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**The Walt Disney Company**  
**Q2 FY14 Earnings Conference Call**

**MAY 6, 2014**

**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**

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**Operator**

Hello, and welcome to the Q2 2014 Walt Disney Company earnings conference call. My name is Eric; 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 this conference is being recorded.



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

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

Good afternoon, and welcome to The Walt Disney Company's second quarter 2014 earnings call. Our press release was issued almost 45 minutes ago, and it's available on our website at [www.Disney.com/investors](http://www.Disney.com/investors). Today's call is also being webcast, and the webcast and the transcript will be available on our website.

Joining me in Burbank for today's call 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.

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

Thanks, Lowell. And good afternoon. We're extremely pleased with our performance in Q2, with revenues up 10%, net income up 27%, and adjusted EPS up 41% to \$1.11 – the highest in the history of our company. And, once again, all of our business segments achieved double-digit increases, or more, in operating income.

Our continued strong performance reflects the strength of our brands and the quality of our content, the extraordinary creative success we're having, and our unique ability to leverage it across the entire company.

The unprecedented global success of Disney Animation's phenomenal *Frozen* continues – and it's now the world's highest-grossing animated film of all time and the best-selling title ever released on Blu-Ray and digital. The demand for *Frozen* merchandise remains extremely high, and the soundtrack was the #1 album in the U.S. again last week. And, as previously announced, *Frozen* is headed to Broadway.

*Captain America: The Winter Soldier* has far surpassed the first *Captain America* in total global box office, which obviously bodes well for our *Avengers* franchise. We've had enormous success releasing Marvel movies on the first weekend of May – including the two biggest domestic openings of all time – and we'll continue this tradition with *The Avengers: Age of Ultron* next year and *Captain America 3* in 2016. *Avengers: Age of Ultron* is currently shooting, and early footage looks great.



This August 1st, we're looking forward to introducing the world to more fantastic Marvel storytelling with a great cast of new characters in *Guardians of the Galaxy*, which we screened last week – and we believe it has strong franchise potential.

Also on the Marvel front, we just announced that Disney Interactive's *Infinity 2* will feature *The Avengers*, as well as other Marvel and Disney characters, when it's released in the fall. Since the first version of the game launched last August, more than three million *Disney Infinity* starter packs have been sold, and it was the best-selling interactive gaming toy of 2013 in the U.S.

And we made some other news last week, when we announced the cast for *Star Wars: Episode VII*, which includes some very familiar faces as well as some exciting new talent, and the reaction has been tremendous. I was at Pinewood Studios with J.J. Abrams a couple of weeks ago and left more confident than ever that *Episode VII* will be the extraordinary movie *Star Wars* fans have been waiting for.

Our Parks and Resorts had another record quarter and we've completed the roll out of *MyMagic+* to all guests, which Jay will get into in a few minutes. Guest reaction has been very positive and we believe the new program is delivering nicely on its promise of improving guest experience. Internationally, Hong Kong Disneyland set new attendance and occupancy records in Q2, and construction on Shanghai Disney Resort continues to go well.

There are an estimated 330 million potential guests within a three-hour travel radius of our Shanghai resort, and by the time we open the gates in late 2015, China's travel market is expected to be 34% bigger than it was in 2012. And the number of upper middle-class and affluent households is expected to grow by 18% a year for most of the next decade. These trends factored into our recent decision with our partners in Shanghai to accelerate expansion with an additional \$800 million investment.

Turning to Media Networks, both our Cable and Broadcast businesses had a solid quarter. We showcased the strength and long-term potential of ESPN at our investor day last month. It's an incredible brand that continues to drive tremendous value for us, and we've got a lot of reasons to be excited about what's coming up, including: a great NBA post-season, culminating with the finals on ABC; the World Cup from Brazil; a very promising *Monday Night Football* schedule; and ESPN's first foray into the NFL post-season.

Finally, I'd like to share a few thoughts about our acquisition of the top online video network, Maker Studios. We're excited about entering the short-form video space in a much more assertive manner, to boost the presence of our brands and franchises in this increasingly valuable and fast-growing arena. Maker's production talent and leadership will create exciting new opportunities to drive value from our content and create new content as well.

By any measure, we had great success in Q2 – creatively, financially, and strategically. In addition to our unique ability to leverage content across the entire company to create



maximum value, our unparalleled portfolio of incredibly strong brands is a clear strategic advantage that we expect will be evident in our results for years to come.

Now I'm going to turn this call over to Jay, so he can walk you through the details of our results in the second quarter. Jay?

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

Thanks, Bob and good afternoon everyone. We had a great first half of fiscal 2014. In fact, it's the best first half in the company's history. Our second quarter results once again reflect the significant benefit we derive from our strategy of investing in high-quality content. As Bob mentioned, adjusted earnings per share for the second quarter were up 41% to \$1.11.

Each segment delivered meaningful increases in operating income, and in the case of the Studio, operating income was up over 300% to \$475 million dollars, representing one of the Studio's best quarters ever.

During the quarter, the growth in operating income at the Studio was due primarily to the domestic home video release of *Frozen* and the film's strong theatrical performance overseas, where it has generated approximately \$770 million dollars in international box office to date. Higher operating income from television distribution also contributed to growth in the quarter.

Media Networks delivered higher operating income in the second quarter due to growth at both Cable and Broadcasting. At Cable, growth in operating income was driven by ESPN, domestic Disney Channels and higher equity income from our investment in A&E Television Networks.

Growth in ESPN's operating income was due to higher affiliate revenue and lower programming and production costs, partially offset by lower ad revenue. ESPN continued to benefit 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 lower than in the prior year as contractual rate increases for college basketball were more than offset by the absence of costs for UK sports rights.

During the second quarter, ESPN deferred \$80 million dollars less in affiliate revenue than in Q2 of last year due primarily to the signing of a new affiliate contract. As we look to the third quarter, we expect ESPN to recognize approximately \$190 million dollars less in previously deferred affiliate revenue compared to the prior year. I'll remind you these changes have no impact on full-year results.

Ad revenue at ESPN declined low-single digits in the second quarter due to a decrease in units sold and lower ratings, partially offset by higher rates. The marketplace was not particularly robust in the second quarter. So far this quarter, ESPN ad sales are pacing up mid-single digits,



driven by demand for the World Cup. The broadcast of those matches gets under way in late Q3 and runs through the first two weeks of Q4.

Domestic cable affiliate revenue growth was up low-double digits in the quarter, which was aided by the timing of program covenants. Adjusted for the timing of deferred revenue at ESPN, growth in domestic cable affiliate revenue was up high-single digits.

Broadcasting operating income was up in the quarter driven by higher affiliate revenue and lower expenses, partially offset by lower advertising revenue. Ad revenue at the ABC Network was down in the quarter due to lower ratings, partially offset by higher rates. Quarter-to-date scatter pricing at the Network is running mid-single digits above upfront levels.

At Parks and Resorts, our Q2 results reflect strong underlying trends in the business. Total revenue was up 8% and operating income was up 19% as a result of continued strength at our domestic operations. Results at our international operations were comparable to the prior year, as growth at Hong Kong Disneyland was offset by a decline at Disneyland Paris. Total segment margins were up 120 basis points in the second quarter, and were adversely impacted by about 200 basis points due to new initiatives.

The second quarter also included one less week of the Easter holiday compared to last year. Adjusted for the timing of the Easter holiday, operating income would have been up an estimated 31%.

Growth in operating income at our domestic operations was driven by higher guest spending at Walt Disney World and higher attendance at Disneyland Resort, partially offset by higher costs primarily related to the continued rollout of *MyMagic+*.

We made *MyMagic+* available to all on-property guests during the first fiscal quarter and to all other guests at the beginning of the third quarter. We are pleased with some of the changes in guest behavior and park dynamics we are already seeing. Guest adoption of our *MyMagic+* pre-visit planning tools is encouraging. Roughly three quarters of our resort guests are using them to plan their visit. And, just one month after making pre-arrival planning of *FastPass+* available to our day guests, more than 25% of them are pre-engaging with us.

Historically, guests who pre-plan spend more time at our parks, so we like these early trends. *MyMagic+* has also increased the engagement with *FastPass+* by 40% relative to the legacy *FastPass* system, and allowed us to increase the number of guests we can accommodate during peak periods. Our research indicates that these benefits are driving higher overall levels of guest satisfaction.

During the second quarter, per capita spending at our domestic parks was up 4% on higher ticket prices, food and beverage and merchandise spending. Attendance at our domestic parks



was up 3%, setting a second-quarter attendance record. Per room spending at our domestic hotels was up 3% and occupancy was up 6 percentage points to 86%.

So far this quarter, domestic resort reservations are pacing up 3% compared to prior year levels, while booked rates are up 6%.

At Consumer Products, operating income increased 37% and margins were higher by almost 500 basis points, reflecting continued strength in our merchandise licensing business and retail. Growth in licensing was driven by higher revenue for Disney Channel, Mickey and Minnie and *Planes* properties. On a comparable basis, earned licensing revenue in the second quarter was up 8% versus last year—that's three consecutive quarters of mid- to high-single digit growth in earned revenue, which is pretty impressive.

Results at Disney Interactive were significantly better than we anticipated when we reported Q1 results due to the continued success of *Disney Infinity*. We had another profitable quarter, which makes it three consecutive quarters of profitability—a first for the segment. In addition to the success of *Disney Infinity*, growth in our Japan mobile business also contributed to higher operating income, albeit to a lesser extent.

We continued to repurchase our stock during the second quarter and we are still on pace to repurchase between six and eight billion dollars for fiscal 2014. During Q2 we repurchased 19.9 million shares for about \$1.5 billion dollars. Fiscal year-to-date, we have repurchased 58.2 million shares for \$4.3 billion dollars.

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

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

Okay, thanks Jay. Eric, we are ready to open it up for questions.

## Q&A

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**Operator**

(Operator Instructions) Michael Nathanson, MoffettNathanson.

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**Michael Nathanson** – Analyst, MoffettNathanson

Thanks. I have one for just Jay and Bob. Could you talk about Consumer Products for a second? You didn't call out *Frozen* in either the press release or the comments. So could you talk about



that impact *Frozen* had this quarter on Consumer Products? And then if you think about it more broadly given the shortages of inventory, how big can *Frozen* be, and what -- can you benchmark it to some other -- one of your franchises? And when is the timing of *Frozen* in terms of hitting -- if there's a catch-up trade on the inventory side? So let's talk about that for a second.

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

Hi, Michael. In terms of the impact this quarter of *Frozen*, we saw that impact much more heavily at the Disney Store than we did broadly in the merchandise area. In fact, 9 out of the 10 highest-selling items at the Disney Store in the quarter were *Frozen* merchandise. So it not only had great sales but increased footfall at the store and -- at the stores -- and they had a very, very strong result.

Obviously with the release of the DVD, I think you'll see the impact -- the second part of your question -- the impact on our license business with the impact we see in general. High periods like back-to-school and obviously Christmas in Q1 of next year, you'll see the biggest impact.

But whether it's music, whether it's interest in the DVD or general interest in this franchise, it will continue to be a driver, we believe, for some time into the future. It was not in our licensing business, obviously, one of the top three franchises in terms of driving, as you mentioned.

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**Michael Nathanson** – Analyst, MoffettNathanson

Okay. And then I just wondered could Bob -- I know you spent time in the past sizing some of the franchises. How would this rank in terms of what you are thinking about compared to Princesses and some of the other things you've done on the investor days in the past? Is this a billion dollar franchise, you think, in the next couple of years?

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

This is definitely up there in terms of our top probably five franchises. So you can expect us to take full advantage of that over the next at least five years, I would guess. We are already taking a number of steps, for instance, to increase the characters' presence in our parks and developing some concepts around that. We're developing a Broadway show. We're talking about other forms of storytelling related to *Frozen*, whether it's publishing or Interactive or the like.

So I think this is going to be -- given -- the passion for this film and these characters is so extraordinary, so well beyond what we ever even imagined, that it would be hard to believe that it wouldn't sustain itself over a fairly long period of time.



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**Michael Nathanson** – *Analyst, MoffettNathanson*

Okay. Thanks, Bob.

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

Thank you, Michael. Operator, next question please.

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**Operator**

Alexia Quadrani, JPMorgan.

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**Alexia Quadrani** – *Analyst, JP Morgan*

Thank you. Just a question on the parks. You've had such great success lately at the parks, and you look like you have a few more tailwinds ahead going into the June quarter and beyond -- a little bit of a benefit from the late Easter, the earlier pricing at Disney World, and then the opening, I think, of the final bit of the *Fantasyland* reservation -- renovation there.

I guess could you give us any color on how we should think about can that growth continue? And then any color maybe on the cost side with the launch cost, if there is anything significant for this last phase of the opening and I guess additional costs of *MyMagic+* there, or is most of that behind us?

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

Taking the back half of your question first, Alexia, I don't think you should look for any extraordinary costs as we continue to market the opening of *Fantasyland* with the *Mine Coaster*. I would say that -- and we have been saying that the only extraordinary cost, which of course we expect to taper over time, is our launch of *MyMagic+* which, in Q3, we launched to all day guests -- in fact, all guests now who visit Walt Disney World. And we're still very much in the process of communicating its benefit, and I think guests are picking up on that very quickly.

In terms of the business overall, you mentioned the one week of Easter that will give us about a \$45 million lift in Q3. And looking forward, it's very hard to look in a crystal ball. But we gave you the pacings on bookings and rates. You're right that we have the price increase earlier at Walt Disney World that will continue to help us year over year relative to when we took that price increase last year. And we don't have any crystal ball that we haven't revealed to you that I want to talk about any further.





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**Alexia Quadrani** – *Analyst, JP Morgan*

And then just a follow-up, staying on the parks. And I don't know how much you can say on this front. But given your past experiences, is there any sort of general commentary you can give us on how we should think about the profitability ramp when Shanghai opens?

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

You know, I don't think it's prudent to talk in advance of an event that's over 1.5 years away. I think that we are obviously very happy with the progress we are making in the construction of that project. We're very excited about the market trends that we see in terms of the general ability of the traveling -- and the increase in the ability of -- the traveling middle class in China. The approximate population that we feel we can market to. But I don't want to make any predictions about what will happen post-opening.

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**Alexia Quadrani** – *Analyst, JP Morgan*

Okay. Thank you very much.

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

Thanks, Alexia. Operator, next question please.

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**Operator**

Jessica Reif Cohen, Bank of America Merrill Lynch.

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

Thanks, the first one is for Bob. It's clear that this branded content strategy in the film division is unique, and obviously it is a huge success. I was just hoping you could give us some color or your views on where you think you are in this strategy. Is it fully rolled out? And are you comfortable now -- are you confident that Marvel is at a new higher level?

It seems like each division, given the few films and very focused, are really working and working throughout the organization. So I'd love to get your views on kind of how far you are on that strategy.

And then for Jay, you mentioned with the new *FastPass* part of the *MyMagic+* rollout, that capacity -- that you can get more people in and out of the parks. How much did capacity increase?



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

I'm obviously biased Jessica, but I think the strategy of making branded movies is definitely working. And I think that we really are just seeing the beginnings of it in terms of their impact on the Company, particularly since we have a fair amount of visibility about the pipeline from all of these great brands.

It's clear, for instance, that we've continued the great success of Pixar since that acquisition and that that acquisition has had a great impact on raising the quality level and the success of the films at Disney Animation. Not just with *Frozen*, but *Tangled* before it and *Wreck-it-Ralph* and films coming up.

Marvel, as far as we're concerned, is just getting started. The results of *Captain America*, though, I think are very, very telling. Because when you look at a film that is approaching almost \$700 million in global box office, I think \$680 million, and you compare that to *Captain America* one, which did under \$400 million worldwide -- and you even look at it versus *Thor* movies, a few of the *Iron Man* movies, you're looking at a film that has actually done substantially better than a lot of the Marvel films that we put out.

Now, it was a great film. But it's clear that momentum is building for that franchise. And with *Avengers Two* in production and coming up and characters from *Avengers* still very much in favor with audiences, I think there's huge potential there.

In addition to that, we've got a new film, *Guardians of the Galaxy*, coming out August 1 in the United States this summer, which we've seen. I mentioned it in my comments. We feel quite good about that, too. That's a whole other Marvel realm or universe in terms of where it takes place, the characters that populate it and the stories that you can tell for those characters. I think -- I'm not going to predict that we've got another *Avengers* on our hands, but that's certainly the goal.

And then, of course, you layer in to all of this other Disney live motion pictures like *Maleficent* coming up; *Cinderella*, which is in the final stages of production. *Tomorrowland*, another film we feel quite good about. The pipeline is rich there and the brand is strong.

And then obviously I won't forget *Star Wars*. We would be the first to admit that even we are surprised at the fervor and the level of interest, the passion for this property. We knew that it was strong when we made the acquisition, but as we've gotten into it more and we've gotten closer to it, as the film essentially starts filming, it's just amazing to us just what kind of pent-up demand there is. And we feel great about where it is creatively, we feel good about the script, we feel great about the director, we feel really good about the cast, and we couldn't be more excited about it.



As we mentioned on earlier calls, we intend to make at least three of the *Star Wars* sagas -- *VII*, *VIII*, and *IX* at a cadence that should be roughly every other year. And then we're in development on spinoff films, which we've not gotten specific about. But we feel that we've got at least three that we're targeting to go into production. So that pipeline is going to be rich certainly through the end of this decade.

And then lastly, I know I'm getting wordy, but when you look at the world today, we actually see growth in the motion picture business that is largely due to huge growth in international markets, China being probably the biggest one. The Chinese movie market has tripled in the last four years. It's the number two market in the world; we think it's going to become the number one market by 2020. And our films are doing very well in those markets, *Captain America* the most recent example.

So there's also -- so there's great opportunity. There is also a lot of competition globally, and we think that when you've got these brands that are well known and in demand, you are at a much better position competitively than you would be without them.

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

In terms of your second question on *FastPass+* and *MyMagic+* in general, in my opening remarks I talked about what's happening. I want to emphasize that whatever I say about both of these new products, that we are in very, very early days. And we have to sort of calibrate what our findings have been by the fact that we're only a few months in.

But what we have found -- and of course, capacity increases only really matter in our peak days and weeks. But because of *FastPass+*, the ability to basically plan your day as it relates to top attractions in the park in advance has had huge pickup by our guests. It allows a better distribution of guests around the park. And, quite often, the amount of capacity we can let into the park is highly driven by pinch points and particular areas of the park that we don't want to get too overcrowded. So when guests are better distributed around the park, we can often allow more in.

And I don't want to get into the specific numbers; it is in the thousands, but I don't want to get into the details about what that might ultimately mean financially. But we know that from a guest experience, when you are down at Walt Disney World on peak days for Easter, Christmas typically, some weeks in the summer, it is a huge enhancement in your experience when you can go to the park you want to go to on the day you want to and not fear that it is going to be closed out. So we see this as all great stuff.

Again, very early in the process, but we are very, very encouraged across all the variables that we had hoped to achieve with *MyMagic+* and *FastPass+*.



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

Thank you.

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

Thanks, Jessica. Operator, next question please.

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**Operator**

David Bank, RBC Capital Markets.

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**David Bank** – *Analyst, RBC Capital*

Thanks very much. A question, I guess, on Maker Studios. And your successful acquisitions of scale I think historically, certainly since, Bob, you've been running the company, have tended to focus on brands that you simply can't build, right? They had to be bought. They had incredible value. And most of them have turned out pretty successfully.

So how do you put Maker in that context? What couldn't you build? What is the world-class brand that you've acquired here, and how does the Disney difference kind of make it a more powerful platform?

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

Well, I think Maker has established itself as a bit of a brand in what is clearly a fast-growing space of short-form video online or on mobile platforms. But as we look at Maker, we see it first and foremost as a distribution platform and a very successful one. One that not only can command more eyeballs, more consumption, but with that more advertising revenue or revenue in general.

We did not believe that we had the ability in the Company near-term to distribute as effectively and to sell as effectively. We also thought they had an expertise from a production and a creator perspective on creating short-form video that we didn't think was as deep as it could've been at Disney. So we bought a lot of different capabilities, but mostly distribution.

As we look at it, we believe that by creating access for the Maker people to some of our big brands and characters in storytelling -- *Star Wars* would be a perfect example of that; *Marvel* is another one -- that we can actually allow the Maker people to substantially improve the distribution or the reach of shorter-form video using these characters and stories. But also add their expertise on the production side.



They also have great access to data and algorithms that you wouldn't have unless you had volume. It would take a long time to build the kind of technological expertise in that regard to essentially maximize the potential of the video online. They've got all that.

So we look at this as a great opportunity both for Maker and for Disney: Maker using our IP, Disney using their expertise to distribute our product much more effectively.

The other thing I want to add is this is also potentially a great marketing opportunity for the company. More and more, we're taking advantage of short-form video and distribution for marketing messages from movies, our theme parks and our television shows. And you can see the marketplace with a fair amount of it. But getting maximum traction from a distribution perspective takes a lot of expertise and a lot of experience, and they've got that. So we think there's a huge marketing opportunity for this company.

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**David Bank** – *Analyst, RBC Capital*

Can you give us any detail in terms of impact on the income statement just as a quick follow-up?

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

It will be dilutive, David, for a couple of years; a couple of cents.

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**David Bank** – *Analyst, RBC Capital*

Thank you very much.

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

Operator, next question please.

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**Operator**

Ben Swinburne, Morgan Stanley.

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**Ben Swinburne** – *Analyst, Morgan Stanley*

Jay, I just wanted to confirm that you're still expecting Cable expense growth, I think, in the high-singles on programming this year; that's still the expectation? I know first half was quite a bit lower.



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

Yes. You know, we've been -- we've said from the outset, and I said to many of you at the investor day, that we always expected those programming costs to be back-loaded in the second half of the year. And it is simply related to the calendar of sports rights as they roll in.

I ticked a couple of them off, I guess I'll do it again: Major League Baseball being one; the new NFL contract, which kicks in in Q4 of 2014; and we've got the World Cup this year in the third and fourth quarters. Those are the biggest drivers. There's also some college football in there. And lastly, as I had mentioned before, the launch of the SEC Network. So that is what is driving the somewhat back-loaded nature of our increase in costs for the year.

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**Ben Swinburne** – *Analyst, Morgan Stanley*

And this might be a bit of a stretch tying these together, Bob, but when you look at the bet that you've made with Maker and the bet in online video and maybe the agreement you made with DISH, which at least it seems that allows them to move towards an online streaming bundle, it seems like the company is taking a view that they want to be -- you want to have Disney present for the future of television or future of streaming.

And I'm wondering if you look at that as a hedge against pay TV and what will be happening in pay TV? Do you view them as complementary? I know this is probably a 10-year view than a six-month view, but how are you looking at those decisions in the context of your business -- which, as you outlined a few weeks ago at ESPN, the Media Networks throw off a lot of cash flow for the company and the pay TV bundle drives that. Any color there would be helpful.

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

Well, I view this as complementary. You're throwing a lot of different concepts into the mix there. Maker and the streaming video that's possible through the new DISH deal.

Now on the Maker front, we think short-form is a frontier opportunity for us, meaning huge growth in consumption. We'd like to take advantage of that growth by essentially generating more revenue, more consumption of our product -- not just for marketing messages I mentioned a few minutes ago.

So we really believe in essentially growth in entertainment on new media platforms -- short-form and long-form, too. If you look at what we did with *Disney Movies* -- the DMA product, *Disney Movies Anywhere* -- we launched recently is another example of that.



We think that you are going to see continued growth in consumption of media, entertainment in particular, on mobile platforms -- smartphones and tablets. And we feel we need to be present in that space.

On the DISH side, that's a completely different story. The bet that's being made there by us and by DISH is that that product has the ability to attract people who may not have already signed up for multi-channel service. And getting them to sign up for something instead of nothing we believe would be of real value to us.

And there is, I guess, an example of something that is very complementary to what you call the pay TV model. The same as we've been doing with the WATCH apps that we've been pretty aggressive with, a complimentary product to make the pay TV model more attractive for subscribers.

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**Ben Swinburne** – *Analyst, Morgan Stanley*

Got it. Thank you.

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

Thank you, Ben. Operator, next question please.

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**Operator**

Todd Juenger, Sanford Bernstein.

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**Todd Juenger** – *Analyst, Bernstein*

Thank you, I've got a question on ABC and then a follow-up on the Parks. So ABC -- according to our numbers, it looked like primetime ratings were down, I don't know, maybe double digits year-over-year, which by the way was not unique among broadcast networks. And yet you had total revenue that was flattish, and profitability was up.

So my question is, as you think about that business going forward, how do you think about -- I'm sure your plan is not to continue to have ratings erosion of that degree. But how do you think about putting capital at risk pursuing higher audiences versus the reality perhaps that there might be some audience erosion that's inevitable, and the new economic formula that might suggest you focus more on profitability?



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

Well, first of all, ABC is still profitable. And as we look at the year that they've had -- we look at, first of all, the C3 rating, 18-49, because that's the primary driver of revenue. Because the Network, we -- ABC has very little sports, some of it provided by ESPN, but less than certainly some of the other networks -- we tend to look at non-sports programming. And as we see it, we're down high-single digits in the C3 18- 49 number ex-sports for the season, little bit more than that for the quarter that we just reported.

The name of the game, obviously, is strengthening our programming, which is what ABC is just in the middle of with a lineup of pilots that has just been screened, and decisions that are being made this week to populate the schedule for the fall. It is our hope that we will reverse the tide of some of that ratings erosion with better shows on the air, quite frankly. And that's what the mission is.

In addition to strengthening programming and raising ratings, and hopefully revenue if the marketplace cooperates, the goal is also to own a substantial amount of that programming. And in today's world, that can create huge value for the owner of that property, as we've seen in many, many different cases both with our programming and programming that is created by others -- thanks to obviously many new entrants in the marketplace, Netflix and Hulu among them.

So we're still viewing this business as a profit-generating business and a business that can generate a substantial -- or acceptable returns on invested capital for the company.

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**Todd Juenger** – *Analyst, Bernstein*

Hey, that's a perfect segue into the follow-up I wanted to ask on Parks. Jay, I don't know if you or Bob want to take this, but let me take another run at the Parks because return on invested capital is a metric that, in the early days of the latest cruise ships, is a metric you actually, I think, shared with us a couple of times. If I recall correctly, you talked about ROIC's in the mid-to high-teens for the new cruise ship operations. I would think that, at least for Disney California Adventure, you have enough time now to have measured that. In fact, I'm quite sure you measured that. I wondered if you'd share with us what you think the returns on that capital deployment have been.

And then put that in the context now of the future to come openings including, of course, Shanghai and the new capital you decided to put on top of that, and sort of what your hurdle rate and thoughts around the ROIC in that is. Thanks.





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

Sure. You may remember, I don't actually -- Todd, I'm not sure you were following our company then, but when we announced the expansion of Disney California Adventure, we said that we believed that the returns would be attractive, i.e. above our cost of capital at that time. In fact, so far -- and you know, of course, returns in the Parks business are based over a long-term, but so far we have been absolutely thrilled with the results of that investment that we put in place.

And, to a large extent, on some variables meeting and others exceeding our expectations for what that investment could bring. So we still are very, very bullish that the returns that you and we are both going to feel very good about those returns. Although, I'm sorry, I'm not going to share the explicit numbers with you. But when I say pleased, I certainly mean above our cost of capital.

Similarly, for Walt Disney World, we don't -- the expansion there, we don't take on projects that we don't believe will exceed our hurdle rate, and the signs are absolutely go-forward-great on Walt Disney World. Bob talked earlier about the world interest in *Frozen* that is very focused on Ana and Elsa. You remember that the expansion of *Fantasyland* was very focused around Princess meet-and-greets, and we can only expect great things there. And you've seen the numbers quarter after quarter of Walt Disney World, including the last quarter where we have been able to price behind these investments and still feel very strong about our volume going forward.

So we feel very good about it. I wish I could be more forthcoming with the numbers. But as I say, they will work themselves out or pay back over time. All signals so far are very strong.

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**Todd Juenger** – *Analyst, Bernstein*

If I could just ask -- thanks, Jay -- just a very quick follow-up. When you think about China, I think I understand your cost of capital philosophy. Is there an extra hurdle rate, sort of a risk factor that you've thrown in the top there that makes your expected returns need to be higher? Is that a fair statement? And any color you put on the way think about it would be great. Thanks.

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

Well, the China situation, because it's a shared investment, is a little more complicated situation. First, we don't like to take on projects that on a total ownership basis don't have returns that we would like to see for our investors. But remember, we have a much more limited investment, and the flows are complicated between our partners and ourselves. So we also look at the return to Disney's investment in that. And in both cases, we feel very good about it.



We do risk-adjust our hurdle rates in general. I don't want to get into the details of that, but I think you know that most companies, based on relative inflation rates and other risk factors, adjust international hurdle rates appropriately. And we do as well.

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

Thank you, Todd. Operator, next question, please.

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**Operator**

Anthony DiClemente, Nomura.

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**Anthony DiClemente** – *Analyst, Nomura*

Thanks, couple questions. First, Jay, I think on ESPN, on the last quarterly call you had said pacing was up. You mentioned in your prepared remarks that just the ad market has been soft. We've seen that in the other media companies' earnings reports. How would you really explain the slowdown in the market since your comment? Does it seem like something temporary that happened toward the latter part of the quarter, or is it something that's perhaps a little bit more ongoing or permanent, be it budget shifts to digital or anything -- any other call-out in terms of the ad market more broadly?

And then second question for Bob, just had a question about Shanghai in terms of your decision to accelerate the CapEx. Should we think of that as more of an acceleration or in addition to the existing plan? And then just wondering if you could give us some more color on the updated cadence of capex for Shanghai as we get closer to the opening? I'm just wondering if that acceleration or addition has any impact on potential capital returns in 2015. I know that you've not given guidance on that but would love to hear any incremental color, given your decision on the \$800 million. Thank you.

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

Okay, Anthony, let me take the first half of that, which was the ESPN ad sales. Obviously, when we spoke to you all last quarter, we gave you what our pacings were. That was a fact. I think that what happened in the quarter -- there are a couple of complicating factors that are not typical of any quarter for ESPN.

First, every four years we have the perturbation in the sports market of the Winter Olympics or the Summer Olympics in the other years. It's very hard to predict what the impact of that is going to be. We took a guess at it; the impact turned out to be a little more than we thought.



We also -- when you're broadcasting live sports, the match-ups and the cities involved in the match-ups -- and now I'm speaking specifically about the NBA -- have something to do with the ads you sell behind them. And whether it's Los Angeles, New York or Boston, three very big markets for basketball, are not involved in the NBA postseason.

And so, they affect our ratings. We already mentioned that we thought the ad market was a little bit soft. And, look, I don't think this is a permanent situation. We have seen it this quarter. I don't expect it to be a long-term phenomenon.

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

The question about Shanghai and capex, we always anticipated expanding that park. In fact, the property that we've allocated for the project provides ample opportunity for expansion. As I said last week and early this week and as we indicated earlier today, what we're doing here after basically seeing some rather dramatic changes in the marketplace that we believe were positive is that we are accelerating investment. The \$800 million, which is what we announced we were accelerating it by, is obviously shared with our partners, the Shanghai government. So its impact from a capital expense perspective is relatively modest for us.

It is our hope that with this expansion, which increases capacity, that most of it will be available to us at opening. Puts a little more pressure on us because we're essentially building something that is bigger. But that is certainly the goal.

And then you can expect that in success, which we have every reason to believe will occur, that there will be continued investment in this park because of the size of the property and the size of the market -- most populous city in the most populous country in the world, which, as we've said a few times, 330 million people that we believe are potential park guests living within a 3.5 hour trip. It's a pretty compelling circumstance or opportunity for us and our partners and probably will deserve an infusion of more capital investment because we think the returns are going to be rather significant for us from this project.

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**Anthony DiClemente** – *Analyst, Nomura*

Anything you can tell us on the buyback? Okay, thanks.

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

On your question on the capex -- so I want to first of all -- what Bob just talked about, what you asked about, is really a 2015 and 2016 event. It won't affect our capital expenditures in 2014. And in fact, previously what I had told all of you was that we expected our capex in 2014 to be \$1 billion higher than it was in 2013. And when adjusted for the Shanghai partner's contribution, it would be \$600 million higher.



In fact, I want to update that. I think our capex in 2014 will actually be \$800 million higher, not \$1 billion, and \$400 million, not \$600 million, on an adjusted basis after the contribution from Shanghai. And that simply has to do with the timing. Obviously when you put a big project in place, you have all kinds of planning and you map against how that money will be spent. It's slightly different -- in fact, it's slower -- it's a little bit slower, which means that spending will be out in 2015 and 2016.

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

Thanks, Anthony. Operator, next question, please.

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**Operator**

Jason Bazinet, Citi.

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

Just a question for Mr. Rasulo. I think in the past, you mentioned that for the total capex outlays for Shanghai, you would see it come out of the investing activities and then you'd see an add-back of it on the financing side for the portion that is not yours. Are we already seeing those add-backs on the financing line of the cash flow statement?

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

Yes we are, Jason. Those are being added in. Look, they're not day-for-day, obviously. We expend the capital, there's a process by which our partner reimburses the share of spending. But it is lockstep; it's not delayed.

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

Okay, and that's just under Financing and Other in the numbers that you give us?

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

Yes, that's correct, Jason. 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**

David Miller, Topeka Capital Markets.

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**David Miller** – *Analyst, Topeka Capital*

Just another question on Shanghai. Bob or Jay, just correct me if I'm wrong. I remember maybe five years ago -- four years ago, five years ago or so, when Hong Kong opened -- kind of the core criticism, if you will, against the park at the time was just that it was too small. And, indeed, I think crowds just sort of overwhelmed that property for the first six or nine months or so. Is that -- is the residue left over from that memory part of the reason why you guys accelerated this investment in Shanghai because you just want to be sure that it's not too small? Or what led to this specifically? Was there another market study done or another sort of demographic study done to make you determine that the eligible patrons, as you alluded to, are -- will get into the park quicker? How -- if you could answer that, I'd appreciate it. Thanks very much.

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

Well, we've learned a lot from Hong Kong. Actually, the problem that we had was a good problem to have, in that demand was greater than we had expected initially. This is a different circumstance in many respects, but it doesn't mean that some of the learnings that we gleaned from Hong Kong can't be applied. And we are doing that, have every reason to believe we are going to continue to do that.

So I guess that's a way of my saying that we've -- as we've looked at this market since we made the decision to build, since we broke ground, and we've seen further development, more development than we expected, we clearly are reacting to what we believe will be greater demand than we initially anticipated for the park in its first year of operation or its early years of operation. And we want to make sure that we build enough capacity to meet that demand.

There are other things we're going to resort to, to manage expectations in terms of visitation. For instance, it's likely that when we go to the market selling tickets, there will be tickets that are date-specific tickets so that we can manage, in effect, traffic or visitation much more carefully than you would if you just sold tickets and didn't have a date and had no idea when the people who bought the tickets were going to show up.

So we're going to apply a number of things that we've learned over the years both from Hong Kong and other parts in how we -- what we build, how much we build and how we operate.

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**David Miller** – *Analyst, Topeka Capital*

Okay. Thank you very much.



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

Thanks, David. Operator, we have time for one more question.

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**Operator**

Michael Morris, Guggenheim Securities.

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**Michael Morris** – *Analyst, Guggenheim Securities*

One on the DISH personal subscription over-the-top service, what is -- how important is it to you that they reach the critical mass needed for that service to take off? And is it a situation where the ball is really in their court to go out and get partners? Is it something that you can actively support in some way and bring other content and companies on board? And are you looking at a similar service with any of your distribution partners? And then I have one on Parks. Thanks.

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

It's DISH's responsibility to get critical mass from a programming perspective -- I saw Charlie Ergen last week, and he's doing just that. I'm not going to give you an update on how he is doing, but it's their responsibility, we don't intend to participate in that pursuit at all. We'd like to see this product rolled into the marketplace because we think it's a smart thing for us to do, something that we should certainly try. Is it critical? No. But it's certainly critical that he gets critical mass from a programmer's perspective in order to bring it to market.

And the second part of your question -- second part on DISH was?

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**Michael Morris** – *Analyst, Guggenheim Securities*

Other distribution partners, whether you're --

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

Whether you're going to sell it to others.

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

Oh, I'm sorry. Yes, yes, yes. We are open to selling it to others, but we have not engaged in any of those discussions yet.



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**Michael Morris** – *Analyst, Guggenheim Securities*

Okay, great. And then at Parks, Comcast is committed to investing in both the park and the resorts -- the hotel is done in Orlando. And I'm curious, what have you seen in the past when competitors have invested locally? Is it a drag, or does it actually generate more traffic in the region? How does that usually shake out? Thanks.

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

What we've typically seen is it drives more traffic to the region, basically business goes up in Orlando or Central Florida. And so, we -- and we don't necessarily view it as negative for us because it drives more people to the area.

And we not only have great product, but we have new product too. *Fantasyland* is the most recent example of that. As you know, we're developing *Avatar* for that park. Looking at a variety of other things to add in Orlando -- opening up a hotel, Four Seasons is opening up this summer as a for instance. So there'll be plenty more that we put into the marketplace that will take advantage of any growth the marketplace has.

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**Michael Morris** – *Analyst, Guggenheim Securities*

Great. Thank you.

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

Okay, 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 Investor Relations website.

Let me also remind you that certain statements on this call may constitute forward-looking statements under 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 afternoon, everyone.

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The **WALT DISNEY** Company



**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](http://www.disney.com/investors).