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Disney Speaker:

Tom Staggs,
Senior Executive Vice-President and CFO,
The Walt Disney Company

moderated by,

Aryeh Bourkoff

PRESENTATION

Aryeh Bourkoff - Analyst, UBS

Good afternoon, everyone. I'm Aryeh Bourkoff, our Media Analyst at UBS, and we're going to do another of these Q&A fireside chat formats. We're very pleased to have with us today The Walt Disney Company and Mr. Tom Staggs, who is the Company's CFO. The Walt Disney Company is a global media company with content operations in four major business segments: Studio Entertainment, Parks and Resorts, Consumer Products, and Media Networks. It's been a busy year for Disney under the leadership of Bob Iger and Tom Staggs. The company made big news in January with the purchase of Pixar, and that deal seems to be getting off to a good start given that the *Cars* DVD itself sold 5 million DVDs in its first two days of release, and now we're on track with the next film, *Ratatouille*, to be released in the summer of 2007. This summer the company also launched Disney Mobile, the first wireless service designed for families, and has made a successful transition of *Monday Night Football* from ABC to ESPN, which



is now first in total prime-time viewers for the month of November. We are joined today by Tom Staggs, Senior- Executive Vice President and the CFO of the Company.

I want to start off and say that this has been a great year. The stock's up more than 35% on a good performance across many of your segments. What's planned for 2007? What are the key strategic imperatives for the company?

Tom Staggs - *Senior Executive Vice President and CFO, The Walt Disney Company*

Well, a lot happened in 2006. We were obviously pleased with the results, but at the end of the day, what we also saw was very consistent with where we wanted the Company to go over time. That is, we were fortunate to have some very successful creative products: *Pirates of the Caribbean*, *Cars*, *High School Musical*, et cetera, and we were able to leverage that product across a wide range of our businesses.

And for us, that ability to leverage creative content and extend it through a broad array of businesses is critical to what we think can lead to a higher return on invested capital for our Company as a whole. And that's, as we think about where we're going over the longer term, that's essential to what we're doing. We exist in a hit-driven business. And it's great when you have hits, but what's important is that we focus our investment on making products which have hit potential, but also have the potential to be franchised as it lives beyond just their initial windowing or their initial release as a film. As a franchise, it goes into Consumer Products, Theme Parks and et cetera. It's why you've seen us shift more of our investment towards Disney-branded products, and why we've been investing in the ESPN brand. Having those properties that resonate through a number of different platforms, we think, is key to where we're going over the longer term.

Aryeh Bourkoff - *Analyst, UBS*

We've talked a lot about, at this conference, the correct asset mix for a lot of different companies in the media sector. Disney's asset mix is diverse, as you mentioned, with key brands like Disney, ESPN and ABC. On the fourth quarter conference call, you talked about an increased investment plan for 2007 with certain specific areas. Could you talk about that and where you want to grow that asset base?



Tom Staggs - *Senior Executive Vice President and CFO, The Walt Disney Company*

Sure. What we mentioned was that our capital expenditures would go up by \$400 million to \$500 million in 2007 as compared to 2006. About half of that is going to be in our domestic theme parks. That still leaves us in that comfortably below a billion-dollar range that we've targeted and said that we'd expect in a steady state. What we're doing in theme parks is trying to make sure, of course, that we keep our properties fresh, but we're also focusing investment around really leveraging more of our creative content. And in this instance, over the next several years, you'll see a lot of that around the Pixar properties.

This year there's a couple of *Nemo* attractions opening, there's the Submarine attraction at Disneyland, and a new stage show at the Animal Kingdom in Florida. We've got a *Monsters*-based attraction opening up on the heels of one that opened in California last year. And so we want to try to make sure that we're taking those properties that really differentiate Disney and differentiate the park experience and make sure we're extending that competitive advantage out in the future.

This investment, I think, is indicative of how we want to think about the parks. However, it's not like we think that in the foreseeable future, we're going to meaningfully expand our park footprint inside the United States. I don't see another major theme park investment in the foreseeable future. There's a possibility of some hotel expansion over time. We've had some very strong occupancies the last couple of years. We'll continue to look at that, but it's really about keeping the properties front and center, making sure we're extending the life of our properties inside the theme parks and, as I said, extending that competitive advantage.

The biggest piece of the increased capital is really around digital initiatives. And obviously, we have digital initiatives on the content side, but that doesn't show up in capital expenditures. That's actually in our expense line. But from a capital standpoint, we're building out our digital capabilities. The best example is ESPN, where we have a digital facility. We're building a second digital facility. And for those of you who haven't visited Bristol, it's really a different way of thinking about creating content. In other words, we're creating digital environments so that whenever we're cutting shots, when we're doing pieces, they are digitally available for all of the platforms that we serve and on a real-time basis. And so the days of running tapes around are over. But we also think that it's a content publishing environment that gives us a leg up in this



business, both in terms of timeliness as well as quality of the product and our ability to leverage that across platforms.

If you watched *Monday Night Football* this year, it's worth taking a look at all of the different platforms that ESPN is leveraging when it does its Monday night coverage. It's truly a multi-platform approach. We're getting on average 30 million hits on the Website during the day of *Monday Night Football*. We've got it on radio, we've got it on ESPN 360, on Deportes, all of the platforms really participating. And so what we've done is taken our investment in football and leveraged it further. And that's going to continue to be a part of the game plan as we go forward. George Bodenheimer and his team have done a really nice job of really looking down the road and thinking about what sort of digital environment they're going to be in and taking advantage of it. And I think, as you think about ESPN going out four, five, seven years, that is going to be a contributor to its growth, that existence of those multi-platform capabilities.

Aryeh Bourkoff - *Analyst, UBS*

Sticking with the investments, just to clarify on the theme parks - are there any talks about investment targets for theme park development outside the United States?

Tom Staggs - *Senior Executive Vice President and CFO, The Walt Disney Company*

Well, the number that I was talking about was really specifically inside the U.S. The investment will continue outside, and when we think about China, as an example, making sure that we continue to ensure the success of Hong Kong Disneyland is a very important part of that strategy. That is a flagship asset in that marketplace. It's only been open a year, and these are long-term propositions. But I think that you will see us continue to try to make sure that we're pushing for success in the international parks as well.

Aryeh Bourkoff - *Analyst, UBS*

Are there any other properties on the slate after Hong Kong?



Tom Staggs - *Senior Executive Vice President and CFO, The Walt Disney Company*

Well, we have been looking at possibilities of other theme park expansion outside the United States. I believe that expansion will come. We haven't put a specific time frame on it. As you know, we've had conversations about a park in Shanghai. It's impossible to predict the course of that conversation, the speed of that conversation, but that's something that I think we'd like to see happen down the road. And then there are other markets where perhaps the full-blown theme park product isn't the best entry vehicle, but there are other products that we think can fit into some other markets as we consider the way to build our theme park business more globally into the future. Each of those, though, is obviously out several years in terms of when you'd see it opening, or when we really have substantial investment. We tend to share the investment with partners when we talk about international theme park investment. I think that's a model you should expect to repeat itself as we look at new opportunities going forward.

Aryeh Bourkoff - *Analyst, UBS*

So if there was any incremental investment for Shanghai, it wouldn't materially change the numbers in fiscal '07?

Tom Staggs - *Senior Executive Vice President and CFO, The Walt Disney Company*

Yes, I don't suspect that we'll see a material uptick in Shanghai, for example, just because Shanghai's in the discussion stage at this point. We're a long ways from breaking ground on something. We need to reach an agreement first that works for both the Chinese government and for us, and I think that will come with time. But I wouldn't want to put a time frame on it.

Aryeh Bourkoff - *Analyst, UBS*

Okay. One of the statements that Bob Iger made in the last conference call was with respect to the digital growth, that it would take years to recoup the investment in digital. Could you clarify that statement and how does the company, especially from your position on the finance side, think about investments in digital and getting a return on those investments?



Tom Staggs - *Senior Executive Vice President and CFO, The Walt Disney Company*

Well, there's two ways to really look at that. One is the digital investment that we talked about in the ESPN plant, for example, and we've done the same thing with HD upgrades with most of our television stations. We've invested in digital capabilities at the studio, et cetera. Those, in terms of where we're taking that business, are sort of more rapid payback, depending on how you assign incremental revenues. But when we talk about the new digital initiatives, you break that business down for our company. We did last year, in our fiscal 2006, a little over \$500 million in revenues for these businesses from digital. That was about a third, a third, a third, roughly, between e-commerce, advertising-based product, and then paid content. Mobile was one of the biggest places where we had the paid content. That number should go to something around \$700 million this year, and I expect that Mobile would be one of the fastest growers. I think advertising's going to grow quickly. I suspect that for us, anyway, e-commerce will grow but on a much slower basis. And the digital download business, I think, will start to emerge. But that's still going to be relatively small.

We're investing in that product, we're investing in our capabilities in that regard. You've seen it at ABC.com, et cetera. The numbers are still small, so it's going to be a while before that really moves the needle, but we like that investment. We want to continue it.

Aryeh Bourkoff - *Analyst, UBS*

That's \$700 million, approximately of revenue for digital in fiscal '07?

Tom Staggs - *Senior Executive Vice President and CFO, The Walt Disney Company*

Right.

Aryeh Bourkoff - *Analyst, UBS*

When do you think you'll break even on that number, or are you already?



Tom Staggs - *Senior Executive Vice President and CFO, The Walt Disney Company*

Well, the Internet is an interesting business, because we can take one course and drive it to break even, actually relatively quickly. I think that we are more inclined to take the course of driving greater growth. We're investing in Disney.com right now. We're going to launch a new Disney.com in January. I think it's going to be a more robust service. It will involve more personalization, more community-based aspects, and I think it will also better capture the broad breadth of content that Disney has to offer. That's an investment that we're happy to make. If we decided we didn't want to make it, Disney.com would show a profit. As it is, we'll use that profit to invest in the future. And so I would think that for the next couple of years, anyway, I'm very happy to be in an investment mode for those businesses.

Aryeh Bourkoff - *Analyst, UBS*

Now, where does the iTunes downloads and the collaboration with Apple fit into that \$700 million? How material is that?

Tom Staggs - *Senior Executive Vice President and CFO, The Walt Disney Company*

The iTunes movie downloads, as apart from the television, which we talked about at length before. The television continues to be robust, and we've had good success there. But for the movie downloads, our current run rate is that they would do about roughly \$25 million in the first year, that's the order of magnitude. And so you have to put that in context of the home video business, obviously, which is a multi-billion dollar revenue business for us. So it's small.

The interesting part for us is that we only see signs that it's incremental. We see no signs of cannibalization from that business thus far. *Cars* is the best example right now. *Cars* is in the marketplace. It looks to me like *Cars* could be a number close to what *The Incredibles* did in terms of domestic home video units. And that is with *The Incredibles* having been a higher box office number. So it looks like it will actually convert to home video, and it's at a higher rate than we did with *The Incredibles*. So that's been a very successful title for us in that regard. And *Cars* is the second biggest downloaded title out of the theater on the iPod. So they seem to be, and I won't go so far as to say mutually reinforcing, but they do seem to be accessing a different part of the market,



and that's important for us, because, obviously, home video is a very big business for us. We want to make sure we're making content available to consumers on a basis that works for them, that they want, and at a value that works for them. But it doesn't show any signs of impacting home video sell-through for us at all.

Aryeh Bourkoff - *Analyst, UBS*

In fact, the other way. Growing.

Tom Staggs - *Senior Executive Vice President and CFO, The Walt Disney Company*

On the contrary. Right.

Aryeh Bourkoff - *Analyst, UBS*

And do you have any updated figures on the units sold for the *Cars* DVD yet?

Tom Staggs - *Senior Executive Vice President and CFO, The Walt Disney Company*

Well, as I said, I suspect that it will be about the same as what we did for *The Incredibles* domestically. So it's quite strong.

Aryeh Bourkoff - *Analyst, UBS*

Now, continuing on the iTunes track, any other ideas for collaboration with Apple coming up? We had some time to meet with someone in the Buena Vista Games Division last week in your offices, and it seems like that could be an area where there could be some collaboration on the console business at some point. What else could Apple and Disney do together?

Tom Staggs - *Senior Executive Vice President and CFO, The Walt Disney Company*

Well, I think that the dialogue that goes on between ourselves and Apple, that's now been facilitated by Steve being a major shareholder, and the dialogue is really a beneficial one. That's a company that does a great job, I think, of obviously leading

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technology but also really understanding the consumer. That's fundamental to our business strategy. We're not so much a technology developer as Apple is, but we certainly want to leverage technology. We want to leverage innovation to get our great content out there. And we certainly have to make sure that we're paying attention to the consumer and the consumer experience. That's really central to what we're doing, for example, with Disney.com and what we've done with ESPN.com. So there's a benefit there. I wouldn't speculate on what formal collaboration there might be. I think that we're pleased with the way our product is represented on the iTunes platform, and that's gone well for both sides, I think. So we'll continue to look for opportunities, but I think that the dialogue itself is a benefit.

Aryeh Bourkoff - *Analyst, UBS*

And sticking to some of the investments that you mentioned in the theme parks and obviously digital. There's also an investment in the video game segment that's driven by the market opportunity. Can you talk about the video game opportunity and what you're spending there this year?

Tom Staggs - *Senior Executive Vice President and CFO, The Walt Disney Company*

Yes. You know, video games are an opportunity that we're actually pretty excited about. Now, we invested about \$100 million in the development of games that we published last year. And I expect that number to increase by about 30% this year for 2007. And we're going to ramp that up. Our target is to have about \$350 million of development investment per year, if you look about five years out.

Central to our strategy, though, is that we're really focusing our investment, like 80% of our investment, on Disney-branded titles. We think that that's where we can play with the greatest potential competitive advantage. We don't pretend that we are the world's experts in action, non-branded games. There are others that are quite good at that. I think when we rely on the Disney brand and establish Disney properties, we'll create some original IP in the games business, but we'll be focused primarily, initially, on existing franchises and franchises that come out of the studio, so, *Narnia* being a very good example of it, a very successful game for us last year.

I think we stand to earn an attractive return, we stand to carve out a competitive advantage, and a place and business that makes sense. It will take time. Obviously, the

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development spending we're doing now certainly will dampen profits in Consumer Products somewhat as that's the division that they roll up in, but I think that we like where we're going with our business overall, and it's one more creative center.

If you look at the economics of it, obviously, a publisher takes on incremental risk to develop the game and publish it and put it out there and market it, and they're compensated for that risk. So, if you look at profitability of *The Incredibles* game, which was licensed to THQ, it was about the same as our profitability on *Chicken Little*, which we published ourselves, *The Incredibles* obviously being a much bigger, more successful movie title and a bigger game. The issue is that we think that when we focus on the Disney brand and properties, the risk-reward ratio is in our favor, and we're okay taking on that incremental publisher risk and trying to capture those incremental profits.

Aryeh Bourkoff - Analyst, UBS

One of the criticisms of the problems of Wall Street is the world asking what's next after great times, and obviously now coming off of a strong year, this year has some tough comps in terms of the growth of some of the theme parks given the attendance figures with the promotional period for the fiftieth anniversary, and obviously, the strong rebound at ABC. It's a feeling of generally just across-the-board strength. The consensus numbers for '07 show less than 10% type of growth rates for EPS. You talk about investments. Are these investments going to be used to try to catapult growth into double digits for a few years to come, given your assets?

Tom Staggs - Senior Executive Vice President and CFO, The Walt Disney Company

Well, I think that you highlighted a few of the sort of headwinds we might have from an EPS standpoint this year, and there are a couple. If you look below the operating income line, we do have a greater amount of dilution for the Pixar acquisition this year because we've got a full year of having those shares outstanding. We have a tax benefit that we had last year that--I guess taxes don't get mentioned that much--but it amounted to \$0.05 a share last year that we won't have in 2007, so that obviously has a real impact. At the same time, there's a replacement tax regime that starts to ramp up in 2008, so it's a near-term issue.



But if you look at the operating businesses, I really like the way the theme parks are positioned competitively, and I think they are positioned to continue to grow their business nicely over time. In any given year, I hesitate to make predictions, because you don't know exactly where consumer confidence will be, where consumer spending will be. And certainly, as we sit here today, I have very little visibility on what the summer season will look like. Having said that, I know that there are some tough comps because of the success of the fiftieth anniversary at Disneyland, especially in this first quarter that we're in. We had a record attendance last year at Walt Disney World, and we had strong record attendance at Disneyland.

So we know that's the case, but at the same time, as I said, if you look at where our parks are positioned, the competitive advantage they have in the marketplace, their opportunity to grow over time, it's still one of those assets that I feel very good about. We talked about the ramp-up in investment there. It's still a business that's going to deliver after-tax free cash flow after investment that's going to be north of \$1 billion a year. So it's a business where we can continue to improve our margins from where we had them last year, and we can continue to improve our return on invested capital in the business, even as we invest to make it fresh.

For the studio, I think the year is going to be defined in large measure by just how successful are films like *Pirates of the Caribbean III*. *Pirates of the Caribbean II* came out in home video today, so we'll see how that goes, but the home video market for us has been pretty strong, so I'm hopeful that that will continue. We've got *Ratatouille* in the summer, we've got *Meet the Robinsons*, our animated film from Disney Animation in the spring, something called *Wild Hogs* in the spring and another film, *Underdog* in the summer. Those are the big things to watch in terms of the swing factors at our Studio business.

Then in our Consumer Products business, which I continue to think is one of the underappreciated businesses that we have, last year we saw very strong growth in our earned royalty business in licensing. Now, merchandise licensing is far and away the biggest piece of our Consumer Products business. I think we'll see strong growth in earned royalties again this year. The underlying trends are there. It's also a business that is better positioned than it was five years ago. You go back five years, 80% plus of our licensing revenues were driven off of standard characters, *Mickey Mouse and friends* and *Winnie the Pooh*. This year those two represent about 50%, because we've built up *Princess*, we've built up other properties. And to be growing earned royalties at a healthy clip off of that base is a stronger business position.

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Last year we had about \$70 million more in royalty guarantee revenue recognition than we will see in 2007. And so if you look at the reported line, you're not going to see the growth, but if you look at the underlying business, I like the trends very much. And of course, we talked about the video game investment. Consumer Products growth will be more challenged, but the business itself is in very good shape. And of course, that's a high margin, high cash flow business.

And then the last piece is Media Networks. ABC's off to a nice start this season if you take sports out, because *Monday Night Football* came off. And even though *Monday Night Football* drove some pretty good revenues and high ratings, it was a loss for us, and so we will pick up that loss on the ABC line. That helps us some. We also should be able to enjoy higher CPMs if the ad market continues.

I would characterize the ad market as solid but not spectacular. First, the fourth calendar quarter, our first fiscal quarter, we're seeing scatter for primetime mid single digits above the upfront. If you look broader than that, we saw some nice strength in political advertising at the television stations, but that was the primary driver of growth there, and in cable, we've got greater strength at a very well established branded network like ESPN, where we've got nice figures versus some of the more general interest networks, which have a tougher ad market to be selling into. And so, as I said, solid but not spectacular ad market, but we see strength there that will position us well from the Media Networks standpoint.

Aryeh Bourkoff - Analyst, UBS

Sticking with ESPN and within the Media Networks segment, you just completed a very intricate deal with Comcast for an affiliate agreement that I understand was hundreds of pages. What kind of things did you get from that agreement that you were looking for, and I think there was a big video-on-demand component. How does Disney think about the economics of VOD?

Tom Staggs - Senior Executive Vice President and CFO, The Walt Disney Company

I think one of the important things that comes out of that agreement is that it's a long-term agreement. It covers the waterfront in terms of our properties. I think that it was done on a basis that works for Comcast and works for us. So it's a fair deal. It gives us good visibility and good certainty in terms of the revenues from the affiliate side, and

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gives them the same view and same certainty. It also allows us to step back from it all and say, "Okay, we've got a common goal, which is to improve the consumer experience, and drive growth across our businesses," and I think that's where the dialogue in the later stages of the negotiation went and where it is now. And that is, "All right, how do we think about where the consumer's going, and how do we better deliver these properties," et cetera. And I think that that, to me, is perhaps the most profound part of the agreement, is that, if you looked, five, seven, 10 years ago, people in some instances correctly characterized the relationship between the programmers and the cable operators as a very sort of adversarial one. I think that with the deals that we've been striking, the long-term deals, we've really focused our attention now on building up digital platforms for distribution. We've got content to go over those platforms. How do we think about doing it better? And I think that's going to be productive for both of us.

Aryeh Bourkoff - *Analyst, UBS*

How about the video-on-demand side? What are the terms of that deal?

Tom Staggs - *Senior Executive Vice President and CFO, The Walt Disney Company*

Well, in video-on-demand, we'll have a small handful of titles that will be at a window 15 days after home video. But we're going to have video-on-demand content available. I think that we've got a fair split with them. But we both said that we're going to keep that confidential. Next season we'll have some ABC shows that will be available for free. That's an ad-supported model. We're kind of inventing this business together, and I'm sure certain of it will shift over time as we both hone in and figure out what works the best. But I think that's part of what I was talking about in terms of the ability to sort of leverage these platforms to provide a better consumer experience and better reach consumers.

Aryeh Bourkoff - *Analyst, UBS*

Now, in terms of the affiliate deal and the rate. The last two big deals that ESPN did with Cox and Charter was a few years ago, and that was important. They got a 7% type of rate on average, starting much higher and eventually coming down. Do you think



that Comcast, with their size, would be able to get a better rate, or is that not the way to look at it?

Tom Staggs - *Senior Executive Vice President and CFO, The Walt Disney Company*

Well, I think that Comcast obviously enjoys a rate that reflects its size. The increases are consistent with other deals that we've done. And so it's not a shock to the system of ESPN, and it's not a shock to the system of Comcast in terms of what deal got done. No, I think both sides would say that they're pleased with where it came out, that it feels like a good deal.

Aryeh Bourkoff - *Analyst, UBS*

It sounds like they got pretty much the same rate as Cox and Charter.

Tom Staggs - *Senior Executive Vice President and CFO, The Walt Disney Company*

We never comment specifically on rates. But their rates do reflect their greater size. Their rate of increase, they're generally consistent across the different deals that we've done.

Aryeh Bourkoff - *Analyst, UBS*

Okay. And from *Monday Night Football*, how should we think of it? Obviously, you've had increased costs this next year, fiscal '07, with ESPN, but you don't at ABC. So does it just shift over and it's sort of a wash in the Media Networks segment? Or does the profitability actually improve because maybe CPMs are a little bit better than you're getting on ESPN, or how do I think about the revenue and the cost split between ABC and ESPN with respect to *Monday Night Football*?

Tom Staggs - *Senior Executive Vice President and CFO, The Walt Disney Company*

Well, you will see a profit improvement at ABC as a result of *Monday Night Football* going off. And on the ESPN side, you've got higher rights to anniversary here, and so that has an impact, obviously. But when I look at the overall ESPN business, given the



growth we expect in affiliate fees, and if we continue to see strength in the advertising market, they are very well positioned to deliver growth this year that's consistent with the overall goals we've set for them. We said we would grow on average double digits from '04 to '09 at ESPN, and I mentioned on our conference call that I thought they were positioned to have a growth rate consistent with that goal.

Aryeh Bourkoff - *Analyst, UBS*

And that got into an average double digit growth rate for that period?

Tom Staggs - *Senior Executive Vice President and CFO, The Walt Disney Company*

Yes.

Aryeh Bourkoff - *Analyst, UBS*

But not necessarily per year. But they're potentially positioned to do that.

Tom Staggs - *Senior Executive Vice President and CFO, The Walt Disney Company*

Yes. First of all, we're not big on giving guidance in general, but we also try not to as the year-by-year can be impacted by what the advertising market is doing and what the economy looks like in a given year, how many football games there are in one year versus another. So putting all that aside, I think that you've got a nice growth trajectory for ESPN.

Aryeh Bourkoff - *Analyst, UBS*

ESPN, in our model, is almost 40% of the overall valuation of the company, and it's obviously become a huge asset with different tentacles everywhere. Eighty percent owned by Disney, 20% by Hearst. So would you ever think about doing anything strategically with that asset in terms of realizing the value of it, separating it from the business?



Tom Staggs - *Senior Executive Vice President and CFO, The Walt Disney Company*

I think that we're really pleased with the way that the ESPN platform has been built out under George Bodenheimer's leadership, Steve Bornstein before him. And one of the things that we've been able to do is really take some of the brand-building skill and discipline in the platform in building their unit and cross-utilize that expertise between Disney, between ABC, and between ESPN. Even though ESPN is not quite as integrally intertwined with the other businesses, actually we do have some nice synergy that we have in running that with the rest of the businesses. So I feel pretty good about ESPN being part of the overall family as it is.

Aryeh Bourkoff - *Analyst, UBS*

Financially and operationally?

Tom Staggs - *Senior Executive Vice President and CFO, The Walt Disney Company*

Yes.

Aryeh Bourkoff - *Analyst, UBS*

Okay. Could you talk a bit about the acquisition that you announced, that you made last night in the UK? I thought it was interesting and a natural extension of your sports franchises in the UK. How about that deal and the size of that deal?

Tom Staggs - *Senior Executive Vice President and CFO, The Walt Disney Company*

Yes, we acquired the North American Sports Network, which is based in UK but it's present across some 34 districts or countries across Europe. It's about 6 million subscribers. This is a business where the interest in North American live sports has been growing over there. ESPN has wanted to be in the live sports business in Europe. We think it's a good way to continue to build the ESPN brand. You have ESPN Classic over there, but having live sports is a big deal. And, as you can imagine, the programming that we have here in the United States on a network like that is able to be leveraged, so we have some assets to bring to bear that looks to me like a very value accretive acquisition. It's not a big acquisition. It's modest, in fact.

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Aryeh Bourkoff - *Analyst, UBS*

About \$120 million or so? Is that right?

Tom Staggs - *Senior Executive Vice President and CFO, The Walt Disney Company*

There are reports, and the order of magnitude of the reports is basically accurate. So it's in that ballpark. I think that from a standpoint of building the ESPN brand in Europe, it can be an important deal.

Aryeh Bourkoff - *Analyst, UBS*

Turning to the Film Division, in 2006 and just looking at it as it goes back halfway to the end of the year with your key franchise hits and obviously the DVDs now coming out into the fiscal first quarter of '07. When you look at the weighting or distribution of that growth for the Studio segment in '07, is that going to be a first half or more of a barbell approach, with the first quarter of '07 being strong because of DVDs, and then the end of '07 would be strong with the next Pixar hit?

Tom Staggs - *Senior Executive Vice President and CFO, The Walt Disney Company*

Well, when I look at the Studio business sort of on a quarterly basis, we've got *Cars* and *Pirates* and *Little Mermaid* in video this quarter, which is obviously a strong lineup. We've got a much tougher comp in the second quarter in terms of what product is going to be in the marketplace. And then the second half of the year, I think, has a lot to do with the fact that we've got *Pirates III*, but we had *Pirates II* last year. It's difficult for me to predict today what that comparison is going to look like. We have *Ratatouille*, which looks like a great film, versus *Cars* last year. So the summer's a little bit more difficult to call until we get closer and see how those titles do.

Aryeh Bourkoff - *Analyst, UBS*

Now, *Ratatouille*, I understand, screened very well last week. Can you talk about some of the findings?



Tom Staggs - *Senior Executive Vice President and CFO, The Walt Disney Company*

No. I've seen it, I like it a lot. I think they produced a great film. It's not done yet, they are in the process of producing a great film, but we studiously avoid making predictions about films. I think, more importantly, though, when we look back at the Pixar acquisition, the integration has really gone even better than we might have hoped. The impact that John Lasseter, Ed Catmull, and the rest of the Pixar team have made in terms of the creative spark and energy that they've helped provide inside Disney Feature Animation, and frankly, more broadly than that in the theme parks, et cetera, that is very exciting.

We've appointed a very talented woman who's going to head Disney Consumer Products for Animation as a product line, and the development of Consumer Products will now be more integrated with the creative process. For both Disney Feature Animation and Disney/Pixar Animation, I think that bodes well for where the creative quality and products are going for Consumer Products. I think you're just going to have a more seamless creative process and a more energized creative process.

And the most important things for our company, because we are a content-driven company, is that we make sure that our culture is revolving around creativity and innovation and creating an environment that really attracts and retains the best talent. Pixar has done a lot for us in that regard, and I think that we want that to continue. We're going to continue to invest in that culture. I'm sitting here today and I'm even more convinced in the importance of and the value creation potential of the Pixar deal.

Aryeh Bourkoff - *Analyst, UBS*

We had a chance to meet with some of the folks at the Pixar segment, including Dr. Catmull, last week. We wrote a note about some of the findings and the details, and one of the things he mentioned was that while Disney was the purchaser of Pixar, obviously, from the animation perspective, Pixar really was the driving force behind the integration. And he talked about the fact that since the acquisition, and now that the integration's underway, you've actually reacquired some key talent that had left the company, including the directors of *Aladdin* and *The Little Mermaid*. It sounds like the integration's going very well. What kind of measurement point do you look for to judge that?



Tom Staggs - *Senior Executive Vice President and CFO, The Walt Disney Company*

Well, the answer is that we won't judge it by any particular film. But when you spend time, you walk the halls and then sort of examine the creative process, that's really how we have to measure it, and that's why we've been so encouraged. We do have some folks who had left who wanted to come back, feeling like this was the place to make animated films. And that's a really positive sign.

I think that, we look at *Cars*, and I know some people have said that *Cars* looks like it was a little less than we hoped it would be. We're actually extremely pleased with *Cars*, because I talked about the strength of the DVD, but also I suspect that *Cars* will do more at retail from a Consumer Products standpoint this year than it did last year. It's a franchise that has real potential, long-lived potential, and we're continuing to invest in that franchise, keep it fresh. We're looking at the possibility of putting *Cars*-based attractions at theme parks over time, and it's building those franchises that could become part of the base of our company's creative strength, but also our earnings base.

That's what can dampen volatility, that's what can improve returns over time, and it's exactly the kind of property we had hoped we would build out of it. *Cars* is the last film in the old deal before the acquisition, the last movie meal deal. So *Cars* would have been part of the library per se, anyway. But it's really important to know that we've now got their creative team thinking about, "Okay, how do we extend this franchise inside and across all the assets of The Walt Disney Company?" That wasn't happening before. And I think it's really important.

I've talked about the fact that we will have dilution from Pixar this year, and it's going to be meaningful dilution, and it makes the growth rate on the EPS line much more difficult this year than it would otherwise be. At the same time, it's going to be increasingly difficult as you look at '08, '09, 2010, to even talk about dilution because the Pixar effect in terms of leveraging those properties across all of our businesses is very positive, but it's much harder to measure with great certainty. The bottom line is, I think you're going to see better earnings, better returns for our company, as a result of Pixar being an integrated part.



Aryeh Bourkoff - *Analyst, UBS*

Pixar is known for its high quality hits, and they've been very successful with the hits that are coming out pretty much once per year. Do you see a scenario where Pixar will start to develop two hits per year? Is that something that you think is needed for the acquisition to make sense from a financial perspective?

Tom Staggs - *Senior Executive Vice President and CFO, The Walt Disney Company*

We've targeted two animated films per year as sort of what we've talked about. I think it's possible that in some years it will be higher, some years it will be lower, because we're going to base our release schedule on what makes the most sense for the creative projects that we have in the pipeline. And we're quite serious about that.

I think that if you get into a factory mentality in the film-making business, and especially animation, then you tend to have your release schedule drive your creative process. And that is something that we've got some experience with, and I think that it doesn't serve us well. At the same time, what's going on right now is that the number of projects that are in development that people are getting excited about continues to increase. And so the sort of fountain of creative ideas looks very robust, and so these things that can drive that pace that I was talking about, or even a higher pace, that's great, but that will be what drives it. I think that the two films per year, steady-state pace that we talked about is the right one. But it's also one that I feel comfortable with from a value perspective as well.

Aryeh Bourkoff - *Analyst, UBS*

And it's not necessarily something that we would see in fiscal '07. I mean, fiscal '08, rather. It could take a few years before you get to that run rate?

Tom Staggs - *Senior Executive Vice President and CFO, The Walt Disney Company*

Yes, it will take some time to get to a steady state. I'm not telling you exactly what the release schedule is going to be, but we've got some projects in development. We announced just a couple of days ago that there's some trimming going on in terms of staff at the Disney Feature Animation side of things. Not a major cut, but we're trying to



make sure that we've got the workforce right sized. And I think that that's all about having the right staffing, the right group to do that creative process.

Aryeh Bourkoff - *Analyst, UBS*

And you've mentioned, I think, overall, studio cuts saving about \$100 million on an annual basis. How much of that will be realized in fiscal '07?

Tom Staggs - *Senior Executive Vice President and CFO, The Walt Disney Company*

Well, a lot of it is near term. I think the best way to think about it in the Studio business, is that we've also reduced the number of releases per year. So if you want to think about overhead per release, that number isn't really coming down. What we've done is right-size the overhead for the release schedule that we think is the right one for our company. So, as you and I have discussed many times in the past, putting most of our investment against the Disney brand of titles, and making sure that we're trying to develop those titles that have franchise potential, is a better strategy, I think, one that over time leads to better overall returns.

Aryeh Bourkoff - *Analyst, UBS*

And it's obviously a focus on the profitability of the film business improving. Talk about the benefits of doing *Pirates II* and *III* together, was there any synergy there?

Tom Staggs - *Senior Executive Vice President and CFO, The Walt Disney Company*

Well, I think there was certainly creative synergy, and I think there was probably production synergy, but I'm not going to pretend they're not expensive films. They're very, very expensive films. The good news is that I think we're going to get a nice return on that investment. But, we've got a very strong team on it, Jerry Bruckheimer, Gore Verbinski, and the team from Disney production under Bruce Hendricks. They know how to take what we're spending and put it up on the screen, as you saw in *Pirates II*. It was up there on the screen, and that's really what we have to ask for. I think they're delivering it.



Aryeh Bourkoff - *Analyst, UBS*

I just have two more questions and we'll open it up to the audience and the microphones that will be going around. First on the balance sheet. You talked about, I think you have a \$6.6 billion buyback authorization program, and you have committed to repurchasing the shares that you issued in the Pixar transaction, which I think is remaining \$900 million or so, in that area.

Tom Staggs - *Senior Executive Vice President and CFO, The Walt Disney Company*

There is not very much left.

Aryeh Bourkoff - *Analyst, UBS*

So then you have, obviously, \$5.7 billion excluding the Pixar deal to buy back and have authorized. Is there an intention or time frame to use that remaining \$5.7 billion? Because I think you've only committed to the \$900 million.

Tom Staggs - *Senior Executive Vice President and CFO, The Walt Disney Company*

I won't predict beyond what we said about buying the Pixar shares back. We've tried to studiously avoid saying, "Here's how many shares we're going to buy back and how much we're going to spend." We've said, though, that we're going to continue to be buyers of our stock, and we are buyers of our stock. I think that reflects both our long-term point of view about the business, but it also hopefully reflects the discipline we bring to the allocation of the capital. We're not big believers in just having cash pile up on our balance sheet. I think that for the right idea we've got to access the capital markets. I think we are a return-driven company, and so that's what I think makes sense, and you should expect that to continue.

Aryeh Bourkoff - *Analyst, UBS*

One of the topics of conversation around the conference and around the environment we're in is interest rates and basis points and companies going private. Private equity, obviously, is everywhere. This is a record year for high yield issue, and not that you're a high owned company, but you have a balance sheet that's very favorable, 1.2 to 1.3

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times lever on a net-debt basis. Do you need to be that conservatively capitalized in this environment, where capital's so cheap?

Tom Staggs - *Senior Executive Vice President and CFO, The Walt Disney Company*

I don't think we need to be that conservatively capitalized. I'm actually comfortable with our current leverage ratios. I think it gives us a fair amount of firepower if we need to do something. I don't have anything sort of jumping off the shelves that we have to go do. But I'm not saying that we think we should lever up tomorrow just to go buy a bunch of stock either. I think that we've said that we were targeting sort of a single-A kind of a rating. We're in that ballpark. I'd like to stay in that ballpark for now. I think that it's a bit of a sweet spot for us. I think we could debate perhaps there's a lower cost of capital with higher leverage. The fact is that in this range, our debt trades well through its rating, and we've got a benefit from that, and I think part of that's the quality emphasis we put on the balance sheet. So we've got very strong free cash flow creation potential. It feels to me like we're in a pretty good spot from that standpoint. And, of course, if we went private, I wouldn't get invited to come do these things with you, so that wouldn't work.

Aryeh Bourkoff - *Analyst, UBS*

You still look at the debt. The last question I have is on YouTube. Obviously, negotiations are going on with the media companies and YouTube around copyright issues. Ann Sweeney talked this week about how--or last week, rather--about how the current system is not the right system in terms of having to pull down content that has been infringed upon. Are you having discussions with YouTube? How do you think that will progress? Will that be a transactional-based model, where you share revenue, or will you expect to get a lump-sum payment of some kind for their free use?

Tom Staggs - *Senior Executive Vice President and CFO, The Walt Disney Company*

I think what you should expect is that our first choice is to pursue a market-based solution to the issues of copyright protection, and that we will continue to favor having access to consumers with our products. It's incumbent upon us to try to make sure that we're accessing the market on a basis that's convenient for consumers but is priced correctly, et cetera. But there are serious issues with regard to copyright and intellectual



property protection that's an important asset of our company that you, all of our shareholders, I think want us to make sure that we're minding. So, we're going to look with all the players at market-based solutions to keep our content available to people, respecting intellectual property, make sure it's priced correctly, make sure that we're garnering the value from that product that we should. Now, I purposely don't want to be too specific about exactly where they'll come out, partially because I don't know for a fact exactly what that right answer is yet, because those conversations need to continue, and we need to make sure that we're examining sort of all avenues to get to the right answer.

Aryeh Bourkoff - *Analyst, UBS*

Is there an urgency around the conversations given that your content is not posted in the user-generated sites?

Tom Staggs - *Senior Executive Vice President and CFO, The Walt Disney Company*

I think it's certainly a topic of great interest to us. It's something that we're focused on.

Aryeh Bourkoff - *Analyst, UBS*

Okay. The microphone's going around. Any questions, please?

Unidentified Audience Member

Thanks. Could you give us some perspectives on the iTunes versus Target and Wal-Mart debate that's been in the press recently? And also, any update on the pace of iTunes downloads of movies more recently?

Tom Staggs - *Senior Executive Vice President and CFO, The Walt Disney Company*

Sure. With regard to our relationships with mass retail, those are obviously discussions that are ongoing. And I think you probably saw Wal-Mart's recent announcement that they're going to test some download mechanisms in the marketplace themselves.



First of all, it's important to keep the perspective of the download revenues today and the volume of downloads versus the volume of DVDs. *Pirates*, as I said, streets today. *Cars* is just out. That's important for us, because it's a good time. But we also know that it's a very good time for us to put that product in the marketplace for our distribution partners. It drives a lot of traffic and it's continued to do so. We also know that we need to continue to invest in our DVD products. It's a differentiated product from a download. It's a different product, and it's a different consumer proposition. And I think that our retail partners recognize that and take that into account in thinking through things.

But we're all feeling our way a little bit through this, and so some of the conversations can get more interesting at times than others. But at the same time, as I look across the relationships we have with mass retailers, they're actually in good shape, and I think they're going in a positive direction. I think the give-and-take and the back-and-forth is part of the process that we have to go through. At the same time, as we've said to you on a number of occasions, we want to make sure that to the extent the platforms are there, that they are providing access to our consumers for our content on a basis that is desirable for the consumers and delivers value. But we want to do it in a way that is respectful of and takes into account the existing relationships and the existing importance of that business, which we're doing.

Unidentified Audience Member

Now with respect to the MVNO strategy, Disney Mobile. Can you talk about the progress there and what you've learned from the ESPN experience and how that's different?

Tom Staggs - *Senior Executive Vice President and CFO, The Walt Disney Company*

Sure. Let me address the second part of the question you asked about the current pacing of the downloads for movies. I don't watch it day to day. There was an initial sort of spurt of excitement, and it's settled in at a pretty nice pace. I mentioned that at today's pace, it probably looks like about \$25 million of revenue in the first year. And I think we all need to see the Christmas season, how many units, video iPod units are sold, what the product does in the marketplace. It's like anything else. The product, I think, is going to dictate a lot of it. So I still feel like it's early days for that business, and we'll continue to sort of watch it over time.

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On the MVNO question, we've had Disney MVNO in the marketplace for a little while. We only just recently ramped up some of our retail presence. And so far, we're pleased with where that's going. It's obviously the early days and the numbers are yet small. But so far, so good, and we're about on track with what we had expected it to be at this point in time. So that seems to be going fine. But the good news is the market that we're hitting is the market we thought we would appeal to, which is really driven by Moms who are making the decision that they want cell phones for a family, so it's a 70% to 80% Mom-driven decision. The majority of kids using the product are between ages 8 and 13, sort of right in the sweet spot. There's actually a number of kids at 14 and up that are in the subscriber base as well. So that's good. The response to the utility, the features, the GPS feature, the on-the-fly call monitoring and, well, not listening in, but number of minutes and maybe we should add that--I was kidding. You know, who you can call, that sort of thing. Really good response to the value proposition from the subscriber base that we've gotten, and I think it's now a matter of getting it out there to folks. It's a much different product proposition than we had with ESPN MVNO, and I think we're doing the right thing to move that to sort of a license arrangement for the ESPN content, because that was a content-driven proposition. This has got a lot more utility to it. There's obviously content that's a part of it.

Unidentified Audience Member

Comparing the progress reports at each one at the early stage, you're relatively more pleased with Disney than you were with the ESPN strategy?

Tom Staggs - *Senior Executive Vice President and CFO, The Walt Disney Company*

Yes, they're rolling out in a different way with a different retail strategy and certainly with different price points. It's a little difficult to compare. But right now, we're pleased with where the Disney one has gone, and the ESPN one, obviously, we decided that we wanted to pursue a different strategy.

Aryeh Bourkoff - *Analyst, UBS*

Any other questions?



Unidentified Audience Member

As your online strategy continues to evolve, and your iTunes movies continue to ramp, and your ESPN product continues to ramp, it would come through a long period of very depressed pricing in the world of bandwidth. How do you think about that? Obviously, it's a cheaper way of delivering a product, but over time, as you continue to push your product, your content, and your brands out, is that something that you think of as a cost of delivery over time, potentially going up as this consolidation is happening? Or is that something that you allow your distributors to worry about?

Tom Staggs - *Senior Executive Vice President and CFO, The Walt Disney Company*

Well, bandwidth and the trend of the cost in bandwidth and the way that we choose to deliver and how that impacts the cost of bandwidth, or the cost of the delivery, the bandwidth used, that's something that we try to think about as we're going along. Now, we've obviously got distributors that are thinking about it every single minute of every single day, I think. But we try to factor that into our overall value equation. Some of the methodologies that we or others have tried early on don't necessarily scale in that form. You've got to distribute potentially in different ways. You've got to be more efficient with the use of bandwidth, and we're going to continue to take a look at how we can do that.

But you put your finger on it. I think that overall, the bandwidth costs will continue to go down as the distribution mechanisms get more and more efficient in that, and so I think that will be a part of the equation, but right now it doesn't look like it's going to be an impediment to at least the foreseeable future. Now, mass downloading just through streaming of movies over the Internet, if it got too huge right now, it would choke the system. But I think that there's some work to be done technologically there. At least the folks that are more into this than I am feel that there are solutions to that that can allow us to continue to deliver. We continue to think that it's a variety of different approaches, whether it's datacasting, whether it's a variation of peer-to-peer, it remains to be seen.

Aryeh Bourkoff - *Analyst, UBS*

Just to finish up with the last word, sort of along the lines of how we started. As you look at fiscal 2007, the year ahead, will the Disney story be mostly in organic growth to

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go with the expansion you talked about, or do you have capital set aside for potential acquisitions like on the Internet side or internationally that you want to pursue?

Tom Staggs - *Senior Executive Vice President and CFO, The Walt Disney Company*

I think that the central part of our strategy in our growth thesis revolves around the extension of our content and our properties on the new platforms and into new geographic markets. I think that there's good growth potential over time in Europe. What we think that we need to do there is continue to move the Disney brand, broaden the appeal of the Disney brand there, just as we've done in the United States to programming Disney Channel, through a powerful Disney brand of movies like *Pirates of the Caribbean*, *Narnia*, et cetera.

In emerging markets like China and India, we have to tailor our approach to those individual markets, but in general, we will drive behind our brands and our content, although in some instances content that we develop in-market for the market. That will become a bigger part of what we're doing. I think that is core. We think that the growth opportunities over time from that are attractive. So we'll be opportunistic about acquisitions. The extent that we see acquisitions that we think are leveragable against our core set of businesses, or extend us into a business where we can really bring to bear a competitive advantage that our company possesses, that's something that could be interesting to us, at least that we feel we can add value to it and deliver value over time. We don't sit here today thinking that we need an acquisition to round out the portfolio or to participate in a business that we don't yet participate in. We'll, as I said, we'll be opportunistic about that and take it as we go.

Aryeh Bourkoff - *Analyst, UBS*

Okay, with that, thank you very much, Tom. I appreciate your time. Thanks.

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