The Walt Disney Company's

"Sleeping Beauty" Bonds*

Disney Brothers Studios was founded in October 1923. Disney's first cartoon character, Mickey Mouse, also dates from 1923. In the early 1990s, the Walt Disney Company ("Disney") continued to focus on the entertainment business. In fiscal 1991, theme parks and resorts accounted for approximately 46% of Disney's total revenues, including the original Disneyland Park and Disneyland Hotel in California, Disney World destination resort in Florida, and Euro Disney in France. The Company also received royalties based on Tokyo Disneyland's revenues.

Disney's motion picture segment accounted for another 42% of total revenues and included live-action and animated movies (ranging from Pinocchio to Aladdin) as well as The Disney Channel, and KCAL, a Los Angeles television channel. Motion pictures were distributed under the names Walt Disney Pictures, Touchstone Pictures and Hollywood Pictures.

Disney's consumer products segment accounted for the remaining 12% of fiscal 1991 revenues. Fees came from licensing the Walt Disney name, Disney characters, books, songs and music. In addition, the Company sold Disney-related products through the Disney Store and other outlets.

On August 18, 1992, Disney filed a prospectus with the Securities and Exchange Commission stating:

> The Walt Disney Company ("Disney") may offer from time to time its senior unsecured debt securities consisting of notes, debentures or other evidence of indebtedness (the "Debt Securities"), at an aggregate initial offering price of not more than $1,000,000,000 or, if applicable, the equivalent thereof in any other currency or currencies.

On July 21, 1993, Disney filed a pricing supplement to the August 1992 prospectus announcing the issuance of $300 million of bonds that will mature on July 15, 2093 (see Exhibit 1). Amid some controversy (see Exhibit 2), but apparently high demand from pension funds and insurance companies, Disney became the first corporation since 1954 to issue 100-year bonds.[1] Given that relatively few companies last 100 years, much less 170 (recall that Disney

---

* Prepared by Professor Robert Bowen for class discussion purposes only. Revised July 2008.

[1] This was the Chicago & Eastern Illinois railroad. Source: Moody's Bond Record.

was founded in 1923), perhaps the Wall Street Journal headline announcing the issuance was not too surprising: "Disney Amazes Investors With Sale of 100-Year Bonds" (7/21/93, p. C1).

Disney debt was rated double-A (similar to that of McDonald's, the hamburger chain). McDonald's had recently issued 40-year bonds at 75 basis points (0.75%) above the 30-year Treasury bond yield. The 30-year Treasury bond yield was approximately 6.6% on July 21, 1993. On that date, the Disney bonds were priced to sell at par with a coupon rate of 7.55%.

The purpose of this case is to examine the economics and mechanics underlying long-term debt. Specifically you will:

- Apply the present value concept
- Discuss the risks in investing in fixed rate long-term securities
- Discuss management's strategy in issuing such bonds
- Practice using a spreadsheet to create a (large) bond amortization table
- Prepare journal entries related to the transaction

Questions:

1. Speculate why Disney management chose to issue unusually long-term bonds? (e.g., What predictions was management making about future interest rates?)

2. Why did the Disney bonds have a higher yield than 30-year U.S. Treasury bonds?

3. From the perspective of the bondholder, which was more valuable, the $300 million principal (or face value) of the bonds or the semi-annual coupon payments? [Hint: Calculate the present value of a) the face value and b) the coupon payment stream.]

4. The Pricing Supplement to the Prospectus discusses Disney's option to call or redeem the bonds beginning July 15, 2023 at 103.02% of their face value – declining to 100% of face value after July 15, 2043.
   a. From the perspective of the bondholder, what effect does the Company's call option have on the attractiveness of the Bonds at the issuance date?
   b. From the perspective of the Disney Company, why would management include a call option in the terms of the bond?
   c. On the next day, Coca-Cola issued $150 million of 100-year <u>non</u>-callable bonds. Speculate as to how the yield differed between the Disney and Coca-Cola issues.

5. From the perspective of the bondholder, calculate the market value of the bonds one year *after* the date of issuance *if*:
    a. Long term yields for similar risk securities increased by 1%.
    b. Long term yields for similar risk securities decreased by 1%.
    c. Interest rates had not changed but the expected life of the Company dropped from 100 years to 50 years (with 49 remaining).
    d. Discuss the potential impact of inflation on bondholders.

6. From the perspective of the Disney Company, use a spreadsheet to prepare bond amortization tables based on the following *independent* sets of assumptions:[2]
    a. Bonds issued at par (face value) with semi-annual coupon payments.
    b. Bonds issued at a discount (i.e., less than face value) with semi-annual coupon payments, where the coupon rate of 7.55% was less than the market yield of 9%.
    c. Bonds issued at a premium (i.e., greater than face value) with semi-annual coupon payments, where the coupon rate of 7.55% was greater than the market yield of 6%.

7. From the perspective of the Disney Company, prepare a journal entry to:
    a. Record the issuance of the bonds on July 29, 1993. (Hint: look at the cover page of the Pricing Supplement to the Prospectus.)

8. As senior manager at Disney in 1993, would you have supported the issuance of 100-year bonds given the then-current economic environment?

---

[2] Hints:
a. Consider using the attached template to set up your spreadsheet.
b. Once basic formulas have been inserted in the spreadsheet, the "fill down" command will be useful to complete the schedules. If everything has been entered properly, the ending value of the bonds, after repayment of the principal, should equal (approximately) zero.

Exhibit 1

PRICING SUPPLEMENT
(To Prospectus Supplement and
Prospectus each dated August 18, 1992)

$300,000,000

The Walt Disney Company

7.55% SENIOR DEBENTURES DUE 2093

Interest payable January 15 and July 15

The Senior Debentures (the "Debentures") will mature on July 15, 2093, and will be redeemable on not less than 30 nor more than 60 days' notice, at the option of the The Walt Disney Company ("Disney"), in whole or in part, at any time on or after July 15, 2023 at the redemption prices set forth herein, plus accrued and unpaid interest to the redemption date. See "Description of the Debentures" herein, "Description of the Notes" in the Prospectus Supplement and "Description of the Debt Securities" in the Prospectus.

The Debentures will be represented by global securities (the "Global Securities") registered in the name of a nominee of The Depository Trust Company, as Depositary. Beneficial interests in the Debentures will be shown on, and transfers thereof will be effected only through, records maintained by the Depositary or its participants. Except as described under "Description of the Notes" in the Prospectus Supplement, owners of beneficial interests in the Global Securities will not be entitled to receive physical delivery of the Debentures in definitive form. See "Description of the Notes" in the Prospectus Supplement.

THESE SECURITIES HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE SECURITIES AND EXCHANGE COMMISSION OR ANY STATE SECURITIES COMMISSION NOR HAS THE SECURITIES AND EXCHANGE COMMISSION OR ANY STATE SECURITIES COMMISSION PASSED UPON THE ACCURACY OR ADEQUACY OF THIS PRICING SUPPLEMENT OR THE PROSPECTUS SUPPLEMENT OR THE PROSPECTUS TO WHICH IT RELATES. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

PRICE 100% AND ACCRUED INTEREST

	Price to Public(1)	Underwriting Discounts and Commissions(2)	Proceeds to Disney(1)(3)
Per Debenture	100.000%	1.125%	98.875%
Total	$300,000,000	$3,375,000	$296,625,000

(1) Plus accrued interest from July 15, 1993.
(2) Disney has agreed to indemnify the Underwriters against certain liabilities, including liabilities under the Securities Act of 1933, as amended. See "Underwriters."
(3) Before deducting expenses payable by Disney.

The Debentures are offered, subject to prior sale, when, as and if accepted by the Underwriters and subject to approval of certain legal matters by counsel for the Underwriters. It is expected that delivery of the Debentures will be made on or about July 28, 1993 through the book-entry facilities of The Depository Trust Company, against payment therefor in New York funds.

MORGAN STANLEY & CO. Incorporated

MERRILL LYNCH & CO.

July 21, 1993

Exhibit 2

Selected Quotes from the Financial press about
The Walt Disney Company's "Sleeping Beauty" Bonds

New York Post, 7/22/93

However, some argued that the issue was a Mickey Mouse offering -- since the company can call the bonds after 30 years. "It's just a gimmick," said Rick Meckler, chief investment advisor at Liberty Views and former manager of the CBS pension fund.

An official at a large insurance company who spoke on the condition of anonymity said: "We weren't interested. [We might have been had there] been a more attractive yield spread and if they were non-callable."

New York Times, 7/22/93

Several money managers were quick to dismiss the idea of buying the 100-year Disney bond. They said it was a great idea for the entertainment company to lock in low-interest rates for a long time. But they said buyers were taking on considerable risk, especially because the bond can be called or paid off by the company in 30 years.

Disney would call the bond if interest rates declined, which is what bondholders want because prices rise when yields fall.[3] "If things are working to your advantage they will take it away from you and if it is working to your disadvantage you get to keep it," said Charles P. Smith, a managing director at T. Rowe Price Associates in Baltimore.

"I think we are getting to silly season on structures," added Thomas A. Shively, a senior vice president at State Street Research, a money manager in Boston.

Los Angeles Times, 7/25/93 (by Allan Sloan, a financial columnist for Newsday in New York)

Things are getting really goofy in the financial markets. Here is the Walt Disney Co., one of the world's shrewdest borrowers, scarfing up $300 million of eternal money by issuing 100-year bonds. But at the same time Disney is nailing down every long-term dollar it can get, the U.S. Treasury, under orders from the Clinton Administration, is cutting back long-term borrowings and increasing short-term borrowings.

Who do you think is making the right call? Mickey Mouse or Uncle Sam? I put my money on the mouse.

---

[3] This note is not part of the quote. Bondholders want interest rates to fall because it makes the market value of their bonds rise. However, having the bonds callable (or called) under these circumstances is <u>not</u> good news.