FitchRatings

RATING ACTION COMMENTARY

Fitch Downgrades Disney's IDR to 'A-' from 'A'; Maintains Negative Outlook

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Fitch Ratings - New York - 06 May 2020: Fitch Ratings has downgraded the Long-Term Issuer Default Rating (IDR) assigned to The Walt Disney Company (Disney) and its subsidiaries to 'A-' from 'A'. At the same time, Fitch has downgraded the company's Short-Term IDR and CP ratings to 'F2' from 'F1'. In addition, Fitch has downgraded the senior unsecured issue ratings to 'A-' from 'A'. The Rating Outlook on the Long-Term IDR remains Negative. A full list of ratings follows at the end of this release. Approximately $55.5 billion of debt outstanding as of March 28, 2020 is affected by Fitch's action.

Based on Fitch's assessment of Disney's financial flexibility, the lower of the two short-term options for the current 'A-' IDR has now been assigned.

Fitch's rating action incorporates our expectation that the coronavirus pandemic will materially weaken Disney's operating and credit profile through the remainder of the company's fiscal year 2020 and into its fiscal year 2021, with shortfalls driven primarily by the Parks, Experiences and Products segment. Fitch recognizes the steps the company has taken to mitigate the impact of the pandemic on its operations and to bolster its liquidity position. However, Fitch anticipates that Disney's businesses and cash flow generation will experience material erosion relative to initial expectations, which will negatively impact credit protection metrics over the rating horizon. Fitch's base case indicates Disney's total leverage (defined as total gross debt with equity credit to operating EBITDA) will spike to over 6.0x at fiscal year-end 2020 (September) before trending down to approximately 2.2x by the end of the company's 2022 fiscal year-end with the return of economic activity as the coronavirus threat diminishes. Fitch believes the company's credit profile is more reflective of the 'A-' rating level owing to the slower pace of deleveraging and Disney's inability to return credit metrics in-line with those previously outlined for the 'A' rating category within Fitch's rating horizon.

The Negative Outlook incorporates the high degree of uncertainty around the timeframe and pace at which Disney's operations will normalize following the coronavirus pandemic. Fitch would consider stabilizing the outlook once there is more clarity on the pace of the park's re-opening across geographies and the resulting capacity and attendance levels. Fitch will also continue to evaluate Disney's ability to mitigate run-rate operating losses and reign in capital expenditures and other cash spending to limit the cash flow impact from anticipated operating losses. Also, Fitch will consider Disney's ability to apply excess cash flow to debt reduction so that total leverage approaches 2.5x by fiscal year-end 2022.

Fitch believes the coronavirus pandemic will have a broad influence on Disney's operating profile, but that the company's Parks, Experiences and Product segment will bear the brunt of the impact due to ongoing park closures. Fitch believes the park closure will likely be extended through Disney's fiscal third quarter, resulting in significant revenue contraction and operating losses. Fitch's base case assumes domestic parks reopen on or about July 1 subject to guest density and park capacity limitations. Disney's Media Networks business will experience advertising revenue declines stemming from the cancellation of professional and college sports leagues. Additionally, Studio Entertainment segment revenues will decline, reflecting the disruption of the theatrical exhibition window.

Fitch believes Disney has the financial flexibility and capacity to withstand the impact of the coronavirus pandemic. Liquidity resources include approximately $15.3 billion of cash on hand as of March 28, 2020 (adjusted to reflect the issuance of C$1.3 billion of senior notes), along with $12.25 billion of available revolver capacity under three credit facilities. Commitments under these credit facilities support the company's CP program and expire in March 2021 ($5.25 billion), March 2023 ($4 billion) and March 2025 ($3 billion). Disney's liquidity position was further solidified by an additional $5 billion bank facility, which is due to mature in April 2021. Offsets to available liquidity include approximately $8.5 billion of CP outstanding and $2.4 billion of scheduled maturities remaining in fiscal 2020. Scheduled maturities are well-laddered and manageable considering FCF generation expectations and access to capital markets.

As Disney strategically repositions from traditional linear to a direct-to-consumer (DTC) business model, the company will increase investment in television and film content production capabilities to support its DTC initiatives. Disney launched its Disney+ streaming service in November 2019, and Fitch recognizes the inherent execution risks as meaningful investments are required to support subscriber growth and retention and will result in material near-term segment operating losses. Fitch acknowledges that initial subscriber growth has exceeded its expectations as the company's subscriber base exceeds 50 million as of April 2020. Hulu's operating losses are expected to peak during FY19 before narrowing and achieving profitability during FY23. Similarly, the operating losses generated by ESPN+ streaming are expected to peak in FY20 before it reaches profitability during FY23. The incremental investments necessary to execute the strategic repositioning as well as the full consolidation of Hulu will weigh on Disney's operational and credit protection metrics, limiting the capacity to accommodate strategic or operational shortfalls.

KEY RATING DRIVERS

Effects of Pandemic: The coronavirus pandemic will result in a significant negative shock to Disney's financial performance, particularly the company's Parks, Experiences and Products segment. Disney has implemented an unprecedented closure of all of its theme parks properties across geographies and taken additional steps to mitigate the impact of the pandemic, including suspending its dividend payment in July 2020, reducing executive compensation and furloughing over 120,000 employees. Fitch's forecast assumes that Disney's parks will reopen at the beginning of its fiscal Q4 with capacity limitations. Cruises could face a longer-term recovery in demand owing to negative public sentiment, although this is a much smaller part of the overall business.

Disney's other businesses are also facing headwinds during this period. Disney's Studio Entertainment segment will shift releases out of this period. Incrementally, with the cancellation of major sporting events, both ESPN and the ABC networks will face challenges from the loss of advertising revenues. Fitch also anticipates a general weakening in the advertising environment as marketers and marketing budgets scale down.

Fitch believes that Disney's operating performance could experience a sharp and meaningful rebound once it can return to normalcy. Fitch notes that its current forecast does not consider a deeper macroeconomic shock or any longer-lasting impacts to consumer behavior.

Significant Financial Flexibility: Disney's conservative financial policy, global scale and business diversification along with significant liquidity resources strongly position the company to withstand the temporary but material disruption of its operating profile stemming from the pandemic.

In the interim, Disney has the ability to mitigate the impact to cash flow and liquidity through a variety of levers. Fitch expects that the company will reduce discretionary capital expenditures and anticipates total capex of approximately $4.4 billion during fiscal 2020. In addition, content production has been halted, and there will be a positive short-term cash benefit owing to the high upfront costs associated with these projects. Fitch believes these factors will significantly offset the pressure from short-term operating income shortfalls. Nonetheless, Fitch does expect that Disney will report negative FCF of approximately $4 billion in fiscal 2020 before rebounding in fiscal 2021 to approximately $2.3 billion of FCF generation.

Consistent Financial Policy: Fitch expects that Disney will prioritize liquidity and stabilization of its operating profile while dealing with the coronavirus pandemic. Once the threat passes, Fitch believes the company will continue to focus on debt reduction and forego its dividend payment and share repurchases until leverage is reduced to a level consistent with its 'A-' rating. Fitch notes the established leverage threshold of 2.5x for Disney at the 'A-' category.

Strategic Pivot to DTC: Disney's investment related to its DTC strategy and capabilities to transform their relationships with consumers of their products and leverage the company's unique content creation and monetization capabilities is appropriate, in Fitch's view. The launch of Disney+ has been a substantial success thus far, as the company has grown its subscriber base to over 50 million as of April 2020. Disney expects Disney+ to reach profitability in fiscal 2024, with peak operating losses in the 2020-2022 timeframe. While there will initially be a drag on profitability from investments, we view the low pricing as necessary due to heightened DTC competition.

We believe Disney must amass a certain level of scale, with respect to subscribers, to not only be profitable but a true competitor in the streaming ecosystem. The DTC strategy, along with Disney's market-leading asset and IP portfolio strengthened by its acquisition of 21st Century Fox (21CF), will better position the company to withstand and capitalize upon ongoing secular pressures across the media and entertainment landscape. Fitch continues to believe content owners and creators such as Disney are best-positioned to address secular threats and opportunities as the media consumption paradigm matures, and that the key to successfully executing the DTC strategy will be its capability to invest in original content creation to feed their respective DTC business models.

Leading Market Positions and Leveragability: Disney has a very consistent investment strategy centered on creating or acquiring intellectual property and content that is leverageable across Disney's various platforms. Disney is uniquely positioned, relative to its peers, to capitalize on and monetize its internally or externally developed franchises and brands, which in turn strengthens its operating and credit profile and provides Disney with a sustainable competitive advantage.

Strength of Cable Networks: Disney's strong portfolio of cable networks, ESPN in particular, underpins the company's ratings. Fitch believes the top-tier channels will continue to be a must-carry for distributors and are likely to retain pricing power. Disney's operating profile benefits from the stability, recurring dual-stream revenue profile, high operating margin and FCF-generation characteristics attributable to its cable network business. We expect that this segment will continue to generate a significant amount of Disney's cash flow.

DERIVATION SUMMARY

Overall, the ratings reflect the company's leading market positions within its core businesses. Further, Disney has a very consistent investment strategy that is centered on creating or acquiring intellectual property and content that is leverageable across its various platforms (cable and broadcast network, studio, parks and resorts and consumer products).

Disney's cable networks generate a meaningful portion of total revenue and EBITDA, resulting in incremental stability in the total revenue and FCF profile. Secular issues - such as the steadily declining multi-channel video subscriber base and its effect on affiliate fee revenue, rising programming costs (particularly for sports programming), the impact of foreign exchange and Disney's ability to pass the higher costs on to multi-channel video programming distributors (MVPDs) - will remain a significant risk to the company's operating profile. However, Fitch believes Disney is in a strong position to retain pricing power going forward, as its collection of top-tier cable networks continue to command audience and ratings and be a must-carry for MVPDs. In addition, Disney has, in large part, successfully matched the tenor of its long-term sports programming rights with the terms of its various affiliation agreements with the MVPDs.

The ratings incorporate the cyclicality of the company's businesses, particularly Parks, Experiences and Products and the advertising portion of broadcast and cable networks. These segments will potentially face incremental challenges in the event of a more prolonged economic shock resulting from the coronavirus pandemic. There is limited cushion in the 'A-' IDR to accommodate incremental stresses. However, Fitch believes there are meaningful cash flow levers that Disney can utilize to continue its planned debt reduction.

KEY ASSUMPTIONS

--Total revenue declines of roughly 10% in fiscal 2020 as incremental revenues from the Disney-21CF merger in 2019 and the rollout of Disney+ are more than offset by headwinds from the coronavirus pandemic.

--The pandemic results in a meaningful operating income loss, primarily related to forgone revenues in the Parks, Experiences and Products segment (approximately a 47% revenue decline in 2020). Fitch's base case forecast assumes that parks do not broadly re-open until the July time horizon and at reduced attendance capacity owing to lingering public health concerns. The Studio Entertainment and Media Networks segments are impacted by the required film slate delays and the cancellation of all major sporting events, which will be a drag for both ESPN and the ABC Networks advertising revenues. Fitch also assumes the overall advertising market weakens owing to a contraction in the economic environment and advertisers' pullback on budgets. Conversely, DTC remains resilient with strong revenue growth due to the rollout of Disney+.

--Operating losses are partially mitigated by cost-reduction efforts including the potential for reduced labor during the crisis.

--Overall EBITDA declines approximately 50% in 2020, followed by a return to growth in 2021. Fitch does not forecast EBITDA to normalize in the $17 billion range until fiscal 2022.

--Fitch anticipates operating losses will be partially offset by declines in cash taxes, capex and reduced cash content expenditures.

--Disney halts the dividend and forgoes its July 2020 payment. Fitch does not expect Disney to resume the dividend until operating performance normalizes, likely in the fiscal 2022 time horizon.

--Fitch forecasts FCF of negative $4 billion in fiscal 2020.

--Disney issues $6 billion in U.S.-denominated notes and C$1.3 billion in Canadian-denominated notes in March 2020. Cash balances will remain high relative to historic levels during the pandemic thereafter, Disney diverts excess balance sheet cash and FCF towards absolute debt reduction. Fitch assumes cash balances normalize at roughly $4 billion, in line with historical levels.

--Fitch expects total leverage (total debt with equity credit/EBITDA) to peak slightly in excess of 6.0x (5.0x on a net leverage basis) in fiscal 2020 and normalize back to the 2.0x range by 2022.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

--Near-term upward ratings momentum is not likely owing to uncertainty around the financial impact of the coronavirus pandemic, the increasing potential for an economic downturn and Fitch's expectation that total leverage (total gross debt with equity credit/EBITDA) will remain elevated over the near term as Disney manages through these operating headwinds.

--Fitch would consider stabilizing the Outlook once there is more clarity related to the timeframe for resuming a normalized course of business, particularly a return of demand within the company's Parks, Experiences and Products segment, following the diminishment of the coronavirus pandemic. Fitch will evaluate Disney's ability to mitigate run-rate operating losses and reign in capital expenditures and other cash spending to limit the cash flow impact from anticipated operating losses. Also, Fitch will consider Disney's ability to apply excess cash flow to debt reduction so total leverage approaches 2.5x by fiscal year-end 2022.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

--An extension of the coronavirus pandemic and related business shutdown beyond Fitch's base case, any longer-lasting impacts to consumer behavior or a deeper macroeconomic shock that delays Disney's efforts to reduce leverage below 2.5x will likely lead to negative rating action.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Non-Financial Corporate issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

LIQUIDITY AND DEBT STRUCTURE

Fitch believes Disney's liquidity position is strong and will position the company to withstand the coronavirus pandemic and related closure of its domestic parks business. The company's liquidity position is supported by approximately $15.3 billion of cash on hand as of March 28, 2020 (adjusted to reflect the issuance of C$1.3 billion of senior notes), along with $17.25 billion of available revolver capacity under four credit facilities, including the $5 billion credit facility that matures in April 2021. Disney has $12.25 billion of credit facilities that support the company's CP program that are due to expire in March 2021 ($5.25 billion), March 2023 ($4 billion) and March 2025 ($3 billion). Offsets to available liquidity include approximately $8.5 billion of CP outstanding and $2.4 billion of scheduled maturities remaining in fiscal 2020. Scheduled maturities are well-laddered and manageable considering FCF generation expectations and access to capital markets.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG CONSIDERATIONS

The highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or to the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

RATING ACTIONS

ENTITY/DEBT	RATING		
21st Century Fox America, Inc.	LT IDR	A-	Downgrade
• senior unsecured	LT	A-	Downgrade

ENTITY/DEBT	RATING		
ABC Inc.	LT IDR	A-	Downgrade
• senior unsecured	LT	A-	Downgrade
The Walt Disney Company	LT IDR	A-	Downgrade

VIEW ADDITIONAL RATING DETAILS

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APPLICABLE CRITERIA

Parent and Subsidiary Rating Linkage (pub. 27 Sep 2019)

Corporates Notching and Recovery Ratings Criteria (pub. 14 Oct 2019) (including rating assumption sensitivity)

Corporate Rating Criteria (pub. 02 May 2020) (including rating assumption sensitivity)

Sector Navigators: Addendum to the Corporate Rating Criteria (pub. 02 May 2020)

APPLICABLE MODELS

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Corporate Monitoring & Forecasting Model (COMFORT Model), v7.9.0 (1)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

21st Century Fox America, Inc.	EU Endorsed
ABC Inc.	EU Endorsed
Disney Enterprises, Inc.	EU Endorsed
The Walt Disney Company	EU Endorsed
TWDC Enterprises 18 Corp.	EU Endorsed
Twenty-First Century Fox, Inc.	EU Endorsed

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United States