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COMPANY UPDATE / ESTIMATE CHANGE / PRICE TARGET CHANGE

The Walt Disney Company

DIS — NYSE — Long-term Buy-1

Lower 1Q Results But Ahead of Expectations; Raising Price Target Based on Earnings Outlook.

Key Metrics

DIS - NYSE	(as of 2/7/17)		$109.00
2 Year Price Target			$132.00
52-Week Range			$86.25 - $111.99
Shares Outstanding (mil.) (basic)			1,592
Market Cap. ($ mil.)			$173,528
3-Mo. Average Daily Volume			8,348,627
Institutional Ownership			60%
Total Debt/(Total Debt + S.Equity) (12/16)			30%
ROE (TTM ended 12/16)			19%
Book Value/Share (12/16)			$29.63
Price/Book Value			3.7x
Annual Dividend & Yield		$1.56	1.4%
EBITDA Margin (TTM ended 12/16)			30%

EPS FY 9/30 (excludes nonrecurring items)

	2016	Prior 2017E	Curr. 2017E		Prior 2018E	Curr. 2018E
1Q	$1.63		$1.55	A		
2Q	$1.36	$1.43	$1.41			
3Q	$1.62	$1.65	$1.66			
4Q	$1.10	$1.25	$1.28			
Year	$5.72	$5.85	$5.90		$6.45	$6.60
P/E	19.1x		18.5x			16.5x

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

Revenue ($mm)

	2016	Prior 2017E	Curr. 2017E		Prior 2018E	Curr. 2018E
1Q	$15,244		$14,784	A		
2Q	$12,969	$13,390	$13,375			
3Q	$14,277	$14,470	$14,575			
4Q	$13,142	$14,040	$13,966			
Year	$55,632	$57,300	$56,700		$60,150	$60,250

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

- **Fiscal 1Q results were down from a year ago, but earnings were better than expected.** Total revenues decreased 3% to $14.784 billion, $475 million below recent street consensus. Operating margin declined 123 basis points, leading to a 7% drop in operating income. Diluted EPS excluding nonrecurring items were $1.55, down 5% from a year ago. The street consensus EPS estimate was $1.50 and our estimate was $1.52.
- **Results were impacted by a few factors.** As in recent quarters, the Media Networks segment was impacted by higher programming costs, decreased viewership, and lower ad revenues at ESPN, an undesirable combination. We believe the profit decline at ESPN is not indicative of a long-term trend. Other factors impacting 4Q results include lower licensing revenues and a particularly difficult comparison to strong results a year ago. Positive factors included a strong quarter from Parks & Resorts.
- **We have updated our financial model.** We continue to project modest growth in FY17. We reiterate the tough comparison created by the tremendous success of *Star Wars: The Force Awakens* (December 2015 theatrical release) and the positive spillover effect it had on numerous segments throughout FY16. We have lowered our FY17 revenue estimate but raised our EPS figure modestly, due in part to 1Q results.
- **We maintain our LT Buy rating and are raising our two-year price target by $12 to $132 per share.** Our target is based on progression of time and a higher forward earnings figure. We have a particularly favorable view on FY18, including a return to growth at ESPN, improved profitability at Shanghai Disney, and a strong film slate. Our target represents a future valuation in line with the current level and the historical average. Our Suitability rating on DIS remains 1.

Note Important Disclosures on Pages 7-8.
Note Analyst Certification on Page 7.

Exhibit 1
Consolidated Statements of Income (figures in millions except percentages and per share data)

	First Quarter Ended		
	12/31/16	**1/2/16**	% chg.
Revenues:			
Cable Networks	$4,428	$4,521	(2.1%)
Broadcasting	1,805	1,811	(0.3%)
Media Networks	6,233	6,332	(1.6%)
Parks & Resorts	4,555	4,281	6.4%
Studio Entertainment	2,520	2,721	(7.4%)
Consumer Products & Interactive Media	1,476	1,910	(22.7%)
	14,784	15,244	(3.0%)
Operating Income:			
Cable Networks	864	975	(11.4%)
Broadcasting	379	295	28.5%
Equity in Income of Investees	119	142	(16.2%)
Media Networks	1,362	1,412	(3.5%)
Parks & Resorts	1,110	981	13.1%
Studio Entertainment	842	1,014	(17.0%)
Consumer Products & Interactive Media	642	860	(25.3%)
	3,956	4,267	(7.3%)
Income Before Taxes	3,725	4,358	(14.5%)
Less: Taxes	1,237	1,448	(14.6%)
Net Income	2,488	2,910	(14.5%)
Less: N.I. Attrib. to Noncontrol. Int.	(9)	(30)	(70.0%)
N.I. Attrib. to Walt Disney Co.	$2,479	$2,880	(13.9%)
Diluted EPS, as reported	**$1.55**	**$1.73**	**(10.4%)**
Adjustments:			
Nonrecurring Tax Benefits	$0.00	$0.00	
Restructuring/Impairment	$0.00	$0.03	
Other Expense (Income)	$0.00	($0.13)	
Diluted EPS Excluding Items	**$1.55**	**$1.63**	**(4.9%)**
Avg. Diluted Shares Outst.	1,603	1,668	(3.9%)
Operating Margins:			**bp chg.**
Cable Networks	19.51%	21.57%	(205)
Broadcasting	21.00%	16.29%	471
Media Networks	21.85%	22.30%	(45)
Parks & Resorts	24.37%	22.92%	145
Studio Entertainment	33.41%	37.27%	(385)
Consumer Products & Interactive Media	43.50%	45.03%	(153)
Total	26.76%	27.99%	(123)
As a % of Total Revenues:			
Corporate & Other Activities	0.92%	0.89%	3
Net Income from Contin. Oper.	16.83%	19.09%	(226)
Tax Rate	33.21%	33.23%	(2)

Note: EPS adjustments may not add due to rounding

Source: The Walt Disney Company Note: September fiscal year

Additional comments on 1Q results. We were generally pleased with fiscal 1Q results. Revenues were lighter than we expected in the Media Networks (ESPN issues) and Consumer Products (lower licensing activity, tough comparison) segments. Media Networks, the company's largest segment, remained under pressure from higher programming costs, lower ad revenues based on lower ratings, and subscriber losses 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. Results at the Broadcasting segment, which includes the ABC and Freeform television networks, came in above our expectation due to contractual rate increases and decreased programing cost write-downs for network programming. The 17% drop in Studio Entertainment profits reflected a tough comparison to last year, which featured the debut of *Star Wars: The Force Awakens*.

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 1Q, cash and equivalents were $3.736 billion. Total debt stood at $20.490 billion, about 30% of total capitalization. Compared to a year ago, cash was down and debt was up. This reflects cash uses such as share repurchases and dividend payments, as well as capital expenditures and borrowings related to Shanghai Disney Resort (opened in June 2016) and the recent equity investment in BAMTech. Shareholders' equity was $47.177 billion.

During 1Q, the company spent $1.465 billion on share repurchases. The weighted average share count for 1Q was approximately 4% lower than the prior year period. In FY16, the company repurchased 73.8 million shares for approximately $7.5 billion, representing an average purchase price of just under $102 per share. Despite recent strength in the DIS share price, we expect buybacks to continue. Management recently stated it expects to spend in the range of $7-8 billion on share repurchases for FY17.

Dividend increase. On 11/30/16, Disney announced a 10% increase to its semi-annual dividend, taking the rate to $0.78 per share. We believed a rate increase in the 5-10% range was likely. The annualized rate of $1.56 per share equates to a current yield of 1.4%. The company's current dividend policy includes two payments during the year, in January and July. In FY16, Disney spent $2.3 billion on dividend payments and we expect a higher amount in FY17 (after factoring a higher rate per share but fewer shares outstanding).

BAMTech minority stake. Although it took place in 3Q of FY16, we remind investors of Disney's $1 billion purchase for a 33% stake in BAMTech. While the investment (two payments of $500 million each) is expected to result in minor near-term earnings dilution, the long-term implication is significantly positive, in our view. BAMTech will become a key partner in the delivery and support of streaming video and other digital products from Disney, ABC, and ESPN, as well as future digital initiatives across the entire company.

BAMTech will collaborate with ESPN to launch and distribute a new ESPN-branded, multi-sport streaming service. The direct-to-consumer service will feature content provided by both BAMTech and ESPN, and include live regional, national and international sporting events. Current content on ESPN's traditional channels will not appear on the new subscription streaming service. More details about the new service are forthcoming. In the longer term, we believe this new initiative with BAMTech could lead to a blueprint as to how the existing suite of ESPN channels could be delivered on an "over the top" (OTT) basis direct to consumers.

ESPN. Investors' concern with ESPN has been an oft-discussed issue in the past year or so—rightfully so given cable industry trends of "cord-cutting" by consumers. We believe consumers are adapting to new viewing alternatives and habits, getting some sports satisfaction in quick doses from online sources, often at lower prices compared to large channel bundle packages offered by cable operators.

While the total subscriber base to the ESPN suite of channels is down significantly from its peak a few years ago, we believe this should stabilize at some point and possibly rise as the company adds distribution/consumption alternatives that make watching the channels less expensive and/or more convenient. The company continues to forge new relationships with non-traditional distribution partners (perhaps the "traditional" partners of the future) that expand the overall presence of ESPN. These include Sony, Sling, Hulu, DirectTV and others. While the landscape is changing, we are confident Disney/ESPN has the high quality content and management skill to get the network back on a growth track and remain perhaps the most valuable asset at the company.

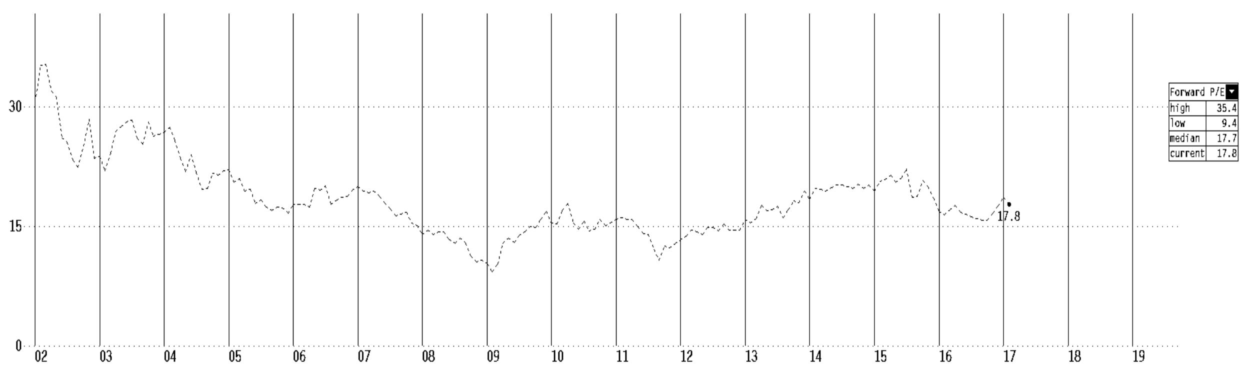
Earnings outlook. We have updated our financial model to reflect 1Q results and an updated outlook for Disney's various businesses for the remaining quarters of FY17. Our annual revenue estimate is lowered by $600 million to $56.7 billion, while our diluted EPS estimate is raised $0.05 to $5.90. We project a 1% drop in net income, with share repurchases leading to the slight EPS gain.

We remain bullish on FY18 due to the favorable timing of several product/service introductions, as well as projected stabilization at ESPN early in the year and growth in the latter portion. We are adding $100 million to our revenue estimate and $0.15 to our diluted EPS estimate. In what we view as a conservative measure, we assume 10 basis point contraction in company-wide operating margin due to potentially higher costs associated with the major growth vehicles.

In the longer term, our forecast includes mid single-digit revenue gains, modestly 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. We believe acquisitions are likely, but have not factored any in our financial forecast.

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 18.5x our FY17 estimate and 18.0x our estimate of twelve-month forward earnings. As noted in Exhibit 2 below, the median forward multiple on DIS over the past fifteen years is 17.7x. Over a more recent five year period, the median is 17.6x.

Exhibit 2
Historical Forward Price/Earnings multiple



Source: Baseline Note: September fiscal year

Also, DIS is currently trading at 1.0x the forward multiple on the S&P 500. More often than not, the stock has traded at a premium to the market multiple throughout its history. Over the past fifteen years, the median multiple has been 1.2x, with a high of 1.6x and a low of 0.8x. The median multiple over the past five years is also 1.2x.

As with many media companies, cash flow and related valuation measures can be useful. Enterprise Value divided by EBITDA 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, DIS currently trades at 10.8x our updated estimate of FY17 EBITDA, which we project to grow less than 2% from FY16. The multiple on our FY18 EBITDA estimate is 10.1x. Over the past ten years, we believe DIS shares have typically traded at forward EBITDA multiples in the 8x-12x range.

Opinion. We believe future growth potential from Lucasfilm/*Star Wars*, Shanghai Disney Resort, Pixar, Marvel and other assets, as well as expanded and more efficient distribution methods for ESPN, could support a valuation at or above the current level. 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 ESPN's ad revenues, subscription levels, and the changing landscape for content distribution. Based on current challenges with the cable industry, we believe a Long-term Buy rating is most appropriate. This rating is based on a recommended investment time frame of two years. Not only does this give the company time to address the aforementioned challenges, it also captures a period that should include realized potential from growth projects such as Shanghai Disney Resort and annual output from Lucasfilm/*Star Wars* (original saga and spin-off movies).

Our two-year price target is $132 per share, $12 above our previous target. This increase reflects the passage of time and a higher forward earnings figure. We believe this target is based on conservative assumptions with margins, earnings, and stock valuation. We believe a higher figure could be justified if the planned cable network (ESPN) distribution initiatives are realized faster than we have assumed. The projected outlook supporting our price target includes a modest earnings year in FY17 (3% EPS growth) followed by a rebound in FY18 (12% EPS growth). We remind investors that FY18 includes the next original film in the *Star Wars* saga (December 2017 planned release).

Our two-year price target assumes a P/E multiple of 18.0x applied to our estimate of forward earnings two years from now. This is in line with the current forward multiple mentioned above. We believe this level is appropriate given the company's growth plans, solid fundamentals, potential double-digit EPS growth over a multi-year period, and potential uses of free cash flow.

Additionally, our two-year target represents an EV/EBITDA multiple of 10.6x using our FY19 EBITDA estimate; this compares to the current 10.8x multiple on our FY17 EBITDA estimate. Annualized total return potential based on our target, the current dividend, and the current stock price is just over 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 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. In addition, planned CEO succession in 2018 following the retirement of Bob Iger represents a major event and therefore represents a unique risk factor, in our view.

Exhibit 3
Income from Continuing Operations (figures in millions except percentages and per share data)

	FY18E	*% chg.*	*FY17E*	*% chg.*	FY16	% chg.	FY15	% chg.
Revenues:								
Cable Networks	*$17,825*	*4.2%*	*$17,100*	*2.8%*	$16,632	0.3%	$16,581	9.7%
Broadcasting	*7,750*	*7.6%*	*7,200*	*2.0%*	7,057	5.6%	6,683	10.6%
Media Networks	*25,575*	*5.2%*	*24,300*	*2.6%*	23,689	1.8%	23,264	10.0%
Parks & Resorts	*19,425*	*5.6%*	*18,400*	*8.4%*	16,974	5.0%	16,162	7.0%
Studio Entertainment	*9,450*	*8.6%*	*8,700*	*(7.8%)*	9,441	28.2%	7,366	1.2%
Cons. Prod. & I'active Media	*5,800*	*9.4%*	*5,300*	*(4.1%)*	5,528	(2.6%)	5,673	7.4%
	60,250	*6.3%*	*56,700*	*1.9%*	55,632	6.0%	52,465	7.5%
Operating Income:								
Cable Networks	*6,860*	*3.9%*	*6,600*	*(2.2%)*	6,748	(0.6%)	6,787	4.9%
Broadcasting	*1,160*	*8.4%*	*1,070*	*6.3%*	1,007	0.1%	1,006	17.8%
Media Networks	*8,020*	*4.6%*	*7,670*	*(1.1%)*	7,755	(0.5%)	7,793	6.4%
Parks & Resorts	*3,850*	*4.1%*	*3,700*	*12.2%*	3,298	8.8%	3,031	13.8%
Studio Entertainment	*2,750*	*10.0%*	*2,500*	*(7.5%)*	2,703	37.0%	1,973	27.4%
Cons. Prod. & I'active Media	*2,075*	*9.2%*	*1,900*	*(3.3%)*	1,965	4.3%	1,884	28.0%
	16,695	*5.9%*	*15,770*	*0.3%*	15,721	7.1%	14,681	12.9%
Corporate & Other Activities	*(650)*	*1.6%*	*(640)*	*0.0%*	(640)	(0.5%)	(643)	5.2%
Nonrecurring Charges	*0*		*0*		(156)		(53)	
Other Income (Expense)	*(40)*	*100.0%*	*(20)*		(129)		0	
Interest Inc. (Exp.), net	*(185)*	*(5.1%)*	*(195)*	*N/A*	72		(117)	N/A
Pre-tax Earnings Excluding Nonrecurring Items	*15,820*	*6.1%*	*14,915*	*0.3%*	14,868	7.2%	13,868	13.2%
Less: Taxes	*5,379*	*3.0%*	*5,220*	*2.8%*	5,078	1.2%	5,016	18.2%
Less: Minority Interests	*415*	*3.8%*	*400*	*0.3%*	399	(15.1%)	470	(6.6%)
Net Income	*$10,026*	*7.9%*	*$9,295*	*(1.0%)*	$9,391	12.0%	*$8,382*	11.7%
Diluted EPS:								
As Reported	*$6.60*	*11.8%*	*$5.90*	*3.0%*	$5.73	16.8%	$4.90	15.0%
Excluding Nonrecur. Items	***$6.60***	***11.8%***	***$5.90***	***3.2%***	**$5.72**	**11.1%**	**$5.15**	**19.2%**
Avg. Diluted Shares Outst.	*1,520*	*(3.5%)*	*1,575*	*(3.9%)*	1,639	(4.1%)	1,709	(2.8%)
EBITDA	*$19,005*	*7.5%*	*$17,680*	*1.6%*	$17,401	7.6%	$16,170	11.8%
Operating Margins:								
Cable Networks	*38.49%*		*38.60%*		40.57%		40.93%	
Broadcasting	*14.97%*		*14.86%*		14.27%		15.05%	
Media Networks	*31.36%*		*31.56%*		32.74%		33.50%	
Parks & Resorts	*19.82%*		*20.11%*		19.43%		18.75%	
Studio Entertainment	*29.10%*		*28.74%*		28.63%		26.79%	
Cons. Prod. & I'active Media	*35.78%*		*35.85%*		35.55%		33.21%	
Total	*27.71%*		*27.81%*		28.26%		27.98%	
As a % of Total Revenues:								
EBITDA	*31.54%*		*31.18%*		31.28%		30.82%	
Corporate & Other Activities	*1.08%*		*1.13%*		1.15%		1.23%	
Tax Rate	*34.00%*		*35.00%*		34.15%		36.17%	

Note: EBITDA represents segment operating income less corporate expenses plus depreciation & amortization

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) - FOX - $30.16
Comcast Corp. (partial owner of Hulu) - CMCSA - $74.86
Time Warner Inc. (partial owner of Hulu) - TWX - $96.22
AT&T Inc. (owner of DirectTV) - T - $41.12 - Buy
Sony Corp. - SNE - $32.11
Dish Network Corp. (owner of Sling) - DISH - $60.42

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.	
	# of	% of		
Rating	**Stocks Covered**	**Stocks Covered**	**Banking**	**No Banking**
Buy	36	30%	17%	83%
Hold/Neutral	76	62%	7%	93%
Sell	10	8%	0%	100%

As of 6 February 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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