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The inside story of how Nelson Peltz got his way at Disney — and his detailed plan for a rebound

By Shawn Tully

Nelson Peltz is ensconced in his penthouse—like 41st floor offices on Park Avenue, an Old World space featuring paneled archways and architectural drawings of historic European theaters and palaces.

But there's another kingdom on his mind today—the Magic Kingdom.

Just hours before this February morning, the 80-year-old CEO and founding partner of fabled private equity firm Trian Fund Management had delivered a shocker by nixing his planned battle for a board seat at the Walt Disney Co., canceling what loomed as the highest profile proxy shootout in years. Now, in this tony setting, Peltz is deploying a favorite metaphor of "getting to Brooklyn," the borough where he grew up and scored his first success driving trucks, then running the family food supply business. In Peltz's parlance, a faulty strategy gets you stuck in endless traffic or sends you careening off course to the Bronx or Queens. "We had a route to Brooklyn, and we were afraid Disney would take the wrong route and not get to Brooklyn," declares Peltz in signature deep basso tones. "Then suddenly, Disney surprises us by saying *they're taking our way, right over the Brooklyn Bridge!*" Loop in the signature crackling laugh.

No wonder Nelson Peltz was in a mirthful mood—he's just captured the strategic outcome he'd coveted without waging the brutal war he'd expected. In an exclusive, 90-minute interview with *Fortune*, Peltz delved deep into what he thinks of CEO Bob Iger's newly unveiled turnaround plan, and what Disney needs to do to compete going forward—as well as his journey through the fog of proxy war. The game changer, Peltz explains, was the blueprint that Iger introduced on Disney's first quarter earnings call after market close the previous day. "As we're listening to Iger's list of changes, restoring the dividend, big cost cuts, scaling back breakneck growth in streaming, making creative people fully responsible for their P&Ls, we're going, 'Check, check, check'—this is practically everything we wanted," says Peltz. "We had a 100-page deck ready to drop that would have covered everything he says he's going to do. If a guy is going to do everything you wanted him to do, where's the argument?" Peltz was cheered by the $5.5 billion in total cost cuts, including large reductions in corporate overhead, that Iger pledged on the call.

Trian's already feasting on the prospects of a comeback at the beleaguered Magic Kingdom that it may have helped spark. Since Trian bought its Disney shares between mid-November and mid-December, its stake has jumped 18% to around $1 billion, yielding paper gains of roughly $150 million for its investors. And Trian will now save the $25 million it would have cost to fund an epic proxy fight. Though Peltz declares himself "a cheerleader" for Iger's new direction, he declines to comment on his plans to either sell or hold his Disney stock.

Following Peltz's surprise announcement on Feb. 9, Disney stated in a press release, "We respect and value the input from all our shareholders and appreciate the decision announced by Nelson Peltz this morning." This writer informed Disney of the facts in this story; the company declined to comment.

Most of all, Peltz contends that Disney can be turned around. And he knows exactly how.

Another P&G

Peltz makes it clear that he launched the proxy battle at Disney only as a tactic of last resort. He typically strives to avoid that grueling gauntlet to winning a board seat by deploying persuasion instead. Trian practices what Peltz calls "operational activism." It's an approach where the Trian team develops an in-depth program to revive underperformers by recharging renowned but lagging brands through creative marketing, dividing product groups into freestanding profit centers where a single leader is responsible for the P&L, and transferring people at bloated headquarters to the divisions that make and sell the products. Having served on 11 public boards, Peltz has won a reputation as a genial—if loud and tenacious—collaborator whose reform agenda wins over initially reluctant, or even hostile, directors and CEOs. In most cases, including his overtures at Mondelez International, Invesco Ltd., and Unilever, among many others, Trian takes a big stake and the directors invite Peltz aboard. Starting in 2019, Trian even won its agenda at plumbing and HVAC supplier Ferguson PLC without taking a director's chair.

Though Peltz hates proxy conflicts, he says they're necessary in one overall situation: when a company he's targeted is struggling but refuses to acknowledge that it has big problems. "If

we can't agree on the problem, we have to go to war," he told me. It's the standoff that triggered the only three proxy campaigns in Trian's history, the salvos at H.J. Heinz, DuPont, and Procter & Gamble. In all three cases, he says, the CEOs and boards thought their companies were doing great, and showed zero interest in Trian's proposals, though their poor numbers belied the claims that all was fine. "The CEOs and the boards had a totally different route to Brooklyn than we had," says Peltz. "They thought they were already in Brooklyn." P&G is a classic case in point. Trian's proposal for reforming P&G's overcentralized organization chart resembled what it likely envisaged for Disney. "We wanted to go to Brooklyn by route A by dividing their old 'matrix' system into individual P&Ls. The board wanted to keep route B," recalls Peltz.

Once Peltz's strong showing in the proxy vote won a seat in early 2018, the consumer products giant hired McKinsey & Co. to study how the enterprise should be structured. "McKinsey recommended a route A+ or A- that was very similar to our route to Brooklyn," recalls Peltz. "If P&G had agreed to that change when we first talked, we would not have had a proxy fight." At Heinz in (in 2006) and DuPont (in 2015) as well, a proxy battle was the only way to surmount fierce resistance. At the ketchup maker, Peltz was able to secure sweeping reforms by winning over the CEO and board. At DuPont, Peltz lost a close proxy battle to a CEO who quickly departed. The new leader, Ed Breen, marshaled Peltz to help shepherd the merger with Dow that split the mashup into three units, including ag supplier Corteva. By the way, Bill Johnson of Heinz and David Taylor of P&G, both of whom at first fought Peltz's advances, turned into big fans. Shares of Heinz and P&G far outpaced the S&P during Peltz's tenure as a director, and the DuPont breakup delivered steady gains to shareholders. "The ultimate structure of the DuPont-Dow merger and ultimate split was created at my home with the CEOs there and no bankers present," recalls Peltz.

The Disney scenario, says Peltz, was unlike any situation he'd encountered. Its difficulties were exactly the ones Peltz is expert at solving, matchless but increasingly unprofitable brands, huge overhead, and a complex, authority-diluting matrix management. But it wasn't at all clear that the Magic Kingdom was another P&G or Heinz that refused to acknowledge it was on the wrong path. "I couldn't tell if Disney recognized it was taking the wrong route to Brooklyn or not," declares Peltz. "Or if so, what they were going to do about it. The lack of communication and tight timing on board nomination were such that we had no choice but to launch a proxy battle." Peltz made his moves while navigating through a thick fog that, when it lifted, revealed a meeting of minds that stilled the cannons firing in both camps. But Trian's contribution lives on. It identified in forensic detail the failings that dulled the enchantment for what had been the biggest U.S. media success story of the 21st century and pointed to solutions. In effect, Trian established the report card that Disney must ace. And the backstory of how Peltz targeted the once impregnable Disney castle and dueled versus the returning knight-savior Bob Iger is a Hollywood saga in itself.

Peltz advances on the Magic Kingdom

Peltz claims that prior to the clash over his request for a board seat, he'd always been friendly with Iger. "As a person, I always believed he was forthright with me," says Peltz. "When I was in L.A., I'd often have breakfast with Bob, and he and CFO Christine McCarthy came to our offices in New York." In fact, Iger even invited Peltz to address his board in 2019, as part of kind of prominent speaker series; preceding Peltz was BlackRock chief Larry Fink. "The directors asked me about the media landscape at a time when Elliott Management was pressuring AT&T following its acquisition of Time Warner," he says. "It was unusual that the board was then interested in my take on media, when they later claimed I knew nothing about the industry," jokes Peltz. "At the 2019 meeting, the directors sure weren't asking me about AT&T's telephone business!"

In July of 2022, Disney's then-CEO Bob Chapek invited Peltz and his wife, Claudia, to lunch at Disneyland Paris. According to the Trian filing timetable, Peltz told Chapek he was interested in joining the Disney board. A few days later, as disclosed in Disney's "Background" to its proxy filing for the shareholder vote, Ike Perlmutter, former CEO and currently chairman of Disney unit Marvel Entertainment—and a Peltz Palm Beach neighbor—started lobbying hard for his friend. The Disney account relates that Perlmutter called CFO McCarthy and director Safra Catz, CEO of Oracle, to argue that adding Peltz to the board would "help Chapek counter recent headwinds he had faced [and] solidify his position as CEO." It would later become clear that Chapek sorely needed support, as the sharp fall in Disney's profitability was stirring a boardroom revolt.

Then, one of the darkest days in Disney history hastened Peltz's pursuit. On Nov. 8, Disney reported Q4 and FY 2022 results that fell far short of Wall Street's expectations, notching a minuscule $162 million in net income for the quarter, and an almost 50% drop in free cash flow for the September fiscal year, as streaming losses kept mounting. Chapek's air of optimism and seeming obliviousness to how bad things looked on the call startled investors. The next day, Disney's stock tumbled 13%, erasing $24 billion in market cap.

The next day, Peltz called a further-damaged Chapek to say he'd be formally requesting a board seat. Trian also capitalized on the sharp drop in Disney's stock to amass shares at what proved bargain prices. The following week, Peltz sought to push the process forward by hosting Chapek for lunch at his Palm Beach mansion, decorated with museum-quality paintings by 19th-century French Impressionists. On Nov. 20, the Disney board fired Chapek and brought back Iger, who'd headed Disney as CEO from 2005 to early 2020, then stayed on as executive chairman. Peltz and Iger first spoke on a Nov. 23 video call, where Peltz told his old friend he intended to start a proxy contest if Disney didn't name him as a director. But the board shunned Peltz's overtures; in the "Background to the Solicitation" section of its filing for the annual meeting vote, Disney stated that the board "focused on the fact that Mr. Peltz did not have the relevant media or technology experience to offer that would further that key objective for the company." As reported in its "Background," the board later cited as a reason for its rejection a Peltz directorship's potential for "disrupting" management and his alleged failure to present "a single strategic idea for Disney."

Peltz was in a bind. The filing deadline for nominating directors was Dec. 10. "If Trian missed that date, we'd have to wait until next year," says Peltz. "We didn't know if Disney had a good comeback plan under Iger so we felt we had to file for the seat." But now that Peltz was an official adversary, Disney went into lockdown. The company's extreme caution was perhaps understandable: In the previous few months, it had settled talks with activist Dan Loeb's Third Point by naming a new, independent director; fired its CEO five months after extending his contract; and was girding for an assault from Trian.

On a Dec. 20 call, according to the Trian "Background," Iger told Peltz that, in effect, his general counsel had advised him not to speak to the perceived barbarian at the kingdom's gates. But Peltz pushed for a hearing with the board, which happened on Jan. 10 in Burbank, Calif. Trian had sent all directors a 36-

page deck detailing all aspects of what it deemed strategic miscues that accounted for Disney's recent poor results days before. Peltz and Trian partners Ryan Bunch and Peltz's son Matt Peltz were present, as was Iger, while all other Disney directors appeared on-screen in 11 boxes. The board strictly limited Trian's time onstage to 45 minutes. According the background section of the Trian proxy, the outside directors didn't pose any questions. Asked by *Fortune*, Disney declined to comment on the meeting. It's interesting that in asking no questions, the board didn't take the opportunity to defend Disney's performance.

The next day, Disney chairman Susan Arnold called Peltz to propose an arrangement where Trian could receive confidential information about Disney and meet with management and the board each quarter to better understand its strategy. The offer didn't move Peltz. "It was something about, 'You can come in quarterly, you can't come in other times,'" he recalls. "And you had to vote your stock with the company." Trian would never agree to such an arrangement. It had not signed a standstill agreement with any of its portfolio companies in over a decade. As Disney expressed in its "Background" account, "Mr. Peltz said he wouldn't be muzzled, and that the Trian group would proceed with its proxy contest immediately."

Also on Jan. 11, Trian officially launched the proxy fight, and issued the same deck it had sent to Disney's directors, under the title "Restore the Magic." The document provided an illuminating deep dive into the factors accounting for the astounding, three-year reversal from a financial superstar to a struggling underachiever.

Disney's poor performance since 2019

What intrigued Peltz about Disney: how such a fabulous collection of properties, boasting a superb record for decades, could suffer such a dramatic reversal of fortune. The Magic Kingdom's galaxy traditionally encompassed ABC and ESPN in linear TV, the Marvel, Lucasfilm, and Pixar film studios, and the 12 theme parks; the 2019 acquisition of 21st Century Fox properties added 20th Century Fox Studios and its enormous library including the Star Wars movies, the Fox TV production arm whose cache of shows counts *The Simpsons, The X-Files,* and *Modern Family*, and the FX and Nat Geo networks. "We love the company," Peltz told me. "We're big believers in brands, and Disney may have the best brands in the world." But the profitability of that incredible, star-studded roster was going in a negative direction. "The reason is that we believe Disney's problems were self-inflicted, which is also the reason they could be fixed, and Disney could return to generating results in line with the greatness of its brands," Peltz told me.

Since FY 2018 (ended Sept. 30), Disney over the next four years swelled sales by 41% to $83 billion, driven by explosive growth in streaming subscribers. But Disney's suffering from a gigantic cost problem: In that period, its noninterest expenses jumped far more, by 70% to $76 billion—corporate overhead alone grew by 85%—driving adjusted EBITA down by almost one-fourth, from $18 billion to $13.8 billion. So extreme was the shrinkage that in May of 2020, Disney suspended the dividend it had paid continuously for over 64 years. Disney cites the setbacks dealt by the pandemic, especially to the parks. But that segment boomed in FY 2022, posting its best year ever, hitting $7.9 billion in operating income, 76% more than in 2018. It was cratering profits in media and entertainment, home to so many of Hollywood's top franchises, that sank the overall numbers. At $100 per share as of Feb. 24, Disney's stock is languishing below its price in the spring of 2015. Even after the bounce that coincided with Peltz's arrival and Iger's return, its shares are still down almost 50% from the all-time high registered in early 2021. Disney has also substantially underperformed both the S&P and a basket of media peers—prices of Comcast and Sony Group have also fallen from their peaks, but the declines are less severe than for Disney.

Viewed from a high level, the source of Disney's shrinking returns couldn't be more basic: It's piled on huge loads of capital and is generating big negative returns on the multiple tens of billions it's added. Two excellent metrics illustrate the problem. The first is COROA, or cash operating return on assets, developed by accounting expert Jack Ciesielski. COROA measures how a company rates as a steward of its capital by gauging the cash flow it garners from all the assets still in use throughout the business. COROA adjusts cash flow by adding back cash interest and taxes, removing distortions caused by leverage and levies. It also subtracts stock-based compensation that imposes a hidden cost on shareholders via dilution. From FY 2018 to 2022, Disney almost doubled its average yearly asset base under COROA from $129 billion to $246 billion. Yet its cash flow dropped from $17.0 billion to $7.8 billion. Hence, its return on that extra $117 billion was a *negative* 8%. The cash flow shrinkage was an issue Peltz highlighted. As he told me, "For us, free cash flow is next to godliness."

The second yardstick, economic value added, provides a similarly dark picture. EVA is a proprietary tool that corporate ratings service ISS uses to measure corporate performance and assess pay for top executives. It calculates whether companies' profits are beating the key bogey, their cost of capital. If they fail to meet that benchmark, they're squandering investors' money; if they're bettering the COC, they're creating value. ISS ran EVA numbers for Disney, and once again, the descent from excellent to poor is distressing. In FY 2018, Disney was besting its cost of capital by a terrific nine points. In 2022, its profits were lagging its COC by two points, for a swing of 11 points in the wrong direction. Peltz, in our interview and in his deck, makes it clear that accumulating a mountain of new capital, and losing money on it, accounts for the stock price's flagging record.

3 factors are to blame for Disney's poor performance

Three interrelated problems—all the result of decisions taken by the board and CEOs Chapek and Iger—are at the heart of Disney's woes. The first is the Fox acquisition. As Iger has said, the rationale for the $71.3 billion purchase was to hugely grow both Disney's stockpile of TV shows and movies, and its capacity for producing new content, to bolster the foray into streaming that towered as its top imperative. The idea was sound, but in winning a bidding war versus Comcast, Disney vastly overpaid.

According to the convincing numbers in Trian's deck, the net price that Disney issued in cash and stock, less the proceeds from divesting several assets, was $52 billion. In FY 2018, pre-Fox, Disney's media and entertainment division earned $9.4 billion in EBIT, and for Fox, the number was running at $1.9 billion. Disney also pledged to capture $2 billion in synergies. Hence, if the existing media and entertainment arm had simply kept making the same money, the Fox properties also saw no change, and Disney clinched the advertised savings, the division in 2022 would have been earning $13.3 billion. But after adding back the losses for streaming, a business Disney basically didn't have in 2018, media and entertainment made, by Trian's estimates, just $7.1 billion. Their conclusion: The Fox deal, despite adding all that capital, imposed a huge drag on profits, a view that's consistent with the COROA and EVA figures. Says Doug Creutz, an analyst at Cowen & Co., "The Fox deal dramatically and structurally lowered Disney's return on capital."

The second and third areas causing severe stress are the

streaming juggernaut that keeps heaping on losses, and a matrix management structure that fails to control costs and separates the managers who make the content from the profits or losses their movies or shows are furnishing. To Iger's credit, he's proposing to change course from the Chapek days and impose urgently needed reforms in both realms. Peltz endorses Disney's drive to make streaming its lead vehicle for future expansion. But like many analysts and institutional investors, and now Bob Iger, he believes that Disney's been chasing breakneck growth at the expense of profitability. In 2019, Disney set a goal of signing 60 million to 90 million subscribers for Disney+ by 2024. But it zoomed past that number in a year and now boasts 164 million subs, as its viewership exploded when folks stayed home and gorged on shows during the pandemic. Disney also signed tens of millions of unprofitable subs in India. As its audience ballooned, Disney kept losing more and more money. As the Trian deck shows, the deficit expanded from $1.7 billion in FY 2021 to $4.0 billion in the last fiscal year, lifting cumulative losses to $11 billion.

The source of the shortfall is twofold: According to Disney, spending on content for Disney+ will hit $9 billion in FY 2024, almost four times its 2019 forecast, whereas sub growth exceeded predictions by a far lesser multiple. Disney also made gigantic outlays for promotion and advertising to attract the hordes. Why did Disney expand at such reckless speed? It was following a craze that captured streaming's top names, including leader Netflix. "Wall Street was valuing the streaming stocks based on number of subscribers, not profits," says Creutz. "Disney went down the same path as the others, spending more money on marketing and content than the revenue opportunities, plus they were signing very low revenue subs in India." Peltz tells me he's seen it all before. "Remember in 2000 when it was all clicks and eyeballs?" he declares. "People and the markets get so caught up in those frenzies, until one day it's hell for clicks and eyeballs. Disney and other streamers were buying people at no return. I'm not old enough to have been there for the Tulip bulb frenzy in Holland during the 1600s, and I lost my wooden shoes, but the same craziness happened in streaming."

To Peltz's applause, Iger promises to focus streaming not on growth, but profitability. In a recent CNBC interview, the Disney chief acknowledged that "we got a little bit intoxicated with our subscriber growth" and that Disney was "too aggressive" in its promotions aimed at recruiting customers. Disney, he says, will no longer issue goals for subscribers. Instead, his efforts will center on fulfilling the long-standing target of turning the corner by generating earnings from the streaming platforms by the end of its FY 2024. Another laudable Iger goal: making Disney's trademark family fare and exclusive franchises—think *Star Wars* or *Iron Man*—a far bigger part of its digital content, versus the standard TV shows and movies that don't hold the Magic Kingdom edge over what's produced by its competitors. Iger's challenge is a big one, avoiding a ruinous arms race in spending on shows and marketing, but still providing special programming that subs will happily pay full price to watch.

Getting rid of matrix management

In its deck, Trian strongly emphasized how Peltz had successfully prodded P&G to shift from a highly centralized structure to one based on individual profit centers. Before Peltz joined the P&G board in 2018, the maker of Tide, Pampers, and Head & Shoulders ran a bifurcated organization: The product categories handled marketing that promoted and positioned the brands, while separate regional sales organizations sold the products across all categories in their territories. The product chiefs didn't control their sales budgets, so they didn't have full sway over their P&Ls. Besides, P&G engaged an overly large headquarters staff that sold legal, tech, and other services to the product groups. At Peltz's recommendation, P&G recast its business units into five autonomous profit centers, including health care, beauty, and grooming, that now exercise full responsibility over their revenues and expenses. It is believed that many flowed from Cincinnati office towers into the operating units. The overhaul is a major reason that P&G, in part by getting a tight grip on its costs, has lifted profits by 45% since the close of 2017, and grown its share price by 80%.

Under Iger, Disney followed the individual "verticals" model. Its studios that conceived and produced the content were reportedly responsible for all costs, and free to choose whether the shows and films would appear first in theaters, on cable TV, or on Disney+ or Hulu. The managers manufacturing entertainment owned their P&Ls. That system gave them a strong incentive to ensure that everything they produced brought the best margins, and to distribute the product to the platform where it would make the most money. But in October of 2020, new CEO Chapek imposed a sweeping reorganization that took the decision of where Disney would show movies or programs, or license them to other networks, away from the content chiefs. Instead, he transferred that authority to a new top-down corporate group called Disney Media and Entertainment and Distribution, or DMED. It appears that Chapek made the move to boost Disney's all-out offensive in streaming. The idea was that the production chiefs couldn't hold back their top programming from first being shown on say, Disney+, whose success was now Disney's top priority.

The rise of DMED coincided with a steep ramp in Disney's costs. It's difficult to isolate its influence on expenses, but the new structure clearly weakened the production units' incentive to economize, since they were selling their output to DMED, which was now responsible for how much revenue they gathered. In any case, Iger has judged Chapek's gambit a failure. On the Q1 earnings call, he pledged a counter-reorg "aimed at returning greater authority to our creative leaders and making them accountable for how their content performs financially." To Peltz and the analysts, Iger's stance signals a return to the former, highly successful system where the studios held sway over their P&Ls. Peltz suggests that a recommendation to dump the matrix orientation was part of the 100-page manifesto that he pulled after Iger advanced a similar agenda. "The three words we dislike most," he told me, "are 'matrix' and 'unallocated overhead.'" Adds Peltz: "The role of the operating management is to grow sales, profit, and market share with very little corporate interference. The staff's role is to assist operating management where requested, but not replace them!" The Trian boss seems cheered that Iger appears to be targeting the overhead problem as part of the campaign to lower costs by an impressive $5.5 billion.

Iger seems to be making all the right calls—all but one. He should have backed Peltz as a board member. There's no one like this veteran campaigner to exhort leaders to do what they're promising and push the process along by showing them how to deliver. Iger would have benefited from Peltz's counsel, and would probably end up praising him like his former foes at P&G and Heinz. For getting to "Brooklyn," there's no guide like Nelson Peltz.

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