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Conference Call Transcript

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PRESENTATION

Operator

Good afternoon ladies and gentlemen. Welcome to the Walt Disney Company's second quarter fiscal year 2005 conference call. At this time all participants have been placed on a listen-only mode and the floor will be opened for questions following the presentation. [OPERATOR INSTRUCTIONS] It is now my pleasure to turn the floor over to your host, Ms. Wendy Webb, Senior Vice President of Investor Relations and Shareholder Services. Ma'am, you may begin.

Wendy Webb ***SVP IR and Shareholder Services***

Thank you. Good afternoon and thanks for joining us. You may have noticed that Disney's second quarter earnings were released earlier than expected today. Because of the inadvertent communication of certain earnings information internally, we posted our results early in order to ensure they were broadly distributed as promptly as possible. Please note that as usual Disney's second quarter 10(Q) will be filed and available this afternoon. On the call with us today are Michael Eisner, Disney's CEO, Bob Iger, President and Chief Operating Officer and CEO-elect and Tom Staggs, Senior Executive Vice President and CFO. Michael will lead off followed by Bob and Tom. Then we will open up the call to you for Q&A. We will try our best to conclude the call by 5:30 Eastern Time. So let's get started. Michael?

Michael Eisner ***- Walt Disney - CEO***

Thank you, Wendy. Almost exactly two years ago in a second quarter earnings call like this one I commented about the things that set Disney apart that will power future growth. Specifically, I said and I quote, "the fundamental strength of our brands, characters and creativity remains intact." I went on to say, "I am pleased with the way our management team is responding to the current external challenges." And I predicted that the Company would post impressive gains in the months and years ahead. Well, now 24 months later it is very gratifying to see that my faith in our people, our products and our plans was extremely well founded.

Disney has been roaring back and, as we predicted, is showing strong, dependable earnings and attractive growth. We more than doubled our earnings between 2002 and 2004, excluding certain gains and losses that we do not believe are representative of our ongoing businesses, and we are well on our way to delivering healthy double-digit growth again this year. This will make 2005 the third consecutive year of double-digit growth, with an average growth rate over this period of more than 30% per year, again excluding certain gains and losses. Our second quarter's earnings growth of 27% is just the latest demonstration that, across the Company, our management team continues to execute on the plans that were developed several years ago in the face of disruptive downturns in the economy and in tourism. The quarter's year-over-year earnings surge was all the more impressive when you consider that there was some softening in the general economy due to energy prices and that Q2 last year was extremely strong, up 73% over the prior year.

The second quarter was also noteworthy for a non-financial highlight, the announcement by the Board of Directors that Bob Iger was to become Disney's next Chief Executive Officer. Though this action has not been directly reflected in any of our Q2 results, I believe it will prove to be the highest highlight of the quarter. Bob shares responsibility for the success that the Company is enjoying today and he can be counted on to keep Disney seamlessly moving forward, while putting his own creative stamp on this most creative of companies. Bob, along with our entire management team, has been taking meaningful steps to position the Company for future growth. The NFL deal, which Bob will discuss in greater detail, is great for ESPN and also great for ABC. Thanks to George Bodenheimer's leadership, we have a deal that will enhance ESPN as the number one destination for sports fans, while allowing ABC to leverage its tremendous success this season by programming Monday nights with more great ABC shows.

The successful Miramax negotiations, spearheaded by Dick Cook, will position The Walt Disney Studios extremely well, since this transaction lowers the Studio's cost base and total capital investment, while maintaining Miramax as a valuable part of our live action portfolio. This deal also keeps us in business with Harvey and Bob Weinstein, who are massively creative executives. At Walt Disney Feature Animation, we have moved fully into computer generated animation, and based on the screening I saw of *Chicken Little,* it is a medium in which Disney animation will soar. Two weeks ago, Bob and I returned from a trip to India where we saw firsthand the enormous potential of that dynamic and energetic nation. Like China, India offers Disney new opportunities across the spectrum of our businesses.

Bob's familiarity with that region in particular and with the global markets generally will undoubtedly lead to insightful decisions for our Company. And just as we look to benefit from emerging economies around the world, Bob and the rest of our management team are positioning us to benefit from emergent technologies. We believe the transition from analog technology to digital will be as significant for content companies as the switch from silent to sound was for the movie studios. Of course, Disney was at the leading edge of that earlier transition when Walt introduced a mouse named Mickey in the world's first sound cartoon. Similarly, Disney will be leading the way into the digital era.

Because of the consistent strength of our family-friendly content and proven ability to exploit that content across all businesses, Disney brings unique advantages to the new markets that technology will be creating. The common thread pulling through both our international and technological growth will as always be creative excellence. An entertainment Company's first obligation is to entertain. While this may seem self-evident it is a daunting task and through the years no one has done it better than Disney. Our ability to entertain people of all ages on all continents, across all of our businesses was most recently on display last week when we launched the celebration of Disneyland's 50th

Anniversary. As you know, we have had enormous success over the years leveraging meaningful incremental attendance and revenue gains with anniversary celebrations at individual parks.

Now, for the first time we are conducting a global anniversary celebration, during which we will offer great new attractions and shows at each of our existing ten theme parks. And then in September, we will showcase the opening of an entirely new Disneyland park in Hong Kong. All of this activity is being coupled with our worldwide marketing campaign, which you've likely seen, to remind people of the affinity they have for Disney theme parks, which are and have always have been, in a class of their own. The response last week was tremendous. Advanced bookings are very encouraging and the product is spectacular. We have high hopes for this global celebration, which underscores in so many ways the advantages Disney has over all other media companies.

The 50th Anniversary Celebration, in a way, is also a celebration of the very exciting expansion of our asset base during the last seven years. At Parks and Resorts, we have added four new theme parks, two cruise ships, over 650 Disney Vacation Club units and more than 8,000 hotel rooms. In our other businesses, we have brought online five new cable networks in the U.S., 17 international Disney Channels, the Disney Internet Group and we have grown our stage play business with 16 plays in eight countries. We've also made outstanding content acquisitions of Baby Einstein and the Muppets. These assets, and many more, represented a considerable investment in the future growth and value of our Company. We will, of course, continue seeking strategic growth investments ever mindful of high-return opportunities. But, the fact is that we now have in place an asset base that we believe represents an unrivaled platform for performance in the coming years. Through the next few months, I will continue to review the many fantastic plans and projects that are underway across the Company.

Starting in October, I look forward to joining the worldwide audience who will be enjoying this coming wealth of Disney entertainment in theaters, on television, at theme parks and on cell phones and on devices not yet invented. And, of course, as a major shareholder, I look forward to the growing value that these creative activities can generate. Two years ago, I concluded my earnings remarks by saying, "As long as we consistently provide great entertainment and manage it well, our Company will prosper." Since I spoke those words, Disney has certainly prospered, as it has throughout its storied history and as I expect it will for decades to come. With that in mind, it is my pleasure to turn the call over to the President of The Walt Disney Company and its CEO-elect, Bob Iger.

Bob Iger - ***Walt Disney - President, COO, CEO-Elect***

Thank you, Michael. We are obviously pleased with the increase in earnings this quarter, but we are more gratified by evidence that our efforts to position Disney to deliver long-term value to shareholders over the past several years have been successful. Our results also indicate that even in the midst of the digital revolution, to which Michael alluded, one thing seems apparent; companies providing great content will thrive. At Disney, the creative projects on our near term horizon, new films from our studio, like the *Chronicles of Narnia*, the new shows to be unveiled next week at our ABC fall schedule announcement and, of course, Hong Kong Disneyland, to name just a few, look very promising.

Additionally, our library of creative content is virtually impossible for our competitors to replicate and our corporate culture maximizes success by leveraging each of our businesses to support creative initiatives. These factors, in conjunction with our world renowned brands, place our Company in a very strong position to exploit not only the compelling new opportunities being created in the emerging global markets, but also those presented by the rapid growth of new technologies and distribution platforms worldwide. We intend to be market leaders by providing our creativity and content to both these areas and toward that end, we are making strategic investments in a wide variety of new initiatives to drive growth and strong returns. Our investments cover a broad array of initiatives that leverage our unique competitive strengths and offer the potential for substantial upside in the future.

Simply put, our goal is to develop more great creative product, for more people, in more places, in more ways than ever before. Our expanding presence in the video game industry is just one example. In April, we announced two small but important deals that position us to expand in this $27 billion industry as a top tier game publisher, the acquisition of the successful video game developer, Avalanche Software and the establishment of a new development studio in Vancouver, Canada, an important hub of game development talent. With those two moves, we've augmented our in-house talent and development capacity in this important area of growth for the Company.

In our Internet-based businesses we also see great potential for our content. ESPN.com consistently ranks as the number one sports site in terms of unique users. Disney Online holds the number one spot with kids and families, and combined, our Internet sites rank number seven in top properties. We are seeing strong current performance as a result. Total revenues for our combined online businesses grew 25% year-over-year this quarter, with online advertising across our sites up by almost 40%. Wireless technology represents another tremendous opportunity for our Company, especially as mobile phones become a major source of information and entertainment for consumers on a global basis. Disney is already one of the world's largest providers of wireless content, with Disney mobile content now available in 31 countries, through relationships with 60 carriers and distributors. Since the beginning of fiscal year '05, Disney Mobile has entered six new markets and signed 14 new distribution deals.

We recently announced our intention to expand our wireless footprint with ESPN mobile, our ESPN MVNO phone service in early 2006 and we are exploring the opportunity to leverage the Disney brand in this area as well. We expect ESPN Mobile to use existing content to create new revenue streams and, because we use an already built infrastructure, the capital required is relatively modest. We are excited about our prospects in these areas but our new MVNO and video game initiatives represent just two of the larger slate of projects we are launching to position us to take advantage of new markets created by emerging technological platforms.

We are equally well situated to tap into the vast potential that exists outside the U.S. with the growth in world economies, especially those in Asia. Our current focus in that region of the world is on Hong Kong Disneyland, which will open on budget and ahead of our original schedule on September 12, 2005. Even in advance of the opening of Hong Kong Disneyland, our research is showing a rapid increase in Disney brand affinity in Hong Kong and Southern China, where our pre-opening marketing efforts are having a noticeable impact. The public is clearly excited about Disney. As Michael mentioned, we recently returned from India where we met with both senior government officials and industry leaders to provide a global overview of Disney and our strategic plans for developing our businesses in that region.

Our presence in India is currently less developed than in China, but awareness of Disney is high. In December, 2004, we launched *Disney Channel India* and *Toon Disney,* and each of those networks now reaches 14 million homes. These channels are important because they help create a real connection with Disney, which paves the way for growth in our other lines of business. We are also focused on expanding the reach of these channels as cable and DTV platforms grow throughout that country. While we are positioning ourselves to take advantage of new market opportunities, we continue to invest in our core businesses to maintain our leading market positions.

At our parks, our ability to create products that are beloved by our customers and guests translated into double-digit increases in profits for our domestic resorts. Last week, our theme parks team launched *The Happiest Celebration on Earth*. We think that this eighteen-month long global celebration commemorating 50 years of Disney theme parks will provide families with a powerful reason to visit Disney destinations. And we are reaching out to them with an unprecedented marketing campaign in terms of scale and creativity. When you combine the magnitude of this celebration with recent optimism in the travel and tourism market, you have a recipe for higher volumes at our parks. The initial response to the 50th has been strong, as evidenced by bookings at our hotels pacing consistently ahead of last year since we launched the marketing campaign for this great event.

At the Walt Disney Studios, our management team continues to prove that combination of creativity and financial discipline can yield consistently strong performance even in the hit-driven film business. Disney's *The Pacifier*, which crossed the $100 million mark in domestic box office, was an especially good example of how we combined these factors for success in Q2. We've seen a similarly strong showing in home video, where Buena Vista Home Entertainment again is among the market leaders so far this year, driven by both *The Incredibles*, which is the number one selling title this year, and Disney's *National Treasure*, which has sold over 6 million units since its recent release.

Our cable networks delivered robust ratings and double-digit growth in ad revenue across the board in Q2. At ESPN, our new eight-year agreement with the NFL for *Monday Night Football* further solidifies ESPN's competitive position as the world's leading supplier of sports programming. In addition to 17 regular season games, the deal includes a wide variety of rights across TV and other assets including *NFL Primetime*, *NFL Draft*, *NFL Live*, *ESPN HD*, *ESPN Deportes*, as well as wireless rights, which will help to fuel ESPN Mobile.

While it was not easy for ABC to say goodbye to the landmark *Monday Night Football*, we believe that our new NFL deal with ESPN was the right decision in any light and the improved performance of ABC primetime did make the decision to move this franchise to a new platform a little easier. With ABC's primetime ratings up 15% versus last year, we are seeing a greatly improved primetime scatter marketplace for ABC in the current quarter. Given that ABC ratings levels have exceeded our expectations this season, and the positive signs we are seeing in the marketplace, we continue to believe that the network will be profitable in fiscal 2005. In addition, ABC's position as we move into the upfront sales market is greatly improved relative to the prior year in terms of not only our delivery of adults 18 to 49, but also our delivery of upscale and higher educated viewers where we outperformed CBS and Fox. All of these factors bode well for fiscal 2006.

As we will discuss next week, when we announce ABC's new fall schedule, we are continuing our focus on developing new, profitable entertainment programming that will build on the network's current momentum and, as importantly, continue to fill the pipelines for international markets, new platforms and ancillary revenue streams that we simply couldn't tap into these past few years. In international markets, *Desperate Housewives* has been licensed to 153 territories worldwide, where its performance continues to break records for U.S. acquired series. Similarly, *Lost* has been licensed to 183 territories worldwide, making it Buena Vista International's fastest-selling series in history. With the recent mid-season success in *Grey's Anatomy* in the U.S., we are expecting great results when we take this program to market as well.

With the market for TV product on DVDs doubling to $3.5 billion in 2004, we also see significant opportunities for growth in this area. *Alias* DVDs, featuring its first three seasons, have already generated $70 million in incremental revenue. DVDs for both *Desperate Housewives* and *Lost* will be released this September. We are also pursuing VOD and other digital opportunities, and are in discussions with cable and satellite affiliates to launch an ABC Video On Demand product.

The success we've seen across our businesses is at its core, a function of our ability to profitably bring great creative product to market, which in turn is a function of the talented people within our organization. We are well aware that not every creative effort will be a hit and that creative success requires taking creative risks on occasion. As such, we recognize that we must encourage the creative process by celebrating our successes and learning from our mistakes. Our senior management team is committed to attracting and retaining the best talent in the industry so that our products, and in fact all of our efforts, are imbued with the level of creativity necessary to drive consistent and growing financial performance. I am committed to creating a business environment where this approach is not only fostered, but where it is expected. Now let me turn the floor over to Tom Staggs.

Tom Staggs - ***Walt Disney - CFO, SEVP***

Thank you, Bob. Michael and Bob provided several examples of our efforts to expand the variety and reach of our creative content. With each new venture our long-term objective remains the same, to delight our audiences, guests and consumers while delivering long-term value for our shareholders. Our results for Q2 reflect our success in this regard.

The outstanding performance of our domestic theme parks was a highlight for the quarter. Plans set in place years ago to invest for the long term in the asset base of this division have put us in a strong competitive position that is apparent in our recent trends. Excluding the impact of consolidating Euro Disney and Hong Kong Disneyland in Q2, theme park revenue grew by 7%, operating profit increased 26%, and margins increased by nearly 2 percentage points.

Improved occupancies, guest spending and visitation at Walt Disney World were all key drivers of our parks' performance. Attendance at Walt Disney World was up mid-single digits versus last year's strong Q2. International visitation showed the biggest percentage increase, growing by more than 20% versus last year. Per capita spending increased by 10% at our Florida parks, driven largely by a price increase in conjunction with our recently launched *Magic Your Way* pricing program. Hotel occupancy and occupied room nights at Walt Disney World increased by 7 percentage points and 9%, respectively, with the increase in occupied room nights helped in part by the reopening of the French Quarter hotel at Port Orleans late in the prior year quarter. Per room spending was off by a little less than 1% versus the prior year quarter, primarily driven by somewhat lower merchandise spending.

On the west coast, Disneyland Resort attendance was 3% below Q2 from last year on lower local resident visits. A likely contributor to this fall-off was the heavy rain in Southern California, where we are on the verge of breaking a 120 year old record for annual rainfall. Inclement weather at Walt Disney World and the build up to our 50th Anniversary Celebration likely contributed to lower resident attendance there as well. However, as was the case at Walt Disney World, international visitation at Disneyland was up by more than 20% this quarter and domestic visitation also improved. Per capita spending at Disneyland grew double-digits in Q2, as it has for each of the last two quarters. Occupancy at Disneyland was roughly 80%, 1 percentage point below prior year, but per room spending was up 6%. Looking ahead, trends continue to be encouraging as our room reservations on the books for our domestic resorts are running double-digit percentages ahead of the prior year for Q3. Obviously, trends are often difficult to read and we would like to see further recovery in travel and tourism. But as our 50th Anniversary Celebration gets underway, we are positioned to show further improvement in our theme park results and extend our leadership in the family vacation market.

We are also positioned well at Media Networks, especially in cable. Total revenue for the cable group was up 8%, even though as we discussed last quarter, provisions in ESPN's carriage agreements caused us to defer a little over $100 million of affiliate revenue that would have otherwise been recognized in Q2. We expect to recognize the vast majority of the revenue deferred this year later over the next two quarters, with the largest benefit coming in Q4. Timing of revenue recognition aside, ESPN continues to present the most popular and technologically sophisticated sports telecasts in the industry and this translated into stellar performance again this quarter.

ESPN had its most watched March quarter ever, among all key demographics, and as Bob mentioned, posted double-digit increases in advertising revenue. ESPN's performance was helped to some extent by an NFL game being shifted into Q2 and by some additional college bowl games in the quarter. The strong results are continuing in the current quarter as ad sales at ESPN are running high single digit percentages ahead of the prior year.

Bob mentioned our new long-term deal with the NFL, which starts in the 2006 season. From an accounting perspective, the new contract provides for average increases over the life of the contract in Disney's annual payments to the NFL of approximately 4% per year. You should expect that our revenue recognition of this new contract will reflect this payment schedule.

Turning to our other cable properties, ABC Family continues to grow its ratings, and in Q2 this resulted in a more than 30% increase in ad revenue. Third quarter-to-date, total household ratings at ABC Family are up 20% and ad sales again are pacing double digits ahead of last year.

The Disney Channel U.S. ranked number one in primetime with tweens 9 to 14 versus all basic cable networks for the 23rd consecutive quarter, and ranked second with kids 6 to 11.

And on the international front, as Bob discussed, we are pleased with the performance of our newest Disney Channel in India, which helps to establish Disney in one of the fastest growing and most populous markets in the world. Our investment in our new India and Japan channels this year will total approximately $40 million. Even after this investment, our international cable operations were profitable in the aggregate again this quarter.

The ABC Network continues to exceed our expectations in terms of ratings improvement and we are beginning to feel the corresponding financial lift. For the second quarter, CPMs came in mid single-digit percentages above upfront levels and this trend has continued into the June quarter so far. Primetime performance and a solid ad market drove an improvement of nearly $40 million in results at the network for the quarter.

At our TV stations, gross ad sales for Q2 were up roughly 4% versus the prior year. But as was the case in the second quarter, Q3 has started out with ad pacings that are slightly lower than last year.

At our radio group, we delivered revenue and operating profit growth driven primarily by the strength of general market stations and our branded product offerings, including ESPN and Radio Disney networks. Ad sales at our radio station group were up by low double-digit percentages in Q2. So far for Q3, our radio station ad sales are up modestly versus last year, but radio network sales are down.

At the Studio, our 2005 slate continues to perform well, especially our Disney-branded live action titles. The performance of *The Pacifier* in theaters and *National Treasure* on DVD underscore the advantage that the Disney brand can provide us.

Home video has also contributed to the Studio’s growth with key titles *The Incredibles*, *Bambi* and *Ladder 49* selling almost 28 million combined units worldwide in Q2 alone. International home video comparisons, however, were difficult given that *Pirates* and *Finding Nemo* were still in release in some international territories. The growth in DVD continues for us, especially in international markets. Total worldwide DVD sales exceeded 88 million units this quarter, an increase of over 25% versus last year, which has more than offset the decline in VHS.

At Consumer Products, results were helped by the absence of roughly $20 million in losses from the Disney Stores and the recognition of license guarantee revenues from Mattel. Earned royalties across our licensing businesses were up mid-single digits in the quarter. Although it's still a small component of Consumer Products, Buena Vista Games’ operating profit increased substantially in Q2, driven by sales of *The Incredibles* console game and GameBoy Advance titles including, *Finding Nemo*, *Kim Possible* and *Lizzie McGuire*. With our recent moves to increase our development capabilities in this important area, we plan to increase our development spending and expense for video games over the coming quarters as we invest for future growth.

During the last several years, we have delivered against all of our key financial metrics: growth in earnings, increased returns, and strong cash flow. We intend to extend this streak, especially as Disney's portfolio continues to evolve toward a less capital-intensive mix through growth in Media Networks and through reduced capital needs at parks.

Our strong results are also reflected in the continued strength of our liquidity and our balance sheet. We have made good on our promise to improve our credit statistics. We enjoy an attractive average effective yield on our debt portfolio of just over 4.5% as of the end of Q2 with a weighted-average maturity of more than nine years. We should continue to enjoy relatively favorable rates since 85% of our net debt portfolio is at fixed interest rates. And given the strength of our balance sheet and cash flow, we will look to deploy excess cash towards value creating opportunities in our core businesses and towards acquisition opportunities. We take our responsibility to profitably allocate capital seriously and we will pursue opportunities to invest, provided we are convinced that the investment will ultimately deliver value to our shareholders.

We also expect to continue to return value to shareholders through our dividend and through share repurchase. In Q2 we repurchased over 15 million shares of Disney stock and we expect to be a buyer of our stock again this quarter.

Our March quarter results are certainly gratifying, but we will remain focused on continuing to deliver strong results. This business is hit-driven and we will inevitably experience short-term swings on our road to long-term growth. Obviously, that's easier to say when our results have been consistently strong and our outlook is good.

As Michael said, we feel we are well on our way to delivering double-digit growth in our earnings again this year, barring any unforeseen downturns in the environment. And on a longer term basis, we continue to target, on average, double-digit annual percentage growth in our earnings off our strong 2004 base through at least 2007, coupled with improving returns on invested capital and strong cash flows. But even as we dealt with the downturn of a couple of years ago, a fundamental part of our strategy has been to invest in our brands and other assets with an eye towards positioning Disney for long-term sustainable success.

Because of the tremendous assets we manage, especially those under the Disney and ESPN banners, we have a powerful platform for: launching greater entertainment across the growing spectrum of distribution outlets; improving the odds that our creative risk-taking will bear fruit; increasing the reach, duration and value of our hits; and providing a more solid base of financial performance from which to grow. And with that let me turn the floor over to Wendy Webb for Q&A.

Wendy Webb ***SVP IR and Shareholder Services***

Thank you, Tom. We are ready to take the first question, operator.

QUESTION AND ANSWER

Operator

[OPERATOR INSTRUCTIONS]. Our first question is coming from William Drewry from CSFB.

William Drewry ***- Credit Suisse First Boston - Analyst***

Thanks. Maybe for Tom or for Bob. A question on the theme parks, just wondering given the forward bookings looking as strong as they are. I assume that you spent a lot of money in front of the 50th Anniversary. Just wondering if that margin improvement, 200 basis points that we saw in the quarter, if we can see an acceleration off of that in forward quarters? That's question number one. And then just a second question, I've noticed that in the last few days you continue to be pursued by the dissident ex-directors despite pretty much exceeding every Street expectation for the last two years. So, I'm just wondering, if anything material can come out of this latest lawsuit or is it just basically frivolous noise?

Tom Staggs ***- Walt Disney - CFO, SEVP***

Well, Bill let me take the first question first. The margin obviously, as we've said, we expect to be driven primarily by continuing to increase our asset utilization. And I don't know that we want to make any quarter by quarter predictions, but clearly we are on track. We believe we are on track to attain our 20% plus margins goal as we've discussed in the past. You're right to point out that marketing and sales increases had some impact on margins in the quarter. Not dramatic, but we were spending ramping up to the 50th. To the extent that we are as successful as we hope to be in the 50th, the volume increase should more than make up for that. And so far from the bookings it looks good, but it's still early.

Bob Iger ***- Walt Disney - President, COO, CEO-Elect***

I will take your second question, Bill. We believe that the complaint, the lawsuit, is completely without any basis and we've turned it over to our legal people for handling. I know I speak for Michael when I say that this is a great company with great people. And that we are concentrating on our performance, which is creating high quality product and delivering greater shareholder value. And I for one will not allow myself to be deterred or distracted from achieving those goals. I also want to say that since I was chosen to be our next CEO, I've spent a tremendous amount of time with people that work at this Company. And they are just plain fed up with all of this. They want the rhetoric to end and they want to be allowed to concentrate on what they do best, which is making great product and driving a great company forward. And I am very optimistic that they are going to achieve that.

Operator

Our next question is coming from Anthony Noto of Goldman Sachs.

Anthony Noto *- Goldman Sachs - Analyst*

Thank you very much. Bob, I was wondering if you could comment on the ABC Broadcast Network's profitability? Tom had mentioned that you still expect it to be profitable next year. But I was wondering if you could comment on its profitability level this year? It looks like it was close to being profitable. Do you think it could be profitable in the second half of your fiscal year? So the June quarter and the September quarter? And then, Tom, if I look out at the year on an operating income basis, sort of first half versus second half, is it possible for the second half of the year to have OI growth double the first half of the year? So something roughly in the 20% range given an easy comp you have in September, the ESPN benefit and then home videos and the ABC Broadcast Network? Thanks.

Bob Iger *- Walt Disney - President, COO, CEO-Elect*

Anthony, when we were referring to ABC profitability, we were talking about fiscal 2005. So we believe that barring the unforeseen, which is really a significant downturn in the market, we can't really think of anything else at this point, that ABC Network will likely be profitable in 2005. And clearly given the way they're positioned for the upfront, the strength of their schedule, the strength of their development, they should have an even easier time achieving that in fiscal 2006. There are some ins and outs because they have the Super Bowl next year but we are really pleased with how they are positioned. I mentioned their upscale demographics. They have great programs to sell and a great rating story and demographic story to sell to advertisers in this upfront. And we believe that given their development, that they've got more attractive programs to offer advertisers. And their schedule will be stronger this coming fall than it was this past fall.

Tom Staggs *- Walt Disney - CFO, SEVP*

Anthony, with regard to the remainder of the year, we talked at the beginning of this year that we thought we would achieve double-digit growth and as we said, we are on track for that. We also said that we expected the growth rates to be stronger in the second half of the year than in the first half of the year, especially given the tough comparables we saw in Q1. We are very optimistic about where the year goes from here. Again, I won't make specific growth rate projections quarter by quarter. But we do continue to believe that the growth rate in the second half of the year can be more effective than the first.

Operator

Our next question is coming from Doug Mitchelson of Deutsche Bank.

Doug Mitchelson *- Deutsche Bank Securities - Analyst*

Thanks. If I could take Anthony's question one step further. If you look out one year and football goes away, you look at the profitability of other networks that have similar ratings levels, it seems like ABC should be in a position to make hundreds of millions of dollars. So, just curious when you look out a few years, do you think that's an accurate statement? And then just wondering, nice to see your share repurchase program start in earnest, but given your current valuation, is there any issue out there that would stop you from ramping your repurchase program to even a faster pace? Thanks.

Bob Iger *- Walt Disney - President, COO, CEO-Elect*

Doug, the absence of football is clearly going to help ABC's bottom line, which is one of the primary reasons we exited football on the network and maintained it on ESPN. We are not going to project the network's performance over a long period of time. As I said, we are well positioned in a variety of ways entering fiscal 2006. But I think it would not be prudent for us to really make too many predictions in terms of a growth trajectory of their profitability.

Michael Eisner - ***Walt Disney - CEO***

One thing we should remind everybody, there was a method to our madness. When we acquired *Monday Night Football* for ABC in '98, with it came the ESPN full-season package. And with that came the escalating revenue from cable companies to The Walt Disney Company. Monumental growth that was fueled by basically agreeing to *Monday Night Football*. The world is a little different now. ESPN is on track, has its arrangements with cable, and has solidified its position by moving *Monday Night* from ABC to ESPN. ABC in that same period did its turnaround, has a foundation of programs now on which they can build Monday night. And if you look at the history, it's almost been impossible to come back in January on Monday night on ABC to replace almost a whole new night every year. So ABC is now in position to be competitive five nights a week, 52 weeks a year going in with this momentum. So the strategic thinking on the NFL from the beginning, I think, has been sound.

Tom Staggs - ***Walt Disney - CFO, SEVP***

Doug, you asked about share repurchase, and we try to seriously avoid making predictions of how much we might do in share repurchase. But given the strength of our cash flow expectations and our earnings expectations, we do think that we will be deploying capital towards share repurchase. And we are committed overall to investing our capital where we can make the most sense for shareholders. But we certainly believe that share repurchase in a meaningful way is a part of that equation going forward.

Operator

Our next question is coming from Kathy Styponias of Prudential.

Kathy Styponias - ***Prudential - Analyst***

Hi, two questions. First, a New York publication today suggested that you were in the midst of trying to sell your radio business. Could you comment on whether you are a buyer or seller of such assets? And then second, somewhat of a housekeeping question for you, Tom. You made comments about the new NFL deal, that the revenues to the NFL rise about 4% per year. Should we assume that as far as the depreciation schedule is concerned for the rights that we should be using a 4% run rate? So in other words, in year one of the new contract, the costs are going to be up something to the tune of $360, $350 millionish or so from the prior year? Thanks.

Bob Iger - ***Walt Disney - President, COO, CEO-Elect***

Kathy, as you know we've been in the radio business for a long time and it's been a good business for us, delivering significantly in terms of free cash flow. And it's also extremely well managed under John Hare and a very, very seasoned team of radio management. As we've said about a number of our assets, we are always open to looking at possibilities of either buying or selling assets, all with an eye towards improving our shareholder value. And so we are continuing that process. We are not going to comment specifically, though, as to whether we are looking to buy or sell radio properties at this point, except to say that we maintain an ongoing process again of analyzing all of our businesses.

Tom Staggs - ***Walt Disney - CFO, SEVP***

Kathy with regard to the NFL, the eight-year deal totaled just a shade under $8.9 billion. And as we've said the payment schedule that we've agreed to reflects an average growth rate per year of 4%. So, I think that gives you pretty much everything you need to know to know how the amortization schedule will work on the rights, because the rights amortization we currently expect will mirror the payment schedule.

Operator

Thank you. Our next question is coming from David Miller of Sanders Morris Harris.

David Miller *- Sanders Morris Harris - Analyst*

Hi, Tom, while most of the Street focus is on ESPN, you guys have quietly done a great job growing SOAPnet. I think the advertiser base on SOAPnet has doubled within the past year. Please correct me if I'm wrong on that. Can you talk about what the EBIT contribution was from SOAPnet in the quarter and where you stand on margins right now? What do you expect the ultimate operating margin for SOAPnet to be once it hits maturity? Thanks.

Tom Staggs *- Walt Disney - CFO, SEVP*

I think that SOAPnet is pretty much right at that inflection point. It has been showing the kind of attractive growth that you are talking about in terms of advertisers. We've grown the subs to just under 40 million. We hope to grow that further as Anne Sweeney discussed at our conference in January. And so, we're really quite pleased. SOAPnet, in the second quarter was profitable, but not by a ton, not by very much. And so as I say, they are at an inflection point where now as we go forward we are really looking to see SOAPnet contribute more in terms of profitability. But we think there's a great future for this. And this is a channel which, I think as Michael has discussed a number of times in the past, has a fan base that rivals ESPN in terms of its affection and its loyalty to the product.

Michael Eisner *- Walt Disney - CEO*

Yes. For somebody who ran Daytime and was very involved in those soap operas, this is the silent asset that nobody writes or talks about very much. But right from the beginning the soap operas at ABC, *General Hospital* and *One Life To Live* and so forth are unbelievably strong. And this asset once you get past the 40 million, 50 million to the 60, 70 million in subs, will be an unbelievable, I believe, a steady earner for the Company and attractive.

Bob Iger *- Walt Disney - President, COO, CEO-Elect*

To Tom’s point on viewer loyalty, it's the number one basic cable network among women 18 to 49 in terms of minutes viewed and days viewed per month, which is a testament to just how loyal its viewers are. And I think that bodes well for its future.

Michael Eisner *- Walt Disney - CEO*

In my day the people that ran sports were the stars, the people that ran Daytime hardly got reservations at the hotel but we made all the money.

Operator

Raymond Katz from Bear Stearns.

Raymond Katz *- Bear Stearns - Analyst*

Tom could you just review for us where you expect to end the year on free cash flow using the schedule, the summary schedule on page eight as a basis of discussion?

Tom Staggs *- Walt Disney - CFO, SEVP*

Well, to a certain extent, although - -

Raymond Katz *- Bear Stearns - Analyst*

I'm sorry, Tom, if you could sort of just pull out Hong Kong and Europe for us so we can take a look at the Company as we've usually looked at it?

Tom Staggs - ***Walt Disney - CFO, SEVP***

Sure, we've given you general guidance as to what we think the earnings will do. And I'm not going to give you specific guidance on cash flow, to make a specific prediction. As you know, we had record cash flow last year and what we said at that time was that a part of that record cash flow was due to the timing of certain items that benefited 2004. 2004 would have been a record even without the benefit of those differences, but those timing differences hurt 2005 to a certain extent. We have a strong lineup of home video left in the year, some of which will extend beyond the fourth quarter into 2006 in terms of receivables and inventory, et cetera. So, I would expect that from a working capital standpoint we will continue to make some investment there that will impact our cash flow. So, as I said at the beginning of the year I would expect that free cash flow for the year will come in likely with a several hundred million dollar swing from one year to the other from 2004 to 2005. So, we will have very strong cash flow overall. But I still expect 2005 to be down from 2004's record levels because of timing of those items. So, other than that I think that, as you can imagine, for the cash flow from operations before the working capital impact, we are looking to continue to grow as we grow our income.

Operator

Our next question is coming from Lowell Singer of SG Cowen.

Lowell Singer - ***SG Cowen & Co. - Analyst***

Thanks. Tom, a question for you on the studio. It seems like you have four big tent pole films for FY06, you've got *Narnia*, *Chicken Little*, *Cars*, and *Pirates 2*. Can you give a sense as to what individually or cumulatively the negative costs and the P&A costs are on those four films? Thanks.

Tom Staggs - ***Walt Disney - CFO, SEVP***

Well, those are all reasonably expensive films. And I don't believe Pixar has given out any estimates on what they are going to spend on *Cars* and I certainly won't do it for them. But those pictures are the most expensive of the pictures we have for the slate. They represent a substantial portion of our investment in the slate for next year. They also represent a collection of pictures that we are as excited about and as confident in as we've been in recent memory. So we feel quite good about it.

Michael Eisner - ***Walt Disney - CEO***

We should mention that *Cars* is a joint venture between us and Pixar. We each put up 50% of the cost and *Narnia* is capped for The Walt Disney Company, so our exposure is protected.

Operator

Our next question is coming from Spencer Wang of J.P. Morgan.

Spencer Wang - ***J.P. Morgan - Analyst***

Good afternoon. First question for Tom, the U.S. theme park capital expenditures through the first six months are actually running a little bit below last year's on an annualized basis. So, is that the right expectation I guess for park capital expenditures in 2005? And then with respect to the Studio, DreamWorks is having some issues with respect to *Shrek 2* returns. Can you just talk a little about how *The Incredibles* is selling through? Thanks.

Tom Staggs - ***Walt Disney - CFO, SEVP***

With regard to capital expenditures, we expect capital expenditures to be up modestly for the domestic parks, but not meaningfully - - not substantially versus last year in part due to the spending we've been doing for the products for the 50th Anniversary. The vast majority of the increase in our capital expenditures is being driven by the building of Hong Kong Disneyland and the consolidation of that business, which really we've consolidated for the last part of last year, but the construction of course really ramped up this year and will continue until the opening - - or until the park is turned over to the operators. And so that's really the biggest driver. We've got a little bit more investment going on in some of our media properties in terms of digital capabilities. Although, those are small capital expenditures in relation to the overall total. And so you should expect us to be comfortably inside that meaningfully under $1 billion guidance that we've given in past years with regard to capital spending at the domestic parks.

Bob Iger *- Walt Disney - President, COO, CEO-Elect*

And on *The Incredibles*, the only thing we've said publicly beyond what opening day sales were is that domestic net sales are just under 18 million units, obviously sales are ongoing. That's consistent with what was said in Pixar's earnings release last week. What we look at is conversion rate of domestic net sales to U.S. box office. And so when you look at how *The Incredibles* has converted based on its U.S. box office, it's substantially higher in terms of number of units for every 10 million U.S. box office than *Shrek 2*. And so we are relatively pleased with the success of *The Incredibles* in the home video market. It's also selling internationally and doing quite well, but I don't believe to date we've been public about those numbers.

Operator

Our next question is coming from Mike Gallant of CIBC World Markets.

Mike Gallant *- CIBC World Markets - Analyst*

Great. On the bookings comment you made about double digits, in the June quarter you talked about, I was wondering if you actually could clarify what the international side is doing? I think you said down at Disney World international was up 20% in the March quarter. So what's the equivalent looking like so far in the June quarter? And then when you look at minority interest year over year, besides ESPN getting backed out is there anything material going on, I guess on some of the international cable networks that would not give us the true look at what ESPN's profitability did this quarter versus last year? Thanks.

Tom Staggs *- Walt Disney - CFO, SEVP*

With regard to the minority interest, the short answer is the biggest driver on the minority interest line if you pick out the change in the balance sheet or the income statement due to the consolidation, it is ESPN. I'm cautious to sort of tell you that it is a direct driver but there aren't a lot of things happening sort of out of the ordinary in that regard. And the first question?

Wendy Webb *SVP IR and Shareholder Services*

Double-digit booking, how much in international?

Tom Staggs *- Walt Disney - CFO, SEVP*

The bookings in terms of international? We're seeing strength in bookings both in international and domestic. And so they both are contributing. I would expect - - again it's early in the quarter and we try to be cautious in reading these trends but, I would expect that we will continue to see strength in both domestic visitation and domestic tourist visitation. We've got new attractions opening. That generally leads to strong resident attendance as well. And generally as we build up to an anniversary celebration or to a new attraction we sometimes see a little bit of pent up demand from the locals who know that the new attractions are coming on. So, we may see some benefit there. But again, I am cautious to make any specific predictions. But there's nothing in the numbers that would suggest that we are going to see much change in terms of the strength in international.

Bob Iger *- Walt Disney - President, COO, CEO-Elect*

But the new pricing strategies clearly are working, and take up rates on those are consistent with what we expected when we launched them earlier in the year. And what is really working is the Magic Express, which is the ability to land in Orlando and not go to baggage claim but have your bags essentially delivered directly to your room. Interestingly enough, about one-third of our guests right now are taking advantage of that and the project has only been underway since early May, a couple of weeks. So that's very, very good news.

Operator

Thank you. Our next question is coming from Douglas Shapiro, Bank of America.

Douglas Shapiro *- Banc of America Securities - Analyst*

Thank you. I guess Tom, as a follow up to the share buy-back question before, I was just wondering if it would ever make sense for you to modestly lower your targeted credit rating to BBB+, or is your use of the CP market, does that make that unlikely?

Tom Staggs *- Walt Disney - CFO, SEVP*

Well, BBB+, A- our access to the CP market wouldn't be terribly different. So that's not really a key driver. And picking the balance sheet credit statistics is more an art than science. We happen to think that ratings that are consistent with about an A- are pretty much a sweet spot for us both in terms of the type of balance sheet that we like to have, the liquidity that we like to have in terms of being able to take advantage of opportunities, to the extent they show themselves. I'm not saying that - - you never say never. And circumstances can change. But we are very comfortable with where we set our targets for the balance sheet. We are also very comfortable with where we are going with cash flow and our ability to deploy significant capital towards share repurchase going forward barring some opportunities that are truly compelling from a shareholder value standpoint that would have us divert the cash in other directions.

Wendy Webb *SVP IR and Shareholder Services*

We have time for just one more question, operator.

Operator

Our final question is coming from Michael Nathanson of Sanford Bernstein.

Michael Nathanson *- Sanford C. Bernstein & Company - Analyst*

I was just hoping to get clarity on home entertainment. Given that international was down and domestic was up, how much was overall growth? If you focus on receivables there was a big jump quarter over quarter? Can you just tie that back for us and how much of that was the driver *The Incredibles*?

Tom Staggs *- Walt Disney - CFO, SEVP*

Well, if you go back and look from the standpoint of the working capital, *The Incredibles* was a big component of our receivables this quarter. And you have to understand the flow of our working capital as we go along. We almost always have a build up in working capital in the first quarter of each year and that's expected. Last year we had quite a lot of that flow back to us because of the tremendous home video sales that we've shown in Q1 of fiscal 2004. This year we maintained a much higher net investment in receivables as a result of the fact that *The Incredibles* was out and selling quite well. And so that really was the biggest single driver of the year over year increase in what we saw from a receivables balance. So that was the biggest component of that.

Wendy Webb ***SVP IR and Shareholder Services***

Okay. Thanks again for joining us today. Note that the reconciliation of nonGAAP measures to equivalent GAAP - -.

Tom Staggs ***- Walt Disney - CFO, SEVP***

Wendy, just one thing, sorry, I didn't answer the first question yet.

Wendy Webb ***SVP IR and Shareholder Services***

Okay.

Tom Staggs ***- Walt Disney - CFO, SEVP***

I think you asked what did our net international and domestic home video do. Unit sales were up about 4% in total between international and domestic for both DVD and VHS when you combine domestic and international.

Wendy Webb ***SVP IR and Shareholder Services***

Great. So I have to say that we have the reconciliation of non-GAAP measures to equivalent GAAP figures that can be found on our Investor Relations Website. Let me also remind you that certain statements in today's press release and on this conference call may constitute forward-looking statements under the securities laws. These statements are made on the basis of management's views and assumptions regarding future events and business performance as of the time the statements are made and management does not undertake any obligation to update these statements.

These statements are subject to a number of risks and uncertainties and actual results may differ materially from those expressed or implied in light of, among other things, future decisions by the Company and by market, economic, political, competitive, regulatory, social, cultural, environmental, technological and other developments beyond the Company's control. Additional information concerning factors that could cause actual results to materially differ from those in the forward-looking statements is contained in our annual report on Form 10(K) and in our other filings with the Securities and Exchange Commission. This concludes Disney's second quarter conference call.

Operator

Thank you. This does conclude today's teleconference. You may disconnect your lines at this time. Have a great day. Thank you.