



The  
**WALT DISNEY**  
Company

## Q3 FY17 Earnings Conference Call

AUGUST 8, 2017

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*



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## **PRESENTATION**

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### **Operator**

Welcome to The Walt Disney Company Q3 FY17 Earnings Conference Call. My name is Karen. I will 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. Lowell, 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 Third Quarter 2017 Earnings Call. About 25 minutes ago, we issued two press releases, both our earnings release and a press release announcing our acquisition of majority ownership of BAMTech and two upcoming direct-to-consumer streaming services. Both of those releases are available on our website at [www.disney.com/investors](http://www.disney.com/investors). Today's call is also being webcast, and a recording and transcript will also 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. So with that I will 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, everyone. Besides today's earnings release, which Christine will detail after my remarks, we are also announcing a major strategic shift in the way we distribute our content. We're excited by this change, and see it as an important, logical way for us to take advantage of the combination of our strong brands with the technological evolution the entire media business is undergoing.

It's been clear to us for a while that the future of this industry will be forged by direct relationships between content creators and consumers. Given our incomparable collection of strong brands that are recognized and respected the world over, no one is better positioned to



lead the industry into this dynamic new era – and we’re accelerating our strategy to be at the forefront of this transformation.

Last year we acquired a substantial stake in BAMTech to help us scale and monetize our streaming capabilities. Since then, we’ve been increasingly impressed with the platform, the leadership, and the potential to drive growth. So much so that we’re investing an additional \$1.6 billion dollars to increase our stake from 33% to 75% and acquire control of the company.

This move gives us immediate access to the team and the technology we need to deliver the highest-quality direct-to-consumer experience – which ultimately gives us much greater control of our own destiny in a rapidly changing market.

As a direct result of this acquisition, we’re greatly expanding our plans for the first ESPN-branded direct-to-consumer service. We’re creating a more robust, multi-sport package, which will give sports fans access to more live sports – 10,000 additional events annually – including Major League Baseball, the National Hockey League, Major League Soccer, Grand Slam Tennis, and college sports. Additionally, we’ll make individual sports packages available for purchase, including MLB.TV, NHL.TV, and MLS Live.

Subscribers will access the new service through an enhanced version of the current ESPN app, which millions of fans already use for sports news and programming. We’ll fully integrate the new subscription service into this same app as part of our strategy to create the premier digital destination for sports. Consumers who are pay TV subscribers will also be able to access the ESPN television networks in the same app on an authenticated basis. Ultimately, we envision this will become a dynamic sports marketplace that will grow and be increasingly customizable, allowing sports fans to pick and choose content that reflects their personal interests.

Our new, direct ESPN service will be available to consumers in early 2018.



Of course, one of the most compelling brands for a direct-to-consumer product is Disney. And to that end, we will launch a Disney-branded streaming service in 2019 – which will be unlike anything else in the market.

The new service will become the exclusive home in the U.S. for subscription video-on-demand viewing of the newest live action and animated movies from Disney and Pixar, beginning with the 2019 slate, which includes *Toy Story 4*, the sequel to *Frozen*, and *The Lion King* from Disney live-action, along with other highly-anticipated movies. We'll also be making a substantial investment in original movies, original television series, and short-form content for this platform – produced by our Studio, Disney Interactive, and Disney Channel teams. Subscribers will also have access to a vast collection of films and television content from our library.

With this strategic shift, we'll end our distribution agreement with Netflix for subscription streaming of new releases, beginning with the 2019 calendar year theatrical slate.

These announcements mark the beginning of what will be an entirely new growth strategy for the company – one that takes advantage of the opportunities the changing media and technology industries provide us to leverage the strength of our great brands.

Turning to another major growth area for us, today's results reflect our aggressive investment in our Parks and Resorts business. Given the success of these investments, and their continued attractive returns, we're continuing to leverage our great intellectual property in numerous investments across our Parks and Resorts businesses.

Over the last decade we've transformed Disney California Adventure, doubled the size of our cruise fleet, brought the phenomenal world of *Pandora* to life in Orlando, and opened the spectacular Shanghai Disney Resort, which has already welcomed more than 13 million guests.



Looking ahead, we'll open *Star Wars: Galaxy's Edge* in Disneyland and Disney World in 2019, and we just announced an immersive Star Wars-themed hotel in Orlando as well.

The most popular attraction in Shanghai Disneyland is our e-ticket *TRON Lightcycle* experience, and we're bringing the same attraction to Disney World as part of our ongoing expansion there. We're also transforming Epcot, with new attractions based on *Ratatouille* and *Guardians of the Galaxy*.

We're making some important investments in Disneyland Paris, including transforming the existing Hotel New York into our first Marvel-themed hotel.

And we're adding three incredible new ships to the award-winning Disney Cruise fleet – all of which will be completed by 2023.

Before I turn the call over to Christine, I want to mention some of the movies we're looking forward to from our Studio.

We've got four movies from Marvel in the next fiscal year alone – *Thor: Ragnarok*, *Black Panther*, *Avengers: Infinity War*, and *Ant-Man and the Wasp*. The full Marvel development activity extends well into the next decade.

We've got a lot of fantastic animation on the way – starting with Pixar's *Coco* and *The Incredibles 2*. Additionally, highly anticipated sequels to *Frozen*, *Wreck-It Ralph*, and *Toy Story* are in production.

We're also looking forward to *A Wrinkle in Time* from Disney live-action, as well as live-action versions of *Mulan*, *Dumbo* and *The Lion King*.



And, coming soon from a galaxy far, far away – *Star Wars: The Last Jedi* will be in theaters this December, followed by a Han Solo origin story next year and *Episode IX* in 2019.

The Studio slate is the strongest we have ever had, reflecting the valuable intellectual property we acquired in the last decade, and the array of talent at our Studio business.

And with that, I'm going to turn the call over to Christine to talk about our quarter, and then we'll be happy to take your questions. Christine?

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**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 third quarter, excluding certain items affecting comparability, were \$1.58, down 2% compared to last year.

As I mentioned during last quarter's earnings call, we expected a number of factors to adversely impact our third quarter results, the largest of which was higher programming expenses at ESPN due to the first year of the new NBA contract. I'll discuss the impact of these factors in greater detail as I go through the individual segment results.

Let's start with Parks and Resorts where operating income was up 18% in the third quarter driven by growth in our international operations. Results at our domestic operations were comparable to Q3 last year. Third quarter segment results benefited from the timing of the Easter holiday, which fell entirely in Q3 this year, compared to Q2 last year. We estimate the timing of Easter drove an 80 million dollar benefit to operating income and accounted for about 8 percentage points of the 18% growth in segment operating income.

The growth in our international operations was due primarily to the absence of pre-opening expenses at Shanghai Disney Resort and improved results at Disneyland Paris. As Bob mentioned, we feel very good about how Shanghai Disney Resort has performed during its first full year of operations and we expect the resort to be modestly profitable for the fiscal year.



At Disneyland Paris, the resort's 25<sup>th</sup> Anniversary celebration helped drive growth in guest spending and attendance. Late in the third quarter, we increased our ownership in Disneyland Paris to 100%. We are encouraged by the resort's third quarter results and, as Bob mentioned, we are making investments to drive future growth.

In our domestic business, higher guest spending and attendance drove 6% revenue growth, but the increase in revenue was offset by higher expenses to support higher volume and new attractions, including *Pandora – The World of Avatar* at Animal Kingdom and *Guardians of the Galaxy – Mission: BREAKOUT!* at Disney California Adventure, as well as costs associated with an 18-day dry dock of the *Disney Fantasy*.

Attendance at our domestic parks was up 8% in the quarter, benefiting from the timing of the Easter holiday, which accounted for about 3 percentage points of that growth. Per capita spending in our domestic parks was up 2%. At our domestic hotels, per room spending was up 8% while occupancy was down 2 percentage points to 88%. If you adjust for rooms not available due to refurbishments, occupancy would be comparable to prior year.

So far this quarter, domestic resort reservations are pacing down 3% versus prior year driven by reduced room inventory due to conversions and ongoing room refurbishments, while booked rates are up 6%.

Segment operating margin was about 24% for the third quarter, up 120 basis points over Q3 last year. We estimate the favorable timing of Easter accounted for approximately 120 basis points of margin expansion in the quarter.

At Studio Entertainment, operating income was lower in the quarter as growth in television distribution was more than offset by lower theatrical and home entertainment results. While our Studio is having another phenomenal year, with over \$2.1 billion dollars in operating income year-to-date, I'll remind you last year the Studio delivered record profitability. The



decline in theatrical distribution during the third quarter reflects the performance of key titles in Q3 last year, including *Captain America: Civil War*, *The Jungle Book*, *Finding Dory* and *Alice Through the Looking Glass* compared to *Guardians of the Galaxy Vol. 2*, *Pirates of the Caribbean: Dead Men Tell No Tales* and *Cars 3* in Q3 this year. Home Entertainment results also faced a difficult comparison, as they reflected the phenomenal sales of *Star Wars: The Force Awakens* in the quarter last year compared to very strong sales of *Rogue One: A Star Wars Story* this year.

At Media Networks, our Cable and Broadcasting businesses generated lower operating income in the third quarter compared to last year. Cable results were driven by a decrease at ESPN where higher programming expense and lower advertising revenue more than offset growth in affiliate revenue. As we've discussed, ESPN is in the first year of its new NBA contract, and about \$400 million of the \$600 million year-one cost step-up was incurred in Q3.

Total Cable expense growth for the third quarter came in at 14%, about 2 percentage points better than the 16% we discussed on our last call. Ad revenue at ESPN was down 8% in the third quarter as higher rates were more than offset by a decrease in impressions. During the third quarter, ESPN had two fewer NBA Finals games and 3 fewer conference playoff games compared to last year. We estimate this impact was roughly equivalent to the decline in ad revenue compared to the prior year. So far this quarter, ESPN cash ad sales are pacing down compared to prior year.

Turning to Broadcasting, third quarter operating income reflected lower advertising revenue and higher programming costs, partially offset by higher affiliate revenue.

Ad revenue at the ABC Network was down 5% for the third 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 11% above upfront levels.





We continued to see nice growth in Broadcasting affiliate revenue driven primarily by higher rates.

Total Media Networks affiliate revenue was up 2% in the quarter due to growth at both Cable and Broadcasting. The increase in affiliate revenue was driven by about 7 points of growth due to higher rates, partially offset by approximately a three and a half point decline due to a decrease in subscribers. I'll note that year-to-date, the impact of sub losses on the growth in affiliate revenue is less than 3 percentage points.

At Consumer Products and Interactive Media, operating income was up 12% in the third quarter due primarily to an increase in our merchandise licensing business, which was driven by lower costs in the quarter compared to last year. Operating income growth came in a little lower than we had planned, and while we still anticipate OI growth for the second half of the fiscal year, we don't expect these results to be sufficient to drive growth at Consumer Products and Interactive Media for the full year.

During the third quarter, we repurchased 22.3 million shares for \$2.4 billion dollars. Fiscal year-to-date, we've repurchased 64.3 million shares for approximately \$6.8 billion dollars and we are on track to repurchase between \$9 to \$10 billion for the full year.

And with that, I'll now turn the call back over to Lowell for Q&A.

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

All right Christine, thanks. Operator, we're ready for the first question.

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**Operator**

(Operator Instructions) And we do have our first question from Ben Swinburne from Morgan Stanley.



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**Ben Swinburne** — *Analyst, Morgan Stanley*

Thank you. A lot of news today. I guess, Bob, to start out with, can you talk a little bit about the ESPN over-the-top service and whether you've had any discussions with your MVPD providers in how this may fit or not fit into their retail offerings? And along those lines, as you head into a renewal cycle, obviously, there's a lot of focus on your pricing power. Did this offer change your perspective on pricing power for the network? You've shifted away from your historical distribution model a bit here. But obviously, a lot of media companies have already gone through this process: HBO, CBS, et cetera. So how are you thinking about -- is there a relationship between your core distributors and this new ESPN service that you're bringing to market?

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

We have not had conversations with our distributors. We -- as we enter a new round of distribution negotiations, we have all the confidence in the world in our ability to strike deals that are favorable to the company given the strength of the product that we offer, particularly the strength of the brands. If you look very specifically at ESPN, we still see it as a must-have service for the multichannel providers because of the array of product that ESPN has licensed and what they produce as original programming for the service.

We have seen, as I think many of you have, a pretty interesting and dramatic increase in, I'll call it, app-based media consumption. Much of it is on over-the-top, direct-to-consumer services. And in our 33% investment in BAM a year ago, we got a real good perspective -- or gained a good perspective on just how strong and high-quality that product is, and felt that given the trends that we're seeing in the marketplace, given the strength of the ESPN brand, and given how robust this platform is, it gave us an opportunity to really take advantage of all of this, so the combination of all these things. And so we accelerated our right to buy control of the service, basically so that we could have even more control of our own destiny. But it was also something that the partners of BAMTech, notably Major League Baseball and National Hockey League, concurred with.



And so this gives us the ability to launch a new service, one that we've been talking about, but that will be even more robust than the one we anticipated. In the first year of operation, it should offer consumers approximately 10,000 additional live sporting events over what ESPN offers on its linear networks. This is a combination of the contribution of the partners, as well as what BAMTech has licensed, as well as what ESPN will provide and has also licensed to BAMTech. We're creating a one-app experience so that from a consumer perspective, there's a real ease of use and ease of navigation so that you can -- as an ESPN fan, you can use -- go to one app; look at scores and highlights, as you know ESPN provides; authenticate it to watch the linear networks; or buy up or buy an additional amount of live sports programming basically in the same experience on the same service. That's essentially it.

It does give us optionality in the future. If we see changes in the distribution model, if we see either greater erosion or bigger opportunity to migrate the linear networks to a more direct-to-consumer proposition, we certainly have the technology to do it, and it can be done under relatively seamless circumstances. But we're not currently anticipating doing that as we launch this new app.

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**Ben Swinburne** — *Analyst, Morgan Stanley*

That's very helpful. And just on the Disney-branded direct-to-consumer service, Bob. As I'm sure you're well aware, one of the beauties of the Netflix model is it's global, and so you're talking about a massive footprint to leverage your content. Are you thinking in the same way about the Disney-branded service? You mentioned the change in your pay TV -- pay one rights with Netflix in the U.S., but how are you thinking about the global opportunity and what you need to do on the content side globally?

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

Well, one of the beauties of the Disney brand is just how global it is and how strong the fan base of Disney is globally. Interestingly enough, Netflix did not have global rights to our Disney movies. They bought opportunistically in certain markets. So what we see doing on the Disney



front is we will take our Disney-branded and Pixar-branded movies that had been part of the Netflix pay agreement, starting with the calendar 2019 slate. By the way, that will include *Lion King*, *Frozen 2* and *Toy Story 4*, among others. We'll migrate those, in effect, pay window Disney and Pixar movies to a subscription Disney-branded service. We'll also tap into a vast library of movies and television shows that have been made by the company, the channel, and the Studio over the years, and we'll invest significantly in original movies and television shows exclusively for this subscription service. We'll also roll out the service in multiple markets outside the United States, but it will vary from market to market based on existing distribution agreements and different market dynamics. But I think you have to think about a Disney-branded direct-to-consumer subscription service as a global product, even though we're being more specific today about launching a domestic product in the latter part of 2019.

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**Ben Swinburne** — *Analyst, Morgan Stanley*

That's very helpful. Thank you.

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

Ben thanks for the questions. Operator next question please.

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**Operator**

And our next question comes from Michael Nathanson from MoffettNathanson.

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**Michael Nathanson** — *Analyst, MoffettNathanson*

Thanks. Bob, I have two for you. One on the Netflix content and then on ESPN. For Netflix, you haven't mentioned yet what you're going to do with Lucasfilm and Marvel titles. Will those stay on a pay one service? And if so, why not go direct right now? And then I have an ESPN question.



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

Well, what we're saying specifically is that the Disney-branded app will have the Disney and Pixar films. The disposition of the Marvel and Lucas or Star Wars films, we have not determined yet. We've had a discussion internally about what -- how best to bring them to the consumer. It's possible we'll continue to license them to a pay service like Netflix, but it's premature to say exactly what we will do. We certainly have that opportunity. There's been talk about launching a proprietary Marvel service and Star Wars service, but we're mindful of the volume of product that would go into those services, and we want to be careful about that. We've also thought about including Marvel and Star Wars as part of the Disney-branded service. But there, we want to be mindful of the Star Wars fan and the Marvel fan and to what extent those fans are either overlapped with Disney fans or they're completely basically separate or incremental to Disney fans. So it's all in discussion. What we will say is that Disney and Pixar will definitely be part of this and not be part of any other pay-window distributor in the United States. The disposition of Marvel and Star Wars, we'll announce at a later date when we've determined what to do.

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**Michael Nathanson** — *Analyst, MoffettNathanson*

Okay. And then on ESPN in your announcement today, what will change on the WatchESPN app? It's partly authenticated and also you offer a lot of content on the ESPN3 service, which isn't really a channel, but you've given more content to it. So how does WatchESPN evolve as you go more direct with your BAMTech idea?

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

Well, we don't intend to migrate product off the primary linear services. We've already licensed product to BAM that ESPN had licensed from third parties, and we will increase the amount of ESPN product that will be part of this service, particularly a lot of college sports. We're not getting specific yet about exactly what will come from where. But I did mention 10,000 live events, that is basically the estimate that we've got based on the inventory that we've taken on how many sporting events will be available for this very specific subscription service.



Let me take a step back for a minute, just to give you some -- a little bit of perspective about BAM, too. What impressed us about BAM was, first of all, it's the most robust live streaming platform out there. When you think about live sports and how much a sporting event live is consumed basically concurrently by the masses, you need a very, very robust technology platform to serve that. BAM is the only one out there that has that. In addition, they have great, essentially, customer management systems and technology. That's everything from onboarding and retention, to credit card management, to password management. They also have good ad technology, think about the opportunities in terms of dynamic ad insertion as a for instance, and they basically have very, very strong data management as well and the ability for us to mine user data so that we can get greater customization and personalization.

So this is something -- when we talk about the current ESPN app, while that app is a very robust app, it didn't have nearly the robust amount of product on it that I just described that will enable us to do the kind of things that we want to do. So as you think about the app going forward, think about one app, it looks pretty similar to the app that you've got now, except it can do a lot more, all the things that I just described. You can use it as an authenticated subscriber of a multichannel service, which basically gives you access to the direct -- to the streams of the ESPN channels, or you can buy up or buy additional sports products through the subscription. But again, it's the same seamless experience. And there will be upsell opportunities for us as well. So you'll watch a highlight, if you want to buy -- maybe part of a game that is going on live, if you want to buy that game, you'll be able to buy it directly through the app or subscribe to the service directly through the app. It's basically one-stop shopping for the consumer, and it's one-stop shopping for us in terms of our ability to manage the consumer that wants to consume sports through ESPN.

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

Thank you Bob.



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

Alright Michael thank you. Operator next question please.

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**Operator**

Our next question comes from Doug Mitchelson from UBS.

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**Doug Mitchelson** – *Analyst, UBS*

Thanks so much. Bob, continuing along this theme. I'm just curious, are there restrictions in your current MVPD deals that hold you back from taking ESPN over-the-top -- the main channel -- until you are fully through the renewal cycle? And I'm curious if you envision distributors partnering with you to bundle and sell these services with their broadband or video services? And then I've got a follow-up.

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

I'm not going to comment specifically about the agreements. There are elements to the agreements that -- well, first of all, if we wanted to take ESPN direct, we could. There are elements to the distribution agreements that we have that would cause us to -- if we were to bring the service direct to the consumer -- or create some, I'll call them, suboptimal circumstances for us. I'm not going to get into detail about that. If we were to create a direct-to-consumer app that had the linear services, just as Netflix is distributed by multichannel servers out there or products out there, we would give our distributors an opportunity to distribute our app and other third parties as well.

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**Doug Mitchelson** – *Analyst, UBS*

Do you think that ESPN is -- we all think it's about \$7 or \$8 within the bundle. Do you think there's an opportunity for this direct-to-consumer service to show that ESPN is undervalued within the bundle? Do you think it's fairly priced within the bundle based on your research?



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

I think you're kind of leading the witness a little bit there. I'm not going to get -- I'm not going to comment on our pricing today or our potential pricing power going forward. The ESPN brand is still very strong. As you look at the array of sports that ESPN has licensed, whether it's major sports from the NFL to the NBA to Major League Baseball to all the college packages or the great tennis that we have, it's a very high-quality service that, I think, is very much in demand from consumers. It obviously has suffered a bit from the overall impact of digital technology and new forms of media consumption on the ecosystem. One of the reasons that we're doing this is because of the trends that we're seeing. But another reason that we're doing it is because of the strength of the brand and the opportunity that this technology and the consumer trends that the technology has created are providing. It's not just a defensive move; it's an offensive move.

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**Doug Mitchelson** – *Analyst, UBS*

If I could ask one quick follow-up on the Disney service. Where will the team that runs that service be housed? Will they be within one of the Disney units? Will they and the programming team that's going to be doing the original TV and movie content be housed in a new unit?

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

We're creating a -- basically a management team that BAM will report to. Well, actually, we're creating a Board because we'll have a couple of outside owners. I will be Chairman of that Board, and we'll manage essentially the technology platform that is BAM. ESPN will control, in effect, its own destiny in terms of, let's call it, the programming of the app and the disposition of sports rights, et cetera and so on, and then we will create a team that will manage the Disney side, too. But the Studio, the Disney Channel team and our interactive team will all create products specifically for that Disney-branded subscription product. And I'll be directly involved on both sides.





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**Doug Mitchelson** – *Analyst, UBS*

Thank you.

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

Alright Doug thank you. Operator next question please.

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**Operator**

And our next question comes from Alexia Quadrani from JP Morgan.

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

Thank you. Bob, you're having so much success with your Studio IP, not just the box office, but driving growth in the parks as well. I guess, now that you have another or let's say different outlet for growth with the announced Disney streaming service, is there a consideration to increase your investment even further in the Studio?

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

Yes. What we're going to be doing, I think you have to look at it in a different way, but it's a good question. We are going to be using our capital increase -- and it will represent increased spending that we hope to get a little bit more specific about either in the next earnings call or sometime in a later date when we have a little bit more visibility. But we've already begun the development process at the Disney Channel and at the Studio to create original TV series and original movies for this service. So if the Studio makes, let's call it, roughly 10 films a year or distributes 10 films a year, that includes Marvel and Pixar and Star Wars and Disney-branded and Disney Animation, we've commissioned them to make -- to produce more films with the incremental films being produced very, very specifically and very exclusively for this service. So this will represent a larger investment in Disney-branded intellectual property, both TV and movies.



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

And then just a follow-up for Christine, if I may. The 3.5% sub loss I think you highlighted, just -- I assume that's a net number with some of the current streaming services out there sort of offsetting the traditional linear decline. Any color on how notable those maybe net adds either are now or are likely to become in the coming quarters from what you see?

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

That is a net number, Alexia, and there were additional digital MVPDs this quarter that helped that number.

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

Thank you.

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

Alright thanks Alexia. Operator next question please.

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**Operator**

And our next question comes from Todd Juenger from Sanford Bernstein.

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**Todd Juenger** – *Analyst, Sanford C. Bernstein*

It's probably no surprise, following along similar themes. Kind of a quickie and then a bigger one. Let me do the -- just -- so the quickie. Just to confirm, I think this is probably clear, I just would love to confirm it with your relationship with Netflix. So other than the specific output that you've identified from Disney and Pixar, and then we talked about Marvel and Lucasfilm, all the other relationships you have with Netflix in terms of licensed ABC content and kids content and original content for Netflix, is it safe to assume that you intend to continue partnering with them and doing work with them as it makes sense over the future? Or is there any change to that? And I do have a follow-up.



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

There's no change from our side. I can't speak for them, but we've had a great relationship with them. We made a decision some years back to license them the Studio output deal. They paid us well for that, and they did well as well. It represented real anchor programming for Netflix before they had an opportunity to ramp up their own original production, which they've obviously done aggressively and quite successfully. The Marvel relationship is a perfect example of how well we've done with them in terms of creating original product. That's been very mutually beneficial. It's done well for them, as they've leveraged the strength of the Marvel brand. And it's done well for us as we've mined our IP and obviously made money from it. They have also licensed a number of ABC shows. We hope they'll continue to do that. This doesn't represent a change, except on the Disney / Pixar side. And as I cited earlier, possibly on the output deal for Marvel and Star Wars films, which we're still discussing and debating.

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**Todd Juenger** — *Analyst, Sanford C. Bernstein*

Okay. Fair enough. The follow-up, I'm struggling with how exactly to phrase this, so I'll do my best. When you think about major strategic shifts that you've announced in terms of your distribution, obviously your peers and competitors will be expected to react and respond as well. And so I know you won't comment on what you expect them to do. But I guess, I just -- I'm sure you've thought through the different scenarios that this could play out, and the reactions ripple through the industry. I guess, the specific, best way I can phrase the question is: a specific concern that many people have is, if this causes more of your peers and competitors to go direct themselves, that you could imagine a non-sports, better-quality direct offering coming to be in some way that would perhaps be appealing to lots of households who maybe don't care about sports and maybe that would be bad for ESPN. Have you -- any new thinking or have you thought through the pros and cons about this? Would love your thoughts on those types of scenarios. Thanks.



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

I'm still trying to get -- figure out who's a peer and who's a competitor. We've kicked around a number of scenarios here. And frankly, it's -- the discussion that we've had isn't something that we necessarily want to disclose to the outside world. Frankly, I'm not sure that this step is going to make much of a difference in terms of the -- we'll call it the disposition or the health of the multichannel ecosystem. I think there are forces, whether they're technological in nature or sociological or economic in nature, out there that are changing the way media is consumed in general. And I don't think this is either going to hasten them or exacerbate things in any way. What it does do, though, is a couple of things: First of all, it gives us the ability to leverage the strength of our brands, which a lot of our peers and competitors do not have. Secondly, it gives us what I'll call optionality. It's a word I have not used very much in my life, but it gives us the flexibility really to move our product to the consumer in many new ways, ways that we've not been able to do before because of just how strong this platform is that we've bought control of. We're very excited about that. We think it sets this company up well, no matter what changes occur, in the media ecosystem. I think if there's a headline, it would be one -- Disney leveraging its brands to take advantage of technological and consumer trends and giving us flexibility if there are major shifts or continuing changes that occur in the marketplace, which I don't -- right now, no one else has.

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**Todd Juenger** — *Analyst, Sanford C. Bernstein*

Alright welcome to the club of people who use the word optionality. Thanks a lot for your thoughts Bob.

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

Alright Todd thank you. Operator next question please.

**Operator**

Our next question comes from Omar from Credit Suisse.

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**Omar Sheikh** – *Analyst, Credit Suisse*

Good afternoon everyone. Thanks for the questions. Just a couple for me. First, to Christine maybe. I wanted to ask about the guidance that you've given that you'll have -- you'll feel earnings dilution from the -- for two years from the BAMTech acquisition. I wonder whether, Christine, you could just maybe help us understand sort of how much we might see in '18 and '19? Obviously, there's the consolidation impact from adding the service to your income statement, but then the release also mentioned investment in the Disney-branded service. So maybe you could just walk us through the '18 and '19 impact of those two elements.

And then just while you're thinking about that, maybe one for Bob. I have a question about the appetite for sports rights costs within ESPN in the context of the new service. So I guess the question is, do you think that your historical strategy of acquiring a very broad range of rights across multiple sports, big and small, will remain the case long-term in the context of the new service? Or do you think having a direct relationship with consumers and being able to tailor a service more closely to individuals might change that? Thank you.

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

Sure. Thanks, Omar. If you're talking about dilution as it relates to the acquisition of BAMTech, what we've said so far is that it will be modest for the next couple of years. We may get more specific on that when we come back at our year-end conference call in November. But right now, we're just going to leave it as modestly dilutive. You've also asked about the investment that we'll be making in this new offering and how that would impact '18. I think what you're asking is, would it impact '18 earnings? And the answer is there will be additional investment. We've not yet fully concluded what that is and the sequencing and timing of that spend. There will also be content as well as investment spending for technology. So the combination of those is something that we'll be prepared to speak with you about more specifically later this year.



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

And to your -- the second part of your question. This acquisition and the subsequent launching of the service give us yet another way to reach consumers; a fairly compelling way, in effect an incremental way to monetize sports rights. With that, we have, we think, more of an opportunity to license sports rights for this service. Just as BAMTech has been in the market licensing sports for its subscription service, we'll continue to do that under us.

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**Omar Sheikh** – *Analyst, Credit Suisse*

Okay thanks that's clear.

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

Okay Omar thank you. Operator next question please.

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**Operator**

Our next question comes from Jessica Reif Cohen from Bank of America Merrill Lynch.

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

Thanks. Just a couple of follow-ups on the direct-to-consumer service and then a different topic. Do you have any thoughts on pricing for either of the services? And will you include advertising? Or is it 100% subscription? And the last part of this direct-to-consumer is, are you considering premium VOD -- a premium VOD window as part of this? And then the separate topic on advertising. The market pricing seems to be very strong, but almost no company has been able to take advantage of the pricing, obviously due to ratings issues. In your view, how much is measurement? Or is it the lack of capture from nonlinear viewing? And could you talk about what you're doing currently to kind of fix whatever you -- however you see that problem?



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

Okay. Well, multiple questions. First of all -- oh, you mentioned something about a pay window. We're not planning to put our movies -- to use this service to encroach on the theatrical window, if that's what you're asking. We do hope to use this service to give people the ability to buy -- to download to own or to download to rent Disney movies in the window prior to pay, which used to be called the home video window. There's no reason why we shouldn't be doing that. But the priority here is this is a direct-to-consumer product, a subscription product. We do not intend on the Disney product to have advertising. Obviously, we do on the BAMTech side. I mentioned earlier, they have some really strong ad technology, and there are some great capabilities there and a great opportunity to do a better job at monetizing, I'll call it, sports consumption but through the sale of advertising. I think -- I'm not sure I completely understand the last part of your question partially because I was concentrating on answering the first few parts of the question. But was that about methodology, Jessica?

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

I mean, average pricing for the -- generally, every media company that has reported has talked about how strong their pricing and scatter pricing is. But you can't -- you and everyone else can't take advantage of it because ratings have been so weak. Is it all measurement? Or is it the lack of capture of nonlinear viewing? And what are you doing to kind of take advantage of a relatively strong market? What will you change?

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

We've had -- we've definitely had some ratings challenges at ABC. So while the scatter marketplace, as Christine noted, has been relatively strong, we obviously haven't taken advantage of the marketplace as much as we could have because of our ratings issues. So I think the first thing that's got to change is we've got to have better performance. There's a whole other side to monetization, which you alluded to. We've had some great, for instance, great consumption of our product in a C3, C7 window, and we would hope that particularly C7, who knows whether we'll ever monetize beyond that, would improve in terms of our ability to



monetize. We also know that the entire, I'll call it, traditional TV ecosystem is disadvantaged in terms of sale of advertising because of our lack of access to consumer data. And that's something that we've got to improve. We've had -- first, on the ESPN front, we've had some really good success monetizing ESPN out of home and also some success monetizing what we've been doing on the WatchESPN app or streaming. The technology that we're gaining through BAM gives us the ability to improve that significantly, significantly. How we leverage it to the ABC business, I'm not 100% sure at this point, but I think I've answered your question at least as best I could. There are a variety of dynamics at stake in terms of why monetization of the ABC side isn't as strong as it could be, though.

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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**

Our next question comes from Jason Bazinet from Citigroup.

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**Jason Bazinet** — *Analyst, Citi*

I just had a question for Mr. Iger. Philosophically, on pricing of these over-the-top apps, it seems like there's at least a handful of ways you could approach it. The one is maybe the way Amazon or Netflix do it where you could argue it's underpriced and they're either trying to drive prime memberships or gain first-mover advantage. There's another model where the pricing is set to sort of insulate you from cannibalization risk, maybe the way your Hulu service at \$40 is launched where you're sort of agnostic what the consumer does. I think CBS's apps are sort of similar to that. And then there's a third way you could price, which is just to profit-maximize on that stand-alone app, right, based on whatever your assessment is of the right price to maximize revenues. Can you just talk philosophically about how you're thinking about the retail price of these various apps, whether it's ESPN or Disney?





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

We've given it a lot of thought, but we're -- it's premature for us to make any announcements, frankly, because we're still considering a number of different factors. Some, by the way, that you cited. Clearly, our -- this is a real priority for us as a company in terms of getting it right. Not just getting it right from a programming perspective, meaning the product itself; getting it right from a user interface perspective, which BAMTech will obviously provide us with; but also getting it right in terms of pricing and distribution. What we're going to go for here is significant distribution because we believe one way to be successful in the long run is for both of these services to reach a maximum number of people. That shouldn't suggest a huge discount on what we might be able to charge, but it should suggest at least initially a very reasonable approach to our pricing. We don't necessarily enter this with a notion that we're going to cannibalize our existing businesses significantly, but we have had a discussion about whether our pricing strategy could have an impact one way or the other on that. And again, because we haven't named a price for these yet -- we haven't determined it, we have ranges here, obviously, because we've done some modeling -- I think when we do, we'll give you the benefit of our thinking in exactly what it is we're trying to accomplish. But I think you have to look at both of these as huge priorities for the company. This is -- I would characterize this as extremely important, a very, very significant strategic shift for us. We talked a lot about trends about direct-to-consumer, particularly intellectual property, creators and owners having the ability to reach consumers directly. When you have a strong fan base like Disney has or ESPN, that creates all forms of other opportunities in terms of tapping into customer passion for the brand and connection to the customer. And again, I'm going to put this at the top of our list in terms of company strategic priorities over the next number of years.

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**Jason Bazinet** — *Analyst, Citi*

Thank you very much.

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

Thanks Jason. Operator next question please.

**Operator**

Our next question comes from Steven Cahall from Royal Bank of Canada.

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**Steve Cahall** – *Analyst, RBC Capital Markets*

Hi just maybe switching gears to the Parks for a few minutes. Maybe the first question is, you've kind of continued to defy gravity on the incremental margin at Parks, and it looks like bookings are pretty strong domestically for the upcoming quarter. So is there any reason to think that those sort of 20% to 30% incremental margins are not sustainable? And then separately, I think the comment on Shanghai was kind of an upgrade in terms of profitability versus the previous comment of being breakeven this year. So what do you think tracked ahead of your expectations for the year to deliver that result? Thanks.

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

Okay, Steve. I'll take the Parks margin question. You are seeing nice margins. There has been consistent improvement on a quarterly basis. What you saw this quarter was the contribution of our international park operations kicking in, both Shanghai as well as Disneyland Paris. So I think it's fair to assume that the management of the Parks segment is very committed to driving improvement in margin. And when you look at the investments we're making and the cadence with which we have new attractions opening over the next couple of years, we expect those margins to stay strong and hopefully stay on the trajectory they're on now.

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

On the Shanghai front, when we opened the park, we were confident that we had built a great product, but we didn't know exactly how the market would react. And then now, over a year of operation, the market has reacted really well. To begin with, I mentioned earlier on the call, we had 13 million visitors so far. Secondly, guest satisfaction is extremely high. Length of stay is a couple of hours longer per stay than -- or per visit than we had anticipated. And about 2/3 of our visitation is coming from outside the Shanghai area. So as I've said before, this is basically a national tourist destination. So it is a very, very well received product in China. And the nice



news is, of course, we have plenty of opportunity for expansion. And in fact, some of the expansion construction is already underway, and *Toy Story Land* is going to open up next year.

In terms of the specific impact to the bottom line, obviously when you have attendance at the level that we have, that obviously is a reason why the profitability is higher. We've had extremely high occupancy in our hotels. On the merch side and the food and beverage side, a little bit less than we had expected but not appreciably. And so the overall effect of great guest satisfaction and substantially greater visitation is an operation that in its first 14 months of service is more profitable than we anticipated.

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**Steve Cahall** – *Analyst, RBC Capital Markets*

Thank you.

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

Thanks Steven. Operator we have time for one more question.

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**Operator**

Perfect. Our last question comes from Dan Salmon from BMO Capital Markets.

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**Dan Salmon** – *Analyst, BMO Capital*

Hey good afternoon. Thanks for taking the question. Bob, if we take a step back and look at the announcements here around BAMTech, around the direct-to-consumer apps, and in addition, around significantly more investment in originals and exclusives for those services. Obviously, you've mentioned the Netflix deal, which you do not aim to renew. There are some moving pieces here in what you do with Star Wars and Marvel IP. But as we think about out year operating income estimates, what are the other sort of key variables impacting your licensing revenue, impacting your programming and production expenses, that we should sort of have in our heads as we think about the impact of this significant change to improve the company over



the long-term? I would think about pace of global rollout, as we talked about earlier. But what are the other things that you think are the key variables we should have in mind?

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

I don't want to sound impertinent. I can't give you much guidance there. I can only say that you have to look at, first of all, I'll call it, our product cycle. With a slate of Marvel films that goes well into the next decade and the same on the Star Wars front, and probably the strongest slate of Disney films that we've ever had in development, you have to consider the options from a revenue-generating perspective that that provides us in multiple windows in multiple ways, whether it is licensed to third parties in a variety of forms or whether it's proprietary on our services, meaning subscription, et cetera and so on. I also think you have to consider global trends in the direction of, as I said earlier, app-based media consumption over direct-to-consumer OTT services, which gives us the ability to improve our fortunes in terms of how we monetize the great IP and the strong brands that we have, whether it's in increased advertising revenue, whether it's in the -- basically the value creation proposition of knowing the consumer better and mining data more effectively, whether it's in basically creating stronger bonds or stronger brand affinity. We've got this unbelievably passionate base of Disney consumers worldwide. And virtually all of our businesses, except Theme Parks, we've never had the opportunity to even connect with them directly or know who they are. And it's high time that we got into the business, particularly with the technology available to us, to accomplish that. Once we do, and this gives us the ability to do it, then I think the monetization possibilities are extraordinary for this company. There will be some sacrifices. Obviously, if you -- as you move product from, I'll call it, a licensed-to-third-party model to a self-distributed model, you're forgoing the licensing revenue that you would get for whatever revenues you generate by all the things that I just described. We believe that ultimately -- I can't give you an idea of when or how long -- the profitability, the revenue-generating capability of this initiative is substantially greater than the business models that we're currently being served by.



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**Dan Salmon** – *Analyst, BMO Capital*

Great thanks. I guess we will look forward to those more details next quarter. Thanks Bob.

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

Thank you, Dan, 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. I'll 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 our other filings with the Securities and Exchange Commission.

This concludes today's call. Have a great rest of the day, everyone.

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**Operator**

Thank you, ladies and gentlemen. This concludes today's conference. Thank you for participating. You may now disconnect.

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