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Walt Disney Company:

The 1984 Attempted Takeover and the Recovery

Plan Devised by Michael Eisner

By Pamela Howell

Directed by Professor Edward Wolfe

Presented to the Western Kentucky University Honors Program

Spring 1997

Approved by

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Abstract

Beginning with a brief history of the 1984 attempted takeover of the Walt Disney Company, this study provides a financial analysis of the then-targeted company. What follows is a discussion of Michael Eisner's management techniques for rejuvenating Disney and a financial analysis of the company in 1996 to show the progress the company has made under Eisner's leadership.

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Introduction

Walt Disney Company has maintained a reputation for quality family entertainment since its inception in 1938 under the guidance of Walt Disney. However, in 1984 Saul Steinberg attempted to take over this company so that he could sell the corporation, in pieces, for more than the stock cost. This would have produced an enormous profit for Steinberg. To avert this takeover, Disney Company paid greenmail and brought in a white knight, the Bass Brothers, to purchase Steinberg's stock. Then, Roy Disney and Stanley Gold led a successful campaign strategy to oust Ron Miller from the position of CEO and to hire Michael Eisner and Frank Wells to rediscover a financially strong company. Why Disney was a potential takeover target and why and how, from an investor's point of view, Michael Eisner and Frank Wells were able to rejuvenate the corporation are the subjects of this investigation.

The Takeover Attempt

"Walt was a real genius. He was running the company fifteen years after his death," said movie analyst Denis Forst.[1] Indeed, after the death of Walter Elias Disney, his famous company, Walt Disney Productions, was focused on the completion of Walt Disney World and EPCOT Center, Walt's last dream.[2] During the 1970s, though, Walt Disney Productions did not change with the consumers. Management continued to ask itself what Walt would have done, but it failed to recognize that the genius in Walt Disney was his creativity and ability to appeal to consumer demands. By early 1980, Walt Disney Productions had fallen significantly behind in the movie production industry. In 1971, just prior to the opening of Walt Disney World, the film division accounted for 50 percent of the total annual revenues of Walt Disney Productions, but by 1979 it had fallen to 20 percent of total revenues.[3] In 1984, the attempted takeover of Walt Disney Productions by Saul Steinberg and later by Irwin Jacobs was due in large part to Disney's poor management decisions, decisions that led to the undervaluation of

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[1]Tom Nicholson and Peter McAevey, "Saving the Magic Kingdom," *Newsweek* 8 October 1984:44.

[2]Walt Disney Productions and Walt Disney Company will be used interchangeably throughout this paper.

[3]John Taylor, *Storming the Magic Kingdom* (New York: Alfred A. Knopf, 1987), 21.

Disney stock.

Those poor management decisions were best exemplified by Esmond Cardon Walker, known as Card, who first joined the company in 1938 as a mailroom messenger but worked himself up to the position of executive vice-president in charge of operations after Walt's death.[4] In 1971 he was named president, in 1976 was declared chief executive office, and in 1980 became chairman of the board.[5] This Idahoan was feared by subordinates because of his tyrannical approach, his public criticism of employees, and his refusal to listen to others.[6] Throughout his reign, Walker refused to pay for advertising of the theme parks; if he needed advertising, he would convince one of the major networks to run a special on the theme parks. He also very rarely raised ticket prices, even though inflation was continuing, because he feared that it might ruin the "friendly company" image of Disney. His biggest fault was that he resisted any change in the movie industry. Walker was so worried about ruining the wholesome family image of Disney that he did not encourage the movie division to keep in touch with the moviegoers. On February 24, 1983, Walker announced his resignation as chairman of the board, and at the same time Ron Miller was named president and chief executive officer.

Ron Miller, former tight end for the Los Angeles Rams, was married to Walt's older daughter, Diane. In 1953, he first began working for Walt Disney Productions as a

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[4]Ron Grover, *The Disney Touch* (Homewood: Business One Irwin, 1991), 11.

[5]Taylor, 12.

[6]Myron Magnet, " No More Mickey Mouse at Disney," *Fortune* 10 December 1984:57.

liaison between Disneyland, which was under construction, and the park designers.[7] Diane Miller said of Walt's impression of Ron Miller, "I think he [Walt] was thrilled with the way Ron came along and grasped it [the movie industry]. And actually, Ron . . . was like a blank notebook. Dad could take him and mold him in his pattern. . . . I think the nicest thing I ever did for Dad was that . . . I was able to marry a man who was able to fit into Dad's dream, Dad's organization."[8] In 1976 he was named head of production at the studios, and upon Walker's retirement he was named chief executive officer. Whereas Walker had not focused upon the movie industry, Ron Miller knew that this was the key to the rejuvenation of Walt Disney Productions. As Ron Miller himself said, "It was clear that we were in never-never land. . . . If we were going to make movies for a broad audience, we needed a second distribution label."[9] Touchstone Films made its debut in 1984 with the movie *Splash.*

While Miller understood the needs of the movie industry, he lacked the vision that the company needed. He also lacked the experience to make key decisions on his own; instead, he looked to Ray Watson for advice. Most importantly, people perceived him to be incompetent, and on Wall Street perceptions can create their own realities. Even Ray Watson, chairman of the board and a close friend of Miller, recognized Wall Street's perceptions of Ron Miller. On July 28, 1984, Watson wrote a memo stating that the

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[7]Taylor, 18.

[8]Ibid., 20.

[9]"Problems in Walt Disney's Magic Kingdom," *Business Week* 12 March 1984:50.

investment community "knew little of Ron when he was made CEO, they have seen little of him since. . . . The negative of that act in their minds was not balanced by the image of a strong leader. . . . Thus their view is that we are a rudderless boat caught in a violent storm. . . . We need to resolve the [Ron Miller] issue as soon as possible."[10] According to Wall Street, Walt Disney Productions needed a new management team in order to revitalize the company and its stock.

Wall Street was not the only place where people were searching for new management; Roy Edward Disney also was worried about the inefficiencies of management. According to Michael Eisner, "Roy has been the catalyst for the whole change in the company's direction."[11] Roy Disney, the only nephew of Walt Disney, worked at Disney for twenty-three years before resigning on March 4, 1977, stating, "It is with deep regret that I hereby tender my resignation as Vice President and employee of Walt Disney Productions, due to what seem to me to be deep and irreconcilable philosophical differences with present management. . . . "[12] His major complaint was that current management, particularly Card Walker, had focused on expansion of the theme parks to the detriment of the film division.

As the largest single stockholder of Walt Disney Productions, Roy Disney had

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[10]Taylor, 179.

[11]Stewart Toy and Cynthia Green, "Roy Disney's Adventures in Tomorrowland," *Business Week* 5 August 1985:66.

[12]Taylor, 15.

seen his 1.1 million shares decline to a worth of only $55 million, which was $30 million less than its worth a year earlier.[13] After Stanley Gold, who had been running Shamrock Holdings Company (Roy Disney's private holding company) for Roy Disney since 1978, told him that they needed to develop a plan of action, Roy Disney proceeded to resign from the board of directors on March 9, 1984.[14] Stanley Gold developed a "Brain Trust" consisting of Roy Disney, Stanley Gold, Peter Daily, Mark Siegel, and Clifford Miller.[15]

Upon deciding to attempt to oust management, Stanley Gold bought 550,000 additional shares of Disney stock. He then talked to Frank Wells, who told him to recruit Michael Eisner. Another person contacted by Gold was Michael Milken, the junk-bond king at Drexel Burnham Lambert, who said he could raise $2 billion in junk bonds to proceed with a leveraged buyout; however, Disney would be forced to sell some of its assets in order to pay the bonds.[16] Faced with this tough dilemma, Disney decided not to attempt a leveraged buyout, but would rather use a proxy fight to attempt the takeover. He wanted to maintain the company as a whole because he realized that the divisions of the company had a high level of synergy, which is the concept that the whole is greater that the sum of its parts. Each division promoted the entire company, and the weakness of one division, namely the film division, had brought down the entire company.

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[13]Grover, 14-15.

[14]Magnet, 60.

[15]Taylor, 6.

[16]Ibid., 90.

According to Roy Disney, "It became a real estate company that also happens to make movies."[17] He was determined to bring about managerial changes that would focus more on the studio. When news leaked out that Disney was going to attempt a proxy fight, management met with him, and an agreement was reached through which Disney, Gold, and Daily were given seats on the board of directors.[18] Disney felt that on the board of directors he would be able to deal internally with the management crisis.

Saul Steinberg, chairman of Reliance Group Holdings, was known as a corporate raider who acquired companies in hostile takeovers and then got rid of management. In February 1984, Steinberg seriously began to consider Disney and had his research department do an investment analysis on the company; the researchers found that the liquidation value was approximately $100 per share.[19] Steinberg, recognizing that the market value of Disney stock was significantly undervalued, decided to pursue a leveraged buyout. A leveraged buyout is the purchase of a company through the use of debt, typically through the issuance of junk bonds.[20] Reliance began acquiring Disney stock, and on March 29, 1984, it filed Schedule 13D with the Securities and Exchange, stating it had purchased 2.1 million shares of Walt Disney Productions, or 6.3%, "for

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[17]Toy and Green, 66.

[18]Magnet, 62.

[19]Taylor, 51.

[20]Jeff Madura, *Financial Markets and Institutions* (Minneapolis: West Publishing Company, 1995), 204.

investment purposes."[21] On June 8, 1984, Steinberg set up MM Acquisitions as the company to take over Walt Disney Productions; its stockholders were Reliance, Fisher Brothers Financial and Development Company (a New York property company), and Tracinda Corporation, controlled by Kirk Kerkorian.[22] Steinberg's plan of arbitrage involved asset stripping, which occurs when a company acquires the undervalued firm and sells off individual divisions to realize a profit. Under this plan, Fisher Brothers and Tracinda each pledged $75 million for the leveraged buyout, Kerkorian reserved the right to buy the studio and film library for $447.5 million, and Fisher Brothers held exclusive rights, for ten years, to purchase undeveloped property in Florida and California.[23]

Walt Disney Company had several strategies to pursue in attempting to ward off a corporate takeover. The first strategy was to extend the company's line of credit with Bank of America from $300 million to $1.3 billion.[24] Secondly, Skadden Arps Slate Meagher & Flom, New York takeover lawyers, suggested Disney search for an acquisition in an attempt "to dilute Steinberg's holdings by issuing more shares, to gain a friendly major shareholder, and to make the company more expensive by making it bigger

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[21]Taylor, 58.

[22]Ibid., 112.

[23]"The Bigger Splash From Saul Steinberg's Dive into Disney," *Economist* 16 July 1984:69.

[24]Taylor, 57-58.

and more profitable."[25] Disney Company found an acquisition opportunity in Arvida Corporation, a Boca Raton real estate and development company that owned approximately 20,000 acres in Florida, Georgia, and California and would be useful to Disney by helping develop the company's 17,000 undeveloped acres in Florida and the 840 undeveloped acres in California.[26] This acquisition did dilute Steinberg's holdings, it brought in a "white knight" in the Bass Brothers, and it enlarged the assets of the company. On June 6, 1984, the deal was closed by paying $200 million worth of stock (approximately 3.3 million shares) for Arvida, thereby making the Bass Brothers the second largest shareholders with 5.9% of the company stock.[27] The third and final strategy Disney utilized was paying greenmail. On June 11, Reliance offered $67.50 a share to acquire 49% of Disney stock; however, Disney stepped in and paid $325.5 million for Steinberg's 4.2 million shares.[28] The purchase of Steinberg's stock at a higher price in order to remove the threat of a takeover is called the payment of greenmail. In the agreement, Steinberg promised not to buy Disney stock for ten years.

The Bass Brothers Enterprises, a Fort Worth, Texas, oil conglomerate worth $4

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[25]Magnet, 60.

[26]Peter Hall, "Sentiment Aside, Disney Makes a Deal," *Financial World* 13-26 June 1984:20.

[27]"How Disney is Circling the Wagons," *Business Week* 4 June 1984:1.

[28]Ibid., 113,128.

billion, acted as a "white knight" for Disney because they immediately purchased a large amount of stock in Disney from Irwin Jacobs, another corporate raider who looked into taking over Disney after Steinberg received greenmail but decided that it was too large a deal, to prevent any further attempted takeovers by corporate raiders. This increased their stake in Disney to 24.8%, making them the single largest shareholders.[29]

[29]Magnet, 62.

The Takeover Target: Disney as of February 1984

Economic Analysis

In analyzing the stock of Walt Disney Productions at the time Saul Steinberg began to consider buying stock in Disney (February 1984), one must first analyze the economic environment at that time. The economy had been experiencing a bull market, a period of rapidly increasing stock prices, since 1982. For the three months prior to February 1984, the Dow Jones Industrial Average fell 1 percent, from 1229.87 (11-1-83) to 1220.58 (1-31-84). At this time many analysts were speculating about whether the bull market would continue or would end.

The economy appeared strong amid reports that the unemployment rate fell for three consecutive months, from 8.8% in October to 8.2 % in December. This was a decline of 2.5 percentage points from a year earlier, the sharpest annual drop in thirty years.[30] Personal income was rising during this period, and inflation was at a ten-year low of 3.8%.

The most important news related to the stock market was the prediction by

[30]"Business Wide," *Wall Street Journal,* 15 January 1984: 1.

financial analysts that after-tax corporate earnings would increase by 25% in 1984. This, coupled with the other economic data, led many to predict a strong economy with low inflation and a continuation of the bull market.

Industry Analysis

Walt Disney Productions is classified by the *S&P Industry Surveys* as belonging to the leisure industry, being further categorized in the amusement parks division. This industry has gained some strength in recent years as consumers have come to regard recreation as a necessity rather than something reserved for those with extra time and money. In 1984, Steinberg would have known that the Standard and Poor's movie division had experienced a couple of years of record box-office receipts. Also, the future looked good thanks to technological advances such as cable television and VCRs. Disney itself had a movie division, but it was ranked 8th in the motion picture industry, last place.

During the early 1980s, amusement parks had not been performing as well as expected because of lower disposable incomes, a previously weak economic climate, and increased competition from other entertainment companies.[31] Disney remained the leader of corporations in the amusement park category. "A high degree of success in attracting . . . repeat business through the continuous upgrading of existing operations

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[31] *Standard and Poor's Industry Surveys.* (New York: Standard and Poor's, April 1982), L35.

and the addition of new attractions [had] been an important factor in the success of the two theme parks operated by WALT DISNEY PRODUCTIONS."[32] Disney, because of its presence as the market leader, had the name recognition and the family image which gave it a competitive advantage over its competitors; however, as can be seen in Table 1, it was not financially ranked number one in its industry.

Company Analysis

Walt Disney Company was incorporated in 1938 (under the name Walt Disney Productions) by Walter Elias Disney. In 1928 the introduction of Mickey Mouse in *Steamboat Willie* began events that eventually led to the construction of Disneyland, and subsequently, the corporation grew into a billion-dollar enterprise. By 1935 Mickey Mouse was acclaimed to be "the best known and most popular international figure of his day."[33] The release of *Snow White and the Seven Dwarfs* in 1937 began Disney's trend of releasing full-length animated cartoons (of which there are 34). Then, Walt Disney expanded to live-action films such as *Song of the South.*

Walt developed the idea for a theme park while taking his daughters to a local

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[32] *Standard and Poor's Industry Surveys,* (New York:Standard and Poor's, January 1983), L34.

[33] Mirabile, Lisa(ed.), *International Dictionary of Company History.* (Chicago: St. James Press, 1992), p. 173.

carnival. He wished that there was a park for the entire family to enjoy; then, he decided to create the perfect place for the family to enjoy together. After the creation of Disneyland in California, Walt decided to perfect his dream in Florida, where he would have the land to develop everything his mind could imagine. However, Walt died of lung cancer before his dream was realized. Walt Disney World was completed soon after his death, and his brother, Roy Disney, continued the dream.

Financially, the Walt Disney Company was stable in 1984. Table 2 shows the per share growth rates in terms of earnings, book value, and cash flows. It had a huge amount of cash and no long-term debt, as can be seen in Table 3. Corporate raiders look for companies with low debt, high levels of cash, and an undervalued stock price. Disney had huge inflows of cash from the theme parks, cash which was used to fund future projects; therefore, it had no reason to use long-term debt. Table 3 also shows a general trend downward for the profitability ratios. For example, the net profit margin, which measures the percentage of every dollar of revenue that makes it to the net income, averaged 12.04% from 1977 to 1983; however, since 1980 it has trended downward, reaching a low in 1983 at 7.13%. This was a 48.38% decline from the high of 14.78% in 1980. These figures were lower in part because of extraordinary expenses associated with the opening of EPCOT and the start-up of the Disney Channel. The major problem appeared to be the motion picture division, which had released major box-office flops in recent years such as *Baby: Secret of the Lost Legend.*

The estimated 1984 earnings per share (EPS) was found by multiplying the 1983 EPS by the average 1977 to 1983 EPS growth rate (8%). This resulted in an estimated 1984 EPS of $2.92. Using the EPS average growth rate for 1972 to 1983 of 8.00%, the future EPS were estimated (See Table 4). Expected growth was associated with the opening of EPCOT and with the appearance of a new motion picture label, Touchstone Pictures.

Next, the high and average low P/E ratio for the previous eight years (1976-1983) was found (See Table 5). Then, in Table 6, those ranges were taken and multiplied by the estimated EPS to get a range of future estimated stock prices. According to this model, Disney stock was trading within the range of its intrinsic value. Disney stock ended 1983 around 52, while the high range of the estimated stock price was $56.65. The significant problem with this model is that the estimated EPS growth rate (used in Table 4) was influenced heavily by the decline in EPS from 1981 to 1983. Future projections, especially with the new opportunities for growth associated with EPCOT, the Disney Channel, and Touchstone Pictures, should have been higher than the 8% average. If one omits years 1981-1983 from finding the average growth in EPS, which is then 16%, one will find in Tables 7, 8, and 9 that the estimated stock price should have been between $60.84 and $40.95. This shows Disney stock to have been trading in the middle of the estimated stock price range.

Another approach to this same model involves using the equation $P_0=E_1 x P/E_1$. P_0

is the estimated value of the stock at the current time. E_1 is the estimated earnings for the coming year; 1984 (E_0) was found in Table 4 to be \$2.97. P/E_1 is the expected P/E ratio or the ratio of price to projected earnings, which was estimated in Table 5 to be 19.42. When these numbers are placed in the formula, the estimated value of the stock was \$63.44.[34] This valuation shows Disney to have been \$11.44 (18%) under its intrinsic value at the end of 1983.

One major concern of this model is that it does not take into account those assets which may have been undervalued on the balance sheet. When Ray Watson hired Stan Ross of Kenneth Leventhol and Company to analyze Walt Disney Productions for a leveraged buyout, he did a valuation of the assets of the corporation. He found that the theme parks could be sold for up to \$2 billion, the film library was underutilized and could be worth up to \$1 billion, and the real estate holdings (17,000 undeveloped acres in Florida) were worth \$340 million to a corporate raider.[35] Saul Steinberg did an intense valuation of Disney and found the liquidation value of Disney (the price if all the assets were sold off) to be in excess of \$100 per share, almost double the trading price of Disney stock.[36]

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[34] $P_0 = 3.27*19.42 = 63.44$
$E_1 = 2.97*1.10 = 3.27$

[35] Taylor, 40.

[36] Lawrence Minard, "Who Will Win the Keys to Disney's Magic Kingdom?" *Forbes* 4 June 1984:32-34.

Michael Eisner, The Man Who Brought Change to Disney

When Michael Eisner and Frank Wells joined Disney's management as chief executive officer and president respectively, they found a poorly managed company. Sid Bass best described the situation when he said, "In many ways, Walt's shadow actually held the company together. I couldn't understand how a company that was this badly managed at the top could be so fantastic at the middle management level. The executives at the park remembered how Walt had done it."[37] When Walt had been running the show, there was a special managerial relationship established between himself and his brother, Roy O. Disney; Walt handled the creative side while Roy handled the financial side. The team of Eisner and Wells was thought to possess the same careful balance of creativity and financial savy that would allow for the growth of Disney.

Michael Eisner began his career at ABC where, in 1969, he was placed in charge of Saturday-morning children's programming, and within a few years he had moved ABC

Steinberg's valuation stated the theme parks were worth S55 per share, the consumer products division was worth $10 per share, the filmed entertainment was worth $12 per share, the hotel business was worth $9 per share, the undeveloped land was worth $9 per share, and deferred taxes that would never be paid were worth $9 per share. This brings the valuation to $109 per share.

[37]Grover, 57-58.

from last place in Saturday-morning ratings to first place by developing such cartoons as *The Jackson Five* and *The Osmond Brothers*.[38] Eisner then became president of Paramount Pictures, where he was at when the Disney opportunity presented itself. His reign as president of Paramount saw the release of such films as *Saturday Night Fever, Raiders of the Lost Ark, Star Trek - The Motion Picture, An Officer and a Gentleman, Terms of Endearment, and 48 Hours.*[39] Eisner knew that his talent and experience from ABC and Paramount would prove useful in the task of reviving Disney. As he explained at the time, "The area Disney has been weak in is exactly the area in which I am strong. If we can do here what was done at Paramount, think what that would mean to the size of the company."[40] Eisner focused on particular divisions of the company to provide the growth: filmed entertainment, theme parks, and consumer products.

The filmed entertainment was the lifeblood for the company during Walt's time, and when Eisner joined the company, its pulse was almost gone. Under Card Walker and Ron Miller, Disney had been releasing an average of four feature films; Eisner was determined to make Walt Disney Studios a major film studio by eventually producing twelve feature films a year (the industry average). Eisner used the same key to success at

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[38]Taylor, 206.

[39]Ibid., 200-201.

[40]Geraldine Fabrikant, "Disney and the Street: Will the Love Affair Last?" *Business Week* 11 March 1985:40.

Disney as he had at Paramount: a good story is a must. After he found a good story, he searched for potential superstars or former superstars, like Bette Midler or Richard Dreyfus, who had not made a major film in years; this was one way he was able to keep production costs down. Disney was able to keep its average cost of producing a film at $14.5 million, well below the industry average of $18 million.[41] Another key to success in the film division was the formation of Silver Screen Partners, limited partnerships that financed over $1 billion for Disney films.[42] Of the first fifteen films produced under Michael Eisner, all except *Offbeat* were profitable.[43]

Another new development at Walt Disney Studios was the television syndication as well as the new Disney Channel. "Though the earnings from film production had received the most publicity, the video, TV syndication, and cable units together had actually been responsible for 60% of the studio's revenues."[44] Syndication first saw success with the television show *The Golden Girls* and continued success with such syndications as *Duck Tales, Chip 'n Dale's Rescue Rangers, Siskel and Ebert and the Movies, Win Lose or Draw, and Live With Regis and Kathy Lee.*[45] The Disney Channel

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[41]Christopher Knowlton, "How Disney Keeps the Magic Going," *Fortune* 4 December 1989:120.

[42]Howard Rudintsky, "Creativity, With Discipline," *Forbes* 6 March 1989:41-42.

[43]Grover, 104.

[44]Ibid., 151.

[45]Ibid., 146.

had begun in 1984 with more than a million subscribers; however, it experienced an extremely high level of people unsubscribing. Through an aggressive marketing campaign and the purchase of outside programming, the Disney Channel began to show a profit. More recently, in 1995, Walt Disney Company acquired Capital City/ABC; this acquisition will prove to expand the entertainment opportunities available to the Walt Disney Company.

The "crown jewels" of the Walt Disney Company included the film library, which consisted of twenty-three animated films, three decades of *Walt Disney*, 200 one-hour movies such as *Zorro* and *Davy Crockett*, 162 live-action films, and over 500 short cartoons.[46] The first action by Eisner was to release *Pinocchio* (May 1985) on videocassette; the success of that release prompted the release of *Sleeping Beauty* (October 1986), *Lady and the Tramp* (October 1987), *Cinderella* (1988), and *Bambi* (1989).[47] By 1989 the animation division was ready to produce classics comparable to the classics Walt had produced. In 1989, *The Little Mermaid* was released, followed by *Beauty and the Beast* and *Aladdin*. The filmed division was the focus of the growth because the success of this division could be paralleled to the theme parks and the consumer products division.

The second area for potential growth was the theme parks. The first action was to

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[46]Magnet, 64.

[47]Grover, 141-143.

slowly increase theme park ticket prices. In 1985, a family of four paid $62 for one day in the parks; by 1987 that figure was at $92.[48] The good new was that the company able to raise the admission price while at the same time increasing attendance figures. This was a direct result of an extensive advertising campaign. Until Eisner joined the Disney team, the company had never paid for advertising the theme parks. Jack Lindquist, vice-president for marketing, was placed in charge of a $19 million campaign to advertise the Orlando theme parks and a $18 million budget to promote the 30th anniversary of Disneyland.[49] These two strategies, raising ticket prices and advertising, resulted in the profits from theme parks nearly tripling between 1983 and 1987.

Disney owned 17,000 undeveloped acres in Florida; this land could be developed into hotels and activities in conjunction with the theme parks. In 1984, "A Hyatt Hotel outside Disney's borders, without benefit of being linked to the parks by Monorail, was charging as much as $10 a night more than a comparable Disney hotel,"[50] because there were only three hotels on Disney property (none were built since 1973), and they experienced at least a 90% occupancy rate year round. Disney began construction on over 6,700 hotel rooms, developing such resorts as The Caribbean Beach Resort, The Swan and Dolphin, and The Grand Floridian Beach Resort.

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[48] Ibid., 79.

[49] Ibid., 67.

[50] Ibid., 42.

Another way Eisner utilized the undeveloped acreage was to develop new attractions. The first such endeavor was the creation of the Disney/MGM Studios, which opened in September 1989. Through a twenty-year agreement with MGM/UA, Disney gained use of the famous roaring lion and exclusive rights to 250 MGM movies.[51] The Disney/MGM Studios opened with such attractions as The Great Movie Ride, The Magic of Disney Animation, Beauty and the Beast Stage Show, and The Indiana Jones Stunt Spectacular. Over the years, additional attractions have been developed for all three theme parks, such as Star Tours, The Tower of Terror, Alien Encounter, The New Tomorrowland, Splash Mountain, Captain EO (now Honey I Shrunk the Audience), and Body Wars, in an effort to appeal to young adults. Another attempt to attract young adults to Disney World was Pleasure Island, a nighttime entertainment center where New Year's Eve is celebrated nightly; it features such clubs as Mannequins, Jazz Club, Beach Club, 8-Traks, Adventurers Club, Comedy Club, and Neon Armadillo. The Village Marketplace, located adjacent to Pleasure Island, was expanded, and by 1998, AMC Theaters, Pleasure Island, and the Village Marketplace will be doubled in size. Other projects included Typhoon Lagoon and Blizzard Beach, water parks; Celebration, a Disney-run community; the Disney Institute, where people can take classes in a variety of fields; Discovery Island, a wildlife preserve; The Wedding Pavilion; and The Walt

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[51]Ibid., 174.

Disney World Speedway. By the year 2000, Disney will have completed construction of a cruise-line, Animal Kingdom, Wide World of Sports Complex, and Coronado Springs Resort. Michael Eisner has expanded the activities available at Walt Disney World in an attempt to expand the length of vacations. So far, it has succeeded, with average vacation time spent at Walt Disney World currently at seven days.

The last division Eisner looked to expand was the consumer-products division. Previously, Disney only received royalties from toy companies for its products; under Eisner, the company began to develop its own line of toys and to sell them to manufacturers in an attempt to increase profits. Steve Burke developed the concept of The Disney Store, which first opened in 1987 in Glendale, California, and was generating $1000 per square foot by the end of the first year.[52] Eisner quickly expanded The Disney Store to other malls throughout the nation. Also, J.G. Hook designed the Mickey & Co. label to distribute modern men's and women's clothing lines.[53] Then, in order to reach every potential customer, Disney developed The Disney Catalog. By 1990, the consumer-products division generated earnings five times the 1984 figure.[54]

Through the 20-20 Plan, whereby each division of the company was expected to

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[52]Ibid., 256.

[53]Ibid., 259.

[54]Rita Koselka, "Mickey's Midlife Crisis," *Forbes* 13 May 1991:42.
1984 revenues = $110 million
1990 revenues = $574 million

produce an average growth rate of 20% in order to produce an overall company growth rate of 20%, Eisner was able to bring phenomenal growth to Disney. From 1984 to 1989, net income grew at an average annual rate of 50%, and return on equity increased to 22%.[55] More importantly, the stockholders' worth had increased tremendously. "The market value of Disney's equity increased from $2 billion in 1984 to $10 billion in 1987, a 400% rise in . . . three years."[56]

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[55]Knowlton, 111.

[56]*Walt Disney Company Annual Report*, 1987:32.

The Revitalized Company: Disney as of December 1996

Economic Analysis

As of December 1996, the economic climate for the market was extremely positive as seen by the record highs of the stock market indices. Over the previous three months, the Dow Jones Industrial Average rose 873.31 points (from September 3 to November 29); this was a 13% increase over those three months. November alone saw a 499.77 point increase. The manufacturing index had been above 50 for several months, which meant that the economy was continuing to expand. Consumer confidence, which was wavering a few months earlier because of fears of inflation, had been strengthened after data released showed that inflation remained low. The Labor Department reported that the employment cost index rose .6% in the third quarter; this was considered to be the best gauge of wage and benefit trends. The consumer price index rose .3% in October, the same as September. Also, retail sales rose .2% in August, .7% in October, and .2% in November. The Thanksgiving weekend saw stronger-than-expected sales, figures which led many analysts to predict December's sales would be stronger than originally predicted. With inflation remaining in check, the unemployment rate hovered around a seven-year low of 5.1%. Another good sign for the economy was that I/B/E/S

International, a New York firm that tracks earning estimates, stated that 54% of the companies in the Dow Jones Industry Groups reported earnings above analysts' expectations for the third quarter. The economy appeared to be moderately growing, and inflation appeared to be under control, so the Federal Reserve left short-term interest rates unchanged.[57]

Industry Analysis

Disney is considered "the most significant creator of wholesale amusement in its innovative theme parks."[58] According to Value Line, Disney Co. falls into the entertainment industry. This industry is currently marked by vertical and horizontal integration, allowing the industry to be dominated by a few key players. Over the past several years, these companies have not brought high returns to their stockholders because of enormous expenses associated with attracting talent and management.

The entertainment industry relies on the stable production of motion pictures, television productions, and music recordings. The initial creation of a movie, a television program, or an album is very expensive, but the duplicates are very inexpensive. To

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[57] *Wall Street Journal*, Dow Jones Publishing, 1996.

[58] Kevin Hillstrom, *Encyclopedia of American Industries, v.2.* (New York; Gale Research Inc., 1994), 1202.

make a profit, the company must rely on a high sales volume.

Many entertainment companies are beginning to diversify into the theme-park division. These parks, exemplified by Walt Disney World and Universal Studios, are themed by characters from cartoons, movies, or other company trademarks. These entertainment companies are also expanding into the retail industry by opening up stores to sell exclusive merchandise. Currently, this industry is the country's top net exporter and has the ability to generate extremely high profits in the international market so long as it is able to control expenses.[59]

Personal income is very important to this industry because if consumers have low disposable income (income left over after the necessities have been paid for), they will not be able to go to the movies as often, buy the latest music, or take a vacation to a theme park. Unemployment and consumer confidence also affect the spending habits of consumers. If people are employed and are confident that their jobs will last, they are likely to spend more freely.

Moody's Industrial Review Index compared Disney with other companies in the recreation industry (See Table 10). According to *Dunn's Business Rankings*, Disney is the 69th largest public company based on sales volume.

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[59]*Value Line.* (New York: Value Line Publishing, Nov. 29, 1996), p. 1776.

Company Analysis

Financially, The Walt Disney Company is doing very well. Table 11 shows the per share growth rates in terms of revenues, earnings, cash flow, and book value over the past ten years. These numbers show a strong growth trend in the company because of increased expansion and diversification opportunities. Table 12 contains the ratio information on activity, performance, profitability, and leverage for Disney. Under profitability ratios, the net profit margin averaged 12.19% during the period from 1985 to 1995 (including the 1995 ratio of 11.1%), with a high of 15.2% and a low of 10.3%. The return on equity is another profitability ratio that requires analyzing. The return on equity has averaged 18.95% with a high of 23.62% and a low of 13.34%.

Disney is fairly common among institutional investors, who hold about 46% of the shares outstanding.[60] The third quarter of 1996 went extremely well for Disney with a reported 27% jump in quarterly profits thanks to strong home video sales and a strong growth in theme-park attendance, related to the 25th Anniversary in Walt Disney World and the end of the Main Street Electric Light Parade. S&P has earnings for 1996 estimated at $1.90 per share, while Value Line has estimated $2.25 per share. Earnings for 1995 were $2.53. Using the earnings-per-share growth rate of 15.5% and 1996 EPS equaling $2.25, as estimated in Value Line, one may estimate the future EPS (See Table

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[60] *Standard and Poor's Stock Reports.* July 10, 1996.

13). Calculations of the average high P/E ratio and average low P/E ratio for the past eleven years appear in Table 14. Then, in Table 15, those ranges from Table 14 have been multiplied by the estimated EPS to get a range of future estimated stock prices. According to this model, Disney is selling near its intrinsic value. Currently Disney is trading around 73, while the high range of the estimated price of the stock is $74.74. Using this estimation model, Disney is not a buy (meaning not a good investment) if an investor is looking for undervalued stocks.

Another approach to this model is to estimate the price using the equation $P_0 = E_1 * P/E_1$. E_1 is the estimated earnings for the next year; 1996 (E_0) was estimated by Value Line as $2.25. P/E_1 is estimated by S&P to be 33.1. When these numbers are placed in the formula, the estimated value of the stock is $86.02.[61] This valuation shows Disney to be approximately $13 under its intrinsic value (15% below its intrinsic value).

With the recent DJIA highs, most major companies' stock prices have been brought close to their intrinsic value. One may conclude that Disney is currently at its intrinsic value and may not produce abnormal returns in the next few years.

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[61] P0 = 2.60 * 33.1 = 86.02
E1 = 2.25 * 1.155 = 2.60

Conclusion

There are many different models which can be used to estimate the intrinsic value of a corporation. The model used here was probably not the same one used by Saul Steinberg because as a corporate raider he was looking at the liquidation value rather than the intrinsic value. For investors who bought stock in 1984 before Michael Eisner joined the company, the returns in the following years were tremendous. Eisner and Wells effectively began to look at every asset on the balance sheet and use it to its greatest potential for profits. Most importantly, they took the motion pictures division and created a powerhouse that went from being rated last in the motion picture industry in 1982 to being number one in 1996. From a shareholder's point of view, the Eisner-Wells team returned enormous growth rates, as can be seen in Table 11. In the ten years since Eisner became President and CEO of Disney, the average growth rate of revenues per share has been almost 20%, compared with the 8% growth rate before Eisner.

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Appendix 1

Table 1: Disney's Rank Among Companies in the Entertainment Division of the Leisure Industry

1982

Area	Rank	Amount
Revenues (in Millions of Dollars)	2nd	$877.0
Net Income (in Millions of Dollars)	3rd	$964.0
Return on Equity	6th	8.10%
Return on Assets	4th	5.30%
Dividend Payout Ratio	2nd	40%

Source: Standard and Poors Industry Survey, October 1983.

Table 2: Per Share Data for Walt Disney Co.

	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	Avera
Earnings Per Share	$1.29	$1.49	$1.51	$1.91	$2.31	$2.53	$3.04	$3.51	$4.16	$3.72	$3.01	$2.70	
Growth Rate		15.50%	1.34%	26.49%	20.94%	9.52%	20.16%	15.46%	18.52%	-10.58%	-19.09%	-10.30%	8.
Book Value Per Share	$14.61	$16.21	$17.67	$19.83	$22.09	$24.51	$26.71	$29.76	$32.22	$35.99	$37.04	$38.54	
Growth Rate		10.95%	9.01%	12.22%	11.40%	10.96%	8.98%	11.42%	8.27%	11.70%	2.92%	4.05%	9.
Cash Flows Per Share	NA	NA	NA	NA	NA	$0.23	$0.27	$0.30	$0.34	$0.31	$0.27	$0.33	
Growth Rate							17.39%	11.11%	13.33%	-8.82%	-12.90%	22.22%	7.

Source: Standard and Poors Industry Surveys, October 1981.
and Standard and Poors Compustat PC Plus.

Co.

	1977	1978	1979	1980	1981	1982	1983
Liquidity Ratios							
Current Ratio	3.35	3.47	4.02	3.48	2.39	1.11	1.4
Quick Ratio	2.29	2.76	3.27	2.61	1.69	0.56	0.8
Activity Ratios							
Inventory Turnover	NA	6.81	7.51	6.79	6.67	7.19	8.93
Total Asset Turnover	NA	0.72	0.7	0.72	0.68	0.55	0.58
Days to Sell Inventory	NA	53	48	53	54	50	40
Performance Ratios							
Sales/ Net Property Plant and Equipment	0.95	1.1	1.14	1.11	0.89	0.59	0.67
Sales/ Stockholder's Equity	0.82	0.86	0.83	0.85	0.86	0.81	0.93
Profitability Ratios							
Net Profit Margin	13.01%	13.27%	14.28%	14.78%	12.09%	9.72%	7.13%
Return on Assets	8.50%	9.08%	9.51%	10.03%	7.55%	4.76%	3.91%
Return on Equity	10.63%	11.42%	11.84%	12.58%	10.41%	7.85%	6.65%
Return on Investment	10.63%	11.42%	11.84%	12.58%	9.55%	6.30%	5.33%
Leverage Ratios							
Interest Coverage Before Tax	576	94.94	7922.8	333.42	125.06	8.33	4.78
Long Term Debt/ Stockholder's Equity	0.00	0	0	0	9.01	24.71	24.73
Total Debt/Total Assets	0.00	0	0	0	7.51	14.98	14.81
Total Assets/ Common Equity	1.25	1.26	1.24	1.25	1.38	1.65	1.7

Source: S&P Compustat PC Plus CD-Rom

Table 4: Estimated EPS - 8% Growth Rate

Growth Rate 8.0%

	Actual	Estimated				
	1983	1984	1985	1986	1987	1988
EPS	$2.70	$2.92	$3.15	$3.40	$3.67	$3.97

Table 5: Average P/E Ratios

	1976	1977	1978	1979	1980	1981	1982	1983	Averag
High P/E Ratio	26	19.17	15.5	12.68	12.95	18.04	19.68	31.39	[illegible]
Low P/E Ratio	17	12.5	10.36	9.4	8.53	11.16	15.28	20.37	[illegible]

Source: S&P Compustat PC Plus CD-Rom

Table 6: Estimated Stock Price

	1984	1985	1986	1987	1988
High	$56.65	$61.18	$66.07	$71.36	$77.07
Low	$38.13	$41.18	$44.47	$48.03	$51.87

Table 7: Estimated EPS - 16% Growth Rate

Growth Rate 16.0%

	Actual	Estimated				
	1983	1984	1985	1986	1987	1988
EPS	$2.70	$3.13	$3.63	$4.21	$4.89	$5.67

Table 8: Average P/E Ratios

	1976	1977	1978	1979	1980	1981	1982	1983 Aver
High P/E Ratio	26	19.17	15.5	12.68	12.95	18.04	19.68	31.39
Low P/E Ratio	17	12.5	10.36	9.4	8.53	11.16	15.28	20.37

Source: S&P Compustat PC Plus CD-Rom

Table 9: Estimated Stock Price

	1984	1985	1986	1987	1988
High	$60.84	$70.58	$81.87	$94.97	$110.16
Low	$40.95	$47.50	$55.10	$63.92	$74.15

Appendix 2

Table 10: Disney's Rank among Companies in the Recreation Industry

1995

Area	Rank	Amount
Revenues (in Millions of Dollars)	1st	$12,112.1
Net Income (in Millions of Dollars)	1st	$1,380.1
Operating Profit Margin	2nd	18.68%
Return on Capital	4th	11.94%
Net Plant (in Millions of Dollars)	1st	$6,190.3
Working Capital (in Millions of Dollars)	1st	$3,616.3

Source: Moody's Industry Review Index, 5-31-96.

Table 11: Per Share Data for Walt Disney Company

		1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	Aver
Revenue Per Share		$3.89	$4.73	$5.46	$6.45	$8.49	$11.09	$11.87	$14.31	$15.93	$19.19	$23.10	
	Growth Rate		21.59%	15.43%	18.13%	31.63%	30.62%	7.03%	20.56%	11.32%	20.46%	20.38%	1
Earnings Per Share		$0.32	$0.46	$0.71	$0.95	$1.28	$1.50	$1.20	$1.52	$1.63	$2.04	$2.53	
	Growth Rate		43.75%	54.35%	33.80%	34.74%	17.19%	-20.00%	26.67%	7.24%	25.15%	24.02%	2
Book Value Per Share		$2.29	$2.71	$3.50	$4.43	$5.62	$6.62	$7.43	$8.97	$9.39	$10.51	$12.68	
	Growth Rate		18.34%	29.15%	26.57%	26.86%	17.79%	12.24%	20.73%	4.68%	11.93%	20.65%	1
Cash Flows Per Share		$0.55	$0.71	$1.02	$1.26	$1.65	$1.95	$1.73	$2.16	$2.34	$2.90	$3.46	
	Growth Rate		29.09%	43.66%	23.53%	30.95%	18.18%	-11.28%	24.86%	8.33%	23.93%	19.31%	2

Source:
Value Line,
November 29, 1996.

		1985	1986	1987	1988	1989	1990	1991	1992	1993	1994
Activity Ratios											
	Inventory Turnover	17.5	18.98	16.62	16.35	15.73	16.29	15.1	14.09	11.09	10.4
	Total Asset Turnover	0.72	0.82	0.83	0.77	0.78	0.8	0.71	0.74	0.75	0.82
	Days to Sell Inventory	21	19	22	22	23	22	24	26	32	35
Performance Ratios											
	Sales/ Net Property Plant and Equipment	0.84	0.99	1.24	1.13	1.2	1.28	1.2	1.35	1.29	1.36
	Sales/ Stockholder's Equity	1.7	1.74	1.56	1.46	1.51	1.68	1.6	1.6	1.7	1.83
Profitability Ratios											
	Net Profit Margin		10.00%	13.60%	15.20%	15.30%	14.10%	10.30%	10.90%	10.40%	11.00%
	Return on Assets	59.90%	79.20%	10.31%	10.22%	10.56%	10.27%	6.75%	7.52%	5.71%	8.66%
	Return on Equity	14.64%	17.43%	21.26%	22.13%	23.10%	23.62%	16.44%	17.36%	13.34%	20.16%
	Return on Inventory	8.64%	12.58%	16.52%	18.76%	20.57%	17.10%	11.19%	12.94%	10.90%	14.58%
Leverage Ratios											
	Interest Coverage Before Tax	4.54	7.71	14.78	23.45	16.17	15.61	8.15	9.56	6.86	10.91
	Long Term Debt/ Stockholder's Equity	69.46	38.57	28.69	17.96	12.31	38.13	46.96	34.18	22.47	38.26
	Total Debt/Total Assets	28.41	17.53	15.36	8.52	12.93	19.75	23.48	20.46	20.3	22.9
	Total Assets/ Common Equity	2.45	2.2	2.06	2.17	2.19	2.3	2.44	2.31	2.34	2.33

Source: S&P Compustat PC Plus CD-Rom

Table 13: Estimated EPS

Growth Rate 15.5%

	1996	1997	1998	1999	2000
EPS	$2.25	$2.60	$3.00	$3.47	$4.00

Source: Value Line Growth Rate and Estimated 1996 EPS

Table 14: Average P/E Ratios

	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	Average
High P/E Ratio	7.3	13.7	20.6	17.1	34.1	34.1	32.4	45.3	47.9	48.6	64.3	33.
Low P/E Ratio	3.7	7	10.3	13.5	16.2	21.5	23.4	28.5	36	37.8	45	22.

Source: Value Line

Table 15: Estimated Stock Price

	1996	1997	1998	1999	2000
High	$74.74	$86.33	$99.71	$115.16	$133.01
Low	$49.68	$57.39	$66.28	$76.55	$88.42