A Financial Valuation of Media and Entertainment Companies

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Abstract. This paper provides a comparative investment analysis of four leading firms in the media and entertainment industry: Walt Disney Company (DIS), Netflix, Inc. (NFLX), Warner Bros. Discovery, Inc. (WBD), and Paramount Global (PARA). By evaluating valuation metrics, growth rates, and profitability, the study identifies Netflix and Disney as potential high-return investments. While Disney demonstrates steady growth through diversified revenue streams, Netflix's strong brand and innovative advertising strategies sustain investor confidence despite its premium valuation. Conversely, Warner Bros. and Paramount face profitability challenges; Warner Bros. suffers from goodwill impairments and market uncertainties, while Paramount's transformation strategy hinges on future execution. Scenario analysis suggests Netflix as the most promising investment, with projected EPS growth of 10% and significant cumulative returns. Disney follows, benefiting from its experiences segment, albeit with potential content impairments. Risk factors, including competitive pressures, technological advancements, and membership retention, are highlighted, particularly for Netflix. This analysis underscores the dynamic interplay of strategic positioning and financial resilience in navigating the rapidly evolving media landscape, offering insights into investment decision-making in this sector.

Keywords: Media and Entertainment Industry, Value Investing, Risk Assessment.

1. Introduction

For the investment analysis, four competing firms in the media and entertainment industry are selected [1]. They are Walt Disney Company (DIS), Netflix, Inc. (NFLX), Warner Bros. Discovery, Inc. (WBD), and Paramount Global (PARA).

DIS: Disney is a diversified entertainment conglomerate with a strong global presence in multiple segments, including media networks, streaming (Disney+), studio entertainment, theme parks, and consumer products.

NFLX: As a pioneer in the streaming industry, Netflix is a market leader focused exclusively on subscription-based streaming services. Netflix has strong brand and subscriber base position, known for its extensive original content and global reach.

WBD: Warner Bros. Discovery is a major media conglomerate with diverse assets, including HBO Max, Warner Bros. Studios, and Discovery Channel. Its presence in both streaming and traditional media allows it to compete in various entertainment sectors, from film and television production to direct-to-consumer streaming.

PARA: Paramount is a key player in media and entertainment, encompassing Paramount Pictures, CBS, and the streaming service Paramount+. With a mix of traditional broadcasting, film production, and streaming, Paramount has a well-known brand.

2. Valuation and Growth Analysis

This section will focus on the valuation and growth-related ratios to analyze the potentials of the four competitors mentioned above. Table 1 below is the valuation ratio table of four companies.

Table 1. Valuation ratios of four companies

Company	Walt Disney	Netflix	Warner Bros	Paramount
Ticker	DIS	NFLX	WBD	PARA
Share Price (29 Oct. 2024)	$95.62	$751.92	$7.64	$10.42
TTM EPS	4.64	17.67	-4.8	1.5
NTM EPS	5.09	22.76	-0.42	1.3
TTM P/E	20.61	42.55	NA	6.95
NTM P/E	18.79	33.04	NA	8.02
Revenue Growth rate	4.5%	13.3%	0.9%	1.3%
EPS growth rate	9.7%	28.8%	NA	-13.3%
PEG ratio	2.12	1.48	NA	NA
GP/A	14.4%	28.7%	13.7%	13.6%

Both TTM and NTM EPS of Warner Bros are negative, because its Q2 total EBITDA (adjusted) has a 15% decrease compared to the prior year quarter. In the second quarter of 2024, Warner Bros made $9.1 billion goodwill impairment charge from the Networks segment, in response to the difference between market capitalization and book value, continued softness in the U.S. linear advertising market, and uncertainty related to affiliate and sports rights renewals, including the NBA. Therefore, investor expectation of Warner Bros is low due to its $10 billion loss in Q2.

Paramount has low P/E ratios and negative EPS growth rate. Although Paramount has a strong performance in Q2 (13% increase in the Direct-to-Customer (DTC) streaming segment), the investors are not confident with its future earnings. As of the third quarter earnings meeting on November 8th, Paramount is focused on strengthening its balance sheet and enhancing its streaming business in preparation for its upcoming merger with Skydance Media. These initiatives are part of Paramount's strategic plan aimed at transforming its streaming segment to accelerate profitability. It depends on how Paramount delivers its strategic plans (i.e. transforming streaming to accelerate profitability) to determine whether it is undervalued or not [2].

PEG ratios of Disney (2.12) and Netflix (1.48) indicate that both companies might be fairly valued relative to their growth rates. Even though Netflix is possibly overvalued, Netflix has much high revenue and EPS growth rate, compared with Disney. Netflix offers the highest growth but at a premium, while Disney appears more reasonably priced given its steady growth.

3. Profitability Analysis

Based on the analysis in the Section 2, Netflix and Disney are the two companies that have more potentials to have higher return compared to the other two companies (Warner Bros and Paramount). This section will continue to analyze the profitability performance by line charts, shown in Appendix B.

As illustrated in Figure 1, the profitability of Disney has continued the unexpected increasing trend from 2020 to 2022 under the COVID-19 related disruptions, through its higher DTC subscription revenue and higher theatrical distribution and advertising revenue [3]. However, The EPS decrease between 2022 and 2023 was due to the restructuring and impairment charges in fiscal 2023 ($3.9 billion). The charges primarily related to content impairments resulting from a strategic change in its approach to content curation ($2.2 billion) and goodwill ($0.7 billion) at its entertainment and international sports linear networks reporting units.

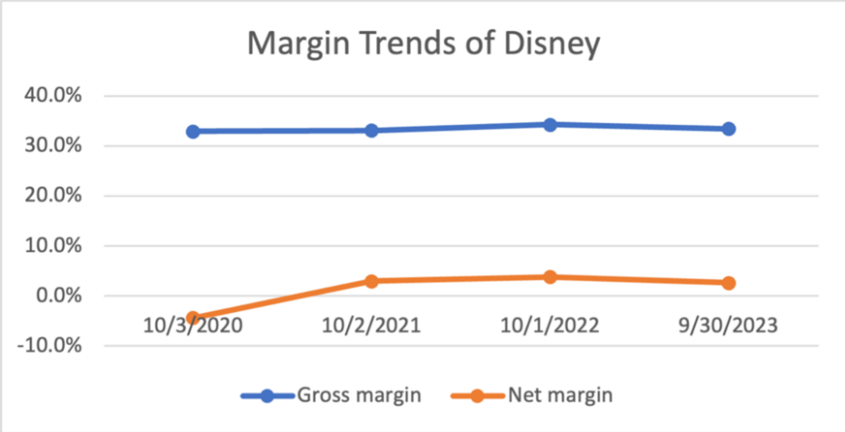

Figure 1. Gross profit margins and net profit margins of Disney from 2020 to 2023

Although the revenue growth rate of Netflix (13.3%) is lower than its EPS growth rate (28.8%), there is no deteriorating trend in its gross and net profit margins, as shown in Figure 2. It primarily due to Netflix's revenues growing at a faster rate as compared to its growth in cost of revenues, and decreased technology and development expenses [4]. Under the intensely competitive and rapidly changing market in the entertainment market, Netflix continues to building its advertising business and improves its offering for advertisers. The Netflix's ads membership was up 35% in 24 Q3, and its ad tech platform is on track to launch in Canada in Q4 and more broadly in 2025. The continuous surprising EPS of Netflix has been still enhancing the investors' confidence of its future performance.

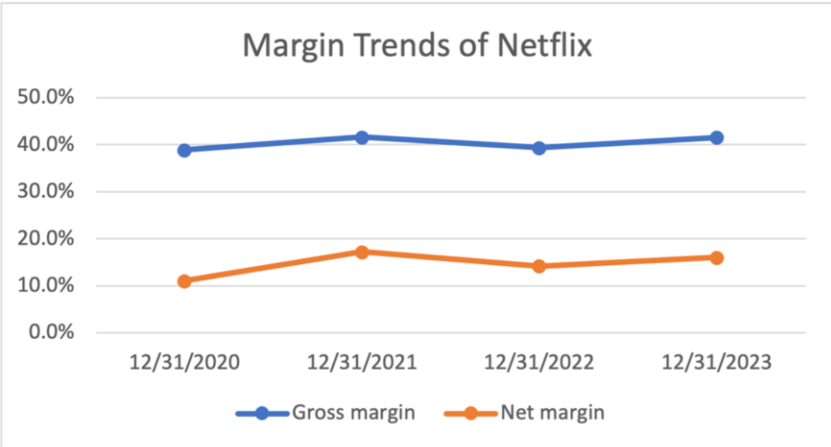

Figure 2. Gross profit margins and net profit margins of Netflix from 2020 to 2023

In consistent with the findings in the above valuation and growth section, Warner Bros and Paramount both have some challenges in their profitability (as illustrated in Figures 3 and 4).

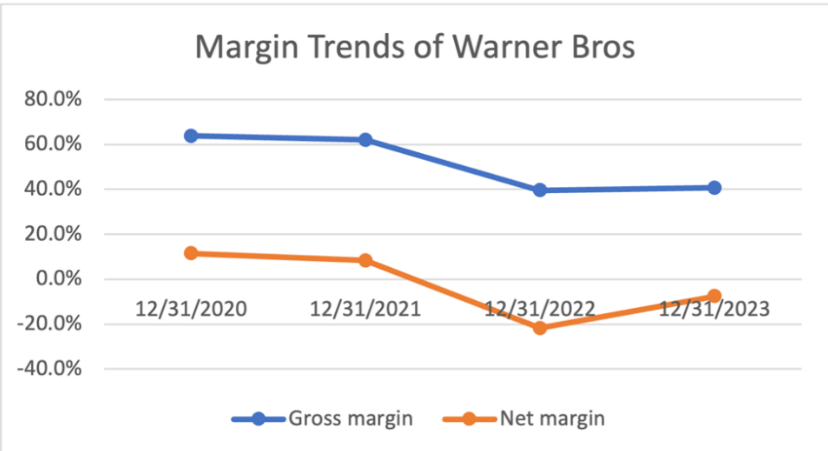

Figure 3. Gross profit margins and net profit margins of Warner Bros from 2020 to 2023

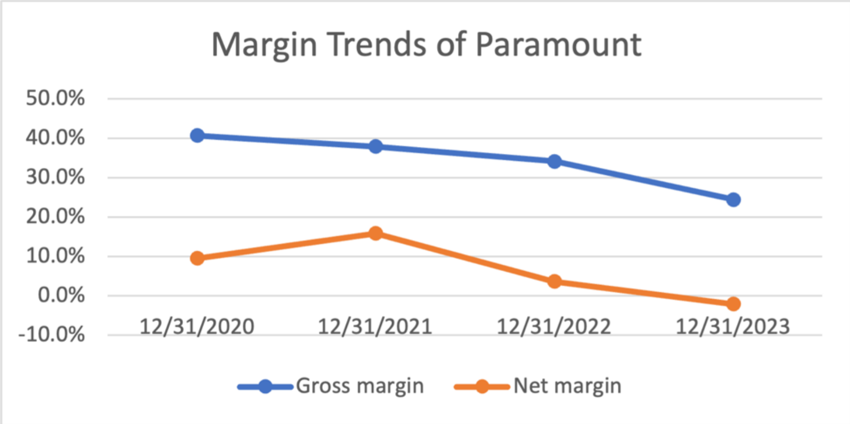

Figure 4. Gross profit margins and net profit margins of Warner Bros from 2020 to 2023

4. Investment Recommendation & Risk Analysis

4.1. Assumptions of Scenario Analysis & Investment Recommendation

Based on Warner Bros.' negative EPS and its five-year cumulative return disclosed in the 2023 annual report; it is advisable to exclude WBD as a potential investment first. However, it is expected to gradually return to a positive profit as it continues to invest significant resources in acquiring and maintaining sports programming licenses, joint ventures, and producing higher-quality content [5]. Despite Paramount's declining revenue trend, its overall transformation plan shows promise for successful implementation, leading to a cautiously optimistic outlook. Assuming that EPS growth rate will be closely with revenue growth at an estimated 1%, Paramount could be considered a potential investment with moderate growth expectations.

Disney benefits significantly from its experiences segment, which is expected to perform well compared to competitors [6]. However, given the rapidly changing demand for content, future strategic adjustments could lead to additional content impairments. Consequently, EPS growth is projected to gradually slow, with an assumed growth rate of 6%. While market expectations for Netflix remain high, making the stock appear expensive, Netflix has consistently beaten EPS forecasts for the past three quarters, suggesting continued growth potential [7]. However, challenges in maintaining and expanding membership, along with the possibility of large content impairments similar to Disney, are likely to moderate future growth. I assume its EPS growth rate of 10%, indicating potential for further upside but at a slower pace.

Based on the above assumptions, the calculated five-year cumulative returns are illustrated in Table 2. The recommended stock is Netflix, with much higher expected return than its three competitors.

4.2. Risk Factors

Competition: Providing content across various distribution platforms is a highly competitive business worldwide [8]. Netflix experiences competition for the development and acquisition of content, distribution of content, sale of commercial time on its networks.

Membership: If Netflix does not continuously provide value to its members, including making improvements to the service in a manner that is favorably received by them, Netflix's revenue, results of operations and business will be adversely affected [9]. Netflix must continually add new members both to replace canceled memberships and to grow its business beyond the current membership base.

Technological Developments: The media entertainment and internet businesses in which Netflix participates increasingly depend on the ability to successfully adapt to new technologies including shifting patterns of content consumption and how entertainment products are generated [10].

5. Conclusion

This paper provides a comprehensive investment analysis of four prominent media and entertainment companies: Walt Disney Company, Netflix, Inc., Warner Bros. Discovery, Inc., and Paramount Global. By evaluating key financial metrics such as valuation ratios, growth rates, profitability performance, and risk factors, the analysis highlights the distinct strengths and challenges faced by each firm in a highly competitive and evolving industry.

Netflix emerges as the most attractive investment option due to its superior EPS and revenue growth rates, robust profitability, and innovative strategies in advertising and content delivery. Despite a premium valuation, its ability to continuously exceed market expectations underscores its strong growth potential. Disney also demonstrates promising investment potential, supported by its diversified revenue streams and steady growth. However, potential future impairments from strategic content adjustments may moderate its long-term growth trajectory.

Warner Bros. and Paramount face more significant challenges. Warner Bros.' recent goodwill impairment and declining profitability have lowered investor confidence, although strategic investments in content quality and sports programming may gradually improve its financial outlook. Paramount, while showing signs of progress in its streaming segment, must successfully implement its transformation plan to regain investor confidence and deliver sustainable growth.

The analysis also considers risk factors critical to investment decisions, such as industry competition, technological disruptions, and the ability to adapt to shifting consumer preferences. For Netflix, maintaining membership growth and addressing increasing competition are key to sustaining its leadership position.

In conclusion, Netflix stands out as the optimal investment choice, offering high growth potential but requiring cautious monitoring of its valuation and execution risks. Disney provides a balanced alternative with steady growth, while investments in Warner Bros. and Paramount should be approached with caution until significant improvements in profitability and strategic execution are evident. This study underscores the importance of integrating financial metrics with industry dynamics in making informed investment decisions.

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