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COMPANY UPDATE / ESTIMATE CHANGE / PRICE TARGET CHANGE

The Walt Disney Company

DIS — NYSE — Long-term Buy-1

Review of 4Q Results; Price Target Raise

Key Metrics

DIS - NYSE (as of 11/10/17)		$104.78
2 Year Price Target		$128.00
52-Week Range		$95.78 - $116.10
Shares Outstanding (mil.) (basic)		1,538
Market Cap. ($ mil.)		$161,152
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		3.6x
Annual Dividend & Yield	$1.56	1.5%
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	$1.65		
2Q	$1.50	$1.60	$1.61		
3Q	$1.58	$1.76	$1.75		
4Q	$1.07	$1.39	$1.29		
Year	$5.70	$6.40	$6.30		$6.75
P/E	18.4x		16.6x		15.5x

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	$15,560	$15,500		
2Q	$13,336	$14,010	$13,975		
3Q	$14,238	$15,260	$15,225		
4Q	$12,779	$14,370	$14,100		
Year	$55,137	$59,200	$58,800		$60,500

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 4Q results were down from a year ago.** Total revenues declined 3% to $12.779 billion, about $450 million below recent street consensus. Operating margin dropped over 210 basis points, leading to an 11% decline in operating income. Diluted EPS excluding nonrecurring items were $1.07, down 3% from a year ago. The street consensus EPS estimate was $1.12 and our estimate was $1.11. Challenges in the quarter included Hurricane Irma, the cancellation of an animated film project, and technology investments and valuation adjustment at majority-owned BAMTech.
- **There were positive aspects to the quarter, too.** The Parks & Resorts segment overcame several closed days due to Hurricane Irma and posted higher revenues and operating income, due mainly to strong results at the international parks. Also, the company continued with meaningful share repurchases during the quarter. Just days after the quarter end, a renewal agreement was reached between DIS and a large cable operator.
- **There are some major growth initiatives in development.** CEO Bob Iger announced the recent signing for another trilogy of *Star Wars* movies after the current trilogy ends. Work continues on planned direct-to-consumer content streaming services, powered by BAMTech. This includes an ESPN-branded service expected to debut in Spring 2018 and a Disney-branded service (also including Marvel, Pixar, and Star Wars content) planned for late 2019.
- **We maintain our LT 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. We have raised our two-year price target by $3 to $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.

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

	Fourth Quarter Ended			Fiscal Year Ended		
	9/30/17	10/1/16	% chg.	9/30/17	10/1/16	% chg.
Revenues:						
Cable Networks	$3,951	$3,956	(0.1%)	$16,527	$16,632	(0.6%)
Broadcasting	1,514	1,702	(11.0%)	6,983	7,057	(1.0%)
Media Networks	5,465	5,658	(3.4%)	23,510	23,689	(0.8%)
Parks & Resorts	4,667	4,386	6.4%	18,415	16,974	8.5%
Studio Entertainment	1,432	1,811	(20.9%)	8,379	9,441	(11.2%)
Consumer Products & Interactive Media	1,215	1,287	(5.6%)	4,833	5,528	(12.6%)
	12,779	13,142	(2.8%)	55,137	55,632	(0.9%)
Operating Income:						
Cable Networks	1,236	1,251	(1.2%)	5,353	5,965	(10.3%)
Broadcasting	229	271	(15.5%)	1,205	1,193	1.0%
Equity in Inc. of Investees	10	150	(93.3%)	344	597	(42.4%)
Media Networks	1,475	1,672	(11.8%)	6,902	7,755	(11.0%)
Parks & Resorts	746	699	6.7%	3,774	3,298	14.4%
Studio Entertainment	218	381	(42.8%)	2,355	2,703	(12.9%)
Consumer Products & Interactive Media	373	424	(12.0%)	1,744	1,965	(11.2%)
	2,812	3,176	(11.5%)	14,775	15,721	(6.0%)
Corporate & Unallocated Shared Exp.	(190)	(183)	3.8%	(582)	(640)	(9.1%)
Restruct., Impairment & Other	(98)	(31)	216.1%	(98)	(156)	(37.2%)
Other Income	255	0		78	0	
Other Items	0	18		0	203	
Net Interest Expense	(85)	(99)	(14.1%)	(385)	(260)	48.1%
Income Before Taxes and Minority Interests	2,694	2,881	(6.5%)	13,788	14,868	(7.3%)
Less: Taxes	829	989	(16.2%)	4,422	5,078	(12.9%)
Net Income	1,865	1,892	(1.4%)	9,366	9,790	(4.3%)
Less: N.I. Attrib. to Noncontrol. Int.	(118)	(121)	(2.5%)	(386)	(399)	(3.3%)
N.I. Attrib. to Walt Disney Co.	$1,747	$1,771	(1.4%)	$8,980	$9,391	(4.4%)
Diluted EPS, as reported	$1.13	$1.10	3.0%	$5.69	$5.73	(0.7%)
Diluted EPS, excluding items	**$1.07**	**$1.10**	**(2.7%)**	**$5.70**	**$5.72**	**(0.3%)**
Avg. Diluted Shares Outst.	1,547	1,615	(4.2%)	1,578	1,639	(3.7%)
Operating Margins:			bp chg.			bp chg.
Cable Networks	31.28%	31.62%	(34)	32.39%	35.86%	(348)
Broadcasting	15.13%	15.92%	(80)	17.26%	16.91%	35
Media Networks	26.99%	29.55%	(256)	29.36%	32.74%	(338)
Parks & Resorts	15.98%	15.94%	5	20.49%	19.43%	106
Studio Entertainment	15.22%	21.04%	(581)	28.11%	28.63%	(52)
Consumer Products & Interactive Media	30.70%	32.94%	(225)	36.09%	35.55%	54
Total	22.00%	24.17%	(216)	26.80%	28.26%	(146)
As a % of Total Revenues:						
Corporate & Other Activities	1.49%	1.39%	9	1.06%	1.15%	(9)
Net Income from Contin. Oper.	14.59%	14.40%	20	16.99%	17.60%	(61)
Tax Rate	30.77%	34.33%	(356)	32.07%	34.15%	(208)

Source: The Walt Disney Company Note: September fiscal year

Additional comments on 4Q results. Revenues 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 4Q, 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 11/30/16, 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 1.5%. The company's current dividend policy includes two payments during the year, in January and July. In FY17, Disney spent $2.4 billion on dividend payments and we expect a slightly higher amount in FY18 (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.

Update on streaming services. Earlier this year, Disney announced a major change to the way it distributes its content with plans for two direct-to-consumer streaming services. Made possible by its recent majority stake in BAMTech LLC, Disney plans to launch *ESPN Plus* in Spring 2018 and an untitled Disney-branded service—including content from Walt Disney, Marvel, Pixar, and Star Wars/Lucasfilm—in late 2019. New films from these studios would become part of the Disney-branded streaming service after the customary initial theatrical window. 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. Much anticipation exists for *Star Wars: The Last Jedi*, with showings beginning Thursday, December 14. We believe the film could break several box office records. *Solo: A Star Wars Story*, part of Disney's plans for incremental franchise story lines, is set for release on May 25, 2018. 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.

Media reports potential interest in Fox assets. Shares of Disney and peer 21st Century Fox were both up on high volume on 11/6/17 as several media outlets reported that Disney had an interest in buying certain Fox assets. Both companies declined to comment. We believe Disney may have an interest in some Fox assets, including their movie studios (mainstream live action, animation, and niche/lower budget), television production operations, certain cable networks, and other smaller assets. Due to various reasons—some strategic and some related to anti-trust issues—potential discussions do not likely involve Fox's sports, news, and business networks, as well as its signature television broadcast network.

For Disney, positive factors of a deal could include gaining a wealth of content (ideal for Disney's planned direct-to-consumer streaming services), gaining enhanced negotiating/pricing power with various entities, and adding more cable networks (fx and National Geographic) to its existing portfolio. Possible synergies are numerous, one example being the *Avatar* movie franchise, which is distributed by Fox but licensed by Disney for its popular new addition to the Animal Kingdom theme park. *Avatar* is the all-time highest grossing movie (worldwide), and there are two sequels currently in development. We believe a potential purchase of Fox assets makes great strategic sense for Disney. We will monitor the situation and provide more information as warranted.

Outlook. We remain 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 FY18. 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 updated our earnings model—not yet reflective of 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. This outlook includes modest reductions to our fiscal 2018 revenue and EPS estimates in a fine-tuning measure. We are reducing our revenue estimate by $400 million to $58.8 billion, with the majority of reduction coming from the Media Networks segment. We assume a modest gain in total company operating margin and continued share repurchases, leading to a projected 10% gain in EPS from fiscal 2017 to $6.30, a reduction of $0.10 from our previous estimate.

We have initiated estimates for fiscal 2019. This appears to have a tough built-in comparison as it relates to the *Star Wars* franchise. Whereas the current fiscal 2018 year will include two *Star Wars* films—*The Last Jedi* in December 2017 and *Solo* in May 2018—as of now fiscal 2019 will not have any new films from the popular franchise. This is the main reason for seemingly modest growth in key financial metrics for fiscal 2019. This includes our projections of 3% revenue growth and 7% EPS growth.

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 possibly 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 16.6x our FY18 EPS estimate. This compares to the stock's median forward multiple of 17.4x over the past five years. We find this time period most insightful given that it includes ownership of key assets such as Marvel, Pixar, and Lucasfilm, whereas a period of ten or more years would include some years with those powerful assets and some without.

The forward multiple on DIS represents 0.84x 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 10.2x our projection of FY18 EBITDA. According to Thomson Reuters, over the past five years DIS shares have traded at EV/forward EBITDA multiples in the 7.8x-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 believe the long-term outlook at the company is favorable, more so now (following the company's recent announcements regarding its content streaming services and another *Star Wars* trilogy) than we did at the beginning of the year. 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, $3 above our previous target. This increase reflects our updated earnings forecast, 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 FY18. 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 level and the five-year median figure, a reflection of 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 10.3x based on our estimate of forward EBITDA in two years. This compares to the current 10.2x multiple on our projection of FY18 EBITDA. Annualized total return potential based on our target, the current dividend, and today's intra-day stock price is about 12%. 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. In addition, CEO succession in mid-2019 following the planned retirement of Bob Iger represents a major event and therefore represents a unique risk factor, in our view.

Exhibit 2
Income from Continuing Operations (figures in millions except percentages and per share data)

	FY19E	% chg.	FY18E	% chg.	FY17	% chg.	FY16	% chg.
Revenues:								
Cable Networks	$17,400	3.6%	$16,800	1.7%	$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	24,800	3.7%	23,925	1.8%	23,510	(0.8%)	23,689	1.8%
Parks & Resorts	21,100	6.7%	19,775	7.4%	18,415	8.5%	16,974	5.0%
Studio Entertainment	9,300	(4.1%)	9,700	15.8%	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%)
	60,500	2.9%	58,800	6.6%	55,137	(0.9%)	55,632	6.0%
Operating Income:								
Cable Networks	6,050	4.3%	5,800	8.4%	5,353	(10.3%)	5,965	(12.1%)
Broadcasting	1,225	4.3%	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	7,325	4.3%	7,025	1.8%	6,902	(11.0%)	7,755	(0.5%)
Parks & Resorts	4,400	8.0%	4,075	8.0%	3,774	14.4%	3,298	8.8%
Studio Entertainment	2,650	(4.5%)	2,775	17.8%	2,355	(12.9%)	2,703	37.0%
Cons. Prod. & I'active Media	1,925	(1.3%)	1,950	11.8%	1,744	(11.2%)	1,965	4.3%
	16,300	3.0%	15,825	7.1%	14,775	(6.0%)	15,721	7.1%
Corporate & Other Activities	(660)	1.5%	(650)	11.7%	(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	(520)	4.0%	(500)	29.9%	(385)	N/A	(260)	
Pre-tax Earnings Excluding Nonrecurring Items	15,120	3.0%	14,675	6.4%	13,788	(7.3%)	14,868	7.2%
Less: Taxes	4,990	3.0%	4,843	9.5%	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	$10,030	4.1%	$9,632	7.3%	$8,980	(4.4%)	$9,391	12.0%
Diluted EPS:								
As Reported	$6.75	7.3%	$6.30	10.6%	$5.69	(0.7%)	$5.73	16.8%
Excluding Nonrecur. Items	**$6.75**	**7.3%**	**$6.30**	**10.4%**	**$5.70**	**(0.3%)**	**$5.72**	**11.1%**
Avg. Diluted Shares Outst.	1,485	(2.9%)	1,530	(3.0%)	1,578	(3.7%)	1,639	(4.1%)
EBITDA	$18,840	4.5%	$18,025	7.4%	$16,779	(3.6%)	$17,401	7.6%
Operating Margins:								
Cable Networks	34.77%		34.52%		32.39%		35.86%	
Broadcasting	16.55%		16.49%		17.26%		16.91%	
Media Networks	29.54%		29.36%		29.36%		32.74%	
Parks & Resorts	20.85%		20.61%		20.49%		19.43%	
Studio Entertainment	28.49%		28.61%		28.11%		28.63%	
Cons. Prod. & I'active Media	36.32%		36.11%		36.09%		35.55%	
Total	26.94%		26.91%		26.80%		28.26%	
As a % of Total Revenues:								
EBITDA	31.14%		30.65%		30.43%		31.28%	
Corporate & Other Activities	1.09%		1.11%		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 - FOXA - $28.84

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

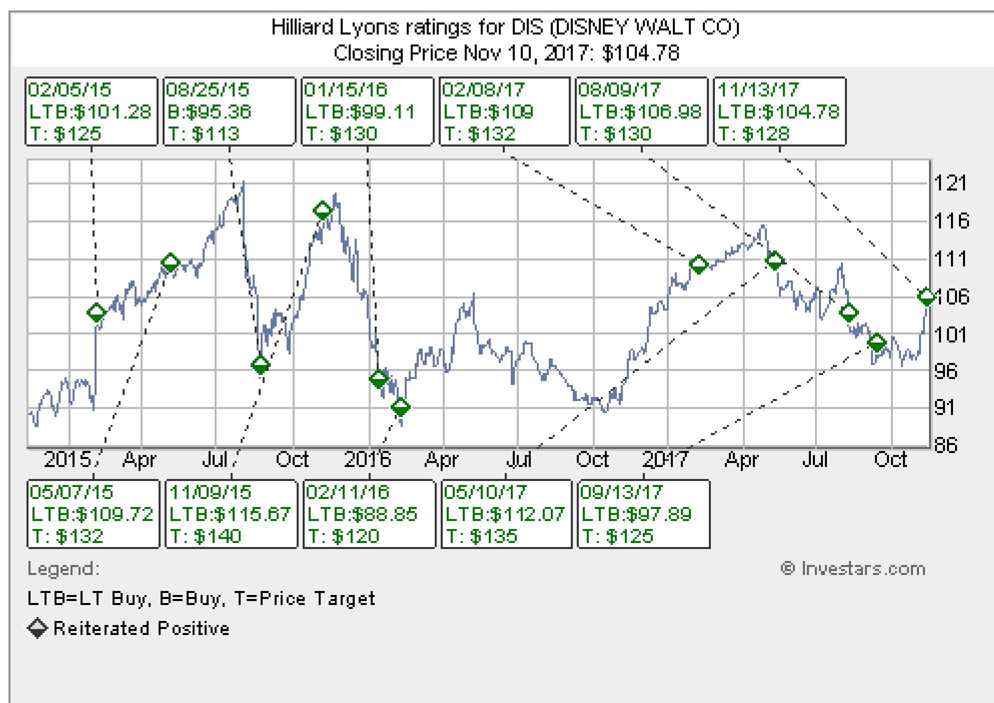
Buy - We believe the stock has significant total return potential in the coming 12 months.
Long-term Buy - We believe the stock is an above average holding in its sector, and expect solid returns to be realized over a longer time frame than our Buy rated issues, typically 2-3 years.
Neutral - We believe 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	32	29%	13%	88%
Hold/Neutral	73	65%	7%	93%
Sell	7	6%	0%	100%

As of 8 November 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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