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The Walt Disney Company
Q1 FY14 Earnings Conference Call

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Disney Speakers:

Bob Iger

Chairman and Chief Executive Officer

Jay Rasulo

Senior Executive Vice President and Chief Financial Officer

Moderated by,

Lowell Singer

Senior Vice President, Investor Relations

PRESENTATION

Operator

Welcome to the Q1 2014 Walt Disney Company earnings conference call. My name is Robert, and I will be your operator for today's call. At this time, all participants are in a listen-only mode. Later we will conduct a question and answer session. Please note that this conference is being recorded.



I will now turn the call over to Mr. Lowell Singer, Senior Vice President of Investor Relations. Mr. Singer, you may begin.

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

Thanks, operator, and good afternoon everybody. Welcome to The Walt Disney Company's first quarter 2014 earnings call. Our press release was issued about 45 minutes ago and is available on our website at www.disney.com/investors. Today's call is also being webcast, and the webcast and transcript will also be available on our website.

Joining me for today's call in Burbank are Bob Iger, Disney's Chairman and Chief Executive Officer, and Jay Rasulo, Senior Executive Vice President and Chief Financial Officer. Bob will lead off, followed by Jay, and then, of course, we will be happy to take your questions.

So with that, let me turn the call over to Bob, and we will get started.

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

Thanks, Lowell.

Good afternoon. We had a very strong first quarter, with earnings per share up 32%, when adjusted for comparability, and operating income up double digits across all business segments.

Our Parks and Resorts had a great quarter, setting attendance records at Walt Disney World, Hong Kong Disneyland and Tokyo Disney Resort. The popularity of *Disney Infinity* drove Interactive's profitability for the second consecutive quarter. The demand for *Frozen*, *Star Wars* and Disney Junior merchandise added up to a great quarter for our Consumer Products division. And Media Networks delivered 20% growth in operating income, led in part by higher affiliate and advertising revenues at ESPN.

While all our operating units delivered solid results this past quarter, we are particularly pleased with the performance of our studio, driven by the enormous success of Disney Animation's *Frozen*, Marvel's *Thor: The Dark World*, and Walt Disney Studios' *Saving Mr. Banks*, and that's what I want to focus on today.

As we have articulated in the past, our studio strategy is to essentially make three types of movies: big releases with broad appeal and franchise potential under the Disney, Marvel and Lucasfilm brands; animation, which is the heart and soul of this company and is stronger than ever under the Pixar and Disney brands; and lower-budget, original films that entertain audiences and enhance the Disney brand through exceptional storytelling.



In today's global marketplace big, franchise films play extremely well, particularly those with either action or family appeal. In fact, of the world's top 20 highest grossing movies of all time, 19 are franchise drivers and almost half of those carry the Disney, Pixar, Marvel or Lucasfilm brand. With all of the creative brands that are now part of our company, as well as the thousands of characters and phenomenal storytelling behind them, we believe we are uniquely positioned to maximize the ever expanding global movie market.

Our success with Marvel is a great example. There is no question that the phenomenal success of *Avengers* strengthened the *Avengers* franchise and is now driving subsequent *Avengers*-based character films to stronger box office performance. *Iron Man 3* topped \$1.2 billion in global box office, far exceeding the \$632 million for *Iron Man 2*. Likewise, *Thor: The Dark World* has delivered more than \$635 million in global box office versus \$450 million for the first *Thor* movie.

We expect this trend to continue when *Captain America: The Winter Soldier* opens on April 4th in the United States. And, having seen it a few times already, I can tell you this sequel takes the *Captain America* story to an incredible new level, and I think audiences are going to be more invested in this character than ever before. Because all Marvel content and characters exist in a connected universe, this movie also sets some critical events in motion that will lead directly into *Avengers: Age of Ultron*, and some facets of the story in *Captain America: The Winter Soldier* will also be reflected in upcoming episodes of Marvel's *Agents of S.H.I.E.L.D.* on ABC.

In August, we'll release *Guardians of the Galaxy*, introducing audiences to a new cast of great Marvel characters.

As we announced last quarter, *Star Wars: Episode VII* premieres in December of 2015, and it looks to be one of the biggest movies we've ever released. Nothing I say here today could ever capture or convey the magnitude of global anticipation for this movie. So I'm just going to say the excitement is fully justified, and leave it at that.

We're also very pleased with the work being done at Walt Disney Studios, blending their own form of tentpole films with lower-budget, great original films, like *Saving Mr. Banks*, that do so much to enhance the Disney brand image. And we're excited about our upcoming slate including *The Muppets: Most Wanted*; Angelina Jolie as *Maleficent*; John Hamm in *Million Dollar Arm*; George Clooney in *Tomorrowland* -- which is directed by Brad Bird -- and Disney's first-ever live-action *Cinderella*.

Lastly, Animation is one of our biggest priorities because it's one of our most important creative businesses. With Pixar and the creative resurgence at Disney Animation, we now have the two strongest animation brands, generating some of the greatest creative work in the industry -- with *Frozen* being the most recent example.



Frozen has now surpassed *The Lion King* to become the most successful Disney Animation movie of all time. It's exceeded \$870 million in global box office, before even being released in two of our most important markets. It just opened in China in the last 24 hours and will open in Japan on March 15th.

Frozen is not only a tremendous financial success, it's also an incredible creative triumph -- earning the Golden Globe for best animated feature film of the year, as well Oscar nominations for Best Animated Film and Best Song. It also just picked up five Annie Awards for outstanding achievement in animation.

Two months after opening, *Frozen* is still big in theaters -- it was second in U.S. box office just this past weekend. Additionally, the soundtrack is at the top of the charts and high demand for *Frozen* merchandise continues to drive strong retail sales. In the tradition of *The Lion King* and *Beauty and the Beast*, Disney's *Frozen* will also be going to Broadway.

When we acquired Pixar in 2006, our goal was to not only support and benefit from the continued creative and commercial success of Pixar, but to rejuvenate Disney Animation under new leadership. Accomplishing this was not only a priority, but something that is and will continue to drive value across the company for years to come.

We congratulate all those involved with *Frozen*; its success speaks volumes about the future of animation at our company.

We're obviously proud of our performance this quarter, and it's very satisfying to see long-term strategies come to fruition, delivering results and driving greater value for our company and shareholders.

I'm going to turn the call over to Jay to talk about the details of our quarterly performance and will be back for questions later on. Jay?

Jay Rasulo – Senior Executive Vice President and Chief Financial Officer, The Walt Disney Company

Thanks, Bob and good afternoon everyone. We are pleased with our first quarter results.

Segment operating income was up 27% on revenue growth of 9%. The strong financial performance was broad-based, as each segment posted double-digit growth in operating income and margin expansion compared to prior year. I think once again this quarter demonstrates that our investment strategy continues to create value.

Media Networks delivered another great quarter of financial performance led by Cable Networks, which generated an impressive 34% increase in operating income driven by growth at ESPN and higher equity income. This more than offset a decline in operating income at Broadcasting.



Growth in ESPN's operating income was due to higher affiliate and advertising revenue. ESPN also benefitted in the quarter from the absence of losses at our ESPN UK business, which was sold in the fourth quarter last year. Programming costs at ESPN were comparable to prior year as contractual increases for the NFL and college football were offset by the absence of costs for UK sports rights.

During the first quarter, ESPN deferred 18 million dollars less in affiliate revenue than last year. As we look to the second quarter, we expect ESPN to defer approximately 75 million dollars less in affiliate revenue than last year.

Ad revenue at ESPN was up 10% in the first quarter due to higher rates and an increase in units sold, partially offset by lower ratings. So far this quarter, ESPN ad sales are pacing up slightly despite the impact of the Winter Olympics.

Over the last couple of years we have provided insight into our Cable affiliate revenue growth on an aggregate basis. Given some of the recent business model changes internationally and the impact of foreign exchange rates, we think it might be more helpful to break out the domestic affiliate growth as it constitutes the majority of our affiliate revenue. As such, our domestic cable affiliate revenue growth was up high single digits in the quarter. Adjusted for the timing of deferred revenue at ESPN, growth in domestic cable affiliate revenue was still up high single digits. It's also important to note that the growth in Q1 reflected the last quarter in which year-over-year comparisons were aided by the new affiliate deals that took effect in the second fiscal quarter of 2013.

Equity income was up in the quarter due to higher income from our investment in A&E Television Networks, as well as the absence of equity losses from our investment in the ESPN Star Sports joint venture, which we sold in the prior year.

At Broadcasting, lower operating income was driven by higher programming expenses at the ABC Network due to program write-offs as well as a contractual rate increase for *Modern Family*. Program sales in the quarter were down compared to last year when we sold *Revenge* and *Army Wives*. Ad revenue at the Network was up low-single digits in the quarter as a result of higher rates and increased units sold, partially offset by lower ratings. Quarter-to-date scatter pricing at the ABC Network is running more than 10% above upfront levels.

At Parks and Resorts, growth in operating income was once again due to strength at our domestic operations, as investments at Walt Disney World and the Disneyland Resort continue to pay off. Results at our international operations were up modestly over the prior year, with growth at Hong Kong Disneyland partially offset by a decline at Disneyland Paris. Total segment margins were up 170 basis points in the first quarter.

Growth in operating income at our domestic operations was driven by higher guest spending at Walt Disney World and the Disneyland Resort, partially offset by higher costs primarily related



to the continued rollout of *MyMagic+*. For the quarter, per capita spending in the parks was up 8% on higher ticket prices and food and beverage spending. Per room spending at our hotels was up 5%. Attendance at our domestic parks and occupancy at the hotels were comparable to the first quarter last year, in which we saw increased visitation due to the opening of *Cars Land* at Disney California Adventure and the grand opening of the *Fantasyland* expansion at Walt Disney World, the last phase of which we'll complete in a few months with the launch of *Seven Dwarfs Mine Train*.

So far this quarter, domestic resort reservations are pacing up 7% compared to prior year levels, while booked rates are up 2%.

As Bob said, Studio Entertainment had a great quarter as a result of the global box office success of both *Frozen* and *Thor: The Dark World* compared to *Wreck-It Ralph* and no Marvel title in the first quarter last year.

Studio operating income was up 75% driven by increases in our theatrical business, and to a lesser extent an increase in home entertainment due to lower distribution and marketing costs, partially offset by lower unit sales.

At Consumer Products, operating income increased 24% and margins were higher by 400 basis points, reflecting strength in our merchandise licensing business and continued improvement at retail. Growth in licensing was driven by the inclusion of Lucasfilm's results, as well as higher revenue from *Planes*, Disney Junior properties and *Monsters*. On a comparable basis, earned licensing revenue in the first quarter was up 5% versus last year and that follows the 9% growth in earned revenue in the fourth quarter.

We continue to be pleased with the results of our retail business, specifically in North America where comp store sales were up due to strong sales of *Frozen* and Disney Junior merchandise, demonstrating the power of our franchises to drive our retail businesses, as well as the Disney Store's ability to support a company franchise. The North American stores have now posted comp store sales growth for eight consecutive quarters.

At Interactive, we had another profitable quarter driven primarily by significant improvement in Core Games and, to a lesser extent, continued growth in our Japan mobile business. Higher operating income in Core Games was due to strong sales of *Disney Infinity* compared to *Epic Mickey 2* last year.

As we look at the second quarter, I want to point out that the Easter holiday will fall entirely in Q3 this year, whereas one week of the two-week holiday period fell in Q2 last year. We estimate the impact of this one-week shift on Parks results to be roughly 45 million dollars in operating income shifting out of Q2 and into Q3.



At Interactive, we expect quarterly results to be somewhat lumpy throughout the year as they will largely follow the timing of key game releases. While the segment posted an operating profit in Q1, we expect an operating loss in the second quarter that's comparable to the loss in Q2 last year.

We significantly increased our pace of share repurchase during the first quarter by buying back 25.3 million shares for about 1.7 billion dollars. Fiscal year-to-date, we have repurchased 33.7 million shares for 2.3 billion dollars.

Overall, we feel great about the start of the fiscal year. Our financial position is strong, and given recent and ongoing investments, we remain confident in our ability to drive growth and thus create value for our shareholders.

And with that, we are now ready to take your questions.

Q&A

Operator

(Operator Instructions). Alexia Quadrani, JPMorgan.

Alexia Quadrani – Analyst, JP Morgan

Frozen seems to have had a really incredible staying power at the box office, still doing so well domestically many weeks after its initial release. Can you help us frame, I guess, both the benefit we may see to the Studio in the March quarter from these box office results but also home video release, I believe, in the middle of March, and maybe the longer-term benefits both in film and maybe Consumer Products?

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

Well, we won't give you specific numbers Alexia, but obviously the film's success continues in the quarter that we are currently in, although it was released in November, Thanksgiving weekend.

So the box office is still growing, both domestically and internationally. It was second this past weekend with our sing-along, and internationally it continues to grow. We just opened in China within the last 24 hours, and we open in Japan March 15th.



We had a mammoth opening and great success in South Korea. It's actually the biggest animated film ever in South Korea, box office above \$45 million. So we think that bodes well for both the Asian markets that are just opening or will open.

It's continuing to drive sales in our stores and across licensing, so it will have an effect there. Clearly, we are having success on the music front, albeit small from a numbers perspective. And this has real franchise potential. So just beyond the quarter that we are in, expect to see not just with new product that we create from *Frozen*, but expect to see continued interest in this and continued impact on the bottom line for quite a while.

Alexia Quadrani – *Analyst, JP Morgan*

And just a related follow-up, if I may -- just on the Consumer Products business, can you size just roughly how big the business is in China, and can that business in general or should that business in general -- post a Shanghai opening -- really have a much bigger opportunity?

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

Consumer Products in China is still somewhat small for us. We don't have stores. We have some licensing. But by and large, the numbers are fairly modest, but they are growing. We do believe that Shanghai will have an impact on the Disney brand in China, which should affect both Consumer Products and -- well, actually, movies and television post-opening. But we have no idea what that will be.

But clearly, it is a growth market for us. It has become one of the largest markets in the world from a movie perspective because of all the added screens that have gone into China. The park will have, obviously, a big effect on the future of our business there. And so we continue to believe and are very bullish in that market.

Operator

Doug Mitchelson, Deutsche Bank.

Doug Mitchelson – *Analyst, Deutsche Bank*

Thanks so much. One for Bob and one for Jay. Bob, I would think there's a natural limit to the number of brands each business or one company could support. So maybe it's an odd question, but I'm curious if you see any challenges managing this many franchises, and any comment about the Company's ability to build more franchises at this point?



And Jay, did affiliate revenue benefit in the quarter from a higher accrual rate for DISH even though the DISH deal wasn't done, and do you plan on ever signing the DISH deal?

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

I think we do plan on signing a DISH deal. Look, the key brands of the Company are ESPN, Disney, obviously Marvel, Pixar, Lucas, ABC. We are not really looking to build additional brands right now either organically or through acquisition. But these brands all have a lot of growth potential, both by mining them better across platforms and across the world, but also by creating new franchises within each brand. So we have already demonstrated, for instance, under Marvel, just how strong the *Avengers* franchise is. And, as my remarks indicated, what impact that has on the individual components -- *Iron Man, Thor, Captain America*, specifically. We are trying and believe we have a real opportunity to create other franchises under Marvel. *Guardians of the Galaxy* is the next one up, which is for next summer, the coming summer. So we think that the opportunity for franchise building, given all the characters and story telling capabilities of these businesses, are great for the Company.

We don't really have a problem managing the array of brands that we have. We actually think that we are in quite an enviable position. We met recently just to look at our movie slate going forward, and everything seems to be fitting in nicely. Meaning we don't seem to be bumping up against one another within the Company, and we think that we really are well-positioned to take advantage of the marketplace without really creating traffic jams.

Doug Mitchelson – *Analyst, Deutsche Bank*

Okay, great.

Jay Rasulo – *Senior Executive Vice President and Chief Financial Officer, The Walt Disney Company*

Relative to DISH, Doug, I'm not going to comment on the financial terms of that renewal. But, as Bob has said before, we continue to extend our agreement with them as we continue to have productive, forward-looking conversations that we believe will result in us moving forward with them for the long-term.

Doug Mitchelson – *Analyst, Deutsche Bank*

Yes, Jay, specifically I was just wondering if the December quarter benefited from your estimates as to what the new rate card would be. So, in other words, has the benefit of a DISH renewal already begun, or is it delayed until a deal is actually sign?



Jay Rasulo – *Senior Executive Vice President and Chief Financial Officer, The Walt Disney Company*

No, I understand your question, but I'm not going to give any guidance on that.

Doug Mitchelson – *Analyst, Deutsche Bank*

Oh, I see. All right. Thank you.

Operator

Michael Nathanson, MoffettNathanson.

Michael Nathanson – *Analyst, MoffettNathanson*

I have one for Jay and one for Bob. Hey, Jay, thanks for giving the pace on the affiliate revenue growth for domestic. That's one of my go-to questions, so let me ask this question. There's a real lumpiness in Cable Networks expenses the past couple quarters. And if our math is right, this quarter costs were flat for cable in general. So can you talk a bit about expectations this fiscal year for Cable expense growth and the phasing of that growth over the next fiscal year?

Jay Rasulo – *Senior Executive Vice President and Chief Financial Officer, The Walt Disney Company*

Sure. So Cable programming expenses, we expect them to grow in the high-single digits for the entirety of fiscal 2014. But -- and of course that's mostly driven by ESPN -- that will be very back-loaded this year, Michael. And the reason for that is basically the kick-in of a series of new deals. Just to tick through them, Major League Baseball, their contract will kick in in Q3 and Q4. The NFL contractual increase in Q1 2014 and the new deal in Q4 2014. World Cup, which -- you know when that is, in our third fiscal quarter. And college football, Q1 2014 and Q4. And the launch of the SEC network, which will begin in Q4 of 2014. So most of those increases will occur in Q3 and Q4.

Michael Nathanson – *Analyst, MoffettNathanson*

Okay. And then for Bob, you guys have talked about the cost of *MyMagic+* this quarter. But can you give us some indications of how the rollout is going on, the revenue and customer behavior. Because per caps is really good this quarter, so what's going on with *MyMagic+*?



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

I can't quantify it from a financial perspective yet. It's still early, and we are still rolling out facets of it. What I can say is that what has been rolled out has been a real success, both for the guest and for us. So to give you a for instance, our Parks people in Walt Disney World believe during the peak holiday season that we were able to accommodate about 3,000 more additional guests in the Magic Kingdom per day, thanks to *MyMagic+*. One of the most attractive features and one that I think will have possibly the biggest benefit is the *FastPass+*, which is the ability to reserve three times on three attractions per day, either before you visited the park if you are a resort guest, or on the day that you enter the park if you are a same-day or a single-day ticket holder.

What we are seeing there is substantially higher utilization of that product among our guests than we saw with a traditional *FastPass*, by the way, by a wide margin. And since the goal of this was to make the guest experience better, enable the guest to experience more, to do so more efficiently, and essentially to be able to customize, we think that these are very, very good signs for us because clearly guest satisfaction is very, very important to the value equation for us, both how they spend their time when they are with us and a determining factor in terms of whether they come back.

So this is all very good. So I would say the biggest impact is, one, being able to accommodate more people, because it's just more efficient, and secondly, enabling guests to have a substantially better experience than they have had before because they are doing more.

Jay Rasulo – *Senior Executive Vice President and Chief Financial Officer, The Walt Disney Company*

Michael, since you mentioned the higher spending, we reported out 170 basis points of margin improvement this quarter. But actually, on an underlying operating basis, the quarter is actually even stronger than that because everything that Bob just mentioned -- we are in roll out. New initiatives are a drag on our margins, almost to the tune of 190 basis points. Now, there's some pension benefit in there that we've talked about before at the Parks, yes, but when you look at adding back 190 basis points to the 170 we reported, it is a very strong operating quarter for Parks and Resorts.

Michael Nathanson – *Analyst, MoffettNathanson*

Thanks, Jay. Thanks, Bob.

Operator

Jessica Reif Cohen, Bank of America Merrill Lynch.



Jessica Reif Cohen – Analyst, Bank of America Merrill Lynch

I guess, at this point, follow-ups to some of the questions asked. But, Bob, on the film strategy overall, you have such a unique strategy with these very definable brands and each studio, I guess, doing one to two films per annum. So I was just wondering what -- is there a benefit in terms of marketing costs because they are focused, you know what you are getting with Marvel or Pixar? And what is the ripple effect to other Disney businesses? Are you seeing -- obviously, there is a huge benefit in these franchises from home entertainment and Consumer Products -- but is there some way like a tie ratio that is like an improvement that you -- a relative improvement that you know is coming because of these kinds of films?

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

Yes. Well, there's definitely a benefit on the marketing front. When you put the name Marvel on a movie, we think that it gives us essentially a head start with the audience. Just, by the way, the anticipation of these films suggests that before we even go into the marketplace with a significant marketing spend, awareness among the potential audience is very, very high.

Now, that's probably the most obvious when it comes to *Star Wars*. But I've really been impressed with the early buzz that we are seeing for the Marvel films. *Captain America* is just huge. Now we are already in the marketplace with some marketing, but it has been relatively limited. We had a pre-game, for instance, in the *Super Bowl*. And yet the din, so to speak, and the interest in the *Captain America* film, which comes out here in the States April 4th, seems much louder than it would be for what I'll call a non-branded film.

And I believe that Marvel, Pixar, Disney, certainly Lucas-*Star Wars* all basically fall into similar categories. The ripple effect across all of our businesses from these films is already not only clear but pretty significant for us, and we believe it will only grow in significance. *Frozen* probably is a great example. Now, you have seen countless times over the past where a big franchise animated film has, really, the ability to lift a number of our businesses. We have gotten that over the last 10 years mostly from our Pixar films. The fact that we are starting to generate that from the Disney films -- *Tangled* is a great example of that, this is a huge example -- suggests that we are creating some momentum there.

And, of course, Consumer Products, obvious what we are doing with the bottom line, in terms of music, the impact of course, on home video -- all big. But, for instance, one of the characters in *Frozen* -- with the host of the Christmas show, the *World of Color* or the holiday *World of Color* version at California Adventure, before for the movie even opened, and there were huge crowds just to see the character, and the movie wasn't in the marketplace. Now, it ended up obviously helping us since the movie came out.



Now I think that there's -- I hate to use the word synergy -- maybe the better word is our ability to leverage the success of these characters and franchises, not just across the company but across the world is, I think, really significant and will only grow in significance.

Also, just a few other things -- and we announced an *Iron Man* attraction for Hong Kong. We've talked about developing more *Star Wars* presence at the park. We don't have specifics there, but I can tell you there's a lot of active development there, not just for domestic parks, but for some of our international locations. You will see *Frozen* in more places than you've certainly seen today. There's much more potential for Marvel in certain parks, too.

What we are doing on the Interactive front, I think, is also key. The fact that the *Infinity* game did so well is great in 1.0, but can you imagine what will happen when we fuel future iterations of that game with an even broader set of our stories and our intellectual property and our brands? There's just a lot. I know that I sound like a huge cheerleader for the Disney brands, but I obviously am feeling rather enthusiastic today because of these earnings but continue to feel very optimistic about the potential.

Jessica Reif Cohen – Analyst, Bank of America Merrill Lynch

No, it's obviously you have a very, very unique strategy in the film -- well, across all of your businesses -- but started by film. And then just my second question on *MyMagic+*, I know you said the benefit of guest satisfaction, but there must be some benefit to revenue to be able to swipe the bracelet and get out of one of the stores quickly. Is it showing up in the per cap revenues? And on the cost side, how much more is there to go? How much more is there to go on those?

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

Well, look, what we spend and how we account for it, I don't really want to get into that. There's some impact on the bottom line. But this is still a very new product. So we're not even close to being able to quantify it in a public sense. In fact, we are actually just learning more about how it's working and what impact it's having on our business today. I think you may be jumping to conclusions that the per cap spending was a direct result of *MyMagic+*. At this point, it's still a little bit early. It's possible it had some impact, but I can't say today that I know for sure that it did.

We do know, as I said, talking to George Kalogridis, who runs Walt Disney World, which I did this morning, that he really believes that he was able to accommodate 3,000 more people a day in the busiest period of the year in the Magic Kingdom, which is our number one park. That obviously has bottom line value, but we can't tell you what that is.



Jessica Reif Cohen – *Analyst, Bank of America Merrill Lynch*

Okay. Thank you.

Operator

Todd Juenger, Sanford Bernstein.

Todd Juenger – *Analyst, Bernstein*

A quick one for Jay and then one for Bob. Jay, just on A&E Television, last quarter I think we saw some surprising softness there. This quarter it looks to come through particularly strong. Can you just comment, like, is either quarter more emblematic of how that business is performing, or is the right answer somewhere in between? Thanks.

And then Bob, I just want to ask you, what do you think about what comes next at Interactive? You started talking about it a few minutes ago in your euphoric listing of all the great brand strength at Disney. But you have been marching with a goal of profitability there for a long time, and so you have gotten there. So what now? How big can that be? Are there more big product launches like *Infinity* to come, or do you just keep adding that for a while? Where do you want to take that business over the next X number of years? Thanks.

Jay Rasulo – *Senior Executive Vice President and Chief Financial Officer, The Walt Disney Company*

Thanks, Todd. Starting with AETN, I would look at last quarter more of an outlier than I would this quarter. They basically saw higher advertising revenue, driven by shows that you can probably tick off as easily as I can -- *Duck Dynasty, Pawn Stars, Ax Men, Dance Moms*. And on Lifetime, they've got some new scripted shows. So that's basically what is driving their success. They had some lower programming and marketing costs this quarter. But in general, we are incredibly happy with our investment in A&E and I think that you can continue to look for good things there.

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

On the interactive front, Todd, there will be new iterations of *Infinity*. What that game proved to us is the strength of that platform, basically the gameplay itself, which was great, and the fact that Disney characters, Disney intellectual property could work on that platform. So that's a big deal.

So what's next, of course, is new iterations of that, a 2.0, a 3.0, and mining a broader set of our more popular characters.



What we are doing, the rest of Interactive, you will see more licensing rather than publishing on the Console side, except for *Infinity*. We are also basically tracking what we are seeing in the industry, doing a fair amount of work in creating efficiencies and moving off of some of the more traditional platforms into the mobile space, mostly for social games and for other casual games. That's a big move for us, and some of the announcements that were made this week are indicative of a shift in strategy there to both reduce our spending in that space and to basically seek to grow the business where the customers or the users are, which is more on the mobile front. I think those are the two -- *Infinity* and the move to mobile basically for all our games -- are the two big trends you will see. Again, all with an eye toward not just being profitable but improving profitability, and no guidance there in terms of how profitable this could become.

Todd Juenger – *Analyst, Bernstein*

All right. Thank you for preempting my follow-up. Thank you, Bob.

Operator

Ben Swinburne, Morgan Stanley.

Ben Swinburne – *Analyst, Morgan Stanley*

Thank you. Jay, I want to come back to the ESPN comments you made, first on the expense side. I think you said high-single digit programming costs for the year for the Cable segment, so overall maybe mid-singles when you include SG&A. And I don't know if you'd want to quantify the UK impact on the revenue and OI line in the quarter, but just trying to get a better sense of the organic trends in the ESPN business.

Jay Rasulo – *Senior Executive Vice President and Chief Financial Officer, The Walt Disney Company*

Thanks Ben. On -- coming back to the UK question -- so you know that this was an unprofitable business for ESPN. In round numbers, the impact is about \$20 million of benefit to the quarter. And they had, in round numbers, \$65 million of affiliate revenue that flowed to that company, and obviously expenses were higher.

Ben Swinburne – *Analyst, Morgan Stanley*

Okay. And you had made a comment in your prepared remarks that you were reminding us this was the last quarter of benefiting from some renewals. Are you suggesting there should be a bit of a slowdown in the March quarter on domestic affiliate? I just wanted to ask you a follow-up on that point.



Jay Rasulo – *Senior Executive Vice President and Chief Financial Officer, The Walt Disney Company*

I am not going to give you a prediction on what those numbers will look like. I'm just saying that we, as of next quarter, we will be lapping those, I think it was five affiliate deals that were renewed in the prior year.

Ben Swinburne – *Analyst, Morgan Stanley*

Got it. And then just lastly, Bob, on the film business, one of the things that has been a headwind in the industry has been home video. And I'm wondering if you are feeling a little better about the outlook there, given some of the successes on digital and EST. Is it too early to get excited, or do you feel like maybe that business -- that part of the film business starts to grow from here?

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

Well, as least as we see it, if you look back on 2013 across the industry, you saw low-double digit declines, I think the number I heard was 13% on the physical sale side, and an increase of about 50% on the digital side, obviously on a much smaller base. The result of both was that home video was relatively flat, if not flat, for the year. I guess that is a good sign because the continued deterioration of the physical goods side at least is being mitigated somewhat by digital. We have been bullish about digital, particularly our prospects in digital, because we think we've got brand advantage there by creating destinations on digital platforms for our brands -- think Marvel, Disney, Pixar, Lucas as a for instance.

We think there will be opportunities either through current digital emporia or directly. But I don't -- I think it's still early in terms of just how significant that all could be. I think the bottom line is that we are making movies that we believe stand a better chance of doing well in the secondary markets than non-branded, non-franchised movies. Particularly movies that are directed at families.

Ben Swinburne – *Analyst, Morgan Stanley*

Thank you very much.

Operator

Anthony DiClemente, Nomura.



Anthony DiClemente – *Analyst, Nomura*

Thanks very much. A couple on ESPN. The 10% ad sales growth in the quarter, just wondering, Jay, maybe if you could talk about the drivers of that. You were able to grow ad sales through some of the ratings softness and I just wanted to hear about how -- the drivers there. And then looking to the next quarter, if we were to exclude the impact from the Olympics that you mentioned in your prepared remarks, what would the recurring ad sales growth at ESPN look like? Thanks and I have a follow-up.

Jay Rasulo – *Senior Executive Vice President and Chief Financial Officer, The Walt Disney Company*

Well, I hate to be tautological, but what was really driving the revenue growth are the rates that ESPN received for the ads it sold on its programming. And I think I also mentioned -- but if I didn't, I will tell you that the units were also up for the quarter. And that was somewhat offset by the lower ratings that you mentioned. So that was really the driver there.

Relative to the Olympics, we don't expect there to be a significant impact on our Networks from the Olympics period coming forward, nothing -- I would say *de minimis*, if I were to describe it.

Anthony DiClemente – *Analyst, Nomura*

Okay. And just a quick follow-up about the launch of the SEC network. We would love to hear a little bit more about -- if you could just remind us about the opportunity there in terms of ad sales growth, affiliate fee growth, and will there be any launch costs associated? I know you mentioned about the rights fees hitting, but are there any other launch costs that we should be mindful of as it pertains to the SEC network? Thanks.

Jay Rasulo – *Senior Executive Vice President and Chief Financial Officer, The Walt Disney Company*

Well, obviously there will be production costs associated with the SEC network in addition to the rights costs from the conference. But I don't like to predict out to the future in terms of what the rates and subscribers will look like as we ramp that up. Suffice it to say, we are extremely excited about this opportunity. Anyone who is at all interested in college football is well aware of the impact of the SEC, not only in the states that encompass the schools, but more broadly because of their powerhouse nature in college football. And we feel great about the opportunity to sign a long-term deal with them.

Anthony DiClemente – *Analyst, Nomura*

Okay. Thanks a lot.



Operator

David Bank, RBC Capital Markets.

David Bank – *Analyst, RBC Capital*

Thanks very much. This question is, I guess, for Bob. Bob, as improved VOD technology is being deployed and consumer behavior suggests it's poised to supplant DVR usage as the preferred method of time shifted viewing, I guess Disney and the rest of the existing TV ecosystem have the opportunity to out-Netflix Netflix and the SVOD guys by -- you could enable viewers to binge on stacked episodes of the best shows on television, and you don't need digital ad spot services.

But the issue with the opportunity seems to be that some of the contracts that you all have signed with these digital guys limits the amount of episodes you can stack on VOD. So I guess my question is, in the long run, do you think that structure needs to change? Would you like to see full season stacking on VOD? What is stopping that? How do you see it evolving?

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

I think that's a very good question. Our feeling on it is, first of all, that product is differentiated from Netflix and that Netflix, at least their off-network deal, is offering prior season shows, first of all, for a subscription. VOD largely has five – look-back on five episodes. The demand for essentially a full season, which I think is growing, is out there. But I think that's an opportunity in terms of monetization for us, either directly from the consumer or by the distributor or from the distributor, I should say.

And so, if distributors are going to be given the ability to offer their customers essentially same-season, full-season stacking, then there's a cost associated with this. And we expect to get paid for it, again an interesting opportunity for us.

The other opportunity, of course, is a world where consumers do not have the burden of having to set their DVRs for shows and, in effect, have access to many more shows without having to essentially do something premeditated or before a show airs perspective. That will increase, in my opinion, the non-live viewing of programming. And then the question is, what is our monetization capability there? Right now, there is some disablement of the commercial skipping in the C3 window, and so we are actually getting ratings for and us getting paid by advertisers in that window.

If consumption increases there, and I believe it will because of the availability or the ease of use in that window, then I think the monetization can increase as well. And that's why I think it's very, very important for us in that window to protect the value of the commercial.



Eventually, there will be dynamic ad insertion, and that will, I think, result in even more opportunities for IP owners or networks to monetize. But that's just starting.

David Bank – *Analyst, RBC Capital*

Thank you very much.

Operator

Jason Bazinet, Citi.

Jason Bazinet – *Analyst, Citigroup*

Thanks so much. This is the second quarter in a row, I guess, where I have been surprised at the strength in your Consumer Products division. And I was just wondering if you might -- you may not have this, but is there any rule of thumb you could share with us in terms of the linkage between box office gross and consumer products sales? In other words, if the movie naturally fits toward selling consumer products and you do \$10 of box office, you will do X dollars in Consumer Products? And the reason I ask is my sense is this could be very big as we glide towards *Star Wars VII*.

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

Jason, there's no rule of thumb because it's not really about box office, although box office has an impact. It's about whether the storytelling and the characters are easily leveraged or adapted to various forms of consumer products, whether it's toys or books or whatever, clothing, you name it. So it's more about that. If you have both, which *Frozen* is a good case in point. You also have play patterns -- for instance, Princess, you've got great characters, you've got great music, and you have huge box office -- that is as good as it gets. And the Marvel movies tend to fit into that category, as we know. Not all at an equal level, but certainly they have that opportunity, and you mentioned *Star Wars*. Of course, that's probably at the top of the heap. *Cars* was another great example of that.

Obviously, box office has an impact because it suggests the popularity of characters and stories. But you still have to have the right characters and stories to ultimately monetize on the Consumer Products side.

Also, it's not just about movies, it's also about television. So, if you look at Disney Consumer Products today and you look at the last couple of quarters, one of the reasons why you've continued to see growth is the success of programs on Disney Junior, which is a platform that we only launched within the last year and has suddenly hit big in terms of interest with young



kids 2-5, where -- actually it has done well in ratings in kids older than five -- with a number of shows -- *Doc McStuffins* and *Sofia the First* are two obvious examples -- that are very monetizable on the consumer products front.

Jason Bazinet – *Analyst, Citigroup*

Thank you very much.

Operator

Marci Ryvicker, Wells Fargo.

Marcy Ryvicker – *Analyst, Wells Fargo*

Thanks. I have two quick questions. First, it sounds like there was a benefit from the absence of ESPN Star Sports. So how much of a drag was this last year in the comparable quarter?

And then secondly, Jay, you mentioned fiscal Q2 there will be a loss in Interactive, and can you just talk about what that is from?

Jay Rasulo – *Senior Executive Vice President and Chief Financial Officer, The Walt Disney Company*

Starting with your second question, our results in Interactive are very tied to game releases. And in Q2, we are not releasing any big games. Obviously, the division continues in terms of its production capabilities and distribution capabilities. So without the release of a title of significant revenue, we are going to have some downdraft in those quarters.

Your first question, relative to ESS Star Sports, look, round numbers it's about \$20 million of drag that we got released from this quarter.

Marcy Ryvicker – *Analyst, Wells Fargo*

Thank you.

Operator

David Miller, Topeka Capital Markets.



David Miller – Analyst, Topeka Capital

Congratulations on the stellar results. Bob, I'm just curious if you guys are in negotiations with the domestic theater circuit here so far on *Star Wars*? Are you in discussions with these guys about maybe taking advantage of just pent-up demand here, a massive amount of pent-up demand, and maybe gunning for more than 52% on theatrical splits? Or are you just not there yet, it's just too early? Anything you are willing to tell us would be great.

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

We did some new deals with the domestic distributors within the last year. I'm not aware that we are in negotiations now. But we did some deals within the last year, and those deals reflected the strength of our studios late in the year and in years to come. So that would obviously include *Star Wars*. And there are potentially additional opportunities worldwide, but I can't really comment further on the state of any negotiation or whether there is any negotiation going on.

David Miller – Analyst, Topeka Capital

Thank you.

Operator

Tuna Amobi, S&P Capital IQ.

Tuna Amobi – Analyst, S&P Capital IQ

Thank you so much. So Bob, with regard to the WATCH apps, I was wondering if there's any new data points you can share with us? And I know you had outlined various avenues to monetize that, if you can update us on which of those you see getting the most traction, it would be helpful.

And then separately for Jay, the retail business, I believe North America clearly, I think, seems to be outperforming the overall industry for the holiday season. I know a lot of retailers that actually have reported lackluster results, and you guys have put together some really consecutive streak there. So I'm just wondering what you see as the main driver of that? Are there any trends that you are seeing in terms of any particular items or SKUs that are driving the momentum? Any kind of color for the future would also be helpful. Thank you.



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

(technical difficulty) ...to get them to carry the WATCH app and to enable us to monetize them, that's a component of the negotiations that are underway right now. So growth and adoption will come in part from not just consumer demand but new deals that we cut.

We are also seeing some modest advertising growth. We believe that will increase, obviously, with greater adoption, but also when we start getting more meaningful data from Nielsen on consumption and mobile platforms. So all very positive, as far as we are concerned.

And clearly, the quality of the devices is improving as well, both from a speed perspective and quality of the screen, and that's a good sign, too.

Jay Rasulo – *Senior Executive Vice President and Chief Financial Officer, The Walt Disney Company*

On your question on North American stores, obviously we are very, very happy with the development of our North American retail business. I think I mentioned this -- two years in a row, every quarter we have seen ups -- and there are a couple of pieces to that.

First of all, you will recall that we have reoriented our stores in our best locations towards a more franchise focus from what they were before, which, for lack of a better term, I will call a more emporium focus.

And highlighting franchises that are hot and popular has had a definite impact on the results of the Disney store. And it has resulted not only in quarter-to-quarter higher comp sales, but also higher gross margins across, as we get to really front items that have better margins and those items end up getting purchased in part because of how they are merchandised. But you can't forget the power of the franchises that backs those. And over the most recent quarter, obviously if I had to pick out a single item, I would say *Frozen* items were the single most demanded items at Disney Stores, but quickly followed by the power of the Disney Junior properties that have come on amazingly strong.

So the combination of powerful franchises, as Bob mentioned 10 or 15 minutes ago, in terms of the quality that drives Consumer Products, in addition to just better merchandising, has resulted in much better results over the last couple years.

Tuna Amobi – *Analyst, S&P Capital IQ*

Okay. That's very helpful. Did the new concept have anything to do with that at all? I know you were starting to roll that out a couple years ago. Where do you stand with that now?



Jay Rasulo – *Senior Executive Vice President and Chief Financial Officer, The Walt Disney Company*

Yes. That was the first thing I said. As we renovated a lot of -- we are up to almost 100 stores now worldwide renovated into IP -- what we call Imagination Park stores -- that really reoriented the way we merchandise to highlight franchises of the company rather than being emporium style, where you might go to find anything Disney.

Tuna Amobi – *Analyst, S&P Capital IQ*

Thank you so much.

Operator

Michael Morris, Guggenheim Securities.

Michael Morris – *Analyst, Guggenheim Securities*

Thank you, good afternoon guys. Two questions. One is just back on the strength in advertising at ESPN in the quarter. Can you talk a bit -- most of us believe that advertising related to sports is more valuable due to the DVR resistance of the content. Can you talk about the relationship in pricing between sports inventory and general and entertainment inventory? Is it much higher on sports inventory, and are you seeing the value increase at a faster pace there?

And then, secondly, on talking about the films in China, you did the partnership -- the production partnership on *Iron Man 3*. Can you talk about whether or not you think that was a big contributor to the strength that that film had in China compared to the second film in the series and whether you plan to do more partnerships like that in the future? Thanks.

Jay Rasulo – *Senior Executive Vice President and Chief Financial Officer, The Walt Disney Company*

Thanks, Michael. On your question on advertising, look, I'm not 100% sure how to answer that because obviously there's a wide variety of programming across the ESPN Network, some that demand very high rates and some that garner lesser rates. So I don't know how to compare that head-to-head to the kind of advertising on entertainment product.

There is also the notion of the multiplatform capabilities of ESPN that, of course, they have sold, we have talked about to you folks very aggressively in that being number one in all but magazine publishing in terms of platforms, really gives ESPN incredible leverage, and advertisers have lots of opportunities to take their products broadly to consumers where those consumers live today.



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

On the China question, the success of *Iron Man 3* I think was mostly due to the film itself and the continued interest in and knowledge of Marvel and *Iron Man*, in that particular case. And we think that the Marvel brand as it grows in China bodes well for future films, starting with our next one. I don't think it's a function of, necessarily, partnerships.

Michael Morris – *Analyst, Guggenheim Securities*

Maybe, if I could, just on the first question asked a different way. For the same size audience, is it more expensive to buy, let's say, a produced sporting event than it is a scripted original program that's also a high-quality program? And if so, are you seeing a differential in, let's say, those two types of programs expanding as time progresses?

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

I'm not sure there's an easy answer to that. You are selling basically the same size audience or a specific size audience within a demographic whether that's delivered live or whether it's delivered in a C3 window. Now, obviously, C3 is not a selling demographic or a selling point in sports because it is live. But you are basically selling eyeballs, whether they are delivered right away or within three days. I don't think you see a diminishment in quality if you deliver the eyeballs live or versus if you deliver them within that window. There are plenty of entertainment programs that are sold on a C3 basis that with comparable ratings do just as well as sporting events, and with comparable ratings -- again I'm talking delivery of demographics.

So I don't think -- the advantage, of course, of live is that it doesn't fall out of the C3 window or the non-monetizable windows, one of the reasons why we are all interested in monetizing consumption beyond just three days.

I was looking, by the way, at numbers from our primetime schedule, and I was pretty impressed with the Live+7 ratings. We've got shows that jumped over 50% in 18-49 delivery in the L+7 rating category. And yet we are only monetizing C3. So that just speaks to more of an opportunity there. But I don't think you are seeing much of a differential in terms of absolute rates, again, for comparable audience delivery, for sports live versus another program that is not live.

Michael Morris – *Analyst, Guggenheim Securities*

Great. Thank you.



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

Thanks, Mike, and thanks again 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 website.

Let me also remind you that certain statements on this call may constitute forward-looking statements under these 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, 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 call. Have a good night, everyone.

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Forward-Looking Statements:

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 28, 2013 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.