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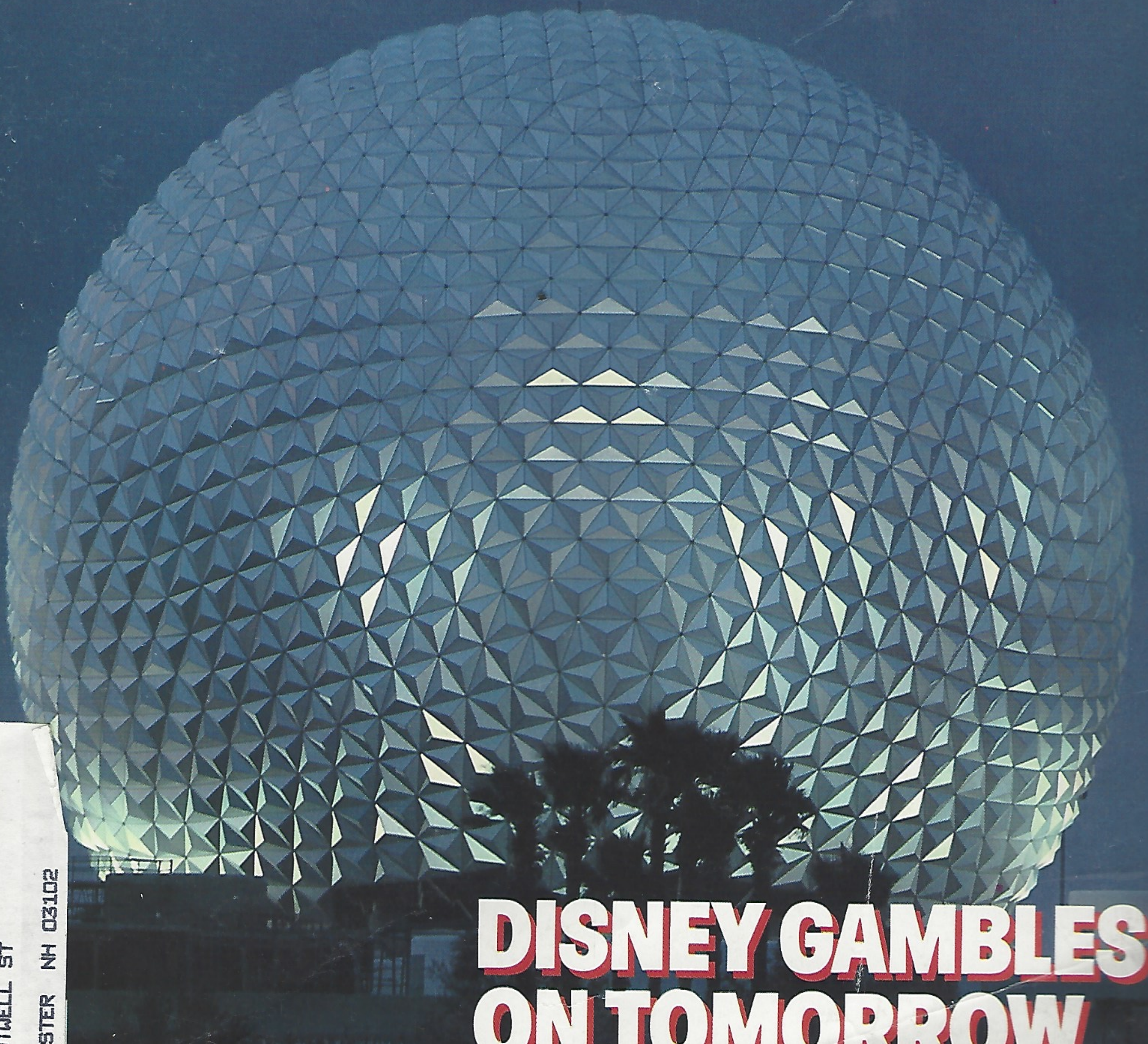
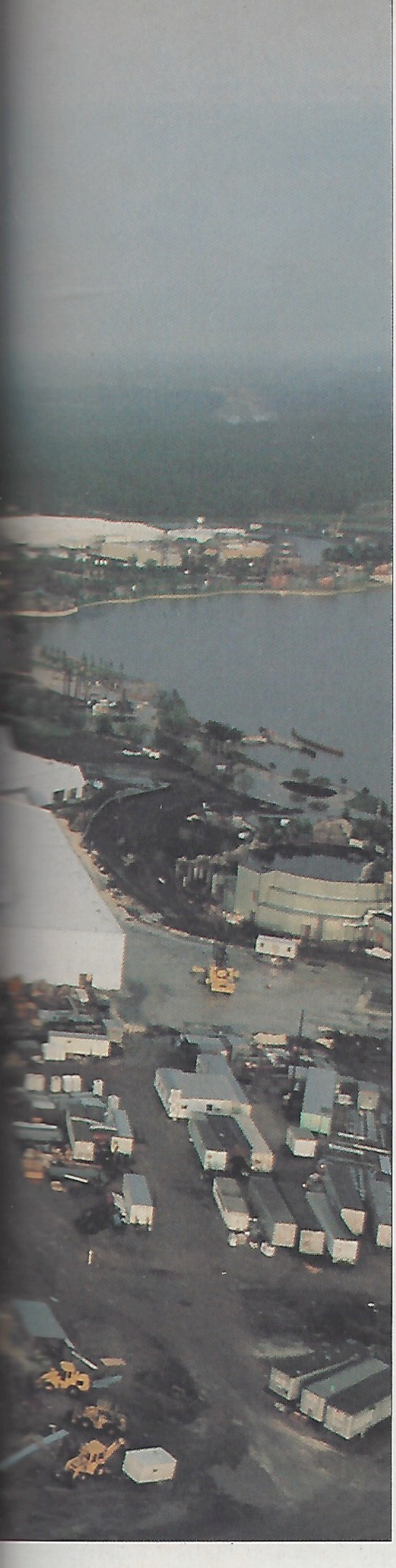


DISNEY GAMBLES ON TOMORROW

Spaceship Earth at the new Epcot Center

The Experimental Prototype Community of Tomorrow Center, with Spaceship Earth at upper left, covers 550 Florida acres.



FORTUNE
October 4, 1982

COMPANIES

Disney Gambles on Tomorrow

With $900 million and oceans of hoopla, Walt's successors bet that Disney World's Epcot Center will bring back the glory days.

by IRWIN ROSS

Before long, no American above the age of 3 is likely to be oblivious to the existence of Epcot Center, the country's newest and most expensive entertainment park, which has so far cost Walt Disney Productions $900 million. The soon-to-open project at the vast Disney World resort complex near Orlando, Florida, has been extravagantly publicized by an organization long skilled at self-promotion ("the newest wonder of the world" ... "Walt Disney's greatest dream"). So compelling is the Disney name that all three TV networks will feature Epcot's opening on their early morning shows during the first week of October; NBC's *Today* show alone plans to send 35 people to Orlando. Later in the month CBS will air an hour-long special broadcast.

To accommodate those segments of the media unwilling to pay their own way, the Disney organization will be running a series of junkets during October for 1,500 or so journalists who will be entertained for three days at Disney World's hotels, beaches, and restaurants while exploring the wonders of Epcot. (They will fly free on Eastern Air Lines, the "official airline" of Walt Disney World.) The publicity deluge will later be supplemented by a barrage of paid ads—24-page inserts in *Time, Life, People, Newsweek,* among others—at a total cost of around $3 million.

Research associate: Brian Dumaine

All this is designed to draw visitors to a new kind of theme park—a permanent world's fair that combines pop history with titillating exposure to the marvels of advanced technology and snippets of culture from several foreign countries. Epcot stands for Experimental Prototype Community of Tomorrow, but Epcot Center has much less to do with urban planning than with the Disney organization's profitable flights of fancy. The company expects Epcot's turnstiles to register eight million to ten million admissions (at a top one-day price of $15) during its first year—enough to turn a profit and justify an investment that represents nearly half the assets on Disney's balance sheet.

The success of Epcot is critical to Disney's future prosperity, for the fabled entertainment company has recently suffered unaccustomed reverses. It sustained a 10% decline in earnings to $121.5 million, on revenues of $1 billion, in its 1981 fiscal year, which ended last September

Photographs by John Madere

30—a performance considerably worse than that of most of the FORTUNE 500. This was followed by an earnings drop of 14% in the nine months that followed. Disney is still profitable, of course; it provided stockholders with a 10.4% return on equity last year. But for a company that enjoyed an enormous growth rate for three decades, the recent slide is unsettling.

Disney's problems are those of a child prodigy now grown to maturity but still following the script written by its parents. Walt Disney, a genius in the entertainment arts, died of cancer in 1966 at the age of 65. Sixteen years later, the master's presence still pervades the Disney studio in Burbank, California, the corporate headquarters. His picture is everywhere—in the entrances to buildings, in the hallways, in executives' offices. His name and obiter dicta are invoked on all occasions; he is always referred to as Walt, for the company custom is to call everybody by first names. At Disney World, top executives walk around with little Mickey Mouse name tags labeled Dick or Marty or Jack.

What Walt used to say

The Disney people are all friendly, informal, and chatty but marvelously discreet about not revealing anything that could remotely be regarded as a company secret. They also never let a visitor forget the educational aspects of the theme parks, while stressing their entertainment appeal. "As Walt used to say," says Dick (Richard Arlin) Nunis, 50, the boss of outdoor recreation, " 'I'd rather entertain and hope people learn than teach and hope they are entertained.' " It clearly would not be enough to entertain and make pots of money.

Walt, apparently, was full of such nuggets. Why are theme parks good business? Nunis: "Walt said, 'Everyone's a kid at heart—all you have to do is let him find a way to be one.' " Commenting on the huge size of Disney World's hotel rooms, each with two queen-size beds and a convertible sofa, Nunis points out that Walt said, "I want big rooms, so that a whole family can stay in a room." And so it was done, whatever the loss of conjugal privacy.

Anything associated with the Disney heritage is sacrosanct. Why, for example, does the company retain that inelegant acronym, Epcot, with its faintly medicinal overtones, evocative of ergot and Ex-Lax? "We used it because it was inspired by Walt," says Card (Esmond Cardon) Walker, 66, Disney's chief executive. Indeed, Walt (Walter Elias) coined the term shortly before his death. "People will learn to master it," Walker says confidently.

The company's top management, most of whom knew and worked for Walt for years, has the inbred quality of a small college faculty whose senior members have all held tenure for 20 years. As it happens, the studio's manicured lawns and clean-swept streets, bearing such cute names as Dopey Drive and Snow White Boulevard, do resemble a sleepy Midwest campus where students have not yet learned to rebel or litter. Walker, chief executive since 1976, has spent his working life with the company, starting in the traffic department in 1938. His encyclopedic knowledge of the business made him invaluable to Walt, with whom he was on cordial personal terms, as he is with Walt's widow, Lillian, and two daughters.

Walker plans to retire next year and turn over his job as chief executive to Ron (Ronald W.) Miller, 49, president and chief operating officer for the last two years. Nobody doubts that the Disney board will approve Miller, a former tight end who spent a season with the Los Angeles Rams; he has long been regarded as the heir apparent. He is married to Walt's older daughter, Diane.

Ron Miller bridles at any suggestion that he owes his rise to nepotism. He volunteers that "my father-in-law saw me break a rib playing football and he said, 'Look, this is no place for the father of my grandchildren,' so he brought me into the company. Then it was up to me." For most of his years at Disney, Miller worked on films and for a dozen years before becoming president held the title of executive producer. All of which would seem to make him an odd choice to be chief executive, for the film division has done poorly. Card Walker disagrees, arguing that the decline was the fault not of Ron but of the fickleness of public taste.

The fact is that the succession is firmly controlled by two branches of the Disney family, Walt's side and that of his late brother Roy. The family owns more shares than any other group. Roy's son, Roy E. Disney, 52, controls 4.96% of the stock; 8.5% is in the hands of Walt's widow and daughters and in trusts for two grandchildren. These two family blocks were recently worth $241 million.

Both branches of the family will vote for Miller to succeed Walker, even though Roy Disney, a director of the company, left its employ a few years ago after what he calls "artistic differences" with Ron. (He will not specify their exact nature.) Roy maintains that it has been good for the company to have an assured line of succession—an argument normally heard in behalf of constitutional monarchy.

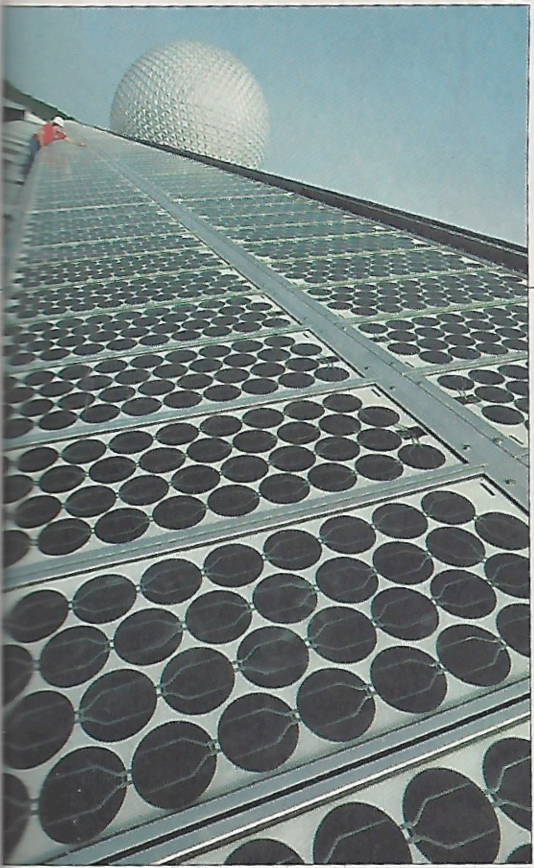
Gold in the Magic Kingdom

For a long time the legacy of Walt Disney was enough to propel the company to towering success. In the first eight years after his death, earnings increased 285% on a revenue rise of 230%. The biggest jump came in the year after Walt Disney World opened in 1971. Disney World's Magic Kingdom, a kiddie theme park modeled after Disneyland in California, counted 10.7 million admissions in that first year, more than had been forecast. From 1973 through 1980 the company's profits soared another 183%, though nearly 70% of that gain represented inflation. Then came the recent falloff.

The decline had several causes. Both Disneyland and the Magic Kingdom had apparently reached saturation levels—in appeal, not in capacity. After several years of flat attendance, Disneyland peaked at 11,522,000 admissions in fiscal 1980, then declined a bit in 1981. In the 11 months ending August 31, admissions were down 9% from the prior year. Management put the blame largely on a drop in Mexican tourism due to the peso's devastation.

continued

The World of Energy



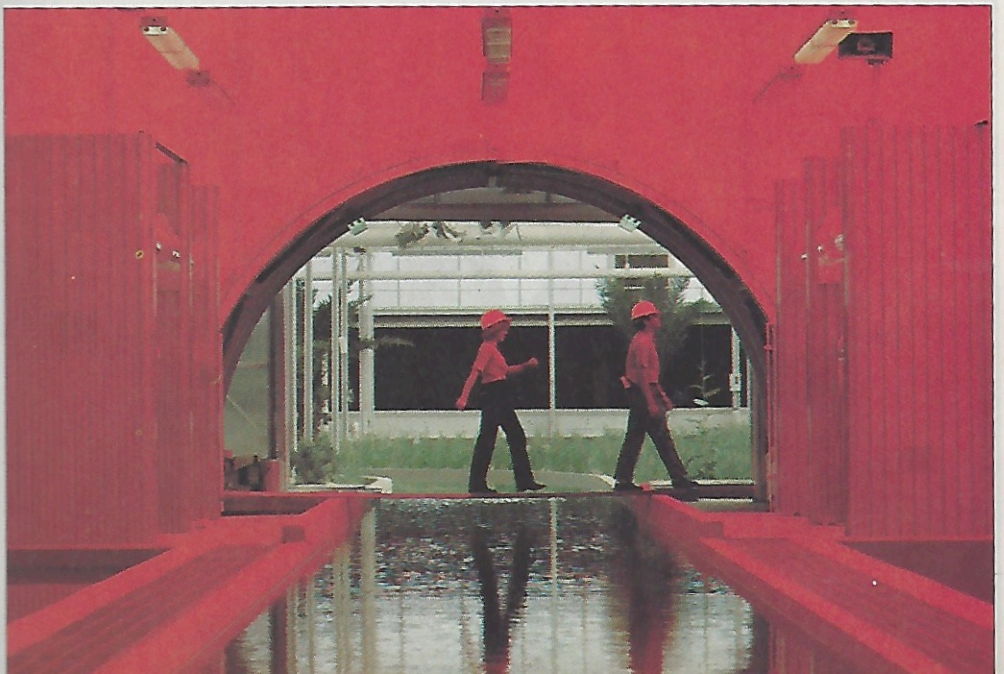
Ge

A Taste of Technology with Continental Sauce

Future and past are blended in Epcot Center, three and a half miles by monorail from Disney World's established hit, the Magic Kingdom. On top of Exxon's Universe of Energy a workman inspects solar collectors; within it the visitor will see films and exhibits setting forth the history and future of energy. The German pavilion offers a capsule view of the country in a quick stroll. The red-lighted aquarium in Kraft's pavilion, the Land, is part of an exploration of new agricultural techniques—in this case, aquaculture. The worker at right is painting a newly built column in the Italian pavilion to make it look old. The Disney planners got some of the details of Epcot Center wrong—the re-creation of St. Mark's Square in Venice misplaces the Doges' Palace—but the whole is entertaining.

Italy

The Land



In the last four years 50% of Disney's film revenues have come from re-issues.

(Disneyland is only 99 miles from Mexico.) At the Magic Kingdom, attendance has declined from a peak of 14,071,000 admissions in 1978 to 13,221,000 in 1981. Management blames 1982's further slump of 5% on the recession, the Knoxville world's fair, and visits postponed until after the opening of Epcot Center. These factors, however, do not explain the four-year trend.

Although mature operations, Disneyland and Disney World are still plenty profitable; they accounted for 69% of the company's revenue and 60% of its operating profits in fiscal 1981. Disney's consumer products—"character" merchandise (such as Mickey Mouse shirts), publications, educational materials, videocassettes, and videodisks—have also done well, as has television. The company has several projects in the works to increase the appeal of its network TV shows, which have run for 28 years.

The movie business has been a grievous disappointment in the last ten years. Films have shown no growth in revenues, if inflation is taken into account; in the last two years the company has written off $37 million on six of the ten movies it produced, including two co-productions with Paramount. Only one recent picture, an animated feature released in 1981 called *The Fox and the Hound*, has been a hit, with total revenues so far of nearly $50 million. In its present doldrums the company likes to say that *Fox* has grossed more than any of its other pictures, overlooking the impact of inflation. In real terms, Disney's biggest hit was *Mary Poppins*, a live-action film released back in 1964—the last live-action hit the company has produced. Disney realized $44 million from *Mary Poppins* in its first two years.

The film division has been saved only by the re-issue of *Snow White*, *Fantasia*, *Bambi*, *Pinocchio*, and other Disney classics. In the last four years, 50% of Disney's film revenues have come from re-issues. Mike (Michael L.) Bagnall, 51, chief financial officer, recently offered that startling figure as proof of the vast treasure trove in the Disney library, which contains 25 full-length animated films, 119 live-action feature films, and over 500 other movies, mostly short subjects. Bagnall proved his point, but underscored how poorly the new releases have been doing.

The four-letter dilemma

In 1981 Ron Miller put Tom (Thomas L.) Wilhite, who had been the company's publicity director, in charge of film production for both theaters and TV. Wilhite, then 28, represented youth and a fresh approach; he was a film buff, but had never produced a picture. Shortly before he was appointed, the company changed its long-standing rule of not allowing outside writers and directors to share in the profits of its films, a parsimonious policy that had kept it from even getting a look at many promising properties.

There is agreement in the company about what has been wrong: the market for the Disney brand of wholesome family entertainment is shrinking. This is true enough, but such eminently wholesome films as *E.T.* and *Star Wars* have drawn huge audiences—and were not made by Disney. As Card Walker sees it, young adults today want "a more sophisticated point of view, with more sex and violence." He adds, "We don't ever want to go that far." He fears destruction of "the public acceptance" Disney has striven so long to build. Public acceptance, among other things, involves the theme parks and TV; clearly Walker does not want some fundamentalist preacher exhorting his television flock to shun Disneyland.

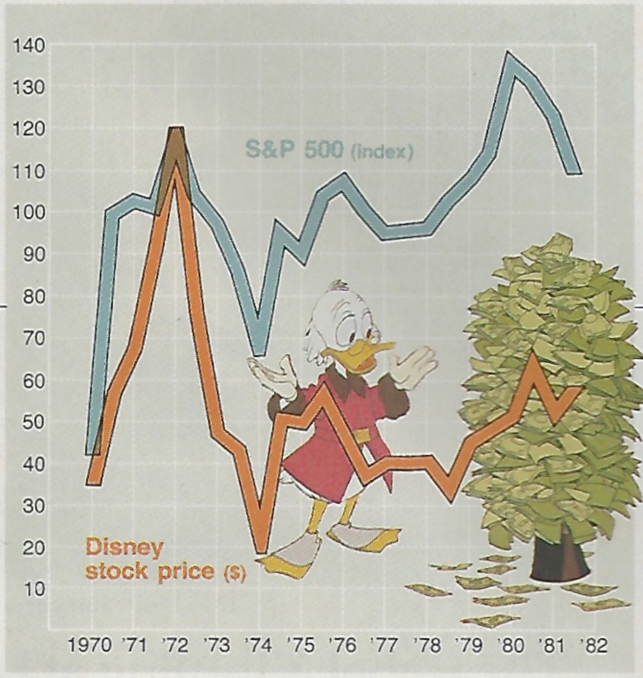
To attract a new audience, young Tom Wilhite and Ron Miller, who still closely supervises the film operation, want to produce films that deal realistically with contemporary problems. But they differ about how they would handle a scene, for example, that calls for a young hero to utter a four-letter word appropriate to the occasion but still unacceptable in polite society.

Norman Seeff

Card Walker (left), Disney's chairman and chief executive, and President Ron Miller present themselves before a wraparound screen, one of the company's many dramatic film projection devices.

Disney's Roller Coaster

Walt Disney Productions used to be a hot stock and has always been volatile. Before and after the opening in October 1971 of Disney World, the highly profitable kiddie heaven near Orlando, Florida, the stock soared so high that it was twice split two for one. For a while Disney shares sold at 80 times earnings. For much of this year the multiple has been a still highly respectable 15. For the S&P 500 Index, 1941-43=10.



In the interests of realism Wilhite would use the expletive, he informed FORTUNE. Miller would delete it.

Wilhite's first film, *Tron*, an adventure fantasy involving humans trapped in deadly games inside a computer, was the product of a new young director, Steve Lisberger, 31. *Tron* was an expensive effort, costing $22 million to produce. The film got enormous advance publicity, but mixed notices from film reviewers—and a powerful pan from an amateur critic, San Francisco security analyst Ted James of Montgomery Securities. After seeing the film at a July preview, James urged clients to unload Disney stock. Other analysts may have offered similar counsel. Disney stock dropped 2½ points in a day. *Tron* has not done well at the box office, but it might break into the black if it wins an audience abroad.

Wilhite's next venture, *Tex*, an inexpensive ($5 million) and episodic tale about a teenager growing up in Oklahoma, was another effort to break the Disney mold. *Tex* acknowledges sex and drug use among teenagers, but avoids barnyard language and keeps its characters fully draped. It was favorably reviewed but drew small audiences when it was shown at southwestern theaters this summer. The film will get a second chance after its New York opening in October.

Seeking to tap the vast potential of cable TV and pick up a dependable audience for Disney films, the company set up a joint venture with Group W (Westinghouse) to launch the Disney Channel, a pay service, next April. Group W dropped out last week, but Disney expects to recruit one million subscribers within the first year. Breakeven will be 1.3 million. Walt Disney Telecommunications President Jim (James P.) Jimirro, 45, a veritable geyser of enthusiasm, expects up to five million subscribers for the Disney Channel by 1986. He hopes for up to $100 million in annual profits. The question is whether subscribers will flock in at $9 a month, on top of the basic cable fee and the cost of the pay channel they may already take.

Even if the other parts of the company do well, Disney's future will still primarily depend on its mammoth investment in Epcot Center, whose total cost will rise to $1 billion by the end of its first year. Nobody has ever before spent that much on an entertainment facility.

So solid is the company, however, that most of the funds for Epcot Center have been internally generated. Disney will get some of its investment back from the corporations sponsoring pavilions, including General Motors, Exxon, and AT&T, which will pay $300 million over a ten-year period for the right to hoist their corporate logos and show their products.

Epcot Center has only a remote relationship to Walt Disney's dream. He conceived of that prototype community as an ideal planned city, with a permanent population of 20,000, and a car-free core of office buildings, surrounded by concentric circles of high-rise apartments, a greenbelt, and suburbs, the whole resembling a vast wheel. Office workers would return home on "people movers" radiating from the city core along spokes of the wheel. The technologically advanced plan sketched by Disney in a television film made to woo the Florida legislature resembled one of those utopian communities popular in the 19th century. It left no room for the residents to modify their environment, and it is odd, at the end, to hear Disney pay the customary tribute to the spirit of free enterprise.

The 43-square-mile stretch of Florida scrub pine and swampland had been purchased when Disney was alive. After his death his followers concluded that his plans for this vast tract were not practical, and modified them freely. They built the Magic Kingdom, three hotels, three golf courses, campgrounds, and much else. Modern technologies were employed, with a sleek monorail and such niceties as miles-long underground suction tubes for garbage collection. These advanced systems prompt Disney executives to insist that all of Disney World is Walt's Epcot. It is at least a well-run resort.

"Adrift in the midnight sky"

Epcot Center is something more—a showcase for the pioneering technologies that Walt Disney wished to incorporate in his ideal community. The center has two sections. First is Future World—dominated by the 180-foot-high globe called Spaceship Earth, in which the progress of communications from the caveman era to the 21st century is displayed in animated tableaux during the course of a 13-minute ride in small cars that can swivel 180°. The trip is dazzling, if a bit abrupt, especially at the end, when, as the souvenir booklet puts it, we "are electronically transmitted into space aboard a burst of telemetry. Momentarily suspended in the heavens, we gaze down upon our small planet, our Spaceship Earth, adrift in the midnight sky."

The other pavilions—among them the Universe of Energy (Exxon), the Land (Kraft), and the World of Motion (General Motors)—do not go so far as to suspend us in the heavens, but there are other hazards. In the Universe of Energy we are conveyed through a prehistoric forest to view the

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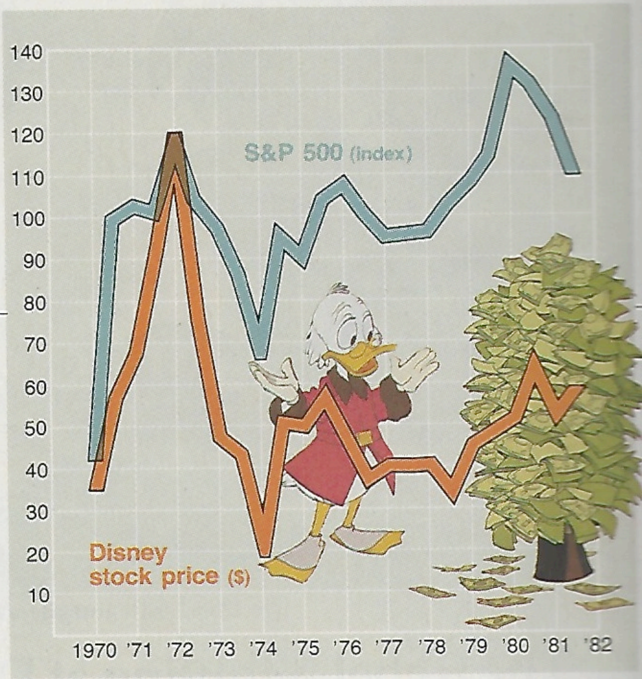

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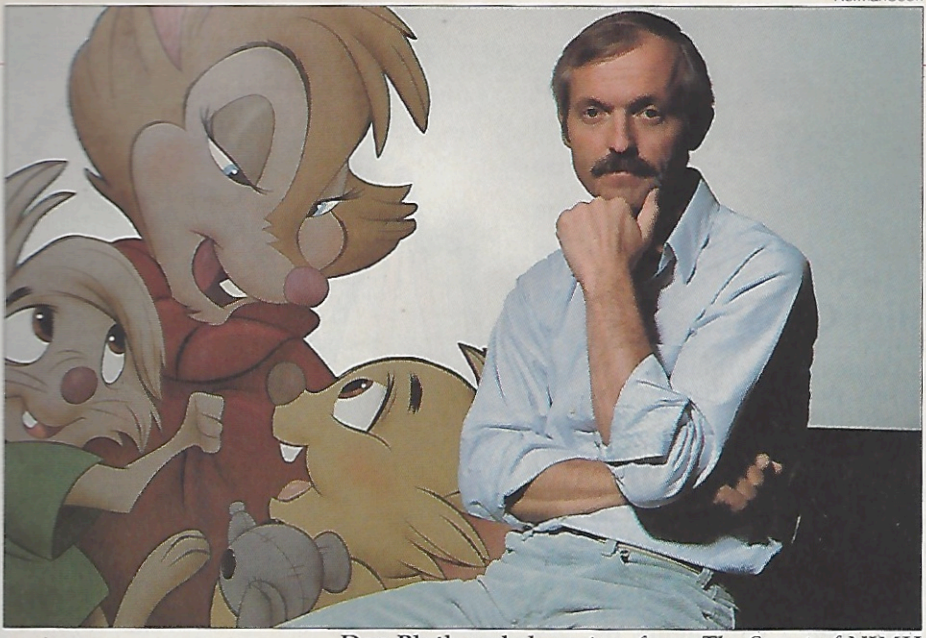

Don Bluth and characters from *The Secret of NIMH*

The Rebel Nibbling at Disney's World

A talented animator whose shop recently produced the well-received film, *The Secret of NIMH*, Don Bluth, 44, walked out of Disney in 1979 with two colleagues and was soon followed by 14 others. His film was bankrolled and marketed by two other ex-Disneyans, Richard Irvine and James Stewart, who head Aurora Productions.

While working an eight-year stint for Disney, Bluth says, he became increasingly disenchanted with the studio's practice of skimping on production values to save money—leaving out such details as reflected images, the sparkle of water, whiffs of smoke from a fire. According to Bluth, Disney was also producing namby-pamby stories, protecting youthful audiences from the grim realities of traditional fairy tales. Bluth's goal, he has repeatedly told the press, is to return to the "classic" Disney techniques of *Snow White* and *Pinocchio*. Some critics thought he did just that in *The Secret of NIMH*, a tale about grim threats to a family of agreeable mice.

The folks at the Disney studio have not taken at all kindly to Bluth's critique. An outspoken rebel in the placid precincts of the Burbank studio was simply unheard of; if people left, they went quietly, not exploiting their apostasy to market their products. In an interview with FORTUNE, Disney President Ron Miller, who had taken an avuncular interest in Bluth's career, called him a "son of a bitch"—language not often heard on Mickey Avenue.

Responding to Bluth's artistic attack, one of Disney's directors of animation, speaking for the studio, (a) said that a lot of smoke and sparkling water were left out even in Walt's time; (b) argued that such production details were of no great importance; and (c) pointed out that touches of this sort will be included in Disney's next animated feature, *The Black Cauldron*. As for the charge of taming fairy tales, this Disney executive hinted at the possibility of competitive slaughter in the fairy kingdoms: "We're not afraid to kill somebody off."

setting in which fossil fuels were produced. Says the souvenir book: "Guests nearly find themselves trapped in the very stratum they are observing, narrowly skirting the molten lava spewed from an erupting volcano."

Beyond Future World is World Showcase, pavilions around a lagoon that represent nine nations: St. Mark's Square for Italy, an English village street, a chunk of Paris at the turn of the century with a miniature Eiffel Tower in the background. In an hour's brisk walk around the lagoon, one can cover the world.

The consensus among analysts is that Disney will make its target of eight million to ten million admissions at Epcot Center the first year. David Londoner of Wertheim & Co., an astute analyst of the entertainment industry, believes that Disney's forecast is conservative. He thinks it likely that there will be 11.5 million admissions the first year, and that Disney will earn back its investment in eight years.

For Disney the great appeal of the project, as with the other theme parks, is cash flow. For tax purposes the company will depreciate the properties in ten years. Their useful life, however, is likely to be far longer than even the depreciation span of 25 years that will be used for normal accounting purposes. For theme parks do not wear out. They have to be maintained, which Disney does assiduously, charging the cost against current earnings and not touching the depreciation reserves. These funds are then available for debt repayment and new investment.

The company's concern with cash flow, as well as the bottom line, is causing Epcot to open a little earlier than its official debut on October 1. The early opening will allow Disney to pick up for its 1982 fiscal year—which ends September 30—$40 million in an investment tax credit and as much as $40 million more in depreciation.

No risk in Tokyo

If Epcot Center succeeds, the company can look forward to years of wholesome earnings. The bottom line soon will be bolstered in other new ways too. Next spring, Tokyo Disneyland will open. It represents a $500-million investment, all of it put up by its Japanese sponsors. The Disney organization, which has risked nothing, will be reimbursed for its expenses and earn royalties of 5% to 10% on Tokyo's sales. The company regards it as an eminently fair deal. The venture will make only a relatively modest contribution to the bottom line: no risk, no pot of gold. But if Tokyo Disneyland succeeds, it could lead to other franchised operations elsewhere.

Even with the best luck in the world, the heady days of the early 1970s, when Disney's stock sold at 80 times earnings, are not likely to return. Nonetheless, investors have kept the stock at a relatively high multiple for the present era—around 15 times earnings in much of the past depressed year. As a leading Los Angeles security analyst, Arthur E. Rockwell of Crowell Weedon & Co., says, "To some people Disney can do no wrong. Disney is a religion." Walt would not disagree. F