Discussion and Evaluation of Disney: Does Disney Overvalued under COVID-19?

Siyu Xiong
Business school, Ulster University, Northern Ireland, United Kingdom
*Corresponding author: Xiong-S1@ulster.ac.uk

Abstract. Disney, like many other international companies, was engulfed by the Corona virus disease (COVID-19). For a substantial portion of 2021, its Theme-park business saw a dramatic fall in revenue and visitor flow rate due to government limitations; the theme parks were shuttered or operated at significantly reduced capacity. Studio Entertainment parts have been rescheduled, shortened, or cancelled in several situations. However, as a result of the epidemic, Disney's revenue has been declining, and the floating share price, as well as some unfavorable headlines, have been a warning flag for investors. More doubts are raised, the most prominent of which being that Disney's value is lower than it was previously and that it is no longer worth investing in. The purpose of this article is to appraise Walt Disney's current worth, especially after the economic crush of pandemic, by different financial methods and give a prediction of its future development.

Keywords: Disney; Evaluation; P/E Ratio; DCF Model; Pandemic (Covid-19).

1. Introduction

The Walt Disney Company, or most known as Disney, is a multinational media and entertainment comprehensive conglomerate based in California, America, at the Walt Disney Studios complex. Similar with many international companies, Disney was also trapped because of the pandemic (COVID-19). Its Theme-park business sharply declined in income and visitors flow rate for restrictions issued by the government, for a considerable period of 2021, the theme parks were closed or operated at a massively reduced capacity. Studio Entertainment programs have been rescheduled, shortened, or cancelled in several situations. However, under the pandemic situation, the revenue of Disney is showing a decreasing trend, the floating share price even some negative news, were the red signal for the investors. There are more doubts about the future of Disney, the chiefly one is that the value of Disney is lower than in the past and it is no longer worth investing in. On the contrary, a thesis is raised that Disney's future development focuses on content creation and streaming media operations, so even if the current financial position is poor due to the loss of theme parks, Disney's profit potential should be believed as the digitalization progresses.

To examine the suspect raised before, this article will compare the profitability of Disney before and after Disney to evaluate the influences of Covid-19 affecting Disney, also compare the average industry and competitor's level to get the multiple of enterprise value, at last give a prediction by evaluating its discounted cash-flow.

2. Background and Current Strategy

The Walt Disney Company, which encompasses Disney Parks, Experiences, and Products (DPEP), Disney Media & Entertainment Distribution (DMED), and four content groups, is a major diversified multinational family entertainment and media organization (2021 Annual report of Disney) [1]. As the profit modes of these two departments are completely different, and the two departments are in separate industries, they also should be discussed separately.

Since early 2020, The epidemic has had a significant impact on public health as well as the global economy; most of the substantial economy for example heavy and light industries were subdue that accumulation of basic products has been slowed and reduced [2]. Moreover, industries which heavily rely on labor like service industry and retail industry even facing a liquidation for low consumption and high labor costs which led to massive layoffs [3]. In the recent three years' annual report, the total
revenues of Disney are $67,418 million, $65,388 million, $69,607 million respectively in 2021, 2020 and 2019, the net incomes (losses) attributable to Disney are $1995 m, $(2,864) m and $11,054 m respectively in 2021, 2020 and 2019[4].

For Disney, the effects of pandemic mainly focused on the DPEP department, which operates Disney’s global theme-parks and consumer products based on its tales and animated characters. Most of Theme-park have two income sources which are the direct revenue generating methods like admission price and the indirect revenue generating methods like restaurants and retail stores, but both revenues demonstrated a decline trend because of restricted visitors' flow [5-6]. In addition, the operation of Theme-park needs high fixed costs including the salary of a large number of staff, high rents and instruments maintenance fee, compared with the limited income under pandemic, Theme-park hard to reach the breakeven point to have positive net profit [7]. Even Disney is one of the largest Theme-park and it continue to expand scale around the world, the Theme-park department illustrated a deficit state.

From the DMED perspective, this department belongs to the media industry which operates the Disney+ and Hulu, as described on its official website. Its revenue sources consist of two parts: the first is Direct-to-Consumer (DTC) that sells various streaming services to consumers; the second is Content Sales and licensing that Disney sells film and media content to third parties and subscription VOD services [8]. However, as most of these trades happened online and the development of digitalization, the media department was actually sustained to make profit during the pandemic [9]. Because most individuals were remaining at home due to mandatory containment measures and health safety compliances, subscriptions have skyrocketed [10]. Compared with the online streaming media, the movie contents production and publication were more worthwhile to concern. Due to the mass shutdown of theaters and unsolved labor problems, lots of projects were delayed and even cancelled. Walt Disney Studios said that they will not be publishing box office numbers after March [11]. Moreover, low box office sales reduced the movie income for the limited movie attendance and shorter shows window [12].

According to the financial analyst and investor Richard Greenfield thesis: Disney is built on a community experience, and unless the world becomes comfortable with the behavioral health of park attendance, Disney's bottom line will be fundamentally hurt [13]. Disney's unique business model could make a recovery more challenging. Not just Theme-park, the media department is also facing challenges: the global video streaming media market is still an emerging market, it brings new threats as well as opportunities for example network security risks and privacy protection, various competitors like Netflix and Youtube. A Moffett Nathanson report admitted that the department could lose at least $2 billion each year until 2024 when is assessed by Disney itself [14]. Therefore, it is reasonable to suspect that the overvalue of the current stock price of Disney and its leading role in the industry.

In contrast, about the future development of Disney, there are some positive views, and some experts also show their confidence about Disney. As the liberalization of epidemic control policies has continued, the global Theme-park will gradually reopen in 2022. From a psychological perspective, the negative emotions and panic brought about by the epidemic have inspired people's yearning for good things, and people need a space or something to offset this negative emotion [15]. Meanwhile, COVID-19 has an influence on consumer behavior especially to non-necessities. To be specific, there is a high possibility of people purchasing goods which could satisfy their pursuit of freedom and reduction of boredom [16]. Disney is recognized as the kingdom of fairy tales and the representative of innocence, under the atmosphere full of happiness and innocence Disney Theme-park built, people can get immersive experience which could meet the emptiness Covid brought, when they in the Disney Park, it is easy to forget the bad feelings and trouble from real life. As a result, both the visitors to Disney Theme-park and the relative products sales will demonstrate an increasing trend soon.

Transactional virtual spaces are becoming more popular as the threat of transmission of infection through physical contact increases. Online labor platforms and digitally structured logistics have
advanced as a result of the possibility for distribution through social relationships. [17]. As the CEO of Disney, Bob Chapek, mentioned in a memo to staff about preparation of celebrating Disney 100th anniversary: "Storytelling excellence," "innovation," and "relentless focus on our audience" are three significant "pillars" that he has set as his objectives for 2022[18]. About the “innovation”, he raised that the creative team should keep their technology evaluation and keep research about digital transformation like metaverse. Moreover, Chairman of Disney, Josh D’Amaro, discussed digitalization from company’s strategy, he admitted the vital position and success of streaming media which means Disney+ and proposed the combination of digital footprint with the physical footprint [19]. All the evidence above show that Streaming media and digitalization will remain key to Disney's future, the growth in digitization has been a beneficial consequence of COVID-19 for third-world economies, since digitalization worked as a hedge throughout the epidemic, particularly on the internet and media companies. [20-21].

Finally, scale effect is a prominent issue when facing a comprehensive and leading company [22]. Even though the revenue and stock price of Disney was seriously decreased under pandemic situation, it still holds large amounts of tangible assets like fixed assets and intangible assets like shares of other companies [23]. The long history and extensive management experience gave the company confidence when facing the challenges. Meanwhile, scaling will be a key feature needed to succeed in the streaming era, as consumers need an unprecedented amount of new content to stay engaged [24]. For Disney, the continuous content output is the core competitiveness.

3. Methodology and Discussion

There are several quite useful economic assessments of investments and enterprises performance measurements that could benefits investors in the decision making.

3.1 Industry and Competitors analysis

Before starting discussions about the profitability and relative value of Disney, the industry and competitors should be chosen for the following comparison. This article mainly chooses competitors which are in the media industries or just like Disney, whose business involves multiple industries. Meanwhile, the selector of competitors should consider the company scale, current and future threat to Disney. Therefore, the chosen competitors of Disney are COMCAST, Netflix and Waner Bros.

3.1.1 Comcast

Comcast Corporation is a media and high-tech enterprise that provides video, high-speed Internet, and voice services to individual and enterprises [25]. It is the world’s largest pay television company and cable television company, also the largest home internet service provider in America in terms of revenue. Comcast’s businesses include Comcast Cable (Xfinity), NBC Universal, Sky Group, Professional Sports and XClass TV (Comcast) purchased by DreamWorks Animation in 2016. Similar to Disney, Comcast also owns the Media department and Theme Park, which meets the requests of competitors.

![Fig. 1 Revenue and Adjusted EBITDA proportion](Data from the Comcast Corporation Annual Report 2021)
According to the annual report of 2021, the total revenues were $116,385 million, $103,564 million and $108,942 million respectively in 2021, 2020 and 2019, the Net incomes attributable to Comcast Corporation were $14,159 million, $10,534 million and $13,0573 million respectively in 2021, 2020 and 2019 [26]. Even though the revenue scale of Comcast was smaller than Disney, the earnings was higher than Disney in last three years. Meanwhile, it is true that the main profit resources of Comcast refer more to Cable Communications which is different from the media operation mode of Disney, it is still a comprehensive and large company in the media and entertainment industry.

3.1.2 Netflix

Netflix, is a subscription-based streaming service as well as a production company located at America and currently products its own movies and TV series, known as Netflix Originals [27]. There are over 220 million customers of Netflix around the world and it’s the second largest entertainment/media firm. Netflix's main goal is to expand its streaming subscription business internationally while staying within operational profit margins. Netflix's primary sources of revenue are membership payments and original content licenses, with which the company will collaborate with a worldwide content creation company. [28].

![How Netflix Makes Money?](Data from Sampathkumar)

From the annual report of Netflix, the total revenues were $29,698 million, $24,996 million and $20,156.5 million respectively in 2021, 2020 and 2019, the operating income were $6,194,5 million, $4,585 million and $2,604 million in 2021, 2020 and 2019. From the data, it can be seen that the impact of Covid-19 was positive to Netflix, which reflects the advantages of streaming media that there is no geographical and time limitation [29]. To Disney, Netflix entered the streaming business earlier and it also has numerous popular original contents, so Netflix is considered as one of the threatening competitors in the media industry.

3.1.3 Warner Bros

Warner Bros Entertainment Inc is a film and entertainment company in America, which often shortened to Warner [30]. Warner has its own television Studios, video game development and publishing firm. Warner Bros also runs a variety of departments specializing in publishing, merchandising, music, theater, and theme parks. The majority of Warner’s revenue comes from multiple platform advertising and distribution, which consists primarily of affiliate fees for linear network delivery, adding revenue from SVOD content licenses, DTC subscription services, and other new forms of digital delivery.

According to the annual report of Warner Bros, the total revenues of Warner Bros were $12,191 million, $10,671 million and $11,144 million respectively in 2021, 2020 and 2019. The net incomes of it were $1,197m, $1,355m and $2,213m respectively in 2021, 2020 and 2019 [31-32]. Because the
earning mode was different from other streaming media company, Warner Bros was less affected by the pandemic, there were still profit during the pandemic.

3.2 Profitability

The first objective is the evaluating the profitability of Disney. Here are some profit margins which can evaluate the profitability of a firm from an accounting perspective.

\[
\text{Operating profit margin} = \frac{\text{Operating income (before tax and interest)}}{\text{Revenues}}
\]

\[
\text{Net profit margin} = \frac{\text{Net profit (after tax and interest)}}{\text{Revenues}} = \frac{R-COGS-E-I-T}{R}
\]

Operating Profit Margin reflects the proportion of profit that a firm earns from its business before taxes and interest are deducted. The operational profit margin reveals how well the target firm performs in comparison, particularly how well it handles expenditures to optimize profits [33]. Meanwhile, the operating margin, which is used to compare similar companies, preferably, with yearly sales and similar business structures [34]. Different from operating profit margin, net profit margin uses net profit as numerator. It considered tax and interest, which makes it the most comprehensive and conservative measure of profitability.

According to Fairfield and Yohn’s theory: the reason of a float in profit margin might be operating efficiency or, alternatively, a shift in accounting conservatism instead of profitability, both of which are problematic in a business, so it is not accurate to forecast the future profitability of a firm by using profit margin [35]. Therefore, in this article, profit margin methods will be only used at the past performance of Disney, to compare the profitability before and after pandemic. Moreover, it is hard to calculate the net profits of the two main departments respectively, which needs to separate the tax and interest into different departments, so the operating profit margin will be used in the following calculation.

**Table 1.** Profit on sales of TWO (media and theme park) department of Disney
(Data from Disney 2021 annual report)

| Profit on sales of TWO (media and theme park) department of Disney | 2021   | 2020   | 2019   |
|-------------------------------------------------------------------|--------|--------|--------|
| (in millions)                                                    | MEDIA  | THEMEPARK MEDIA | THEMEPARK MEDIA | THEMEPARK MEDIA | THEMEPARK |
| Revenue                                                          | 50866  | 16552  | 48350  | 17038  | 43382  | 26225  |
| Total revenue                                                    | 67418  | 67418  | 65388  | 65388  | 69607  | 69607  |
| Proportion (total)                                               | 75.449%| 24.551%| 73.943%| 26.057%| 62.324%| 27.646%|
| Operating income                                                 | 7295  | 471    | 7653   | 455    | 8089   | 6758   |
| Total operating income                                           | 7766  | 7766   | 8108   | 8108   | 14847  | 14847  |
| Proportion (total)                                               | 93.935%| 6.065% | 94.388%| 5.612% | 54.482%| 45.518%|
| Profit on sales                                                  | 14.342%| 2.846% | 15.828%| 2.67%  | 18.646%| 25.769%|
| Profit on sales (total)                                          | 11.519%| 12.34% | 21.33% |        |        |        |
From the chart, it shows the main earnings department is Media for its high proportion of total revenue and operating income. Before Covid, profits from these two departments were nearly equal, separately were 54% and 46% in 2019, but after 2020 Covid-19, almost all the profits, which accounted for over 90%, were brought from the Media department.

The operating income of Disney demonstrated a continuing decreasing trend in the last three years, it dropped from $14847 million to $7766 million, which reflected the serious impact of pandemic. The Theme Park department's profitability sharply decreased after the pandemic as its operating profit margin dropped from 26% to 2.7%, but in 2021 it grew modestly to 2.8%. Media department profitability was slightly decreased from 18% to 14%. As a result, the total profitability generally continued decreasing from 21% to 12% then 11% during 2019 to 2021.

3.3 Relative Value

PE Ratio= Share price/ Earnings per share (EPS)

The price-to-earnings ratio, often known as the PE ratio, evaluate the profitability of a corporation by using share price divided by EPS [36]. It's important for a company to provide EPS that have been adjusted for unexpected factors and anticipated share dilution. Analysts and investors look at a company's P/E ratio to see if the current share price adequately reflects future earnings per share [37].

EV/EBITDA Multiple= Enterprise value (Equity value+ Net debt) / EBITDA (earnings before interest, tax, depreciation and amortization)

EV/EBITDA Multiple is frequently referred to relative valuation to compare different companies in the same (or similar) industry. Apart from that, there are two other functions of EV/EBITDA multiple, which are finding an optimal stock price and assessing value without considering capital structure. Conversely, a company with a low EV/EBITDA ratio may have too low a share price and would provide relative value for an investor.

Both ratios can demonstrate the measuring the financial health of a business. Compared with the EV/EBITDA multiple, some investors prefer the PE ratio when it relates to equity value because of that PE ratio provides a clearer portrait of long-term equity value. However, both margins will be used to measure the relative value of Disney from vertical and horizontal perspective.

![Fig. 3 Stock price and PE ratio of Disney in the last three years](image-url)
3.3.1 PE Ratio & EV/EBITDA Multiple Vertical Comparison (Disney 2019-2022)

Table 2. Some Ratios of Disney

|                     | 2021       | 2020       | 2019       |
|---------------------|------------|------------|------------|
| Net income(loss)    | 1995       | (2864)     | 11054      |
| attributable to Disney |           |            |            |
| EPS                 | 1.09       | (1.58)     | 6.64       |
| P/E ratio           | 139.54     | <0         | 19.70      |
| EBITDA              | 9218       | 5249       | 19350      |
| EV/EBITDA           | 35.06      | 60.13      | 16.1       |

The Net profit, EPS and PE ratio of Disney reached their lowest point, which was even lower than zero in 2020 because of the pandemic as well. As PE ratio indicates the multiple of earnings investors are willing to pay for the company, so it was actually a big loss for Disney in 2020. However, when it came to 2021, the PE ratio sharply increased to 139.54 even the EPS was only 1.09, which represented the high share price during this period that the share prices during 2021 were higher than $150 per share.

EV/EBITDA multiple, is a valuation indicator for the overall company rather than common stock, it increased from 16.1 to 60.13 in 2019 to 2020 but then slightly decreased from 60.13 to 35.06 in 2020 to 2021 not reaching 2019 level.

3.3.2 PE Ratio & EV/EBITDA Multiple margin Horizontal Comparison (2021)

Fig. 4 Stock price and PE ratio of Comcast in the last three years
Fig. 5 Stock price and PE ratio of Netflix in the last three years

Fig. 6 Stock price and PE ratio of Warner Bros in the last three years
(Data from Macrotrends)

Fig. 7 P/E ratio and EV/EBITDA of Disney and Competitors

From the chart above, it shows the PE Ratio & EV/EBITDA Multiple margin comparison between Disney and its competitors. Compared to Netflix, Warner Bro and Comcast, Disney has an extremely high PE ratio that is twice as much as Netflix, almost ten times as much as Warner and nine times as much as Comcast. Similarly, there is also a gap between the EV/EBITDA of Disney and other
competitors. Therefore, a high P/E ratio and high EV/EBITDA multiple imply that the company is potentially overvalued, but it still needs deeper research into cash flow.

3.4 DCF

Discounted Cash Flow (DCF) valuation is a way of calculating a company's present value based on forecasted future cash flows that have been adjusted for the time value of money [38]. In addition to successfully using the DCF model, the target firm should have continuous, positive, and anticipated free cash flows. Companies with sufficient cash flows are often mature businesses that have outgrown their development stages. Therefore, it is reasonable to evaluate and predict the free cash flow of Disney by using DCF.

\[
 EV = \frac{FCF_1}{(1+r)^1} + \frac{FCF_2}{(1+r)^2} + \cdots + \frac{FCF_n}{(1+r)^n} + \frac{TV}{(1+r)^n} \tag{1}
\]

\( EV \) = Enterprise value; \( FCF \) = Free cash flow; \( r \) = Discount rate; \( n \) = The period number
\( TV \) = Terminal value = \( FCF(n) * (1+g) / (r-g) \)

To calculate the terminal value, this article will choose the Gordon Dividend Growth Model to evaluate Disney, the principle of which is to assume that the company's cash flow will continue to grow at a stable growth rate after the forecast period. Here, \( FCF(n) \)= Cash flow forecast for the last year of the period and \( g \) = fixed growth rate. Because the fixed growth rates are usually somewhere between historical inflation and average GDP growth. With average GDP growth of roughly 2.1% and inflation of 1.9% over the past decade, so the fixed growth rate of Disney should be 2% [39].

\[
 DCF = \frac{CF_1}{(1+r)^1} + \frac{CF_2}{(1+r)^2} + \cdots + \frac{CF_n}{(1+r)^n} \tag{2}
\]

The free cash flow of Disney was $1108 million in 2019, 88.73% decline from 2018; for 2020 was $3594 million, 224.37% increase from 2019; for 2021 was $1988 million, a 44.69% decline from 2020. However, before Pandemic, Disney’s average free cash flow from 2016 to 2018 was $8971 million. In 2022, Disney's offline business was still affected by the epidemic, but generally showed a recovery trend, especially after retaliatory spending in the tourism industry. The conservative estimate here is for cash flow to return to 80% of previous years by 2022. Disney’s free cash flow growth averaged roughly 14% a year from 2009 to 2018. Future growth of Disney’s offline business will be tempered until the impact of the pandemic is over. Conservatively, the Cash flow growth for the next five years is estimated to be 10% a year.

Typically, investment banks calculate the weighted average cost of capital (WACC) as a discount rate. Disney’s current WACC is 9.01%, according to calculations by GuruFocus, an investment research firm (2022.6.02), so to calculate the discounted cash flow, the discounted rate is assumed as 9%.
Table 3. Predicted FCF and DCF of Disney in 5 years

| Year | 2022($) | 2023($) | 2024($) | 2025($) | 2026($) |
|------|---------|---------|---------|---------|---------|
| Free cash flow (million) | 7177 | 7895 | 8685 | 9554 | 10509 |
| Discounted free cash flow (million) | 6584 | 6645 | 6706 | 6768 | 6830 |

TV = 10509 * (1+0.02)/(0.09-0.02) = 153131(m)
TV/(1+r)^n = 153131/(1.09)^5 = 99525(m)
EV = 6584+6645+6706+6768+6830+99525 = 133056 (m)

As the outstanding shares of Disney is 1.82 billion shares, the stock price should be $73.1 per share.

The free cash flow can basically return to pre-pandemic level until 2025 which is $9554 million when the growth rate is 14%. According to the current data of GuruFocus, as of June 2022, The Walt Disney Co’s enterprise value is $237,639 million and the current stock price is $110.87 per share which was demonstrated generally a decreasing trend in last 6 months. There is a huge gap between the current data and the prediction data, so it is reasonable to doubt that Disney is overvalued.

4. Discussion

It is clear that Disney is overvalued as the above financial calculations, whether by using each method, it comes to the same conclusion. The stock price of Disney is overvalued by 45% according to the DCF method and the data used in calculating future cash flows are based on the assumption that demand for Disney's services will generally recover by 2022. Meanwhile, it is hard to predict the global pandemic situation, as the regulations of North American and European markets is gradually extended, the Asian market is still limited especially China.

However, there are some limitations when setting the value of DCF model. From a financial perspective, Christine McCarthy, Disney's senior executive vice president and CFO, said that Disney+’s operating results in the first few years after launch are expected to reflect aggressive early investment, assuming long-term success of the business. Operating losses are expected to peak between FY2020-2022, and Disney+ is expected to be profitable in FY2024, so the profitability and future cash flow of Disney’s main business division are expected to a long-term project [40]. As the above predicts cash flow only until 2026, maybe it is not accurate that the time period should be longer.

5. Conclusion

As mentioned in introduction, Disney is a Comprehensive company mainly focuses on media entertainment, which is the main earning department, and theme park business. The repercussions of a wide range of difficulties induced by the coronavirus are already felt in its stock and income. While the pandemic took a toll on the company's amusement parks and cruise operations, the entertainment luckily found success with its streaming media service, but still in a low earning level. The total profits were less than zero during the most tightly controlled periods, which did not happen on other media companies like Netflix. It can also reflect that Disney's ability to risk management in emergencies remains inadequate.

Because of the Great scale and complicated business of Disney, it’s hard to find the similar competitors, like Apple or LVMH, they are all leading enterprises in their industries. According to the results we have discussed, the current stock price of Disney is overvalued for its high PE ratio and high EBITDA multiple much over than its competitors. Meanwhile, by predicting its cashflow for the following years, this article shows a positive trend of free cash flow rising that the profitability can
basically return to pre-pandemic levels until 2025, which also roughly satisfies the McCarthy’s saying about the profitable time of Disney+.

Disney’s traditional sectors, such as cable and theme parks, are gradually rebounding after the shutdowns were lifted and a successful immunization campaign was implemented. With continued strong growth of streaming media users and technology development, streaming media will have a promising future in the next ten years. When the widespread adoption of digitalization becomes inevitable, the various original contents and large scale of Disney will become the most outstanding advantages in competition.

In reference to the stock trend until June 2022, it shows a decreasing trend because the fourth-quarter earnings of 2021 were significantly below expectations. Theory and calculation suggest that the market’s implied outlook expectations are negatively biased, as investors are generally risk-averse and therefore tend to pay higher prices for downside protection such as put options. However, there is no way to directly measure whether this effect exists, but the expectation of a negative bias reinforces an optimistic reading of the implied outlook for this market.

Lastly, this article suggests that Disney should find some new methods to solve the problem pandemic brought like increasing labor cost and delaying projects. It seems that expanding streaming media business is a correct choice for its high profitability, but the longer the crisis lasts, the more mid-term contents production and revenue will be at risk.

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