Q1 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,

Jenn Kettnich

Vice President, Investor Relations

PRESENTATION

Operator

Good day, and thank you for standing by. Welcome to The Walt Disney Company's First Quarter 2022 Financial Results Conference Call. (Operator Instructions).

Please be advised today's conference may be recorded. (Operator Instructions).

I'd now like to hand the conference over to Jenn Kettnich, Vice President of Investor Relations for The Walt Disney Company. Please go ahead.

Jenn Kettnich – *Vice President, Investor Relations, The Walt Disney Company*

Good afternoon, and it's my pleasure to welcome everyone to The Walt Disney Company's First 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 we'll post a transcript of this call to our website.

Joining me today 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, Jenn, and good afternoon, everyone. As we begin the final year of The Walt Disney Company's first century, I am pleased to share our results for the first quarter of Fiscal 2022, starting with the highlights.

Our adjusted EPS of $1.06 is up from $0.32 a year ago. Our domestic parks and resorts achieved all-time revenue and operating income records, despite the Omicron surge. And our streaming services ended Q1 with 196.4 million total subscriptions after adding 17.4 million in the quarter – including 11.8 million Disney+ subscribers.

I'll share more about those items shortly, but first, I want to talk about this unique moment in the history of The Walt Disney Company.

It is perhaps fitting that our 100th Anniversary comes at a time of significant change for us and our industry. In the midst of a global pandemic, fast-changing consumer expectations, and a leadership transition, we reimagined our parks business… substantially increased our investment in content creation… and executed a reorganization that will facilitate our ongoing transformation. Each of those actions has helped set the stage for our second century. And as we approach that remarkable milestone, I am filled with optimism.

We have the world's most creative storytelling engine, an unmatched collection of brands and franchises, and an ability to tell stories that form deep emotional connections with audiences.

We have a portfolio of distribution platforms – including powerful and growing streaming services.

We have diverse revenue streams that span business models and industries – but which are all interconnected to create entertainment's most powerful synergy machine.

We have the country's top news organization and the most trusted brand for following sports.

And, our theme parks continue to be the most magical places on earth.

In short, our collection of assets and platforms, creative capabilities, and unique place in the cultural zeitgeist give me great confidence that we will continue to define entertainment for the next 100 years.

To carry through on that promise, we will be guided by three strategic pillars: Storytelling Excellence, Innovation, and Audience Focus.

Storytelling Excellence is of course dependent on having excellent storytellers. And I am thrilled to share that our legacy of being home to the most accomplished leaders in the industry will continue, as nearly all of our top creative executives have recently renewed, extended, or signed new contracts. I could not be more excited to continue working with these creative powerhouses.

The quality content from our teams was recognized just yesterday with a fantastic 23 Oscar nominations, including three of the five Best Animated Feature Films: Pixar's *Luca*, Walt Disney's Animation's *Raya and the Last Dragon*, and our newest franchise, Walt Disney Animation's *Encanto*, which received three nominations. *Summer of Soul* was recognized in the Best Documentary category. And *Nightmare Alley* and *West Side Story* both received Best Picture nominations.

As you may have seen earlier today, we announced *West Side Story* will debut in most Disney+ markets on March 2, and we can't wait for our subscribers to see this incredible film.

In Q1, our Studios also took us deeper into the Marvel Cinematic Universe with *Eternals* and the Disney+ Original Series, *Hawkeye*… and returned us to that galaxy far, far away with another Disney+ Original Series, *The Book of Boba Fett*.

Our General Entertainment teams also continue to produce programming of the highest quality. In fact last year, our General Entertainment team produced nearly a quarter of the industry's best-reviewed shows, and Q1 saw 10 of their shows achieve a 100% Critic Score on Rotten Tomatoes. That includes *Abbott Elementary*, the first freshman broadcast comedy to earn the 100% "Certified Fresh" score since ABC's own *Modern Family* in 2009.

Our success in branded storytelling is of course no secret. However, it's often lost that the depth, breadth, and quality of our General Entertainment content is also a driving force behind the success of our streaming services. In fact, six of the 10 most-watched programs across our services are general entertainment titles produced by our own team.

And, General Entertainment is an increasingly powerful driver of engagement in most of our international markets, where such content is already included in our service under the Star Brand.

Going forward, integrating more owned general entertainment into our services – especially Disney+ – will be a priority. In fact just today, we added episodes of *Grown-ish*, *Black-ish*, and *The Wonder Years* to our domestic Disney+ service.

Rounding out our content focuses is of course, Sports. Sporting events continue to be the most powerful draw in television, accounting for 95 of the 100 most-watched live broadcasts in 2021. And ESPN once again set the bar this quarter with live games across each of our four major U.S. sports, including the revolutionary *Monday Night with Peyton and Eli*.

And, I am pleased to announce that we have expanded our agreement with Peyton Manning and his Omaha Productions company to extend our relationship through the 2024 NFL season, and will add alternative presentations for UFC, golf, and college football events for each of the next three years.

While multiplatform television and streaming will continue to be the foundation of sports coverage for the immediate future, we believe the opportunity for The Walt Disney Company goes well-beyond these channels. It extends to sports betting, gaming, and the metaverse. In fact, that's what excites us: the opportunity to build a sports machine akin to our franchise flywheel that enables audiences to experience, connect with, and become actively engaged with their favorite sporting events, stories, teams, and players.

Turning to our Distribution results, the continued growth of our streaming services was certainly a standout. Our success at Disney+ this quarter was not the result of any one item, but instead a combination of organic growth and powerful new content, our strategic decision to include the Disney Bundle with all Hulu Live subscriptions, and new market launches.

The remainder of this fiscal year will feature compelling Disney+ Originals from across our brands and franchises, beginning with Pixar's *Turning Red* and Marvel Studios' *Moon Knight* in March.

And the back half of FY22 will feature a truly stunning array of content, including two Star Wars series: *Andor*, and the highly-anticipated *Obi-Wan Kenobi*, which I am excited to announce will premiere on May 25. We'll debut two Marvel series, *Ms. Marvel* and *She-Hulk*… fresh shorts from Disney Animation and Pixar, featuring the worlds of *Big Hero 6* and *Cars*…a live-action reimagining of the Disney classic *Pinocchio*, starring Tom Hanks as Gepetto…and, one of the most anticipated sequels in some time, especially in the Chapek household, *Hocus Pocus 2*…

As I've said before, we continue to manage our services for the long-term, and maintain confidence in our guidance of 230-260 million total paid Disney+ subscribers globally by the end of Fiscal 2024.

Christine will provide more detail into our theatrical results, however, I want to reiterate that we continue to see value in the movie-going experience, especially for big franchise blockbusters. And given the performance of titles like *Spider-Man: No Way Home*, we are looking forward to kicking off our summer slate with another Marvel franchise film, *Doctor Strange in the Multiverse of Madness*.

That said, audiences will be our North Star as we determine how our content is distributed. And we do not subscribe to the belief that theatrical distribution is the only way to build a Disney franchise.

This quarter, audiences proved us right as *Encanto* became a phenomenon within days of its arrival on Disney+, after families' continued reluctance to return to theaters resulted in muted theatrical performance.

With outstanding music from Lin Manuel-Miranda, it became the fastest title to cross 200 million hours viewed on Disney+, and took social media by storm. People around the world expressed their fandom through their own content and conversation, and the *Encanto* hashtag has been viewed more than 11 billion times.

The soundtrack – which debuted at Number 197 on the Billboard 200 chart – reached #1 shortly after debuting on Disney+. And eight of the film's songs hit the Hot 100 Chart, including "We Don't Talk About Bruno", which became the first Disney song to reach #1 since Aladdin's "A Whole New World" in 1993.

At the same time, sales of *Encanto* merchandise defied traditional post-holiday declines, and actually increased following the film's release on Disney+ on Christmas Eve. And, Guests at Disney's California Adventure have loved seeing Mirabel in real life.

These results are exactly what you would expect from the launch of a new Disney franchise, and we are thrilled that Disney+ was the catalyst. We are more confident than ever in this platform as a content service, a franchise engine, and as a venue for the next generation of Disney storytelling.

Finally, I could not be more pleased with the performance of our Parks, Experiences, and Products segment, which posted its second-best quarter of all time.

Over the last several years, we've transformed the Guest experience by investing in new storytelling and groundbreaking technology – and the records at our domestic parks are the direct result of this investment. From new franchise-based lands and attractions… to cravable food and beverage offerings… to must-have character merchandise, there is more great Disney storytelling infused into every aspect of a visit to our parks than ever before. At the same time, we're giving Guests new tools to personalize their visits… and spend less time in line, and more time having fun.

While we anticipated these products would be popular, we have been blown away by the reception. In the quarter, more than a third of domestic park Guests purchased either Genie+, Lightning Lane, or both. That number rose to more than 50% during the holiday period.

While demand was strong throughout the quarter at both domestic sites, our reservation system enabled us to strategically manage attendance. In fact, their stellar performance was achieved at lower attendance levels than in 2019. As we return to a more normalized environment, we look forward to more fully capitalizing on the extraordinary demand for our parks along with the already-realized yield benefits that took shape this quarter.

And we of course will continue to invest in the Guest experience.

I am personally looking forward to *Star Wars:* Galactic Starcruiser at Walt Disney World – a two-night adventure into the most immersive Star Wars story ever created. We are pleased with demand for this premium, groundbreaking experience, which will welcome Guests starting on March 1.

Later this summer, we will debut an innovative new rollercoaster at Epcot, *Guardians of the Galaxy:* Cosmic Rewind, and open Avengers Campus at Disneyland Paris, where the iconic Quinjet landed a few weeks ago ahead of the resort's 30th Anniversary celebrations.

I want to close by thanking our 195,000 employees for bringing Disney magic to audiences and Guests around the world – especially in times like these when the world needs it most. Our company is truly extraordinary, and I am honored to work with the most talented team in the industry to create the next generation of Disney stories and experiences through our focus on Storytelling Excellence, Innovation, and our Audience.

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 quarter were $1.06 cents – an increase of 74 cents from the prior year quarter. Fiscal 2022 is off to a good start as evidenced by our first quarter results and our continued progress towards more normalized operations across our businesses.

At Parks, Experiences and Products operating income was up $2.6 billion year-over-year, as all of our parks and resorts around the world were open for the entirety of the fiscal first quarter. In the prior year quarter, Walt Disney World Resort and Shanghai Disney Resort were open for the entire quarter, while Hong Kong Disneyland Resort and Disneyland Paris were each open for a limited number of weeks, and Disneyland Resort was closed for the entire quarter.

At our domestic parks, we were very pleased with the strong levels of demand we saw for both Walt Disney World and Disneyland. And as Bob mentioned, our reservation system has allowed us to strategically manage attendance.

Overall attendance trends at our domestic parks continued to strengthen in the quarter, with Walt Disney World and Disneyland Q1 attendance up double digits versus Q4, in part reflecting holiday seasonality.

Per capita spending at our domestic parks was up more than 40% versus fiscal first quarter 2019 driven by a more favorable guest and ticket mix, higher food, beverage and merchandise spending, and contributions from Genie+ and Lightning Lane.

Putting these factors together, our domestic parks and resorts delivered Q1 revenue and operating income exceeding pre-pandemic levels, even as we continued managing attendance to responsibly address ongoing COVID considerations.

Looking ahead to Q2, our demand pipeline for domestic guests at Walt Disney World and Disneyland remains strong, benefitting from our 50th Anniversary celebration at Walt Disney World, and new attractions and experiences at both parks.

At International Parks, a profitable first quarter reflected improving trends at Disneyland Paris. We also saw improved results at Hong Kong Disneyland, although the resort is now temporarily closed in response to a resurgence in COVID cases in the region. We expect International Parks will continue to be impacted by COVID-related volatility for the remainder of Q2.

Moving on to our Media and Entertainment Distribution segment, first quarter operating income decreased by more than $600 million versus the prior year, as revenue growth across our lines of business was more than offset by higher programming and production costs.

Revenue growth in the quarter was primarily driven by increased subscription fees from our direct-to-consumer services. We also delivered record advertising revenues for the segment, as we continued to see strong advertiser demand for our live sports and streaming and digital businesses.

Turning to our results by line of business… At Linear Networks, you may recall that we guided to a decrease in operating income of nearly $500 million for Q1 versus the prior year. Operating income of $1.5 billion came in better than expected, primarily driven by our International Channels, which I'll discuss in a minute.

At our Domestic Channels, both Broadcasting and Cable operating income decreased in the first quarter versus the prior year.

Lower results at Broadcasting were impacted by an adverse comparison to prior year political advertising revenue at our owned television stations – as we noted in the guidance we gave last quarter.

At Cable, the year-over-year decrease in operating income reflected higher programming and production costs, and increased marketing spend, partially offset by increases in advertising and affiliate revenue.

Growth in advertising revenue was driven by ESPN, as we benefitted from the start of a normalized NBA calendar and increased viewership for football. ESPN advertising revenue in the first quarter was up 14% versus the prior year, and second-quarter-to-date domestic cash advertising sales at ESPN are currently pacing up.

Total domestic affiliate revenue increased by 2% in the quarter. This was primarily driven by 6 points of growth from higher rates, offset by a 4-point decline due to a decrease in subscribers.

Operating income at our International Channels decreased slightly versus the prior year. These results came in more than $200 million better than our prior guidance primarily due to lower programming and production costs, as well as better than expected advertising and affiliate revenues.

At Direct-to-Consumer, first quarter operating results decreased by $127 million year-over-year, driven by higher losses at Disney+ and ESPN+, partially offset by improved results at Hulu.

I'll note that beginning this quarter, we are providing disclosure on our programming and production expenses by service, as well as additional detail for Disney+ in our 10-Q.

Operating losses at Disney+ increased versus the prior year, as growth in subscription revenue was more than offset by higher programming, technology, and marketing costs.

We ended the quarter with nearly 130 million global paid Disney+ subscribers, reflecting over 11 million net additions from Q4. Taking a look at subscriber growth by region…

We added 4.1 million paid domestic Disney+ subscribers, including a benefit of approximately 2 million incremental subscribers from our strategic decision to include Disney+ and ESPN+ as part of a Hulu Live subscription.

In international markets excluding Disney+ Hotstar, we added 5.1 million paid subscribers, primarily driven by growth in Asia-Pacific and European markets. I'll note that growth in Asia included the benefit of new market launches in South Korea, Taiwan, and Hong Kong in the quarter.

Finally, we were able to resume growth in Disney+ Hotstar markets, with 2.6 million paid subscriber additions in the quarter.

Overall, we are pleased with Disney+ subscriber growth in the quarter, and are looking forward to new market launches and a strong content slate later this year. As I've previously shared, we don't anticipate that subscriber growth will necessarily be linear from quarter to quarter, and we continue to expect growth in the back half of the fiscal year to exceed growth in the first half.

At ESPN+, we ended the first quarter with over 21 million paid subscribers versus 17 million in Q4. Results decreased compared to the prior year, as growth in subscription revenue was more than offset by higher sports programming costs, driven by the NHL and La Liga.

And at Hulu, higher subscription revenues versus the prior year were partially offset by higher programming and production costs driven by increased affiliate fees for Live TV. Hulu ended the first quarter with 45.3 million paid subscribers inclusive of 4.3 million subscribers to our Hulu Live digital MVPD service.

Moving on to Content Sales, Licensing, and Other, results decreased in the first quarter versus the prior year to an operating loss of $98 million, driven by lower theatrical results and higher film impairments, partially offset by improved TV/SVOD results.

As I noted last quarter, while theaters have generally reopened, we are still experiencing a prolonged recovery in theatrical exhibition, particularly for certain genres of films including non-branded general entertainment and family-focused animation.

This dynamic contributed to increased losses in the quarter as we released more titles in Q1 this year versus the prior year, resulting in lower theatrical results. This was partially offset by income from our co-production of *Spider-Man: No Way Home*.

As we look ahead, we would like to give you some context around two items that may impact our second quarter results.

First, as we continue to increase our investment in content, we expect programming and production costs at DMED to increase versus the prior year, primarily driven by Direct-to-Consumer and Linear Networks.

At Direct-to-Consumer, we expect programming and production expenses to increase by approximately $800 million to $1 billion, including programming fees for Hulu Live.

At Linear Networks, we expect programming and production expenses to increase by approximately $500 million, reflecting factors including COVID-related timing shifts. We aired four additional NFL games at the start of the current quarter. And as a reminder, the Academy Awards will be held in Q2 of this year, while they fell into Q3 of the prior year.

Second, at Content Sales, Licensing, and Other a difficult Q2 comparison to prior year TV and SVOD program sales is due in part to our strategic decision to hold more of our owned and produced content for our direct-to-consumer services. As a result, we expect operating income to be adversely impacted by more than $200 million versus the prior year quarter.

With that, I'll turn it back to Jenn and we would be happy to take your questions.

Jenn Kettnich – *Vice President, Investor Relations, The Walt Disney Company*

Thanks Christine. As we transition to the Q&A, let me note that since we are not physically together this afternoon, I will do my best to moderate the Q&A by directing your questions to the appropriate executive.

Also, to help us get to as many analysts as possible today, we ask that you please limit yourselves to one question. And with that, operator, we are ready for the first question.

Operator

Our first question comes from Ben Swinburne with Morgan Stanley.

Ben Swinburne – *Morgan Stanley*

Thank you for the additional disclosure. Bob, I wanted to ask you about Disney+.

The U.S. subscriber base, or the, I guess, the U.S. and Canadian subscriber base is larger than we would have thought. You guys have gotten to, I think, almost, probably more than 1/3 penetrated of total broadband homes. And it's, I guess, interesting to me because it's a narrower service than the international product, which has the Star tile.

So I'm just wondering if you could talk a little bit about how you see the runway still ahead in North America for that product. And then when you look at the international business, so leaving Hotstar aside, what does your research tell you about what the company needs to do to drive that business meaningfully higher? Because to deliver on your '24 guidance, that's really probably the biggest key is to get that sub base going. So I'm just curious, as you look at the plan, what are the things you think really can make that happen?

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

Thanks, Ben. So on the Disney+ U.S. side, you mentioned that we're roughly 1/3 penetrated.

We still have some headroom in each one of our major franchises in terms of those viewers, those fans, that have expressed interest in subscribing. So we are not nearly tapped out on each of the major franchises if someone identifies as a Lucas fan / Star Wars or as a Marvel fan or as a Disney fan.

The biggest opportunity in terms of significance is with general entertainment being added to the service. And I think you've seen just this quarter, we mentioned that today that we're adding in *Grown-ish*, *Blackish*, and a few other titles into our service.

I think that will be a trend of us taking more general entertainment and moving it over to Disney+ because, as you know, about 50% – slightly over 50%[1] – of our consumer base on Disney+ do not have kids. It's a very broad general service, of course, driven by the Disney brand

[1] About 50% globally, slightly over 50% in Europe

and driven by families, but what we've seen time and time again is that the elasticity of Disney and its brand is much greater than we might have given it credit.

And I think nowhere does this play out more, now getting into the international side of your question, than we see in Europe with the Star brand tile being the sixth brand tile within the Disney+ offering in Europe.

The other thing, though, to your question directly on international that's going to drive the international business is the predominance of local content that we are developing in order to appeal to the unique taste of each of those international markets. And I'll point out to the 340 productions that we referenced on the last call that we're developing.

And by the way, we just created a new organization within our company to shepherd the development of that content so that we can maximize the chance that we get some global hits, if you will, out of some of that local content.

And so we're bullish on the future of Disney+, both domestically and internationally, driven by not only additional prevalence of titles within our major franchises, but also general entertainment and specifically in the international territories local content.

Ben Swinburne – *Morgan Stanley*

That's super helpful, Bob. And just curious, as a follow-up, of those 300 productions or the local originals, will we see a lot of that in fiscal '22 come on the service?

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

Yes. That's the slate that comes on, I think, over the next 1.5 years, next 1.5 years to 2 years.

So I don't exactly know the percent that will fall within the context of this year. But we started this initiative about a year ago, and I must say it's actually extraordinary how great the content is that's being developed in the international territories.

Operator

Our next question comes from Michael Nathanson with MoffettNathanson.

Michael Nathanson – *MoffettNathanson*

Going on that same part about international Disney+. Can you talk about what role does sports play, maybe even outside of India? So what are you seeing in Latin America? Does that help close the gap?

And in general, how do you consider maybe loss leading with sports versus pulling back on sports and investing in more of your own content?

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

The sports proposition internationally really varies by market. As you know, in Europe, it's not a big component for us, but in Latin America, it actually is.

And our… the way that we've gone to market in each territory, one of the differences between how we go to market in Asia versus how we go to market in Latin America versus how we go to market in Europe is a function of sports, that's a really big piece of it.

And where you see like in Latin America where we've got a very big percentage of our consumers that are subscribing to our services because of sports, it's a bigger component to that.

Sports for us are – it's a very important strategic offering because the fandom and the passion is so deep. If you look at India, we're certainly going to try to extend our rights on the IPL. But we're very confident that even if we were not to go ahead and win that auction that we would still be able to achieve our 230 to 260.

So it's an important component for us around the world. Obviously really important in India, but not critical to us achieving the 230 to 260 number that we've guided to.

Operator

Our next question comes from Kannan Venkateshwar with Barclays.

Kannan Venkateshwar – *Barclays Bank*

So Bob, if I could just follow up on that comment on IPL.

Hotstar was about 40% of your long-term guide and without cricket, getting to that number seems like a little bit tougher to do, just given the popularity of the sport in the country and also the fact that Hotstar has been in the country for a long time as a localized service.

So just wanted to see what bridges that gap to your guidance if – in the scenario that you don't end up getting Hotstar?

So Christine, from a guidance perspective, I guess the other variable is just a breakeven guidance in 2024 for the streaming service. And you did talk about content spend being at least $8 billion to $9 billion in that year last quarter.

So just given the growth in entertainment content locally around the world as well as some of the investments in sports and Latin America and potentially an increase in cost in India, could you just frame what kind of upside we could see to that content spend budget? Any framework in terms of how to think about it would be useful.

Jenn Kettnich – *Vice President, Investor Relations, The Walt Disney Company*

Bob, do you want to start off on the IPL and Christine can chime in with some more detail on that and the breakeven guidance in content spend?

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

Sure, sure. So while the IPL obviously, is an important part of the Disney+ Hotstar content offering, it's really one component of a broader portfolio of entertainment and sports. In addition to, obviously, the original content and the library content from Disney, Pixar, Marvel, Star Wars and Nat Geo, our Disney+ Hotstar offering does have a massive collection of local content, and we add over 18,000 hours of original programming every year.

So while certainly it's an important component, that local content that we're developing really will mitigate the impact of if we were not to win the auction on IPL. So an important component, but it's not like we see that business evaporating if we don't get it.

Christine?

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

Okay. Kannan, on your question on the breakeven guidance and on Disney+ content spend. We're not updating the guidance. We have that Fiscal '24 guidance out in the marketplace, and we're sticking to it.

We're not yet at a steady state of content expense for Disney, but we expect to have made significant progress by Fiscal 2023.

Operator

Next question comes from Jessica Reif Erlich with Bank of America Securities.

Jessica Reif Ehrlich – *Bank of America Securities*

Maybe switching gears to Theme Parks. The leverage in that business is ginormous as we've seen in this quarter. Would you consider the 34% operating income margin peak margin?

And then just maybe some color because international visitors really haven't come back, we know they stay longer and spend more. Have you gotten all of the technology improvements that you expect?

And within that, with some of the changes that you made in the park, it sounds like you're actually improving capacity. So how should we think about capacity now versus what it was prior to COVID?

Jenn Kettnich – *Vice President, Investor Relations, The Walt Disney Company*

Christine, do you want that one on the margins?

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

Sure. I would say we've been saying this all along through the pandemic, where we have taken measures to really look at the cost base and how we're doing things. And there's been a fundamental shift in some of the operational processes that the parks had used for many, many years – things like the ability to do mobile dining or not having to check in with the human being at a hotel, those kinds of things are all things that add to upside that we have at the parks.

And as you mentioned, Jessica, we haven't yet seen the return of our international guests. And remember, historically, and we always hit this historical boundary of our band of 18% to 22% of our Walt Disney World guests came from outside of the U.S. and they have an even yet started to return.

So I think there's a lot of things that are boding well, and we saw the performance this quarter of Genie and at the other things like Lightning Lane, but it's not just that. It's also really compelling offerings in food, beverage, merchandise. And it's really great to see not only creativity in our content business, but creativity at our parks as well. And that's driving some of that incremental spending that's certainly helping the margins get to that level that we've seen this quarter.

Operator

The next question comes from Brett Feldman with Goldman Sachs.

Brett Feldman – *Goldman Sachs Group*

I believe we're going to be coming up on an anniversary of the first price change that you had for the Disney+ service. And so I was hoping you could give us some insight in terms of how you're thinking about pricing strategy for the product going forward?

And what are the key things that influence that in terms of timing, when you bring new content on distribution partners or anything else we should be thinking about as we model out ARPU?

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

Christine, I'll start with this. And if you want to augment, please do.

We maintain that we offer an extraordinary price value relationship around the world for Disney+. Obviously, the last few years, pretty much the entirety of the launch of Disney+ have been plagued by COVID-related production interruptions. Plus in all fairness, our own recognition that we needed to essentially double our production output. You put those 2 things together, and we certainly have less content than we want.

But as we've said over the last few earnings calls, that will rectify itself in the second half of this year.

We've already reached 1 of our 2 goals. One of the goals was to go ahead and ensure that we had a new title every week, and we've achieved that.

But by '23, we want to get to a steady state, which is even higher than we have right now. And I think that will give us the impetus to increase that price value relationship even higher and then have the flexibility, if we were to so choose, to then look at price increases on our service.

But it's all about content, content, content. And we are bullish about our future content going forward, not only in terms of quality, but also in terms of quantity. And that's really what's driving our bullishness for what we might see as the pricing power that we would have going forward.

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

Hi Brett. The only other thing I would add to that is that we are still only less than 2.5 years into this business, and we're learning a lot about what consumers are watching, consumption patterns, repeatability and all of those things will factor into when we look at the – as Bob mentioned – the price value equation going forward. So as we learn more, we'll continue to refine the business model.

Operator

Our next question comes from Doug Mitchelson with Credit Suisse.

Douglas Mitchelson – *Guggenheim Securities*

I'd echo Ben's appreciation of the extra streaming details. I guess a couple of questions.

Latin America was not mentioned. And I know on the last conference call, there was a discussion of working with distributors on Star post launch to improve traction there. Is there any story as to why there was pretty good success here in Europe and Asia Pac, but a little bit less so in Latin America?

And then probably for Christine, but on the Direct-to-Consumer programming cost increase that you highlighted for Fiscal Q2, I'm not sure if there's more context there, but also can we think about the next couple of quarters thereafter to be something in a similar range? Certainly, the fourth quarter was already highlighted as a quarter where we're going to see a lot of fresh original programming. Anything that could sort of help us shape out the year on that regard would be helpful.

Jenn Kettnich – *Vice President, Investor Relations, The Walt Disney Company*

Thanks, Doug, for the question. Bob, do you want to start off on LATAM or international subs and then Christine, you can add to that.

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

Yes, I will. I'll talk about LATAM because it kind of goes back a little bit to this live sports story that was questioned earlier.

We're actually encouraged by what we see in LATAM, especially given the strength of that Live Sports calendar and a growing pipeline of local original productions. I mean, the reason why we're doing so many local productions because we know what their power is in those localized markets.

And we're also encouraged that we're seeing a dynamic that we also see in the U.S. – which is the vast majority of the sign-ups that came this quarter came from the Combo Plus. In other words, it's the bundle.

And so we're starting to see LATAM sort of pick up some of the same characteristics that we see in domestic. When we started off in LATAM, just like we did with Disney+, it was a little bit slower, but they always seem to keep, kind of, catch-up, if you will. And we believe in the strength of our local originals and those 2,000 live sporting events that we program each month.

Our growing wholesale footprint, you talked about partnerships, that's an important part, particularly in Latin America, that wholesale footprint. And new promotional offers that we are testing in the marketplace.

So we think that the combination of those things plus our ability to migrate our customers from our linear channels to their digital channels really gives us reason to be fairly bullish in Latin America right now.

Christine?

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

Doug, the question on Disney+ programming… We expect to – for the full year spend on content to be – including sports rights to be as much as that $33 billion in total. The increase from year-over-year is more spending on our DTC expansion.

And this also assumes there is no significant production delays – and things could happen for things other than COVID as well, we had a couple of productions that did get delayed for other reasons.

But when you think about, your comment on our heavy slate of content coming to the service in the fourth quarter is true. But remember, the spending for that is before then. So you'll continue to see increased spending this year.

And when you're looking at that $33 billion, I think it's also informative to take into account that about 1/3 of that is for sports rights, including the programming and production, but primarily it's the sports rights. So if you want to think about the total $33 billion, take out 1/3 for sports and the remainder is for content. Not all on Disney+, some of that's for Hulu as well.

Operator

Our next question comes from Michael Morris with Guggenheim.

Michael Morris – *Credit Suisse AG*

I wanted to ask you one about Hulu and just follow up on the parks.

On Hulu, the SVOD ARPU was down a bit year-over-year. You guys cited the lower per subscriber ad revenue. I'm hoping you could talk a little bit more about what's driving that. Is engagement down? Is pricing down? I know there's been some talk of some content that may be coming off the service. So if you could expand on that a bit, that would be helpful.

And then second, I just want to follow up on the earlier question about capacity at the Parks and whether that has expanded through the cycle. So I'm just trying to think about the runway given how strong the per caps have been and we can kind of do the math on how much attendance went down and how much you've reported, it's come back. But I'm curious if you can give us any more perspective on whether we can exceed, or by how much we could exceed, those prior attendance levels.

Jenn Kettnich – *Vice President, Investor Relations, The Walt Disney Company*

Bob, do you want to start off on Parks then Christine can touch on Hulu SVOD ARPU?

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

Okay. I'll start off on Parks. So the issue or the question of capacity at parks is a bit of a complex one because it's driven by several different dynamics.

First of all, we've got really strong domestic demand, as we've said, mitigated a little bit by a lagged return from the international markets. Now that in itself is expected because the booking timetable is so long on international trips. So we believe that will come up and enable us to get closer to where we would have been in the past.

But in terms of sort of the self-management capacity, one of the last things to come back for us, in a post-COVID world – what we hope is a post-COVID world, is actually live entertainment because much of the live entertainment is close proximity. And we are self-regulating that. We are self-managing that because we don't want our guests to feel an excessive level of density. And the place that you get it is parades and firework shows and things like that. So I suspect that over time, we'll start to regain of the capacity drop-off that where it's kind of self-imposing on ourselves.

The other thing I should say is that, to a certain extent, because people spend such a long time in our parks and resorts, the food and beverage component is actually a pretty big one of those. And if there's, we really haven't had too big of an issue in terms of retaining and attracting people into our parks, to work in through our parks, at all. As a matter of fact, we had 85% of our cast members pretty much say, yes, immediately, when we ask them back.

But at the same time, the two areas that have been difficult is hospitality, and right now, we've got 90% of our hotels at Walt Disney World opened and we've got all of our hotels at Disneyland open, but also cooks, I think, kind of, short-order cooks.

And so the capacity constraints, the self-imposed capacity constraints are really a function of our food and beverage, sort of, mitigation, if you will. But the second one is live entertainment, and we're working towards restoring both of those so that we can get up to something that would be more similar to what we've seen in the past in terms of the number of people we put into our parks.

But I must tell you that our ability to increase our guest experience through a very – a reservation system in a very carefully managed demand ticketing system has been something that we really like. And I think guaranteeing our guests that they have a great experience no matter when they come, whether it be the Christmas holiday or whether it be in the middle of the month of September, that's really important to us. And so we're going to self-manage as to optimize the guest experience. But at the same time, we know we firmly got some headroom, whether it's due to international or whether it's due to an expansion and reinstatement of things like live entertainment.

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

Great. And Mike, your question on the Hulu SVOD ARPU.

Let me just start with advertiser demand because I think this is an important concept. It's incredibly robust for advertising on Hulu. We're able to use our data. We offer targeted advertising. Some people call addressable sale. We've built a unified ad platform across all of our businesses that do utilize advertising. So we're seeing that as being a growth business for us and are very, very pleased with it.

On this particular question on the ARPU for Hulu. In the quarter, we benefited growth from some high-impact promotional offers during the quarter – on Black Friday there was one that went into the market. Those particular subscribers are showing high rates of engagement and the conversion of them from the promo to the full price, we're pretty optimistic of that given their engagement levels.

So while it was down, you could view it as this was an offering to get people to sample the product. And the… it seems like the product is being certainly appreciated. And we're hoping for those to once again convert to full pay subscribers.

Operator

This question comes from Jason Bazinet with Citi.

Jason Bazinet – *Citigroup Inc.*

I just had one long-term question. You guys have done so well over the years in terms of running theme parks world-class and storytelling as you alluded to.

The one area where I think Disney has sort of struggled a little bit has been with software development. And as you think about sports betting and the metaverse, it just seems like strategically, that's going to become potentially a more important piece of your core competency going forward. Is that sort of top of mind? Or do you think that's sort of not a correct way to think about sort of the muscles that you guys need to build over the next 5 years?

Jenn Kettnich – *Vice President, Investor Relations, The Walt Disney Company*

Jason, I think you're cutting in and out, but I think we got the gist of the question. Bob, do you want to take that one?

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

Yes, yes. I think I got the gist of it. It is top of mind. It is absolutely top of mind because we realize that in the future, you can call it what you want. You want to call it metaverse, you want to call it the blending of the physical and digital experiences, which I think Disney should excel at for all the reasons that you said in your opening. We realize that it's going to be less of a passive type experience where you just have playback whether it's a sporting event or whether it's an entertainment offering and more of an interactive lean forward, actively engaged type experience.

And this is a very top of mind thing for us because we are continuing over time to augment our skills and the types of people that we attract into The Walt Disney Company to reflect the aggressive and ambitious technology agenda that we have.
You probably noticed that one of my 3 pillars is innovation and specifically technological innovation because we realize that this is going to be an important part of telling story in that third dimension that lean forward interactive dimension. So it is absolutely top of mind.

Jenn Kettnich – *Vice President, Investor Relations, The Walt Disney Company*

Okay. Thanks for the question, and we 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, expectations, beliefs or business prospects and other statements that are not historical 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, including factors contained in our annual report on Form 10-K, quarterly reports on Form 10-Q and in our other filings with the Securities and Exchange Commission.

We want to thank you all 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 business or financial prospects or outlook, position, strategy or strategic priorities, business plans, investments, resiliency, growth, expansion, ambitions, opportunities, innovation, expectations or future; financial or performance estimates or expectations, including expenditure, cost or spending estimates; profitability or loss estimates or expectations, including timing thereof; expected drivers; estimates of the financial impact of certain items, accounting treatment, events, circumstances, products or other offerings or innovations; future subscription levels or nature, opportunities, timing or drivers of subscription growth; the anticipated availability, prices, expansion, timing or nature of our offerings (including content included within our products and services, theatrical releases, experiences and business openings, cruise ships, cross business offerings, new businesses and technology); future operations (ours or others’) and related impacts, timing, conditions, precautions or market responses; future consumer sentiment, demand or spending or market acceptance; workforce matters that are not historical; the continuation of external circumstances (including COVID-19); the future impacts of COVID-19 on our business and recovery timing; future matters related to our contracts; 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 our reorganization announced October 2020, capital investments, asset acquisitions or dispositions, integration initiatives, 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 and consumer preferences;
- health concerns and their impact on our businesses and productions;
- international, regulatory, political, or military developments;
- technological developments;
- labor markets and activities;
- adverse weather conditions or natural disasters;
- availability of content;
- and 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):

- demand for our products and services;
- the performance of the Company’s theatrical and home entertainment releases and other content;
- the advertising market for programming;
- construction;
- expenses of providing medical and pension benefits;
- 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 3, 2020 under Item 1A, “Risk Factors,” Item 7, “Management’s Discussion and Analysis,” Item 1, “Business,” and subsequent reports including, among others, quarterly reports on Forms 10-Q, which risk factors should be read together with the above factors.