



The
WALT DISNEY
Company

Q2 FY17 Earnings Conference Call

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Disney Speakers:

Bob Iger

Chairman and Chief Executive Officer

Christine McCarthy

Senior Executive Vice President and Chief Financial Officer

Moderated by,

Lowell Singer

Senior Vice President, Investor Relations



PRESENTATION

Operator

Welcome to The Walt Disney Company Q2 FY17 Earnings Conference Call. My name is Nicole, and I'll be your operator for today's call. (Operator Instructions) Please note that 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.

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

Good afternoon, and welcome to The Walt Disney Company's Second Quarter 2017 Earnings Call. Our press release was issued about 25 minutes ago and is available on our website at www.disney.com/investors. Today's call is also being webcast, and the webcast and the transcript will be available on our website. Joining me for today's call are Bob Iger, Disney's Chairman and Chief Executive Officer; and Christine McCarthy, Senior Executive Vice President and Chief Financial Officer. Bob will lead off, followed by Christine, and then, of course, we'll be happy to take your questions. With that, let me turn the call over to Bob and get started.

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

Thanks, Lowell and good afternoon, everyone.

We're extremely pleased with our results in Q2 and our continued strong performance – both creatively and financially – reflects what a profoundly productive and exciting era this is for The Walt Disney Company. And that's a direct result of our long-term strategic focus on creating the most compelling branded content, fully leveraging innovative technology, and expanding our global presence. This strategy – along with our eagerness and proven ability to embrace change and disruption – ensures we constantly evolve in ways that are relevant to the market, exciting to our consumers, and vital to our future.



Our approach to the rapidly evolving media landscape is a great example – and a timely one, given the recent attention to that sector, especially ESPN. We recognized the early signs of a shift in the industry, anticipated its impact on our business, and adapted quickly with a strategy that reflects the evolving market. And, we’ve been candid about the trends we’re seeing, which have been a key topic of discussion on these calls since 2015.

The strength of the brand and consumer demand makes ESPN extremely attractive to new platforms and services entering the market -- which has led to ESPN content being featured on a growing array of over-the-top services including Sling TV, Hulu, PlayStation Vue, DirecTV, and YouTube TV.

Consumer response to these offerings is very encouraging. The substantial growth we’re already seeing makes us bullish on the future of these nascent offerings. Right now they’re a small part of the pay-TV universe, but we believe they’ll be a much bigger part of the business going forward. And, from a “per sub” pricing standpoint, these new services are just as valuable to us as traditional platforms.

We’re also taking full advantage of emerging trends by investing in the technology we need to create subscription products that give consumers direct access to our content – from our early investment in Hulu to our recent ownership stake in BAMTech, which will launch a new ESPN-branded service later this year.

ESPN continues to lead the industry when it comes to creating innovative digital products and, as we expand and enhance our mobile presence, we’re seeing tremendous increases in mobile viewing. Almost 80% of the people who connect with ESPN each month access the content on mobile devices. In Q2, ESPN’s suite of mobile apps reached a monthly audience of almost 23 million unique users, who collectively spent more than 5.2 billion minutes engaging with ESPN on those platforms during the quarter. Mobile is clearly going to play a major role in the future



of media, and ESPN is already taking great advantage of the trend with a broad portfolio of compelling apps.

All of these steps create new ways to reach and engage consumers – which enhances the brand and its relevance in a changing market. While we’re clearly excited about our success on new platforms, live sports continue to draw huge audiences to TV. ESPN’s primetime audience in fiscal Q2 was up 15% year-over-year, and the inclusion of Out-of-Home viewing and WatchESPN lifted that audience by another 10%. ESPN also delivered its largest first quarter primetime audience in five years, according to Nielsen, which reports on a calendar basis.

We’re confident in our strategy and ability to manage change across the entire company. In the last decade alone, we’ve navigated seismic shifts driven by technology, increased competition, and changing consumer behavior that impact a variety of business sectors – from movies to merchandising to theme parks. And the results include a studio that’s breaking industry records, 11 separate franchises driving more than a billion dollars each in annual retail sales, and theme parks that are performing extremely well and expanding to meet the demand for Disney experiences across the world.

Our Studio’s extraordinary run continues. In fiscal 2017 we’ve already had two releases that topped a billion dollars in global box office – *Rogue One* and *Beauty and the Beast*.

With a strong opening weekend, Marvel’s *Guardians of the Galaxy Vol. 2* just became the 15th consecutive Marvel movie to open at #1. It’s already delivered \$156 million in U.S. box office, bringing the worldwide total to \$456 million to date. And we’re expanding the presence of the franchise in our parks with our first *Guardians of the Galaxy* attraction, opening at Disney’s California Adventure later this month.

As we’ve previously noted, we have an incredibly robust slate of great Marvel movies ahead – with four releases in the next 14 months alone, including *Thor: Ragnarok*, *Black Panther*,



Avengers: Infinity War, and *Ant-Man and the Wasp*. Fans are especially excited about *Infinity War*, which brings *The Avengers* and the *Guardians of the Galaxy* together onscreen for the first time ever – along with many, many more great Marvel characters.

We've been thrilled with the creative momentum at Disney's live-action studio. In addition to *Pirates of the Caribbean: Dead Men Tell No Tales*, which opens this month, the Studio is having tremendous success re-imagining some of our most beloved characters and stories for a new generation. *Beauty and the Beast* is the latest in an impressive list of wildly successful films, including *Maleficent*, *Cinderella*, and *Jungle Book*, and we've got more on the way, including *The Lion King*, *Dumbo*, *Aladdin*, and *Mulan*.

We've also got an extraordinary slate from Pixar. *Cars 3*, the next great story in the *Cars* franchise, opens in June, and *Coco*, a heartfelt tale of music and family, will be in theaters this Thanksgiving. We're also looking forward to *The Incredibles 2* in the summer of 2018 and the 2019 release of *Toy Story 4*, which opens a new chapter for one of Pixar's most beloved franchises.

Disney Animation is also having a great run, with *Zootopia* taking the Oscar for best animated feature and *Moana* earning two Oscar nominations and generating \$640 million in global box office. In 2019, we'll release *Frozen 2* -- one of the most anticipated sequels in animation history. And, in the tradition of great stage adaptations of Disney animated classics, *Frozen: The Musical* opens for a limited run in Denver this summer, before moving to Broadway next spring.

Turning to Star Wars, anticipation is already building for the December release of *The Last Jedi* and interest is also strong for the Han Solo origin film, which will be followed by *Star Wars: Episode IX*. And, as we speak, construction is underway on two new Star Wars lands at Disneyland and Disney World that will transport guests into an incredible storytelling universe and make them part of the adventure.



And there's more exciting news from our Parks and Resorts. In the next few days, Shanghai Disney Resort will welcome its 10 millionth guest. As the resort has become a true national destination in China, attendance is outpacing our most optimistic projections and the park's performance is exceeding our expectations. The addition of the new *Toy Story Land* will only add to the park's popularity and it's just the first of several planned expansions in Shanghai.

Our long-term strategy – and our proven ability to execute it over the last decade – is paying off in countless ways across the company, and ensures our legendary 94-year-old company remains vibrant and relevant to each new generation of consumers. In the near-term, as we previously noted, we expect to deliver modest growth for fiscal 2017, with a return to more robust growth in fiscal 2018 and beyond.

I'm going to turn the call over to Christine to take you through the details of our quarter, and then we'll be happy to take your questions. Christine?

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

Thanks, Bob, and good afternoon everyone. Earnings per share for the second quarter were \$1.50, which represents an increase of 10% compared to Q2 last year after adjusting for certain items affecting comparability.

Parks and Resorts delivered another strong quarter, with operating income growth of 20% driven by increases at Shanghai Disney Resort and our domestic parks and resorts. As I discussed during last quarter's earnings call, second quarter results benefitted from one week of the winter holiday shifting into the quarter. However, this benefit was more than offset by the timing of the Easter holiday, which fell entirely in Q3 this year, compared to Q2 last year. We estimate these two items had an adverse impact on the year-over-year growth in operating income of 8 percentage points, or about \$45 million dollars.



We are very pleased with the continued progress we're seeing at Shanghai Disney Resort. The resort was modestly profitable during the second quarter, and while we expect an operating loss for the third quarter due to seasonality, we still expect the resort to breakeven for the fiscal year.

At our domestic parks, growth in operating income was largely due to higher attendance, partially offset by higher costs. I'll note that our domestic operations delivered Q2 records for revenue and operating income.

Attendance at our domestic parks was up 4% in the quarter, despite a net adverse impact of about 2 percentage points due to the timing of the winter and Easter holidays. Per capita spending in the parks was comparable to last year. Since Easter shifted out of Q2 this year and the 60th Anniversary celebration at Disneyland Resort was behind us, we offered seasonal promotions during the quarter to drive attendance growth. Admissions spending was in line with prior year, with the impact of these promotions offsetting pricing increases. At our domestic hotels, per room spending was up 1% and occupancy levels of 88% were comparable to last year.

So far this quarter, domestic resort reservations are pacing down 4%, primarily reflecting the timing of promotions and reduced room inventory due to rehabs and conversions at a couple of our hotels, while booked rates are up +11%.

Overall, we feel great about the performance of our Parks business. Segment operating margin was 17.4% for the second quarter, up 150 basis points over Q2 last year, despite an estimated net adverse impact of about 90 basis points due to the shift in the winter and Easter holidays.

At Studio Entertainment, operating income was up 21% due to increases in television distribution and home entertainment, partially offset by lower film share revenue as sales of *Star Wars* and *Frozen* merchandise were higher in the prior year.



TV distribution results were primarily due to international growth and higher domestic rates, partially offset by the timing of domestic title availabilities.

Growth in our home entertainment business was driven by a greater sales mix of new release and Blu-ray titles, and reflects the performance of key titles such as *Moana* and *Doctor Strange* during the second quarter this year compared to *The Good Dinosaur*, *Inside Out*, and *Ant-Man* in Q2 last year.

On the theatrical side, we are extremely pleased with the performance of *Beauty and The Beast* in the quarter and the carryover performance of *Rogue One* and *Moana*, however, operating income was comparable to prior year given the strong performance of *Star Wars: The Force Awakens* and *Zootopia* during Q2 last year.

At Media Networks, operating income was down 3% in the quarter, as growth in Broadcasting was more than offset by lower equity income from Hulu and A&E, and a decline at Cable. Cable results reflect a decline at ESPN, partially offset by growth at the Disney Channels and Freeform.

At ESPN, higher programming and production expenses were partially offset by higher affiliate and advertising revenue. As I've previously mentioned, we expected ESPN's programming costs to be up meaningfully in the second quarter due to the impact of the first year of our new NBA rights deal, and the shift of three College Football Playoff games into Q2 compared to last year. I'll remind you that this year ESPN aired three of the New Year's Six bowl games during the second quarter, whereas it aired all six games during the first quarter last year.

Ad revenue at ESPN was up 5% in the second quarter as higher rates were partially offset by a decrease in impressions. We estimate Q2 ad revenue was down 1% excluding the impact of the three additional bowl games.



Turning to Broadcasting, growth in operating income was due to an increase in program sales and higher affiliate revenue, partially offset by higher programming costs and lower ad revenue.

Higher operating income from program sales resulted from the sale of *Iron Fist* and higher sales of *How to Get Away with Murder* during the second quarter compared to the sale of *Daredevil* last year.

Higher programming costs were due to a greater mix of third-party programs and contractual rate increases for acquired programming.

Ad revenue at the ABC Network was down about 2% in the second quarter, as higher pricing was more than offset by a decrease in impressions. Quarter-to-date, primetime scatter pricing at the ABC Network is running 23% above upfront levels.

Total Media Networks affiliate revenue was up 4% in the quarter due to growth at both Cable and Broadcasting. The increase in affiliate revenue was the result of 7 points of growth due to higher rates, partially offset by a 3 point decline due to a decrease in subscribers.

This quarter, we experienced a slight change in the rate of sub losses. I'll note that the magnitude of the change was less than half a point compared to what we experienced during the first quarter.

At Consumer Products and Interactive Media, operating income was up 3% in the second quarter, as higher operating income from our Games business was partially offset by a decline in Merchandise Licensing. Games results benefitted from the discontinuation of our vertical console games businesses in the second quarter last year. Merchandise licensing results were lower in the quarter, reflecting strong sales of Star Wars and *Frozen* merchandise in Q2 last year.



As we look to the third quarter, there are a couple of comparability items I want to highlight. As I've noted in the past, we expect fiscal 2017 cable programming costs to be up 8% versus fiscal 2016 driven primarily by \$600 million in incremental expense associated with the first year of our new NBA contract. We expect \$400 million of that increase in the third quarter, which will be the biggest driver of a 16% increase in total Cable expenses.

At Parks and Resorts, we anticipate Q3 costs will increase meaningfully versus prior year largely to support underlying volume growth and a variety of growth initiatives. These include the openings of *Pandora – The World of Avatar* at Animal Kingdom, *Guardians of the Galaxy – Mission: BREAKOUT!* at Disney's California Adventure, and *Explorers Lodge* hotel at Hong Kong Disneyland. Higher costs also include a full quarter of operations at Shanghai Disney Resort and will reflect an 18-day dry dock of the *Disney Fantasy*.

I also want to update our capex forecast for the year. Given changes in timing of a number of projects under development, we now expect capex for fiscal 2017 to be \$200 million dollars lower than prior year.

During the second quarter, we repurchased about 18.6 million shares for about \$2 billion dollars. Fiscal year-to-date, we've repurchased 41.5 million shares for approximately \$4.4 billion dollars. As you know, we've always taken a disciplined and balanced approach to allocating capital and in how we manage our balance sheet, which has served our shareholders well.

Given the lower than expected capex and improved operating cash flow, coupled with our continued confidence in our business, we are increasing our share repurchase target by \$2 billion dollars to \$9 to \$10 billion for the year.



Overall, we feel good about the financial results we delivered this quarter and for the first half of the year, and we are still on track to deliver modest growth in earnings per share for fiscal 2017.

I'll now turn the call back over to Lowell, and we'd be more than happy to take your questions.

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

Okay, thank you Christine. Operator, we are ready for the first question.

Operator

(Operator Instructions) Our first question comes from Alexia Quadrani from JP Morgan. Your line is open.

Alexia Quadrani – *Analyst, JP Morgan*

Hi thank you very much. My first question is on the Parks. There's a lot of excitement around the expansion of Animal Kingdom later this month. Can you talk about what the levers are for further financial growth at the Parks sort of in general, not just in Orlando? I guess when you look at how far you've come in terms of margin expansion over the last, say, 5 years, I'm trying to – I wonder what the drivers are specifically for the next leg up. Is it attendance, price, longer stays, or perhaps all of the above?

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

The answer would be all of the above. We have a lot of investment activity, actually across the globe in that segment. You mentioned *Avatar* which opens just in a couple of weeks. We're building two Star Wars Lands, as you know, in Orlando and in Anaheim. We're opening a new hotel in Hong Kong. We opened *Iron Man* recently. We just announced the \$1.4 billion expansion of the Hong Kong Park. We intend to – with our partner OLC – to continue to grow our business in Tokyo. And of course, we've talked about what we're doing in Paris, which is all aimed at long-term investment and long-term growth. And then we had a quarter of



profitability at Shanghai. I mentioned in my comments that we're just days away from Shanghai hitting 10 million people in attendance, which is nicely ahead of where we thought we would be because the year anniversary is in June. And we are already building to expand there. So we think we've got opportunities to continue to grow that. And of course, we've got two cruise ships -- two new cruise ships in the works, and a number of other plans as it relates to our hotel business.

So we think that we've got room on pricing there. It's not just about taking pricing up, it's just about being more strategic at how we price, particularly how we manage demand, and we've taken a number of steps there. We think we can expand length of stay across the globe actually with some of these investments. We have some nice pricing leverage with our hotels. We actually are competing nicely in hotel rates, particularly in Orlando as a for instance, but we have an opportunity to expand. And again our global footprint continues to grow, particularly when you consider expansion in Hong Kong and Paris and ultimately in Shanghai.

So I think there are a lot of levers here. We also have a business that has been great at managing its costs, which go up somewhat this coming quarter -- the quarter that we're in -- because of some of the investments we've talked about. But they've managed their cost to continue to improve margins, and we don't see any reason why that can't continue.

Alexia Quadrani – *Analyst, JP Morgan*

And Bob, just a quick follow-up on the box office. You've had such a huge success there and a great pipeline ahead. I guess are there any concerns at all that the windows may change or move to premium video-on-demand that may become a reality and therefore somewhat disruptive to a system that's clearly working for you?

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

I know that there's been a lot of conversation about it. In fact, I saw the head of AMC on CNBC just earlier talking about it. We're actually not in conversations right now for a premium VOD



window because, frankly, the way we have structured our Studio business, with roughly 10 tentpoles a year and profitability that's continued to grow nicely, we don't really believe that there is a need for us to move that product off of the big screen any faster than we currently are or to do so in a concurrent manner to the big screen experience. The movies we make are perfect for consumption on the big screen, and we've also created global phenomenon with our films where people seem to all want to go see them en masse, as witnessed by this past weekend's results from *Guardians of the Galaxy*.

So we're not concerned about it, we're not really engaged in it. It doesn't seem to be anything that we are considering anytime soon. We'll obviously watch developments, but if it makes sense for us to do it, to grow our business, I imagine we'll be open-minded about it, but nothing now.

I'm glad you brought up movies because to the question you asked about our Parks, another opportunity that we have to grow that business is by mining the great IP made by our Studio. And so just in terms of increasing attendance and doing all the things that we talked about doing, continue to infuse the parks with more of our IP, *Frozen* going into Hong Kong as a for instance, a great example of that, *Guardians of the Galaxy*, *Star Wars*, all those things. Clearly, our demand -- or the demand for our parks has gone up as people have engaged more with our popular IP.

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

Thanks Alexia. Operator next question please.

Operator

Our next question comes from Michael Nathanson from MoffettNathanson. Your line is open.

Michael Nathanson — Analyst, MoffettNathanson

Thanks. Bob, I have one for you on ESPN, it's not about subscribers, it's not about programming costs, it's about *SportsCenter*. And I think from consumption patterns you see that people are



not tuning into *SportsCenter* the way that maybe they used to in a pre-digital world. I wonder, what does ESPN need to do to on air to respond to that challenge? And what are you doing mobility for ESPN to stay relevant on a newsgathering site?

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

I'll start with the second part of your question, Michael. ESPN has taken a number of steps on their mobile business, particularly consolidation of their apps and improving engagement interface with the consumer, customization, personalization, and use of video on the apps to grow engagement significantly. The numbers have been tremendous, and also I should add, the WATCH app, which is also really working nicely, and that's going to continue to grow. And they've got fairly big plans to do that. I think we all know that in today's world, people are accessing their mobile devices to get sports scores, highlights, and varying forms of statistics and information about sports, greater than they ever did. There's nothing that we can really do, I think, to slow that down, except it's important for us to participate in it, and that's what we're doing.

That said, John Skipper and the ESPN team have made a number of moves already on the personnel front and will continue to in terms of moving people around and making the best of basically the talent that ESPN has. In addition to that, they're looking at some program changes overall in terms of how the networks are programmed, all with an eye toward addressing not only where consumers are today, but improving our non-live sports programming numbers.

We're not sitting on our hands, actually there's a lot of engagement about it. But I'd say that the best thing that we can possibly do is to continue doing what we're doing, which is to make that mobile experience great. And we are. And our numbers -- by the way, they're far above the numbers of any competitors in the space. And so while we've seen a lot of consumption basically migrate from live channels on news and information to mobile devices, we've taken advantage of that and we believe the money will follow.



We obviously are engaging with our advertisers in basically forming packages that are combined live -- sorry, not live, but channel packages as well as digital packages, and actually ESPN's advertising mostly combined in that regard. And advertising continues to grow on the digital side, and we feel bullish about it.

Use of video was important, too. If you noticed, Michael, you'll notice on the most recent iteration on your phone, if you use ESPN, the presence of that video player is much greater and the opportunity to personalize or customize it where you name the teams or the sports that are your favorites, and more and more you're more likely to get a highlight of one of those teams or one of those sports in that video player, that's a big deal and you'll see more of that.

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

Thanks Michael. Operator next question please.

Operator

Our next question comes from Ben Swinburne from Morgan Stanley. Your line is open.

Ben Swinburne — *Analyst, Morgan Stanley*

Pretty sure that's Ben Swinburne but I'll ask my question and hope that this is on.

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

We will go with you Ben.

Ben Swinburne — *Analyst, Morgan Stanley*

Okay thanks Lowell. Bob, you mentioned in your prepared remarks, I think that you're seeing substantial growth already for some of these new streaming platforms. You mentioned on CNBC earlier that you think that these services will appeal to a newer consumer, more price-sensitive consumer, and help offset some of the traditional losses. So given you have better



information than we do, maybe you could just elaborate a bit on that and why you're optimistic in raising the buyback to boot.

And then on the Studio side, people obviously are nervous a bit about sort of the profitability levels being at peak margins for the Studio. Wonder if you could talk a little bit about how much more room you see or at least the sustainability in the kind of splits you're driving with particularly the exhibitors, given how much the box office is driving the business. I'm thinking both about the U.S. and also globally where the typical splits are lower for the Studio side of the business model.

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

Well, I'll touch upon the last one first. Given the success of the Studio to date the last few years, and given the slate that is ahead, there isn't a Studio that is more important to the distributors than The Walt Disney Company, particularly when you consider the amalgam of brands, Pixar, Marvel, Disney and of course, Star Wars. And when you look at the slate coming up with *Pirates* and *Cars* and *Thor* and *Coco* and *The Last Jedi* and more Marvel movies, *Black Panther* and *Avengers* and *Han Solo*, *Incredibles* and *Ant-Man* and I could go on, we have a really great relationship with the distributors. We've enabled them to grow and they are enabling us to grow, and we believe that more growth will and should come from that business. One of the reasons why we're not engaged in discussions on this premium VOD window is because what we've got going is working and we have no reason to disrupt that right now. We are making movies that people want to see in the large screen venues that are being built worldwide, and that gives us some leverage with them, yes, but it's also very mutually beneficial.

The buyback, we feel confident in where the company is going. We obviously have a great balance sheet. We have the wherewithal to continue to access capital to not only invest in some of the things that we've talked about, but to manage expansion down the road. And so this is, as you know, we've had a blend of ways that we're returning capital to our shareholders with increased dividends, continued buybacks and, of course, very, very successful large



acquisitions when the opportunities come along and growth in our stock. So this is just part of what has been an ongoing strategy. And as Christine mentioned, because of some reduction in capital expenses that we had expected this year, we felt we had excess capital in looking at opportunities to pass that back to shareholders. We thought, particularly given what we see as the future of our Company, that this was a good buy for us and a good buy for our shareholders. That's a long you-- asked a lot of questions.

On the distribution and the ESPN front and the new OTT platforms, first of all, give us a little bit of credit for being very candid with all of you on an earnings call 2 summers ago when we talked about sub losses of the expanded basic bundle. We did that because, one, we wanted to be candid; and two, we wanted to signal that we had our eyes wide open about what was going on, and we fully intended to address what we were seeing and what we've continued to see. It enabled us to take a number of steps to deal with the issue in a way that long term will serve this company very well. What we've done is we have negotiated deals with all these new distributors. By the way, they've concluded that launching new platforms without ESPN is very challenged. Launching with ESPN gives them an ability to penetrate the marketplace in ways that they wouldn't be able to without it. And so we're -- we've done deals, as you know, with Sony Vue and AT&T Direct and Sling and YouTube, which launched a month ago, and Hulu most recently and there are others entering the marketplace. We've seen really nice growth there but it's nascent. And the growth that we've seen in number of subs, so far, has not made up for the losses that we have seen in the expanded basic service. Those losses have come from cord-nevers, cord-cutters and what had been a migration to lighter packages on those platforms that did not include ESPN. It has been a blend. And it's been fairly steady, which is why we continue to focus on distributing on these new platforms, which, we think, provides opportunities for us and for consumers in a variety of ways. First of all, they're more user-friendly. The interface is typically better because it's newer. They are more mobile-friendly as well. The combination of those as well as the pricing, we believe, makes them more attractive to people in lower economic brackets as well as a new generation or a younger generation of consumers. And that is very, very important to us. Live sports works on those platforms, and young consumers want



live sports and we've got the best array of them. And so we continue to engage with them, we continue to feel optimistic about what we're seeing.

We're also mindful of what's going on what I'll call the traditional business, which is why we are doing what we're doing with our apps business, which is why we're invested in BAMTech because we believe another area of growth for this company is in the direct-to-consumer space, not just with ESPN, but with our other brands, and not just in the U.S, but worldwide. We intend to launch an ESPN-branded service direct-to-consumer by the end of the year. A lot has been said about the cost reductions at ESPN. We're managing that business efficiently. We always have, we always will.

Obviously, there's probably a greater need to do it, given some of the challenges that we've seen near-term, but frankly, what we've been doing in terms of scale, in terms of size is not all that significant when you consider that ESPN has 8,000 employees and we reduced by about 100 a few weeks ago. I don't take it lightly, but the number, it gets headlines. When you think about it, in the scheme of things, or if you just look at it against basically the number of on-air people that ESPN has, it wasn't a particularly significant number or reduction. But we are -- we do believe we need to manage it more efficiently. And we also continue -- we will continue to be aggressive at buying live sports rights, which have not gotten cheaper, we understand, but they have gotten more valuable. And new entrants into the marketplace like Amazon and the talk of others like Facebook only prove the point that we just made, that live sports is important to new digital platforms and live sports is important to anyone who's trying to reach consumers in the media business.

Ben Swinburne – *Analyst, Morgan Stanley*

Thanks for all the color.

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

Okay Ben thanks for the question. Operator next question please.

**Operator**

Thank you. Our next question comes from Doug Mitchelson from UBS. Your line is open.

Doug Mitchelson – *Analyst, UBS*

Oh thanks so much. I think I want to continue along the lines on ESPN, but just to flesh out, Bob, you've been talking more openly about investing in the technology necessary to build ESPN direct-to-consumers. You've talked about what you want to launch by year-end. Does part of the discussion that you implied in your prepared remarks suggest that there is a plan to launch the full-ESPN service direct-to-consumer at some point in time? And what kind of time frame? And if there is no time frame, what would the marketplace triggers be that would cause such a service to become a reality? And I'll just ask a follow-up for Christine. I believe over the next 5 years, ESPN has all of its affiliate renewals, and I think once you're past this June quarter, the sports cost structure is also pretty locked in until about fiscal '22. I was just hoping you'd confirm whether or not I'm accurate on that. Thank you.

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

Doug, we don't have plans right now to take ESPN as it is currently distributed on both new and traditional distributors and go direct with it. Will that eventually happen? I think probably, but there's no plans right now to do that. There are complications as it relates to our current relationships with distributors, and frankly, we don't really feel that we've got a great need to do that. However, ESPN has a large array of rights that it can sell what I'll call off traditional platforms, that it can aggregate as a whole or can sell individually on technology that, frankly, is working. The streaming capabilities at scale of BAM are extraordinary, and we've seen what's going on with mobile device consumption of video, and there's just a great opportunity to take inventory that ESPN has, take advantage of the technology that's out there and grow business in the direct-to-consumer space that, frankly, we've not been in. And we're encouraged with what we've seen already in terms of technology, in terms of some of the entities that have already been out there selling in the direct-to-consumer space, obviously, and believe that we



have a lot of opportunity to participate in that business. But currently, we don't have plans to take the channel and just basically make it available direct. I'm guessing that I'm not giving you any timetable at all. It's not very near, but there is an inevitability to that.

Doug Mitchelson – *Analyst, UBS*

That helps. Thank you.

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

So Doug, it's Christine. Your qualification of the affiliate renewals coming up over the next 5 years through 2022, that time frame is about right.

Doug Mitchelson – *Analyst, UBS*

And then on the sports' cost side, I think this is relatively straightforward because most of the deals are well-known, but after the June quarter, when we look out over the next 5 years, other than maybe something for the Big Ten, there's nothing else significant coming through?

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

That would be correct. Basketball -- the NBA is the last big one for a while. We've not said anything more about new packages, but there's nothing looming that is anything close to the size of the NBA or the NFL or Major League Baseball.

Doug Mitchelson – *Analyst, UBS*

Alright. Thank you.

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

Doug thank you. Operator next question please.

**Operator**

And our next question comes from Omar Sheikh from Credit Suisse. Your line is open.

Omar Sheikh – *Analyst, Credit Suisse*

Thank you. I just had a couple of questions. First of all, for Bob, I just want to continue the theme on the direct-to-consumer strategy. You touched upon the position that BAMTech will have in that. I wondered if you could maybe just flesh that out a little bit. What sort of content you're thinking of putting into a BAMTech-delivered product? And for example, whether or not you think it will be predominantly subscription-based product or ad funded as well, that would be useful. And then just a follow-up for Christine, I don't know whether in your prepared remarks, Christine, you touched on this, but I wondered if you could just give us a number for maybe some guidance on Q3 pacing for cable net ad revenue.

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

There were a number of aspects of the BAMTech business that impressed us tremendously. One I mentioned which is their ability to offer streaming live video at scale. The other was their ad insertion technology. We're extremely impressed with what they built in terms of advertising revenue generation capabilities, and any business that we've contemplated with them would include a blend of a subscription and advertising. In terms of product, it's really premature to suggest what it would be, except there seems to be people jumping to conclusions that there would be sort of a one-size-fits-all product that went to the marketplace, and that's not what we're thinking at all. We actually believe that one of the benefits of direct-to-consumer business is to give consumers the opportunity to buy either subscriptions that are shorter in nature or limited in nature or specifically targeted to things that they're interested in like a given sport or a given team or a given region in a given period of time. So while I think it's possible that there will be an omnibus sports -- multiple sports package offered direct-to-consumer, it's more likely that consumers will have an opportunity to buy the sports they want when they want it as well. And so I think it's early to really get more defined because we



haven't announced anything, but we're certainly working with them on bringing our product forward before the end of calendar '17.

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

Okay, Omar, I'll touch on the Q3 ad sales pacing. So in my comments, I did mention that ad sales are pacing down and this is for ESPN, I think, that you're referring to. And that's reflecting the softness that we're seeing in the overall advertising marketplace. We are, however, very pleased with what we're seeing with the NBA. There's strong demand for the NBA inventory, and the ratings strength to date is encouraging. The teams that are remaining in the playoffs suggest that the performance in the conference finals should be strong. We're also encouraged by live sports. There's a couple of sporting events that did quite well recently. Total audience growth was strong in the recent NFL draft, and we've also seen some very strong Major League Baseball games. And also, the Women's NCAA championship game that was just recently played. I'd also like to touch on more broadly just what we're seeing in the ad market. We are optimistic as we head into the upfront. Over the past year, we've successfully sold impressions across the ESPN platform, and we're confident that this strategy's going to continue to serve us well, particularly now that Nielsen is measuring all those live impressions as one number. Bob talked in his comments about the reach and growth of our platform and that's everything from linear, out of home, over the top, WatchESPN, mobile, digital. And we're quite uniquely positioned with this platform to deliver expansive reach to our very desirable audience. So this unique positioning provides us with optimism that will have a very successful upfront.

Omar Sheikh – *Analyst, Credit Suisse*

Perfect. Thank you very much.

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

Thank you Omar. Operator next question please.



Operator

And our next question comes from Todd Juenger from Sanford Bernstein. Your line is open.

Todd Juenger – *Analyst, Sanford C. Bernstein*

Hi I think I am related to Ben. So at the risk of driving you guys crazy, I'm sorry that the questions I really want to ask happen to be about Media Networks, too. So sorry about that, but here they are. One question is, I love your thoughts about the sort of sister networks at ESPN. Just listening to your comments, Bob or Christine, about the multichannel universe and emerging options for consumers, I just wonder what do you think about the future of ESPN Classic, ESPNNews, ESPNU and those brands in that evolving world. That's one. And then the second question, I just love, I guess, Bob, if you wouldn't mind, just reconciling, there are some of your peers who are saying it's inevitable there will be a non-sports type of skinny bundle offering that comes to the market. But then I hear -- as we listen to you, right, point out that no such thing exists yet and that it seems like, in your point of view, that without sports, it's hard to succeed with one of these services. So those are 2 very different point of views. Do you believe, I guess, that it's possible or that there is a marketplace for a non-sports bundle? Or is that just not in the U.S. market something that you think has very much consumer appetite? Thank you.

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

Someone was out there today talking about a \$10 bundle that didn't include sports. I don't know how many channels you could fit into a \$10 bundle, but I would imagine there wouldn't be any channels that were particularly attractive. Maybe someone will go out with a very low-cost set of channels that can't drive the kind of fees that -- the more popular ones. I'm not sure but I don't see how that's practical in terms of gaining much penetration. In terms of other channels of ESPN programs, clearly, the channels that have the most live sports are the ones that have been the most successful in terms of sub fees and ad revenue and ratings. They've launched some and the SEC Network would be the best example, they've been quite successful



in that regard. We've reduced some of the investment in some of the other channels, but I think it's safe to say that ESPN is going to be out there with a multichannel product for the foreseeable future.

Todd Juenger – *Analyst, Sanford C. Bernstein*

Ok thank you.

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

Todd thank you. Operator next question please.

Operator

And our next question comes from Anthony DiClemente from Nomura. Your line is open sir.

Anthony DiClemente – *Analyst, Nomura*

Thanks very much for taking my question. No ESPN question for me tonight, but I wanted to ask you, Bob, about Disney leadership. With your contract extension complete, and congratulations on that, would you share with us a little bit about how you and the board finally came to that decision? Maybe why it took a little longer than some may have thought? And you previously talked about Lucasfilm and Shanghai as 2 key priorities of yours. Do you have any incremental priorities for the company between now and mid-2019 when your contract does come up? And then maybe talk about is there a way this time around to ensure a smoother succession plan for Disney leadership come mid-'19? And then just a follow-up for Christine. I did want to ask about Consumer Products and the opportunity there in the back half. What is the opportunity? Could Consumer Products really accelerate here in the back half, given the pipeline of IP coming to market in the summer and for the holiday period? Thank you.



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

So Anthony I'm going to try not to be too impertinent but there's been, I think, more made about our succession than it really deserves, suggesting that there's been trouble on the succession front here. And I will only go back to 2005 when I was chosen from being COO of the company for 5 years to be the CEO and the successor to Michael Eisner. And I don't want to characterize my tenure over that period of time, but we had a smooth transition. I moved into the role after having studied under Michael for 5 years. I overlapped with him for 6 months between the time I was named and the time that he left. And it was, frankly, it was seamless.

The board made a decision after deliberating for probably 6 to 9 months, so I think it was extremely thorough. We considered an internal candidate and a number of outside candidates, and it worked as far as, at least as far as I can tell. I'm confident that the board will conduct yet another successful succession process. The decision that was made in terms of my staying longer was, in fact, it had a number of -- there were a number of factors, some are very personal. I've been in this job for 12 years. It's a job that I've loved from the moment that I got it. I had a few more things that I wanted to accomplish, I can't talk about that, but frankly, the #1 priority of mine was making sure that we have another successful transition process. And I thought by giving it another year, I increased the possibility of that happening. And increased the possibility, frankly, of more opportunities for the people within this company as well. So that is my #1 priority. I'd say that's probably the board's #1 priority. We have enough time to not only consider the right candidates, but to make the right decision and to craft a hand-over of sorts or a transition that should be successful.

There are other things that are clearly at the top of my list in terms of priorities, but they are -- they are, I think, they are pretty obvious. It's continuing to grow the company in the digital direction. It's continuing to grow the company globally. It's continuing to solidify ESPN's future by doing the things that I talked about on this call, and probably above all that, which is tied in part to succession but it goes beyond succession, it's making sure that the leadership of this



company across the board is -- it continues to be really strong so that it can deliver the kind of results that everybody expects from us.

Anthony DiClemente – *Analyst, Nomura*

That's awesome thank you.

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

Okay, Anthony, turning to Consumer Products, I think you remember that I previously said that full fiscal year '17 would be driven by our second half performance in the segment. We still expect strong growth in the second half, and it will be driven by two very important IP franchises: Cars and Spider-Man. The *Cars 3* movie which releases on June 16 and *Spider-Man* which releases on July 7, we're looking very much forward to those releases, and we are very optimistic that the two franchises and the merchandise licensing from that will drive a very strong second half performance and our business overall.

Anthony DiClemente – *Analyst, Nomura*

Thank you very much.

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

Alright Anthony. Operator we have time for one more question.

Operator

Thank you and our final question comes from Steven Cahall from Royal Bank of Canada. Your line is open.

Steve Cahall – *Analyst, RBC Capital Markets*

Thank you. Just one on parks and then a quick follow-up. On the Parks, you've continued, I think, to sort of defy gravity with the incremental margin and you talked a lot about the incremental revenue opportunities, so I was wondering if you could shed any light on maybe



some initiatives that you have on the cost side, particularly, as you probably reached (inaudible) here and can throw a bit more resources at the cost. And then with the increase in the buyback, just sort of a longer-term question. If we do happen to go to a point where your cash taxes come down materially, how do you think about how to deploy that incremental free cash flow? Thank you.

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

So on Parks, in my comments, I mentioned that in the third quarter, Parks expenses actually would be up in the third quarter year-over-year. And we anticipate those costs being up because of underlying growth as well as the launching of some major new initiatives which are coming online. You've heard them a few times here: *Avatar*, *Guardians of the Galaxy* at Disneyland as well as a new hotel in Hong Kong. We also have that first full quarter of Shanghai operations in the third quarter, so that will also impact our expense growth. And we also, it's worthy of mention that we have an 18-day dry-dock of 1 of our 4 cruise ships, the *Disney Fantasy*. So for the quarter, the expenses will be up for the Parks segment.

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

I think as it relates to, I'll say margins, I think you're asking more about cost savings, is when we look at margin expansion, we're not just looking at cost savings. We start with the fact that we offer a premium experience. And in order to offer the experience that we offer, we operate these parks across the globe at an industry-leading level or an industry-leading way. The quality of service is part of our -- the brand proposition of our parks to the world, quite frankly, and that takes a cost structure that needs to be supported. We always look though to run it more efficiently. Technology has been our friend in that regard. Some of the steps that we've taken already by deploying technology, whether it's on the sales front, the ticketing front or the overall customer interaction or whether it's on the operations front, have obviously helped. But there are also opportunities on the pricing front. I talked about them earlier. It's not just about raising prices. It's about a strategic approach to pricing that is also designed not only to increase attendance, but to improve margins. So we don't look at it just as a savings initiative. We look



at it as a combination of revenue generation and cost efficiency, combined, obviously, with no loss of service, of quality of service, which is imperative for us.

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

And Steve, I know you had a question on the buyback, but could you repeat the question?

Steve Cahall – *Analyst, RBC Capital Markets*

Yes, it was more of a longer-term question, that if the animal spirits convene in Washington and we end up with more cash because tax comes down, how do you think about incremental deployment of cash in a much more tax-friendly environment?

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

Well, I think the best way to think about that is, we would carefully consider it. It would be a great problem to have to consider tax reform. So it's just one of many things that we would consider, but we have been consistent with our buyback year after year, and I would just leave it at that.

Steve Cahall – *Analyst, RBC Capital Markets*

Thank you.

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

Steven, thank you, and thanks, 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 the securities laws. We make these statements on the basis of our views and assumptions regarding future events and business performance at the time we make them, 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 those 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. Once again, thanks, everyone for joining us.

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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 October 1, 2016 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.