Welcome to Q3 FY18 Walt Disney Company Earnings Conference Call. We sincerely apologize for any difficulty you had joining the call today, and we thank you so much for your patience. My name is Vanessa and I will be your operator for today's call. (Operator Instructions) Please note that this conference is being recorded. I will now turn the call over to Lowell Singer, Senior Vice President of Investor Relations. Sir, you may begin.

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

Good afternoon and welcome to The Walt Disney Company’s third quarter 2018 earnings call.

Our press release was issued about 25 minutes ago and is available on our website at www.disney.com/investors. Today’s call is also being webcast, and the webcast and a transcript will be available on our website.

Joining me for today’s call are Bob Iger, Disney's Chairman and Chief Executive Officer, and Christine McCarthy, Senior Executive Vice President and Chief Financial Officer.

Bob will lead off followed by Christine and we will then be happy to take your questions.

So with that, let me turn the call over to Bob to get started.

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

Thanks, Lowell, and good afternoon, everyone.
Given the events of the last few weeks, I’m going to leave most of the discussion of the quarter to Christine and focus my comments on the 21st Century Fox acquisition to give you greater insight into the tremendous potential we see across our entire company – including our direct-to-consumer services. We’re obviously thrilled with the results of the shareholder votes, and are working to secure the remaining regulatory approvals in a number of international territories.

The assets we’re buying fit perfectly with our plans to substantially grow our intellectual property portfolio and to bring our products to market in ways that consumers, as well as the creative community, find extremely compelling. The recent reorganization of our company supports this ambitious vision, in part by allowing the seamless integration of the businesses, brands, franchises, and executive and creative talent from 21st Century Fox.

We look forward to the opportunities ahead, more confident than ever in our ability to complete this historic acquisition in a timely manner, and in our ability to fully leverage these tremendous assets to drive significant shareholder value.

It’s particularly worth noting that our global growth strategy will be well-served by the international properties in the Fox portfolio. Fox Network Group International’s 350 channels reach consumers in 170 countries, Star reaches 720 million viewers a month across India and more than 100 other markets, and, as you know, Fox also has a significant stake in Sky, the most successful pay television company in Europe. The addition of these valuable assets will greatly enhance our position as a global entertainment company with excellent production and distribution businesses in key and emerging markets around the world.

On the domestic front, we continue to transform our media businesses to take advantage of new technology, as well as the changing consumer trends that are re-shaping the media and entertainment landscape.

As we predicted, smaller, digital bundles have become a rapidly growing part of the MVPD universe, and our early decision to make our high value channels widely available across these
new services certainly added to their consumer appeal. Although the erosion of the expanded basic bundle continues, the impressive growth of these DMVPDs has steadily slowed overall sub losses. To that end, we’ve seen noticeable improvement in the rate of sub loss in each of the last four quarters.

It’s also interesting to note that today, more than half of US homes subscribe to streaming services – and on average, they subscribe to three different SVOD products. About 80% of those homes also have an MVPD subscription of some kind. Consumers are picking and choosing from all the options in the market to create their own personalized mix of content.

Thus, we continue to move full steam ahead on our direct-to-consumer strategy – empowered by our strategic purchase of BAMTech, which allowed us to enter this dynamic space quickly and effectively.

In this era of unprecedented consumer choice, brands matter more than ever. And, our incredible portfolio of high-quality, in-demand, branded content uniquely positions us to strategically – and successfully – navigate this increasingly dynamic marketplace.

We have always believed we have the brands and content to be extremely competitive and to thrive alongside Netflix, Amazon and anyone else in the market, and adding the Fox brands and creative assets such as Searchlight, FX and National Geographic to Disney, Pixar, Marvel, Lucasfilm, and ABC will make our DTC products even more compelling for consumers.

In addition to their recognizable brands and wealth of world-class content, we’re also gaining access to the talent, originality and creativity that makes them great. These businesses have strong relationships and deep respect within the creative community – as well as the proven ability to develop, produce, and distribute high-quality content.

I thought I’d mention some examples: FX is renowned for great, high-quality television. It takes bold and impressive creative risks, and it is highly respected for identifying, supporting and
nurturing innovative talent. Our plan is to provide even more resources to support FX’s existing business, and to further invest in FX as a brand, and as a critical supplier of original content for our DTC platforms.

National Geographic is another tremendous brand built on quality – one that has global reach and cross-generational appeal. We also like that its values are vital and relevant to a planet facing increasing environmental challenge. Again, our goal is to support Nat Geo’s expansion around the world and provide the additional resources required to position the brand as another major provider of DTC content. And, we see numerous other exciting opportunities for this brand across our entire company – including in the eco-tourism space.

Fox Searchlight is another creative engine we respect and admire a great deal. With 20 Oscar nominations last year, along with the Academy Award for best picture, it’s hard to argue that Searchlight needs any help from anyone. Our strategy is to give the studio what it needs to continue to do what it does best, and to also expand the brand’s high-quality storytelling into the DTC space with original television and film projects.

20th Century Fox Film is yet another example. It gives us the opportunity to be associated with and to expand iconic movie franchises, like Avatar, Marvel’s X-Men, The Fantastic Four, Deadpool, Planet of the Apes, Kingsmen, and many others.

We’re obviously very excited to leverage the Fox assets to enhance and accelerate our DTC strategy, but I want to be clear that we remain incredibly supportive and enthusiastic about the movie theater experience. It’s a vital part of our company – in fact, our studio just crossed $6 billion in global box office for the third year in a row.

We’re on track for a late-2019 launch of our Disney-branded streaming service. We already have numerous original projects currently in various stages of development and production for this platform – including the world’s first live-action Star Wars series, and new episodes of the Star Wars: Clone Wars animated series.
Our robust content pipeline also includes theatrical movies such as a live-action version of Disney’s *Lady and the Tramp*, as well as new series based on popular IP from across the company, such as Disney Channel’s *High School Musical* and Pixar’s *Monsters, Inc.* We’re also moving forward with brand new Marvel content. And as I just noted, the Fox acquisition brings even more opportunity to create original programming for this platform.

We’ll share more details about our Disney DTC plans at an investor presentation in the near future.

I also want to note the encouraging initial performance of our ESPN+ service – which launched to great reviews and enthusiasm earlier this year. It’s still early days, but conversion rates from free trials to paid subscriptions are strong, and subscription growth is exceeding our expectations. ESPN+ will become even more compelling to fans across the sports spectrum as we continue to expand the content and enhance the user experience.

ESPN has invested wisely in a number of sports events and packages, and the lineup for “Plus” is quite strong -- the UFC and Top Rank Boxing packages make Plus extremely attractive for fans of combat sports; the service will also offer over 200 college football games this year, 70 in the first three weeks of the season alone. And that’s on top of thousands of other college sports events. Live events from Major League Baseball, the NHL and MLS will also be regular features on the service. And our new rights agreement with Italy’s Serie A – one of the world’s top soccer leagues – will add more than 340 matches per season to ESPN+ starting this year.

It’s safe to say we are very pleased with our progress in the DTC space, and, having spent months working with the Fox management team on integration planning, we are even more enthusiastic and excited by all the opportunities ahead.

I’m now going to turn the call over to Christine to discuss the quarter, and then we’ll take your questions. Christine?
Christine McCarthy – Senior Executive Vice President and Chief Financial Officer, The Walt Disney Company

Thanks Bob, and good afternoon everyone. We are pleased to report another quarter of solid financial performance. Total revenues were up 7% and operating income was up 5%. Excluding certain items affecting comparability, earnings per share for the third fiscal quarter were up 18% to $1.87.

At Parks and Resorts, revenues increased 6% and operating income was up 15% driven by growth at both our domestic and international parks and Disney Cruise Line. Results this year included only one week of the Easter holiday period, whereas third-quarter results last year reflected the benefit of both weeks of the holiday period. We estimate this drove an adverse impact to operating income of 47 million dollars or 4 percentage points on the year-over-year growth rate. Despite this headwind, the segment once again delivered very strong results with revenue and operating income setting new Q3 records.

Higher operating income at our domestic parks and resorts was primarily due to increased guest spending, partially offset by higher costs. Per capita spending at our domestic parks was up 5% on higher admissions, food and beverage and merchandise spending. Per room spending at our domestic hotels was up 8%.

Attendance at our domestic parks was up 1% in the quarter and reflects about a 1 percentage point adverse impact from the timing of the Easter holiday. Occupancy at our domestic hotels was down about two percentage points to 86% reflecting reduced room inventory due to room refurbishments and conversions.

So far this quarter, domestic resort reservations are pacing down 2% compared to prior year, while booked rates are pacing up 7%.
At our international parks and resorts, higher results were due to increases at Shanghai Disney Resort and Hong Kong Disneyland Resort. Q3 results at Disneyland Paris were roughly comparable to the prior year. At Shanghai Disney Resort, growth in operating income was primarily driven by the timing of expenses and higher attendance, partially offset by lower guest spending. Growth at Hong Kong Disneyland Resort was due to higher hotel occupancy and increases in attendance and per capita spending at the park.

Total segment operating income margin was up 190 basis points compared to Q3 last year, and we estimate the timing of the Easter holiday had an adverse impact of about 60 basis points on the year-over-year margin growth.

Turning to the Studio, operating income was higher in the third quarter driven by growth in domestic theatrical distribution due to the performance of *Avengers: Infinity War* and *Incredibles 2* compared to *Guardians of the Galaxy Volume 2* and *Cars 3* in Q3 last year. *Avengers: Infinity War* has grossed over two billion dollars globally, making it Marvel’s highest grossing film of all time. *Incredibles 2* is the top domestic grossing animated film ever, and has generated over one billion dollars in global box to date. And we expect *Incredibles 2* will end its run as Pixar’s highest grossing film, which is quite an accomplishment given Pixar’s track record.

TV/SVOD results were also higher in the quarter due to a combination of title availabilities, overall growth in our international business, and higher rates. These increases were partially offset by lower domestic home entertainment results due primarily to the timing of Star Wars DVD and Blu-ray titles, as *Star Wars: The Last Jedi* was released in Q2 this year whereas *Rogue One* was released in Q3 last year. I’d also note that we had about 100 million dollars of film impairments in the quarter primarily related to two unreleased titles—a Disneytoon Studios film and another animated project in early development.

At Media Networks, operating income was comparable to the third quarter last year as higher results at Broadcasting were offset by a decline at Cable and lower equity income.
Total Media Networks affiliate revenue was up 5% in the quarter due to growth at both Cable and Broadcasting. Higher affiliate revenue was driven by seven points of growth due to higher rates, partially offset by about a two point decline due to a decrease in subscribers. As Bob mentioned, this is the fourth consecutive quarter we’ve seen improvement in the rate of net subscriber declines. While net subscriber counts are still lower than prior year, we’re encouraged by the trends we’re seeing—a slowdown in the rate of decline of traditional subscribers coupled with an impressive acceleration of growth in digital MVPD subscribers. Our portfolio of networks, which includes ESPN, Disney Channel, Freeform and ABC, offers compelling programming for consumers and continues to be a driver of both traditional and digital MVPD subscriptions.

Broadcasting operating income was up 43% in the third quarter due to higher program sales and growth in Network affiliate and advertising revenues, partially offset by higher programming costs. Higher income from program sales reflects higher sales of a number of ABC shows, including *Designated Survivor* and *How to Get Away with Murder*, as well as higher revenue from the sale of Marvel’s *Luke Cage* in Q3 this year compared to *The Defenders* last year.

Growth in affiliate revenue was driven by contractual rate increases. Advertising revenue at the ABC Network was up 3% in the quarter as higher rates more than offset lower impressions.

Quarter-to-date, primetime scatter pricing at the ABC Network is running 23% above upfront levels.

Equity income was lower in the quarter due to higher losses at Hulu and lower income from our investment in A+E, partially offset by the absence of equity losses at BAMTech, which, as you know, we now report as part of our Cable results. The higher losses at Hulu were primarily driven by higher programming and labor costs, partially offset by higher subscription and advertising revenue.
At Cable, operating income was lower in the quarter as higher results at ESPN were more than offset by a loss at BAMTech. BAMTech’s results this quarter reflect higher content and marketing costs and ongoing investment in its technology platform, including costs associated with ESPN+.

At ESPN, operating income was higher in the quarter as growth in affiliate revenue and a favorable comparison to severance costs incurred in Q3 last year more than offset higher programming costs and a decline in advertising revenue. The increase in programming expense was driven by contractual rate increases for NBA programming.

Ad revenue at ESPN was down 3% in the quarter as higher rates were more than offset by lower impressions. So far this quarter, ESPN’s cash ad sales are pacing down 3% compared to prior year.

At Consumer Products and Interactive Media, operating income was down in the quarter as a result of lower licensing income and a decline in comp store sales, partially offset by lower costs at our games business. The decline in licensing was driven by lower revenue from the sale of Spider-Man and Cars merchandise, as both properties benefitted from theatrical film releases in the prior year, partially offset by higher revenue from Avengers merchandise. We expect some of the headwinds that impacted our consumer products business in Q3 will also impact the business in the fourth quarter.

In the third quarter, corporate expenses were about 100 million dollars higher than the prior year. The single biggest driver of the growth was expenses related to our Fox acquisition. In Q4, we expect corporate expenses to be higher by about 35 million dollars driven almost entirely by Fox-acquisition related costs.

During the third quarter, we repurchased 9.6 million shares for 970 million dollars. Year to date, we’ve repurchased 34.6 million shares for approximately 3.6 billion dollars. Given our pending acquisition of Fox and the expected increase in leverage in order to fund the 35.7 billion dollar
cash component, we will not be an active buyer of our stock until our total leverage ratios return to levels consistent with a single-A credit rating. At the time we announced our revised offer for Fox, we said this could happen by the end of fiscal 2021 or by the end of fiscal 2022 depending on the outcome of the Fox-Sky transaction. The ultimate timetable will depend on whether Fox acquires full ownership of Sky, as well as the amount of proceeds from the RSNs disposition.

And with that, I’ll now turn the call over to Lowell and we’d be happy to take your questions.

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

All right. Thanks, Christine. Operator, we are ready for the first question.

Operator

(Operator Instructions) Our first question comes from Michael Nathanson with MoffettNathanson.

Michael Nathanson  —  Analyst, MoffettNathanson

Bob, I have two here. One is on Netflix and your strategy. If you think about what Netflix was able to accomplish, it was just an amazing amount of choice and personalization. So when I think about your own OTT strategy, you have -- you're building amazing -- you have a great content library, you're acquiring a content library, but you're thinking about maybe different apps to different consumers, constituents and different brands. So can you walk through kind of the pluses and minuses you have in -- within Disney on the strategy of maybe building one integrated app versus going in segments and how do you think about that? And the second question is just about China and any update on timing on the regulatory front on the China side?
Bob Iger – Chairman and Chief Executive Officer, The Walt Disney Company

Thanks, Michael. I'll answer the second question first. So we've -- no updates regarding the regulatory filings. In June, our S-4 stated that we anticipated getting the necessary regulatory filings in the various markets around the world between 6 and 12 months from then, and we don't intend to update that at all.

Regarding Netflix and our strategy regarding the apps, first of all, because we will be launching the Disney app into the market probably in about, well, a year, sometime the end of calendar 2019, we're going to walk before we run as it relates to volume of content because it takes time to build the kind of content library that, ultimately, we intend to build. That said, because the Disney app will feature Pixar, Marvel, Disney, ultimately National Geographic will be a contributor, Lucasfilm, Star Wars, we feel that it does not have to have anything close to the volume of what Netflix has because of the value of the brands and the specific value of the programs that will be included on it. And the price, by the way, will also reflect the lower volume of product as will, by the way, the costs of producing and owning all that content.

Obviously, after the deal closes for 21st Century Fox, we'll own 60% of Hulu, so that will fit in very significantly to our app strategy. And then I talked about in my earlier comments, and we've spoken a fair amount about this in the past, we have the ESPN app. As we look at all three, it is our feeling -- and as we look at the environment today, I guess, one thing you could even point to would be the great growth in the new digital OTT offerings where you're looking at essentially fewer channels, slightly less choice for less cost.

We don't really want to go to market with an aggregation play that replicates the multichannel environment that exists today because we feel consumers are more interested in essentially making decisions on their own in terms of what kind of packages that they want. So rather than one, call it, gigantic aggregated play, we're going to bring to market -- well, we've already brought to market, sports play -- I'll call it, Disney play, which is more family-oriented, and then,
of course, there's Hulu. And they will basically be designed to attract different tastes and different segment or audience demographics. If a consumer wants all three, ultimately, we see an opportunity to package them from a pricing perspective. But it could be that a consumer just wants sports or just wants family or just wants the Hulu offering, and we want to be able to offer that kind of flexibility to consumers because that's how we feel the consumer behavior, what consumer behavior demands in today's environment.

Operator

Our next question comes from Ben Swinburne with Morgan Stanley.

Ben Swinburne — Analyst, Morgan Stanley

I want to stay on the OTT topic. Bob, a couple of years ago when you guys had the first Star Wars film come out, you talked about sort of leveraging the entire company's assets to really make that movie successful, or as successful as it could be, made it a priority for the company. Is there a similar opportunity with this OTT launch? And I don't know if you -- if there's anything that you want to share with us today, I know it's a year away, but how have you been thinking about leveraging the parks or your Media Networks or the parts of the business to really make sure that thing gets off the ground and there's as much momentum as possible?

And then, Christine, for you, honestly, a bit of an accounting question, but I think important. Have you guys figured out how you're going to account for the content production on the OTT side? I think you're already spending money on developing, and I don't know if you're close to shooting anything at this point, but will that stuff go on the balance sheet and then be amortized over some useful life estimate? Anything you can give us there since this will start to build in dollar terms would be helpful.
Bob Iger — Chairman and Chief Executive Officer, The Walt Disney Company

Ben, the launch of the Disney DTC product at the end of '19 probably is the biggest priority -- is the biggest priority of the company during calendar 2019. And there will be a significant amount of support given across all of our assets to see to it that, that product launches successfully. We obviously, from a Disney perspective, have connection with and we are in touch with Disney consumers, Disney aficionados all over the world, not just people who have gone to our parks, people who've been to our movies and bought a variety of consumer products and have joined various Disney affinity organizations like D23. And so we actually think that the first priority is going to be reaching the core Disney fan, and we certainly have a number of different company touch points to do that. And then on the second part, I'll let Christine talk about the costs and then how we're going to ultimately manage it from a financial perspective.

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

Ben, so the way we're going to treat the content is we will be capitalizing the cost of the new content. And as you know, we will be starting to do that now and going forward until the launch. That will be put on the balance sheet and we will amortize it once it's finished and airing.

Operator

Our next question is from Jessica Reif with Bank of America Merrill Lynch.

Jessica Reif — Analyst, Bank of America Merrill Lynch

I have a couple of questions on the Fox acquisition. You gave a number when you announced it of $2 billion of synergy, which, I think, it was all cost. And then on this call, you've talked about investing at some other brands like Nat Geo, FX, et cetera. Can you talk a little bit about the investment that you see over the next couple of years? Anything you can say on incremental
revenue? And what's the timing of the transition of the management team transition - would it only be closer to the closing?

And then a different topic, just a quick question, but theme parks, your margins, are getting closer to prior peak, so what you've outlined, can you just talk about where you see that going? Do you have plans to build hotels given all the attractions that you're planning over the next, let's say, 3 years?

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

You're right, Jessica. We have spoken about $2 billion in cost synergies, and we're confident that we're going to be able to deliver those. There will be revenue synergies as well, but we have not been specific about what they are, and we don't intend to get specific about that, at least for the foreseeable future. Maybe eventually, we will, but right now, we don't intend to. We are looking at incremental investment from a content perspective from both the Disney side of the company. So we have a variety of different, as you know, original productions in development and production right now essentially to feed the app. We also intend to turn to the Fox side of the business, I mentioned National Geographic, FX, Searchlight, we're looking at the Fox television studios. There are not only great franchises and brands that come out of those organizations, but there's a lot of talent, both on the executive front, and there's also talent -- there are relationships that we can turn to to help, essentially, to fuel the direct-to-consumer businesses that we have. We have not been specific about what kind of incremental production cost is associated, but there will be -- certainly, there will be some. We believe that as we get closer to launch, we'll have the ability to be just a little bit more specific with all of you about what our plans are from a cost perspective.

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

The only thing I would add to that, Jessica, is on the cost, that $2 billion we had given, that it would be achieved after the second year post closing, and that would be roughly 50% in the first
year, 50% by the end of the second year. And you can anticipate more domestic at the front end just because of regulatory issues outside of the U.S.

On the Parks margins, you did indicate that you saw that increase. Year-over-year, the Parks margin expanded by 190 basis points this quarter, and that included the negative drag from the holiday shift, so that included the 60 basis point drag. The opportunities that we see of continuing to expand Parks margin will be yield management, which we have talked to you about before, and we still believe that there's opportunity for that, especially in the domestic market.

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

And particularly given the fact that we've launched some very, very attractive new properties, including *Toy Story Land* and the Star Wars Lands are going to open sometime in calendar 2019, so that's going to give us some pricing or revenue yield opportunities as well.

Operator

Our next question is from Alexia Quadrani with JP Morgan.

Alexia Quadrani — Analyst, JP Morgan

Two questions. The first one is on ESPN Plus. Can you give us any more data maybe on subscriber growth? I think you've said it's exceeding expectations, I don't know if it's too soon to give us a number, and if there are any lessons you may have learned as you plan for the Disney direct-to-consumer launch, from that launch. And my second question is really if you -- I think you're going through a pretty notable renewal cycle between your major affiliate deals up in 2019. The question really is how are you balancing those negotiations with the distributors, given your high-profile direct-to-consumer priorities?
Bob Iger – Chairman and Chief Executive Officer, The Walt Disney Company

Well, I'll answer the second question. We'll be going to market with some very attractive product. Obviously, I don't think I’ll cover all of what they are because you certainly know what they are, Alexia. And we also know that the traditional distributors are very, very interested in distributing our DTC products, as they do right now, by the way, for Netflix. And so we actually believe that they can, in a sense, live side by side as part of the negotiation and not necessarily cause -- create issues. I think there's a reality that has set in in the distribution side of the business that the business is changing, that consumer habits have changed and that the over-the-top SVOD product is here to stay and is real and is probably going to continue to either compete with the more traditional platforms or complement the more traditional platforms. So we don't really see it complicating our negotiations with the primary distributors.

But first on ESPN Plus, I realized when I said that the subscriber numbers were exceeding our expectations, it was probably going to beg the question, "Well, what are they?" and we haven't been specific. I can only tell you that we're telling the truth, so that doesn't do much good. We had relatively modest expectations. I'm not going to be specific on numbers, we're just not ready to get into that. But as it related to what kind of subscribers we would achieve, from the beginning, in part because of the nature of the product offering, but actually, we've added nicely to that product offering. Boxing is probably the primary example, but there's been some other good programming as well. And we've been heartened by the fact that the conversion rates from free to pay have been quite strong, and the trends that we're seeing in terms of churn are modest in nature in the sense that they're manageable.

As we add more product, I mentioned in my comments we've got a huge lineup of college football, 200 games coming up this coming season, 70 in the first 3 weeks. UFC kicks in. Today, we announced the inclusion of the very attractive Italian soccer league, Serie A. So Cristiano Ronaldo's first match with his new team will be on ESPN Plus, which is exciting. And then, of
course, as the season unfolds the next baseball season and the NHL season, MLS, there'll be regular games from all 3 of those leagues and more and more programming.

So we feel really good about how we're positioned, and we'll continue to look opportunistically in terms of what rights will be available. A lot of the rights in sports are already spoken for. We still have some opportunities, including some opportunities to take some of the rights that we already own for the ESPN primary channels and move them along. I'll give you an example is we have a lot of inventory for the Little League World Series. And we've noted that as we've gotten more specific with consumers about what Little League games will be available, our subscription sign-ups have ballooned in the last few days, which we believe, is a result of interest in just that. So we actually feel good about it. We're -- it's a marathon, it's not a sprint. The product seems to be working well technologically. It's quite stable from a streaming perspective and we feel great about it.

Operator

Our next question is from Doug Mitchelson with Credit Suisse.

Doug Mitchelson – Analyst, Credit Suisse

One for Bob, one for Christine. Bob, are there any overarching principles that is driving how much you think is the right investment level in streaming? For example, is there a need to move quickly because, otherwise, the market would be passing by or should you move slowly to manage the impact on earnings? Any framing of the factors that determine how aggressive the company is turning to digital would be helpful.

And then for Christine, sort of an accounting question related to the streaming service. How do you manage the pay one rights for calendar '19 films from an accounting perspective because it'll apply to other factors as well. Does the film division still include pay one revenue in its ultimates for calendar '19 releases when determining film amortization by window? Or is that something...
we actually have to wait for the streaming service to launch and the streaming service to buy back content?

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

So Doug, to answer the first question, we don't see the need to rush because the market will pass us by simply because the only place people are going to be able to get Disney, Pixar, Marvel, Star Wars original product is going to be on this app. And so we believe whenever we launch, it will be attractive. What we want to do is we want to make sure, when we launch, that it’s viewed as a quality product, that we're serving the fans, particularly of Marvel, Pixar, Disney and Star Wars well, and that the price that we're charging reflects the value that we're delivering. We've mentioned a number of times that we have the luxury of programming this product with programs from those brands or derived from those brands, which obviously creates a demand and gives us the ability to not necessarily be in the volume game but to be in the quality game. And that's not in any way suggesting that Netflix isn't in the quality game, there's a lot of quality there, but they're also in the high-volume game. And we don't really need to do that.

We will fill in, in terms of creating volume, with a significant amount of library content, both movie and television content. And so it's not --as though the cupboards are going to be bare, but we want to produce the programming that we're putting on under the right circumstances, which is -- means with the right budget and right timing. It takes time to produce these, particularly to produce them well. There are a number that are already in production. And so -- we feel good about, ultimately, what we're going to launch with. But I think the way to look at it is to look at it as a service that is focused on those brands. We'll also infuse it with National Geographic product as well when the time is right to do that.

We will continue to spend incrementally on the service. We talked about that a fair amount. But we will always do so, again, with the knowledge that because of the specificity of these brands and the uniqueness of them that we don't have to be in the absolute volume game. We have to put enough on to make sense from a value -- a price to value relationship perspective.
Christine McCarthy — Senior Executive Vice President and Chief Financial Officer, The Walt Disney Company

Okay, Doug, for the question of the pay TV one window. For the time being, you should assume status quo. But as the service launches, we will be reevaluating the way we're treating that window and we'll be getting more information once we finalize how we're going to account for it.

Operator

Our next question is from Todd Juenger with Sanford Bernstein.

Todd Juenger — Analyst, Sanford Bernstein

Bob, I know you talked about an investor event coming up soon, talking about the DTC stuff. And yet, I'm going to ask you, just like everybody else, if you don't mind, a question on that topic. So you've listed now a couple of times all of these great brands that will exist and live on the Disney direct-to-consumer entertainment service. I guess, my question is, pretty much every brand you listed, I believe, has historical content obligations to other licensing partners. So for instance, I'm thinking about Star Wars. The movies are either on Netflix or even on Turner cable syndication in the states. Marvel movies are on Starz or Netflix, that sort of thing. So I guess, my question is, can you just confirm that when you launch, a whole bunch of those historical products associated with those brands, I guess, will not be on your service, it doesn't sound like, in fact there's some scenario where there's no Star Wars old movies at all, maybe. I'd love a comment on that, I might be wrong because I don't the exact carve outs. So that's the main question. If that's true, how big a deal is it and how are you going to message that, are you thinking, with your consumers?
Bob Iger — *Chairman and Chief Executive Officer, The Walt Disney Company*

Well, we knew when we made the decision to do this that a number of the products that have been made and it will be made in the rest of 2018 are encumbered by licensing arrangements that we have with a number of different entities, notably Netflix and Starz, as you mentioned. There are some windows down the road that enable us to put those films on our service. I don't think we've been specific about that, but you'll see when we launch. But starting in 2019, the movies that -- the studio movie slate is clean and unencumbered. And so one of the reasons why we've talked about -- I don't want to say walk before we run, it's not quite that, there's going to be a fair amount of running going on, but we want to make sure we're managing expectations. The price of the service will reflect that. The volume of the product it's on. But it's also one of the reasons why we're creating a fair amount of original content for it as well, original Star Wars series, original Pixar series, original Marvel series, and so on, and some original films as well because it's clear that, from a library perspective, while there's certainly a lot of volume, the recent studio slate will not fully be available at any one time because of the existing deals and it would take time for those rights, ultimately, to revert back to us. But what we have been doing is making sure that since the time that we made the decision to bring the service out, we have not done anything that further encumbers any of our product.

Todd Juenger — *Analyst, Sanford Bernstein*

Okay. Any quick comment on how you have thought about messaging this to a consumer who might buy your service expecting to see, whatever, a Star Wars movie and not find it there? And any concerns you have about -- just like that?

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

We're obviously going to make sure that when we bring this product forward and we market it, people are going to know that if they're looking for, I don't know, *The Force Awakens*, that it's not going to be on. But if they're looking for Star Wars movies that launched in 2019 or original
Star Wars series, you will find that here. And as rights become available or as we're able to negotiate for rights to bring back, you'll see them on the service and so on, and so on.

But if you look at the 2019 studio slate, I was -- I saw something recently posted just about the studio slate. So in calendar 2019, the studio slate is about as strong as it gets. And to give you some ideas, it's got Avengers -- Dumbo -- Captain Marvel, Dumbo, Avengers, Aladdin, Toy Story 4, The Lion King, Artemis Fowl, Jungle Cruise, Frozen 2 and Star Wars Episode IX, all in calendar 2019. None of those films are encumbered by existing distribution deals. So when we launch at the end of 2019, now they’ll still have to be windowed in based on how we bring product to market, but the windowing will not be affected by existing licensing deals. So again, I'm going to read those again, but calendar 2019: Captain Marvel, Dumbo, Avengers, Aladdin, Toy Story 4, Lion King, Artemis Fowl, Jungle Cruise, Frozen 2 and Star Wars. That's a pretty strong slate.

Our next question comes from Steven Cahall.

Maybe just you mentioned the content that you'll be getting from Fox, from Nat Geo and FX and Searchlight and 20th Century...

Pardon me, Steven, you're breaking up. Is there any way you can clear your connection, sir?

I heard it, go ahead.
Steve Cahall – Analyst, RBC Capital Markets

Okay. Is (inaudible) some of the content you'll be acquiring from Nat Geo and FX and
Searchlight and (inaudible). And you're pointing that these, over time, (inaudible) encumbered
some of exclusivity supplying content into (inaudible) some of the licensing?

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

Steven, it's Lowell. It's very hard -- well, you're breaking up. We're hearing every other word.

Steve Cahall – Analyst, RBC Capital Markets

Okay. (inaudible) back in the queue. I'll jump back.

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

Okay, sorry about that.

Operator

Our next question is from David Miller with Imperial Capital.

David Miller – Analyst, Imperial Capital

Just a quick financial question for Christine. Christine, it looks like you have a couple of
upcoming maturing securities. The September 2018 $500 million, that's the corporate MTN and
then the January 2019, I think that's $400 million senior unsecured. Just curious what you plan to
do about those. I assume you can take them out, but just curious as to your thoughts.
Christine McCarthy — Senior Executive Vice President and Chief Financial Officer, The Walt Disney Company

Yes. Thanks, David. We have plenty of capacity to satisfy those maturities. It's absolutely no issue for us from a liquidity perspective.

Operator

Our next question is from Tim Nollen with Macquarie.

Tim Nollen — Analyst, Macquarie Capital (USA) Inc.

A couple of things, please. You mentioned a decline in ad revenue at ESPN in the quarter, and it looks like another similar type of decline in the quarter we're in now. I wonder if you could just talk a little bit about what's driving that. And then I wonder, Bob, you mentioned Sky as part of your comments around Fox. I wondered if there's anything more you could give us a hint on as to what happens with the remainder of the Sky stake that Comcast is bidding for. I don't know if there's anything you can say. And likewise, on the RSNs, I thought the original understanding was that Fox would take those back if that were a regulatory issue. It now seems more like this is something you would take on and then be forced to sell. I don't know if there's anything you can mention on that as well, please.

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

On the RSNs, no, we took on -- initially, in the December deal that we announced, we assumed the responsibility of divestiture if the regulatory process demanded that we do that. It was not -- it wasn't Fox that would either buy them under the circumstance or would take them back. The RSNs, though, in the agreement that was reached with the Justice Department will be sold and the process of selling them is actually already beginning in that conversations are starting, interest is being expressed. And it's likely that we'll negotiate a deal to sell them, but the deal will
not be fully executed or won't close until after the overall deal for 21st Century Fox closes. There's nothing more really to add on that.

On Sky, there's really nothing further to add. I think, just to clarify because there were some erroneous reports about this, but there was a filing in the U.K. today, it was a formal filing as per U.K. law, and that's what Fox had to do to basically formalize its GBP 14 offer for the remaining 61%. But as per our July 8-K filing, our consent is required for an increase in that bid. And since this is a fluid situation, an open matter, we really are not going to comment any further about it. I think that would be the most appropriate.

Tim Nollen — Analyst, Macquarie Capital (USA) Inc.

Understood.

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

And on ESPN ad sales, as you noted, ad revenue was down in the third quarter, and it's still kind of early in the fourth quarter. As Bob mentioned, college football, we are getting into that season and the match-ups are all getting out in the marketplace, and we expect the ad revenue to reflect that. Just looking back at third quarter, I do want to make the note that the difference in the number of NBA playoffs and final games, when you adjust for that, we had one fewer final, we had 2 fewer semi-finals, but we had the benefit of 3 additional conference finals. When you net all that out, ESPN's ad sales in 3Q would have been roughly similar to the prior year.

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

Okay. Tim, thanks. And thanks, again, everyone, for joining us today.

Note that a reconciliation of non-GAAP measures that were referred to on this call to equivalent GAAP measures can be found on our IR website.
Let me also remind you that certain statements on this call, including financial statements and statements as to the expected timing, completion and effects of the proposed transaction may constitute forward-looking statements under the securities laws. We make these statements on the basis of our views and assumptions regarding future events and business performance at the time we make them, and we do not undertake any obligation to update these statements. Forward-looking statements are subject to a number of risks and uncertainties, and actual results may differ materially from the results expressed or implied in light of a variety of factors, including factors contained in our Annual Report on Form 10-K and in our other filings with the Securities and Exchange Commission. This concludes today's call. Have a good afternoon, everyone.

Operator

Thank you, ladies and gentlemen. This concludes today's teleconference. Thank you for participating. You may now disconnect.
Forward-Looking Statements

Management believes certain statements in this call may constitute “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. These statements are made on the basis of management’s views and assumptions regarding future events and business performance as of the time the statements are made. Management does not undertake any obligation to update these statements. Actual results may differ materially from those expressed or implied. Such differences may result from actions taken by the Company, including restructuring or strategic initiatives (including capital investments or asset acquisitions or dispositions), as well as from developments beyond the Company’s control, including:

- changes in domestic and global economic conditions, competitive conditions and consumer preferences;
- adverse weather conditions or natural disasters;
- health concerns;
- international, political, or military developments; and
- technological developments.

Such developments may affect entertainment, travel and leisure businesses generally and may, among other things, affect:

- the performance of the Company’s theatrical and home entertainment releases;
- the advertising market for broadcast and cable television programming;
- demand for our products;
- expenses of providing medical and pension benefits;
- income tax expense;
- performance of some or all company businesses either directly or through their impact;
- on those who distribute our products, and
- the pending transaction with 21st Century Fox.

Additional factors are set forth in the Company’s Annual Report on Form 10-K for the year ended September 30, 2017 under Item 1A, “Risk Factors”, in the Company’s Reports on Form 10-Q for the quarters ended December 30, 2017 and June 30, 2018 under Item 1A, “Risk Factors” and subsequent reports.

Reconciliations of non-GAAP measures to closest equivalent GAAP measures can be found at www.disney.com/investors.