



The WALT DISNEY Company<sup>®</sup>

## **Q1 FY08 Earnings Conference Call**

**FEBRUARY 5, 2008**

**Disney Speakers:**

**Bob Iger**

*President and Chief Executive Officer*

**Tom Staggs**

*Senior Executive Vice President and Chief Financial Officer*

Moderated by,

**Lowell Singer**

*Senior Vice President, Investor Relations*

**PRESENTATION**

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**Operator**

Good day, ladies and gentlemen, and welcome to the first quarter fiscal year '08 The Walt Disney Company earnings conference call. My name is Lauren, and I'll be your coordinator for today. At this time, all participants are in listen-only mode. (OPERATOR INSTRUCTIONS). As a reminder, this call is being recorded for replay purposes. I would now like to turn the presentation over to your host for today's call, Mr. Lowell Singer, Senior Vice President of Investor Relations and Shareholder Services.



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**Lowell Singer** – *Senior Vice President, Investor Relations, The Walt Disney Company*

Thanks, operator. Good afternoon everyone, and welcome to The Walt Disney Company's first quarter fiscal '08 call. Today's call is being webcast, and the webcast can be accessed on our investor relations website. The press release was issued a few minutes ago. It's also available on our website. Following today's call, we'll provide a replay as well as an MP3 file and a written transcript on the website.

Joining me in Burbank for today's call are Bob Iger, Disney's President and Chief Executive Officer and Tom Staggs, our Senior Executive Vice President and Chief Financial Officer. Bob's going to lead off, followed by Tom. We'll then open it up to Q&A. I hope you'll stick around after the Q&A, because besides reading our Safe Harbor provisions, I may just go ahead and endorse a candidate. So with that, let me turn the call over to Bob and we'll get started.

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

Thank you, very much, Lowell, and good afternoon.

I am pleased to report we've started off our 2008 fiscal year with another outstanding quarter, marked by strong creative and financial performances. These results validate our strategic focus, and I am extremely proud of our people, their talent, experience, and commitment to quality and integrity.

There are numerous specifics I could mention, but I will leave that to Tom, and summarize instead what we believe are our strategic priorities, as well as what we see as our competitive advantage.

Before I do that, two items to note: We are extremely gratified by the \$31 million opening weekend box office of the *Hannah Montana/Miley Cyrus 3D* concert film, the highest ever domestic gross during a Super Bowl weekend. Its impressive performance highlights our mission perfectly: create high quality content, and apply innovative technology to raise the level of the consumer experience in a way that differentiates Disney and reaches more people in new ways.

Regarding the Writers Guild strike; it did not have a significant impact on the quarter, and we are hopeful an agreement will be reached soon and the writers will return to work.



Our first quarter performance illustrates a concept we have been articulating lately, which we call the Disney Difference. I would like to elaborate on it, because I believe it can deliver consistent value to shareholders and because it sets us apart from our competitors.

It begins with the fact that we now have multiple creative engines capable of developing and producing quality content in numerous ways...from the Disney Channel, the Studio, and Pixar, to ESPN and ABC, and including our Music Group, our Video Games division, our Internet Group, Publishing, and our Parks and Resorts and Walt Disney Imagineering.

*High School Musical* and *Hannah Montana* came from the Disney Channel. *Pirates of the Caribbean* began at our Parks and Resorts. *Cars* and *Toy Story* are from Pixar. And *The Jonas Brothers* were brought in by our Music Group. All are examples of Disney-branded creative content, emanating from different parts of our company.

This set of creative engines has recently given rise to many new franchises that provide us with a running start in any marketplace at any given time. In essence, we begin each year with a strong brand and franchise foundation, and then build on it with great new stories and characters coming from multiple places. This now includes international markets, where we are investing aggressively to create locally relevant, lasting Disney content.

Five years ago, we could count upon only two major franchises. Today, we have ten vibrant creative properties which are managed and promoted on an integrated basis across business lines. In 2007, two of these, *Disney Princesses* and *Cars* were the most popular lines in their categories worldwide, outselling longtime favorites.

Another important aspect of the Disney Difference is our ability to leverage success across all businesses and territories. Miley Cyrus' incredible weekend box office results and the sale of 8 million CDs are examples. Her sold-out summer concert tour, the *Hannah Montana* video game, popular consumer product lines and hit special event appearances that have driven traffic on Disney.com also underline the point.

Another one of our major franchises, *High School Musical*, is not only a successful television franchise for and from the Disney Channel, but it will also be a feature film later this year and has already produced huge hits in music, publishing and consumer products. So far, more than 15 million DVDs and more than 15 million soundtrack albums have been sold. It can be seen at our Parks and Resorts, where a live *High School Musical* show entertains guests numerous times a day, as an ice show in arenas across America and in more than 2,500 school and amateur productions. *High School Musical* is



also a major international phenomenon, with a sold-out concert tour of Latin America and a new stage show heading to 10 international territories this year.

Let me mention one other franchise, which speaks to the enduring popularity of our content, and our ability to leverage success. When *Toy Story* was first created by Pixar, it was an enormous hit, spawning the even more successful *Toy Story II* as well as a range of merchandise and attractions at our parks and resorts. Eight years after the last theatrical release, *Toy Story* licensed merchandise sales are over \$400 million annually at retail.

Over the next few years, you will see a lot of creativity stemming from this wonderful franchise. This year, a fantastic new attraction *Toy Story Mania!* is opening at Disneyland and Walt Disney World, as is a new stage show on our Cruise Lines. They join the popular *Buzz Lightyear* attraction already delighting guests at each of our global locations. In 2009, new 3-D versions of the first two movies will arrive in theaters and in 2010 *Toy Story 3* will arrive on the big screen, accompanied by a Disney published video game and a new merchandise line.

Two other aspects of the Disney Difference are worth mentioning. The first is our ability to market far more effectively and efficiently than our competitors. Our internal estimates show that consumers last year spent around 13 billion hours immersed in the Disney brand, including 10 billion hours spent watching Disney Channel around the globe, 800 million hours having fun at our Parks and Resorts and nearly 1.2 billion hours watching Disney movies in the theater, on DVD or on their computers. Our mandate is to use these various platforms, as well as our radio networks, retail outlets and a growing number of popular online destinations, to fully support cross business initiatives and grow value. This enables us to reach people effectively and to do so efficiently and economically.

Finally, the Disney name itself differentiates us. As a brand that people seek out and trust, it opens doors to new platforms and markets, and hence to new consumers. It also greatly lengthens the potential lifespan – and the value – of our creative output.

In sum, we believe this dynamic set of valuable business traits creates sustainable shareholder value. It makes us stand out in a cluttered media world. And it can help us temper the impact of challenging economic conditions.

While I've focused here on the Disney brand, I'm also extremely proud of ESPN and ABC. Both are producing great content and are successfully leveraging it across multiple platforms and markets.



The Walt Disney Company is in great shape. We have enormous creative momentum, that is inventing new hits and sustaining old favorites like never before. And we are using the latest technology to enhance our creativity and distribute our entertainment in all kinds of exciting and innovative ways.

And with that, here's Tom Staggs.

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**Tom Staggs** – *Senior Executive Vice President and Chief Financial Officer, The Walt Disney Company*

Thanks, Bob and good afternoon.

We're happy to report solid revenue growth and a double-digit increase in segment operating income in the first quarter. Excluding gains on asset sales in Q1 of last year, we once again delivered double-digit bottom line growth as well.

Our Media Networks set the pace again in Q1, delivering double-digit growth in revenue and operating income, driven in large measure by advertising and affiliate revenue growth at our cable networks. In addition, ABC Family benefited from lower programming costs as the prior year was the last in their legacy deal with Major League Baseball. Home video sales of *High School Musical 2* contributed to our upside as well. The Disney Channel is one of the most important drivers of the Disney brand and one of our most vibrant creative engines, and we continue to invest in original programming and in the reach of our Disney Channels around the world.

At ESPN, growth in affiliate revenues was dampened somewhat by revenue deferrals totaling roughly \$50 million more than what was deferred in Q1 of last year. However, ESPN enjoyed double-digit growth in ad revenues in the quarter, driven by NASCAR, higher ratings in key demos and the strength of the ad market. These higher revenues were offset by increased sports rights and programming costs, primarily due to the addition of NASCAR.

At Broadcasting, operating income improved by 30% versus last year. Although ratings were somewhat lower at ABC, the network ranked number one during the November sweeps for the third consecutive year in key demos and advertising revenue growth for the quarter was solid. The strong ad market and tight supply helped us keep scatter CPMs significantly above upfront levels. The ad market strength has continued into our second quarter with CPMs again tracking double-digit percentages ahead of upfront pricing.

Our TV station results reflected lower ad revenues due to significantly higher political spending in our major markets in the prior year. So far in Q2, ad sales at the stations are pacing ahead of prior year by mid single-digit percentages.



Our parks and resorts segment also delivered double-digit growth in revenues and operating income driven in part by record Q1 attendance at our domestic parks. For the quarter, attendance at our combined domestic parks was 3% above the prior year with Walt Disney World up 4%, driven by increased visitors from both the domestic and international guest segments. Disneyland attendance was slightly above prior year levels.<sup>1</sup> Per capita spending at Walt Disney World grew 3% and spending at Disneyland increased 2%.

Turning to our resorts, our Orlando hotel occupancy was up 4 percentage points to 89% while Disneyland occupancy of 91% was a little below last year. Program spending for our combined domestic resorts was also strong, coming in just above the prior year at Walt Disney World and low double-digit percentages ahead of last year at Disneyland.

At our international parks, both Paris and Hong Kong parks enjoyed double-digit growth in attendance during Q1. At Disneyland Resort Paris, the *15th Anniversary* celebration campaign and recently opened Pixar-based attractions continue to resonate well with guests. Attendance at Hong Kong Disneyland improved significantly versus the prior year as our entertainment offerings during Halloween and the holidays helped to boost attendance from both the local Hong Kong market and mainland China. While the momentum in Hong Kong continued during the first part of Q2, the recent severe weather and associated travel difficulties in China are affecting attendance from the main land this week, which could impact the important Chinese New Year period.

Looking ahead at our domestic parks and resorts, room reservations on the books for Q2 through Q4 of this fiscal year are modestly ahead of where they were at this time last year. Bear in mind that Easter falls in fiscal Q2 this year versus fiscal Q3 last year, which will skew individual quarter comparisons somewhat. We aren't going to forecast the economy, and at this point, the trends don't tell us enough to predict precisely how the remainder of the year will unfold. Having said that, we are pleased with the current pace of business at our parks, particularly given the record attendance we achieved last year. Of course, we'll respond quickly to changes in market conditions if they occur, and more importantly we feel that the unique appeal of our theme park and resort properties and our experienced parks management team position us well to make the most of whatever economic conditions exist.

Turning to Studio Entertainment, our success at the box office has continued. *Ratatouille* was especially strong at international markets. It now stands as the third highest grossing Disney-Pixar movie in terms of worldwide box office. We're also pleased with the strong box offices performances of our holiday releases *Enchanted* and *National Treasure: Book of Secrets*.



The studio faced tough comparisons in home entertainment versus last year's Q1 which featured *Cars*, the second *Pirates* film, and *The Little Mermaid*. This year, *Pirates of the Caribbean: At World's End* and *Ratatouille* performed well, but DVD sales came in roughly 9% behind last year's remarkable results. Bear in mind that Q1 this year included just the domestic and limited international home video release of *Ratatouille*, whereas the prior year included the worldwide DVD release of *Cars*.

The tremendous growth in operating profit of Consumer Products this quarter is further evidence of how we can take successful branded content from one creative center and leverage it across our multiple lines of business to generate higher returns on these creative franchises. The biggest drivers of consumer products from Q1 were sales of merchandise and video games based on our hit Disney Channel properties. We're especially pleased to see the strong results in video games. The Disney brand and our strong portfolio franchises position us well to grow our video game business and we intend to continue to ramp up our development investment in this business.

Bob referenced the expansion of our key character franchises. We believe this broad and growing stable of properties can enable us to continue to grow our licensing business across franchises and product categories. As you think about Q2, though, it's worth knowing that we expect to recognize roughly \$30 million less in minimum guarantees across our Consumer Products business in Q2 of this year versus Q2 of last year.

We have continued to repurchase our stock this year. And given our strong results and free cash flow we expect further share repurchases going forward. For the fiscal year so far, we've repurchased about 46 million shares for roughly \$1.5 billion.

Our earnings this quarter once again provide evidence of the competitive advantage offered by the unique broad-based power of our brands and entertainment franchises and our ability to develop and leverage them across multiple creative engines and platforms. This focus and our integrated approach to managing our company have enabled us to build a strong portfolio of enduring franchises and a solid base of business from which to grow. With that, I'll turn the call over to Lowell for Q&A.

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**Lowell Singer** – Senior Vice President, Investor Relations, The Walt Disney Company

Thanks, Tom. Operator, we are ready to begin the Q&A session.



## Q&A

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### Operator

Thank you. (OPERATOR INSTRUCTIONS). Your first question comes from the line of Michael Nathanson with Sanford Bernstein.

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**Michael Nathanson** - *Analyst, Sanford Bernstein*

Thanks. I have one for Tom. It's about the parks and the cost base. I wonder if you can talk a bit about what the split of the cost base is between fixed and variable now. And has that changed over the years? As you talked before, you're good at maybe managing through different economic environments, what type of revenue slowdown can you absorb before profits will be impacted and what can you do on the cost base to absorb that slowdown if there was a slow down?

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**Tom Staggs** - *Senior Executive Vice President and Chief Financial Officer, The Walt Disney Company*

Our business at the parks has evolved over time. And while we haven't given out a specific percentage, it would be difficult to do so as to what is fixed and what is variable. It's important to know that we do have considerable leeway to add costs based on demand or to take costs out based on a lack thereof. So as you've seen as recently as 2001, we will adjust park hours, we'll adjust rooms that we make available, we'll adjust number of entertainment offerings, et cetera. So while there's clearly a fairly large fixed cost base in parks, we do have the ability to dial up and down our costs.

Having said that, back to your point about the evolution of the business, I think it is important to note that we have added both size and scope in the business. Our Vacation Club business has turned out to be very resistant to downturns. Our Cruise business, frankly, is significantly stronger right now than it was this time last year and has shown itself to be very resilient through any economic condition. So we're more excited than ever about having two new ships coming on.

We're building out our international base and seeing the improvement in Paris and the improvement in Hong Kong I think bodes well for further broadening this base of business at the parks. And I think Bob noted just in the last call that we find that people tend to cancel a planned vacation infrequently, very infrequently, and so as I said in the call, in the prepared remarks, the pace of business to us looks pretty good. We feel like we've got the ability to respond if necessary. But right now, we're feeling pretty



optimistic about where things go from here.

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**Lowell Singer** – *Senior Vice President, Investor Relations, The Walt Disney Company*

Thanks, Michael. Operator, we'll take the next question, please.

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**Operator**

Your next question comes from the line of Doug Mitchelson with Deutsche Bank.

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**Doug Mitchelson** – *Analyst, Deutsche Bank*

Thank you very much. I wanted to ask a question on the film margins. But just a clarification on the prepared remarks, Tom, regarding the bookings. So you're saying that the bookings are up in the March quarter, despite tough comparisons against Easter, so that's one question. But for film, I understand why film revenues were flat for the quarter. I'm more interested in why film costs were up 5% in the face of flat revenues, the only division that showed margin compression.

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**Tom Staggs** – *Senior Executive Vice President and Chief Financial Officer, The Walt Disney Company*

First, just to be clear, Easter last year fell in the third quarter. And so more of the spring break was in the third quarter last year. That's moving to the second quarter this year, which actually would help the second quarter comparison year-over-year, which is why in the prepared remarks I wanted to give you a sense of what rooms on the books look like for the remainder of the year, to sort of help you look through that shift. So yes, Q2 bookings are up nicely over the prior year, but we think some of that is caused by the timing of Easter. So if you look at total rooms on the books, Q2 through Q4, we're up modestly versus the prior year and we feel good about that.

With regard to film costs, what's important to do is break down the nature of the revenues. We had strong theatrical performance this year. And we had strong but not as strong performance in home video. As you know, when you put films out in the theatrical window, the margin is dramatically lower, we're amortizing the P&A, we're amortizing a good piece of the film costs, so that's naturally going to be a lower margin activity. So when home video is driving your results, your margins are going to come up. When theatrical is driving your revenues, you're going to see the margins come down. It's a natural course of business, and I don't think you should read into that there's an issue or something that's changed meaningfully in the nature and make-up of either our cost base or our revenues.



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**Doug Mitchelson** - *Analyst, Deutsche Bank*

Thank you.

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**Lowell Singer** - *Senior Vice President, Investor Relations, The Walt Disney Company*

Thanks, Doug. Operator, next question, please.

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**Operator**

Your next question comes from the line of Spencer Wang with Bear Stearns.

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**Spencer Wang** - *Analyst, Bear Stearns*

Thanks and good morning. Going back to the parks, Tom, you referenced the Vacation Clubs. Can you just size for us how big that business is for you guys in terms of revenue and/or EBIT and how do you book those Vacation Club sales? Are those just booked in the quarter where the units are sold? And then my last question is just on international parks, I think the press release referenced some real estate sales. Can you tell us how big that was in terms of EBIT or if it was material? Thank you.

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**Tom Staggs** - *Senior Executive Vice President and Chief Financial Officer, The Walt Disney Company*

Sure. We don't break out the Vacation Club. Part of the reason that we don't break out the Vacation Club is that it can vary based on quarter, based on the units that we have available for sale, when we're bringing inventory online, et cetera. Generally speaking, we invest in Vacation Club. That investment actually shows up on the balance sheet in the form of inventory. When we make a sale, we book the lion's share of the sale, although some of the sale actually comes through over time, a smaller portion of it, because it's a commitment that's made. And the Vacation Club business for us has been one that's been, as I mentioned, both stable and growing, and we're actually really pleased to have new Vacation Club developments in the works as we talked about in previous calls and in press releases.

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**Spencer Wang** - *Analyst, Bear Stearns*

And on, sorry, the international real estate sales, Tom?



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**Tom Staggs** – *Senior Executive Vice President and Chief Financial Officer, The Walt Disney Company*

International real estate, that really is driven by Disneyland Paris and so the detail of that you would get in the semi-annual results from Paris. But as you may know, there's considerable real estate surrounding our park at Disneyland Paris. Part of the strategy there is to make sure that we're encouraging area development which drives economic activity in the area and then obviously hotel and resort business for the park. So that actually is part of the long-term strategy of that business. So from time to time, as some of that land is put into use, they'll be gains on land sales there. First of all, it wasn't a tremendous driver in the quarter in terms of profitability. But second of all, if you look through that, you still saw very nice increases in attendance at Disneyland Paris and so we're exceptionally pleased with what we've seen over the last four, five, six quarters in Paris.

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**Spencer Wang** - *Analyst, Bear Stearns*

Great. Thank you very much.

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**Lowell Singer** – *Senior Vice President, Investor Relations, The Walt Disney Company*

Thanks, Spencer. Operator, next question, please.

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**Operator**

Next question comes from the line of Ingrid Chung with Goldman Sachs.

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**Ingrid Chung** - *Analyst, Goldman Sachs*

Thank you. Good afternoon. First, Bob, you talked about building franchises earlier. How do you describe the life cycle of these franchises? When do these franchises peak? And what are some of the new emerging franchises that you're excited about?

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

Well, first of all, about the life cycle, one of the things that we've observed over the years is that when we put the Disney name on a high quality character franchise, the life cycle or the life span that such a franchise can deliver value is seemingly endless. The fact of the matter is we have Mickey and Pooh, still our two largest franchises that are decades old. But a number of the Princesses that became a franchise were created out of movies that were also made decades ago. What we've been doing is, as we create a high



quality franchise, and it emerges as a real success in a given business, we gauge whether we believe that success is leveragable across all of our businesses and in multiple territories, and then to what extent we really believe that by investing in that franchise, it can continue to create value over a long period of time. And with that, we've given birth to a number of franchises over just the last three or four years, or we've turned entities into franchises that were created in the recent past, *Toy Story* would be a good example.

The ones of course that we're most excited about recently are things like *High School Musical*, and *Hannah Montana*, clearly, but also *Baby Einstein* would be another example of that, *Pirates of the Caribbean* is another franchise, *Cars* is probably the one that we believe has the biggest potential for the longest period of time, and I think that's evidenced by the fact that we're selling more merchandise in the marketplace now than we did in the year that the film was released. So we've clearly struck a nerve in terms of a play pattern and that has led us to invest in more creativity. So we'll be launching a virtual online world for *Cars* and while I don't have a specific announcement to make, I think it would be a relatively good bet that ultimately there will be a sequel in the works for *Cars*. Again, because we believe the franchise potential of that set of characters. Then of course, lastly, when we really believe something has franchise value, we turn it into attractions in the parks and we're building *Cars* Land for California Adventure, set to open in 2012, and we opened a *Cars*-related attraction in Paris this past year and I'm fairly certain you'll see more creativity and investment in terms of physical attractions at our parks against that franchise.

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**Ingrid Chung** - Analyst, Goldman Sachs

And do you view *Ratatouille* as a franchise also?

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**Bob Iger** - President and Chief Executive Officer, The Walt Disney Company

Nothing against *Ratatouille*, in terms of how great it was creatively, five Academy Award nominations. But no, that wouldn't be one that we would consider a true franchise in terms of its leveragability across multiple businesses or its ability to drive huge value over a long period of time. It is a classic and I'm fairly certain that we'll be able to bring out the *Ratatouille* DVD or whatever the form might be for years to come on a fairly regular basis and it will thrill generations of kids into the future. But I don't see us turning that into the kind of franchise that rise to the level of *Cars*, *Princess*, *Pirates*, Mickey, Pooh, *Toy Story*, et cetera.



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**Ingrid Chung** - *Analyst, Goldman Sachs*

Okay, great. Thank you.

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**Lowell Singer** - *Senior Vice President, Investor Relations, The Walt Disney Company*

Ingrid, thanks. Operator, next question, please.

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**Operator**

Your next question comes from the line of Jessica Reif Cohen with Merrill Lynch.

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**Jessica Reif-Cohen** - *Analyst, Merrill Lynch*

Thank you. Tom or Bob, when you think about your businesses, where do you think you have the most room for revenue and margin improvement? It would seem to be, but I'm not sure you would agree with this, Cable Networks and Consumer Products. And I guess the flip side of that is how much more can Broadcast grow? You seem to be at peak margins relative to some of the other companies. And at Theme Parks I think you're at your own targeted margins.

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**Bob Iger** - *President and Chief Executive Officer, The Walt Disney Company*

Well, I think it's right, expecting that we're going to grow margins significantly in the Broadcast business would probably be wrong. While I don't know that we're necessarily at peak, I don't think that there's significant room ahead. Where we could expand margins of course is with greater success with company-produced and owned series, and which gives us more leveragability on a global basis, particularly as the world builds out in terms of the ability to distribute and ultimately consume intellectual property like that. We definitely believe we have margin expansion in our Parks and Resorts in general. Either in core business, or by investing in adjunct businesses. The cruise ships that we're building would be examples of that, the Vacation Clubs Tom talked about earlier. We demonstrated last quarter, the one that we just announced, that there clearly is improvement potential in our international theme parks and we believe that the results from Paris and Hong Kong certainly demonstrate that.

And then to the point you made, we think we've got considerable margin expansion potential across a wide range of consumer products businesses, notably video games. But also supporting these franchises in a worldwide basis and growing retail sales against these franchises worldwide. And I'd say certainly on the Cable Networks front,



particularly with the Disney Channel, as we grow distribution in worldwide Disney Channel operations. Now, that may cost us a little bit initially with some investment to grow distribution. But I think over the long run, we will not be increasing our cost to distribute our programming costs as much as we will be getting back with increased distribution and the subsequent subscription fee and advertising that comes with it.

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**Lowell Singer** – *Senior Vice President, Investor Relations, The Walt Disney Company*

Thanks, Jessica. Operator, we'll take the next question.

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**Operator**

Your next question comes from the line of Imran Khan with JPMorgan.

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**Imran Khan** – *Analyst, JP Morgan*

Yes, hi, thank you for taking my questions. Two questions, one on parks. Tom, you talked about attendance. Can you help us understand the growth of attendance growth, international versus U.S., to try to get a better sense of what percentage of your growth is coming from international attendance versus the U.S. And secondly, looking at Broadcasting, margins improved on a year-over-year basis, how should we think about ABC margins expansion opportunity from here on, and NBC talked about reducing the number of pilots. What's your plan? Can you give us some color on that? Thank you.

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**Tom Staggs** – *Senior Executive Vice President and Chief Financial Officer, The Walt Disney Company*

Sure. As I mentioned in the prepared remarks, the biggest increases at the parks in terms of attendance is really driven out of the domestic tourist segment and the international segment. Now, on a percentage gain basis, international was the strongest but the domestic portion is obviously a little bit larger to begin with, and so what's interesting to us is that in the first quarter we continued to see strength in both of those places and moreover, even though international is strong and as one might have expected with the dollar being weaker, and as we get through a vacation bookings cycle, we're seeing that strength, we were at the same time pleased to see the gains in attendance at, for example, Disneyland Paris. So I hope that's helpful.



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

I think what we saw last quarter at our parks - not to throw in a Miley Cyrus pun - but was the best of both worlds, because I think the weakness of the dollar against foreign currencies has probably resulted in fewer Americans traveling overseas and has resulted in more people from international markets traveling to the U.S. I think that's why we had record attendance at our domestic parks. It came from basically both sides, which is great. To the second part of your question about Broadcasting margins, you mentioned the number of pilots. It's safe to assume that given the fact that we've had a work stoppage because of the writers' strike and even if there's a settlement soon and the writers go back to work quickly, it is guaranteed that we will make far fewer pilots this year than we have made in the past and there will be some savings there. Unfortunately, that comes at a time when, because of the work stoppage there will also be some revenue loss because of our decrease in the number of shows that we can sell on a worldwide basis that we have owned primarily.

So I don't think you're going to necessarily see much margin improvement in that business in the very near term. I still think there is some margin improvement possible in that business. We've been heartened by the incredible strength of the scatter marketplace and the strength of advertising in general for ABC and so there actually might be some revenue growth potential. And then we have learned in part, thanks to this work stoppage, that business as usual just does not work. And what that primarily means is an attack on costs. And I think you'll see a reduction in general of costs in that business over the next few years, I don't know necessarily if it will have a dramatic effect on margin improvement, it certainly has the potential to deliver some.

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**Lowell Singer** – *Senior Vice President, Investor Relations, The Walt Disney Company*

Thanks, Imran. Operator, next question, please.

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**Operator**

Your next question comes from the line of Anthony DiClemente with Lehman Brothers.

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**Anthony DiClemente** – *Analyst, Lehman Bros.*

Thanks for taking the question. Thinking about the sensitivity of Cable Networks advertising to a recessionary slowdown, have you seen any of that to date? And do you think that there's a chance that the Cable Networks are a little more insulated from an economic slowdown because these are national advertisers, as opposed to local, and do



you think that a potential recessionary slowdown would be mitigated by dollars coming out of Broadcast and into Cable Networks? Thanks.

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

We're fortunate in many ways that the Disney Channel in the U.S. does not take advertising and has healthy sub fees, and so they're immune completely to a recession, certainly in the United States. On the ESPN side, we have an extremely strong dual revenue stream that comes from one of the healthiest subscription fee bases in the country. And that obviously helps. But on the ad side for ESPN, their pacings have generally been strong. They're still a very strong brand and live sports are still very attractive from an entertainment perspective and that obviously I think is what helps drive the advertising rates. I don't really think you'll see us benefit significantly from a migration from advertising that moves from network to cable. We're not all that exposed really when it comes to advertising as a company. Only about 20% of our revenue comes from advertising. So when you think of this company and you think about recession, the impact from an advertising perspective is not all that significant.

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**Lowell Singer** – *Senior Vice President, Investor Relations, The Walt Disney Company*

Thanks, Anthony.

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**Anthony DiClemente** – *Analyst, Lehman Bros.*

Thanks.

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**Lowell Singer** – *Senior Vice President, Investor Relations, The Walt Disney Company*

Operator, next question, please.

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**Operator**

Your next question comes from the line of Rich Greenfield with Pali Capital.

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**Rich Greenfield** – *Analyst, Pali Capital*

Couple questions. When you look back to the last recession in the early '90s, you obviously had a lot fewer hotel rooms at value prices. I was wondering if you could give us some sense of how you think the mix of your overall hotel pool insulates you, or



at least lessens the impact from a potential recession in the U.S., and maybe give us some sense of what the actual price point mix now is versus what it might have been back then. Two, Anne Sweeney, at the analyst meeting last year I think said that you had sold 6.5 million DVDs for *High School Musical 1* by the time of the analyst meeting worldwide. I was wondering, for *High School Musical 2*, standing in early February, where that number would stand on a relative basis? And then just a housekeeping point, the press release said you had a non-recurring gain in the investment income line. Just wondering if you could size those for us and what that might have impacted earnings by on an after-tax basis. Thanks.

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**Tom Staggs** – *Senior Executive Vice President and Chief Financial Officer, The Walt Disney Company*

With regard to the value priced hotels at the parks, I think, Rich, you raise a good point. It is a broader hotel room base. We do have more inventory of affordable rooms and as importantly, I think, two other things. One, we have introduced this really value based pricing where we've got a family of four ability to be at the park for I think right now, it's around \$1,600 for a week at the park with hotel and a meal plan, et cetera. And that's a very strong value and a great alternative for folks and we've had a really good response to that. We also have a very sophisticated yield management system that handles all of the inventory of our rooms at the parks and that really stands us in good stead to take advantage of what's there in terms of demand at the highest possible ADR, and we're extraordinarily pleased with sort of where we see as a business, both in terms of our consumer appeal and then also our ability to respond and to have a broad-based business and inventory of rooms to respond with.

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

On the second question, *High School Musical 2* worldwide will sell roughly the same number of DVDs as *High School Musical 1*. And the third part of the question was about investment income.

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**Tom Staggs** – *Senior Executive Vice President and Chief Financial Officer, The Walt Disney Company*

We have a separate company that does venture capital investing for us called Steamboat Ventures. They've been active since about 2001. They invest in strategically relevant companies and actually one of their primary missions is to make sure that we are really understanding exactly what's going on in the entrepreneurial community around our businesses and it's been a nice strategic boon from that standpoint. Obviously we also seek to make money from it and the returns have been quite nice. This last quarter they realized a return on an investment in a company called Quigo that was purchased. It's an ad serving and optimization firm that actually, in the early going, helped to



stimulate our thinking about how we approach that business and so it was a win from both sides. But that's really what was driving that gain.

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**Rich Greenfield** - *Analyst, Pali Capital*

How much actually was that gain, so we can actually look at what was kind of organic earnings?

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**Tom Staggs** - *Senior Executive Vice President and Chief Financial Officer, The Walt Disney Company*

The gain on the Quigo piece was \$37 million in the quarter.

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**Rich Greenfield** - *Analyst, Pali Capital*

And then the Delta piece?

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**Tom Staggs** - *Senior Executive Vice President and Chief Financial Officer, The Walt Disney Company*

It was about \$18 million. Those are both pre-tax, by the way, Rich, in terms of gain.

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**Rich Greenfield** - *Analyst, Pali Capital*

Thanks so much.

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**Lowell Singer** - *Senior Vice President, Investor Relations, The Walt Disney Company*

Okay. Operator, we'll take the next question, please.

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**Operator**

Next question comes from the line of Jason Helfstein with Oppenheimer and Company.

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**Jason Helfstein** - *Analyst, Oppenheimer & Co.*

Thanks. Two questions. One, is there a way you could give us the growth rate of affiliate fees in the quarter, I guess adjusting for the higher deferrals. And then second, clearly it's impressive what you're doing with these franchises. As we all begin to think about how to try to model that, I guess, longer term, when you used to talk about the syndication opportunities you were able to quantify it in the billions of the long-term



opportunity. How do you think we should think about, kind of, *Hannah Montana*, *High School Musical*, *Cars*, what that opportunity is longer term for the company? Thanks.

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

Jason, we don't break out affiliate fee growth in the quarter. So I think we can't answer that question. Although I think it's important to point out that there were affiliate fees deferred at ESPN, a substantial amount, actually.

On the second part of your question, the whole concept of franchise management is pretty interesting because you have to think about it across so many businesses. To give you a for instance, we've been investing significantly in self-published video games. And our initial foray into it was pretty mixed in terms of how we branded games, Disney and non-Disney, and then we decided that we can drive much more value when we create Disney product than when we create non-Disney. And while there were a lot of doubters in the video game space, what we have discovered is the growth in video games that we are seeing is in one, demographics, and that is that you have more younger people playing video games particularly on platforms like the Wii and the Nintendo DS, and you also have more girls playing, and that plays right into our strategy. And so when you think *High School Musical* and *Hannah Montana*, you suddenly can envision a franchise that is living in many more places than just say the syndicated world of the past. The other thing that we have also found is that music has really found a home in the video games business.

That's certainly clear with some of the properties that are out there from other companies, *Rock Band* would certainly be one of those, *Guitar Hero* the other. But with *High School Musical*, *Hannah Montana*, at some point, the Jonas Brothers, in effect our music strategy becomes leverageable across multiple businesses too. So what we're trying to do is, essentially is identify something that has franchise potential and then immediately invest to mine that potential creatively and then to leverage it financially in many, many places. And we're finding that those many places are many more than we used to see. Online virtual world is another example. Think *Cars*. You have to think not just theme parks and movies and videos, but you have to think an online virtual world as well as the other typical businesses like video games and other merchandise. So, just thanks to technology, when you have a successful franchise and you have the ability as a company to invest in basically self-created product, you can leverage that in many more ways than we ever envisioned in the past and we're structured as a company to do just that.



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**Tom Staggs** – *Senior Executive Vice President and Chief Financial Officer, The Walt Disney Company*

Jason, back to your first question, as Bob said, we don't quote affiliate growth rates. The increase in affiliate revenues in the quarter was \$138 million, and as we mentioned, we deferred \$53 million more in this first quarter than we did in the prior quarter, if that's helpful. As Bob said, we don't quote rates and the rates vary by individual channels so they're not necessarily that useful anyway.

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**Jason Helfstein** – *Analyst, Oppenheimer & Co.*

Thank you.

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**Lowell Singer** – *Senior Vice President, Investor Relations, The Walt Disney Company*

Thanks, Jason. Operator, next question, please.

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**Operator**

Next question comes from the line of Jason Bazinet with Citi.

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**Jason Bazinet** – *Analyst, Citigroup*

Thanks so much for taking the question. Just a quick question, factually, in terms of minority interest in ESPN profitability. Is it generally correct that you can take the minority interest, subtract the total minority interest, subtract Jetix, to get a sense of ESPN's profitability? Second, is it directionally correct that ESPN as a share of your total profits has dropped fairly dramatically over the last four or five years, given the growth of the other segments?

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**Tom Staggs** – *Senior Executive Vice President and Chief Financial Officer, The Walt Disney Company*

There's more going on in minority interest than what you cited. There's Jetix, there's Disneyland Paris, there's Hong Kong Disneyland and so there's a fair amount going on in that line. So I wouldn't necessarily encourage you to try to use it that directly to estimate ESPN profitability. ESPN's profitability, if I go back five years or so ago, actually I think that its profitability as a percent of total company has increased appreciably over that period of time.



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**Jason Bazinet** – *Analyst, Citigroup*

So it's actually gone up?

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**Tom Staggs** – *Senior Executive Vice President and Chief Financial Officer, The Walt Disney Company*

Yes.

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**Jason Bazinet** – *Analyst, Citigroup*

Okay. Thank you.

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**Lowell Singer** – *Senior Vice President, Investor Relations, The Walt Disney Company*

Thanks, Jason. Operator, next question, please.

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**Operator**

Your next question comes from the line of Michael Morris with UBS.

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**Mike Morris** – *Analyst, UBS*

Hi, thank you. Couple questions back to the Broadcasting segment. First of all, the television programming sales on DVD and into syndication have been more important to you in the last few years. Can you give us a little feel for the risk, given a lack of content in the pipeline at this point? Are these items that are going to be pushed out for a complete year? Is there a way to recapture it? And in particular, I'm thinking about your syndication sales in '09 for a couple of key programs. Second of all, you talk about scatter pricing strength in the quarter. But also it seems that ratings have been down pretty significantly across all broadcast networks. Can you talk about the dynamic there? Do you have make goods that are kind of offsetting some of that strength? How sustainable is this model going forward? Thank you.

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**Tom Staggs** – *Senior Executive Vice President and Chief Financial Officer, The Walt Disney Company*

I would say with regard to the pipeline on television programming, we still have a very strong pipeline, we've talked about it in previous calls. As to the exact timing of the availability of that pipeline, of course, that can be impacted by the timing of when we make episodes. But the strongest of the shows that fed into that pipeline, I still expect



those shows to be strong and their appeal in terms of both international syndication and domestic syndication I think is intact. So we feel reasonably good about that. Individual timing of shows, there, it's a little bit hard to predict until we know exactly when the strike might end and how quickly people will get back to work, and what the timing is around that.

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

We also haven't made decisions if it does end, how many shows we will produce. That's effective this season. Because there will be a lag time in terms of when these shows will be available, you start backing into next year or butting up against next year. We haven't made any of those decisions yet.

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**Tom Staggs** – *Senior Executive Vice President and Chief Financial Officer, The Walt Disney Company*

As you would expect and Bob alluded to, the ratings, as there's been less original programming on air, has come down. It's come down for virtually all the networks. Right now, from a make good standpoint, as I sit here today I have fewer make goods than I had a quarter ago. We're in good shape. And I don't think you're going to see an impact from make goods. As I mentioned earlier, we've got a very strong scatter market which bodes well.

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**Mike Morris** – *Analyst, UBS*

Thank you.

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**Lowell Singer** – *Senior Vice President, Investor Relations, The Walt Disney Company*

Okay. Thanks, Mike. Operator, next question.

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**Operator**

Your next question comes from the line of Doug Creutz with Cowen and Company.

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**Doug Creutz** – *Analyst, Cowen & Co.*

Thanks. You have a movie coming out later this year called *Bolt*. And I was wondering if you could say how involved John Lasseter and Ed Catmull have been involved in the production of that movie and do you think that that's likely to, in terms of performance,



act more like a Pixar movie or more like some of the CG movies you've had out in the last couple years.

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

Not going to predict performance but John and Ed have been extremely involved in *Bolt*. This is the first movie from Disney Animation that will really have been produced under their leadership and we have a good team under them that are getting a fair amount of direction from John and company. But *Bolt* will be the first one I guess that the world can use to gauge the impact of that leadership on Disney Animation and so far, so good. We think the movie is in excellent shape and we're very excited about it. It comes out in the end of the calendar year.

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**Tom Staggs** – *Senior Executive Vice President and Chief Financial Officer, The Walt Disney Company*

So fiscal '09.

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**Doug Creutz** – *Analyst, Cowen & Co.*

Great. Thank you.

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**Lowell Singer** – *Senior Vice President, Investor Relations, The Walt Disney Company*

Thanks, Doug. Operator, next question, please.

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**Operator**

Your next question comes from the line of Tuna Amobi with Standard & Poor's Equity.

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**Tuna Amobi** – *Analyst, Standard & Poor's*

Thank you very much. The Consumer Products business was certainly a nice surprise to us. So my question is how much of that is a function of some of these new franchises that you put out, and how much of that could be a permanent shift in that business model? And related to that, Tom, how much of the \$175 million development spending was accrued in the first quarter, as opposed to the latter part of the year? And separately, I think this is the first time in a while I've heard some good vibes coming out of Hong Kong parks. So the question is, what are the major changes that you've made in that park and do you believe that the park has turned a corner for good and



separately also, the main land park in China, if you could update us as well on that timing?

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

You just asked about six questions in one.

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**Tuna Amobi** – *Analyst, Standard & Poor's*

I'm sorry, Bob.

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

Your first question on Consumer Products, a lot of the growth in the first quarter consumer products came from new franchises *High School Musical*, *Hannah Montana*, *Cars*, but we also had significant success with traditional franchises, Mickey and Pooh and Princesses. But I think it bodes very well, if you were to ask Andy Mooney about his business he would immediately say that just a few years ago, as I mentioned in my opening remarks, he could rely on two to three franchises. And now, he can rely on multiple franchises across the globe. And that obviously, I think, bodes very well for the near future for Consumer Products. Tom will answer some of the tougher questions. But your question about Hong Kong, Hong Kong obviously showed significant improvement last quarter. We were very, very bullish about the Chinese New Year, which is basically this week, but there's been horrible winter weather conditions across China, particularly southern China, and it's possible that could put a bit of a damper on our results around Chinese New Year.

What we're seeing in terms of success in that park, Tom mentioned this in some of his remarks, is that events seem to drive a lot of business to the park and we discovered that with Halloween and, basically learning from that lesson, have created a number of events at the park and that's had a dramatic impact on increases in attendance, both from local Hong Kong residents and from people from the mainland, notably southern China. We've also done I think a lot of very, very good work, working with the travel trade, particularly the trade that brings mainlanders over to make sure that when people visit Hong Kong, part of their itinerary is visiting the Hong Kong park, and we added nicely to the menu of attractions at the parks, so far in a small way, but that's going to ramp up. We opened *Small World* this year as a for instance, and we have plans in place to continue to invest more in our attractions menu.

I think the combination of that, improved marketing and an events strategy will put Hong Kong Disneyland on a very, very positive path. We're not making any comments



about the potential development of a park on the mainland. There's been some press about it out of the mainland, but we don't have any news to report, nor do we have anything to say about it further.

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**Tom Staggs** – *Senior Executive Vice President and Chief Financial Officer, The Walt Disney Company*

Tuna, on the question with regard to development spending at interactive games, last year we spent about \$130 million on development. We said we were going to ramp that up this year. One of the things that Bob and I have been chatting about with Andy Mooney is the pace of that ramp-up, given the success, and whether or not there are opportunities to invest a little bit more. We do expense development spending as it's incurred and so if we do ramp up, it would be seen in this year. I would say that you should expect development spending at video games at this point in the neighborhood of about \$180 to \$200 million for fiscal 2008.

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**Tuna Amobi** – *Analyst, Standard & Poor's*

How much of that was in Q1, Tom?

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**Tom Staggs** – *Senior Executive Vice President and Chief Financial Officer, The Walt Disney Company*

A commensurate part of it was in Q1. Q1 development spending was up I believe 70% versus the prior year. So that's nearly \$20 million in additional development spending.

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**Tuna Amobi** – *Analyst, Standard & Poor's*

Okay. Thanks.

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**Lowell Singer** – *Senior Vice President, Investor Relations, The Walt Disney Company*

Okay. Thanks, Tuna. Operator, we have time for one more question.

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**Operator**

Your last question comes from the line of David Miller with SMH Capital.



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**Dave Miller** - *Analyst, SMH Capital*

Hey guys. Congratulations on the stellar results. Two quick ones. First of all, Tom, if you mentioned the advertising sales growth number at ESPN for the quarter, I didn't hear it, so if you could disclose that, that would be great. And then also, Bob, more of a philosophical question for you. If the strike were to end this week as many newswires have been reporting and speculating, what exactly, in your opinion, just theoretically, would that do to the upfront process. Would it push negotiations back, more towards kind of the mid, late-summer time frame, and would we be looking at potentially a delay in the start of the '08-'09 broadcast season? Or, if the strike were to end later this week and everything gets back to normal, do you see the upfront process pretty much occurring as normal as what happened last year? Thanks.

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**Bob Iger** - *President and Chief Executive Officer, The Walt Disney Company*

I think in terms of the upfront, advertisers are probably going to demand some kind of process in the spring, basically under normal time circumstances. And I see us participating fairly aggressively in that process. That's the process of selling a significant amount of upfront time. How we present the schedule, and what schedule is presented is still open for discussion. I noted some comments about that yesterday from another media company. I will say that, personally, I think the matter that the upfront or the schedule is presented with the sort of bells and whistles on a big stage and a fair amount of hors-d'oeuvres feels like a bit of an anachronism to me. But those decisions will ultimately be made by the network and what they feel is right in terms of the best approach to marketing their schedule to advertisers and to the press.

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**Tom Staggs** - *Senior Executive Vice President and Chief Financial Officer, The Walt Disney Company*

Dave, with regard to advertising growth at ESPN, bear in mind that we had NASCAR coming on this year versus not as much the last year or not in the year last year. But if you back that out, you're still looking at low double-digit percentage growth in advertising revenue at ESPN. It was a little better rate than that if you include NASCAR.

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**Dave Miller** - *Analyst, SMH Capital*

Thank you.



**Lowell Singer** – *Senior Vice President, Investor Relations, The Walt Disney Company*

Thanks everyone for joining us today. I'm Lowell Singer and I approve the following message. I want everyone to note that the 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 may constitute forward-looking statements under securities law. We make these statements on the basis of our views and assumptions regarding future events and business performance at the time we make them and we do not undertake any obligation 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 factors contained in our annual report on Form 10-K, and in our other filings with the Securities and Exchange Commission. This concludes today's first quarter call. Thanks.

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Management believes certain statements in this call may constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. 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 or asset acquisitions or dispositions), as well as from developments beyond the Company's control, including:

- adverse weather conditions or natural disasters;
- health concerns;
- international, political, or military developments;
- technological developments; and
- changes in domestic and global economic conditions, competitive conditions and consumer preferences.

Such developments may affect travel and leisure businesses generally and may, among other things, affect:

- the performance of the Company's theatrical and home entertainment releases;
- the advertising market for broadcast and cable television programming;
- expenses of providing medical and pension benefits;
- demand for our products; 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 September 29, 2007 and in subsequent reports on Form 10-Q under Item 1A, "Risk Factors".

Reconciliations of non-GAAP measures to closest equivalent GAAP measures can be found at [www.disney.com/investors](http://www.disney.com/investors).