Disnat GPS Report

Walt Disney (DIS, U$106.83)

December 11 2017

Company Description

With a market capitalization of $150 billion US, the Walt Disney Company is one of the largest media conglomerates in the world. To understand the company's scale, we can look at the Media division, which alone represents approximately 40% of revenues.

The Media division includes one of the four major television networks in the United States (ABC) and various other networks known as "Disney Channels".

The crown jewel of this division is the ESPN sports network and its affiliates (ESPN2, etc.).

Another division, the Disney brand products, has a huge library of movies among other assets.

The latter continues to expand through the regular introduction of new products from various divisions, such as Pixar (*Toy Story*), Marvel Comics and its multiple superheroes and, more recently, the acquisition of Lucasfilm (*Star Wars*).

Obviously, these stories and characters are also marketed as amusement park attractions and other derivative products.

Many consumers, especially young people now opt for television entertainment services without using cable, just as many others are unsubscribing. This phenomenon, called "cord cutting", is a concern for the markets and has weakened the value of Media shares like Disney, Fox, etc.

Cable operators therefore have fewer subscribers and must pay royalties to producers like Disney based on fewer subscriptions, which means less income for producers.

However, even new players will be forced to enter into agreements with Disney, which owns too much content to be ignored or pushed aside by these new players.

At Disnat GPS we are aware of the risks of "cord cutting". However, the change in method of distribution does not change the fact that people want more direct sports, more TV and more movies than ever and therefore, more content. And that is exactly what Disney offers!

This report updates and replaces the previous Disnat GPS report published on Walt Disney on November 8, 2016.

Financial Health

Fiscal Year	2015	2016	2017
Long term debt (in billions of dollars)	13	16	19
Debt/equity ratio	0.29	0.38	0.46

Disney's financial health is extremely strong.

Not only is its debt of less than $20 billion relatively low, translating into a debt to equity ratio of 0.46, but the moderate increase in this debt also leads us to the conclude that this company has a very clear vision of the financial direction it wishes to take.

Moreover, not only is the debt itself easily manageable, but the debt/equity ratio is much lower than that of its main competitors (Time Warner, Fox, CBS, etc.)

This data allows us to appreciate the relatively defensive nature of Walt Disney shares.

In addition, low leverage provides the company a certain flexibility to potentially increase its debt in order to raise dividends, increase its share repurchase program or make certain acquisitions that would be helpful, but are too expensive for its more indebted competitors.

Each new film evolves in a sector which can sometimes be very volatile and represents a new challenge. Disney's financial health is therefore a very important part of our interest in this company.

Growth

Compound Yield	1 year	3 years	5 years	10 years
Earnings	– 1%	4%	5%	5%
Earnings per share	– 1%	10%	12%	10%

In addition to the necessary corporate reorganization that affects short-term results, Disney's historical earnings and earnings per share growth is typically quite stable.

Earnings per share growth of 10% for the past decade would be impressive for any multinational of this size, but the strength and regularity Walt Disney has demonstrated in the media sector is almost miraculous.

The other important point about Disney's growth is that the company should continue to diversify its revenue sources due to its recent acquisitions (Lucasfilm).

The geographic origin of its revenue also contributes to its diversification through its amusement parks in Europe, Japan and China, as well as the increased purchasing power and "leisure dollar" budget of the new middle class in developing countries like China, India and much of Latin America.

Disney has reached a level of diversification that affords it great stability. Impressively, the company remains very stable, although it operates in sectors which are very volatile!

Valuation

Key Ratios	Disney	Disney (5 yr avg)	S&P 500
Price/earnings	18.3	19.6	22.7
Forward price/earnings	16.8	n.a.	21.7
Dividend yield	1.6%	1.3%	1.9%

Disney's evaluation or, more accurately its undervaluation, is one of the main reasons for our interest in this company.

In terms of price/earnings and forward price/earnings ratios, this stock is currently trading at a significant discount compared to its average over the past five years.

In addition to trading at a discount compared to its own average, this stock is also trading at very large discount compared to the S&P 500.

The market currently pays much less for a dollar of Disney's profits than a dollar of profit of an average company in the S&P 500.

We do not agree with the idea that more than 250 companies in the S&P 500 have better future prospects than Walt Disney.

Disnat GPS believes that the fears linked to changes in television distribution methods are real, but we believe Disney's dominance will allow it to hold its own. Once worries have faded, all that will be left is an undervalued stock!

Governance

Fiscal Year	2013	2014	2015	2016	2017
Earnings per share ($)	3.38	4.26	4.90	5.73	5.69
Dividend ($)	0.75	0.86	1.81	1.42	1.56
Number of shares (millions)	1,813	1,759	1,709	1,639	1,578

Over the past five years, Disney's dividend has increased on average by more than 15% per year.

The increase of more than 100% in 2015 indicates that the company is serious in its intention to return a greater portion of its profits to investors.

In addition, the company regularly buys back its shares. In fact, over the past five years, Disney has bought back more than 10% of its outstanding shares.

In terms of internal development, the addition of a new division like Lucasfilm does not only allow Disney to monetize the *Star Wars* franchise, but also to properly time its movie and other product releases to ensure that Luke Skywalker doesn't hurt Iron Man!

Recent company acquisitions (Pixar, Marvel and Lucasfilm) are consistent with the company's core activities. They serve not only to increase revenues: on the contrary, they are the result of smart decisions made as part of a well designed and well implemented growth strategy!

Explanatory Notes

Disnat GPS reports contain five separate sections, each followed by comments from the Disnat GPS Portfolio Strategist regarding the following:

1. Company Description

2. Financial Health

3. Growth

4. Valuation

5. Governance

At Disnat GPS, we believe that the topics, ratios and other financial figures presented here are particularly important.

However, for reasons of space, we can not publish all available data. We therefore invite you to read the additional financial information on the Disnat website.

Furthermore, this report is an analysis of the condition of a company today, with a medium to long term view. It is in no way an adequate tracking of daily activities of the stock market in general or of this particular company.

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Steve Deschesnes, LL.L, GPC, GSPD, FCSI©
Portfolio Strategist
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