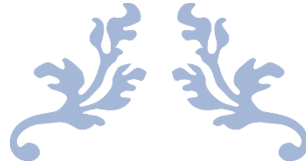

DISNEY'S RELATIVE VALUE

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Disney's Economic Moat & Market Position

An "economic moat" is essentially a company's protection from competitors and disruptors in the form of competitive advantages. These moats can range from access to capital to proprietary technology. Warren Buffett, the creator of this idea, states the following in relation to it:

> We are trying to figure out what is keeping — why is that castle still standing? And what's going to keep it standing or cause it not to be standing five, 10, 20 years from now. What are the key factors? And how permanent are they? How much do they depend on the genius of the lord in the castle?[1]

Analysts at Morningstar view Disney's various brands as an enormous economic moat which shields the company from most short-term market changes.[2] Competitors may or may not find opportunities to weaken Disney's revenue streams. However, it would be a daunting, near-impossible feat for a competitor to undermine Disney's entire brand awareness in the short-term.

Despite operating in an industry which is currently facing disruption at the hands of streaming companies and services such as Netflix (NYSE: NFLX), Hulu, Amazon Prime (NYSE: AMZN), and YouTube (NYSE: GOOGL), analysts such as Neil Macker from Morningstar remain optimistic about Disney's market position.[2] This is due to key network segments (such as ESPN), impenetrable brand loyalty, strategic acquisitions (such as Lucasfilm and Marvel), and a transition into OTT services.

OTT (Over the Top) is essentially another way to say "streaming services". Skeptics about the market position of Disney often cite the rise of such services as being the industry which will ultimately de-throne Disney. However, proponents of Disney's superior market position claim that the consumer's emotional connection to the company's brands means that Disney is here to stay. Additionally, Disney has already begun to move into this new "OTT" industry and proponents claim that its brand power (or economic moat) provides Disney with all the time it needs to make an effective transition.

Recommendation

As of March 3, 2019, The Walt Disney Company's stock was trading at $114 while analysts at Morningstar had it's "Fair Value Estimate" at $135.[2] For investors, this means that shares are currently trading at approximately 18.4 percent less than their intrinsic value. Additionally, as of just last week various analysts had the company's average 12-month target price at $126.55.[3] This would mean over an 11 percent return if the target price were to be hit.

Out of the following options: strong buy, buy, weak buy, weak sell, sell, and strong sell, Disney is a "buy". All forecasts and predictions point towards healthy growth for Disney's stock price for the foreseeable future and its economic moat provides a safety net so that there is enough time to sell if the market begins to indicate a decline in growth.

When considering whether the stock is a "sell" or a "buy", one might want to consider the following six indicators: Price to Book Ratio, Price to Earnings Ratio, PEG Ratio, Price to Free Cash Flow Ratio, Price to Sales Ratio, and Dividend Yield. Compared to the overall industry, Disney's Price to Book and Price to Earnings ratios are below average. However, these ratios still fall within a comfortable zone for investors. Each of the other four indicators perform above industry average with the dividend yield being the furthest above industry average. This is an excellent indicator to be performing well from the perspective of an investor as it directly contributes to an investor's expected return.

On the other hand, when determining the strength of the buy recommendation, it's necessary to look at a few other indicators to try to predict where the company may be headed and how it is currently being run. The specific indicators which eliminate the possibility of the stock being a strong buy are sales growth and net income growth (which indicate how the company has

been growing and how it might continue to grow) as well as the current ratio, quick ratio, and cash ratio (which determine how liquid the company's assets are). These two groups of indicators are commonly placed into categories of indicators referred to as growth ratios and liquidity ratios, respectively.

The most recent figures for Disney as well as the overarching industry show that, for these five indicators, Disney is performing both below average for the industry and less than desirable overall.[3] This lack of growth as well as lack of liquidity shouldn't be ignored by investors. If the industry continues to grow at the same rate, Disney's market share will inevitably begin to decline eventually as other companies within the industry continue to outpace them. Additionally, a lack of liquidity could pose huge problems for Disney if the economy enters a bear market despite its economic moat of brand recognition.

Regardless of those negative points, every other financial indicator suggests that Disney is in a healthy position and is poised to succeed. Its recent strategic decisions as well as its recent differentiation might also turn these negative points around. Disney has recently made two relatively large acquisitions of Lucasfilm and Marvel. This move serves to help Disney appeal to a broader consumer base, expand its brand recognition over a larger demographic, and purchase franchises which should pay dividends for years to come. In addition to these moves, Disney has begun to offer its products through third-party streaming services while it has been developing its own service.

For these reasons, it is recommended that one would buy Disney equity rather than sell it. This recommendation is made with a bit of caution due to the aforementioned growth and liquidity ratios but also with confidence due to its economic moat.

ENDNOTES

[1] Kim, T. (2018, May 07). Warren Buffett believes this is 'the most important thing' to find in a business. Retrieved March 5, 2019, from https://www.cnbc.com/2018/05/07/warren-buffett-believes-this-is-the-most-important-thing-to-find-in-a-business.html

[2] Macker, N. (2019, February 05). Disney's Near-Term Focus Centered on Direct-to-Consumer and Fox. Retrieved March 5, 2019, from http://library.morningstar.com.byui.idm.oclc.org/stock/analyst-report?t=DIS®ion=usa&culture=en-US

[3] Bloomberg L.P. DIS US EQUITY. 01/31/1999 to 01/31/19. Bloomberg terminal, 05 March 2019.