Q4 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 Fiscal Full Year and Q4 2017 Earnings Conference Call. My name is Victoria, and 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 VP of Investor Relations. Lowell, you may begin.

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

Good afternoon, and welcome to the Walt Disney Company's Fourth 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 a copy of the webcast and a 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. Christine will lead off, followed by Bob and we'll be happy to take your questions. So with that, let me turn the call over to Christine to get started.

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

Thanks, Lowell, and good afternoon, everyone. Excluding certain items affecting comparability, earnings per share were $1.07 for the fourth quarter and $5.70 for the full year.

Our fiscal 2017 results came in roughly in line with last year, which is consistent with the guidance we provided in early September, although they were adversely affected by three notable items: First, the impact of Hurricane Irma on our Parks business; second, the impact of canceling the animated film, Gigantic; and third, the impact at BAMTech of a valuation adjustment to sports programming rights that were prepaid prior to the acquisition. In aggregate, these three items reduced fourth quarter and full year segment operating income by about $275 million or approximately $0.11 in earnings per share.
At Parks and Resorts, operating income was up 7% in the quarter due to an increase at our international operations, partially offset by lower operating income at our domestic operations. The impact of Hurricane Irma, which I'll discuss in more detail in a moment, adversely affected total segment operating income by 14 percentage points.

Results at our international operations continued to improve, led by growth at Disneyland Paris and Shanghai Disney Resort. Disneyland Paris benefited from the resort's 25th anniversary celebration and a more favorable tourism environment, which drove higher attendance, guest spending and hotel occupancy. Shanghai Disney's operating income growth was due to higher attendance and, to a lesser extent, lower marketing costs compared to the fourth quarter last year. I'm pleased to note that Shanghai Disney Resort generated positive operating income during its first full fiscal year of operations, which comfortably surpassed our expectations of breakeven for its first year.

At our domestic operations, operating income was 6% below prior year due to lower results at Walt Disney World, which were adversely impacted by Hurricane Irma, partially offset by growth at Disney Cruise Line, Disneyland Resort and Disney Vacation Club. Hurricane Irma disrupted our operations in Florida, forcing the closure of Walt Disney World parks for two days and the cancelation of three Disney Cruise Line itineraries and the shortening of two others. We estimate the aggregate impact of the hurricane was about $100 million in operating income or about a 16 percentage point adverse impact to year-over-year growth at our domestic operations. Operating margins at our domestic operations were down 170 basis points compared to Q4 last year, and we estimate they were adversely impacted by about 220 basis points due to the hurricane.

Attendance at our domestic parks was up 2% in the quarter, reflecting favorable guest response to new attractions, particularly *Avatar Flight of Passage* at Disney's Animal Kingdom, and *Guardians of the Galaxy: Mission BREAKOUT!* at Disney California Adventure, and the unfavorable impact of the hurricane on Walt Disney World attendance. We estimate the
hurricane had an adverse impact on the year-over-year change in domestic parks’ attendance of about three percentage points. Per capita spending was comparable to prior year. Per room spending at our domestic hotels was up 4% and occupancy was down three percentage points to 84%.

So far this quarter, domestic resort reservations are pacing down one percent compared to prior year and reflect reduced room inventory due to conversions and ongoing room refurbishments, while booked rates are up nine percent.

At Media Networks, lower operating income in the fourth quarter was a result of lower equity income and a decline at Broadcasting, while Cable operating income was comparable to prior year.

Equity income was lower in the quarter due to higher losses from our investments in BAMTech and Hulu and lower income at A&E Television Networks. With the closing of our BAMTech acquisition on September 25th, BAMTech’s results will now be consolidated within our Cable Networks business.

At Broadcasting, double-digit growth in affiliate revenue and lower programming expenses were more than offset by lower advertising revenue and a decrease in operating income from program sales. The year-over-year decline in advertising revenue reflects lower impressions at the ABC Network, lower political advertising at our owned stations and the absence of the Emmy Awards, partially offset by higher network rates.

Quarter-to-date, primetime scatter pricing at the ABC network is running 34% above upfront levels.

As I mentioned earlier, Q4 Cable results were roughly comparable to the prior year. At ESPN, growth in affiliate revenue was offset by higher programming costs and lower advertising
Higher spending on programming was primarily driven by a contractual rate increase for the NFL. Ad revenue at ESPN was down low-single digits in the quarter as higher rates were more than offset by a decrease in impressions.

So far this quarter, ESPN's cash ad sales are pacing down due in part to the timing of the college football semifinals and the impact of more game windows on other linear television networks. Like last year, ESPN will air three of the New Year's six bowl games during the fourth quarter. However, this year the two semifinal games will air during the second quarter, whereas they aired during the first quarter last year.

We remain very confident in the value of ESPN's programming, in particular live, must-see exclusive events like the College Football Playoffs, and in ESPN's ability to reach key audiences that advertisers covet.

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 driven by seven points of growth due to higher rates, partially offset by about a three point decline due to a decrease in subscribers. We completed the renewal of a distribution agreement with Altice, which demonstrates the tremendous value of our network and positions us well as we head into future negotiations. By the end of 2019, we expect to have new agreements in place covering about 50% of our subscriber base.

At the Studio, results in the fourth quarter reflect higher film cost impairments, lower operating income from television distribution, driven by the sale of Star Wars Classic titles in Q4 last year and lower revenue share from Consumer Products. Operating income in our theatrical and home entertainment businesses was roughly comparable to the prior year.

At Consumer Products & Interactive Media, segment operating income was lower in the quarter due to a decrease in our merchandise licensing business. While we saw nice growth in
the sale of Cars and Spider-Man merchandise during the fourth quarter, the growth was more than offset by strong sales of Star Wars, Frozen and Finding Dory merchandise in Q4 last year.

During the fourth quarter, we repurchased 33.6 million shares for $3.4 billion, and for the full year we repurchased 89.5 million of shares for $9.4 billion. So far this quarter, we have repurchased 6.5 million shares for approximately $650 million dollars.

With fiscal 2017 now behind us, we are excited for the opportunities that lie ahead for our company, which Bob will discuss momentarily. As we look at fiscal 2018 specifically, our earnings growth will be suppressed somewhat by a couple of factors.

First, the consolidation of BAMTech and its ongoing investment in the business will adversely impact Cable operating income by about $130 million compared to last year. This will affect our Cable results for the first three quarters of the year, with roughly half of this BAMTech-related impact expected in Q1. We expect Cable expenses to be up high-single digits for the year, driven by the consolidation of BAMTech. However, excluding the impact of BAMTech, we expect underlying Cable expenses to be up low-single digits.

Second, we expect our share of losses from our equity investment in Hulu to increase by more than $100 million for the year, driven by Hulu's investment in its digital MVPD service and higher content spending. Given the timing of these investments, we expect about $70 million of that increase in equity losses in the first quarter.

At Consumer Products, a timing issue related to the recognition of minimum guarantee shortfall revenue will cause about $60 million in operating income to shift from Q1 into Q2. The timing issue stems from the fact that these contracts are measured at month-end and our fiscal first quarter ends on December 30th this year, whereas it ended on December 31st last year.
And finally, we will continue to invest in our businesses in 2018, particularly at Parks and Resorts, where we are building two Star Wars lands. We expect these investments, among others, to drive fiscal 2018 consolidated capex higher by about $1 billion dollars.

We continue to see attractive opportunities to deploy capital in a balanced way, whether it’s through investment in our Parks and Resorts business, in support of our direct-to-consumer strategy or by returning capital to our shareholders. We have this flexibility because of our strong balance sheet. For fiscal 2018, we expect to repurchase $6 billion dollars in stock, which is close to what we've repurchased on average over the past five years.

And with that, I'll now turn the call over to Bob.

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

Thanks, Christine...and good afternoon, everyone.

I’d like to take you through our priorities in Fiscal 2018, to frame up the new year – starting with our direct-to-consumer initiatives. We believe creating a direct-to-consumer relationship is vital to the future of our media businesses, and it’s our highest priority this year.

Our decision to acquire control of BAMTech enables us to launch robust DTC offerings, and immediately provides us the tools we need to stream video at scale, to acquire and retain customers, to greatly enhance our advertising opportunities on digital platforms, and to use consumer data to provide a better user experience, while giving us the ability to grow revenue and increase the effectiveness of our digital marketing efforts.

Our first DTC product will be our ESPN-branded sports service, which will be called ESPN Plus. Launching in the spring, the product will be accessible through a new and fully redesigned ESPN app, which will allow users to access sports scores and highlights, stream our channels on an
authenticated basis, and subscribe to *ESPN Plus* for additional sports coverage, including thousands of live sporting events.

This one-app experience will be a one-of-a-kind product, offering sports fans far more than they can get on any other app, website, or channel and immediately propelling ESPN in a new direction. We will demonstrate this app in early 2018, and also detail pricing and other elements to provide some perspective on the potential this represents to our company.

Additionally, we’re leveraging BAMTech to launch a Disney-branded DTC service in the latter part of 2019, streaming the latest Disney, Pixar, Marvel, and Star Wars feature films in the first pay window. Our Studio will also produce four or five feature films a year exclusively for this service.

We’re also planning to produce a number of original series for the new service. We’re already developing a Star Wars live-action series, a series based on our popular Pixar *Monsters* franchise, a *High School Musical* series, and a series from Marvel Television, along with a rich array of other content, including new movies from our Disney Channel creative team as well as a variety of short-form films and features from across our company. The service will also offer thousands of hours of Disney film and TV library product.

In the coming months we’ll share more specifics about content development, launch plans, and investment levels.

Our strategic acquisitions have been a key driver of the historic achievements and performance we’ve achieved over the last decade. We believe BAMTech is another game-changing acquisition, and we are confident in our ability to generate maximum value from it.

The acquisition of Marvel helped drive our Studio’s performance. Since 2009, the movies we’ve released in the Marvel Cinematic Universe to date have delivered an average global box office
of more than $840 million each. We have four new Marvel movies in Fiscal 2018 starting with Thor: Ragnarok, which has already topped $500 million in worldwide box office since it premiered two weeks ago. To put this early performance into perspective, the box office total for the entire run of our first Thor movie in 2011 was $449 million. Thor: Ragnarok is also one of the best-reviewed Marvel movies to date.

We’re very excited about Marvel’s next great movie, Black Panther, which opens next February, and we’re bringing the Avengers back in May with the release of Infinity War. Our final Marvel movie of the year, Ant-Man and the Wasp, will be in theaters next July.

As you know, our acquisition of Pixar effectively revitalized our entire animation business, which is essential to the health of our company. Since that acquisition, the average global box office for our animated movies has risen to more than $665 million and we’ve captured nine of the ten Oscars awarded for feature animation.

We’ll release two new movies from Pixar in Fiscal 2018. We’re thrilled with the early reaction to Coco, which opens at Thanksgiving, and we’re also looking forward to the summer release of The Incredibles 2.

We had big ambitions for the Star Wars franchise when we acquired Lucasfilm five years ago and we’re already exceeding our expectations. The Force Awakens and Rogue One alone delivered more than $3 billion at the box office, revealing the tremendous, enduring appeal of this franchise and establishing a strong foundation for the future. We’re thrilled to have two new Star Wars movies in theaters during this fiscal year. The Last Jedi opens December 15th, ticket presales are strong, and the excitement will only intensify as we get closer to the release date. And we just wrapped production on Solo, our second stand-alone Star Wars movie. It’s essentially the Han Solo origin story, and given the huge popularity and global affection for this iconic character, we expect a lot of interest and enthusiasm when it opens over Memorial Day weekend.
We’ve got more great Star Wars movies already planned for years to come. In addition to the 2019 release of *Episode IX*, we’re very happy to announce that we’ve just closed a deal with Rian Johnson, the director of *The Last Jedi*, to develop a brand new Star Wars trilogy.

We continue to make significant investments required to drive long-term growth across our entire company. In our Parks and Resorts, for example, we’ve commissioned three spectacular new cruise ships, which will all be completed between 2021 and 2023. We’re nearing completion on *Toy Story Lands* in Shanghai and Orlando, both of which will open by next summer, and major construction continues on our Star Wars lands in Disneyland and Walt Disney World, which are on schedule to open in 2019. We’re also adding new attractions and hotels in our resorts around the world, along with cutting-edge technology to enhance the guest experience.

We remain optimistic about our future in part because quality truly does matter and the quality of our content, our products and our services sets Disney apart. No other company in entertainment today is better equipped to meet the challenges of a changing world or better positioned for continued growth thanks to our collection of brands, our strong franchises and our unique ability to leverage IP across our entire company to maximize value and create new opportunities. We’ll continue to invest for the future and take the smart risks required to keep moving forward.

I’m now happy to turn the call over to Lowell, and then Christine and I will be happy to take your questions. Lowell?

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

Okay Bob, thanks. Everyone, just so you know, we have been having some slight technical issues on the call, I think with our host. So we have switched phones and if, for some reason, we get disconnected during the call, we will dial back in. So with that, we are happy to take the first question.
Operator

Our first question comes from Michael Nathanson from MoffettNathanson. Please go ahead.

Michael Nathanson – Analyst, MoffettNathanson

Thank you. I have just one for Bob, and it's a two parter. One is, because you didn’t say ‘we're not going to talk about press speculation’, you have a chance to actually address the stories this week in the press, if you don't want to do that --

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

Michael, let me jump in. It's Lowell. I have some bad news and good news. The bad news is, as is our practice, we are not going to take any questions on press speculation, but the good news is, we'll give you another question.

Michael Nathanson – Analyst, MoffettNathanson

Thank you Lowell. It’s very kind of you. So Bob --

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

Lowell could not wait to say that.

Michael Nathanson – Analyst, MoffettNathanson

So within your presentation a minute ago, you walked through your film strategy, and that was essentially fixing Disney's film content. So this week, Kevin Mayer was saying that Disney has turned their attention to looking at TV, because that's where the challenges are. So I wonder, when you think about television, do you see the television challenge for you guys as having the right platform? The right model? Or having the right content? So is there a content fix here that maybe needs to be done as you did in film?
Bob Iger — Chairman and Chief Executive Officer, The Walt Disney Company

Well, we think that the world today offers ample opportunity to monetize high-quality, in-demand television programming. I think that’s been demonstrated by a number of entities out there today. And if you look at consumption, which admittedly is fragmented, it’s actually quite significant in terms of people’s interest in consuming TV. We’ve had -- over the last few years, we’ve had some disappointments on the ABC side, but we’ve been focused on turning that around. We’re actually very pleased with the performance of The Good Doctor already, and we have three dramas in mid-season that we’re quite excited about as well, including a Grey’s Anatomy spin-off. So I think as we look at TV, we think yes, some improvement with -- from a quality perspective would be helpful, but we also think we’ve got great opportunities.

We also have strong production and creative capabilities, both from the ABC production side, also from the Disney television production side and from Marvel. And I mentioned in my earlier comments that we’re in development on a Star Wars live-action series as well. So our intention as a company is to take advantage of the opportunities that exist out there today for good television and to produce more of it.

Michael Nathanson — Analyst, MoffettNathanson

Okay Thanks.

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

Okay Michael thanks. Operator next question please.

Operator

Our next question comes from Alexia Quadrani from JP Morgan. Please go ahead.

Alexia Quadrani — Analyst, JP Morgan
Thank you. I've got one for Bob, one for Christine, if I may. Bob, I guess, when you look at your film studio specifically, you've really outperformed with such a huge margin and the pipeline continues to look so robust. I guess, can more scale or acquisitions facilitate further growth? Or is your plate really full enough, given the successful studios and IP you already have?

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

I appreciate the question, I think it’s a bit — leading the witness a little bit, as it relates to the subject that Michael brought up earlier. There’s -- I don't think that there's ever such a thing as having too much quality or too many strong franchises when it comes to films. We do not feel right now that we have a great need to add to the film slate that we have, because as you cited, we're doing just fine. That doesn’t mean there isn't room for more, we just don't have a significant or urgent need for that. That said, we’ve also, as a company, demonstrated an ability to leverage success in this area, not just in our Studio, but across various other businesses, particularly Consumer Products and Theme Parks. And so we're always going to be looking to add to the number of film franchises that we produce and own.

Alexia Quadrani — Analyst, JP Morgan

Thank you. And then Christine, I know it might be too early days, but I was wondering if there's any color you can provide on the investment spending associated with the 2019 direct-to-consumer launch. Any sort of early data you can give us in a way to frame how we should think about potential earnings adjustments going into that product launch?
Christine McCarthy – Senior Executive Vice President and Chief Financial Officer, The Walt Disney Company

Alexia, we have not yet finalized what the content spend is going to be and the cadence of it. But as Bob mentioned, we will be providing more information on that as it develops over the next few months.

Alexia Quadrani – Analyst, JP Morgan

Thank you very much.

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

Alexia thank you. Operator next question please.

Operator

Our next question comes from Ben Swinburne from Morgan Stanley. Please go ahead.

Ben Swinburne – Analyst, Morgan Stanley

Thank you. Bob, now that you've got the Altice deal done, so your first renewal this cycle is sort of behind you, and at least for this quarter the subscriber losses seem to have gotten less severe, how are you feeling about that business over the next couple of years? Is that a business that you think operating income should grow? Do you have the sort of confidence? I wonder if you could talk a little bit about the outlook for that business and how the OTT launch fits into it.

And then Christine, if I could just follow up on Alexia's question on the -- either forgone licensing or incremental programming, are we able to say at least for fiscal 2018 that we won't have a material impact from those two factors hitting earnings? Since you didn't list them when you talked in your prepared remarks about the sort of factors to be thinking about this year.
Bob Iger — Chairman and Chief Executive Officer, The Walt Disney Company

Ben, I won't say too much about the Altice deal. I know you asked the business overall, but I will say that in that deal we met or achieved our -- both our pricing and our distribution objectives, which bodes very well for negotiations that we will be having in 2019 and beyond, actually 2018 and beyond rather -- Verizon in 2018, and Charter and AT&T/Direct beyond that, and then Comcast beyond that. We're pleased with where we ended up.

We're also pleased with trends that we're seeing on the OTT side, where we've seen a nice pickup in subs in the -- basically, the new players in the market. And what we're really heartened by is the fact that some of them are spending a fair amount and have just stepped up their marketing efforts aggressively. If you watched the World Series, you probably couldn't have missed the number of spots that were in almost every hour for, I guess it was YouTube, a new OTT service. That we think is great. It's also interesting that these OTT -- the entrants in the OTT business are spending in live sports. They obviously believe that the sports fan is potentially a primary customer of new OTT services. And what we've seen as well is that millennials seem to be particularly interested in these services. I think it's a combination of pricing and the user-friendly nature of these services.

As we've said call after call, we've had some sub issues that we've been dealing with, but Christine's comment suggested that, while we lost some subs in the quarter, the losses were not as steep as they had been in prior quarters. And we're not -- we're heartened by that as well, but it is one quarter.

The other thing I want to note that's interesting, which ties into your question about the health of the business, is that Nielsen provided us with two weeks of data, which is essentially data about live consumption of sports across multiple platforms, including streaming and these OTT services. And what they told us was that, by including that, we had a 25% increase in total day ratings and a 29% increase among -- in Primetime. That was basically -- that includes out-of-home viewing as well.
So we think that the trends that we're seeing, albeit they're still not lengthy trends, but they are at least giving us some reason to feel good about the business. We've always felt we were positioned well because of ESPN and Disney and ABC.

On the direct-to-consumer front, we've said as well that we're going into that business because we believe that our direct-to-consumer opportunities, given the technology that's out there, are significant, and given the fact that we've got these great brands and franchises. And we think that what we're doing can easily be complementary to the multichannel services in the market, both the traditional ones and the new ones. And when you see the apps that we will demonstrate sometime after the first of the year, you'll see that we're coming up -- we're developing one app experiences, where ESPN's app will enable the highlights and scores that ESPN typically gives, will enable live streaming of the channels on an authenticated basis, and we'll also add a Plus service, which will enable users to subscribe to, for an extra fee, to thousands more live sporting events a year.

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

Ben, to answer your question on the 2018 spend, in my comments I mentioned the BAMTech investment that is going to impact Cable operating income by $130 million. That's BAMTech, but on the Disney DTC, we don't expect any significant items to impact spend in 2018.

Ben Swinburne — Analyst, Morgan Stanley

That's helpful. Thank you both.

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

Okay operator next question please.
Operator

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

Jessica Reif Cohen – Analyst, Bank of America Merrill Lynch

Thanks. Maybe switching it up a little bit, but can you talk a little bit about addressable or targeted advertising? Is it still off limits on the Disney DTC offer? And how do you think about the tipping point on adjustability across all Disney advertising-related platforms?

And then just -- Christine, if we could just follow up on some of the capex questions. Could you talk about the cadence at all beyond fiscal 2018? It was great to get the color for fiscal 2018, but given the number of projects, Toy Story Lands, Star Wars lands, the cruise ships, et cetera, Shanghai, can you just talk about what fiscal -- beyond fiscal 2018, fiscal 2019 through 2022 or 2023, what the cadence might be?

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

Jessica, on the first question, we're going to launch the ESPN service in the spring. That obviously will be advertiser supported. BAMTech, as we said at your conference and as I said in my remarks earlier, offers us some far more, I should say, capabilities when it relates to -- as it relates to addressable ads, live or inserted live on a dynamic basis into live sporting events. And so we feel that that gives us a lot of capability that we haven't had before. Whether that extends -- that capability extends to our other businesses in the non direct-to-consumer, I'm not sure.

We currently are not planning to sell ads on the Disney service, but that's just in development. There may be some interesting possibilities in terms of sponsorships versus inserted ads. But as of now, we're not planning to have the programming that airs in the OTT -- in the, sorry, the DTC service, interrupted by commercials.
Christine McCarthy — Senior Executive Vice President and Chief Financial Officer, The Walt Disney Company

Jessica, on capex, you see for this year that we gave the comment that you can expect capex for 2018 to be about $1 billion above the 2017 level. And once again, a lot of that spend is going into the completion of the two Star Wars lands, and we're also completing Toy Story Land in Orlando and there are other initiatives that are in process around the globe.

We've talked about the longer-term menu, and I think at some of the meetings we've had, we've talked about both the longer-term plans for our Parks and Resorts business and developing out further on attractions and resorts. So I think it's fair to assume that we will continue to make investments in areas in which we see driving long-term value and long-term returns. So I would say, this is a business that we feel very confident in and the business is working right now at a very high level, and will continue to do so.

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

The other thing to add to that is, when you look at the results of our international parks, Shanghai as Christine cited, and the improvements that we’re seeing in Paris and the restructuring in Paris, as well as Hong Kong and in Tokyo, we have ample opportunity to continue to invest and continue to expand those businesses. And with the franchises that we have, and their popularity in these markets, the opportunity actually has increased significantly over the last few years.

Jessica Reif Cohen — Analyst, Bank of America Merrill Lynch

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

Thank you Jessica. Operator next question please.

Operator

Our next question comes from Jason Bazinet with Citi. Please go ahead.

Jason Bazinet — Analyst, Citi

Just a question for Mr. Iger. Not really talking numbers, but more philosophically, as you approach Disney DTC, have you decided sort of the cadence that you're going to approach this opportunity? In other words, you could go and sort of spend large and sort of say there's only going to be one or two winners on the back-end of this evolution and Disney's going to be one of them. And another way you could do it is, just sort of spend consistent with the revenue that that new business generates so it doesn't really contribute to earnings, maybe over the next three to five years. Can you just describe how you're thinking about the cadence of your approach?

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

Sure. Before I do that, I know that there's been a lot written about whether this is aimed at being a Netflix killer, et cetera, and so on. By the way, they have been a good partner of ours. Our goal here is to be a viable player in the direct-to-consumer space, space that we all know is a very, very compelling space to be in. We also believe that our brands and our franchises really matter, as we've seen through Netflix and all other platforms. And so that gives us an opportunity as well.

We are working on the cadence that we will produce and sort of schedule product in this OTT service. We've not determined fully what that will be, although we've laid out, on a calendar basis, a fair amount of specifics. We're still working to develop original movies and original TV
shows and figure out what makes the most sense, part of it has to do with when they will be available.

But I'd say that we're -- I don't want to say we're going to walk before we run, because we're going to -- as I've said earlier, we're going to launch this thing pretty aggressively. But I think what you'll see is a ramp up over time of production spending that will start with a product that we believe is representative of the great brands and franchises that we have, between Marvel and Disney and Pixar and Star Wars, and then grow from there.

Jason Bazinet – Analyst, Citi

Okay. Very helpful. Thank you.

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

Thank you Jason. Operator next question please.

Operator

Our next question comes from Todd Juenger from Sanford Bernstein. Please go ahead.

Todd Juenger – Analyst, Sanford C. Bernstein

Thanks. I can't help but ask my respective question on the entertainment OTT, I'm sorry. And then I have a quick one on Consumer Products as well. Actually, just picking up kind of right where you left off, Bob, I'm just very curious to know how you're thinking about the role of the Disney brand, obviously very important to the service, and what that means in terms of the type of content you envision ultimately fits within that brand on the service. You've talked about a lot of Disney-branded content specifically, and I heard you list, obviously, Marvel and Lucasfilm and Pixar. It begs the question, do you think about Freeform and ABC content as also fitting within Disney? And then even when you start thinking of content that you could license in or otherwise get a hold of outside of your company, can you imagine that fitting in the
service? Or does this need to stay narrowly defined, sort of all about the Disney brand and what
that means? Thanks.

And then, quickly just on Consumer Products. I was wondering how you think the -- Cars has
been the stalwart of Consumer Products for so long. You've had a new release of a movie. Just
wondered how the results lived up to your expectations on the Consumer Products side to
that? And depending on your answer to that, any learnings there as you think about other
franchises, particularly in the animation space, that have lasted a long time, in the new world of
the consumer opportunity there? Just any learnings from that would be great. Thank you.

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

Okay, Todd. So this -- the service will be Disney-branded. It'll be, in other words, it will be
Disney named. We haven't determined what the name is yet, but it will be Disney named. The
product we have in Europe is called Disney Life, but we've not decided what this one will be yet.

I think you have to think about it like you think about our Theme Parks, where they are Disney
Parks, but you go in and you see Marvel and Star Wars and Pixar, for instance. So it's a
collection -- it will be a collection of just those brands. And if one of those series, whether it's
from Marvel or Lucas or whatever, has standards -- first of all, nothing's going to be hard,
nothing is going to be R -- but has standards that don't necessarily fit completely with, I'll call
them the G or G-rated Disney, there'll be ample filtering opportunities for people using it. So if
you just want your kids to see the Disney-only product, that can easily be accomplished.

We're not ruling out the possibility of licensing product from third parties for it provided the
product fits with the Disney brand. As it relates to ABC and Freeform, we're going to continue
to produce product for ABC and Freeform, and our production capabilities for programming like
that; we'll also look to sell product to third parties including Hulu. And it's also possible, by the
way, that ABC Productions could end up producing for the Disney-branded service as well,
we've actually talked about that a bit. But we're going to stick to Disney-branded service, and it will include Marvel, Pixar and Lucas brands within it, or Star Wars brands.

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

So Todd, on your question on Consumer Products, specifically related to Cars. Cars is still a very strong franchise for us. So even though Cars 3, the theatrical release of the movie underperformed, and the performance of Consumer Products in this calendar year was a little bit lighter than we would have liked it to be, it's still one of our strongest franchises, and when we talk about some of the franchises that are over $1 billion annually, Cars is in there.

And just another thing about 2018, for Consumer Products. We feel really, really good about the lineup we have going into this year. We have Star Wars Episode VIII: The Last Jedi. We deferred revenue in the fourth quarter into the first quarter, like we did with Episode VII for that. We also have Han Solo, a movie coming out named Solo in the spring quarter, and we've got four Marvel movies including Avengers in the spring. We also have Mickey's 90th birthday. You should mark your calendar for this, it's November 18, 2018, but Mickey's 90th is something that the entire company's going to get behind, and that should also be good for our Consumer Products business.

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

Todd thank you. Operator next question please.

Operator

Our next question comes from Steven Cahall from RBC. Please go ahead.

Steve Cahall — Analyst, RBC Capital Markets

Thank you. Two for me. First, Bob, on direct-to-consumer. I was wondering if you have given any thought to the pricing strategy. Netflix has certainly been rewarded for strong subscriber
growth, rather than necessarily revenue growth. So do you think you build more equity value by coming out with a product that's really inexpensive in the Disney-branded direct-to-consumer, in order to maximize sub growth early on?

And then Christine, just on the buyback guidance. I think you did a little less than $9 billion in free cash flow this year, and you've got a $1 billion step up in capex, so that's $8 billion in free cash flow before any cash flow growth next year at the operating line. So why the big step down in the buyback year-on-year? Are you just trying to be conservative and give yourself some wiggle room as you go through the year? Is it a view to the share price? Is it a view to build cash on the balance sheet? Any color there would be great. Thank you.

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

Steven, we've given a lot of thought to pricing, to both the ESPN and the Disney-branded service, and I can't get specific with you yet. We haven't actually officially determined it, but we said we will be forthcoming with you on this sometime after the first of the year.

I can say that our plan on the Disney side is to price this substantially below where Netflix is. That is, in part, reflective of the fact that we'll have substantially less volume. You'll have a lot of high quality, because of the brands and the franchises that will be on it that we've talked about, but it will simply launch with less volume, and the price will reflect that.

It is our goal to attract as many subs as possible starting out. We think we've got some interesting opportunities there given the affinity to Disney, whether it's with our Disney-branded credit card holders, our Annual Passholders, people who are members of D23, people who own Vacation Club units at Disney, people who visit our parks frequently, there's a gigantic potential Disney customer base out there that we're going to seek to attract, with pricing that is commensurate with -- or that balances the quality of the brands and franchises that are in there, but also takes into account the volume. And that will give us an opportunity to grow in volume and to have the pricing over time reflect the added volume as this product ages.
Christine McCarthy – Senior Executive Vice President and Chief Financial Officer, The Walt Disney Company

Steve, on the buyback, that $6 billion is a number that, as I mentioned, is the average over the last five years -- roughly the average over the last five years. As you saw both in 2017 and 2016, we came in at a higher level than what we originally started out the year at. So if you want to view that as a conservative approach, we are early in the year and we'll make adjustments as we go through the year based on the business environment. But once again, we have increased the last couple of years from what we originally started out at.

Steve Cahall – Analyst, RBC Capital Markets

Thank you.

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

Alright thanks, Steve. Operator next question please.

Operator

Our next question comes from Marci Ryvicker from Wells Fargo. Please go ahead.

Marci Ryvicker – Analyst, Wells Fargo

(technical difficulty)

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

Marci? Okay operator let’s move on. Oh there you are. Now we got you Marci.

Marci Ryvicker – Analyst, Wells Fargo

A little more color on sports write-offs, if that’s what they were, related to BAMTech? Was it a certain sport? Was this just technical just because there’s so much sensitivity around sports
rights, right now? And then, second question, there was an article that came out at some point, talking about, maybe there's a time when ESPN may not participate or have NFL rights, and maybe you're changing your distribution agreements to allow some sort of flexibility. Is there any -- (technical difficulty)

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

Okay. We lost you, Marci. Is that? Can you hear us still Mike?

Marci Ryvicker — Analyst, Wells Fargo

Can you hear me?

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

We got the two questions, so --

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

The NFL was one which, we're not going to comment on, we've had a long, healthy relationship with the NFL. It's important for our -- ESPN, both the live games that we have on Monday night and all the shoulder programming that we do. Some of it, or much of it licensed directly from the NFL, and we're not going to comment on anything related to the future relationship, or the -- as it affects our distribution agreements.

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

So on the BAMTech valuation adjustment: that was an adjustment to programming rights that were prepaid prior to the acquisition. And we're not going to be specific on it, but it does relate just to one rights deal, and we looked at it based on current performance and the duration of the contract, and we didn't think we had enough time to recover the payments, so the contract was marked-to-market.
Marci Ryvicker — Analyst, Wells Fargo

Thank you.

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

Okay Marci thanks. Operator next question please.

Operator

Our next question comes from Tim Nollen from Macquarie. Please go ahead.

Tim Nollen — Analyst, Macquarie

Hi thanks. Bob, I'd like to follow up on your comments on the really strong pickup in ratings from the streaming viewership. I know there's a summit being convened later this month by one of your peers. I just wonder if you have any comment to make on broader use of digital measurement in the TV ecosystem?

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

Well, I think, first of all, as I said earlier, it just was two weeks, and we like the trend, obviously, but we have to give this more time. Frankly, we're not really surprised by it though, because we've known for a long time that out-of-home viewing of sports is significant and the more granular or the more unimpeachable data we can get on that, the better, because it just confirms what we all know, we all watch sports wherever we are, or out of the home. It also confirms that sports on mobile platforms, which often is out of the home, is also growing in popularity. And this picks up a lot of that consumption. And the other thing it includes, it includes live sports viewership on new OTT entrants — on new OTT platforms. And there, too, in part because of the interest in those platforms for millennials, suggests that sports -- live sports is very, very important to those platforms. And I think that's reflected in the fact that every one of these services that launched has launched with the rights to distribute ESPN, and to all of
their customers. And because they know how vital it is, and as I said earlier, just the fact that these platforms are advertising in live sports suggests they're going after the sports viewer or the sports fan, because they think that's a -- that has high potential for them as a customer.

So we're -- we feel good about what we're seeing and while there's obviously been a lot of attention paid to ESPN and subs, et cetera, and so on, we've never lost our bullishness about ESPN. The brand is strong, the quality of their programming is strong. There are always opportunities to improve. We're just launching a new morning program, as a for instance, but we like where ESPN is these days and we believe that one of the best things that we've got going for ESPN is the new technology in the marketplace that's enabling people to watch sports on more user-friendly platforms and wherever they are. And if we can measure that, and add to that the technology that we need to monetize advertising in more effective ways, that's a pretty good combination.

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

Tim, thank you. Operator we have time for one more question.

Operator

Our next question comes from Barton Crockett from B. Riley. Please go ahead.

Barton Crockett — Analyst, FBR

Okay thank you for taking the question. I was interested in looking at the bigger kind of impact of Hulu. So you've got some drag from your share of the losses in the earnings of Hulu, but you've also got a benefit from -- you are selling them programming to some degree, you're getting subs from them, they pay you fees, there's some share of advertising. I was just wondering, when you net it all together, is this actually a net drag, or largely mitigated or maybe a net positive, if you look at the broader impact of Hulu?
Bob Iger — Chairman and Chief Executive Officer, The Walt Disney Company

Talking over time or to date? Because we know to date....

Barton Crockett — Analyst, FBR

To date and obviously, over time, you think it works. But just right now, as you're kind of ramping up, I think there's some mitigation of the expenses there with some of the benefits.

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

So to date, the P&L impact of Hulu is positive to the company -- for the year, sorry, for the year, not to -- for fiscal 2017. It's positive to the company because the investment that we've made in it as it grows has been offset by the licensing fees that we've gotten for both our channels, but largely in 2017, because they didn't launch the service until late, than the licensing of programming to the standard Hulu service. It was also an improvement from 2016. So in other words, we had growth to the bottom line in Hulu from 2016 to 2017.

Where -- our continued investment in Hulu is because we're confident in its ability to both grow in terms of its SVOD service, but also to grow as an OTT multi-channel operator. And we've seen some nice numbers there. Still, just the beginning, and we're not going to get specific about what those are.

We've got new management at Hulu as well, Randy Freer's now running it, and I know he's certainly bullish about it. And we continue to believe that long-term, Hulu is a significant -- will be a significantly valuable investment for us. We also believe that we can grow our licensing to Hulu, I talked earlier about television production, it's yet has another opportunity for us.

Barton Crockett — Analyst, FBR

Okay that's great, thank you.
Thank you, Barton, and thanks, everyone, for joining us today. Sorry about some of the technical glitches. 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 factors contained in our Annual Report on Form 10-K and in our other filings with the Securities and Exchange Commission.

This concludes the call. Have a good afternoon, everyone.

Operator

Thank you, ladies and gentlemen. This concludes today's call. 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.