HILLIARD LYONS

Entertainment & Leisure
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COMPANY UPDATE / ESTIMATE CHANGE / PRICE TARGET CHANGE

Key Metrics			
DIS - NYSE	(as of 5/9/17)		$112.07
2 Year Price Target			$135.00
52-Week Range			$90.32 - $116.10
Shares Outstanding (mil.) (basic)			1,580
Market Cap. ($ mil.)			$177,071
3-Mo. Average Daily Volume			5,930,091
Institutional Ownership			63%
Total Debt/(Total Debt + S.Equity) (3/17)			31%
ROE (TTM ended 3/17)			19%
Book Value/Share (3/17)			$29.92
Price/Book Value			3.7x
Annual Dividend & Yield		$1.56	1.4%
EBITDA Margin (TTM ended 3/17)			31%

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		$1.50	A		
3Q	$1.62	$1.66	$1.63			
4Q	$1.10	$1.28	$1.27			
Year	$5.72	$5.90	$5.95		$6.60	$6.70
P/E	19.6x		18.8x			16.7x

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		$13,336	A		
3Q	$14,277	$14,575	$14,750			
4Q	$13,142	$13,966	$14,130			
Year	$55,632	$56,700	$57,000		$60,250	$60,300

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).*

The Walt Disney Company

DIS — NYSE — Long-term Buy-1

Fiscal 2Q EPS Exceeds Expectations; Fine Tuning Estimates and Price Target

Investment Highlights

- **Similar to the previous quarter, fiscal 2Q included revenues slightly below expectations but EPS ahead of expectations.** Total revenues increased nearly 3% to $13.336 billion, $110 million below recent street consensus. Operating margin improved 49 basis points, leading to a near 5% increase in operating income. Diluted EPS excluding nonrecurring items were $1.50, up 10% from a year ago. The street consensus EPS estimate was $1.41, as was our estimate.
- **There were pros and cons to the quarter, in our view.** The Media Networks segment continued to be impacted by higher programming costs and subscriber losses at ESPN. Combined with overall soft ad revenues, the segment produced a 3% drop in operating income. Positives included robust profit growth from the Parks & Resorts and Studio Entertainment segments, decent cost containment, and continued share repurchases.
- **We have fine-tuned our financial model, but are keeping our projection of modest EPS growth in FY17.** We note the tough comparison to a strong FY16, which included company-wide benefits created by *Star Wars: The Force Awakens*. Also, we have lowered our overall operating margin assumption due to certain higher expenses. We have made slight increases to our revenue and EPS projections for FY17 and FY18.
- **We are maintaining our LT Buy rating and raising our two-year price target by $3 to $135 per share.** Our target is based on progression of time and a higher forward earnings figure. In the next few years, we anticipate stabilization followed by resumption of growth at ESPN, major new attractions at the theme parks, growth and improved profitability at Shanghai Disney Resort, and a powerful film slate. Our price target represents a future valuation slightly below the current level. Our Suitability rating remains 1.

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

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

	Quarter Ended			Six Months Ended		
	4/1/17	4/2/16	% chg.	4/1/17	4/2/16	% chg.
Revenues:						
Cable Networks	$4,062	$3,955	2.7%	$8,490	$8,476	0.2%
Broadcasting	1,884	1,838	2.5%	3,689	3,649	1.1%
Media Networks	5,946	5,793	2.6%	12,179	12,125	0.4%
Parks & Resorts	4,299	3,928	9.4%	8,854	8,209	7.9%
Studio Entertainment	2,034	2,062	(1.4%)	4,554	4,783	(4.8%)
Cons. Prod & Int. Media	1,057	1,186	(10.9%)	2,533	3,096	(18.2%)
	13,336	12,969	2.8%	28,120	28,213	(0.3%)
Operating Income:						
Cable Networks	1,791	1,846	(3.0%)	2,655	2,821	(5.9%)
Broadcasting	344	302	13.9%	723	597	21.1%
Equity in Income of Investees	88	151	(41.7%)	207	293	(29.4%)
Media Networks	2,223	2,299	(3.3%)	3,585	3,711	(3.4%)
Parks & Resorts	750	624	20.2%	1,860	1,605	15.9%
Studio Entertainment	656	542	21.0%	1,498	1,556	(3.7%)
Cons. Prod & Int. Media	367	357	2.8%	1,009	1,217	(17.1%)
	3,996	3,822	4.6%	7,952	8,089	(1.7%)
Income Before Taxes and Minority Interests	3,751	3,446	8.9%	7,476	7,804	(4.2%)
Less: Taxes	1,212	1,170	3.6%	2,449	2,618	(6.5%)
Net Income	2,539	2,276	11.6%	5,027	5,186	(3.1%)
Less: N.I. Attrib. to Noncontrol. Int.	(151)	(133)	13.5%	(160)	(163)	(1.8%)
N.I. Attrib. to Walt Disney Co.	$2,388	$2,143	11.4%	$4,867	$5,023	(3.1%)
Diluted EPS, as reported	$1.50	$1.30	15.1%	$3.05	$3.04	0.4%
Adjustments:						
Restructuring/Impairment	$0.00	$0.00		$0.00	$0.03	
Other Expense (Income)	$0.00	$0.06		$0.00	($0.07)	
Diluted EPS Excluding Items	**$1.50**	**$1.36**	**10.0%**	**$3.05**	**$3.00**	**1.8%**
Avg. Diluted Shares Outst.	1,591	1,643	(3.2%)	1,597	1,655	(3.5%)
Operating Margins:			**bp chg.**			**bp chg.**
Cable Networks	44.09%	46.68%	(258)	31.27%	33.28%	(201)
Broadcasting	18.26%	16.43%	183	19.60%	16.36%	324
Media Networks	37.39%	39.69%	(230)	29.44%	30.61%	(117)
Parks & Resorts	17.45%	15.89%	156	21.01%	19.55%	146
Studio Entertainment	32.25%	26.29%	597	32.89%	32.53%	36
Cons. Prod & Int. Media	34.72%	30.10%	462	39.83%	39.31%	53
Total	29.96%	29.47%	49	28.28%	28.67%	(39)
As a % of Total Revenues:						
SG&A and Other Exp.	14.55%	16.48%	(192)	13.96%	14.75%	(79)
N.I. Attrib. to Walt Disney Co.	17.91%	16.52%	138	17.31%	17.80%	(50)
Tax Rate	32.31%	33.95%	(164)	32.76%	33.55%	(79)

Source: The Walt Disney Company Note: September fiscal year

Additional comments on 2Q results. We were generally pleased with fiscal 2Q results. As in the previous quarter, revenues were a bit lighter than we expected at 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 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. The Parks & Resorts segment benefited from better than expected results at Shanghai Disney Resort (first year of operation) and the domestic parks (higher attendance and guest spending), despite the negative factor of the Easter holiday falling in the company's fiscal 3Q this year compared to 2Q last year.

Results at the Broadcasting segment, which includes the ABC and Freeform television networks, were above year ago levels as well as our expectation. Studio Entertainment generated slightly lower revenues, which reflected a tough comparison to last year, but an increase in operating income due to growth in television and subscription video on demand (SVOD) distribution. The theatrical release of *Beauty and the Beast* was among the segment's highlights for the quarter. Similarly, the Consumer Products & Interactive Media segment had a revenue decline but operating income gain. Licensing revenues and retail sales were down from strong results a year ago that were fueled by *Star Wars: The Force Awakens* and *Frozen* business, yet segment operating income benefited from the absence of the unprofitable *Disney Infinity* videogame.

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 2Q, cash and equivalents were $3.800 billion. Total debt stood at $21.653 billion, about 31% 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 an equity investment in BAMTech (made in August 2016). Shareholders' equity was $47.267 billion.

During 2Q, the company spent $2.035 billion on share repurchases, bringing the six-month total to $3.500 billion and a fiscal year-to-date total (through 5/8/17) of $4.400 billion. The weighted average share count for 2Q was approximately 3% 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. We expect buybacks to continue. In fact, along with 2Q results, DIS announced that the size of the company's repurchase authorization had been increased by $2 billion, taking the range to $9-10 billion for the current fiscal year. Based on this, and current share prices, we expect more repurchases in this fiscal year's 2H than 1H.

Dividend update. On 11/30/16, Disney announced a 10% increase to its dividend, taking the semi-annual rate to $0.78 per share, or $1.56 per share annualized. This 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). We expect a dividend increase to be announced in late November of this year, at a rate similar to last year's 10% hike.

BAMTech minority stake. Although it took place in August 2016, we remind investors of Disney's $1 billion purchase for a 33% stake in BAMTech. While the investment (two payments of $500 million each) has resulted in some 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. We expect direct-to-consumer video distribution services utilizing this technology to launch later this calendar year, with ESPN-branded content initially being the focal point.

Specifically, 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. ESPN remains an important asset, yet industry dynamics are forcing changes at the business. Consumer trends of "cord-cutting" or opting for smaller channel bundles have lowered the subscriber base of the sports broadcasting giant. 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. A decline in subscribers, some ad revenue pressure, and higher programming costs (including a recent NBA contract) have been challenging. This led to recent cost cutting initiatives such as a headcount reduction that included numerous on-air personalities. We believe such expense reductions are unpleasant but necessary, and we continue to have confidence in ESPN head John Skipper and Disney CEO Bob Iger and the managerial decisions they make.

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 in the future.

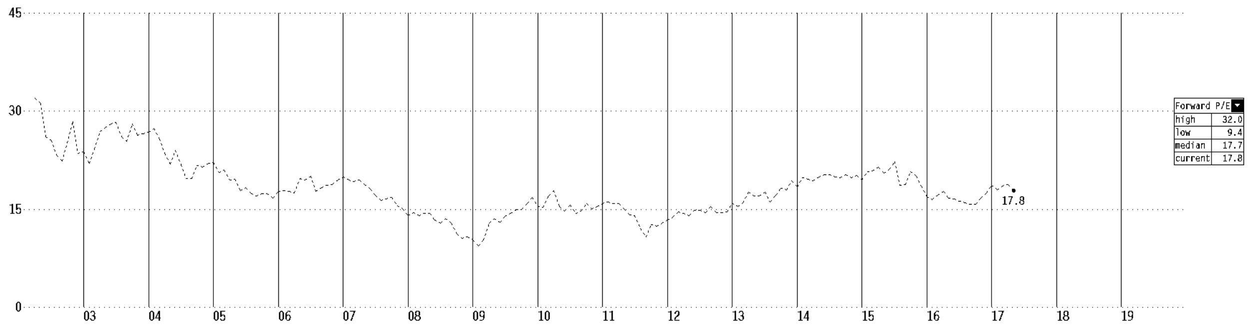
Earnings outlook. We have updated our financial model to reflect 2Q results and an updated outlook for the remaining quarters of FY17. Our annual revenue estimate is increased by $300 million to $57.0 billion, while our diluted EPS estimate is raised $0.05 to $5.95. We project essentially flat net income, with share repurchases leading to a projected 4% EPS gain.

We remain bullish on FY18 due to the favorable timing of several product/service introductions, as well as projected stabilization and improvement at ESPN. We are adding $50 million to our revenue estimate and $0.10 to our diluted EPS estimate. We assume an approximate 30 basis point improvement in company-wide operating margin, led by gains in Parks & Resorts and Studio Entertainment.

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 18.0x our estimate of twelve-month forward earnings. As noted in Exhibit 2 on the following page, the median forward multiple on DIS over the past fifteen years is 17.7x. Over a more recent five year period, the median is 17.9x.

Exhibit 2
Historical Forward Price/Earnings multiple



Source: Baseline Note: September fiscal year

Also, DIS is currently trading at just under 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 1.1x, with a high of 1.6x and a low of 0.8x. The median multiple over the past five years is 1.2x.

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, DIS currently trades at about 10.6x our projection of forward EBITDA. Over roughly the past decade, we believe DIS shares have typically traded at forward EBITDA multiples in the 8x-12x range.

Opinion. We are bullish on the company's outlook over the next few years. We believe the Studio Entertainment has never been on stronger footing, with growth potential from the Lucasfilm/*Star Wars*, Pixar, Marvel and Disney brands. Over the next three years, we expect numerous films that could have a significant company-wide impact. These include, but are not limited to, new releases from popular franchises such as *Pirates of Caribbean*, *Cars*, *Thor*, *Star Wars*, *Incredibles*, *Avengers*, *Toy Story*, *Indiana Jones*, and *Frozen*. 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. At Media Networks, we anticipate expanded and more efficient distribution methods for ESPN, along with a more efficient cost structure.

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 growth potential from numerous projects mentioned above.

Our two-year price target is $135 per share, $3 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. The projected outlook supporting our price target includes modest EPS growth in FY17 (4% EPS growth) followed by a rebound in FY18 (12.5% growth) and continued expansion in FY19 (11% growth). We remind investors that FY18 includes the release of *Star Wars: The Last Jedi* (December 2017 planned release), which we expect to benefit a variety of businesses throughout the company.

Our two-year price target assumes a P/E multiple of 17.5x applied to our estimate of forward earnings two years from now. This is slightly below the current forward multiple of 18.0x. We believe this level is appropriate, if not conservative, given the company's growth plans, earnings outlook, solid fundamentals, and potential uses of free cash flow.

Additionally, our two-year price target represents an EV/EBITDA multiple of 10.2x based on our estimate of forward EBITDA in two years. This compares to the 10.6x multiple on our current projection of forward EBITDA. Annualized total return potential based on our target, the current dividend, and the current stock price is approximately 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	*$17,420*	*2.9%*	*$16,925*	*1.8%*	$16,632	0.3%	$16,581	9.7%
Broadcasting	*7,310*	*2.2%*	*7,150*	*1.3%*	7,057	5.6%	6,683	10.6%
Media Networks	*24,730*	*2.7%*	*24,075*	*1.6%*	23,689	1.8%	23,264	10.0%
Parks & Resorts	*19,810*	*7.1%*	*18,490*	*8.9%*	16,974	5.0%	16,162	7.0%
Studio Entertainment	*9,910*	*7.4%*	*9,225*	*(2.3%)*	9,441	28.2%	7,366	1.2%
Cons. Prod. & I'active Media	*5,850*	*12.3%*	*5,210*	*(5.8%)*	5,528	(2.6%)	5,673	7.4%
	60,300	*5.8%*	*57,000*	*2.5%*	55,632	6.0%	52,465	7.5%
Operating Income:								
Cable Networks	*6,750*	*3.8%*	*6,500*	*(3.7%)*	6,748	(0.6%)	6,787	4.9%
Broadcasting	*1,150*	*7.0%*	*1,075*	*6.8%*	1,007	0.1%	1,006	17.8%
Media Networks	*7,900*	*4.3%*	*7,575*	*(2.3%)*	7,755	(0.5%)	7,793	6.4%
Parks & Resorts	*4,000*	*8.7%*	*3,680*	*11.6%*	3,298	8.8%	3,031	13.8%
Studio Entertainment	*2,875*	*8.5%*	*2,650*	*(2.0%)*	2,703	37.0%	1,973	27.4%
Cons. Prod. & I'active Media	*2,125*	*12.4%*	*1,890*	*(3.8%)*	1,965	4.3%	1,884	28.0%
	16,900	*7.0%*	*15,795*	*0.5%*	15,721	7.1%	14,681	12.9%
Corporate & Other Activities	*(635)*	*(1.6%)*	*(645)*	*0.8%*	(640)	(0.5%)	(643)	5.2%
Nonrecurring Charges	*0*		*0*		(156)		(53)	
Other Income (Expense)	*(20)*	*(60.0%)*	*(50)*		(129)		0	
Interest Inc. (Exp.), net	*(435)*	*(5.4%)*	*(460)*	*N/A*	72		(117)	N/A
Pre-tax Earnings Excluding Nonrecurring Items	*15,810*	*8.0%*	*14,640*	*(1.5%)*	14,868	7.2%	13,868	13.2%
Less: Taxes	*5,217*	*8.0%*	*4,831*	*(4.9%)*	5,078	1.2%	5,016	18.2%
Less: Minority Interests	*380*	*(5.0%)*	*400*	*0.3%*	399	(15.1%)	470	(6.6%)
Net Income	*$10,213*	*8.5%*	*$9,409*	*0.2%*	$9,391	12.0%	*$8,382*	11.7%
Diluted EPS:								
As Reported	*$6.70*	*12.5%*	*$5.95*	*3.9%*	$5.73	16.8%	$4.90	15.0%
Excluding Nonrecur. Items	***$6.70***	***12.5%***	***$5.95***	***4.1%***	**$5.72**	**11.1%**	**$5.15**	**19.2%**
Avg. Diluted Shares Outst.	*1,525*	*(3.5%)*	*1,580*	*(3.6%)*	1,639	(4.1%)	1,709	(2.8%)
EBITDA	*$19,165*	*8.3%*	*$17,700*	*1.7%*	$17,401	7.6%	$16,170	11.8%
Operating Margins:								
Cable Networks	*38.75%*		*38.40%*		40.57%		40.93%	
Broadcasting	*15.73%*		*15.03%*		14.27%		15.05%	
Media Networks	*31.95%*		*31.46%*		32.74%		33.50%	
Parks & Resorts	*20.19%*		*19.90%*		19.43%		18.75%	
Studio Entertainment	*29.01%*		*28.73%*		28.63%		26.79%	
Cons. Prod. & I'active Media	*36.32%*		*36.28%*		35.55%		33.21%	
Total	*28.03%*		*27.71%*		28.26%		27.98%	
As a % of Total Revenues:								
EBITDA	*31.78%*		*31.05%*		31.28%		30.82%	
Corporate & Other Activities	*1.05%*		*1.13%*		1.15%		1.23%	
Tax Rate	*33.00%*		*33.00%*		34.15%		36.17%	

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) - FOX - $27.96 Comcast Corp. (partial owner of Hulu) - CMCSA - $39.08 Time Warner Inc. (partial owner of Hulu) - TWX - $98.13 AT&T Inc. (owner of DirectTV) - T - $38.22 - Buy Sony Corp. - SNE - $35.41 Dish Network Corp. (owner of Sling) - DISH - $61.24

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

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.

	Hilliard Lyons Recommended Issues		Investment Banking Provided in Past 12 Mo.	
Rating	**# of Stocks Covered**	**% of Stocks Covered**	**Banking**	**No Banking**
Buy	32	26%	13%	88%
Hold/Neutral	79	64%	8%	92%
Sell	12	10%	0%	100%

As of 8 May 2017

Other Disclosures

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