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COMPANY UPDATE / ESTIMATE CHANGE

The Walt Disney Company

DIS — NYSE — Long-term Buy-1

Disney to Acquire Key Assets from Fox; CEO Bob Iger to Stay Through 2021

Key Metrics

DIS - NYSE (as of 12/13/17)		$107.61
2 Year Price Target		$128.00
52-Week Range		$96.20 - $116.10
Shares Outstanding (mil.) (basic)		1,538
Market Cap. ($ mil.)		$165,504
3-Mo. Average Daily Volume		8,000,000
Institutional Ownership		63%
Total Debt/(Total Debt + S.Equity) (9/17)		36%
ROE (TTM ended 9/17)		19%
Book Value/Share (9/17)		$29.26
Price/Book Value		3.7x
Annual Dividend & Yield	$1.68	1.6%
EBITDA Margin (TTM ended 9/17)		30%

EPS FY 9/30 (excludes nonrecurring items)

	2017	Prior 2018E	Curr. 2018E	Prior 2019E	Curr. 2019E
1Q	$1.55	$1.65	$1.63		
2Q	$1.50	$1.61	$1.60		
3Q	$1.58	$1.75	$1.74		
4Q	$1.07	$1.29	$1.28		
Year	$5.70	$6.30	$6.25	$6.75	$6.65
P/E	18.9x		17.2x		16.2x

Note: Quarterly EPS figures may not add to annual figure due to rounding.

Revenue ($mm)

	2017	Prior 2018E	Curr. 2018E	Prior 2019E	Curr. 2019E
1Q	$14,784	$15,500	$15,500		
2Q	$13,336	$13,975	$13,950		
3Q	$14,238	$15,225	$15,220		
4Q	$12,779	$14,100	$13,980		
Year	$55,137	$58,800	$58,650	$60,500	$60,400

Company Description: *The Walt Disney Company is a worldwide entertainment company engaged in animated and live-action film and television production, character merchandise licensing, consumer products retailing, book, magazine, and music publishing, television and radio broadcasting, cable television programming, and the operation of theme parks and resorts. Past acquisitions include ABC/ESPN (1995), Pixar (2006), Marvel Entertainment (2009) and Lucasfilm, Ltd (2012).*

Investment Highlights

- **Today represents one of the most interesting and significant days in company history, in our view.** The Walt Disney Co. announced an agreement with 21st Century Fox whereby Disney would acquire major key assets from Fox for $66 billion. This would be, by far, the largest acquisition Disney has ever made. In addition, the company announced that well-regarded Chairman and CEO Bob Iger would extend his tenure at the company through 2021, nixing his plans to retire in 2019. Finally, today also marks the release of *Star Wars: The Last Jedi*, which we believe will become one of the highest grossing movies in company history.

- **The Fox assets to be acquired represent a great strategic fit, in our view.** Not only would the deal bring high-quality, incremental content and complementary assets to Disney, it would also strengthen the company's international reach and growth opportunities. The deal is expected to close in 12-18 months.

- **Existing growth initiatives at Disney remain in place.** The company recently announced plans for another trilogy of *Star Wars* movies after the current trilogy ends. Work continues on planned direct-to-consumer content streaming services, powered by majority-owned BAMTech. This includes an ESPN-branded sports service expected to debut in Spring 2018 and a family-oriented service—including Disney, Marvel, Pixar, and *Star Wars* content—planned for late 2019.

- **We reiterate our Long-term Buy rating.** We recommend purchase of DIS based on a bright fundamental outlook and an attractive stock valuation. We believe each operating segment has meaningful growth potential over the next few years. Our two-year price target is $128 per share based on our current assumptions regarding forward earnings and valuation. Our Suitability rating is 1.

Note Important Disclosures on Pages 8-9.
Note Analyst Certification on Page 8.

Review of planned acquisition. Today, 12/14/17, The Walt Disney Co. announced an agreement with 21st Century Fox whereby Disney will acquire certain key assets of Fox. Fox will retain some assets and create a new company for existing Fox shareholders. Importantly, Disney CEO Bob Iger has agreed to continue as Chairman and CEO through 2021 to ensure effective integration and management of the assets to be acquired. Iger, age 66, has postponed his retirement several times to date, opting each time to continue his tenure as Disney's clear leader. Most recently, he had planned to retire in 2019.

In the potential $66 billion transaction, DIS would become owner of the Fox film and television studios, some cable television networks (FX and National Geographic), 22 regional sports networks, controlling interest in video streaming provider Hulu, and international cable properties Star (India) and Sky (Europe, 39% stake).

The deal does not include the Fox television network and affiliates, Fox News and Fox Business cable networks, and some national sports cable networks, which would collectively become part of the new Fox company. Some of these assets would likely raise anti-trust issues given similar DisneyABC/ESPN assets.

It remains to be seen what roles current Fox executives, including CEO James Murdoch, son of media mogul and long-time Fox principal Rupert Murdoch, might have at Disney. We are hopeful James Murdoch can play a key role in Disney's future leadership.

In the planned transaction, Disney would issue 0.2745 shares of DIS stock for each Fox Class A (non-voting) and Class B (voting) share for a current value of roughly $52 billion. With the assumption of nearly $14 billion in net debt, the total transaction value is just over $66 billion. This total transaction value represents 11.9x estimated 2018 adjusted EBITDA (earnings before interest, taxes, depreciation & amortization) of the assets to be acquired, or 8.3x when including expected synergies of $2 billion. On an EPS basis, the deal is expected to be dilutive in the first full year following the acquisition, and accretive in the second year. As per normal procedure, the deal is subject to shareholder and regulatory approvals. There is no certainty that a deal will take place. We will not make official adjustments to our financial models until deal closing is assured, which could take 12-18 months.

Past large acquisitions by DIS (including Cap Cities/ABC in 1995, Pixar in 2006, Marvel Entertainment in 2009, and Lucasfilm in 2012) were funded either partially or fully with DIS stock. With active share repurchasing, actual earnings dilution in those cases were less than we originally expected.

We believe the planned purchase of Fox assets makes great strategic sense for Disney, as it would bring a wealth of high quality content to Disney. Examples include the film franchise *Avatar*, full rights to Marvel properties *X-Men* and *Fantastic Four*, numerous successful television shows such as *Modern Family*, and the 22 regional sports networks that could mesh well with Disney's ESPN. In addition, the deal would bring greater distribution and expanded international reach, particularly with the Star and Sky international cable operations. The planned transaction with Disney will not affect Fox's current efforts to acquire the remaining 61% of Sky it does not already own. Disney's planned acquisition of the 21st Century Fox businesses is not contingent on Fox's Sky transaction being consummated.

The related extension of Bob Iger's contract is another major benefit, in our view. We believe Iger is one of the most valuable assets at the company, and has proven his mettle many times over since taking the CEO reigns in 2005. He has postponed planned retirements several times in the last decade, including his latest decision to remain in place at Disney through calendar 2021. We also believe Disney has the financial strength to complete and digest the acquisition, as well as integrate and support the businesses effectively. We view the acquisition multiples as reasonable given the complementary nature of the assets and the incremental growth potential for Disney.

We view today's news items as significant positives for Disney. However, we are not making adjustments to our financial model or price target on DIS shares as it relates to the planned acquisition. Rather, we consider it prudent to wait until deal closing occurs, as customary closing conditions must be met.

Recap of 4Q results. Revenues for Disney's fiscal 4Q ended September 30, 2017, were lighter than we expected at the Media Networks, Studio Entertainment, and Consumer Products segments. Media Networks, the company's largest segment, was impacted by lower results at Freeform (formerly ABC Family) and higher programming costs and lower ad revenues at ESPN. The company remains active in strategizing and forging relationships with new distribution partners to position ESPN more favorably in the future, yet this is likely to have more of a benefit in the intermediate or longer term.

Studio Entertainment results were impacted by film cost impairment related to an animated film project no longer considered viable and lower results from theatrical and subscription video-on-demand (SVOD) distribution. Declines at the Consumer Products & Interactive Media segment primarily related to lower merchandise licensing revenues compared to one year ago when the associated entertainment properties were more robust.

The Parks & Resorts segment was the main bright spot in the quarter, in our opinion. Domestic operations were impacted by Hurricane Irma, which led to park closures and cruise line cancellations for a few days in September. Management estimates about $100 million in lost operating income. However, the segment's revenues and operating income for the quarter were up 6-7% over the year ago figures. Bright spots included the favorable impact of new *Avatar*-inspired attractions at Animal Kingdom and higher international results due to attendance gains at Shanghai Disney Resort (recently completed its first year of operation) and Disneyland Paris (25th anniversary celebration).

Financial condition. We consider Disney's overall leverage and liquidity to be at healthy levels for a major media conglomerate. At the end of fiscal 2017, cash and equivalents were $4.017 billion. Total debt stood at $25.291 billion, about 36% of total capitalization. Compared to a year ago, cash was down and debt was up. This reflects cash uses such as share repurchases, dividend payments, and capital expenditures, as well as borrowings related to Shanghai Disney Resort and equity investments in BAMTech. Shareholders' equity was $45.004 billion.

During 4Q, the company spent $3.424 billion on share repurchases, bringing the fiscal 2017 total to $9.368 billion (average purchase price of approximately $105 per share). In fiscal 2016, the company spent $7.499 billion on share repurchases. The weighted average share count for 4Q was approximately 4% lower than the prior year period. We expect buybacks to continue. In fact, thus far in 1Q of fiscal 2018, the company has spent $650 million on share repurchases. Management stated it expects to spend about $6 billion on buybacks during the current fiscal year, about the average over the past five years.

Dividend outlook. On 11/29/17, Disney announced a 7% increase to its dividend, taking the semi-annual rate to $0.84 per share, or $1.68 per share annualized. This equates to a current yield of 1.6%. The company's current dividend policy includes two payments during the year, in January and July. In fiscal 2017, Disney spent $2.4 billion on dividend payments and we expect a slightly higher amount in fiscal 2018 (after factoring a higher rate per share but fewer shares outstanding). We expect future dividend increases each year, announced around late November or early December.

Recap of streaming services. Earlier this year, Disney announced a change in the way it will distribute content with plans for two direct-to-consumer streaming services. Made possible by its majority stake in BAMTech LLC, Disney plans to launch *ESPN Plus* in Spring 2018 and an untitled family-oriented service—including content from Walt Disney, Marvel, Pixar, and Star Wars/Lucasfilm—in late 2019.

The *ESPN*-branded service will feature an extensive amount of professional and collegiate sporting events, while the family-oriented service would feature a wide variety of content, including high-profile films from the aforementioned studios after a customary initial theatrical window and lower-profile films that would debut on the service. We note Disney management has consistently expressed its support of, and dependence on, movie theatres as the initial distribution outlet for its major films.

BAMTech has cutting-edge proprietary technology and acumen integral in the creation of "over the top" (OTT) networks. While the BAMTech majority stake purchase comes with expected near-term earnings dilution, we believe the long-term impact is significantly positive. Pricing and exact launch dates of the streaming services have not been announced. These actions reflect the growing industry trend of forging direct relationships between content creators and consumers. The Walt Disney Co., with what we consider to be unparalleled content, seems to be at the forefront of this movement. This is consistent with our long-standing view that management is sharp, visionary, and a major positive investment factor.

Star Wars franchise news. Today represents the full-scale debut of *Star Wars: The Last Jedi*. We believe this movie could break several industry and company records. Word of mouth and early reviews have generally been quite favorable. We expect financial benefits from *The Last Jedi* to extend across numerous divisions of the company throughout the fiscal year. Looking ahead, *Solo: A Star Wars Story*, is set for release on May 25, 2018. This project is part of Disney's plans for incremental *Star Wars* franchise story lines, as first demonstrated by *Rogue One: A Star Wars Story* in December 2016. The mainstream *Star Wars* trilogy gets back on course with *Episode IX* (working title only), directed by J.J. Abrams with a planned release date of December 20, 2019.

Along with recent 4Q results, the company disclosed it has signed writer/director Rian Johnson (director of *The Last Jedi*) to oversee the production of a new *Star Wars* trilogy of films following completion of the current trilogy. While this is not surprising given the success of the revitalized franchise, we view confirmation of the project, and the involvement of Mr. Johnson, as positive factors.

Outlook. We are bullish on the company's outlook over the next several years. At Media Networks, we anticipate expanded and more efficient distribution for ESPN, including the future OTT streaming service and a more efficient cost structure for the traditional, or "linear," networks that are delivered through cable operators. We believe the Studio Entertainment segment has never been stronger, with growth potential from the Lucasfilm/*Star Wars*, Pixar, Marvel, and Disney brands. We believe *Star Wars: The Last Jedi* is likely to become the highest grossing movie of calendar 2017 and benefit many aspects of the company during fiscal 2018. The Parks & Resorts segment could benefit from new attractions/lands at the domestic parks, hotel expansion at some locations, and growth at Shanghai Disney Resort beyond its debut year.

We have made minor updates to our financial model, which does not reflect the future streaming services since many variables (such as expense structure, exact launch dates, and pricing) are unknown at this time, but reflective of the near-term business outlook as we see it. Furthermore, as stated, we have also not yet incorporated the planned Fox acquisition in our model. Our fine-tuning adjustments includes a $0.05 EPS reduction this year and a $0.10 reduction next year after updating some revenue and margin assumptions.

In the longer term, our basic financial model includes mid single-digit revenue gains, improving profit margins, operating leverage, and share repurchases. We believe this could result in upper single-digit growth in EBITDA and low double-digit growth in earnings per share.

Valuation. Given solid company fundamentals and relatively clean earnings, we believe a price/earnings approach to valuation is most appropriate. DIS shares are currently trading at 17.2x our fiscal 2018 EPS estimate and roughly 17.0x our estimate of forward twelve-month earnings. This compares to the stock's median forward multiple of 18.7x over the past five years and 16.6x over the past ten years. We find a five-year period more insightful given that it includes ownership of all major assets of the company such as Marvel and Lucasfilm, whereas a period of ten or more years would include some years with those powerful assets and some without.

The current forward multiple on DIS represents 0.83x the forward multiple on the S&P 500. More often than not, DIS has traded at a premium to the market multiple throughout its history. Over the past five years, the median relative multiple has been 1.04x.

As with many media companies, cash flow and related valuation measures can be useful. Enterprise Value divided by EBITDA (earnings before interest, taxes, depreciation & amortization) focuses on the implied total value of a company (market capitalization plus net debt) relative to its cash flow generating ability and is commonly used in analysis of media companies. On this measure, and based on today's intra-day price, DIS currently trades at 10.3x our projection of twelve-month forward EBITDA. According to Thomson Reuters, over the past five years DIS shares have traded at EV/forward EBITDA multiples in the 8.0x-12.8x range and a mean of 10.4x.

Opinion. We believe DIS shares can move higher in the coming years on the basis of overall higher revenues, cash flows, and earnings. We have attempted to make conservative assumptions regarding the main business segments, including the ESPN brand and related metrics such as ad revenues, subscription levels, and the planned content distribution initiatives. We have not yet incorporated the planned acquisition of key Fox assets, but we would generally view it as a major positive.

We believe the long-term outlook at the company is favorable, particularly given the extension of Bob Iger's tenure, the recent announcements regarding content streaming services, and plans for another *Star Wars* trilogy. We believe this outlook and the current stock valuation make our Long-term Buy rating most appropriate. This rating is based on a recommended investment time frame of two years. Not only does this give the company time to implement new strategies and address challenges, it also captures a period that should include growth projects from all of the company's major businesses.

Our two-year price target is $128 per share. This increase reflects our updated financial model, which we believe is based on conservative assumptions with revenues and margins. The projected outlook supporting our price target includes improved EPS growth beyond the tough comparison year of fiscal 2018. Our price target reflects a P/E multiple of 17.9x applied to our estimate of forward earnings two years from now. This assumed valuation is above the current forward multiple but below the five-year median figure despite what we believe is improving long-term fundamentals and an exciting outlook. We believe our projected valuation is reasonable, given the company's growth plans, earnings outlook, and potential uses of free cash flow.

Additionally, our two-year price target represents an EV/EBITDA multiple of 10.4x based on our estimate of forward EBITDA in two years. This is similar to the current multiple on our projection of forward EBITDA. Annualized total return potential based on our target, the current dividend, and the recent closing stock price is about 11%. We typically require expected double-digit returns on investments in DIS, with consideration given to the company's blue-chip nature and our view of the stock as a core holding.

Suitability. Our Suitability rating on DIS is 1 on a 1-to-4 scale (1=most conservative, 4=most aggressive). This is based on factors such as the company's size, diversification, operating history, and financial strength. We consider DIS a core holding in equity portfolios.

Risks. Factors that could impact business conditions and operating results, and therefore impede achievement of our price objective, include adoption of new business models such as the planned content streaming services, adverse geopolitical events, contraction in leisure travel, a soft advertising market, weak domestic or international economies, low demand for the company's products and services, potentially dilutive acquisitions or strategic investments, and various other factors that could impact consumers' discretionary spending habits. A new risk factor is the planned acquisition of certain Fox assets, including the related financial commitment and the potential integration of those assets, with no certainty the transaction takes place. In addition, the planned retirement of CEO Bob Iger in 2021 and related management succession issues are longer term issues to consider, in our view.

Exhibit 1
Income from Continuing Operations (figures in millions except percentages and per share data)

	FY19E	% chg.	FY18E	% chg.	FY17	% chg.	FY16	% chg.
Revenues:								
Cable Networks	$17,350	3.9%	$16,700	1.0%	$16,527	(0.6%)	$16,632	0.3%
Broadcasting	7,400	3.9%	7,125	2.0%	6,983	(1.0%)	7,057	5.6%
Media Networks	24,750	3.9%	23,825	1.3%	23,510	(0.8%)	23,689	1.8%
Parks & Resorts	21,050	6.6%	19,750	7.2%	18,415	8.5%	16,974	5.0%
Studio Entertainment	9,300	(3.9%)	9,675	15.5%	8,379	(11.2%)	9,441	28.2%
Cons. Prod. & I'active Media	5,300	(1.9%)	5,400	11.7%	4,833	(12.6%)	5,528	(2.6%)
	60,400	3.0%	58,650	6.4%	55,137	(0.9%)	55,632	6.0%
Operating Income:								
Cable Networks	6,000	4.2%	5,760	7.6%	5,353	(10.3%)	5,965	(12.1%)
Broadcasting	1,210	3.0%	1,175	(2.5%)	1,205	1.0%	1,193	18.6%
Equity in Inc. of Investees	50	0.0%	50	(85.5%)	344	(42.4%)	597	
Media Networks	7,260	3.9%	6,985	1.2%	6,902	(11.0%)	7,755	(0.5%)
Parks & Resorts	4,300	5.7%	4,070	7.8%	3,774	14.4%	3,298	8.8%
Studio Entertainment	2,650	(3.8%)	2,755	17.0%	2,355	(12.9%)	2,703	37.0%
Cons. Prod. & I'active Media	1,925	(1.0%)	1,945	11.5%	1,744	(11.2%)	1,965	4.3%
	16,135	2.4%	15,755	6.6%	14,775	(6.0%)	15,721	7.1%
Corporate & Other Activities	(665)	1.5%	(655)	12.5%	(582)	(9.1%)	(640)	(0.5%)
Nonrecurring Charges	0		0		(98)		(156)	
Other Income (Expense)	0		0		78		0	
Other Items	0		0		0		203	
Interest Inc. (Exp.), net	(530)	6.0%	(500)	29.9%	(385)	N/A	(260)	
Pre-tax Earnings Excluding Nonrecurring Items	14,940	2.3%	14,600	5.9%	13,788	(7.3%)	14,868	7.2%
Less: Taxes	4,930	2.3%	4,818	9.0%	4,422	(12.9%)	5,078	1.2%
Less: Minority Interests	100	(50.0%)	200	(48.2%)	386	(3.3%)	399	(15.1%)
Net Income	$9,910	3.4%	$9,582	6.7%	$8,980	(4.4%)	$9,391	12.0%
Diluted EPS:								
As Reported	$6.65	6.3%	$6.25	9.9%	$5.69	(0.7%)	$5.73	16.8%
Excluding Nonrecur. Items	**$6.65**	**6.3%**	**$6.25**	**9.7%**	**$5.70**	**(0.3%)**	**$5.72**	**11.1%**
Avg. Diluted Shares Outst.	1,490	(2.7%)	1,532	(2.9%)	1,578	(3.7%)	1,639	(4.1%)
EBITDA	$18,670	4.0%	$17,950	7.0%	$16,779	(3.6%)	$17,401	7.6%
Operating Margins:								
Cable Networks	34.58%		34.49%		32.39%		35.86%	
Broadcasting	16.35%		16.49%		17.26%		16.91%	
Media Networks	29.33%		29.32%		29.36%		32.74%	
Parks & Resorts	20.43%		20.61%		20.49%		19.43%	
Studio Entertainment	28.49%		28.48%		28.11%		28.63%	
Cons. Prod. & I'active Media	36.32%		36.02%		36.09%		35.55%	
Total	26.71%		26.86%		26.80%		28.26%	
As a % of Total Revenues:								
EBITDA	30.91%		30.61%		30.43%		31.28%	
Corporate & Other Activities	1.10%		1.12%		1.06%		1.15%	
Tax Rate	33.00%		33.00%		32.07%		34.15%	

Note: EBITDA represents segment operating income less corporate expenses plus depreciation & amortization
Operating income from Cable Networks segment includes equity in income of investees

Source: Company reports and Hilliard Lyons estimates Note: September fiscal year

Additional information is available upon request.

Prices of other stocks mentioned:

21st Century Fox Inc. (partial owner of Hulu):
- FOXA (Class A non-voting shares) - $32.75
- FOX (Class B voting shares) - $32.34

Comcast Corp. (partial owner of Hulu) - CMCSA - $38.58
Time Warner Inc. (partial owner of Hulu) - TWX - $90.06

Analyst Certification

I, Jeffrey S. Thomison, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject company(ies) and its (their) securities. I also certify that I have not been, am not, and will not be receiving direct or indirect compensation in exchange for expressing the specific recommendation(s) in this report.

Important Disclosures

Hilliard Lyons' analysts receive bonus compensation based on Hilliard Lyons' profitability. They do not receive direct payments from investment banking activity.

The author of this report or members of his household have a long position in the common stock of The Walt Disney Company, but may not engage in buying or selling contrary to the recommendation.

Investment Ratings

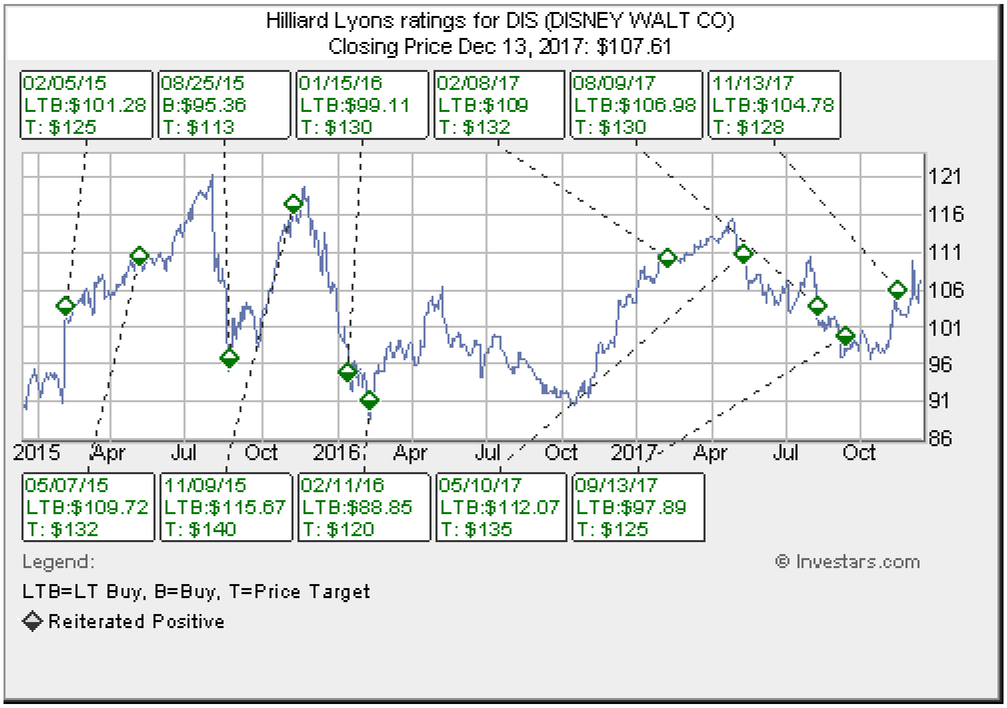
Buy - We believe the stock has significant total return potential in the coming 12 months.
Long-term Buy - We believe the stock is an above average holding in its sector, and expect solid returns to be realized over a longer time frame than our Buy rated issues, typically 2-3 years.
Neutral - We believe the stock is an average holding in its sector, is currently fully valued, and may be used as a source of funds if better opportunities arise.
Underperform - We believe the stock is vulnerable to a price set back in the next 12 months.

Suitability Ratings

1 - A large cap, core holding with a solid history
2 - A historically secure company which could be cyclical, has a shorter history than a "1" or is subject to event driven setbacks
3 - An above average risk/reward ratio could be due to small size, lack of product diversity, sporadic earnings or high leverage
4 - Speculative, due to small size, inconsistent profitability, erratic revenue, volatility, low trading volume or a narrow customer or product base

	Hilliard Lyons Recommended Issues		Investment Banking Provided in Past 12 Mo.	
Rating	**# of Stocks Covered**	**% of Stocks Covered**	**Banking**	**No Banking**
Buy	31	28%	13%	87%
Hold/Neutral	74	66%	9%	91%
Sell	7	6%	0%	100%

As of 6 December 2017



Note: Price targets accompanying Buy ratings reflect a one year time period while price targets accompanying Long-term Buy ratings reflect a two to three year time period.

Other Disclosures

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