Q2 FY22 Earnings Conference Call

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Disney Speakers:

Bob Chapek

Chief Executive Officer

Christine McCarthy

Senior Executive Vice President and Chief Financial Officer

Moderated by,

Alexia Quadrani

Senior Vice President, Investor Relations

PRESENTATION

Operator

Thank you for standing by, and welcome to The Walt Disney Company's Second Quarter 2022 Financial Results Conference Call. (Operator Instructions).

Please be advised this conference is being recorded. (Operator Instructions).

I would now like to hand the conference over to your speaker today, Alexia Quadrani, Senior Vice President of Investor Relations for The Walt Disney Company. Please go ahead.

Alexia Quadrani – *Senior Vice President, Investor Relations, The Walt Disney Company*

Good afternoon, it's my pleasure to welcome everyone to The Walt Disney Company's Second Quarter 2022 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 replay and transcript will also be available on our website.

Joining me for today's call are Bob Chapek, Disney's Chief Executive Officer; and Christine McCarthy, Senior Executive Vice President and Chief Financial Officer. Following comments from Bob and Christine, we'll be happy to take some of your questions. So with that, let me turn the call over to Bob to get started.

Bob Chapek – *Chief Executive Officer, The Walt Disney Company*

Thanks, Alexia, and good afternoon, everyone.

In Q2, Disney's employees and Cast Members continued to execute against our strategic priorities of Storytelling Excellence, Innovation, and Audience Focus—and I could not be more proud of what they've achieved.

Our strong results this quarter—including fantastic performance at our domestic parks and continued growth at our streaming services—along with the creative achievements of our content teams, once again proved that we are in a league of our own.

We have entertainment's most iconic brands and the world's favorite franchises, a high-quality creative pipeline that will continue to drive engagement and consumption, and an unrivaled synergy machine with touchpoints that reach audiences across distribution channels, geographies, and demographics – all of which come together to create a deep, emotional connection with audiences across generations.

I'd like to share a few highlights from the quarter that illustrate these strengths, and then Christine will go through the details of our results.

As I said, our domestic parks were a standout. They continue to fire on all cylinders, powered by strong demand, coupled with customized and personalized Guest experience enhancements that grew per capita spending by more than 40 percent versus 2019.

Response to next generation storytelling like *Star Wars: Galactic Starcruiser* has been phenomenal. In fact Guest ratings for this immersive experience, which opened March 1st, are incredibly high and in-line with our best-in-class offerings. Demand is strong, and we expect 100 percent utilization through the end of Q3.

Looking ahead, we could not be more excited to officially welcome riders on *Guardians of the Galaxy*: Cosmic Rewind at Epcot on May 27th. One of the longest indoor roller coasters in the world, the attraction puts Guests in the middle of an exciting adventure as they're called on to help the Guardians out of a jam. With our first-ever reverse launch and rotating cars that turn riders 360 degrees—Guests won't miss a second of the story during our most immersive coaster experience yet.

At Disneyland Paris, we are thrilled to take the next step in our ambitious expansion plan: the opening of Avengers Campus this summer as part of the resort's 30th anniversary celebration. As Europe recovers from the pandemic, we've seen strong yield growth at Disneyland Paris and look forward to its continued recovery.

Another standout this quarter were our streaming services.

We ended Q2 with more than 205 million total subscriptions after adding 9.2 million in the quarter. That includes 7.9 million Disney+ subscribers, keeping us on track to reach 230 to 260 million Disney+ subscribers by fiscal 2024.

The growth of the platform since its launch reinforces its unique nature. Quite simply, we believe Disney+ is one of a kind—a service based on exceptional branded content, with wide appeal across all four quadrants. It's certainly popular with families—but as a reminder, almost half of Disney+ subscribers are adults without kids.

In recognition of Disney+'s unique ability to attract viewers from a range of demographic groups, we are selectively enhancing Disney+ with general entertainment titles designed to drive sign-ups among specific audiences, and deepen engagement amongst those cohorts.

A benefit of our incredible creative engines and decades of general entertainment excellence is that we can reach these demographics not only through the creation of original titles, but also by shifting resources from across our content ecosystem, especially as consumer behavior continues to evolve.

Our strategy is not just to fill our distribution pipelines—but to be thoughtful with each asset to best position it among our various distribution options.

For instance, *Dancing with the Stars* is a beloved show that has entertained viewers for more than 30 seasons on ABC and is a wonderful example of content that brings the whole family together. We recently announced that Disney+ will be the series' new home starting this fall.

Beyond targeting specific demos, we are equally enthusiastic about our growth potential in international markets. We currently have over 500 local original titles in various stages of development and production. 180 of those titles are slated to premiere this fiscal year, increasing to over 300 international originals per year in steady state.

We believe these premium local originals, along with branded content with broad international appeal, will attract new subscribers and drive engagement.

One example in production is *Nautilus* from our EMEA team. Based on *20,000 Leagues Under the Sea*, *Nautilus* is the origin story of the iconic submarine from the perspective of its mysterious commander, Captain Nemo. This is just one example of how our global network of creative hubs can develop and produce original content with worldwide appeal.

And, by the end of Q3, we plan to roll out Disney+ to 53 new markets across Europe, Africa and West Asia, starting with South Africa next week.

Before leaving Disney+, I want to mention our recently-announced plans to introduce an ad-supported subscription offering in the U.S. by the end of the calendar year, and internationally in 2023. Expanding Disney+ access through multiple price points is a win for consumers and advertisers.

Of course, all of our success is rooted in great content.

Our General Entertainment team continued its string of phenomenal series with Hulu's *Pam & Tommy* and *The Dropout*. And while not in the quarter, we could not be happier with the performance of *The Kardashians*.

More great general entertainment content is ahead, like the second season of *Only Murders in the Building* on Hulu and the record-breaking 19th season of ABC's *Grey's Anatomy*.

This quarter, our studios earned six Academy Awards, including Best Animated Feature for Walt Disney Animation Studios' *Encanto*, and Best Documentary Feature for Onyx Collective and Searchlight Pictures' *Summer of Soul*.

Pixar Animation Studios' *Turning Red* premiered March 11th on Disney+ and became the fastest title to reach 200 million hours viewed on the platform.

The Disney+ Original Series *Star Wars: The Book of Boba Fett* drew positive reaction from audiences, and Marvel's *Moon Knight* continued the studio's impressive track record.

Looking ahead, our studios will continue to deliver high quality content at scale, with an exciting array of series and films coming to all of our distribution channels. In fact, our slate for the remainder of this year is incredibly strong, with titles like *Obi-Wan Kenobi*, *Ms. Marvel, Lightyear, Thor: Love and Thunder*, *Black Panther: Wakanda Forever*, and the long-anticipated *Avatar: The Way of Water*.

Finally, I must mention the phenomenal success of Marvel's *Doctor Strange in the Multiverse of Madness*, which opened to roughly $450 million worldwide this past weekend. Domestically, it was the 2nd highest opening weekend of the pandemic era, and 11th highest opening of all time.

Our strategy of distribution flexibility has worked well for us, and these fantastic results are another sign of our ability to succeed no matter the platform.

That success extends to sports. ESPN viewership was notably strong for the quarter, across both live events and studio programming, with ratings up double digits, and we remain encouraged by how fans are engaging with sports content coming out of the pandemic. Opening Weekend of the NBA playoffs was the most viewed in the past decade, and the ratings have been fantastic, with over 4.3 million average viewers through 20 games on ABC and ESPN.

Our groundbreaking NHL deal is unique in its exposure across ESPN, ESPN+, ABC and Hulu, culminating with the Stanley Cup playoffs, which began on May 2nd.

In fact the combination of NHL and NBA playoffs going on simultaneously kicks off an exciting stretch of championship programming that also includes Wimbledon, the NCAA Women's and Men's College World Series, UFC, boxing and more.

Coming off the success of *Monday Night Football with Peyton and Eli*, we recently debuted our new season-long MLB alternative broadcast, *KayRod Cast* with Michael Kay and Alex Rodriguez. And we began the inaugural season of *PGA Tour Live* on ESPN+, featuring over four thousand hours of live golf coverage from 35 tournaments.

Before I hand it over to Christine, I want to say a few words about our unique synergy machine—or franchise flywheel if you prefer.

What sets Disney apart is our ability to reach people with our uniquely engaging content across an array of touchpoints to make our portfolio of businesses and brands a bigger part of their lives.

This enables us to not only create new franchises like *Encanto*, but to also build on *existing* IP across our lines of business.

One example of this is our Toy Story franchise, which was created almost three decades ago, with the release of the first film in 1995—and which is now brought to life across distribution platforms, geographies, businesses, and time.

At our Parks, we've built a portfolio of four immersive Toy Story lands, with more than 20 attractions and live character interactions available around the world, as well as two themed hotels.

The franchise is a cornerstone of Disney+, with all four feature-length films, as well as the original short series *Forky Asks a Question* exclusively available on the service.

And nearly 30 years after the film debuted, Toy Story is still a key consumer products franchise, generating over $1 billion in annual retail sales.

And in just a few weeks, Pixar's *Lightyear* will tell the origin story of everyone's favorite space ranger when it hits theaters on June 17th.

Of course Toy Story is just one of our many franchises—but it illustrates our unparalleled ability to bring stories to life in more ways, for more people, in more places.

In fact, our franchise library and capabilities will continue to set us apart even further as we bring our IP to life through next generation storytelling that is more integrated and connected across consumer touch points.

As we look to our second century, that's our mission: to transform entertainment by combining extraordinary storytelling with innovative technology to create an even larger, more connected, and magical Disney universe for families and fans around the world.

With that, I'll hand it over to Christine.

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

Thanks Bob, and good afternoon everyone.

Excluding certain items, diluted earnings per share for the fiscal second quarter were $1.08 – an increase of 29 cents versus the prior year quarter. We continue to be pleased with our financial results, with total segment operating income increasing by 50% versus the prior year quarter, and by over 80% year-to-date.

Our Parks, Experiences and Products segment continued to show strong signs of growth and recovery, as operating income increased by nearly $2.2 billion year over year, to approximately $1.8 billion.

Growth was primarily driven by our domestic parks, which were open for the entire quarter. In the prior year, Walt Disney World was open, but Disneyland was closed for the entire quarter.

We continue to be pleased with the overall demand and attendance trends at our domestic parks. In fact, there were many days in the quarter where we saw demand exceed 2019 levels; however, we are continuing to control attendance through our reservation system, with an eye on delivering a quality guest experience.

As Bob mentioned earlier, per capita guest spending at our domestic parks increased by over 40% versus Q2 of fiscal 2019, and by 20% versus Q2 of fiscal 2021, with increases across the board – on admissions, food and beverage, and merchandise.

Looking ahead to the third quarter, our forward-looking demand pipeline at both Walt Disney World and Disneyland remains robust. And while attendance from international visitation is still in the early days of recovery, we are beginning to see some improvements.

We are also thrilled that as of the end of March, all of our domestic resorts are now open – a major milestone as we continue to move through the impacts of the pandemic.

At our international parks, operating results improved versus the prior year due to growth at Disneyland Paris, which was open in Q2 and closed during the prior year quarter. This was partially offset by lower results at Hong Kong Disneyland and Shanghai Disney, both of which were impacted by COVID-related closures in the quarter.

Consumer Products operating income increased in the quarter, reflecting higher sales of merchandise based on several of our iconic franchises including Mickey and Minnie, Spider-Man, Star Wars and Disney Princess.

Moving on to the Media and Entertainment Distribution segment, second quarter operating income decreased by approximately $900 million versus the prior year, as revenue growth of about $1.2 billion, primarily driven by Direct-to-Consumer, was more than offset by higher expenses, including programming and production expenses at Linear Networks and Direct-to-Consumer, which came roughly in line with the guidance we gave last quarter.

At our Linear Networks business, operating income in the quarter was $2.8 billion, or roughly flat versus the prior year, as modest growth at our domestic channels was offset by a decline at our international channels.

Domestically, higher operating income at Broadcasting was partially offset by lower results at Cable.

Broadcasting results benefitted year-over-year from affiliate revenue growth, in addition to higher advertising revenue due to the timing of the Academy Awards, which aired in Q2 this year, versus Q3 last year. These impacts were partially offset by higher programming and production costs, also driven by the timing of the Academy Awards.

At Cable, lower operating income versus the prior year was primarily due to an increase in programming and production costs. The largest component of the increased cost was driven by four additional NFL games versus the prior year – consisting of three regular season games as well as the return of the Pro Bowl. These impacts were partially offset by growth in Cable advertising and affiliate revenue.

Advertising revenue at ESPN increased by over 30% in the quarter, and third-quarter-to-date domestic cash advertising sales at ESPN are currently pacing up significantly, benefiting from a return to a pre-COVID NBA schedule that is driving increased viewership and pricing.

Total domestic affiliate revenue increased by 5% in the quarter. This was primarily driven by 7 points of growth from higher rates, partially offset by a 3-point decline due to a decrease in subscribers.

Operating income at our International Channels decreased versus the prior year, driven by lower affiliate revenue and an increase in programming and production costs, partially offset by advertising revenue growth.

At Direct-to-Consumer, operating losses widened to almost $900 million, due to higher losses at Disney+ and ESPN+ and lower operating income at Hulu.

The higher losses at our DTC services were largely driven by higher programming and production expenses - in line with what we noted in our guidance last quarter.

At Disney+, programming and production costs grew, along with marketing and technology costs, to support our growth around the world; partially offset by higher subscription revenue.

We ended the quarter with nearly 138 million global paid Disney+ subscribers, reflecting close to 8 million net additions from Q1.

A little over half of those net adds were from Disney+ Hotstar, which benefited from the start of the new IPL season towards the end of the second quarter.

Internationally, excluding Disney+ Hotstar, we added over two million paid subscribers versus the first quarter, with Latin America being the strongest contributor, driven by growth of the Combo+ offering. Domestically, net adds of approximately 1.5 million reflect, in part, the success of tentpole content releases including *Turning Red* and *Moon Knight*, as well as the strength of our bundled and multi-product offerings.

ESPN+ ended Q2 with 22.3 million paid subscribers, a net increase of about 1 million versus Q1. Operating results decreased compared to the prior year due to higher sports programming costs and lower pay-per-view income, partially offset by subscription revenue growth.

And at Hulu, which ended the second quarter with 45.6 million paid subscribers, higher subscription and advertising revenues versus the prior year were more than offset by higher programming and production, marketing and technology costs.

Moving on to Content Sales, Licensing, and Other, results decreased by approximately $300 million versus the prior year, driven by lower TV and SVOD results, which we discussed in our guidance last quarter, in addition to a decrease in home entertainment results. As a reminder, these impacts are deliberately aligned with our strategic decision to utilize our content on our own direct-to-consumer services.

Before I touch on a few things that we'd like you to keep in mind for the back half of the fiscal year, I'll quickly note two other relevant items for the second quarter.

We recognized a revenue reversal of $1 billion related to the early termination of content licensing agreements with a customer, in order to make that content available on our own direct-to-consumer services. Because substantially all of the consideration we received was recognized as revenue at the time that content was originally made available in previous years, we've recorded amounts to terminate the agreements, net of remaining amounts of deferred revenue, as a revenue reversal.

Finally, a note on the impact of some tax related items on our Q2 EPS. Our diluted earnings per share excluding certain items of $1.08 includes an adverse impact of approximately 11 cents due to the impact of higher effective tax rates on foreign earnings – including the impact of a recent change in U.S. tax regulations.

It's worth mentioning that while our annual effective tax rate has generally been correlated with the U.S. statutory rate, there are many complex puts and takes in any given period which can lead to these variances quarter to quarter, and we currently expect the full year tax rate could remain somewhat elevated above the U.S. statutory rate.
Now, as it relates to the third quarter and the second half of fiscal 2022…

At DPEP, closures at our Asia theme parks could adversely impact operating income in the third quarter by up to approximately $350 million versus the prior year. As a reminder, Hong Kong Disneyland was closed for the first three weeks of the quarter; Shanghai Disney has been closed quarter-to-date, and we do not yet have visibility to a re-opening date.

As we continue to strategically prioritize leveraging our content for our own services, we expect Content Sales, Licensing and Other operating results to decrease in the third quarter by approximately $150 to $200 million versus the prior year. The expected decrease is primarily driven by declines in content licensing, along with a continued decline in home entertainment results.

Direct-to-Consumer programming and production costs in Q3 are expected to increase by more than $900 million year over year, reflecting higher original content expense at Disney+ and Hulu, increased sports rights costs, and higher programming fees at Hulu Live.

At Disney+, while we still expect higher net adds in the second half of the year versus the first half, it's worth mentioning that we did have a stronger than expected first half of the year.

Additionally, note that some of the eastern European markets we're launching in towards the end of Q3, including Poland, are in regions being impacted by geopolitical factors.

As it relates to content spend, we previously stated that we expect fiscal year 2022 cash content spend to total as much as $33 billion. We've adjusted that amount, to as much as $32 billion, to reflect a slightly slower cadence of spending than anticipated during the first half of the year.

Note that we are still expecting a strong content slate in the back half of the year, and as Bob mentioned, we are confident in our long term subscriber guidance of 230-260 million Disney+ subs by fiscal 2024. We also still expect that Disney+ will achieve profitability in fiscal 2024.

And with that, I'll turn it back to Alexia and we would be happy to take your questions.

Alexia Quadrani – *Senior Vice President, Investor Relations, The Walt Disney Company*

Thank you, Christine. We are happy to be back here in person for this call, but to make it easier, I will help direct the questions. (Operator Instructions)

And with that, operator, we're ready for the first question.

Operator

Your first question is from Brett Feldman with Goldman Sachs.

Brett Feldman – *Goldman Sachs*

Bob touched on pricing to some degree during his comments. So I thought we could come back to that. One of the questions we've been getting is, how do you think about the right cadence for revisiting pricing on Disney+ really when you can take price higher?

It just seems like there's a lot of factors that would go into that, including the fact you'll be launching a new ad-supported tier. You're putting a lot more content onto the service. You've seen some increased competition. And obviously, there's some inflationary pressures, and I'm just not quite sure if you put all that to a pot, what that yields in terms of how you're thinking about pricing.

Bob Chapek – *Chief Executive Officer, The Walt Disney Company*

As you know, we launched with an extremely attractive opening price point on Disney+, and we've been very comfortable with the price-value relationship that we've offered. And as you know, as we increase our content investment, we believe that that's going to give us the ability to adjust our price and still, at the same time, maintain that strong value proposition.

You mentioned the Disney+ ad tier – I think this is going to give us the ability to reach an even more broad audience as we expand Disney+ across multiple price points. And using some of our other services, we can see the additive nature of an ad-driven service that enables us to keep the price lower. Of course, that's made up for by the additional revenue that we would get per user on the advertising spending.

So we believe that we can sort of move up and cascade up our net price over time given the tremendous value that we started with and the increased price-value relationship of all the new content. We're pretty bullish about that. Thank you.

Operator

Next question is from Ben Swinburne with Morgan Stanley.

Ben Swinburne – *Morgan Stanley*

A question and, if I can, Alexia, just a clarification from the prepared remarks.

On parks, as you know, you'll start to lap some really strong significant double-digit per-capita growth as you move through the rest of the summer and into the fall. And I'm just wondering, particularly given how focused everybody is on the economy and inflation, the consumer, if you're seeing any signs that would suggest that you're going to see substantial deceleration or even maybe not grow your per capita growth at the domestic parks. Just be curious on how you're thinking about the full year and as you lap these comparisons.

And then I just wanted to come back, Christine, on the second half net adds. Are you still expecting a stronger second half at Disney+ than the first half and you're just calling out that maybe the relative comparison won't be as pronounced? I just wanted to make sure we understood what you were saying.

Alexia Quadrani – *Senior Vice President, Investor Relations, The Walt Disney Company*

Bob, why don't you take the first half and then Christine can follow up.

Bob Chapek – *Chief Executive Officer, The Walt Disney Company*

We continue to see really strong demand, and we're encouraged by the trends that we're seeing, particularly as we're going to get some improvements to international visitation. But we're controlling our attendance, as Christine mentioned in her comments, using our reservation system to optimize the guest experience. But that domestic yield strategy, and we're also seeing it in Paris, is really exceeding our expectations.

If you remember, last quarter, we mentioned that we had some high hopes for it, but we were seeing well above what we had anticipated. Well, I'm happy to say that in Q2 we're even, as you say, we're lapping those numbers again even higher.

So we're very, very encouraged by the continuation of the trends that we're seeing in terms of the number of people, for example, that sign-up for Genie+, plus the willingness to come to our parks with our balanced reservation system, which really helps us sort of manage our price per day, if you will.

So that domestic yield strategy has really structurally allowed us to increase that per-capita spending meaningfully without having to rely solely on raising ticket prices, and we don't see any end in sight for that.

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

Great. Ben, your question on net adds for the second half of the year. We still do expect an increase over the first half. However, the first half came in better than expected, so that delta that we had initially anticipated may not be as large. But we still do expect an increase in the second half to exceed the first half.

Operator

Our next question comes from Michael Nathanson with MoffettNathanson.

Michael Nathanson – *MoffettNathanson*

I have 2. First would be, Bob, it seems that the equity markets are now focused on, kind of, the cost to achieve subscriber growth and maybe not just focused on the sub numbers as much as the cost to achieve.

So I wonder, given the rising content costs you're seeing in things like sports and competition around the globe, how do you measure maybe the need to drive shareholder returns versus attaining those sub targets that were laid out in 2020?

And how and when will you determine what the ROIC would be on maybe the next 100 million subs versus the first 100 million subs?

And then, Christine – can you talk a bit about any type of incremental margins at the parks? Very strong so far, halfway through the year. Any type of inflation on the parks that could limit maybe the margin growth we've seen at this point?

Bob Chapek – *Chief Executive Officer, The Walt Disney Company*

So as you know, we're very carefully watching our content cost growth. And we reaffirmed, as you heard earlier, our guidance on both subs and on profitability. So we think they move together.

It's obviously a balancing act, but we believe that great content is going to drive our subs, and those subs then in scale will drive our profitability. So we don't see them as necessarily counter.

We see them as sort of consistent with the overall approach that we've laid out. We're extremely happy with the content that we've got both across the general entertainment option, which frankly is – you heard that 50% of our subs are families without kids.

And so at the same time, that relative content expenditure is a little cheaper than our typical franchise expenditure on a per-program basis. So even though we're adding a lot of content both in local, international markets and as well in the general entertainment area, it doesn't come at the per-title level, if you will, that we've been seeing sort of to date on our general franchise films.

That said, we're balancing all 3. And we're very confident that going forward, we're going to hit both of those sub guidance and profitability guidance by bringing in the cost at a reasonable level relative to their ability to attract and retain our subs.

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

Michael, on the parks margins, as Bob said, we feel really good about the consumer demand and what we're seeing in the forward-looking bookings and everything else in the attendance levels. So we feel good about that portion of margins.

The one that is more challenging is what we face with inflation. But we do pay close attention to all the recent inflationary pressures, and it covers everything from merchandise to food and beverage.

For those, we are actually always looking at mitigating impacts of rising costs. But I'll give you a good example of one that we are executing on, and that is the increased cost in fuel. We have a very robust fuel hedging program at Walt Disney World, and that reduces risk and minimizes volatility, reduces volatility in the cost of fuel. And so while we suspended that program while the parks were shut, we have reopened that program and we are doing what we can to minimize the impact on that particular cost.

We do have the labor impacts. Rising wages is something everybody is dealing with and a tighter labor market.

On the supply chain, our business isn't immune to the global supply chain challenges. And to the extent we experience any product availability impacts given strong demand that we're seeing, we're working with our suppliers to diversify some of our suppliers, and we're also working with shippers to expedite time to receive those through shipping.

But right now, it's very difficult to accurately forecast the potential financial impact due to the fluidity of the situation. But you can trust that we are fully aware of it, and we're working hard to mitigate any pressure on the margins.

Operator

Jessica Reif Ehrlich with Bank of America. Please go ahead.

Jessica Reif Ehrlich – *Bank of America Securities*

I have one big question, one multipart. With the upfronts coming next week, can you give us any color on how you're thinking about what this year's upfront will be like given changes in measurement, multiple platforms that you're selling across and, of course, the economy?

And staying with the theme, given your upcoming rollout of the AVOD platform for Disney+, you already have Hulu ad inventory, and as you're adding Disney+, do you think this will grow the pie overall for Disney advertising dollars? Or will this ultimately just drive share shift from traditional broadcast linear? Is it incremental or not? How are you thinking about that?

And how much do you think that having an ad-supported service will increase overall TAM for subscribers?

Bob Chapek – *Chief Executive Officer, The Walt Disney Company*

Okay. Let's see. I'm going to take the first part first. We're expecting a very positive reaction from advertisers overall. And as you suggest, this is a combination of our excitement around the Disney+ ad tier. They have been asking for this for years. And we also expect Hulu, as you know, which has been very strong for us at the same time, to be a key contributor of our performance at the upfront this year.

The other thing is that sports are going to continue to be in high demand. And so with the advertisers, we focused on the right deals that we've made over the past few years as well as our robust slate of original content.

In terms of sort of the growing-the-pie idea, we believe that the value proposition of advertising with Disney+ is only enhanced with our addition of an ad-supported tier on Disney+. So we believe it's good for the consumer because it's going to give us another entry price point, but it's also going to be great for the advertisers.

Our advertisers increasingly are looking for multiple platforms to reach a broader reach. And we think that as a company, we're going to provide that given our portfolio of streaming and our Linear Networks.

So I think we're creating more avenues, both for consumer choice and for comprehensive advertising solutions for our advertising customers at the same time.

Operator

From Steven Cahall with Wells Fargo, please go ahead

Steven Cahall – *Wells Fargo Securities*

Just 2. Maybe first, Bob, what's holding you back from making ESPN+ a fully a la carte sports network?

Disney historically has always been more aggressive in the pivot to streaming than some of the peers. We've already seen some of the peers put a lot of their key sports like the NFL on to streaming. You talked a lot about how much the bundle is working with Disney+ and Hulu.

So just really wondering how you're thinking about all the content you've got on ESPN+ and what it would take to make that fully a la carte and drive the DTC strategy even harder?

And then Christine, I have asked this before, so I'm just going to try again. Of the $32 billion in content spend, any help in sizing maybe how much of that is either general entertainment or local content?

Bob Chapek – *Chief Executive Officer, The Walt Disney Company*

Okay. So as you know, on all of our Linear Networks, they're huge cash generators for us. So to some extent, we're doing a really good job of chopping down some of the debt that we've had to accumulate due to either acquisition or through the COVID challenge.

And so the hesitancy to move too fast away from those is really a cash flow situation that I think puts our company in a healthier overall situation.

At the same time, we're very conscious of our ability to go more aggressively into the DTC area of ESPN. And so what we're doing is sort of putting one foot on the dock, if you will, and one foot on the boat right now. But we know that at some point when it's going to be good for our shareholders, we'll be able to fully go into an ESPN DTC offering the way that you described.

And we fully believe that there is a business model there for us that's going to enable us to regain growth on ESPN+ in a full DTC expression. But at that point, obviously, that will have ramifications on immediate cash flow that we get from our legacy Linear Networks.

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

Okay. Steve, to answer your question on that $32 billion of content spend and where it's going, remember back when we talked about that initially, we talked about it being about 1/3 in sports. That still remains.

And when you think about the balance of that $32 billion, a meaningful amount of it will be enterprise-wide content budget that will be dedicated into investments into the general entertainment content that we can leverage across all of our various distribution platforms. When we say that, we mean linear, theatrical, as well as direct-to-consumer.

And as I mentioned earlier, our world-class creative teams are focused on creating content that will drive subscriber growth in targeted segments and deeper engagement across the platform.

This includes leveraging our existing intellectual property. Also, we're intent on creating new franchises – you saw that in *Encanto*. And investing in general entertainment, local language content and sports rights.

Even though you didn't ask about local language content, I do want to give you some perspective because we haven't provided this previously. As Bob mentioned, we have about 500 shows in the pipeline for local content outside of the U.S. or English speaking.

When you look at that 500, I'll give you some broad breakdowns. In the Asia Pacific region, including Southeast Asia, of that 500, 140 is in that region; in EMEA it's 150; in India it's 100; and in Latin America it's 200. So we haven't given that before, but I think that also kind of breaks it up in the various regions that we are in outside of the U.S.

Operator

Next question is from Kannan Venkateshwar with Barclays.

Kannan Venkateshwar – *Barclays*

So Bob, first, I guess, when we think about the streaming goal, if we are really looking at 240 million subs at the midpoint, with the new ad-supported streaming service, what proportion of the base do you expect will be on that tier versus normal premium tier, especially given the fact that now you may have to do more than 50 million subs a year to get to that goal given the trend lines for this year? So that would be the first one.

And secondly, I don't think Disney has been able to release a movie in China since 2019. If you could just help us understand what the roadblocks there are and when we could see some change in that process?

Bob Chapek – *Chief Executive Officer, The Walt Disney Company*

Okay. I'm going to start with China. The situation there has been very fluid, and as you could probably guess, very complicated both from a business standpoint and from a political standpoint.

But as you know, we've got a long record of success and a strong fan base for our brands and franchises in this market. And our most recent releases were *Death on the Nile* and *Encanto*. And we'll continue to submit our films for release.

And it's worth noting, I think, though, that at the time that we're having some difficulty in getting our films in China that *Doctor Strange* did extraordinary. We've just crossed $500 million in less than a week without this market.

So we're pretty confident that even without China, if it were to be that we continue to have difficulties in getting titles in there, that it doesn't really preclude our success given the relatively lower take rate that we get on the box office in China than we do across the rest of the world.

Christine, do you want to talk about streaming?

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

Sure. On streaming, right now, we have not disclosed a mix or expected mix of an ad-supported tier. So we don't have any additional details on that product, and that includes pricing as well.

But when we expand Disney+ across multiple price points with this new Disney+ ad tier, we are able to reach an even broader audience, and we'll create more avenues for consumer choice. And this is a consistent theme that you've heard from us, having the consumer be our North Star.

We'll continue to evaluate what makes sense for the service, our brand and our core principle of providing consumers with the maximum flexibility and choice. So we expect the advertising revenue we earn will contribute positively to our ARPU as we look to achieve our long-term profitability goals.

Operator

Our next question comes from Philip Cusick with JPMorgan.

Philip Cusick – *JPMorgan Research*

I have a couple of follow-ups, if I can, thank you. On parks, can you talk about where the parks are – the U.S. parks are in terms of staffing and cost as well as the potential for upside or not in those domestic attendance numbers for customers?

And then, Bob, if I can go back to your comment on ESPN going all online someday. I think most of us expect us to happen eventually. Clearly, that will be a huge change in the P&L at both DTC and linear.

When that happens, does the overall profitability of the company take a hit for a year or two? And how does the long-term sports on ESPN+ model work? And what's the structure of that versus what we've seen in the past of a purely linear model?

Alexia Quadrani – *Senior Vice President, Investor Relations, The Walt Disney Company*

Christine, do you want to start with the first question? And then Bob second.

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

Sure. On our parks business, we're obviously extremely pleased with our domestic parks operations and how they have come back so robustly.

But on domestic attendance, we could, but we're choosing to limit attendance using our reservation system. And once again, that goes back to us trying to balance demand and attendance throughout the year, not have days when consumers in the parks aren't enjoying the experience. So attendance is something that we're controlling, but we're doing it to have a better consumer experience.

And some of the things that we've brought back – we will continue to expand with additional capacity, but some capacity that we just brought back in April were things like the character meet-and-greets at our domestic parks. And we also brought back in April our Nighttime Spectaculars at the Disneyland Resort.

And we'll also be opening a new attraction at Walt Disney World, *Guardians of the Galaxy:* Cosmic Rewind at the end of this month on Memorial Day weekend, and that is all new capacity, and we're really looking forward to having our guests experience that.

Bob Chapek – *Chief Executive Officer, The Walt Disney Company*

Okay. And on the ESPN question, we're not ready to share the specifics of our model in terms of how long it would take for us to reach profitability on that or the impact that it would have on our linear business.

But I would emphasize that we're only going to do it if it's accretive to our shareholder value when it comes time to actually pull the trigger. But I can tell you that it will be the ultimate fan offering that will appeal to super fans that really love sports. And I think there's nobody but ESPN that, frankly, could actually pull that off.

But we don't have a lot of specifics when it comes to structure. But we do believe that because sports is so powerful, in fact, in the last quarter, 46 of the top 50 most viewed programs on linear TV were sports. And obviously, ESPN dominates that.

And I do believe that sports is the third leg of our domestic offerings, in terms of our DTC offerings, and right now, that expression is through the bundle. And I think that could become very powerful for us going forward in the future.

Operator

From Doug Mitchelson with Credit Suisse.

Doug Mitchelson – *Credit Suisse AG*

So I guess 2 questions, if I could. Bob, you've continued to suggest a lot of confidence in Disney+ guidance. Can you talk about trends for churn and engagement for Disney+? And I'm not sure if you're willing to share how much of Disney+ viewing is new content versus library, just thinking as more and more new content starts to show up and ramp.

And then separately, and maybe this is for Christine – Alexia, you'll let me know. But I'm just curious what you think the international fee park margin potential because it peaked at 16% in fiscal '19. I think we're getting a pretty good idea that the domestic theme parks is going to be very, very profitable.

But international is still a bit of a mystery. I know you've got some parks closed and there's some disruption, but you also have a good idea of what you're seeing in the U.S., how you could apply that overseas and what you've done with the cost structure during the pandemic.

And also, if you look back at fiscal '19, sorry for making the question a little bit longer, but Hong Kong was shut down for part of the year; China was, what, in year 3. So I'm just curious if those international margins, do we think about the getting closer and closer to U.S. margins over time?

Alexia Quadrani – *Senior Vice President, Investor Relations, The Walt Disney Company*

Bob, why don't you take the first half and then Christine can follow up on parks.

Bob Chapek – *Chief Executive Officer, The Walt Disney Company*

Okay. In terms of our confidence in Disney+ guidance, as you probably know, we have a tremendous amount of data that we get on our DTC platforms, things like the first view, what's the first view that somebody watches when they first come on to our platform, which is a pretty good proxy for maybe why they signed up.

There's also the amount of time spent, the engagement scores and then, of course, the churn, information that you sort of look at.

And we've said this before in past earnings calls, but we're extraordinarily pleased with the low churn that we see, particularly given the bundle. The bundle is really efficient in terms of churn. And that gives us a lot of bullishness when it comes to the idea of bigger offerings from Disney.

So as we sort of take each of these elements, when we get a new piece of content, we'll look at first view, we'll look at engagement, we'll look at the amount of time they spend on it. And we can model. We can do a lot of modeling.

And that modeling suggests that in addition to things like local market content, new content coming online, both in terms of general entertainment and from franchises as well as new markets being added that, that Disney+ guidance is going to be very achievable for us both in terms of the sub adds and in terms of the operating performance.

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

Okay. On international theme parks, Doug, on Asia, I think it's really too early for us to tell. And as you heard in my comments, we said that we could see a negative impact of Hong Kong and Shanghai of $350 million in the next quarter, so just keep that in mind.

But it is a bit of a tale of two cities. I can give you some very positive trends we're seeing out of Disneyland Paris. So just like domestically, we're seeing very strong yield growth at Disneyland Paris. And we're looking forward to its continued recovery, particularly with the recent launch of their 30th anniversary celebration.

Avengers Campus, that's the first new themed area of our multi-year expansion that we've talked about previously for DLP, that will open this summer. And what has already opened is the – one of our large hotels over there, the New York Hotel, has been re-themed in a Marvel theme and Avengers theme. So that's very exciting. And our guests love staying there.

So I think what we're seeing in Paris gives me hope. Hope is not a strategy, but it gives me hope that our other parks in Asia will see that same rebound when their COVID-related headwinds abate.

Doug Mitchelson – *Credit Suisse AG*

If I could just follow up, maybe the simple way to put it is, you've talked about the potential for higher park margins than previous peak. Would that apply to both domestic parks, and separately, international parks longer term?

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

Well, Doug, we've said it for domestic. We're not going to update that for international. There's just too much uncertainty with the region in Asia that has two of our parks right now.

Alexia Quadrani – *Senior Vice President, Investor Relations, The Walt Disney Company*

Operator, we have time for one more question.

Operator

From Michael Morris with Guggenheim. Please go ahead.

Michael Morris – *Guggenheim*

I have a couple on this advertising tier we're talking about for Disney+.

My first is, can you share anything else on what remains to be done prior to the rollout, the implementation of that advertising tier? Are there assets you need to acquire? Or what are you building or anything like that given the pieces that you do already have in place through your ownership of Hulu, et cetera? So I'm curious about the advertising infrastructure.

And then the second, you touched on this a little bit, Christine, but I'm curious if you can share any more relative sizing of the ARPU potential of the ad-supported service. Given that Disney+ is still half the price of Netflix domestically, I'm curious if ad-supported ARPU could actually be higher than where you are right now and if this does present a catalyst for you to raise price on the ad-free service.

Alexia Quadrani – *Senior Vice President, Investor Relations, The Walt Disney Company*

Bob, why don't you start and then Christine can finish.

Bob Chapek – *Chief Executive Officer, The Walt Disney Company*

Okay. We're in really good shape in terms of being able to meet our timing with our Disney+ ad tier. And that's largely because we're already doing it.

The combination of our ESPN+, streaming tech stack and our experience in Hulu and the software, we think that our current advertising capabilities really substantially prepare us to already bring this tier into operations.

So there's nothing that we need to go acquire or, frankly, even in any significant way developing anything new. And that's due to the ongoing investments in technology that we've made over time to increasingly automate much of this process.

And we've been looking forward to this for a while. So this is something that's well-greased, if you will. And our teams are hard at work at making that become a reality.

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

So on the incremental information you had touched on our ad-supported tier. At this time, we haven't announced a price point for it. So we're not going to do that today. But we will continue to evaluate what makes sense for the service in terms of pricing.

And I will say that you can look to our experience with Hulu and their ad-supported tier. We believe that this will contribute to ARPU. And we look at it as certainly something additive that will work towards achieving our long-term profitability goals.

Alexia Quadrani – *Senior Vice President, Investor Relations, The Walt Disney Company*

Okay. Thanks for the question, and I want to thank everyone for joining us today. Note that a reconciliation of non-GAAP measures that were referred to on this call to equivalent GAAP measures can be found on our Investor Relations website.

Let me also remind you that certain statements on this call, including financial estimates or statements about our plans, guidance, expectations, beliefs or business prospects or other statements that are not historic in nature, 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.

For more information about such factors, please refer to our Investor Relations website and the press release issued today as well as the risks and uncertainties described in our annual report on Form 10-K, quarterly reports on Form 10-Q and other filings with the Securities and Exchange Commission. We want to thank you for joining us today and wish everyone a good rest of the day.

Forward-Looking Statements

Certain statements in this call may constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995, including statements regarding our future performance; business or financial prospects, trends or outlook; business plans; demand pipeline; financial or performance estimates or expectations, including estimated operating income, operating results, programming and production costs and cash content spend; future subscriber levels and growth; expected drivers; estimates of the financial impact of certain items, accounting treatment, events or circumstances; anticipated demand, timing, availability, utilization or nature of our offerings (including experiences and business openings, content within our products and services, content releases and pipeline); business recovery; impacts of COVID-19; consumer and advertiser sentiment, behavior or demand; growth and drivers; strategies; direct-to-consumer expansion, plans, new subscription offerings and pricing; and other statements that are not historical in nature. 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, asset acquisitions or dispositions, new or expanded business lines, cessation of certain operations or creative decisions) or other business decisions, as well as from developments beyond the Company's control, including:

- further changes in domestic and global economic conditions;
- changes in or pressures from competitive conditions;
- changes in consumer preferences or demand;
- health concerns and their impact on our businesses and productions;
- international, regulatory, political, legal or military developments;
- technological developments;
- labor markets and supply chain activities;
- adverse weather conditions or natural disasters; and
- availability of content;

each such risk includes the current and future impacts of, and is amplified by, COVID-19 and related mitigation efforts.

Such developments may further affect entertainment, travel and leisure businesses generally and may, among other things, affect (or further affect, as applicable):

- our operations, business plans or profitability;
- demand for our products and services;
- the performance of the Company's content;
- the advertising market for programming;
- income tax expense; 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 2, 2021 under the captions "Risk Factors," "Management's Discussion and Analysis," and "Business," and subsequent filings with the Securities and Exchange Commission, including, among others, quarterly reports on Forms 10-Q.