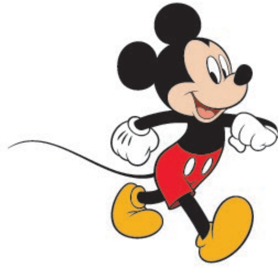

The Walt Disney Company

Q2 FY23 Earnings Conference Call

May 10, 2023

Disney Speakers:

Bob Iger

Chief Executive Officer

Christine McCarthy

Senior Executive Vice President and Chief Financial Officer

Moderated by,

Alexia Quadrani

Senior Vice President, Investor Relations

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PRESENTATION

Operator

Good day, and welcome to The Walt Disney Company's Second Quarter 2023 Financial Results Conference Call. (Operator Instructions).

After today's presentation, there will be an opportunity to ask questions. (Operator Instructions). Please note, this event is being recorded. I would now like to turn the conference over to Alexia Quadrani, Senior Vice President of Investor Relations. Please go ahead.

Alexia Quadrani – *Senior Vice President, Investor Relations, The Walt Disney Company*

Good afternoon. It's my pleasure to welcome everybody to The Walt Disney Company's second quarter 2023 earnings call. Our press release was issued about 25 minutes ago and is available on our website at www.disney.com/investors. Today's call is being webcast, and a replay and a transcript will also be made available on our website.

Joining me for today's call are Bob Iger, Disney's Chief Executive Officer; and Christine McCarthy, Senior Executive Vice President and Chief Financial Officer. Following comments from Bob and Christine, we will be happy to take some of your questions. So with that, let me turn the call over to Bob to get started.

Bob Iger – *Chief Executive Officer, The Walt Disney Company*

Thank you, Alexia, and good afternoon, everyone.

Allow me to digress for a moment to congratulate Universal for the tremendous success of *Super Mario Brothers*. It certainly proves that people love to be entertained in theaters around the world, and it gives us reason to be optimistic about the movie business.

Now turning to our results. We're pleased with our accomplishments this quarter, which are reflective of the strategic changes we've been making throughout our businesses.

We're also proud of what we continue to deliver for consumers, from movies to television, to sports, news, and our theme parks. A few recent highlights include Marvel Studios' *Guardians of the Galaxy Vol. 3.*, which topped the global box office in its opening weekend with $289 million.

The first round of the NBA playoffs was the most-watched ever across Disney networks, and we've been averaging 5 million viewers throughout the first 22 games — up 15% versus the comparable point in last year's playoffs. ABC continued its run as the #1 entertainment broadcast network for the fourth consecutive season.

And at our domestic parks, we continued to improve the guest experience with our recent pricing changes, and exciting new attractions, including the reimagined Mickey's Toontown at Disneyland and TRON Lightcycle / Run at Walt Disney World.

I've been back at the company for almost six months. And in that time, we've embarked on a significant transformation to strategically realign Disney for sustained growth and success.

I'm pleased to say that the strategy we detailed last quarter is working. Our new organizational structure is returning authority and accountability to our creative leaders. As well as allowing for a more efficient, coordinated, and streamlined approach to our operations. The cost-cutting initiatives I announced last quarter are well under way, and we are on track to meet or exceed our target of $5.5 billion.

We're delivering progress on a number of fronts, including a reduction in streaming operating losses this quarter, and I am very optimistic about our direct-to-consumer business longer term.

Combined, our brands, franchises and robust library are a significant differentiator in this space, and the meteoric subscriber growth we've seen since our launch three years ago only further reinforces that.

As I think about our path forward in streaming, we have a number of clear opportunities to further position our DTC business for success.

First, as a significant step toward creating a growth business, I'm pleased to announce that we will soon begin offering a one-app experience domestically that incorporates our Hulu content via Disney+.

And while we will continue to offer Disney+, Hulu and ESPN+ as stand-alone options, this is a logical progression of our DTC offerings that will provide greater opportunities for advertisers, while giving bundle subscribers access to more robust and streamlined content, resulting in greater audience engagement and ultimately leading to a more unified streaming experience.

We will begin to roll out this one-app offering by the end of the calendar year, and we look forward to sharing more details in the future.

Despite the near-term macro headwinds of the overall marketplace today, the advertising potential of this combined platform is incredibly exciting. And when you drill down into the details, you can see why. Over 40 percent of our domestic advertising portfolio is addressable, including streaming, which we expect will continue to grow over time.

We're also focused on the growth opportunity in programmatic advertising, and we are well positioned to scale as the market improves and audiences continue to grow. We've added more than 1,000 advertisers over the past year, and now have 5,000 advertisers across our streaming platforms, with over a third buying advertising programmatically today.

In addition, we plan to launch our ad tier on Disney+ in Europe by the end of this calendar year, which will drive both increased inventory and revenue over the long-term.

The truth is, we have only just begun to scratch the surface of what we can do with advertising on Disney+, and I'm incredibly bullish on our longer-term advertising positioning.

Meanwhile, the pricing changes we've already implemented have proven successful, and we plan to set a higher price for our ad-free tier later this year to better reflect the value of our content offerings. As we look to the future, we will continue optimizing our pricing model to reward loyalty and reduce churn, increase subscriber revenue for the premium ad-free tier, and drive growth of subscribers who opt for the lower-cost, ad-supported option.

Additionally, I'd like to share a few other key areas where we see opportunities for improvements in our streaming business.

First, it's critical that we rationalize the volume of content we're creating and what we're spending to produce our content.

Second, our legacy platforms enable us to expand our audiences and often augment our potential streaming success while at the same time allowing us to amortize our content costs across multiple windows.

We also need to strike the right balance between our local and global programming, as well as our platform and program marketing.

Finally, we must continue calibrating our investments in specific markets, looking at the total addressable market and ARPU prospects and evaluating the profitability potential.

All of these factors combined are why we are confident that we are on the right path for streaming's long-term profitability – the strength of our content; the one app experience and the enormous advertising potential that comes with it; rationalizing the volume of content we make and what we're spending; maximizing windowing opportunities; recalibrating our investments internationally; perfecting our pricing model; and consolidating our global streaming business under the leadership of Disney Entertainment co-Chairmen Alan Bergman and Dana Walden. We are doing the essential work now to position our streaming business for sustained growth and success in the future.

Turning to our parks, we see this business as a key growth driver for the company. This past quarter, we've been especially pleased with the performance of our parks internationally. And we have several international expansions underway that will allow our Parks to continue to build capacity and drive longer-term growth.

At Disneyland Paris, our Avengers campus has been a resounding success in its first year, and we have ongoing investment underway there, including a *Frozen*-inspired land currently in development. Our *Zootopia*-inspired expansion opens later this year at Shanghai Disney Resort. "Arendelle: The World of Frozen" expansion is set to open at Hong Kong Disneyland in the second half of 2023. And Tokyo Disney Resort, which is currently celebrating its 40th anniversary, will be opening the new Frozen Kingdom, Rapunzel's Forest, and Peter Pan's Never Land in the coming year.

Regarding our domestic parks, we just announced additional changes coming in 2024 that will improve the experience for guests visiting Walt Disney World, including further expanding access for Annual Passholders to visit on certain days without reservations, as well as removing the need for an additional reservation for guests with date-based tickets. This is just another example of how we're continuously listening to our guests and finding ways to improve their experiences.

And, we have a number of growth and expansion opportunities at our parks, and we're closely evaluating where it makes the most sense to direct future investments.

The unyielding popularity of our world-class Parks business and our unparalleled content, powered by our brands and franchises, is what sets Disney apart. From the very beginning 100 years ago, our timeless stories and characters have been the key to our success and hold a special place in the hearts of generations of fans and families.

We're leaning into this across every segment of our business, as illustrated with our strong summer slate of theatrical releases, including Disney's *The Little Mermaid*, Pixar's *Elemental*, and Lucasfilm's *Indiana Jones and the Dial of Destiny*.

As we've been looking at the structure of the company these past several months, what's become clear is that there is an enormous opportunity to harness our full potential by increasing alignment and coordination in marketing across our businesses.

That's why I named Asad Ayaz the first-ever Chief Brand Officer, in addition to his role as president of marketing for our studios.

For years, our businesses have been incredibly successful in marketing our content, experiences, and products. And now, with greater integration of our touchpoints with consumers, especially streaming, we are able to be more efficient – and more successful ¬– in reaching the right audiences with the right offerings from across our businesses.

Disney means so much to so many people around the world. That's a privilege we take seriously. And I know I speak for our terrific Chairmen – Alan, Dana, Jimmy, and Josh – when I say that our goal is to continue finding innovative new ways that allow guests and audiences to have even deeper connections with us. And that's why I'm so thrilled to be taking this more proactive approach to our brand and marketing work.

With that, I will turn things over to Christine.

Christine McCarthy – *Senior Executive Vice President and Chief Financial Officer, The Walt Disney Company*

Thanks Bob, and good afternoon, everyone.

Excluding certain items, fiscal second quarter diluted earnings per share were 93 cents, a decrease of 15 cents versus the prior year, as improvements at DPEP and Direct-to-Consumer were more than offset by declines at our Linear Networks business.

As Bob mentioned, we are making excellent progress on our cost cutting initiatives and are on track to meet or exceed the efficiency targets we outlined last quarter.

During Q2, we took a restructuring charge of approximately $150 million, primarily related to severance. While we are continuing to refine our estimates, we currently expect to record additional severance charges of approximately $180 million over the remainder of this fiscal year, with the bulk of that additional charge expected in the third quarter.

We are in the process of reviewing the content on our DTC services, to align with the strategic changes in our approach to content curation that you've heard Bob discuss. As a result, we will be removing certain content from our streaming platforms, and currently expect to take an impairment charge of approximately $1.5 to $1.8 billion. The charge, which will not be recorded in our segment results, will primarily be recognized in the third quarter as we complete our review and remove the content.

And going forward, we intend to produce lower volumes of content, in alignment with this strategic shift.

Now, to dive into our quarterly results by segment.

Starting with our Media and Entertainment distribution business, a year over year decline in operating income was driven primarily by a $1 billion decrease at Linear Networks. DTC results improved versus the prior year, and Content Sales, Licensing and Other operating results in the second quarter declined modestly.

At Linear Networks, results were consistent with guidance given last quarter, driven by decreases of approximately $800 million at our Domestic Linear Networks and $160 million at our International Linear Networks.

Domestic results decreased at both Cable and Broadcasting. At Cable, this was largely due to higher sports programming and production costs, which were driven by the timing of costs for the College Football Playoffs and the NFL we discussed last quarter, in addition to NBA contractual rate increases and higher sports production costs.

Lower Broadcasting results reflected decreases in advertising revenue across the ABC Network and our Owned Television Stations.

Second quarter Domestic Linear Networks affiliate revenue decreased by 2% from the prior year, driven by a six-point decline from fewer subscribers, partially offset by three points of growth from contractual rate increases. Rate growth was adversely impacted by one percentage point from the timing of revenue recognition from certain non-owned TV stations.

Second quarter domestic linear advertising revenue declined 10% year over year, although ESPN ad revenue was up 2%, or flat when adjusted for certain non-comparable items including CFP timing.

The sports advertising marketplace is currently stable, with quarter-to-date ESPN domestic linear cash ad sales pacing up.

However, the overall entertainment advertising marketplace has been challenging. While the weakness has moderated somewhat, we anticipate that some softness may continue into the back half of the fiscal year.

But as Bob mentioned, we are optimistic about our ability to continue to be a leader in advertising throughout the business cycle, particularly as it relates to our capabilities in addressable and programmatic. And we look forward to sharing more details at our Upfront presentation next week.

International Channels operating income decreased versus the prior year, driven by lower advertising revenue, partially offset by lower programming costs.

Moving on to Direct-to-Consumer, operating losses improved sequentially by approximately $400 million versus Q1.

During the second quarter, Disney+ core subscribers grew modestly, with over 600 thousand net additions. Core international subs increased by close to one million. While domestic subs declined slightly in the quarter from continued impacts from the price increase, domestic ARPU increased sequentially by 20%, reflecting strong subscription revenue growth.

And while the softness we saw in Q2 domestic Disney+ net adds may linger into Q3, we do expect Core sub growth to rebound in Q4.

At ESPN+ and Hulu, subscribers increased slightly over the prior quarter. ARPU at Hulu was impacted by lower per-subscriber advertising revenue, in line with the comments we made last quarter regarding near-term softness in the addressable advertising space.

DTC expenses, including programming and production costs, and SG&A, declined in the second quarter versus Q1. Our Direct-to-Consumer operating results in Q2 outperformed our guidance by about $200 million, due in part to timing shifts of marketing expenses driven by recent slate changes at Disney+ and Hulu. The shift of some of those costs into the third quarter will contribute to Q3 DTC operating losses widening by approximately $100 million versus Q2.

As we have noted before, the path will not be linear, as the strategic changes and improvements we're executing on take time to deliver. But we remain confident in our long-term trajectory, with continued opportunities to further improve results given our content curation strategy, planned price increases, expanding our relationships with our advertisers and our ongoing disciplined approach to costs.

At Content Sales, Licensing and Other, we generated a $50 million loss in the quarter, a bit shy of our prior guidance that results would be roughly breakeven. Lower results in the second quarter versus the prior year were due to a decrease in TV/SVOD distribution results, partially offset by improved theatrical distribution results due to the continued success of *Avatar: The Way of Water*.

In the fiscal third quarter, we anticipate this business's operating results will decline by $150 - 200 million versus the prior year, driven primarily by timing of the marketing of theatrical releases, with key titles *Elemental* and *Indiana Jones and the Dial of Destiny* not premiering until very late in the quarter.

Moving on to Parks, Experiences, and Products, operating income increased by over 20% versus the prior year to $2.2 billion, with increases at both International and Domestic Parks and Experiences, partially offset by lower merchandise licensing results at Consumer Products.

Our international parks were a bright spot this quarter, with strong year-over-year operating income growth driven by higher attendance and improved financial results at Shanghai Disney Resort, Disneyland Paris and Hong Kong Disneyland Resort.

At Domestic Parks and Experiences, operating income increased 10% versus the prior year, driven primarily by the continued post-pandemic recovery of our cruise line, partially offset by a comparison to a gain from a real estate sale in the prior year.

Q2 Domestic Parks operating income came in slightly below the prior year but was still up over 50% versus 2019. Results generally reflect the cost pressures we cited in last quarter's earnings call, including: wage increases, costs associated with new guest offerings and other inflationary cost impacts.

Domestic year over year increases in attendance and per capita spending were 7% and 2%, respectively. Per cap growth was more moderate this quarter, as we are comparing against the first full quarter of offering Genie+ and Lightning Lane at both parks in the prior year.

Domestic Parks and Experiences operating margins were comparable to the prior year, once adjusted for the impact of the prior year's real estate sale.

Please keep in mind that in the back half of this fiscal year, there will be an unfavorable comparison against the prior year's incredibly successful 50th Anniversary celebration at Walt Disney World. We typically see some moderation in demand as we lap these types of events, and third quarter-to-date performance has been in line with those historical trends.

This comparison, coupled with inflationary cost pressures, including from a new union agreement, is expected to drive a modest adverse impact to Domestic Parks and Experiences operating margins in the third quarter compared to the prior year.

However, we expect the contribution from continued strong performance at our international parks in Q3 to result in DPEP segment level operating margins that are slightly higher than the prior year.

DPEP will continue to be a growth business for our company, and we will manage all of these factors in-line with our enduring focus on our guests.

Before we conclude, I would like to note a couple of items related to our expectations for the total company this year.

For fiscal 2023, cash content spend company-wide is expected to remain roughly comparable to last year, excluding any potential impacts from the writers' strike.

And we expect that fiscal 2023 capital expenditures will total approximately $5.6 billion. This is lower than our prior guide of $6 billion, largely due to timing of projects at DPEP, as well as lower technology spend at DMED.

We still expect fiscal 2023 revenue and operating income to grow in the high single digit percentage range.

There are still many moving pieces, including macroeconomic factors, the state of the global advertising market and content timing shifts, which could impact our plans and expectations for the back half of this year.

But as Bob mentioned earlier, we are incredibly optimistic about the long-term value creation opportunities that the changes we are currently executing on can generate for our company, and we look forward to keeping you updated on our progress.

And with that, I will turn the call over to Alexia for Q&A.

Alexia Quadrani – *Senior Vice President, Investor Relations, The Walt Disney Company*

Thanks, Christine. As we transition to Q&A, we ask you to please try to limit yourselves to one question in order to help us get to as many analysts as possible today.

And with that, operator, we're ready for the first question.

Operator

(Operator Instructions) And our first question will come from Ben Swinburne of Morgan Stanley.

Ben Swinburne – *Morgan Stanley*

Thank you, good afternoon. Bob, I wanted to ask you about what you learned on sort of two topics over the last several months. One is around the price increase on Disney+. You've sort of commented that you think it went well. Obviously, we can see the subscriber trends. And you sound optimistic that the company can continue to drive ARPU over time. If you can just talk a little bit about what you've seen in the customer base and reaction and engagement that gives you confidence around pricing power for Disney+ looking ahead.

And then a similar question around the cost rationalization and re-org at the company now that you're sort of deep into that. What have you learned about the opportunity for that to drive better financial results for the company? And Christine sort of teased it that there might be more opportunities that maybe exceed expectations. But do you think there's more to do, I guess, is the short question on the cost side. Thank you very much.

Bob Iger – *Chief Executive Officer, The Walt Disney Company*

Thanks, Ben. On the first question regarding price increases. First, we were pleasantly surprised that the loss of subs due to what was a substantial increase in pricing for the non-ad-supported Disney+ product was de minimis. It was some loss, but it was relatively small. That leads us to believe that we, in fact, have pricing elasticity.

With that in mind, I think one of the things that we not only have discovered but that we believe we have to do is that we've got to widen the delta between the ad-free service and the ad – the non-ad-supported service. Because we clearly would like to drive more subs to the ad-supported service, which we did in the quarter by the way. The obvious reason, because the ARPU potential of the ad-service Disney+.

And in fact, as we look to this Upfront, and after careful and considerable discussion with our sales team led by Rita Ferro, we see that there's going to be a substantial growth in digital advertising in this Upfront. I mean, quite substantial.

Suggesting, for the obvious reason because digital advertising is so attractive to advertisers, that there's an opportunity for us to really lean in to ad-supported. And again, raising our prices on the ad-free, keeping the prices on the ad supported relatively modest, maybe – perhaps no increases, increasing the delta, driving more subs in a higher ARPU direction.

So we're heartened by it, and we are optimistic. And that is one of the strategies that we believe will help lead us ultimately to profitability and growth. Along with the second thing that you mentioned, which is the cost rationalization. And I'll tag team with Christine on this.

Clearly, we – as she mentioned, we're on a path to meeting or exceeding $5.5 billion in growth – sorry, in cost reductions that we mentioned last quarter. That comes in two categories: content spend and SG&A. I'm going to let Christine handle the SG&A.

But on content spend, we said at the time, most of that will come starting in '24 and leading in – and into '25 because we were committed to so much content already in '23. I'll let Christine handle the timing of the SG&A reductions and what potential impact that would have.

Clearly, again, the price increases, the – pushing more viewers – sorry, more subscribers to the ad-supported and the cost containment are among the things we're doing to get to profitability.

Christine McCarthy – *Senior Executive Vice President and Chief Financial Officer, The Walt Disney Company*

Hi Ben, I'll just further elaborate on some of the SG&A progress that we've had. And thanks for picking up that I did tease that by saying that we would meet or exceed our targets of $2.5 billion.

But as we've gotten into this, there's been great cooperation throughout the entire company, which has been really rewarding. Because we're looking at this – and of course, there's the reality of headcount reductions, and we're going through those. But there's also other things that we're finding more and more opportunities on eliminating redundancies, looking at ways to become more effective by utilizing resources, people and other resources across other businesses.

But we're really leaning into all the opportunities. There's technology, which we've also seen a lot of good progress. Some of it will be – and I say some will be realized in the balance of this year, really at the end of the fiscal year. But the real impact is going to help us in '24.

But once again, since we're all into it, I think, once again, having it be company-wide and having it be something that all of our business leaders have embraced, we're looking for a real comprehensive look throughout the SG&A buckets.

Bob Iger – *Chief Executive Officer, The Walt Disney Company*

And one more thing to add to that, Ben. We launched Disney+ in many, many markets around the world, including many very low ARPU markets. And not only did we launch in those markets, we spent a lot of money on marketing in those markets and we spent money on local content. So as we rationalize this business and we head in the direction of profitability, clearly, we're looking at opportunities to reduce expenses in those markets where the revenue potential just isn't there.

Operator

The next question comes from Phil Cusick of JPMorgan. Please go ahead.

Phil Cusick– *JP Morgan*

Hi, great to see the parks doing so well. Christine, can you dig into the contribution from Shanghai and where that is relative pre-COVID and to its potential?

And Bob, Florida is such a big part of the value of the company, but you have this political issue that only seems to get more press. It seems like you're stuck with this fight. So how should investors think about the risk, both the near-term and long-term business for Disney?

Christine McCarthy – *Senior Executive Vice President and Chief Financial Officer, The Walt Disney Company*

Hi Phil, yeah, let me address our results at Shanghai. They were incredibly positive this quarter. We've been really gratified to see the bounce back from the pandemic closures that we had.

We're not going to get into too many specifics but suffice it to say that the business is doing extremely well on both an attendance and a per-cap basis. We see that momentum continuing.

And we also have some new attractions. We've talked about *Zootopia* coming later this year. And we believe that, that is going to drive even further attendance and spending at the park.

But Shanghai is doing extremely well, and we've been really gratified to see that bounce back. Like I said, it was closed for quite a long period of time during the pandemic.

Bob Iger – *Chief Executive Officer, The Walt Disney Company*

Regarding Florida, I got a few things I want to say about that, Phil.

First of all, I think the case that we filed last month made our position, and the facts very clear. And that's really that this is about one thing and one thing only, and that's retaliating against us for taking a position about pending legislation. And we believe that in us taking that position, we were merely exercising our right to free speech.

Also, this is not about special privileges or a level playing field. Or Disney in any way using its leverage around the state of Florida. But since there's been a lot said about special districts and the arrangement that we had, I want to set the record straight on that, too.

There are about 2,000 special districts in Florida, and most were established to foster investment and development, where we were one of them. It basically made it easier for us and others, by the way, to do business in Florida. And we built a business that employs, as we've said before, over 75,000 people and attracts tens of millions of people to the state.

So while it's easy to say that the Reedy Creek special district that was established for us over 50 years ago benefited us, it's misleading to not also consider how much Disney benefited the state of Florida.

And we're also – we're not the only company operating a special district. I mentioned 2,000, the Daytona Speedway, it has one. So do The Villages, which is a prominent retirement community, and there are countless others. So the goal here is leveling the playing – if the goal is leveling

the playing field, then a uniform application of the law or government oversight of special districts needs to occur or be applied to all special districts.

There's also a false narrative that we've been fighting to protect tax breaks as part of this. But in fact, we're the largest taxpayer in Central Florida, paying over $1.1 billion in state and local taxes last year alone. And we pay more taxes, specifically more real estate taxes as a result of that special district.

And we all know there was no concerted effort to do anything to dismantle what was once called Reedy Creek special district until we spoke out on the legislation. So this is plainly a matter of retaliation while the rest of the Florida special districts continue operating basically as they were.

And I think it's also important for us to say our primary goal has always been to be able to continue to do exactly what we've been doing there, which is investing in Florida. We're proud of the tourism industry that we created, and we want to continue delivering the best possible experience for guests going forward. We never wanted or – and we certainly never expected to be in the position of having to defend our business interests in Federal Court, particularly having such a terrific relationship with the state, as we've had for more than 50 years.

And as I mentioned on our shareholder call, we have a huge opportunity to continue to invest in Florida. I noted that our plans were to invest $17 billion over the next 10 years, which is what the state should want us to do. We operate responsibly. We pay our fair share of taxes. We employ thousands of people. And by the way, we pay them above the minimum wage, substantially above the minimum wage dictated by the state of Florida, and we also provide them with great benefits and free education.

So I'm going to finish what is obviously kind of a long answer by asking one question. Does the state want us to invest more, employ more people and pay more taxes, or not? Thanks.

Operator

The next question comes from Michael Nathanson of MoffettNathanson.

Michael Nathanson– *MoffettNathanson*

Thanks, I have two. Bob, first for you is what do you think the impact of the slowdown in your DTC content spending will have on global subscriber growth? And then what does the move to one app in the U.S. offer as a solution?

And Christine, any help on future cash content spending? You said this year is flat. Is this the peak year, and then we start seeing declines from this year? Any help there on future cash content spending would be helpful. Thanks.

Bob Iger – *Chief Executive Officer, The Walt Disney Company*

Michael, when we launched the service – let me remind everyone, it was only three and a half years ago. So we're still a start-up in many ways. The goal was, as you know, global subs. And we wanted to flood the so-called digital shelves with as much content as possible to achieve obviously as much sub growth as possible.

And now as we grow the business in terms of the global footprint, we realized that we made a lot of content that is not necessarily driving sub growth. And we're getting much more surgical about what it is we make. So as we look to reduce content spend, we're looking to reduce it in a way that should not have any impact at all on subs.

We believe that there's an opportunity for us to focus more on real sub drivers. And one interesting example – and I should also throw marketing in too – where when you make a lot of content, everything needs to be marketed. You're spending a lot of money marketing things that are not going to have an impact on the bottom line, except negatively due to the marketing costs.

One thing we also know is that our films, those that are released theatrically, big tentpole movies in particular, are great sub drivers. But we were spreading our marketing costs so thin that we were not allocating enough money to even market them when they came on the service, as witnessed by the ones that are coming up, including *Avatar*, *Little Mermaid*, *Guardians of the Galaxy*, *Indiana Jones*, *Elemental*, et cetera. Where we actually believe we have an opportunity to lean into those more, put the right marketing dollars against it, allocate more from – basically away from programming that was not driving any subs at all.

So I guess this is part of the maturation process. As we grow into a business that we had never been in, we're learning a lot more about it. Specifically, we're learning a lot more about how our content behaves on the service and what it is consumers want.

Christine McCarthy – *Senior Executive Vice President and Chief Financial Officer, The Walt Disney Company*

Hi Michael, I'll address your question on content spend. As you know, this is an area that Bob is spending a lot of time working with our creative teams on. But when you think about that $30 billion overall, and Bob's targeted a annualized saving in the $3 billion range, I just want to remind everyone that the sports component of that amount is now over 30%. Just due to the contractual rate increases that we've had in our contract rights, our sports rights.

The other thing is in fiscal '23, we said that we're going to be roughly comparable to last year. Remember, last year, we came in slightly below $30 billion, and this estimate does not include any potential impacts from the writers' strike. So we have not estimated that because that's a new development, and we haven't really quantified what that would be because we don't know how long it's going to last.

But in general, what we're really doing is looking at a lower volume of content, as I mentioned in my comments. And Bob is once again going through all of the development slates and really looking at not only our Disney-branded but also a more curated approach to our general entertainment content.

Operator

The next question comes from Jessica Reif Ehrlich of BofA Securities. Please go ahead.

Jessica Reif Ehrlich– *Bank of America*

Thank you. Bob, you mentioned that in the Upfront, you will take a bigger share – I mean, you'll lean heavily into digital with AVOD. I'm just wondering, in the face of accelerating pay-TV universe decline, is that enough to offset linear losses? Or when will it be enough to offset linear losses and start to drive growth?

And in the sub-universe decline, thoughts – just wondering if you can give us your updated thoughts on ESPN and how it transitions or when it transitions to ESPN+.

Bob Iger – *Chief Executive Officer, The Walt Disney Company*

Well, I'll address the ESPN first. We haven't really changed our position regarding basically migrating ESPN's flagship service as a direct-to-consumer streaming platform. We think there's an inevitability to that, but it's a huge decision for us to make, and we know that we've got to get it right, both in terms of pricing and timing. And obviously, that has not only a direct impact on the linear channels, but it will have an even greater impact on it if we were to do that.

What we see going on at Linear Networks, as you know, I'm not saying anything that you don't know, is we're seeing both sub declines and advertising weakness. And it's created a worrisome circumstance for us because it's obviously having such a negative impact on the economics of that business. And that's forcing us to take a look at the cost structure of those channels, which ultimately comes down probably more than anything to spending on programming.

The decline in the business is, by the way, something that we predicted starting in 2015, '16, which is why we got into the streaming business to begin with. But the declines that we're seeing put even more pressure on us to turn that streaming business into a profitable growth business for us. And that's why all of the steps that we're taking, both in terms of the organizational structure, the cost reductions, the marketing changes, the changes in how we program the – lean into advertising.

We've also – by the way, Jessica, we've invested a fair amount in the technology needed to serve advertisers digitally much more effectively. With automated sales functionality and delivering in a very, very granular way exactly what advertisers want.

So we're very bullish about leaning into digital advertising. We're bullish about how we're positioned there. We're bullish about Disney+ and Hulu. And that combination, by the way. We think that by making Hulu available as a one-app experience, we'll increase engagement and increase our opportunity in terms of serving digital ads and growing our advertising business.

So, all things are kind of connected. ESPN to the long-term health of the bundle. The growth and the need to grow streaming as a reaction to the deterioration of linear businesses. And of course, all the steps that we've been taking to get to profitability.

Operator

The next question comes from Kannan Venkateshwar of Barclays.

Kannan Venkateshwar– *Barclays*

Thank you. Bob, on Hulu, the revenues of Hulu make it one of the biggest streaming businesses around. And it's also one of the oldest services around, but it doesn't seem to be profitable despite the scale. And sounds like you've made up your mind on buying the rest of Hulu based on the announcement of the combination with Disney+.

Does this combination allow you to change the cost structure of Hulu by maybe dropping content spending or the number of titles on Hulu and raising price because it's now a single service? Any color on your plans with Hulu would be much appreciated.

And Christine, on the parks, could you help us scale the recent – the impact of the recent wage increases in Florida and how that might impact the year?

And historically, the business has delivered mid-single digit or better revenue growth and EBITDA growth faster than that. You now have a number of cruise ships, more attractions, higher price but also higher costs. So could you help us think about the growth algorithm going forward more broadly? Thank you.

Bob Iger – *Chief Executive Officer, The Walt Disney Company*

Kannan, as you know, we have a contractual arrangement with Comcast that will enable them to put their share of Hulu back to us in early 2024. Starting in early 2024, is a – I guess, further right that we have to call their share from them. And it's not really been fully determined what will happen in that regard, except that as we look more and more at the growth of that – or the future of our streaming business – and I mentioned at the first earnings call that I did after I came back that everything was on the table. And in fact, everything was on the table.

But I've now had another three months to really study this carefully and figure out what is the best path for us to grow this business. And it's clear that a combination of the content that is on Disney+, with general entertainment, is a very positive – is a very strong combination. From a subscriber perspective – from a subscriber acquisition, subscriber retention perspective. And also from an advertiser’s perspective.

So where we are headed is for one experience that would have general entertainment and Disney+ content together for every – the reasons that I just described.

How that ultimately unfolds is, to some extent, in the hands of Comcast and in the hands of basically a conversation or a negotiation that we have with them. I don't want to be, in any way, predictive in terms of when or how that ends up. I can say, we've had some conversations with them already. They've been cordial, and they're aimed at being constructive.

But I can't tell you, and I can't really say where they end up. Only to say that there seems to be real value in having general entertainment combined with Disney+. And if ultimately, Hulu is that solution, that's – we're bullish about that.

Christine McCarthy – *Senior Executive Vice President and Chief Financial Officer, The Walt Disney Company*

Hi Kannan, let me address your question on Parks' earnings growth and the outlook there. So I think it's – the way I would phrase this is we do expect a really solid year overall for our domestic parks.

That being said, we also expect increased costs. And we alluded to that in our first quarter earnings call. And they're really coming from a few areas most predominantly.

One is wages with the new union contract coupled with inflationary trends. We do have some new guest offerings, so there's some incremental operating expenses that come along with those. And we also have the operational support for adding a fifth cruise ship to our cruise line fleet. I think you all know that we launched the *Wish* back last fall.

So we continue to look at ways to address cost management. The team down there has done a great job throughout the pandemic and then coming out of the pandemic. But they utilize a variety of tactics to mitigate potential margin pressures and downside risk across the segment.

And some of the levers that they can utilize to really address it are by looking at capacity. In some of our new attractions, they increased the footprint or increased capacity so we can open up the valve a little bit more on attendance. And with some new attractions that are more based on newer IP. So that will get more people not only coming in but wanting to come in and enjoy the experience while they're there.

And we also are really continuing to focus on meeting our customer needs there. But we think that this is a growth business for us. We've said so in the past.

And I do just want to give a call out to our cruise business. That business, as you know, was the most impacted. And we had talked about that – that was going to be the last business to come back from the closures during the pandemic. But that business has come back incredibly strongly over the last year – or this fiscal year.

And even looking out to the balance of our fiscal year, we're very encouraged by what we're seeing there and the reception to, not only our new ship, but also our legacy ships within the fleet.

Operator

The next question comes from Michael Morris of Guggenheim. Please go ahead.

Michael Morris– *Guggenheim*

Thank you, good afternoon. I wanted to ask one on direct-to-consumer advertising. And I'd love to hear any early details you can share about the Disney+ with advertising product. It wasn't mentioned as a driver, and I realize it's early, but would love to hear any early takes there and thoughts about how that might pace over the course of the year.

And then second, Bob, I'd love to ask about artificial intelligence. Clearly, a very hot topic right now. And a technology that seems like it could be pretty impactful to your business, both your ability to use it, but also just given how much intellectual property you have to protect, something that could be a threat as well. So, love any takes that you can share on how that would impact the business over time. Thank you.

Bob Iger – *Chief Executive Officer, The Walt Disney Company*

I think actually, Michael, I'm looking forward to a time where maybe AI does earnings calls for me. You probably – you wouldn't know the difference perhaps. Maybe they'd be better. I don't know.

Michael Morris– *Guggenheim*

I'd use AI to ask the questions, too.

Bob Iger – *Chief Executive Officer, The Walt Disney Company*

It's pretty clear that AI developments represent some pretty interesting opportunities for us. And some substantial benefits. In fact, we're already starting to use AI to create some efficiencies and ultimately to better serve consumers. Getting closer to the customer is something that is a real goal of ours. And we think that AI will provide some great opportunities to do that.

But it's also clear that AI is going to be highly disruptive. And it could be extremely difficult to manage, particularly from an IP management perspective.

I can tell you that our legal team is working overtime already to try to come to grips with what could be some of the challenges here. And we're certainly not the only ones. I think this is across not only our industry, but industries.

So I'd have to say, overall, I'm bullish about the prospects because I think they'll create efficiencies and ways for us to basically provide better services to customers. On the other hand, I think that there's a lot we're going to have to contend with that will be quite disruptive and quite challenging. Getting more specific is not something I really am prepared to do right now.

Christine McCarthy – *Senior Executive Vice President and Chief Financial Officer, The Walt Disney Company*

Hi Mike, I will take the Disney+ ad tier question for you. As you know, we launched back in December, so we've just begun to scratch the surface of what we can really do on advertising on Disney+. And we look at this as an incredible opportunity for longer-term advertising positioning.

Just to remind everyone, we do have a lighter ad load on Disney+ versus what we have on Hulu. And also, notwithstanding the very challenging macroeconomic advertising market, we're still seeing our consumers come into the – not only existing, but also new sign-ups, come into that ad tier. So we're very encouraged by that.

As Bob has mentioned previously, we have invested a lot in our ad tier technology and our data platforms. We're really providing state-of-the-art programmatic and addressable ad tools to our advertisers. So those are also investments that we've made, and we believe are going to pay off, not only today, but position us well for the future as the ad market overall gets stronger.

The other thing I just want to mention is we will be launching the ad tier on Disney+ in Europe by the end of this calendar year. So that'll be another platform that we'll have – or another offering that we'll have for consumers outside of the U.S.

Operator

The last question comes from Doug Mitchelson of Credit Suisse. Please go ahead.

Doug Mitchelson– *Credit Suisse*

Thanks so much. Bob, integrating Hulu into the Disney+ app is intriguing, so I wanted to continue that conversation.

When Disney+ was launched, you noted consumers should not have to buy through your entertainment content to get the Marvel and Star Wars and Disney and Pixar content. And you thought at the time having separate services to give consumers choice was the right approach. Is that still the right approach, to have multiple services to give consumer choice? And if the answer is yes, but you want the efficiency and flexibility of a single app, that would suggest that Disney+ is finally turning into a platform.

And I'm just curious if you see the opportunity to broaden the number of subscriptions that can live on that Disney+ platform or if you can expand the monetization of that platform in other ways, while maintaining a premium experience for consumers.

And if I could just add one for Christine, is fiscal 3Q the peak for streaming losses? Thank you both.

Bob Iger – *Chief Executive Officer, The Walt Disney Company*

We – on the integrated app experience that we announced today, that's for consumers that have subscribed to both services for now. So, in other words, it's taking what we call the dual bundle and putting it together in one experience, which is obviously good for consumers. Why have to close out one app and open another one? So it becomes a one-app experience.

We also think that it will benefit basically consumption in general, lower churn. Be more attractive. It's just an all-in-one. It's a bigger platform, basically more content than it offered before.

Outside the United States, we created that with Star, which doesn't have all the programming of Hulu, but it has a significant amount, and it's working quite well. And it's one of the reasons why we're going to launch that as an advertiser-supported platform as Christine mentioned.

So I think to answer your question, we're bullish about an app that goes well beyond the Disney+ branded content and includes general entertainment, which maybe at one point I called undifferentiated. That was a little harsh. But that includes quality, curated general entertainment for the purpose of growing advertising, growing subscriber fees, growing engagement, growing – lessening churn. And, to address one part of your question, reducing costs.

Christine McCarthy – *Senior Executive Vice President and Chief Financial Officer, The Walt Disney Company*

Hi Doug, and I'll answer your question on the Direct-to-Consumer losses and the peak losses. Just to remind everyone, we did say, and it is the case, that we had peak losses in Direct-to-Consumer in the fourth quarter of '22. That was the quarter that we reported in November.

So, what you've seen since then is we improved on a sequential linked-quarter basis. You've seen a $400 million improvement in Q1, another $400 million improvement in Q2.

In my comments, I did say that Q3, it would widen out by $100 million, because of the timing of some releases and particularly, the marketing of those releases. But we – that will be an aberration. Because it's not a linear path, but we will be improving significantly from '22 peak losses in Q4 through the balance of fiscal '23.

So, you should assume that what you saw back in Q4 was the peak loss, and we have improved for the next two quarters. There'll be that one little blip in Q3, and then we expect to be back on the path for the balance of the fiscal year.

Alexia Quadrani – *Senior Vice President, Investor Relations, The Walt Disney Company*

Okay. Thanks for the questions. I want to thank everyone for joining us today. Note that a reconciliation of non-GAAP measures that were referred to on this call to equivalent GAAP measures can be found on our Investor Relations website.

Let me also remind you that certain statements on this call, including financial estimates or statements about our plans, guidance or expectations or other statements that are not historical in nature may constitute forward-looking statements under the securities laws. We make these statements on the basis of our views and assumptions regarding future events and business performance at the time we make them. We do not undertake any obligations to update these statements. Forward-looking statements are subject to a number of risks and uncertainties, and actual results may differ materially from the results expressed or implied in light of a variety of factors, including economic or industry conditions and execution risks, including in connection with our organizational structure and operating changes, cost savings and DTC business plans relating to content, subscriber and revenue growth and profitability.

For more information about the key risk factors, please refer to our Investor Relations website; the press release issued today; and the risks and uncertainties described in our Form 10-K, Form 10-Q and other filings with the Securities and Exchange Commission. We want to thank you for joining us today and wish everyone a good rest of the day.

Forward-Looking Statements

Certain statements in this call may constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995, including statements regarding our business or financial prospects, trends or outlook; business plans; demand pipeline; financial or performance estimates or expectations (including estimated operating income, operating results, programming and production costs and cash content spend, capital expenditures, profitability and any guidance); organizational structure and leadership decisions; future subscriber levels; estimates of the financial impact of certain items, accounting treatment, events or circumstances; anticipated demand, timing, availability, pricing, utilization or nature of our offerings (including experiences and business openings, content within our products and services and content releases and distribution channel); business recovery; capital allocation, including dividend payments; impacts of COVID-19; consumer sentiment, behavior or demand; expected growth and drivers of performance or growth; cost reductions and source; productivity gains; available efficiencies; strategies and strategic priorities; value of our intellectual property, including franchises; direct-to-consumer expansion and changes to subscription offerings; and other statements that are not historical in nature. Any information that is not historical in nature included in this call is subject to change. These statements are made on the basis of management's views and assumptions regarding future events and business performance as of the time the statements are made. Management does not undertake any obligation to update these statements.

Actual results may differ materially from those expressed or implied. Such differences may result from actions taken by the Company, including restructuring or strategic initiatives (including capital investments, asset acquisitions or dispositions, new or expanded business lines or cessation of certain operations), our execution of our business plans (including the content we create and IP we invest in, our pricing decisions, our cost structure and our management and other personnel decisions) or other business decisions, as well as from developments beyond the Company's control, including:

- further deterioration in domestic and global economic conditions;
- deterioration in or pressures from competitive conditions, including competition to create or acquire content and competition for talent;
- consumer preferences and acceptance of our content, offerings, pricing model and price increases and the market for advertising sales on our DTC services and linear networks;
- health concerns and their impact on our businesses and productions;
- international, political or military developments;
- regulatory and legal developments;
- technological developments;
- labor markets and activities, including work stoppages;
- adverse weather conditions or natural disasters; and
- availability of content.

Such developments may further affect entertainment, travel and leisure businesses generally and may, among other things, affect (or further affect, as applicable):

- our operations, business plans or profitability;
- demand for our products and services;
- the performance of the Company's content;
- our ability to create or obtain desirable content at or under the value we assign the content;
- the advertising market for programming;
- income tax expense; and
- performance of some or all Company businesses either directly or through their impact on those who distribute our products.

Additional factors are set forth in the Company's Annual Report on Form 10-K for the year ended October 1, 2022, including under the captions "Risk Factors," "Management's Discussion and Analysis of Financial Condition and Results of Operations," and "Business," quarterly reports on Form 10-Q, including under the captions "Risk Factors" and "Management's Discussion and Analysis of Financial Condition and Results of Operations," and subsequent filings with the Securities and Exchange Commission.

The terms "Company," "we," and "our" are used above and in this call to refer collectively to the parent company and the subsidiaries through which our various businesses are actually conducted.