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M&A deal-making: Disney, Marvel and the value of "hidden assets"

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Five of the top ten highest grossing movies of 2018 had super-hero themes and earned more than $2 billion in that year alone. Super-hero themed movies also powered the entertainment industry in 2017 and 2016.[1] Given this eye-popping money-making potential, it might come as a surprise when people learn that the creator of many super-hero characters, Marvel Entertainment Group (Marvel), filed for bankruptcy in 1996. The filing was caused by Marvel's aggressive financing and growth strategies that could not be sustained when the comic book/collectibles market experienced a down-turn.[2]

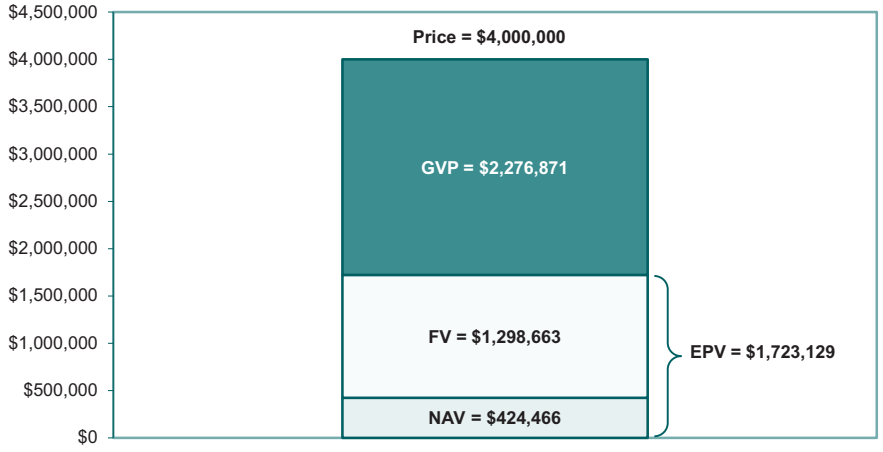
The battle for control of Marvel that took place during the bankruptcy process was as entertaining as any super-hero comic book saga. It pitted well-known financiers Ronald Perelman and Carl Icahn against each other, and was trenchantly told by journalist Dan Raviv in his book, *Comic Wars: How Two Tycoons Battled Over the Marvel Comics Empire... And How Both Lost!!!* [3] The saga's dual plots: first, there was a battle for control waged by Perelman, who bought Marvel in the late 1980s, and Icahn, who began buying Marvel bonds in an effort to take over the company. Both Perelman and Icahn bragged they were never interested in comics, just money. As the battle raged they seemed obsessed with profit and a personal vendetta.

The hero of the story's other plot was Isaac Perlmutter, then the largest stockholder of Toy Biz, which had a minority interest in Marvel before and during the bankruptcy. Perlmutter emerged as the owner of Marvel for the sum of $238 million.[4] He had a much lower public profile than both Perleman and Icahn, but he was just as savvy financially. More importantly though, Perlmutter and his team, which included media executive Avi Arad, had a better understanding of the value of Marvel's portfolio of heroic characters and story-lines. In strategic terms, Perlmutter and his team had an "information advantage" that facilitated their gaining control of Marvel and their realizing value as a result of that control over time.

The value of Marvel made headlines on August 31, 2009, when Disney acquired it for $4 billion. Reacting to critics that insinuated he might have paid too much for a comic book company, Disney's CEO, Robert Iger, commented at the time, "We paid a price that reflects the value [Marvel] created and the value we can create as one company. It's a full price, but a fair price."[5]

It was estimated that 57 percent of the valuation, or $2.3 billion out of the $4 billion purchase price, pertained to the value of expected growth (see Exhibit 1). Significantly, the growth value implied a reinvestment rate of more than 20 percent,[6] which at the time seemed like an aggressive assumption even for a company with Disney's financial resources. Aggressive or not, the strategic question facing Disney was, if they paid a "full price" for Marvel, which seemed likely at the time, how could they profit from the acquisition?

Exhibit 1 Disney's Marvel acquisition: Pricing analysis



Source: Joseph Calandro, Jr., "Disney's Marvel acquisition and strategic financial analysis," *Strategy & Leadership*, Vol. 37, No. 5 (2009), p. 44. All calculations are mine and have been rounded where "NAV" is net asset value, "FV" is franchise value, "EPV" is earnings power value, "GVP" is the growth value premium and "Price" is the amount that Disney paid for Marvel

Hidden assets and value realization

As is now widely known, Disney's value realization strategy was based on investing in movies based on Marvel's portfolio of super-hero characters and, significantly, its decades-old comic book source material. One way they accomplished this was through integrated story arcs and character team-ups.

Disney's development of these movie themes resulted in the 2012 blockbuster movie *The Avengers,* as well as a number of other hits that, cumulatively, generated profits well in excess of the $4 billion acquisition price – in fact, 3.3 times that price,[7] not including comic book, gaming, apparel, television, and toy revenue. To follow the movie-by-movie results, see Exhibit 2.

Significantly, the potential for this profit performance was not foreseen by financial analysts at the time of the Disney acquisition. However, Robert Iger, as a Disney executive experienced at greenlighting huge investments based on stories and characters, was able to identify and assess the value of Marvel's "hidden assets" found in the decades of popular comic book stories. Hidden intangible assets like these are, in a way, analogous to "blue ocean" opportunities of unknown market space, which has the potential to make current competitive strategies "irrelevant because the rules of the game are waiting to be set."[8] This certainly seems to have been the case with Disney-Marvel. Marvel Studios has released 20 films since 2008 within the Marvel Cinematic Universe, from *Iron Man* (2008) to *Ant-Man and the Wasp* (2018). These films all share continuity with each other. The series has grossed over $17 billion at the global box office, making it the highest-grossing film franchise of all time.[9]

Some professional value investors have made fortunes hunting for hidden assets in the firms they invest in. Noted investor Seth A. Klarman explained why: "Historically investors have found attractive opportunities in companies with substantial 'hidden

Exhibit 2 Box office history for Marvel cinematic universe movies

Release date	*Title*	*Production budget*	*Opening weekend*	*Domestic box office*	*Worldwide box office*
Jul 6, 2018	Ant-Man and the Wasp	$ 130,000,000	$ 75,812,205	$ 216,648,740	$ 623,148,740
Apr 27, 2018	Avengers: Infinity War	$ 300,000,000	$ 257,698,183	$ 678,815,482	$ 2,048,803,724
Feb 16, 2018	Black Panther	$ 200,000,000	$ 202,003,951	$ 700,059,566	$ 1,348,359,566
Nov 3, 2017	Thor: Ragnarok	$ 180,000,000	$ 122,744,989	$ 315,058,289	$ 846,980,024
Jul 7, 2017	Spider-Man: Homecoming	$ 175,000,000	$ 117,027,503	$ 334,201,140	$ 880,166,350
May 5, 2017	Guardians of the Galaxy Vol 2	$ 200,000,000	$ 146,510,104	$ 389,813,101	$ 862,317,259
Nov 4, 2016	Doctor Strange	$ 165,000,000	$ 85,058,311	$ 232,641,920	$ 676,405,470
May 6, 2016	Captain America: Civil War	$ 250,000,000	$ 179,139,142	$ 408,084,349	$ 1,140,075,017
Jul 17, 2015	Ant-Man	$ 130,000,000	$ 57,225,526	$ 180,202,163	$ 518,858,449
May 1, 2015	Avengers: Age of Ultron	$ 330,600,000	$ 191,271,109	$ 459,005,868	$ 1,403,013,963
Aug 1, 2014	Guardians of the Galaxy	$ 170,000,000	$ 94,320,883	$ 333,172,112	$ 770,867,516
Apr 4, 2014	Captain America: The Winter...	$ 170,000,000	$ 95,023,721	$ 259,746,958	$ 714,401,889
Nov 8, 2013	Thor: The Dark World	$ 150,000,000	$ 85,737,841	$ 206,362,140	$ 644,602,516
May 3, 2013	Iron Man 3	$ 200,000,000	$ 174,144,585	$ 408,992,272	$ 1,215,392,272
May 4, 2012	The Avengers	$ 225,000,000	$ 207,438,708	$ 623,279,547	$ 1,517,935,897
Jul 22, 2011	Captain America: The First ...	$ 140,000,000	$ 65,058,524	$ 176,654,505	$ 370,569,776
May 6, 2011	Thor	$ 150,000,000	$ 65,723,338	$ 181,030,624	$ 449,326,618
May 7, 2010	Iron Man 2	$ 170,000,000	$ 128,122,480	$ 312,433,331	$ 621,156,389
Jun 13, 2008	The Incredible Hulk	$ 137,500,000	$ 55,414,050	$ 134,806,913	$ 265,573,859
May 2, 2008	Iron Man	$ 186,000,000	$ 102,118,668	$ 318,604,126	$ 585,171,547
Total	**20**	**$ 3,911,100,000**	**$ 2,507,593,821**	**$ 6,869,613,146**	**$ 17,503,126,841**
Total since 2009	**18**	**$ 3,435,600,000**	**$ 2,350,061,103**	**$ 6,416,202,107**	**$ 16,652,381,435**
Ave. since 2009		**$ 190,866,667**	**$ 130,558,950**	**$ 356,455,673**	**$ 925,132,302**

Notes: Note A: Worldwide Box Office total since 2009 of $16,652,381,435 less Product Budget since 2009 of $3,435,600,000 divided by the acquisition price of $4,000,000,000 equals **3.3 times**. Note B: Average since 2009 profit before tax per movie is **$734,265,635**, which equals the Average since 2009 Worldwide Box Office of $925,132,302 minus the Average since 2009 Production Budget of $190,866,667. Note C: Average since 2009 Worldwide Box Office of $925,132,302 divided by the Average since 2009 Production Budget of $190,866,667 equals **4.8 times**

Source: www.the-numbers.com/movies/franchise/Marvel-Cinematic-Universe#tab=summary All "since 2009" calculations are mine and do not include taxes

assets,' such as an overfunded pension fund, real estate carried on the balance sheet below market value, or a profitable finance subsidiary that could be sold for significant gain."[10]

But bargain hunters beware. What appears to be hidden assets today could turn out to be liabilities tomorrow. According to Klarman, "Amidst a broad-based decline in business and asset values... some hidden assets become less valuable and in some cases may become hidden liabilities. A decline in the stock market will reduce the value of pension fund assets; previously overfunded plans may become underfunded. Real estate, carried on companies' balance sheets at historical cost, may no longer be undervalued. Overlooked subsidiaries that were once hidden jewels may lose their luster."[11]

The risk of over-bidding for hidden assets is particularly high in cases of hidden intangible assets, like those at Marvel. There is a risk that such intangible assets – and other potential blue ocean opportunities – could turn out to be mere "puddles." To avoid stumbling when chasing such opportunities, here are some suggestions for evaluating hidden assets during both deal deliberations and later when developing value realization strategies.

1. **The assets are really unseen or their value is obscure:** Are the assets being generally ignored by industry observers or has their value not been determined by knowledgeable experts? What is the history of any previous attempts to commercialize the assets?

2. **The assets are really assets:** In addition to being hidden, the assets must have a reasonable expectation of value. For example, Marvel's comic books with integrated story arcs and character team-ups had a long-term record of profitability, and thus they qualified as "real" at the time of the acquisition.

3. **A focused value realization strategy:** Historically, value realization activities for hidden tangible assets such as overfunded pension funds, real estate carried on the balance sheet below market value and profitable subsidiaries that have significant private market values are fairly straightforward and relatively easy to execute. However, that is generally not the case with hidden intangible assets. Such assets tend to realize value only over time and require focused strategies to enter a new market, a realistic assessment of the acquirer's capabilities, substantial investment and a high level of execution ability. Firms that have accomplished this tend to explicitly incorporate execution considerations into their strategies from the start.[12]

4. **Operational expertise:** It is not enough to have a unique and focused strategy; firms must have the talented people and capabilities to successfully operationalize the strategy over time. Marvel-Disney, for example, has maximized the value of each movie that it has made as both a stand-alone motion picture and as an integral part of the overall "Marvel Cinematic Universe" (MCU) portfolio in order to successfully perpetuate the franchise. Marvel's track record of accomplishment has been extraordinary, as illustrated in Exhibit 2. Marvel's average profit before tax per movie is $734,265,635,[13] which means that its average Worldwide Box Office revenue exceeds its average Product Budget by an impressive 4.8 times.[14]

   Marvel's post-acquisition movie-making strategy was novel, and involved integrated story arcs that are planned over a decade or more using themes and characters consistent with the comic book source material. Disney was uniquely qualified to implement such a strategy given its track-record of producing successful motion pictures. For example, Disney became the first studio to produce a full-length animated motion picture with the 1937 release of *Snow White and the Seven Dwarfs*, which was an immediate and critically acclaimed success.[15] Disney continued such productions to great effect over the decades. It then extended its efforts to joint ventures such as the one with Pixar, which resulted in the 1995 hit movie *Toy Story,* as well several other blockbusters. Disney CEO Robert Iger acquired Pixar in 2006 for $7.4 billion. Over time, Disney became the industry-leading expert in entertainment and large-scale project finance.

   In other words, Disney was and is extremely skilled at assessing story-line market opportunities, and at marshaling the financial and human resources necessary to realize value from such assessments over time. At Marvel, they effectively serialized these capabilities, to great effect.[16]

"Robert Iger, as a Disney executive experienced at green-lighting huge investments based on stories and characters, was able to identify and assess the value of Marvel's 'hidden assets' found in the decades of popular comic book stories."

> **"Such assets tend to realize value only over time and require focused strategies to enter a new market, a realistic assessment of the acquirer's capabilities, substantial investment and a high level of execution ability."**

5. **Managerial discipline:** Disciplined management can be particularly difficult when managing intangible assets in general, and creative assets in particular. The need to "push the creative frontier" can easily lure an organization astray. Movies based on the Marvel characters are not immune to this risk, as *The Fantastic Four* movie of 2015 showed. Its Worldwide Box Office total was $167.9 million against an estimated production budget of $200 million.[17] This movie was not faithful to its comic book source material and was unpopular with the movie-going fan base.

The search for hidden M&A gold

The M&A market has become increasingly competitive over the years for a number of reasons, including increased participation by alternative investors and high-net-worth individuals. In fact, such dynamics seem to be moving the market to a new cyclical phase.[18] As competition intensifies, strategic advantages will become both more important and more transitory. However, an information advantage that corporate strategists generally have over financiers is their more detailed understanding of the industries in which they work and the industries' dynamics.

One way to monetize such an advantage is, first, through the identification and strategic development of hidden assets that can be the basis for new business models. Second, strategists can take steps to mitigate the risk that hidden liabilities will cause value destruction. For example, acquirers should ensure that a material exposure concentration does not put the funding of a company pension fund at risk.

Hidden intangible assets have value to the extent they are deployed in a manner consistent with their fundamental essence. At Marvel, this entailed making super-hero movies consistent with decades of popular comic book source material. Deviating from the essence of intangible assets risks value destruction, as the case of 20th Century Fox's money losing super hero movie, *The Fantastic Four*, in 2015 showed.

The Disney acquisition of Marvel is a dramatic example of how strategic knowledge of hidden intangible assets can be used to win at deal-making in a competitive marketplace, and how the disciplined management of those assets over time can realize a "blue ocean" of value post-acquisition.

Notes

1. Box Office Mojo 2018 Domestic Grosses: www.boxofficemojo.com/yearly/chart/?yr=2018&view=releasedate&view2=domestic&sort=gross&order=DESC&&p=.htm More detailed statistics can be found here: www.statista.com/topics/4741/superhero-movies/
2. Joseph Calandro, Jr., "Distressed M&A and Corporate Strategy: Lessons from Marvel Entertainment Group's Bankruptcy," *Strategy & Leadership*, Vol. 37, No. 4 (2009), pp. 23-32.
3. Dan Raviv, *Comic Wars: How Two Tycoons Battled Over the Marvel Comics Empire... And How Both Lost!!!* (Broadway, 2002).

4. "Comic Book Publisher Marvel Emerges From Bankruptcy," *Los Angeles Times,* October 2 (1998), p. D-5, http://articles.latimes.com/1998/oct/02/business/fi-28533. The price included a mix of warrants and cash.

5. As quoted by Joseph Calandro, Jr., "Disney's Marvel acquisition: a strategic financial analysis," *Strategy & Leadership,* Vol. 38, No. 2 (2010), p. 43.

6. Ibid., p. 45.

7. See Note A of Exhibit 2.

8. W. Chan Kim and Renee Mauborgne, *Blue Ocean Strategy: How to Create Uncontested Market Space and Make the Competition Irrelevant* (Boston, MA: HBS Press, 2005), p. 5.

9. *Williams, Trey (6 May 2018). "How Marvel Became a $16 Billion Franchise: Fandom, Cribbing From Comics and Kevin Feige". TheWrap. Retrieved 16 May 2018.*

10. Seth A. Klarman, *Margin of Safety: Risk-Averse Value Investing Strategies for the Thoughtful Investor* (NY: HarperBusiness, 1991), p. 91.

11. Ibid.

12. Kim and Mauborgne (2005), p. 172.

13 See Note B of Exhibit 2.

14. See Note C of Exhibit 2.

15. Steven Watts, *The Magic Kingdom: Walt Disney and the American Way of Life* (NY:Houghton Mifflin Co., 1997), pp. 66-67.

16. Thanks to an anonymous referee for making this resource-based observation.

17. Source: https://en.wikipedia.org/wiki/Fantastic_Four_(2015_film) Accessed on January 16, 2019. Production costs in this estimate include marketing and distribution costs. This movie was released by 20th Century Fox, not Disney.

18. Joseph Calandro, Jr., "The 'Next Phase' of Strategic Acquisition," *Journal of Private Equity*, Winter (2015), pp. 27-35.

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