



Holland Views – Disney – Price: \$117; MCap: \$174bn

Game changer

Charlie Munger's observation that the emergence of video cassette players in the early 80s was a game changer for Disney because it allowed the company to re-monetise its exceptional quality content we think is apt. In other words, there was latent pricing power within the business that was only realised due to a new distribution channel. Today we believe Disney's Direct-to-Consumer opportunity is another such game changer.

"So a lot of the great record of Eisner and Wells was utter brilliance but the rest came from just raising prices at Disneyland and Disneyworld and through video cassette sales of classic animated movies" – Charlie Munger - A Lesson on Elementary Worldly Wisdom

Reams have been written on the rapidly changing media landscape of the last decade: on Netflix spending \$8bn to develop its own content, on Amazon (a book seller) winning a Golden Globe, on Disney buying Fox (thwarting Comcast, who bought Sky), on AT&T buying TimeWarner (and then raising prices) and on and on. What every player agrees though is the obvious point: Content is King (us too, as you know: Holland Views – Disney – Content King – October 2016).

What strikes us as curious though is that, in Disney's case, whilst many industry observers write and opine *very favourably*¹ on Bob Iger's strategic nous and Disney's execution and prospects – Mr Market still remains sceptical. Sceptical, it seems, on the costs of such change, the ability to scale the offering and the pain of cannibalising existing distribution routes. Mr Market is highly sceptical that moving to OTT² distribution will be accretive.

Wholesaler becomes retailer

At 16x PE, Disney's shares discount no benefit from the game changing move from being essentially a wholesaler of content to suddenly becoming the retailer of it too. Disney is in effect getting access to a low-rent, global shopfront of its own with control of pricing for its unique products – not to mention direct contact with its customers!

We see this is another golden opportunity for Disney to re-monetise the back catalogue and realise increased pricing power in the future. That makes it an opportunity that surely will be accretive to the business. The more we have analysed and debated Disney's prospects over the last two years, the higher our conviction has become that this is a mispriced share.

At the same time, we fully accept that things (forecasts, sentiment, roll-out and cannibalisation costs) could quite possibly get worse before they get better.

We make it our job to seek great companies that are priced like OK ones. Disney owns the best global content and the brands that will keep producing it and it is a high return business with strong FCF generation. It also has the determination to execute this move to becoming a retailer of its own brands online in the same way it is in the theme parks

"When Disney gets behind something, look out." – Steve Jobs³

¹ TIME's recent profile on Iger is a great example

² Over-The-Top – i.e. distributed over the internet

³ 'The Pixar Touch' book

Three Misconceptions

We summarise Mr. Market's three misconceptions thus:

1. *Disney will not be able to execute this transition to a proprietary 'Disney+'⁴ streaming service seamlessly and therefore risks killing its Golden Goose.*
2. *The move to direct selling will cannibalise existing revenue streams from the traditional distributors and the streaming market is just too competitive.*
3. *Disney will take a huge hit to its earnings as it builds out this network and we have no idea if/for how long it will take to get back to steady state.*

We take down those misconceptions one by one later on. In doing so, we draw heavily on Bob Iger's thoughtful and candid comments on the motivation and consequences of Disney's move to direct consumer selling of its media.

Crucially though, we also draw on our own experience as very close-followers of the evolution of WWE (and Formula 1) – two other unique media brands who are embracing the opportunity that direct selling of content is affording them. Importantly, their evolution was two-fold: 1) in terms of their business models and 2) of Mr Market's confidence in such moves. Our earlier work has looked in detail at business model evolution – this note primarily addresses the latter.

"in the future, all companies will be internet companies" – Andy Grove, Intel founder, 1999

First, a reminder of what a great business Disney is

This note is not intended to be a rehash of our earlier work. In our first note on Disney we asked the rhetorical question – *"Could Disney turn out to be one of the few old school companies to truly benefit from the internet"*? This note builds on that earlier work and our now increased conviction that Disney's equity price is attractive thanks to market scepticism. We encourage you to review our earlier work on Disney⁵ (including – notably – a detailed rebuttal of misplaced ESPN concerns in that first note).

Our earlier work concluded that:

1. Bob Iger is a world-class manager of creative talent and brands with an impeccable track record. He is a terrific capital allocator. Iger is also exceptionally candid and consistent in his communication as evidenced in his quotations through this report.

“Journalist Question: *what is the content industry going to look like in five years?*

Bob Iger: *"I believe we have to look at this as opportunity versus threat. Meaning I've tried to manage this company ... in a way that enables us to not only survive but to thrive in a world that doesn't look anything like the world that existed just a few years ago ... There are three ways to do that. The first is make great content. And this is very relevant to the Fox acquisition. The second is to be incredibly innovative about how you bring that content to market. By the way, there isn't a better example than Netflix. The third is to be truly global in nature. – Hollywood Reporter*

To view the remainder of this in-depth report, please contact Andrew Hollingworth, Andrew@hollandadvisors.co.uk for a complete PDF copy.

⁴ Disney+ is the planned name of Disney's streaming service to be launched in 2019

⁵ Holland Views – Disney – Content King, Oct 2016
Holland Views – Disney – Mouse Marries Fox, March 2018
Holland Views – Disney – Blowing Up The Castle, July 2018

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