



Shanghai Disneyland

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BA 456

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Agenda

- Case Introduction
- Background
- Project Description
- Our Analysis
- Recommendation
- Questions?





The Walt Disney Company

- Entertainment Conglomerate consisting of Media, Studio Entertainment, Consumer Products and Theme Parks & Resorts
- Theme Park & Resorts Division
 - Current Park Locations: Anaheim, Orlando, Tokyo, Paris, Hong Kong (2005)
 - Also includes: The Disney Cruise Line, Disney Regional Entertainment, The Disney Vacation Club, The Anaheim Angels, and the Mighty Ducks of Anaheim
 - Revenues of \$7 Billion in 2001, or 28% of company-wide revenue



Disney's Interest in China

- Long-term
 - Consistently searching for areas of expansion where there are un-captured markets
- Current
 - Government relations established through the Hong Kong Disneyland project indicate easier entry into the mainland
- Competitive
 - Universal-Vivendi's land purchase in Shanghai and proposed expansion into Beijing



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Background: Disney Parks

- Disneyland, Anaheim: 1955
- Walt Disney World, Orlando: 1971
- Tokyo Disneyland: 1983
 - Owned and operated by the Oriental Land Company
 - Deal structure indicative of financial turmoil within the company in the early 1980s with a 0% Equity stake
 - Revenue from royalties and management fees
- Disneyland Paris/Euro Disneyland: 1992
 - Disney retains 39% of Equity Interest and receives management fees as part of reported revenue



Hong Kong Disneyland

- \$1.8 Billion USD Project
- 60% Debt
 - 80% Government
 - 20% Commercial
- 40% Equity
 - 43% Disney
 - 57% Government (will eventually sell down ownership stake)
- 6 Million Visitors in its first full operating year, and 1.4 Million additional visitors to Hong Kong
- \$148 Billion value added boost to the Hong Kong economy over the next 40 years
- 35,800 jobs created in the next 20 years



Background: China

- Largest population in the world with relatively slow projected population growth
 - 1.26 B (2001) - 1.5 B (2050F)
 - 63 - 70% Rural
- High growth rates in GDP and foreign direct investment (FDI)
 - Urban income growth of 17.2% in 2002,
 - Growth in FDI of 14.8% in 2002
 - 2003F: US\$58 B
 - 2004F: US\$62 B
- Accession to the World Trade Organization in December 2001
 - Increased support for private and foreign investments
 - Theme parks still fall under Restricted Foreign Investment Industries



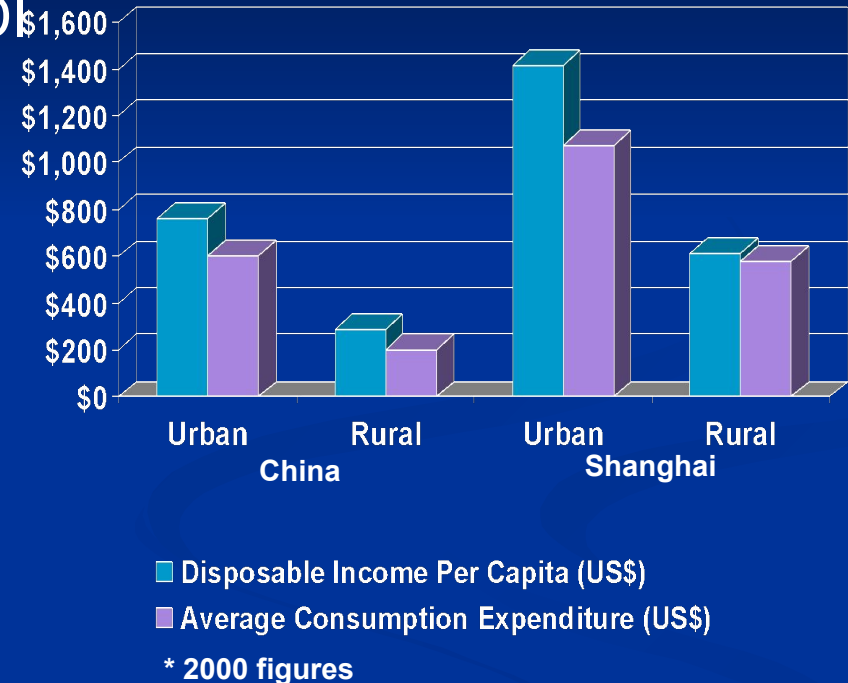
Theme Parks in China

- Most parks in China were American-themed
- Few have survived mainly because of transportation issues
- Admission Prices: 56 – 100 yuan (\$6 – \$12)
- Park Sizes: 70 – 150 acres
- Universal-Vivendi December 2002 agreement to build a park in Shanghai
 - Projected park opening in 2006, with more than 8 million visitors in the first year
 - In discussions to build a similar park in Beijing



Background: Why Shanghai?

- Shanghai leads in GDP and FDI in China
 - GDP US\$4,512 (2001)
 - 9% of total FDI in China
- Shanghai residents (2002)
 - 18.4 M, including floating population
 - Average household size is 2.9
- Tourist population (2000)
 - 64.7 mainland domestic
 - 1.5 million foreign overseas
 - 0.5 million





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Park Location is Key



Expo Site and Universal Property

Significant infrastructure development is occurring to support the 2010 Expo



Target Market

| | |
|---|------------------|
| Target Local Market | (million) |
| By Income Level (yuan) | |
| 30,000 – 60,000 | 2.44 |
| 60,000 – 90,000 | 1.62 |
| > 100,000 | 1.14 |
| <hr/> | |
| Total Local Market (based on income) | 5.20 |
| <hr/> | |
| Tourist Market | (million) |
| Domestic (Mainland) | 64.7 |
| Overseas - Foreign | 1.5 |
| Overseas - Domestic | 0.50 |
| <hr/> | |
| Total Target Market | 71.90 |

* Based on 2008F Population numbers



Project Structure

- 1.27 Billion US\$ total capital investment
- 60% Debt
 - 80% Government
 - 20% Commercial
- 40% Equity
 - 43% Disney
 - 57% Government
- 10.6 Million Visitors in its first full operating year and average annual growth of 1.5%
- Corporate tax rate of 30%, with tax loss carry-forwards permitted for five years



Operating Cash Flows

Revenues

- Admissions (50%)
- Food and beverage (24.5%)
- Merchandise (24.5%)
- Main entrance (1%)

Costs

- Park labor and overhead
- Maintenance materials
- Entertainment (costuming, labor, etc.)
- Food and beverage COGS
- Merchandise COGS
- Support labor
- Miscellaneous



Discussion





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Risk Analysis - Sovereign

- Currency risk is not mitigated by this project since the majority of cash inflows and outflows are in local currency
- Expropriation risk is mitigated some with the government taking a controlling equity stake
- No other commercial or multi-lateral agency partners are involved in the project
- Because the project is in the tourism industry and involves an American cultural icon, the susceptibility to strikes or terrorism is slightly higher than average
- The project's location in Shanghai reduces the overall risk of natural disasters when compared to country averages



Risk Analysis – Operating and Financial

- The technology for this project will be provided by Disney and is proven in other locations
- Potentially lengthy negotiations with the Chinese government increases start-up risks slightly
- Given the project is very service oriented, there is some risk associated with the level of control assumed by the government, but this is difficult to quantify
- There are no financial mitigating factors — rather, this project is closely tied to the government
- Real option: A minor amount of cannibalization from the Hong Kong property may be expected



Cost of Capital

- ICCRC 16.10%
 - U.S. Risk Free 4.00%
 - U.S. Risk Premium 4.00%
 - China's Country Credit Rating 58.9
 - Anchored to U.S. cost of equity

- Adjustments
 - Industry beta adjustment -0.80%
 - Expropriation -0.97%
 - Start-up risks assoc. with Gov't negotiations +0.12%
 - Sensitivity to strikes, terrorism +0.08%
 - Sensitivity to natural disasters -0.12%
 - Real option: Cannibalization from HK Disney +0.08%

- Project Cost of Capital 16.09%



Cash Flow Analysis

| | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 |
|---------------------------------|--------------|----------------|-----------------|-----------------|-----------------|----------------|----------------|
| Admissions | \$0 | \$0 | \$0 | \$0 | \$0 | \$283,179,483 | \$296,060,956 |
| Merchandise | \$0 | \$0 | \$0 | \$0 | \$0 | \$53,532,494 | \$55,967,619 |
| Food & Beverage | \$0 | \$0 | \$0 | \$0 | \$0 | \$53,532,494 | \$55,967,619 |
| Main Entrance | \$0 | \$0 | \$0 | \$0 | \$0 | \$500,000 | \$515,000 |
| Hotel Revenues | \$0 | \$0 | \$0 | \$0 | \$0 | \$13,687,500 | \$14,098,125 |
| Total Revenue | \$0 | \$0 | \$0 | \$0 | \$0 | \$404,431,972 | \$422,609,319 |
| Park Operating Expenses | \$0 | \$0 | \$0 | \$0 | \$0 | \$133,951,636 | \$138,405,572 |
| Hotel Operating Expenses | \$0 | \$0 | \$0 | \$0 | \$0 | \$8,896,875 | \$9,163,781 |
| Start Up Costs | \$0 | \$0 | \$0 | \$0 | \$0 | \$20,000,000 | \$0 |
| Royalty Expenses | \$0 | \$0 | \$0 | \$0 | \$0 | \$20,221,599 | \$21,130,466 |
| Total Operating Expenses | \$0 | \$0 | \$0 | \$0 | \$0 | \$183,070,109 | \$168,699,819 |
| EBIT | \$0 | \$0 | \$0 | \$0 | \$0 | \$221,361,863 | \$253,909,500 |
| Depreciation | \$0 | \$6,350,000 | \$20,637,500 | \$42,862,500 | \$57,150,000 | \$63,500,000 | \$63,500,000 |
| EBITDA | \$0 | (\$6,350,000) | (\$20,637,500) | (\$42,862,500) | (\$57,150,000) | \$157,861,863 | \$190,409,500 |
| Interest on Debt | \$0 | \$0 | \$0 | \$0 | \$0 | \$46,908,093 | \$50,028,135 |
| Taxable Income | \$0 | (\$6,350,000) | (\$20,637,500) | (\$42,862,500) | (\$57,150,000) | \$110,953,769 | \$140,381,366 |
| Adjusted Taxable Income | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$124,335,135 |
| Less: Taxes | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | (\$37,300,540) |
| Less: Debt Principal | \$0 | \$0 | \$0 | \$0 | \$0 | (\$75,679,404) | (\$72,559,362) |
| Less: Capital Expenditures | \$0 | (\$50,800,000) | (\$114,300,000) | (\$177,800,000) | (\$114,300,000) | (\$50,800,000) | (\$38,520,000) |
| Plus: Depreciation | \$0 | \$6,350,000 | \$20,637,500 | \$42,862,500 | \$57,150,000 | \$63,500,000 | \$63,500,000 |
| Less: NWC | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 | \$0 |
| Free Cash Flow | \$0 | (\$50,800,000) | (\$114,300,000) | (\$177,800,000) | (\$114,300,000) | \$47,974,365 | \$55,501,463 |
| PV FCF | \$0 | (\$43,759,152) | (\$84,811,864) | (\$113,644,212) | (\$62,931,341) | \$22,752,817 | \$22,674,387 |
| NPV | \$19,242,097 | | | | | | |
| IRR | 17% | | | | | | |

* Cash flows analyzed through 2029 (per Disney, typical 20-25 year financial analysis time horizon)



Real Options

- Option to wait until Universal Studios opens
 - Already losing any first mover advantage
 - Universal's track record at opening resorts is not on par with Disney's — lessons learned from Universal may be minimal
- Build a resort hotel in conjunction with the park
- Build a “Downtown Disney” entertainment center adjacent to park
- Build another gate after several years of operation (double park size)



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Recommendation

- Begin negotiations with Chinese government
 - Government equity stake and debt provisions
 - Land and infrastructure provisions
- Disney must make the argument that a Shanghai Park would not substantially damage Hong Kong
- Escalating political tensions on the Korean peninsula could change the risk assessment



Questions?





Demand Projections

| Captured 2008 Market (million) | | |
|---|--------------|--------------|
| 30000 - 60000 | 1.83 | 1.84 |
| 60000 - 90000 | 1.30 | 1.23 |
| >100,000 | 0.97 | 0.86 |
| Captured Market Based on Income Level | 4.09 | 3.94 |
| Market From Tourism | | |
| Local - Domestic Tourists | 6.47 | 7.764 |
| Overseas - Foreign Tourists | 0.075 | 0.075 |
| Overseas - Domestic Tourists | 0.005 | 0.005 |
| Total Captured 2008 Market for Disney-Shanghai | 10.64 | 11.78 |
| | | 1.14 |
| Total 2008 Market (million) | | |
| 30000 - 60000 | 2.44 | |
| 60000 - 90000 | 1.62 | |
| >100,000 | 1.14 | |
| Total Market Based on Income Level | 5.20 | |
| Market From Tourism | | |
| Local - Domestic Tourists | 64.7 | |
| Overseas - Foreign Tourists | 1.5 | |
| Overseas - Domestic Tourists | 0.50 | |
| Total 2008 Market for Disney-Shanghai | 71.90 | |



Revenue Projections

Revenue Assumptions

| | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 |
|----------------------------|----------|----------|----------|----------|----------|----------|
| Year | 0 | 1 | 2 | 3 | 4 | 5 |
| Expected Demand (Mil) | 10.64 | 10.80 | 10.96 | 11.13 | 11.29 | 11.46 |
| Admissions (\$ Mil) | \$283.18 | \$296.05 | \$305.49 | \$315.31 | \$325.50 | \$336.10 |
| Merchandise (\$ Mil) | \$53.53 | \$55.97 | \$58.51 | \$61.17 | \$63.95 | \$66.85 |
| Food and Beverage (\$ Mil) | \$53.53 | \$55.97 | \$58.51 | \$61.17 | \$63.95 | \$66.85 |
| Main Entrance (\$ Mil) | \$0.50 | \$0.52 | \$0.53 | \$0.55 | \$0.56 | \$0.58 |
| Total Revenue | \$390.74 | \$408.50 | \$423.04 | \$438.19 | \$453.96 | \$470.39 |

| | 2003 USD | 2008 USD |
|---------------|----------|----------|
| F&B Per Cap | \$4.34 | \$5.03 |
| Merch Per Cap | \$4.34 | \$5.03 |

- Assume Expected Demand Grows 1.5% Annually (Based on Attendance Figures at Other Disney Parks)



Operating Costs

Operating Expenses

| | USD (Millions) | Adjusted (2003 Dollars) | Adjusted (2008 Dollars) | % Revenue |
|--------------------------------|-----------------|-------------------------|-------------------------|-----------|
| Park Labor (Salaried & Hourly) | \$50.00 | \$20.00 | \$23.19 | |
| Costs Associ. w/ Park Labor | \$25.00 | \$25.00 | \$28.98 | |
| Maintenance | \$15.00 | \$15.00 | \$17.39 | |
| Entertainment | \$25.00 | \$24.30 | \$28.17 | |
| F&B | \$10.62 | \$9.77 | \$11.33 | 21.16% |
| Merchandise | \$17.55 | \$14.48 | \$16.78 | 31.35% |
| Support Labor | \$5.00 | \$2.00 | \$2.32 | |
| Miscellaneous | \$5.00 | \$5.00 | \$5.80 | |
| Total Expenses | \$153.17 | \$115.55 | \$133.95 | |

| | 2008 | 2009 | 2010 | 2011 | 2012 |
|--------------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| Park Labor (Salaried & Hourly) | \$23.19 | \$23.88 | \$24.60 | \$25.34 | \$26.10 |
| Costs Associ. w/ Park Labor | \$28.98 | \$29.85 | \$30.75 | \$31.67 | \$32.62 |
| Maintenance | \$17.39 | \$17.91 | \$18.45 | \$19.00 | \$19.57 |
| Entertainment | \$28.17 | \$29.02 | \$29.89 | \$30.78 | \$31.71 |
| F&B | \$11.33 | \$11.84 | \$12.38 | \$12.94 | \$13.53 |
| Merchandise | \$16.78 | \$17.55 | \$18.34 | \$19.17 | \$20.04 |
| Support Labor | \$2.32 | \$2.39 | \$2.46 | \$2.53 | \$2.61 |
| Miscellaneous | \$5.80 | \$5.97 | \$6.15 | \$6.33 | \$6.52 |
| Total Expenses | \$133.95 | \$138.41 | \$143.01 | \$147.76 | \$152.70 |



Capital Structure

Capital Structure Assumptions

| | | Investment Schedule | | | | |
|-------------------|-----------------|---------------------|---------|---------------|---------------|---------------|
| | | Year | Percent | Total | Debt | Equity |
| Park Investment | \$1,200,000,000 | | | | | |
| Hotel Investment | \$70,000,000 | 2004 | 0.1 | \$127,000,000 | \$76,200,000 | \$50,800,000 |
| Total Investment | \$1,270,000,000 | 2005 | 0.225 | \$285,750,000 | \$171,450,000 | \$114,300,000 |
| % Debt | 60% | 2006 | 0.35 | \$444,500,000 | \$266,700,000 | \$177,800,000 |
| % Equity | 40% | 2007 | 0.225 | \$285,750,000 | \$171,450,000 | \$114,300,000 |
| | | 2008 | 0.1 | \$127,000,000 | \$76,200,000 | \$50,800,000 |
| Debt | \$762,000,000 | | | | | |
| Equity | \$508,000,000 | | | | | |
| % Disney | 43% | | | | | |
| % Government | 57% | | | | | |
| Disney Equity | \$218,440,000 | | | | | |
| Government Equity | \$289,560,000 | | | | | |

On-Going Capital Expenditures

Assumptions:

- US Parks spend approximately \$100 Million every 3 years for new attractions
- Assume 10% is local labor
- Labor costs are 1/3 of US
- Estimate Shanghai Disneyland will spend approximately \$93 Million every 3 years (Current Dollars)
- With inflation, translates to \$37.02 Million for 2009, Grow at rate of inflation
- Assume hotel will have \$1.5 Million in Cap Ex every year beginning in 2009, Grow at rate of inflation
- Total Cap Ex in 2009 is \$38.52 Million



Depreciation

| Year | Cap Ex | Depreciation Expense | | | | | Total |
|------|---------------|----------------------|--------------|--------------|--------------|-------------|--------------|
| | | 2004 Cap Ex | 2005 Cap Ex | 2006 Cap Ex | 2007 Cap Ex | 2008 Cap Ex | |
| 2004 | \$120,000,000 | \$6,000,000 | \$0 | \$0 | \$0 | \$0 | \$6,000,000 |
| 2005 | \$270,000,000 | \$6,000,000 | \$13,500,000 | \$0 | \$0 | \$0 | \$19,500,000 |
| 2006 | \$420,000,000 | \$6,000,000 | \$13,500,000 | \$21,000,000 | \$0 | \$0 | \$40,500,000 |
| 2007 | \$270,000,000 | \$6,000,000 | \$13,500,000 | \$21,000,000 | \$13,500,000 | \$0 | \$54,000,000 |
| 2008 | \$120,000,000 | \$6,000,000 | \$13,500,000 | \$21,000,000 | \$13,500,000 | \$6,000,000 | \$60,000,000 |
| 2009 | \$0 | \$6,000,000 | \$13,500,000 | \$21,000,000 | \$13,500,000 | \$6,000,000 | \$60,000,000 |
| 2010 | \$0 | \$6,000,000 | \$13,500,000 | \$21,000,000 | \$13,500,000 | \$6,000,000 | \$60,000,000 |
| 2011 | \$0 | \$6,000,000 | \$13,500,000 | \$21,000,000 | \$13,500,000 | \$6,000,000 | \$60,000,000 |
| 2012 | \$0 | \$6,000,000 | \$13,500,000 | \$21,000,000 | \$13,500,000 | \$6,000,000 | \$60,000,000 |
| 2013 | \$0 | \$6,000,000 | \$13,500,000 | \$21,000,000 | \$13,500,000 | \$6,000,000 | \$60,000,000 |
| 2014 | \$0 | \$6,000,000 | \$13,500,000 | \$21,000,000 | \$13,500,000 | \$6,000,000 | \$60,000,000 |
| 2015 | \$0 | \$6,000,000 | \$13,500,000 | \$21,000,000 | \$13,500,000 | \$6,000,000 | \$60,000,000 |
| 2016 | \$0 | \$6,000,000 | \$13,500,000 | \$21,000,000 | \$13,500,000 | \$6,000,000 | \$60,000,000 |
| 2017 | \$0 | \$6,000,000 | \$13,500,000 | \$21,000,000 | \$13,500,000 | \$6,000,000 | \$60,000,000 |
| 2018 | \$0 | \$6,000,000 | \$13,500,000 | \$21,000,000 | \$13,500,000 | \$6,000,000 | \$60,000,000 |
| 2019 | \$0 | \$6,000,000 | \$13,500,000 | \$21,000,000 | \$13,500,000 | \$6,000,000 | \$60,000,000 |
| 2020 | \$0 | \$6,000,000 | \$13,500,000 | \$21,000,000 | \$13,500,000 | \$6,000,000 | \$60,000,000 |
| 2021 | \$0 | \$6,000,000 | \$13,500,000 | \$21,000,000 | \$13,500,000 | \$6,000,000 | \$60,000,000 |
| 2022 | \$0 | \$6,000,000 | \$13,500,000 | \$21,000,000 | \$13,500,000 | \$6,000,000 | \$60,000,000 |
| 2023 | \$0 | \$6,000,000 | \$13,500,000 | \$21,000,000 | \$13,500,000 | \$6,000,000 | \$60,000,000 |
| 2024 | \$0 | \$0 | \$13,500,000 | \$21,000,000 | \$13,500,000 | \$6,000,000 | \$54,000,000 |
| 2025 | \$0 | \$0 | \$0 | \$21,000,000 | \$13,500,000 | \$6,000,000 | \$40,500,000 |
| 2026 | \$0 | \$0 | \$0 | \$0 | \$13,500,000 | \$6,000,000 | \$19,500,000 |
| 2027 | \$0 | \$0 | \$0 | \$0 | \$0 | \$6,000,000 | \$6,000,000 |