Financial Analysis and Strategic Valuation of Disney

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Abstract: In the context of a global economic deceleration and heightened financial market turbulence, this study strategically opts for The Walt Disney Company as the focal point for investment scrutiny. Firstly, a meticulous exposition of the company's historical context and the most recent developments are presented. Subsequently, a granular examination of financial intricacies is undertaken, delving into aspects such as revenue recognition, film and television content costs, and the valuation of goodwill, other intangible assets, and long-lived assets. This comprehensive financial analysis aims to provide a nuanced understanding of The Walt Disney Company's fiscal standing. Furthermore, three enterprises in direct competition with Disney are meticulously chosen to provide a holistic evaluation of the company's competitive standing. This includes an exhaustive financial comparative analysis encompassing liquidity, solvency, profitability, and investment capabilities. Following this, a meticulous exploration of Disney's strategic valuation ensues, culminating in a detailed exposition of potential investment hazards. In the final analysis, this research synthesizes the insights gleaned from the preceding investigations to proffer targeted investment recommendations. The culmination of these analyses provides a multifaceted perspective that appraises the current financial health of The Walt Disney Company and furnishes actionable insights for prospective investors navigating the complex landscape of contemporary global markets.

Keywords: Disney, Performance Evaluation, Strategic Valuation, Accounting Analysis.

1. Introduction

The Walt Disney Company and its subsidiaries are a global diversified Entertainment company with three business segments: Entertainment and Sports and Disney Parks, Experiences and Products (DPEP) [1]. Acquisitions and the development of the streaming segment have fueled the company's growth. In recent years, the Entertainment business has gained focus. The company has encompassed a number of multiple TV and radio channels such as ESPN, Disney, ABC, Hulu, etc., as well as movie releases from Disney Pictures, Hollywood, 20th Century Pictures, Pixar, Marvel, and Lucasfilm. and Touchstone Films for film distribution. These branding effects are deeply rooted in the hearts of the people and well received by consumers, giving the company an extremely high commercial value [2].

Disney has experienced leadership changes and restructuring impairments in fiscal 2022 and fiscal 2023. Disney announced that Robert A. Iger will succeed Robert A. Chapek as the company's chief executive officer and director on November 20, 2022. Iger will initiate organizational and operational changes within the company as authorized by the Board of Directors to achieve the Board's objectives.

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Disney anticipates that the restructuring and changes in business strategy, once finalized, may result in impairment charges [3]. In Disney's fiscal year 2023, the company conducted a large-scale restructuring involving impairment charges of $3.892 billion. Among them, $2.577 billion was used for content impairment expenses, $721 million was used for goodwill impairment, $5.7 billion was used for severance pay, $141 million was used for equity investment impairment, and US$6 million was used for exiting the Russian business and other expenses [1].

Disney made strategic adjustments in 2023. In the first quarter of 2023, Disney eliminated the Media and Entertainment Distribution (DEMD) division, reorganized it into Entertainment, Sports, and Disney Parks, Experiences and Products (DPEP), and restructured the division heads. Each business unit leader will have full operational control and financial responsibility for creative development, marketing, technology, sales, and distribution and will be responsible for driving global business efficiencies [4]. In April 2023, The Walt Disney Company in the United States began a new round of layoffs totaling 4,000 employees. The layoffs affect streaming platforms ESPN, Entertainment, Disney Parks, and its experience and product divisions. In addition, Disney will continue its layoff plan, which could cut up to 7,000 employees in this round of layoffs to cut $5.5 billion in costs [4].

2. Accounting Analysis

2.1. Revenue Recognition

Disney's services revenue increased 20% to $74.2 billion in fiscal 2022. Disney's revenue sources are complex: advertising sales, resort sales, retail merchandise sales, merchandise licensing fees, and fixed license fees for television/CVOD distribution. In addition, Disney is very disciplined in determining revenue, and its expected earnings will only be recorded as revenue when there is a rating shortfall in advertising sales and retail sales once a licensee has used the available content. Therefore, sales in the income statement are crucial because they have a significant impact on investors' judgment indicators, such as operating profit (OP), profit before tax (PBT), and net income (NI). Analysts will only make correct investment decisions on Disney if revenue cannot be reasonably recognized and accurately measured [3].

Paramount clearly distinguishes the methods of revenue recognition based on different sources of revenue and explains the measurement methods in certain specific circumstances. Advertising revenue is recognized when advertisements are aired on television or streaming media or displayed on digital platforms; Affiliate and subscription revenue will be recognized by continuing to provide customers with the rights to use original programming. Theatrical revenue is based on the final theatrical chain Sales. WBD's revenue recognition method is similar to Paramount's, and the classification is more detailed [5].

Compared with its peers, NFLX's revenue source is relatively single, with the main source of revenue being membership fees. Members are charged before each month's membership, and revenue is recognized ratably over each month's membership period. In addition, if payments made to the partner (credited as "Fees" if the services are completed) do not obtain any services, or if the partner determines the price paid by the member and there is no separate price for the Netflix service (e.g., bundled sales), these payments are considered a reduction in revenue [6].

2.2. Film and Television Content Costs

Disney's cost calculations for film and television content are very complex. The company will use a primary monetization strategy for all direct costs incurred in the production of the capitalized film, as well as the allocation of production expenses and capitalized interest for amortization and impairment purposes.

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Primary monetization strategies are determined at the outset of production and on a consolidated basis based on the means to generate third-party revenue from the use of content. Production costs for primarily monetized content are amortized based on the ratio of current period revenue to estimated ultimate revenue. For film productions, final revenue includes revenue from all sources; for episodes classified as stand-alone series, final revenue includes revenue earned over a ten-year period. Participation fees and residual fees are expensed over the life of the applicable product based on a ratio of current period revenue to estimated residual gross revenue for each product. Acquired film and television libraries are generally amortized on a straight-line basis over 20 years from the date of acquisition. The costs of produced and licensed film and television content are subject to periodic recoverability assessments. For separately monetized content, the unamortized cost is compared to the estimated fair value. If the unamortized cost exceeds fair value, an impairment charge is recorded for the excess. If the unamortized cost exceeds the present value of the discounted cash flows, an impairment charge is recorded for the excess [3].

2.3. Goodwill, Other Intangible Assets, and Long-Lived Assets

Goodwill represents the excess of the acquisition cost over the fair value of the Group's share of the identifiable net assets acquired. Disney conducts impairment testing on goodwill and other indefinite-lived intangible assets annually and accrues accumulated impairment losses at cost. To test for goodwill impairment, the company first conducts a qualitative assessment to determine whether it is more likely than not that the carrying value of the reporting unit exceeds its fair value. If so, a quantitative assessment is required. The quantitative assessment compares the fair value of each goodwill reporting unit to its carrying value. If the carrying value exceeds the fair value, goodwill impairment is recognized before the amount of goodwill allocated to the reporting unit. To determine the fair value of a reporting unit, the company uses a discounted cash flow valuation method, supported by market multiples when reasonable. The company has recorded non-cash impairment charges of $200 million and $300 million in fiscal 2022 and 2021, respectively. Therefore, underestimating impairment losses could increase earnings in the income statement and assets in the balance sheet if the estimation and management judgment of goodwill and its impairment are improper [3].

Paramount and WBD also identify goodwill as one of their important accounting policies, and their accounting policies for goodwill and impairment are similar to those of Disney. Goodwill is very influential in Disney's income statement and balance sheet. Therefore, the annual goodwill impairment requires more accurate estimates and management judgment.

3. Performance Evaluation

Fierce competition between Netflix, Paramount Worldwide, and Warner Bros is mainly reflected in product services, pricing strategies, user attraction, and global markets. In terms of products and services, they have more product overlap in the fields of film production, streaming services, and copyrighted content. Especially in streaming services, Netflix has always been the market leader, while Disney has risen rapidly through Disney+, Paramount, and Warner Bros has also launched its own platform. In terms of pricing strategy, they use different pricing models, including monthly fees and flexible subscription plans, to meet the needs of different user groups, thereby attracting more subscribers. In terms of user attraction, These four companies compete for users' attention by providing excellent user experience, including unique brand image, personalized suggestions, high-quality content, and new technology applications. In the global market, they actively provide localized content and services, conduct business reorganization and expansion to adapt to the

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development of emerging markets, meet the diverse needs of audiences, and achieve the goal of occupying more global markets [7].

3.1. Liquidity

The data in Tables 1-4 are calculated based on the 2022 annual reports of Disney, Netflix, Paramount and WBD.

Table 1: Liquidity ratios of DIS and its competitors.

Company	Current ratio	Quick ratio	Cash ratio
DIS	1.00	0.94	0.40
NFLX	1.17	1.17	6.49
PARA	1.23	1.11	0.26
WBD	0.93	0.93	0.25

From Table 1, Paramount and Netflix have better current ratios and are more flexible in repaying short-term debt. Disney is also within a reasonable range. The current ratio of WBD is less than 1. The company's current liabilities exceed its current assets, indicating that its solvency is weak and it faces liquidity risks.

Due to the special attributes of the entertainment industry, the gap between the quick and current ratios is small. The four companies are all around 1, which is within a reasonable range. Comparing these four companies, Netflix's Cash Ratio is too high, indicating that the company may need to manage funds effectively, miss out on investment income, or reduce capital utilization. Although Disney's cash ratio is low, it is within a reasonable range and better than the other three companies, indicating that it has better cash flow to repay its short-term debt.

3.2. Solvency

Table 2: Solvency ratios of DIS and its competitors.

Company	Total Debt ratio	Long-Term Debt ratio	Times-interest-earned
DIS	51.44%	22.25%	4.75
NFLX	57.24%	29.54%	8.45
PARA	59.57%	26.73%	2.43
WBD	63.68%	36.29%	-2.17

From Table 2, it can be seen that the total debt ratio of Disney, Netflix, and Paramount is at the normal level of 40% to 60%. That is, they can reasonably use debt to finance expansion and operations. However, WBD’s debt-to-asset ratio of over 60% indicates that the company has high debt, which may imply that the company has greater financial risks.

Because companies in the entertainment industry may need to invest in content production, marketing, and technology development, some companies may hold higher long-term debt to support these investments. The long-term debt of these four companies all exceeds 20%, with Disney being the lowest and having the strongest ability to repay debt. Among these four companies, Netflix has the largest Times-interest-earned, followed by Disney, which shows that they all have strong long-term solvency, followed by Paramount, with WBD being the weakest.

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3.3. Profitability

Table 3: Profitability ratios of DIS and its competitors.

Company	Profit Margin	Operating Margin	Asset Turnover
DIS	4.24%	8.18%	0.41
NFLX	14.21%	17.82%	0.70
PARA	3.66%	7.77%	0.52
WBD	-21.58%	-21.79%	1.00

Judging from Table 3, Netflix has the strongest profitability, followed by Disney. Disney's past sustained losses were mainly caused by the company's continued expansion of cost investments to compete in the streaming media market and create high-quality content. However, data for the fourth quarter of 2023 showed that the net profit attributable to Disney was $264 million, a year-on-year increase of 63%, exceeding market expectations. In addition, after Disney merges with Hulu, Hulu and Disney+ will bring higher engagement, more market share, and lower customer acquisition costs, thereby increasing the company's overall profit margins [8]. At the same time, Disney Park’s business has shown a strong recovery after the epidemic. DPEP business revenue in the second quarter of 2023 increased by 17% year-on-year to $7.78 billion in the same period of 2022, and operating profit increased by 23% year-on-year to $2.17 billion, compared with $1.51 billion in the same period of 2019. Financial performance has exceeded pre-epidemic levels. Therefore, Disney's overall performance is stable and improving [9].

3.4. Investment

Table 4: Investment ratios of DIS and its competitors.

Company	ROE	ROA	Market-to-book ratio
DIS	3.54%	1.72%	1.51
NFLX	21.62%	9.24%	8.85
PARA	4.79%	1.89%	0.31
WBD	-15.09%	-5.45%	0.51

As shown in Table 4, among the four companies, Netflix's return on investment is more prominent in terms of ROE and ROA. ROA and ROE are related to factors such as company liabilities, gross profit margin, and profit margin. Disney's ROE and ROA have been greatly affected by the continued increase in costs and operating losses caused by acquisitions, internal strategic adjustments, and streaming media competition. However, Disney has achieved a turnaround in net profit with the support of cost control and diversified businesses. In the future, Disney's streaming media business is expected to maintain sustained growth, and the Disney Parks business will continue to develop steadily. At the same time, Disney will adopt a strategy of increasing subscription fees to increase revenue. Therefore, Disney may reduce the impact of profits on return on investment in the future.

Disney's P/E ratio is greater than 1, which means the company's market value is higher than its book value, indicating that the market has high expectations for its future profitability. Although Netflix's P/E ratio is significantly higher than the other three companies, there is a possibility that the stock price is overvalued by the market.

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4. Strategic Valuation

4.1. Forecast

Table 5: Strategic Valuation ratios of DIS.

	DIS
TTM P/E	26.73
NTM P/E	19.52
EPS growth rate	36.92%
Revenue growth rate	4.46%

Based on Estimize and 2022 financial statement data shown in Table 5, Disney's TTM P/E ratio is 26.73, and the NTM P/E ratio is 19.52. This shows that the market has a relatively optimistic attitude towards Disney's profitability in the past year, and the NTM P/E ratio is lower than the TTM P/E ratio, indicating that the market is more cautious about the company's future profit growth expectations. Factors contributing to this situation include slowing economic development, weak consumption, continued losses due to competition in streaming media, and Disney's internal strategic adjustments. However, for the vigorously developed streaming media business, although Disney's current total number of users and market share is slightly behind Netflix, with the acquisition of Hulu, Disney's streaming media business is expected to maintain sustained growth in the future and successfully achieve profitability. In addition, Disney Park's international business has recovered strongly, and domestic parks in the United States have grown steadily. According to 2023 Q4, this business has exceeded pre-epidemic levels. Disney released its fourth-quarter earnings report after the market closed on Wednesday, and its stock price rose by more than 4% [9].

Based on the comprehensive EPS growth rate and revenue growth rate, on the one hand, the growth trend of the company's streaming media business will drive the improvement of valuation and profitability. On the other hand, the continued recovery of the theme park business will support the company's performance growth and provides sufficient cash flow for the further development of the streaming media business. In addition, Disney's powerful IP resources attract traffic to the theme park business and provide sufficient content resources for streaming media. Therefore, Disney may be undervalued by the market [10].

4.2. Risks

The adverse impact of COVID-19 on the business and revenue sources will continue for an unknown period of time. To cushion the impact of COVID-19, Disney has taken a number of measures, including adding additional debt and delaying or suspending investment projects. Possible future measures include raising additional financing, suspending or reducing capital expenditures, reducing investment in film and television content, and adjusting operating strategies, which may have an adverse impact on the business. In addition, COVID-19 and potential future pandemics may result in operational restrictions, further impacting reputation, employees, customers, and other stakeholders. Therefore, it is difficult for management to estimate future performance as the impact of many adverse factors is difficult to measure [3].

Changes in technology and consumer consumption patterns adversely affect revenue and distribution costs. New technologies are changing every aspect of the existing business models, including consumer demand, distribution of products, entertainment costs, revenue models, competitive content, and the choices advertisers offer to target audiences. At the same time, declining broadcast and television ratings across the industry, reduced demand for home entertainment, the development of alternative distribution channels for broadcast and cable programming, declining

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subscribers to traditional cable channels, and the possibility that movie theater audiences will remain below pre-COVID-19 levels for a long time are affecting traditional release form. In response to these developments, Disney has developed, invested in, and acquired DTC products and has initiated plans to restructure Disney's media and entertainment businesses once again to advance the DTC strategy and develop a new generation of products. However, Disney cannot guarantee that DTC products and other new business models can successfully respond to these changes and generate profits. In addition, the decline in certain traditional forms of distribution may increase the content costs that can be allocated to DTC products, negatively impacting the profitability of DTC products [3].

Potential credit rating adjustments and volatility in global financial markets could make it more difficult for Disney to raise capital. Due to the financial impact of COVID-19 on the business, Moody's downgraded the company's long-term and short-term debt ratings to A2 and P-1 (Stable) as of October 1, 2022, and S&P downgraded the company's ratings to BBB+ and A-2 (Positive), Fitch Ratings A- and F2 (Stable). These rating adjustments that have already occurred, as well as future rating downgrades, may further increase Disney's borrowing costs and financing costs. In addition, Disney's financing costs will further increase due to fluctuations in U.S. and global financial markets. In addition, rising interest rates and possible future turmoil in the U.S. and global credit and stock markets will increase Disney's borrowing costs, making the company's operations more difficult [3].

The acquisition and integration of TFCF and the put/call agreement with Hulu may result in additional costs and expenses. Disney's restructuring plan to acquire TFCF in 2019 to achieve cost synergies has been completed in fiscal 2021. Although Disney achieved significant growth in operating income after acquiring 21st Century Fox, the company's net profit was lower due to the impact of merger and acquisition integration costs, including creation fees for exclusive content for the streaming platform and other integration expenses. Disney has recorded $1.8 billion in restructuring charges, mainly including TFCF awards. In addition, professional services, transaction and financing costs, fees, and expenses have been incurred or may continue to be incurred in connection with the acquisition and integration of TFCF and the put/call agreement with Hulu. These costs, including obligations under the Hulu put/call agreement, could negatively impact the company's free cash flow and result in additional debt [3].

Risks associated with business strategy changes or restructuring have, and may continue to, impact Disney's cost structure, business profitability, or asset values. To adapt to changes in the business environment, Disney reorganized its media and entertainment business into two departments, entertainment and sports, in fiscal year 2023 and conducted a review of its DTC business, resulting in related impairment charges. In fiscal years 2022 and 2021, Disney has strategically adjusted its Disney+ services, brand retail stores, and other businesses. On top of that, Disney has seen leadership changes. Under the combined influence of the two, Disney may not be able to generate expected benefits, and DTC's strategic costs and related losses may continue to grow, thus affecting Disney's distribution strategy across business/distribution platforms. As macroeconomic changes occur, Disney may need to write down the value of assets, such as its linear network goodwill and intangible assets that have been impaired, as well as its retail store assets. Investments in the experience segment, theme park expansion, TFCF acquisitions, and DTC products may affect the resources available and profitability of the company's other businesses, ultimately resulting in negative or low returns. Disney's lack of experience in operating new businesses and the uncontrollable pace of changes in the competitive landscape may make new products unprofitable in the short term and make it difficult to expand into new markets as expected [1].

5. Conclusion

In summary, the comprehensive analysis undertaken in this study yields a nuanced evaluation of The Walt Disney Company's financial landscape. The scrutiny encompassed in-depth accounting analyses, financial evaluations, competitor research, and risk assessments. The findings underscore Disney's commendable performance in liquidity and solvency, indicative of a robust financial foundation. However, the company's overall profitability could be improved by significant investments in streaming media competition, the repercussions of recent acquisitions, and the challenging backdrop of a global economic slowdown. Consequently, the market response has been characterized by a cautious stance.

Nevertheless, Disney's proactive measures, including timely strategic adjustments, internal restructuring initiatives, and the burgeoning success of its streaming media and theme park ventures, have propelled its profitability on a trajectory of steady improvement. Despite this positive trajectory, the study advocates vigilance, emphasizing the necessity of remaining attuned to potential risks stemming from macroeconomic factors and ongoing internal restructuring within Disney. In light of these insights, investors are advised to exercise prudence and circumspection in their decision-making processes, ensuring a thorough assessment of the associated risks before making investment decisions in the dynamic and intricate landscape surrounding The Walt Disney Company.

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