Stock Pitch

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Duke Investment Club

Pitch Agenda

Investment Thesis

Disney (NYSE: DIS)

Disney's monopoly power in the cable TV sector, promising bets on college football and best-in-class creative content with proven monetization avenues mean that the company should regain its historical trading premium to its competitors within the next year.

Recommendation: Buy	Current Price: $67.15	Target: $76.95

Catalysts

- Increasing advertising revenues from college football
- Evidence will build that the market has overestimated risks from new competition
- Monetization of newly acquired and previously developed creative content
- Aggressive stock buyback program compensates us for waiting

Concerns

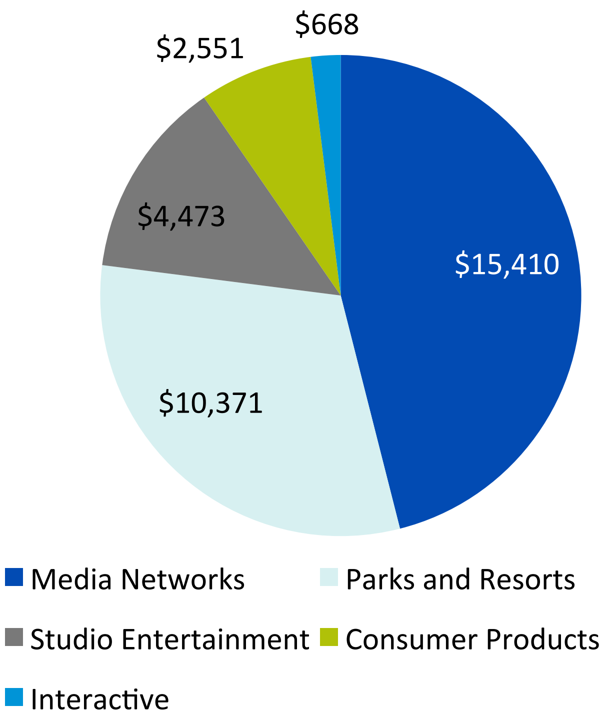
- "Cord-cutting" and increased sports rights prices
- High sector-wide valuations
- Risks inherent in developing creative content

Company Overview

Segment/Revenue Breakdown

- Disney Operates in 5 segments:
- Media Networks: ESPN (~70% revenues), ABC, Disney Channels
- Parks and Resorts: 11 theme parks in 5 main locations, 43 resorts, 4 cruise liners
- Studios: Disney Animation, Pixar, Marvel, Lucasfilm, Touchstone Pictures, Disney Theatrical
- Consumer Products: Licensing, Publishing, and Disney Stores
- Disney Interactive: Video games, Mobile, and Web

Last 9 Months Revenues in $bn



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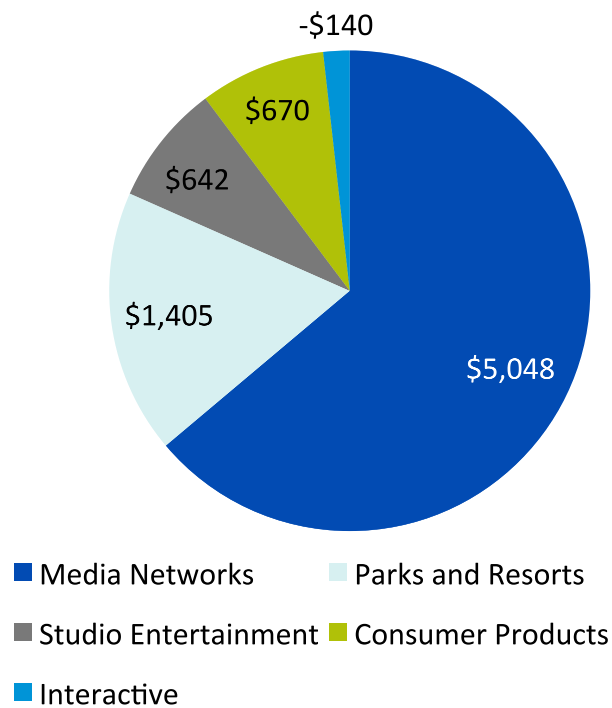
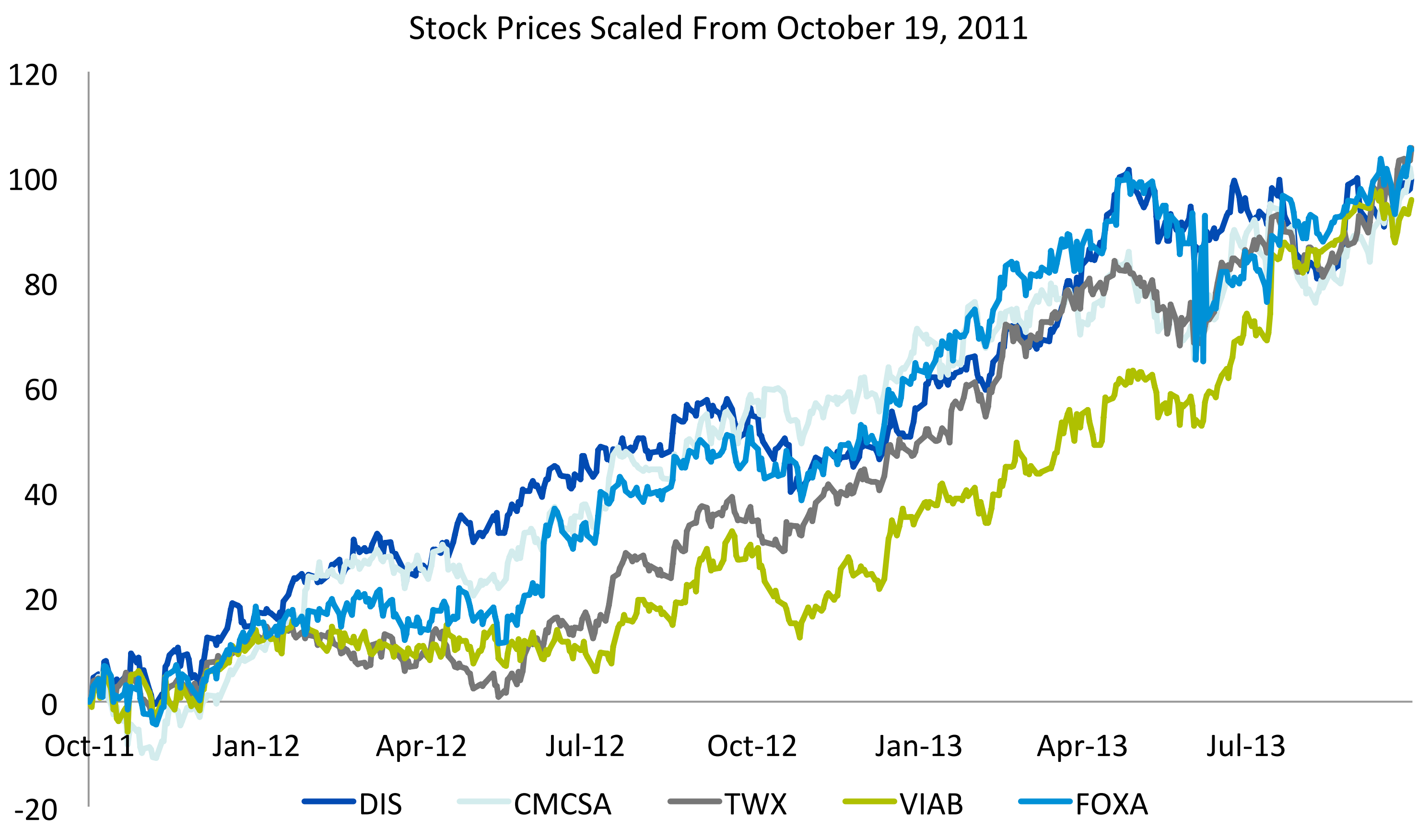


Source: SEC Filings

Stock Price Over the Last 2 Years

Disney, along with other media companies, have seen their share prices roughly double over the last 2 years, higher than the S&P 500 return of 42.5%.



Source: Google Finance

Segment Analysis

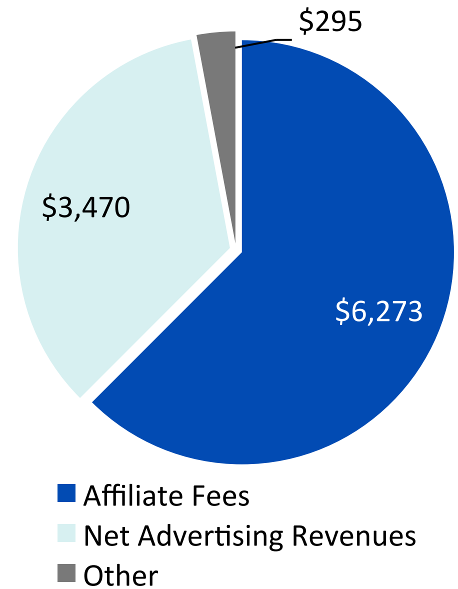
Media Networks

ESPN's Business Model

ESPN's Model for Making Money

- Revenues
  - Affiliate Fees
  - Advertising (~85% profit margin)
- Expenses
  - Rights fees
  - Production costs
- Important trends
  - Affiliate fees and content rights fees are mostly locked in
    - CFO: "I don't want to be too predictive, but, as I have said, we are pretty happy with what we already know from the 70% of deals we have done and what we know the underlying sports rights costs will be over the period."
    - NY Times: "So powerful is the ESPN-fueled bundle that one veteran cable operator described negotiations with Disney as "total surrender."
  - Advertising is variable
    - 65% of ad revenues come from live sports
    - 28% come from SportsCenter
  - 2012 Rights fees were about $5.4 billion, and SG&A was about $875 million

ESPN Revenues FY 2012



Sample Per Subscriber Affiliate Fees

- ESPN: $5.54
- TNT: $1.24
- ESPN2: $0.70
- TBS: $0.59
- Bravo: $0.24
- MSNBC: $0.21
- Weather Channel: $0.13

Source: SEC Filings, NY Times

ESPN’s Sports Rights

ESPN’s contracts show that is has locked up most premium contract past 2020 and made large bets on college football. Importantly, these deals were done prior to ESPN’s negotiations with cable networks, allowing it to lock in profits on affiliate fees.

Sport/Event	Through	Payment ($ bn)
N.F.L	2021	15.2
College Football Playoffs	2026	7.3
M.L.B.	2021	5.6
N.B.A	2016	3.9
Pac-12*	2024	3.0
Big 12*	2025	2.5
SEC	2024	2.3
Big 10	2017	1.0

Source: NYTimes

ESPN vs. Fox1

Fox1 Overview

- Recently, Fox replaced its "Speed" channel with a new 24-hour sports channel that has led to concerns about ESPN being challenged for its leadership role
- Our view is that this channel will operate more in the league of NBCSN and CBS Sports and will not be a true competitor to ESPN
- Fox1 recently attempted to charge affiliates .80 cents per month, but it ended up having to accept 23 cents per month
  - The parent will have to accept heavy losses if it wants to bid for the best content
  - Through the 2020s, there is little premium sports content available
- Ratings-wise, only one Fox1 event has drawn more than 1 million views

NASCAR Contract Case Study

Some concern was sparked by Fox1 winning a NASCAR contract that was previously owned by ESPN

- ESPN's contract paid NASCAR $560 million per year
- FOX1's new contract pays NASCAR $820 million per year

What happened from 2005 to 2013?

- Attendance revenues for NASCAR owners have fallen from $450 million per year to $262 million per year
- Average TV ratings have fallen by 47%

This is similar to what happened to ESPN in Europe

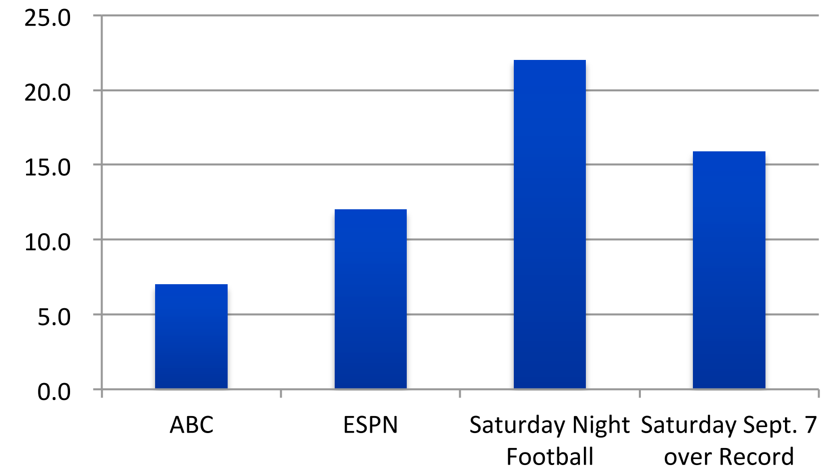
Source: Sportingnews.com

College Football

The Bet is Showing Early Promise

- In our view, college football is a case of ESPN using its monopoly power to build up brands it knows it controls in the future
  - Advertising revenues (~85% profit margin) is where we see upside because of this
  - Costs are locked in until the 2020s, so upside goes to ESPN
- College football is set to be the next large sport
  - TV-friendly
  - ESPN controls the schedule, allowing them to manufacture excitement
  - Proven popularity and acceptance of the sport
    - Regular season NFL primetime games outdraw the World Series
    - Primetime college games are now outdrawing the NBA playoffs
- College football playoffs
  - Coca Cola's VP of Sports and Entertainment
    - "It will be better than the Super Bowl"
- On Sept. 7, ESPN sustained NBA playoff-type ratings for close to 15 hours

Ratings Increases this Season



ESPN's Major College Football Contracts

- College football playoffs
- Most major bowls
- SEC
- Big 10
- Pac 12
- Big 12

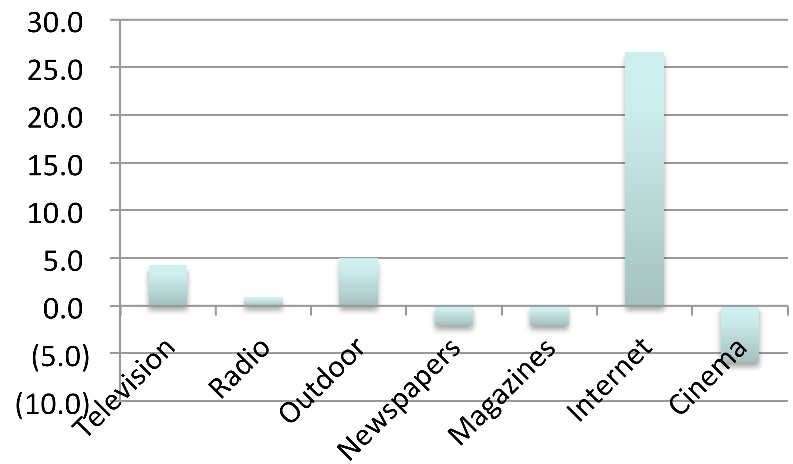
Source: SEC Filings, NY Times

Advertising

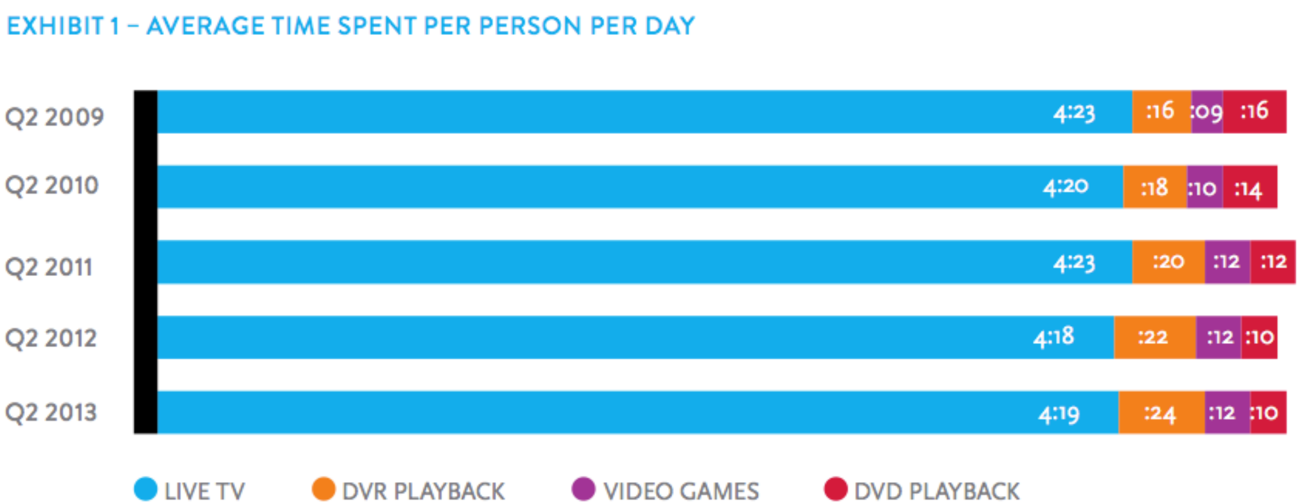
Sports Advertising

- Nielsen – 99% of sports in 2012 were watched either live or on the same day among people aged 18-49
- Men have named ESPN their favorite channel for 14 years straight
- TV spending is not growing as quickly as Internet spending, but it is growing
- Half of households now have DVRS, which should increase the value of live sports
  - Percent watched within a week of initial airing
    - Sports – 95%
    - Comedies – 70%
    - Dramas – 58%

Global Ad Spending is up 2.8% YTD



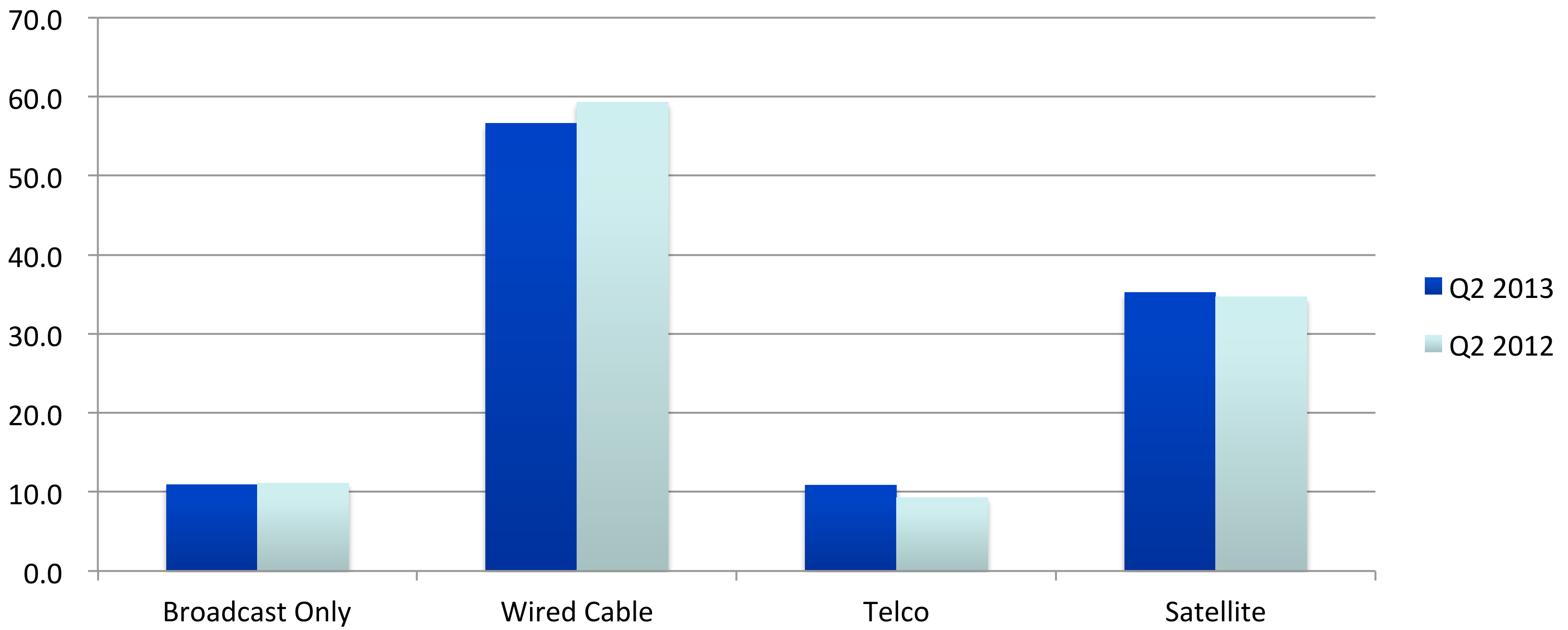
Live TV Still Dominates



Source: Nielsen

Cord-Cutting

Consumers Are Shifting from Wired Cable to Telco & Satellite



- All but 500,000 of the change in wired cable viewers seem to have moved to Telco and Satellite, both of which offer the same bundles with ESPN that Wired Cable does
  - "Telco" means AT&T and Verizon
- Risks remain with more disruptive technologies
  - However, the premium for high-quality content has never been higher (TWC pays $2 for CBS now)
  - Also, the 6 companies that control 90% of TV networks all support the bundle model

Source: Nielsen

Film Studios

Background

Overview

- Founded in 1923
- Third largest segment in terms of revenue generated
- Multiple divisions and subsidiaries allow for concentrated production efforts in different mediums and genres
  - Walt Disney Animation Studios
  - Walt Disney Pictures
  - Touchstone Pictures – responsible for the majority of R-and-PG-13 rated films, distributes DreamWorks's films

Competitive Advantages

- Strong brand image dating back to the early 1900s
  - Mickey Mouse was created at the Studios in 1928
- Structure allows for specialization in types of films
  - Acquisitions allow for diversification
- Other segments (Parks and Resorts, Consumer Products, and Interactive Media Group) provide mutual benefits through advertising
- Increasing international presence, in part fueled by the localization of films in foreign countries

Deals/Acquisitions

- 2006: Pixar Animation Studios for $7.4 billion
  - Kept separation between the two companies – branding of films as "Disney•Pixar"
- 2009: Marvel Entertainment for $4.64 billion
  - Did not affect preexisting deals
  - Bought some distribution rights from Paramount Pictures, including *The Avengers* and *Iron Man 3*
  - Plans to distribute future products with its own studios
- 2012: Lucasfilm Limited for $4.06 billion
  - Acquired film production, products, games, animation, and entertainment technologies
  - Co-branding for future films
  - Does not hold distribution rights to already-produced *Star Wars* or *Indiana Jones* films

Growth

Consensus View

- Recent acquisitions in Pixar, Marvel, and Lucasfilm give the company a broad portfolio of intellectual property to monetize globally over the long term
- Lucasfilm success is already priced in
- Some increases in revenue from continued Marvel production

Our View

- Current valuations do not fully account for Disney's future ability to produce blockbuster films through its other subsidiaries and divisions and its changes in strategy
- Has been shifting to franchise, branded films
- Past trend: Huge variety in box office results with blockbusters' success partially cancelled out by flops
  - John Carter (2012), and The Lone Ranger (2013): high budget films that resulted in huge financial losses
  - "We've also learned that there needs to be a cap on tentpole, nonfranchise films" – CFO Jay Rusolo
  - Acquisitions provide opportunity for Disney to focus on series-related films with high likelihoods of success
- Marvel's potential not fully accounted for
  - Iron Man 3, The Avengers
  - Multiple possibilities for future franchises

Looking Forward

- Marvel has movies planned up to 2021
- Pixar has movies planned for upcoming years
  - *Finding Dory* (2016), potentially *Toy Story 4*
- LucasFilms: new Star Wars trilogy starting in 2015
- Overall more films with established storylines that have shown a history of success

Risks

- Movie flops (Lone Ranger, John Carter)
- Star Wars may underperform
  - Star Wars: The Clone Wars – low ratings, moderate box office success
- Shares trade at a 29% premium to their 5-year average PE
- Piracy: remains potential threat, especially in China as Disney plans to expand overseas

Film	Revenue (US)
The Avengers	$626,428,700
Iron Man (1-3)	$1,080,823,900
Episode I: The Phantom Menace	$689,629,213
Episode II: Attack of the Clones	$409,258,136
Episode III: Revenue of the Sith	$454,523,445
Monsters University	$267,509,000

Parks and Resorts

Background and Consensus

Overview

- Founded in 1971 after the opening of Magic Kingdom at Walt Disney World, joining the original Disneyland
- Resorts began in 1955 as Disneyland Hotel
- Second largest segment in terms of revenue generated
- Currently has locations outside of the US
  - Tokyo (1983), Paris (1992), Hong Kong (2005)
- Cruise Lines – currently four ships in the Bahamas
- Other Ventures – retail stores, timeshare program, tour packages at non-Disney sites
- Acquisitions have resulted in Disney-owned franchises being represented in competitors' parks

Consensus View

- New resorts, parks, and cruise liners will be a boost to future revenues
  - Strong underlying demand
  - Potential per cap spending benefits from MyMagic+
- Overseas expansion opens up a new consumer base, especially in China where American goods are popular
- Potentially the largest source of upside based on marginal expansion potential
  - Bullish, but mostly priced in

Planned Expansion

- Shanghai, China
  - Received approval in November 2009
  - Expected to open on Fall 2015
- Hong Kong – expansion of Disneyland to receive three new lands, including Toy Story Land (total of seven lands)
- Fantasyland renovation – planned for 2014
- MyMagic+ initiative to improve customer experiences
  - Reduce wait time at entry and rides
  - Replace cash with electronic purchase
  - Encourage vacation pre-planning

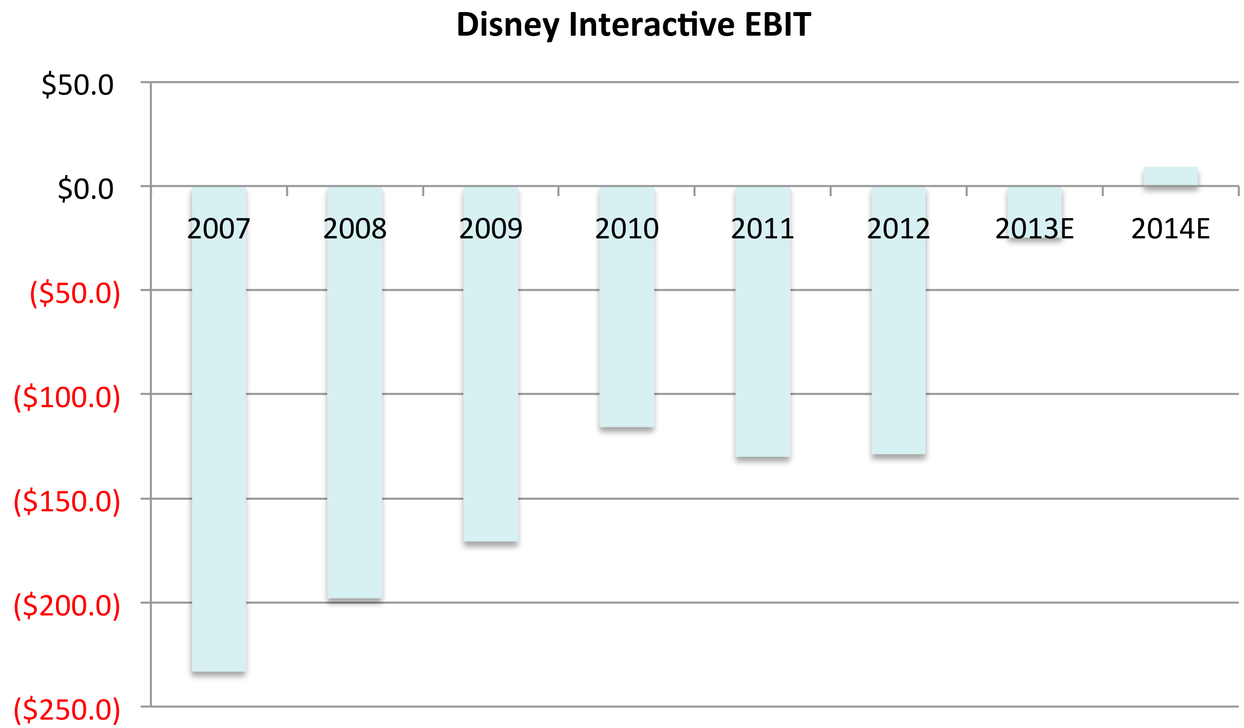
Our View

- Will perform at or above consensus
- While much of the expansion is priced in, markets may have underestimated sources of revenue
  - Hotel reservations for the parks higher than predictions
  - Last year's ticket price increases were higher than expected – could see 2-2.5% upside
- Strong US recovery may result in unexpected upside as consumers spend more on going to theme parks
  - Optimistic unemployment and GDP projections from the Federal Reserve
- Acquisitions provide indirect advertising for parks

Interactive

Disney Interactive

Losses In the Division Are Projected to Taper Off



- Long-term goals
  - Build a relationship with customers
- 55 million households have the WATCH ESPN app
- Finally released a hit game – Disney Infinity
  - About a $100 million development cost. Now sold over 300k units in 2 weeks, for over $75 each

Source: SEC Filings, Estimates from Morgan Stanley Equity Research

Corporate

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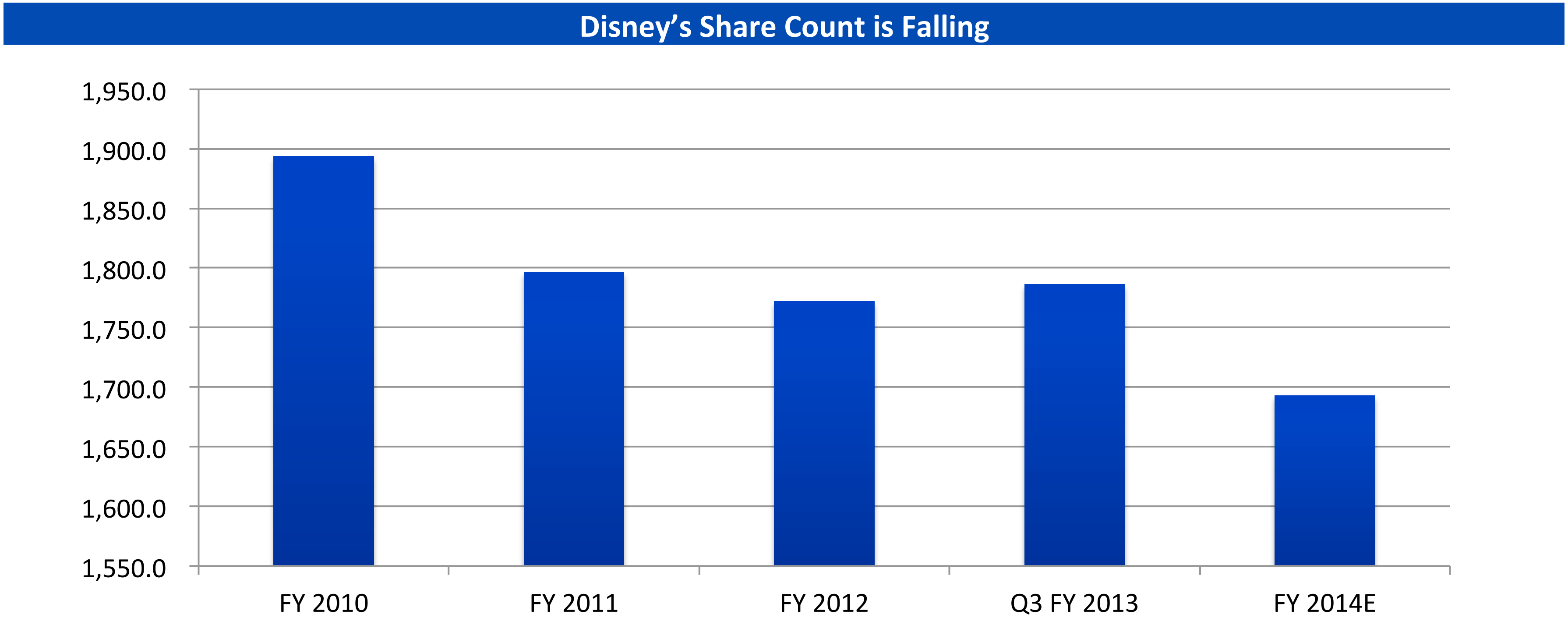

- Management believes the stock is undervalued, as it has increased its buyback to between $6 bn and $8 bn
  - At an average stock price of $75, a $7 billion buyback would reduce the share count by over 5%
  - The stock also pays a dividend of 1.10%
- The current CEO will stay until at least June 2016
- 60% reinvestment, 20% buybacks, 20% acquisitions

Source: Nielsen

Valuation

Comparables Analysis

Company	Ticker	Share Price (US$)	Percent of 52-wk High	Market Cap (US$bn)	EV (US $bn)	EV/ EBITDA (x) FY 2013E	P / E (x) FY 2013E	P / E (x) FY 2014E	Beta	Operating Margin (%)	Price / Book	Dividend Yield (%)
Comcast	CMCSA	47.04	99.0	123.9	162.4	7.8	18.6	19.3	1.30	20.1	2.5	1.7
21st Century Fo	FOXA	34.26	99.0	79.1	89.1	14.5	11.8	22.5	1.04	19.4	4.7	0.7
CBS Corp.	CBS	59.20	99.6	35.8	41.5	11.4	21.3	19.1	1.84	21.6	3.7	0.8
Time Warner	TWX	68.73	99.7	63.2	79.9	10.3	18.8	18.4	1.46	23.3	2.1	1.7
Viacom	VIAB	83.64	98.1	39.9	47.5	11.8	18.8	15.3	1.03	28.0	5.9	1.5
Median						**11.4**	**18.8**	**19.1**		**21.6**	**3.7**	**1.5**
Mean						**11.2**	**17.9**	**18.9**		**22.5**	**3.8**	**1.3**
Disney	**DIS**	**67.15**	**98.9**	**120.0**	**131.0**	**11.4**	**20.4**	**17.2**	**1.25**	**21.1**	**2.8**	**1.1**

	<---------------- FY 2014 P/E Multiples ----------------->						
2014 EPS	**17.5**	**18.0**	**18.5**	**19.0**	**19.5**	**20.0**	**20.5**
3.85	67.38	69.30	71.23	73.15	75.08	77.00	78.93
3.95	69.13	71.10	73.08	75.05	77.03	79.00	80.98
4.05	70.88	72.90	74.93	76.95	78.98	81.00	83.03
4.15	72.63	74.70	76.78	78.85	80.93	83.00	85.08
4.25	74.38	76.50	78.63	80.75	82.88	85.00	87.13

Source: SEC Filings, Google Finance, Zacks

DCF Analysis

	2014	2015	2016	2017	2018	TV
Revenues	$48,343	$52,046	$55,301	$58,896	$62,730	
Gross Profit	10,152	11,060	11,751	12,515	13,330	
Cap. Exp.	2,910	2,994	3,223	3,287	3,500	
FCF	6,261	6,726	7,333	7,812	8,317	
PV of FCF	$6,213	$6,256	$6,156	$6,054	$5,956	$121,866

Key Assumptions	
Long Term Growth Rate	3.50%
5-Year Revenue Growth Rate	6.80%
TV Operating Margin	21.25%
WACC	8.26%

Share Price Calculation	
PV of FCF	$152,502
+Cash	$3,387
- Debt, Preferred/Minority Int.	$12,896
Equity Value	$142,993
Fully Diluted Shares Outstanding	1814
Share Price	$78.83

WACC Calculation	
Beta	1.25
Market Risk Premium	7.00%
Risk-Free Rate	2.61%
Cost of Equity	10.26%
Tax Rate	32.06%
After-Tax Cost of Debt	2.45%
WACC	8.26%

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