distance between the bull and bear cases is an important indicator of the uncertainty underlying the fair value estimate.

Our recommended margin of safety widens as our uncertainty of the estimated value of the equity increases. The more uncertain we are about the estimated value of the equity, the greater the discount we require relative to our estimate of the value of the firm before we would recommend the purchase of the shares. In addition, the uncertainty rating provides guidance in portfolio construction based on risk tolerance.

Our uncertainty ratings for our qualitative analysis are low, medium, high, very high, and extreme.

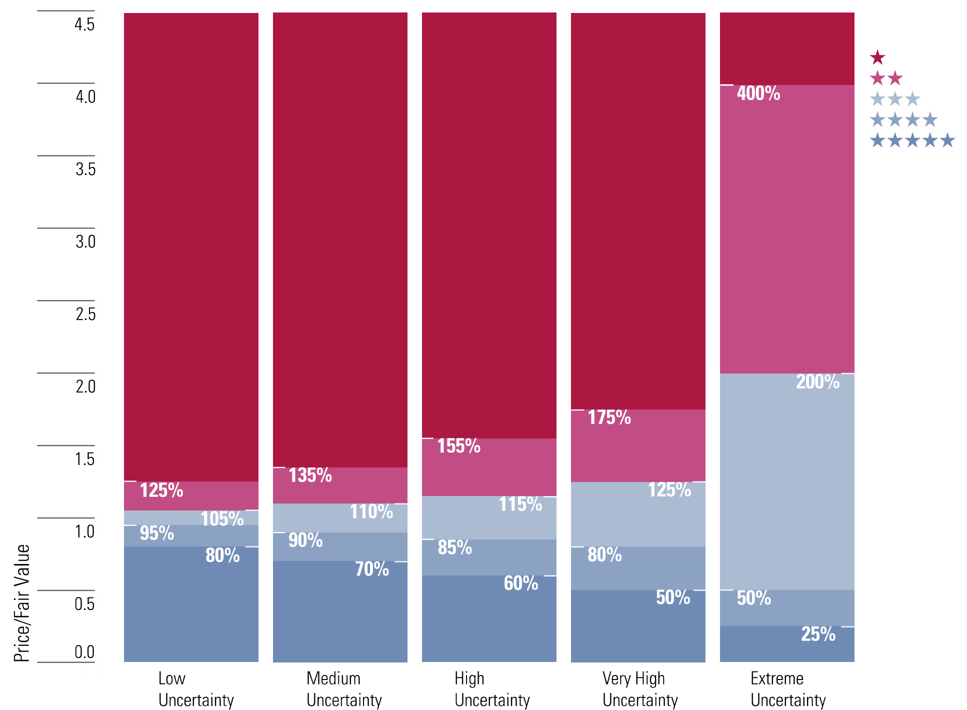
- Low–margin of safety for 5-star rating is a 20% discount and for 1-star rating is 25% premium.
- Medium–margin of safety for 5-star rating is a 30% discount and for 1-star rating is 35% premium.
- High–margin of safety for 5-star rating is a 40% discount and for 1-star rating is 55% premium.
- Very High–margin of safety for 5-star rating is a 50% discount and for 1-star rating is 75% premium.
- Extreme–margin of safety for 5-star rating is a 75% discount and for 1-star rating is 300% premium.

4. Market Price

The market prices used in this analysis and noted in the report come from exchange on which the stock is listed, which we believe is a reliable source.

For more details about our methodology, please go to https://shareholders.morningstar.com.

Morningstar Equity Research Star Rating Methodology



Morningstar Star Rating for Stocks

Once we determine the fair value estimate of a stock, we compare it with the stock's current market price on a daily basis, and the star rating is automatically re-calculated at the market close on every day the market on which the stock is listed is open.

Please note, there is no predefined distribution of stars. That is, the percentage of stocks that earn 5 stars can fluctuate daily, so the star ratings, in the aggregate, can serve as a gauge of the broader market's valuation. When there are many 5-star stocks, the stock market as a whole is more undervalued, in our opinion, than when very few companies garner our highest rating.

We expect that if our base-case assumptions are true the market price will converge on our fair value estimate over time, generally within three years (although it is impossible to predict the exact time frame in which market prices may adjust).

Our star ratings are guideposts to a broad audience and individuals must consider their own specific investment goals, risk tolerance, tax situation, time horizon, income needs, and complete investment portfolio, among other factors.

The Morningstar Star Ratings for stocks are defined below:

★★★★★ We believe appreciation beyond a fair risk-adjusted return is highly likely over a multiyear time frame. The current market price represents an excessively pessimistic outlook, limiting downside risk and maximizing upside potential.

★★★★ We believe appreciation beyond a fair risk-adjusted return is likely.

★★★ Indicates our belief that investors are likely to receive a fair risk-adjusted return (approximately cost of equity).

★★ We believe investors are likely to receive a less than fair risk-adjusted return.

★ Indicates a high probability of undesirable risk-adjusted returns from the current market price over a multiyear time frame, based on our analysis. The market is pricing in an excessively optimistic outlook, limiting upside potential and leaving the investor exposed to Capital loss.

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Research Methodology for Valuing Companies

Other Definitions

Last Price: Price of the stock as of the close of the market of the last trading day before date of the report.

Stewardship Rating: Represents our assessment of management's stewardship of shareholder capital, with particular emphasis on capital allocation decisions. Analysts consider companies' investment strategy and valuation, financial leverage, dividend and share buyback policies, execution, compensation, related party transactions, and accounting practices. Corporate governance practices are only considered if they've had a demonstrated impact on shareholder value. Analysts assign one of three ratings: "Exemplary," "Standard," and "Poor." Analysts judge stewardship from an equity holder's perspective. Ratings are determined on an absolute basis. Most companies will receive a Standard rating, and this is the default rating in the absence of evidence that managers have made exceptionally strong or poor capital allocation decisions.

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- Undervalued: Last Price is below Morningstar's quantitative fair value estimate.
- Fairly Valued: Last Price is in line with Morningstar's quantitative fair value estimate.
- Overvalued: Last Price is above Morningstar's quantitative fair value estimate.

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Quantitative Equity Ratings

Morningstar's quantitative equity ratings consist of:
(i) Quantitative Fair Value Estimate
(ii) Quantitative Star Rating
(iii) Quantitative Uncertainty
(iv) Quantitative Economic Moat
(v) Quantitative Financial Health
(collectively the "Quantitative Ratings").

The Quantitative Ratings are calculated daily and derived from the analyst-driven ratings of a company's peers as determined by statistical algorithms. Morningstar, Inc. (""Morningstar," "we," "our") calculates Quantitative Ratings for companies whether it already provides analyst ratings and qualitative coverage. In some cases, the Quantitative Ratings may differ from the analyst ratings because a company's analyst-driven ratings can significantly differ from other companies in its peer group.

Quantitative Fair Value Estimate: Intended to represent Morningstar's estimate of the per share dollar amount that a company's equity is worth today. Morningstar calculates the quantitative fair value estimate using a statistical model derived from the fair value estimate Morningstar's equity analysts assign to companies. Please go to https://shareholders.morningstar.com for information about fair value estimates Morningstar's equity analysts assign to companies.

Quantitative Economic Moat: Intended to describe the strength of a firm's competitive position. It is calculated using an algorithm designed to predict the Economic Moat rating a Morningstar analyst would assign to the stock. The rating is expressed as Narrow, Wide, or None.

- Narrow: assigned when the probability of a stock receiving a "Wide Moat" rating by an analyst is greater than 70% but less than 99%.
- Wide: assigned when the probability of a stock receiving a "Wide Moat" rating by an analyst is greater than 99%.
- None: assigned when the probability of an analyst receiving a "Wide Moat" rating by an analyst is less than 70%.

Quantitative Star Rating: Intended to be the summary rating based on the combination of our Quantitative Fair Value Estimate, current market price, and the Quantitative Uncertainty Rating. The rating is expressed as 1-Star, 2-Star, 3-Star, 4-Star, and 5-Star.

★: the stock is overvalued with a reasonable margin of safety.
Log (Quant FVE/Price)<–1*Quantitative Uncertainty

★★: the stock is somewhat overvalued.
Log (Quant FVE/Price) between (–1*Quantitative Uncertainty, –0.5*Quantitative Uncertainty)

★★★: the stock is approximately fairly valued.
Log (Quant FVE/Price) between (–0.5*Quantitative Uncertainty, 0.5*Quantitative Uncertainty)

★★★★: the stock is somewhat undervalued.
Log (Quant FVE/Price) between (0.5*Quantitative Uncertainty, 1*Quantitative Uncertainty)

★★★★★: the stock is undervalued with a reasonable margin of safety. Log (Quant FVE/Price) >1*Quantitative Uncertainty

Quantitative Uncertainty: Intended to represent Morningstar's level of uncertainty about the accuracy of the quantitative fair value estimate. Generally, the lower the quantitative Uncertainty, the narrower the potential range of outcomes for that particular company. The rating is expressed as Low, Medium, High, Very High, and Extreme.

- Low: the interquartile range for possible fair values is less than 10%.
- Medium: the interquartile range for possible fair values is less than 15% but greater than 10%.
- High: the interquartile range for possible fair values is less than 35% but greater than 15%.
- Very High: the interquartile range for possible fair values is less than 80% but greater than 35%.
- Extreme: the interquartile range for possible fair values is greater than 80%.

Quantitative Financial Health: Intended to reflect the probability that a firm will face financial distress in the near future. The calculation uses a predictive model designed to anticipate when a company may default on its financial obligations. The rating is expressed as Weak, Moderate, and Strong.

- Weak: assigned when Quantitative Financial Health <0.2
- Moderate: assigned when Quantitative Financial Health is between 0.2 and 0.7
- Strong: assigned when Quantitative Financial Health >0.7

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Research Methodology for Valuing Companies

Other Definitions

Last Close: Price of the stock as of the close of the market of the last trading day before date of the report.

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The Walt Disney Co DIS (XNYS)

Morningstar Rating	Last Price	Fair Value Estimate	Price/Fair Value	Trailing Dividend Yield %	Forward Dividend Yield %	Market Cap (Bil)	Industry	Stewardship
★★★	132.04 USD	130.00 USD	1.02	1.30	1.33	237.63	Media - Diversified	Standard
31 May 2019 22:06, UTC	31 May 2019	08 Sep 2017 06:04, UTC		31 May 2019	31 May 2019	31 May 2019		

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