WALT DISNEY CO/
Form 10-Q
May 08, 2007

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF

THE SECURITIES EXCHANGE ACT OF 1934

For the Quarterly Period Ended

March 31, 2007

Commission File Number 1-11605

Incorporated in Delaware

I.R.S. Employer Identification No. 95-4545390

500 South Buena Vista Street, Burbank, California 91521

(818) 560-1000

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES X NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act (Check one).

Large accelerated filer X Accelerated filer __ Non-accelerated filer __

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

YES NO X

There were 1,981,629,357 shares of common stock outstanding as of May 4, 2007.

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

THE WALT DISNEY COMPANY

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(unaudited; in millions, except per share data)

	Quarter Ended		Six Months Ended	
	March 31, 2007	April 1, 2006	**March 31, 2007**	April 1, 2006
Revenues	**$ 8,073**	$ 8,027	**$ 17,798**	$ 16,881
Costs and expenses	**(6,540)**	(6,841)	**(14,549)**	(14,534)
Gains on sales of equity investments and business			**1,052**	70
Net interest expense	**(130)**	(145)	**(287)**	(308)
Equity in the income of investees	**121**	108	**242**	219
Income before income taxes and minority interests	**1,524**	1,149	**4,256**	2,328
Income taxes	**(590)**	(404)	**(1,616)**	(833)
Minority interests	**(3)**	(12)	**(8)**	(28)
Net income	**$ 931**	$ 733	**$ 2,632**	$ 1,467
Earnings per share:				
Diluted	**$ 0.44**	$ 0.37	**$ 1.24**	$ 0.74
Basic	**$ 0.46**	$ 0.38	**$ 1.28**	$ 0.76
Weighted average number of common and common equivalent shares outstanding:				
Diluted	**2,129**	1,990	**2,138**	1,994
Basic	**2,039**	1,924	**2,049**	1,932

See Notes to Condensed Consolidated Financial Statements

THE WALT DISNEY COMPANY

CONDENSED CONSOLIDATED BALANCE SHEETS

(unaudited; in millions, except per share data)

	March 31, 2007	September 30, 2006
ASSETS		
Current assets		
Cash and cash equivalents	**$ 2,182**	$ 2,411
Receivables	**4,949**	4,707
Inventories	**622**	694
Television costs	**625**	415
Deferred income taxes	**592**	592
Other current assets	**544**	743
Total current assets	**9,514**	9,562
Film and television costs	**5,183**	5,235
Investments	**903**	1,315
Parks, resorts and other property, at cost		
Attractions, buildings and equipment	**29,326**	28,843
Accumulated depreciation	**(14,489)**	(13,781)
	14,837	15,062
Projects in progress	**1,004**	913
Land	**1,193**	1,192
	17,034	17,167
Intangible assets, net	**2,916**	2,907
Goodwill	**22,701**	22,505
Other assets	**1,354**	1,307
	$ 59,605	$ 59,998
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities		
Accounts payable and other accrued liabilities	**$ 5,396**	$ 5,917
Current portion of borrowings	**2,399**	2,682
Unearned royalties and other advances	**2,482**	1,611
Total current liabilities	**10,277**	10,210
Borrowings	**10,290**	10,843
Deferred income taxes	**2,646**	2,651
Other long-term liabilities	**3,521**	3,131
Minority interests	**1,128**	1,343
Commitments and contingencies (Note 11)		
Shareholders equity		
Preferred stock, $.01 par value		
Authorized 100 million shares, Issued none		
Common stock, $.01 par value		
Authorized 3.6 billion shares, Issued 2.5 billion shares at March 31, 2007 and at September 30, 2006	**23,537**	22,377
Retained earnings	**22,625**	20,630

Accumulated other comprehensive income (loss)	**16**	(8)
	46,178	42,999
Treasury stock, at cost, 531.4 million shares at March 31, 2007 and 436.0 million shares at September 30, 2006	**(14,435)**	(11,179)
	31,743	31,820
	$ 59,605	$ 59,998

See Notes to Condensed Consolidated Financial Statements

THE WALT DISNEY COMPANY

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited; in millions)

	Six Months Ended	
	March 31, 2007	April 1, 2006
OPERATING ACTIVITIES		
Net income	**$ 2,632**	$ 1,467
Depreciation and amortization	**732**	726
Gains on sales of equity investments and business	**(1,052)**	(70)
Deferred income taxes	**(125)**	(103)
Equity in the income of investees	**(242)**	(219)
Cash distributions received from equity investees	**203**	226
Minority interests	**8**	28
Net change in film and television costs	**38**	160
Equity-based compensation	**230**	187
Other	**106**	51
Changes in operating assets and liabilities:		
Receivables	**(222)**	(124)
Inventories	**72**	(15)
Other assets	**133**	(17)
Accounts payable and other accrued liabilities	**(35)**	202
Income taxes	**282**	(318)
Cash provided by operations	**2,760**	2,181
INVESTING ACTIVITIES		
Investments in parks, resorts and other property	**(546)**	(462)
Proceeds from sales of equity investments and business	**1,530**	81
Acquisitions	**(167)**	(11)
Proceeds from sales of fixed assets and other	**133**	9
Cash provided (used) by investing activities	**950**	(383)
FINANCING ACTIVITIES		
Commercial paper borrowings, net	**134**	1,600
Borrowings	**186**	415
Reduction of borrowings	**(1,260)**	(1,678)
Dividends	**(637)**	(519)
Repurchases of common stock	**(3,256)**	(1,697)
Equity partner contributions		52
Exercise of stock options and other	**894**	337
Cash used by financing activities	**(3,939)**	(1,490)
Increase (decrease) in cash and cash equivalents	**(229)**	308
Cash and cash equivalents, beginning of period	**2,411**	1,723
Cash and cash equivalents, end of period	**$ 2,182**	$ 2,031

See Notes to Condensed Consolidated Financial Statements

THE WALT DISNEY COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited; tabular dollars in millions, except for per share data)

1. *Principles of Consolidation*

These Condensed Consolidated Financial Statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and the instructions to Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, normal recurring adjustments considered necessary for a fair presentation have been reflected in these Condensed Consolidated Financial Statements. Operating results for the quarter and six months ended March 31, 2007 are not necessarily indicative of the results that may be expected for the year ending September 29, 2007.

These financial statements should be read in conjunction with the Company s Annual Report on Form 10-K for the year ended September 30, 2006.

In December 1999, DVD Financing, Inc. (DFI), a subsidiary of Disney Vacation Development, Inc. and an indirect subsidiary of the Company, completed a receivables sale transaction which established a facility that permits DFI to sell receivables arising from the sale of vacation club memberships on a periodic basis. In connection with this facility, DFI prepares separate financial statements, although its separate assets and liabilities are also consolidated in these financial statements.

The terms Company, we, us, and our are used in this report to refer collectively to the parent company and the subsidiaries through which our various businesses are actually conducted.

2. *Segment Information*

The operating segments reported below are the segments of the Company for which separate financial information is available and for which segment results are evaluated regularly by the Chief Executive Officer in deciding how to allocate resources and in assessing performance. The Company reports the performance of its operating segments including equity in the income of investees, which consists primarily of cable businesses included in the Media Networks segment.

	Quarter Ended		**Six Months Ended**	
	March 31, 2007	April 1, 2006	**March 31, 2007**	April 1, 2006
Revenues* [1] *:				
Media Networks	**$ 3,561**	$ 3,551	**$ 7,472**	$ 7,225
Parks and Resorts	**2,446**	2,251	**4,935**	4,653
Studio Entertainment	**1,550**	1,774	**4,183**	3,819
Consumer Products	**516**	451	**1,208**	1,184
	$ 8,073	$ 8,027	**$ 17,798**	$ 16,881
Segment operating income* [1] *:				
Media Networks	**$ 1,175**	$ 969	**$ 1,925**	$ 1,575
Parks and Resorts	**254**	214	**659**	589
Studio Entertainment	**235**	147	**839**	275
Consumer Products	**125**	104	**360**	374

$ 1,789	$ 1,434	**$ 3,783**	$ 2,813

(1) The Studio Entertainment segment receives royalties on Consumer Products sales of merchandise based on certain Studio film properties. This intersegment revenue and operating income was $51 million and $25 million for the quarters ended March 31, 2007 and April 1, 2006, respectively, and $98 million and $57 million for the six months ended March 31, 2007 and April 1, 2006, respectively.

THE WALT DISNEY COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited; tabular dollars in millions, except for per share data)

A reconciliation of segment operating income to income before income taxes and minority interests is as follows:

	Quarter Ended		Six Months Ended	
	March 31, 2007	April 1, 2006	**March 31, 2007**	April 1, 2006
Segment operating income	**$ 1,789**	$ 1,434	**$ 3,783**	$ 2,813
Corporate and unallocated shared expenses	**(132)**	(138)	**(238)**	(242)
Amortization of intangible assets	**(3)**	(2)	**(6)**	(5)
Equity-based compensation plan modification charge			**(48)**	
Gains on sales of equity investments and business			**1,052**	70
Net interest expense	**(130)**	(145)	**(287)**	(308)
Income before income taxes and minority interests	**$ 1,524**	$ 1,149	**$ 4,256**	$ 2,328

3. *Acquisitions and Dispositions*

Fiscal Year 2007

On February 1, 2007, the Company acquired all the outstanding shares of NASN Limited, an Irish company that operates cable television networks in Europe dedicated to North American sporting events and related programming, for cash consideration and debt assumption totaling $112 million. We are currently in the process of finalizing the valuation of the assets acquired and liabilities assumed.

On November 21, 2006, in connection with the execution of new long-term agreements for the provision of programming to cable service provider Comcast Corporation (Comcast), the Company sold its 39.5% interest in E! Entertainment Television (E!) to Comcast (which owned the remainder of the interest in E!) for $1.23 billion, which resulted in a pre-tax gain of $780 million ($487 million after-tax). On October 2, 2006, the Company sold its 50% stake in Us Weekly for $300 million, which resulted in a pre-tax gain of $272 million ($170 million after-tax). These gains are reported in Gains on sales of equity investments and business in the Condensed Consolidated Statements of Income.

On February 6, 2006, the Company and Citadel Broadcasting Corporation (Citadel) announced an agreement to merge the ABC Radio business, which consists of 22 of the Company s owned radio stations and the ABC Radio Network, with Citadel. The ESPN Radio and Radio Disney networks and station businesses are not included in the transaction. The merger is expected to occur after the ABC Radio business is distributed to Disney shareholders (the Distribution), which is expected to be completed through a spin-off. The agreement was subsequently amended on November 19, 2006. Under the amended terms, (i) Disney s shareholders are expected to collectively receive approximately 57% of Citadel s common stock post-merger, and (ii) the Company expects to retain between $1.10 billion and $1.35 billion in cash, depending upon the market price of Citadel s common stock over a measurement period ending prior to the closing. This cash will be obtained from loan proceeds raised by ABC Radio from third-party lenders prior to the Distribution. If the market price of Citadel s common stock over the measurement period were the same as Citadel s stock price on May 4, 2007, the Company estimates the aggregate value of the retained cash and Citadel common stock to be received by Disney shareholders would be approximately $2.4 billion. The amended agreement provides that the closing will occur no earlier than May 31, 2007, unless Citadel elects to close at an earlier date subject to closing conditions within the merger agreement. The closing is also subject to regulatory approvals, and that either party may terminate the agreement if the closing does not occur by June 15, 2007. Once the Distribution has occurred, the Company will report the results of the ABC Radio business for the current and prior periods separately as discontinued operations. The Company expects that there will be no gain or loss on distribution. As of March 31, 2007, the net assets of the ABC Radio business were approximately $1.4 billion.

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THE WALT DISNEY COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited; tabular dollars in millions, except for per share data)

Fiscal Year 2006

On November 23, 2005, the Company sold a cable television equity investment in Spain, which resulted in a pre-tax gain of $57 million. In addition, on October 7, 2005, the Company sold its Discover Magazine business, which resulted in a pre-tax gain of $13 million. These gains are reported in Gains on sales of equity investments and business in the Condensed Consolidated Statements of Income.

4. *Borrowings*

During the six months ended March 31, 2007, the Company s borrowing activity was as follows:

	September 30, 2006	Additions	Payments	Other Activity	**March 31, 2007**
Commercial paper borrowings	$ 839	$ 134	$	$	**$ 973**
U.S. medium-term notes	6,499		(750)		**5,749**
Convertible senior notes	1,323				**1,323**
Other U.S. dollar denominated debt	305		(305)		
Privately placed debt	54		(54)		
European medium-term notes	191				**191**
Preferred stock	353			(5)	**348**
Capital Cities/ABC debt	183			(1)	**182**
Film financing	276	184	(132)		**328**
Other	260	2	(19)	(21)	**222**
Euro Disney borrowings [1]	2,172			134	**2,306**
Hong Kong Disneyland borrowings	1,070			(3)	**1,067**
Total	$ 13,525	$ 320	$ (1,260)	$ 104	**$ 12,689**

[1] Other activity included a $108 million increase from foreign currency translations as a result of the weakening of the U.S. dollar against the Euro.

5. *Euro Disney and Hong Kong Disneyland*

The Company consolidates Euro Disney and Hong Kong Disneyland and has effective ownership of 51% and 43%, respectively. The following tables set out the impact of consolidating Euro Disney and Hong Kong Disneyland.

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(unaudited; tabular dollars in millions, except for per share data)

The following table presents a condensed consolidating balance sheet for the Company as of March 31, 2007, reflecting the impact of consolidating the balance sheets of Euro Disney and Hong Kong Disneyland.

	Before Euro Disney and Hong Kong Disneyland Consolidation	Euro Disney, Hong Kong Disneyland and Adjustments	Total
Cash and cash equivalents	$ 1,714	$ 468	$ 2,182
Other current assets	7,060	272	7,332
Total current assets	8,774	740	9,514
Investments	1,640	(737)	903
Fixed assets	12,365	4,669	17,034
Other assets	32,130	24	32,154
Total assets	$ 54,909	$ 4,696	$ 59,605
Current portion of borrowings	$ 2,116	$ 283	$ 2,399
Other current liabilities	7,279	599	7,878
Total current liabilities	9,395	882	10,277
Borrowings	7,200	3,090	10,290
Deferred income taxes and other long-term liabilities	6,022	145	6,167
Minority interest	549	579	1,128
Shareholders equity	31,743		31,743
Total liabilities and shareholders equity	$ 54,909	$ 4,696	$ 59,605

The following table presents a condensed consolidating income statement of the Company for the six months ended March 31, 2007, reflecting the impact of consolidating the income statements of Euro Disney and Hong Kong Disneyland.

	Before Euro Disney and Hong Kong Disneyland Consolidation	Euro Disney, Hong Kong Disneyland and Adjustments	Total
Revenues	$ 17,001	$ 797	$ 17,798
Cost and expenses	(13,684)	(865)	(14,549)
Gains on sales of equity investments and business	1,052		1,052
Net interest expense	(213)	(74)	(287)
Equity in the income of investees	178	64	242
Income (loss) before income taxes and minority interests	4,334	(78)	4,256

Income taxes	(1,591)	(25)	(1,616)
Minority interests	(111)	103	(8)
Net income	$ 2,632	$	$ 2,632

THE WALT DISNEY COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited; tabular dollars in millions, except for per share data)

The following table presents a condensed consolidating cash flow statement of the Company for the six months ended March 31, 2007, reflecting the impact of consolidating the cash flow statements of Euro Disney and Hong Kong Disneyland.

	Before Euro Disney and Hong Kong Disneyland Consolidation	Euro Disney, Hong Kong Disneyland and Adjustments	Total
Cash provided (used) by operations	$ 2,764	$ (4)	$ 2,760
Investments in parks, resorts and other property	(419)	(127)	(546)
Other investing activities	1,496		1,496
Cash used by financing activities	(3,939)		(3,939)
Decrease in cash and cash equivalents	(98)	(131)	(229)
Cash and cash equivalents, beginning of period	1,812	599	2,411
Cash and cash equivalents, end of period	$ 1,714	$ 468	$ 2,182

6. *Pension and Other Benefit Programs*

The components of net periodic benefit cost are as follows:

	Pension Plans				**Postretirement Medical Plans**			
	Quarter Ended		**Six Months Ended**		**Quarter Ended**		**Six Months Ended**	
	March 31, 2007	April 1, 2006	**March 31, 2007**	April 1, 2006	**March 31, 2007**	April 1, 2006	**March 31, 2007**	April 1, 2006
Service cost	**$ 42**	$ 46	**$ 84**	$ 92	**$ 6**	$ 8	**$ 12**	$ 16
Interest cost	**74**	56	**148**	112	**15**	15	**30**	30
Expected return on plan assets	**(76)**	(52)	**(152)**	(104)	**(5)**	(4)	**(10)**	(8)
Recognized net actuarial loss	**13**	35	**26**	70		11		22
Net periodic benefit cost	**$ 53**	$ 85	**$ 106**	$ 170	**$ 16**	$ 30	**$ 32**	$ 60

During the six months ended March 31, 2007, the Company made contributions of $51 million into its pension and postretirement medical plans. The Company currently does not anticipate making any material contributions to its pension and postretirement medical plans during the remaining six months of fiscal 2007 but may make additional contributions in fiscal 2007 depending on how the funded status of the plans change and as we gain more clarity with respect to the Pension Protection Act of 2006 (PPA) that was signed into law on August 17, 2006. The United States Treasury Department is in the process of developing implementation guidance for the PPA; however, it is likely the PPA will accelerate minimum funding requirements beginning in fiscal 2009. The Company may choose to pre-fund some of this anticipated funding.

THE WALT DISNEY COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited; tabular dollars in millions, except for per share data)

7. *Earnings Per Share*

Diluted earnings per share amounts are based upon the weighted average number of common and common equivalent shares outstanding during the period and are calculated using the treasury stock method for equity-based compensation awards and assuming conversion of the Company s convertible senior notes. For the quarters ended March 31, 2007 and April 1, 2006, options for 16 million and 93 million shares, respectively, were excluded from the diluted earnings per share calculation as they were anti-dilutive. A reconciliation of net income and weighted average number of common and common equivalent shares outstanding for calculating diluted earnings per share is as follows:

	Quarter Ended		**Six Months Ended**	
	March 31, 2007	April 1, 2006	**March 31, 2007**	April 1, 2006
Net income	**$ 931**	$ 733	**$ 2,632**	$ 1,467
Interest expense on convertible senior notes (net of tax)	**6**	6	**11**	11
	$ 937	$ 739	**$ 2,643**	$ 1,478
Shares (in millions):				
Weighted average number of common shares outstanding (basic)	**2,039**	1,924	**2,049**	1,932
Weighted average dilutive impact of equity-based compensation awards	**45**	21	**44**	17
Assumed conversion of convertible senior notes	**45**	45	**45**	45
Weighted average number of common and common equivalent shares outstanding (diluted)	**2,129**	1,990	**2,138**	1,994

8. *Shareholders Equity*

The Company declared a $637 million dividend ($0.31 per share) on November 28, 2006 related to fiscal 2006, which was paid on January 12, 2007 to shareholders of record on December 15, 2006. The Company paid a $519 million dividend ($0.27 per share) during the second quarter of fiscal 2006 related to fiscal 2005.

During the first six months of fiscal 2007, the Company repurchased 96 million shares for approximately $3.3 billion, of which 67 million shares for $2.3 billion were purchased in the second quarter. On May 1, 2007, the Board of Directors of the Company increased the share repurchase authorization to a total of 400 million shares. The repurchase program does not have an expiration date.

The Company received proceeds of $897 million from the exercise of 39 million stock options during the first six months of fiscal 2007.

The Company also has 1.0 billion shares of Internet Group Stock at $.01 par value authorized. No shares are issued or outstanding.

9. *Comprehensive Income*

Comprehensive income (loss), net of tax, is as follows:

	Quarter Ended		Six Months Ended	
	March 31, 2007	April 1, 2006	**March 31, 2007**	April 1, 2006
Net income	**$ 931**	$ 733	**$ 2,632**	$ 1,467
Market value adjustments for investments and hedges	**(4)**		**(16)**	37
Foreign currency translation and other	**13**	2	**40**	(42)
Comprehensive income	**$ 940**	$ 735	**$ 2,656**	$ 1,462

THE WALT DISNEY COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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Accumulated other comprehensive income (loss), net of tax, is as follows:

	March 31, 2007	Sept. 30, 2006
Market value adjustments for investments and hedges	**$ 13**	$ 29
Foreign currency translation	**127**	87
Additional minimum pension liability adjustment	**(124)**	(124)
Accumulated other comprehensive income (loss)	**$ 16**	$ (8)

10. *Equity-Based Compensation*

The impact of stock options and restricted stock units (RSUs) on pre-tax income is as follows:

	Quarter Ended		**Six Months Ended**	
	March 31, 2007	April 1, 2006	**March 31, 2007**	April 1, 2006
Stock option compensation expense	**$ 57**	$ 63	**$ 111**	$ 121
RSU compensation expense	**37**	33	**71**	66
	94	96	**182**	187
Equity-based compensation plan modification charge			**48**	
Total equity-based compensation expense	**$ 94**	$ 96	**$ 230**	$ 187

Unrecognized compensation cost related to unvested stock options and RSUs totaled approximately $570 million and $438 million, respectively, as of March 31, 2007.

On January 10, 2007, the Company made its regular annual stock compensation grant which consisted of 22 million stock options and 8 million RSUs, of which 1 million RSUs included market-based performance conditions.

The weighted average fair values of options at their grant date during the six months ended March 31, 2007 and April 1, 2006 were $9.24 and $7.12, respectively.

In anticipation of the ABC Radio transaction, the Company needed to determine whether employee equity-based compensation awards would be adjusted for the dilutive impact of the transaction on the employee awards. Certain of the Company s plans required such adjustments to be made on an equitable basis. All other plans permitted such adjustments to be made. In order to treat all employees consistently with respect to the ABC Radio transaction (and other similar future transactions), the Company amended the plans such that all plans require equitable adjustments for such transactions. In connection with these amendments, the Company was required to record a non-cash charge of $48 million in the first quarter of fiscal 2007 representing the estimated fair value of this modification with respect to vested equity-based employee compensation awards. The estimated fair value of the modification with respect to unvested awards remaining at March 31, 2007 is $21 million and will be

expensed over the vesting period of these awards.

11. *Commitments and Contingencies*

The Company has exposure to various legal and other contingencies arising from the conduct of its businesses.

Legal Matters

Milne and Disney Enterprises, Inc. v. Stephen Slesinger, Inc. On November 5, 2002, Clare Milne, the granddaughter of A. A. Milne, author of the Winnie the Pooh books, and the Company s subsidiary Disney Enterprises, Inc. (DEI) filed a complaint against Stephen Slesinger, Inc. (SSI) in the United States District Court for the Central District of

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California. On November 4, 2002, Ms. Milne served notices to SSI and DEI terminating A. A. Milne s prior grant of rights to Winnie the Pooh, effective November 5, 2004, and granted all of those rights to DEI. In their lawsuit, Ms. Milne and DEI sought a declaratory judgment, under United States copyright law, that Ms. Milne s termination notices were valid; that SSI s rights to Winnie the Pooh in the United States terminated effective November 5, 2004; that upon termination of SSI s rights in the United States, the 1983 licensing agreement that is the subject of the *Stephen Slesinger, Inc. v. The Walt Disney Company* lawsuit terminated by operation of law; and that, as of November 5, 2004, SSI was entitled to no further royalties for uses of Winnie the Pooh. SSI filed (a) an answer denying the material allegations of the complaint and (b) counterclaims seeking a declaration that (i) Ms. Milne s grant of rights to DEI is void and unenforceable and (ii) DEI remains obligated to pay SSI royalties under the 1983 licensing agreement. The District Court ruled that Milne s termination notices were invalid. The Court of Appeals for the Ninth Circuit affirmed, and on June 26, 2006, the United States Supreme Court denied Milne s petition for a writ of certiorari. On June 23, 2003, SSI filed an amended answer and counterclaims and a third-party complaint against Harriet Hunt (heir to E. H. Shepard, illustrator of the original Winnie the Pooh stories), who had served a notice of termination and a grant of rights similar to Ms. Milne s, and asserted counterclaims against the Company allegedly arising from the Milne and Hunt terminations and the grant of rights to DEI for (a) unlawful and unfair business practices; and (b) breach of the 1983 licensing agreement.

On October 19, 2006, the parties stipulated to SSI s filing its Fourth Amended Answer and Counterclaims (Fourth Amended Answer) seeking (a) to invalidate the Hunt termination notice, (b) to terminate the Company s rights vis-à-vis SSI, and (c) damages in excess of two billion dollars, among other relief. That stipulation also provided that Hunt and the Company need not respond to the Fourth Amended Answer until the conclusion of two events: the state court appeal in *Stephen Slesinger, Inc. v. The Walt Disney Company*, and the trial in the District Court on the validity of the Hunt termination notice. SSI then sought to withdraw both the Fourth Amended Answer and its stipulation, but on November 3, 2006, the District Court denied that request**.** SSI s motion for summary judgment on the validity of Hunt s 2002 attempt to recapture E. H. Shepard s rights was granted on February 15, 2007, and thereafter, on March 27, 2007, the District Court dismissed as moot all claims against Hunt and three of SSI s counterclaims against the Company related to the Company s agreements with Milne and Hunt concerning the termination and disposition of their rights. In a related development, on January 23, 2007, the Company received notice of a petition by SSI in the United States Patent and Trademark Office seeking, among other things, cancellation of certain Pooh trademark registrations, relief that is effectively duplicative of that sought in the Fourth Amended Answer and, on that ground on February 27, 2007, the Patent and Trademark office granted the Company s request to suspend the proceeding.

Stephen Slesinger, Inc. v. The Walt Disney Company. In this lawsuit, filed on February 27, 1991 in the Los Angeles County Superior Court, the plaintiff claims that a Company subsidiary defrauded it and breached a 1983 licensing agreement with respect to certain Winnie the Pooh properties, by failing to account for and pay royalties on revenues earned from the sale of Winnie the Pooh movies on videocassette and from the exploitation of Winnie the Pooh merchandising rights. The plaintiff seeks damages for the licensee s alleged breaches as well as confirmation of the plaintiff s interpretation of the licensing agreement with respect to future activities. The plaintiff also seeks the right to terminate the agreement on the basis of the alleged breaches. If each of the plaintiff s claims were to be confirmed in a final judgment, damages as argued by the plaintiff could total as much as several hundred million dollars and adversely impact the value to the Company of any future exploitation of the licensed rights. On March 29, 2004, the Court granted the Company s motion for terminating sanctions against the plaintiff for a host of discovery abuses, including the withholding, alteration, and theft of documents and other information, and, on April 5, 2004, dismissed plaintiff s case with prejudice. Plaintiff s subsequent attempts to disqualify the judge who granted the terminating sanctions were denied in 2004, and its motion for a new trial was denied on January 26, 2005, allowing plaintiff to proceed with its noticed appeal from the April 5, 2004, order of dismissal. Argument of the appeal has not been scheduled.

Management believes that it is not currently possible to estimate the impact, if any, that the ultimate resolution of these matters will have on the Company s results of operations, financial position or cash flows.

THE WALT DISNEY COMPANY

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(unaudited; tabular dollars in millions, except for per share data)

The Company, together with, in some instances, certain of its directors and officers, is a defendant or co-defendant in various other legal actions involving copyright, breach of contract and various other claims incident to the conduct of its businesses. Management does not expect the Company to suffer any material liability by reason of such actions.

Contractual Guarantees

The Company has guaranteed certain special assessment and water/sewer revenue bonds issued by the Celebration Community Development District and the Enterprise Community Development District (collectively, the Districts). The bond proceeds were used by the Districts to finance the construction of infrastructure improvements and the water and sewer system in the mixed-use, residential community of Celebration, Florida. As of March 31, 2007, the remaining debt service obligation guaranteed by the Company was $69 million, of which $45 million was principal. The Company is responsible for satisfying any shortfalls in debt service payments, debt service and maintenance reserve funds, and for ensuring compliance with specified rate covenants. To the extent that the Company has to fund payments under its guarantees, the Districts have an obligation to reimburse the Company from future District revenues.

The Company has also guaranteed certain bond issuances by the Anaheim Public Authority that were used by the City of Anaheim to finance construction of infrastructure and a public parking facility adjacent to the Disneyland Resort. Revenues from sales, occupancy and property taxes from the Disneyland Resort and non-Disney hotels are used by the City of Anaheim to repay the bonds. In the event of a debt service shortfall, the Company is responsible for satisfying the shortfall. As of March 31, 2007, the remaining debt service obligation guaranteed by the Company was $389 million, of which $104 million was principal. To the extent that subsequent tax revenues exceed the debt service payments in subsequent periods, the Company would be reimbursed for any shortfalls it funded.

To date, tax revenues have exceeded the debt service payments for both the Celebration and Anaheim bonds.

ESPN STAR Sports, a joint-venture in which ESPN owns a 50% equity interest, has an agreement for global programming rights to International Cricket Council Events from 2007 through 2015. Under the terms of the agreement, ESPN and the other joint-venture partner have jointly guaranteed the programming rights obligation totaling $1.0 billion over the remaining term of the agreement.

12. *Income Taxes*

As a matter of course, the Company is regularly audited by federal, state and foreign tax authorities. From time to time, these audits result in proposed assessments. The Company believes that its tax positions comply with applicable tax law, and it has adequately provided for any probable and estimable exposures. Accordingly, the Company does not anticipate any material earnings impact from any such assessments.

13. *New Accounting Pronouncements*

SFAS 159

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities including an amendment of FASB Statement No. 115* (SFAS 159). SFAS 159 gives the Company the irrevocable option to carry most financial assets and liabilities at fair value, with changes in fair value recognized in earnings. SFAS 159 is effective for the Company s 2009 fiscal year, although early adoption is permitted. The Company is currently assessing the potential effect of SFAS 159 on its financial statements.

SAB 108

In September 2006, the U.S. Securities and Exchange Commission (SEC) staff issued Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* (SAB 108). SAB 108 was issued in order to eliminate the diversity in practice surrounding how public companies quantify financial statement misstatements. SAB 108 requires that registrants quantify errors using both a

THE WALT DISNEY COMPANY

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(unaudited; tabular dollars in millions, except for per share data)

balance sheet and income statement approach and evaluate whether either approach results in a misstated amount that, when all relevant quantitative and qualitative factors are considered, is material. SAB 108 must be implemented by the end of the Company s fiscal 2007. The Company does not currently expect the adoption of SAB 108 to have a material impact on its financial statements.

SFAS 158

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans*, an amendment of FASB Statements No. 87, 88, 106, and 132(R) (SFAS 158). This statement requires recognition of the overfunded or underfunded status of defined benefit pension and other postretirement plans as an asset or liability in the statement of financial position and changes in that funded status to be recognized in comprehensive income in the year in which the changes occur. SFAS 158 also requires measurement of the funded status of a plan as of the date of the statement of financial position. The recognition provisions of SFAS 158 are effective for fiscal 2007, while the measurement date provisions are not effective until fiscal year 2009. If the Company had applied SFAS 158 at the end of fiscal 2006, using the Company s June 30, 2006 actuarial valuation, we would have recorded a pre-tax charge to accumulated other comprehensive income totaling $509 million ($320 million after tax) representing the difference between the funded status of the plans based on the project benefit obligation and the amounts recorded on our balance sheet at September 30, 2006.

SFAS 157

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (SFAS 157). SFAS 157 provides a common definition of fair value and establishes a framework to make the measurement of fair value in generally accepted accounting principles more consistent and comparable. SFAS 157 also requires expanded disclosures to provide information about the extent to which fair value is used to measure assets and liabilities, the methods and assumptions used to measure fair value, and the effect of fair value measures on earnings. SFAS 157 is effective for the Company s 2009 fiscal year, although early adoption is permitted. The Company is currently assessing the potential effect of SFAS 157 on its financial statements.

FIN 48

In July 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48). FIN 48 clarifies the accounting for income taxes by prescribing a minimum probability threshold that a tax position must meet before a financial statement benefit is recognized. The minimum threshold is defined in FIN 48 as a tax position that is more likely than not to be sustained upon examination by the applicable taxing authority, including resolution of any related appeals or litigation processes, based on the technical merits of the position. The tax benefit to be recognized is measured as the largest amount of benefit that is greater than fifty percent likely of being realized upon ultimate settlement. FIN 48 must be applied to all existing tax positions upon initial adoption. The cumulative effect of applying FIN 48 at adoption, if any, is to be reported as an adjustment to opening retained earnings for the year of adoption. FIN 48 is effective for the Company s 2008 fiscal year, although early adoption is permitted. The Company is currently assessing the potential effect of FIN 48 on its financial statements.

EITF 06-3

In June 2006, the FASB issued Emerging Issues Task Force Issue No. 06-3, *How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross versus Net Presentation)* (EITF 06-3). EITF 06-3 indicates that the presentation of taxes within the scope of this issue on either a gross or net basis is an accounting policy decision that should be disclosed. The Company s policy is to present the taxes collected from customers and remitted to governmental authorities on a net basis.

MANAGEMENT S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Item 2: Management s Discussion and Analysis of Financial Condition and Results of Operations

ORGANIZATION OF INFORMATION

Management s Discussion and Analysis provides a narrative of the Company s financial performance and condition that should be read in conjunction with the accompanying financial statements. It includes the following sections:

Overview

Seasonality

Business Segment Results

Quarter Results

Six-Month Results

Other Financial Information

Financial Condition

Commitments and Contingencies

Other Matters

Market Risk

OVERVIEW

Our summary consolidated results are presented below:

	Quarter Ended			**Six Months Ended**		
(in millions, except per share data)	**March 31, 2007**	April 1, 2006	Change	**March 31, 2007**	April 1, 2006	Change
Revenues	**$ 8,073**	$ 8,027	1 %	**$ 17,798**	$ 16,881	5 %
Costs and expenses	**(6,540)**	(6,841)	(4) %	**(14,549)**	(14,534)	
Gains on sales of equity investments and business			nm	**1,052**	70	nm
Net interest expense	**(130)**	(145)	(10) %	**(287)**	(308)	(7) %
Equity in the income of investees	**121**	108	12 %	**242**	219	11 %
Income before income taxes and minority interests	**1,524**	1,149	33 %	**4,256**	2,328	83 %
Income taxes	**(590)**	(404)	46 %	**(1,616)**	(833)	94 %
Minority interests	**(3)**	(12)	(75) %	**(8)**	(28)	(71) %

Net income	**$**	**931**	$	733	27	%	**$**	**2,632**	$	1,467	79	%
Diluted earnings per share	**$**	**0.44**	$	0.37	19	%	**$**	**1.24**	$	0.74	68	%

Quarter Results

Revenues for the quarter increased 1%, or $46 million, to $8.1 billion. The increase was driven by the following:

- increased guest spending and theme park attendance at Walt Disney World and Disneyland Resort Paris,
- higher sales of ABC Studios (formerly Touchstone Television) productions, led by the returning series *Desperate Housewives, Lost* and *Grey s Anatomy* and new series *Ugly Betty*, *Brothers and Sisters* and *What About Brian,*
- higher affiliate and advertising revenues at ESPN,
- higher earned royalties across multiple product categories at Merchandise Licensing, and
- self-published unit volume growth at Disney Interactive Studios (formerly Buena Vista Games) driven by the release of the titles *Meet the Robinsons* and *Spectrobes*.

These increases were offset by the absence of the Super Bowl and three less College Bowl games at the ABC Television Network and lower international theatrical distribution revenues reflecting the strong performance of *The*

MANAGEMENT S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

Chronicles of Narnia: The Lion, The Witch and The Wardrobe and *Chicken Little* in the prior-year quarter, as well as fewer titles in release in the current quarter.

Net income for the quarter increased 27%, or $198 million, to $931 million. The increase was primarily due to higher affiliate and advertising revenues and lower costs at ESPN and improvements in domestic theatrical distribution driven by a better-performing slate of titles in the current quarter and lower distribution expense due to timing of releases.

Six-Month Results

Revenues for the six months increased 5%, or $917 million, to $17.8 billion. The increase was primarily due to the following:

- increased DVD unit sales at home entertainment from the strong performance of *Pirates of the Caribbean: Dead Man s Chest* and Disney/Pixar s *Cars*,
- increased guest spending and theme park attendance at Walt Disney World and Disneyland Resort Paris,
- strong international and DVD sales of ABC Studios productions, and
- higher affiliate and advertising revenues at ESPN.

These increases were partially offset by the absence of Monday Night Football and the Super Bowl and three fewer College Bowl games at the ABC Television Network and lower worldwide theatrical distribution revenues reflecting the strong performance of *The Chronicles of Narnia: The Lion, The Witch and The Wardrobe* and *Chicken Little* in the prior six-month period.

Net income for the six months increased by $1.2 billion to $2.6 billion due to gains on sales of equity investments, growth in worldwide home entertainment and growth at ESPN and the international Disney Channels.

Diluted earnings per share increased to $1.24 from $0.74 in the six-month period. Results for the current and prior-year six months included the net favorable impact of the items summarized in the following tables (amounts in millions, except for per share data):

Favorable/(unfavorable) impact	**Six Months Ended March 31, 2007**		
	Pre-Tax	Net Income	Diluted EPS
Gain on sale of equity investment in E! Entertainment Television	$ 780	$ 487	$ 0.23
Gain on sale of equity investment in Us Weekly	272	170	0.08
Equity-based compensation plan modification charge	(48)	(30)	(0.01)
Total	$ 1,004	$ 627	$ 0.30

	Six Months Ended April 1, 2006		
	Pre-Tax	Net Income	Diluted EPS
Gains on sales of a cable television equity investment in Spain and the Discover Magazine business	$ 70	$ 44	$ 0.02

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MANAGEMENT S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

SEASONALITY

The Company s businesses are subject to the effects of seasonality. Consequently, the operating results for the quarter and six months ended March 31, 2007 for each business segment, and for the Company as a whole, are not necessarily indicative of results to be expected for the full year.

Media Networks advertising revenues are typically somewhat higher during the fall and somewhat lower during the summer months. Affiliate revenues are typically collected ratably throughout the year. Recognition of certain affiliate revenues at ESPN is deferred until annual programming commitments are met. These commitments are typically satisfied during the second half of the Company s fiscal year which generally results in higher revenue recognition during that period.

Parks and Resorts revenues fluctuate with changes in theme park attendance and resort occupancy resulting from the seasonal nature of vacation travel and leisure activities. Peak attendance and resort occupancy generally occur during the summer months when school vacations occur and during early-winter and spring-holiday periods.

Studio Entertainment revenues fluctuate due to the timing and performance of releases in the theatrical, home entertainment, and television markets. Release dates are determined by several factors, including competition and the timing of vacation and holiday periods.

Consumer Products revenues are influenced by seasonal consumer purchasing behavior and by the timing and performance of animated theatrical releases.

BUSINESS SEGMENT RESULTS

The Company evaluates the performance of its operating segments based on segment operating income, which is shown below along with segment revenues:

	Quarter Ended			Six Months Ended		
(in millions)	**March 31, 2007**	April 1, 2006	Change	**March 31, 2007**	April 1, 2006	Change
Revenues:						
Media Networks	**$ 3,561**	$ 3,551		**$ 7,472**	$ 7,225	3 %
Parks and Resorts	**2,446**	2,251	9 %	**4,935**	4,653	6 %
Studio Entertainment	**1,550**	1,774	(13) %	**4,183**	3,819	10 %
Consumer Products	**516**	451	14 %	**1,208**	1,184	2 %
	$ 8,073	$ 8,027	1 %	**$ 17,798**	$ 16,881	5 %
Segment operating income:						
Media Networks	**$ 1,175**	$ 969	21 %	**$ 1,925**	$ 1,575	22 %
Parks and Resorts	**254**	214	19 %	**659**	589	12 %
Studio Entertainment	**235**	147	60 %	**839**	275	>100 %
Consumer Products	**125**	104	20 %	**360**	374	(4) %
	$ 1,789	$ 1,434	25 %	**$ 3,783**	$ 2,813	34 %

MANAGEMENT S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

The following table reconciles segment operating income to income before income taxes and minority interests:

(in millions)	Quarter Ended March 31, 2007	Quarter Ended April 1, 2006	Change	Six Months Ended March 31, 2007	Six Months Ended April 1, 2006	Change
Segment operating income	**$ 1,789**	$ 1,434	25 %	**$ 3,783**	$ 2,813	34 %
Corporate and unallocated shared expenses	**(132)**	(138)	(4) %	**(238)**	(242)	(2) %
Amortization of intangible assets	**(3)**	(2)	50 %	**(6)**	(5)	20 %
Equity-based compensation plan modification charge				**(48)**		nm
Gains on sales of equity investments and business				**1,052**	70	nm
Net interest expense	**(130)**	(145)	(10) %	**(287)**	(308)	(7) %
Income before income taxes and minority interests	**$ 1,524**	$ 1,149	33 %	**$ 4,256**	$ 2,328	83 %

Depreciation expense is as follows:

(in millions)	Quarter Ended March 31, 2007	Quarter Ended April 1, 2006	Change	Six Months Ended March 31, 2007	Six Months Ended April 1, 2006	Change
Media Networks						
Cable Networks	$ 22	$ 19	16 %	$ 42	$ 39	8 %
Broadcasting	25	26	(4) %	50	51	(2) %
Total Media Networks	47	45	4 %	92	90	2 %
Parks and Resorts						
Domestic	197	200	(2) %	396	409	(3) %
International	73	68	7 %	147	136	8 %
Total Parks and Resorts	270	268	1 %	543	545	
Studio Entertainment	**5**	6	(17) %	**16**	11	45 %
Consumer Products	**4**	5	(20) %	**9**	10	(10) %
Corporate	**33**	31	6 %	**66**	65	2 %
Total depreciation expense	**$ 359**	$ 355	1 %	**$ 726**	$ 721	1 %

Business Segment Results Quarter Results

Media Networks

The following table provides supplemental revenue and segment operating income detail for the Media Networks segment:

(in millions)	Quarter Ended **March 31, 2007**	April 1, 2006	Change	Six Months Ended **March 31, 2007**	April 1, 2006	Change
Revenues:						
Cable Networks	**$ 1,899**	$ 1,772	7 %	**$ 3,991**	$ 3,637	10 %
Broadcasting	**1,662**	1,779	(7) %	**3,481**	3,588	(3) %
	$ 3,561	$ 3,551		**$ 7,472**	$ 7,225	3 %
Segment operating income:						
Cable Networks	**$ 963**	$ 809	19 %	**$ 1,416**	$ 1,181	20 %
Broadcasting	**212**	160	33 %	**509**	394	29 %
	$ 1,175	$ 969	21 %	**$ 1,925**	$ 1,575	22 %

MANAGEMENT S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

Revenues

Media Networks revenues were flat at $3.6 billion, consisting of a 7% increase, or $127 million, at the Cable Networks offset by a 7% decrease, or $117 million, at Broadcasting.

Increased Cable Networks revenues were primarily due to growth of $45 million from cable and satellite operators, $30 million from advertising revenues and $52 million in other revenues. Revenues from cable and satellite operators are generally derived from fees charged on a per subscriber basis, and the increase in the current quarter was due to contractual rate increases primarily at ESPN and subscriber growth at ESPN and at the international Disney Channels. These increases were partially offset by higher revenue deferrals at ESPN due to annual programming commitments in new affiliate contract provisions. The deferred revenues are expected to be recognized in the second half of the year. Increased advertising revenue was driven by higher advertising rates at ESPN. The increase in other revenues reflected a settlement of a claim in the bankruptcy of a distributor and higher DVD sales.

Certain of the Company s existing contracts with cable and satellite operators include annual programming commitments. In these cases, revenue subject to the commitment is deferred until the annual commitments are satisfied which generally results in revenue shifting from the first half of the year to the second half. During the quarter, the Company deferred revenues of $227 million related to these commitments compared to $142 million in the prior-year quarter. The increase in deferred revenue was primarily due to annual programming commitments in new affiliate contract provisions.

Decreased Broadcasting revenues were primarily due to a decline at the ABC Television Network, partially offset by strong international and domestic syndication sales of ABC Studios productions, led by the returning series *Desperate Housewives, Lost,* and *Grey s Anatomy,* and new series *Ugly Betty, Brothers and Sisters* and *What About Brian*. The decline at the ABC Television Network reflected the absence of the Super Bowl, three less College Bowl games and fewer hours of other sports programming. In primetime, lower ratings were essentially offset by higher sold inventory and higher advertising rates.

Costs and Expenses

Costs and expenses, which consist primarily of programming rights costs, production cost amortization, distribution and marketing expenses, labor costs and general and administrative costs, decreased 7%, or $178 million, to $2.5 billion consisting of a 10% decrease, or $166 million, at Broadcasting and a 1% decrease, or $12 million, at the Cable Networks. The decrease at Broadcasting was due to lower sports programming costs, partially offset by higher production cost amortization related to the sales of ABC Studios productions and higher costs for the Disney mobile phone service. The decrease at Cable Networks reflected a decrease at ESPN due to the airing of one fewer regular season National Football League (NFL) game and the benefit of the transition of ESPN s mobile phone operations to a licensing model, partially offset by higher programming and other costs at the international Disney Channels.

Sports Programming Costs

The Company has various contractual commitments for the purchase of television rights for sports and other programming, including the NFL, NASCAR, Major League Baseball, various college football and basketball conferences and football bowl games and the National Basketball Association. The costs of these contracts have increased significantly in recent years. We enter into these contractual commitments with the expectation that, over the life of the contracts, revenue from advertising during the programming and affiliate fees will exceed the costs of the programming. While contract costs may initially exceed incremental revenues and negatively impact operating income, it is our expectation that the combined value to our networks from all of these contracts will result in long-term benefits. The actual impact of these contracts on the Company s results over the term of the contracts is dependent upon a number of factors, including the strength of advertising markets, effectiveness of marketing efforts and the size of viewer audiences.

Segment Operating Income

Segment operating income increased 21%, or $206 million, to $1.2 billion for the quarter due to an increase of $154 million at the Cable Networks and $52 million at Broadcasting. The increase at Cable Networks was primarily due

MANAGEMENT S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

to increases at ESPN and the international Disney Channels. The increase at Broadcasting was due to fewer hours of sports programming and strong international and domestic syndication sales of ABC Studios productions. Also included in segment operating income is income from equity investees of $120 million for the quarter compared to $101 million in the prior-year quarter.

ABC Radio Disposition

On February 6, 2006, the Company and Citadel Broadcasting Corporation (Citadel) announced an agreement to merge the ABC Radio business, which consists of 22 of the Company s owned radio stations and the ABC Radio Network, with Citadel. The ESPN Radio and Radio Disney networks and station businesses are not included in the transaction. The merger is expected to occur after the ABC Radio business is distributed to Disney shareholders (the Distribution), which is expected to be completed through a spin-off. The agreement was subsequently amended on November 19, 2006. Under the amended terms, (i) Disney s shareholders are expected to collectively receive approximately 57% of Citadel s common stock post-merger, and (ii) the Company expects to retain between $1.10 billion and $1.35 billion in cash, depending upon the market price of Citadel s common stock over a measurement period ending prior to the closing. This cash will be obtained from loan proceeds raised by ABC Radio from third-party lenders prior to the Distribution. If the market price of Citadel s common stock over the measurement period were the same as Citadel s stock price on May 4, 2007, the Company estimates the aggregate value of the retained cash and Citadel common stock to be received by Disney shareholders would be approximately $2.4 billion. The amended agreement provides that the closing will occur no earlier than May 31, 2007, unless Citadel elects to close at an earlier date subject to closing conditions within the merger agreement. The closing is also subject to regulatory approvals, and that either party may terminate the agreement if the closing does not occur by June 15, 2007. Once the Distribution has occurred, the Company will report the results of the ABC Radio business for the current and prior periods separately as discontinued operations. The Company expects that there will be no gain or loss on distribution. As of March 31, 2007, the net assets of the ABC Radio business were approximately $1.4 billion.

Parks and Resorts

Revenues

Revenues at Parks and Resorts increased 9%, or $195 million, to $2.4 billion due to increases of $135 million at our domestic resorts and $60 million at our international resorts.

Domestic Parks and Resorts

At our domestic parks and resorts, revenue growth was primarily due to increased guest spending and theme park attendance at Walt Disney World and, to a lesser extent, Disneyland Resort. Increased guest spending reflected higher average ticket prices and higher average daily room rates. Additionally, higher vacation ownership sales at Walt Disney World contributed to revenue growth.

The following table presents attendance, per capita theme park guest spending and hotel statistics for our domestic properties:

	East Coast Quarter Ended		West Coast Quarter Ended		Total Domestic Quarter Ended	
	March 31, 2007	April 1, 2006	**March 31, 2007**	April 1, 2006	**March 31, 2007**	April 1, 2006
Parks (Increase/decrease)						
Attendance	**7 %**	3 %	**1 %**	15 %	**6 %**	6 %
Per Capita Guest Spending	**3 %**	(4) %	**3 %**	8 %	**3 %**	(1) %
Hotels						
Occupancy	**88 %**	85 %	**87 %**	89 %	**88 %**	85 %
Available Room Nights (in thousands)	**2,157**	2,217	**202**	202	**2,359**	2,419

Per Room Guest Spending	**$ 224**	$ 216	**$ 294**	$ 262	**$ 230**	$ 220

MANAGEMENT S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

Per room guest spending consists of the average daily hotel room rate as well as guest spending on food, beverages and merchandise at the hotels.

International Parks and Resorts

At our international parks and resorts, revenue growth was due to the favorable impact of foreign currency translation as a result of the weakening of the U.S. dollar against the Euro and higher theme park attendance, guest spending, and hotel occupancy at Disneyland Resort Paris. These revenue increases were partially offset by lower guest spending and theme park attendance at Hong Kong Disneyland Resort.

Costs and Expenses

Costs and expenses, which consist principally of labor, costs of merchandise, food and beverages sold, depreciation, repairs and maintenance, entertainment, and marketing and sales expense, increased 8%, or $155 million. The increase in costs and expenses primarily reflected increases at Walt Disney World and at Disneyland Resort Paris. The increase at Walt Disney World was primarily due to labor cost inflation, new guest offerings, increased marketing, and volume-related costs, partially offset by lower pension and postretirement medical costs. The increase at Disneyland Resort Paris was driven by the unfavorable impact of foreign currency translation as a result of the weakening of the U.S. dollar against the Euro, volume-related costs, marketing, and labor cost inflation.

Segment Operating Income

Segment operating income increased 19%, or $40 million, to $254 million, reflecting increases at Disneyland Resort Paris, Disneyland Resort and Walt Disney World, partially offset by a decline at Hong Kong Disneyland Resort.

Studio Entertainment

Revenues

Revenues decreased 13%, or $224 million, to $1.6 billion primarily due to a decrease of $155 million in international theatrical distribution reflecting the strong performance of *The Chronicles of Narnia: The Lion, The Witch and The Wardrobe* and *Chicken Little* in the prior-year quarter and fewer titles in release in the current quarter.

Cost and Expenses

Costs and expenses, which consist primarily of production cost amortization, distribution and marketing expenses, product costs, and participation costs, decreased 19%, or $312 million, primarily due to decreases in both international and domestic theatrical distribution.

Lower costs and expenses in international theatrical distribution were primarily due to lower distribution and participation expense and decreased production cost amortization resulting from fewer titles in the current quarter. The decrease in domestic theatrical distribution was driven by lower production cost amortization and the timing of distribution expenses.

Segment Operating Income

Segment operating income increased 60% to $235 million primarily due to an improvement at domestic theatrical distribution.

Consumer Products

Revenues

Revenues for the quarter increased 14%, or $65 million, to $516 million, primarily due to increases of $31 million at Merchandise Licensing and $31 million at Disney Interactive Studios. Growth at Merchandise Licensing was due to higher earned royalties across multiple product

categories, which included the strong performance of *Cars* merchandise. Growth at Disney Interactive Studios was due to the release of the self-published titles *Meet the Robinsons* and *Spectrobes*.

MANAGEMENT S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

Costs and Expenses

Costs and expenses increased 11%, or $38 million, primarily due to higher cost of goods sold, product development spending and marketing costs at Disney Interactive Studios.

Operating Income

Segment operating income increased 20%, or $21 million, to $125 million, primarily due to higher earned royalties at Merchandise Licensing.

Business Segment Results Six Month Results

Media Networks

Revenues

Media Networks revenues increased 3%, or $247 million, to $7.5 billion, consisting of a 10% increase, or $354 million, at the Cable Networks partially offset by a 3% decrease, or $107 million, at Broadcasting.

Increased Cable Networks revenues were primarily due to growth of $137 million from cable and satellite operators, $84 million from advertising revenues and $133 million from other revenues. The increase in cable and satellite operator revenues was driven by contractual rate increases, primarily at ESPN, and subscriber growth at the international Disney Channels and ESPN. These increases were partially offset by higher revenue deferrals at ESPN driven by annual programming commitments in new affiliate contract provisions. For the six months ended March 31, 2007, the Company deferred revenues of $408 million related to these commitments compared to $263 million in the prior-year period. Increased advertising revenue was driven by an increase at ESPN primarily due to higher sales of Monday Night Football (which moved to ESPN from the ABC Television Network) compared to Sunday Night Football in the prior year and at the domestic Disney/ABC Cable Networks. Higher other revenues were driven by DVD sales, primarily *High School Musical,* and the settlement of a claim in the bankruptcy of a distributor.

The decrease in Broadcasting revenues was primarily due to a decrease in advertising revenue at the ABC Television Network due to the absence of Monday Night Football and the Super Bowl, three fewer College Bowl games and fewer hours of other sports programming. This decrease was partially offset by increased sales of ABC Studios productions and higher political advertising revenue at the owned television stations. Increased sales of ABC Studios productions reflected higher international and DVD sales of the hit dramas *Desperate Housewives, Lost* and *Grey s Anatomy*.

Costs and Expenses

Costs and expenses decreased 1%, or $70 million, to $5.8 billion consisting of a 7% decrease, or $218 million, at Broadcasting partially offset by a 6% increase, or $148 million, at the Cable Networks. The decrease at Broadcasting was due to lower sports programming costs, partially offset by increases in other programming and production cost amortization (including the cost to replace sports programming) and higher costs for the Disney mobile phone service. The increase at Cable Networks was primarily due to increased costs at ESPN driven by higher programming costs for Monday Night Football compared to Sunday Night Football in the prior year, partially offset by the benefit from the transition of ESPN s mobile phone operations to a licensing model.

Segment Operating Income

Segment operating income increased 22%, or $350 million, to $1.9 billion for the six months due to increases of $235 million at the Cable Networks and $115 million at Broadcasting. The increase at the Cable Networks was due primarily to growth at ESPN, the international Disney Channels and the domestic Disney/ABC Cable Networks. The increase at Broadcasting was due to fewer hours of sports programming at the ABC Television Network, higher sales of ABC Studios productions, and higher revenues at the owned television stations, partially offset by higher costs associated with the Disney mobile phone service. Also included in segment operating income is income from equity investees of $241 million for the six months compared to $208 million in the prior-year.

Parks and Resorts

Revenues

Revenues at Parks and Resorts increased 6%, or $282 million, to $4.9 billion due to increases of $200 million at our domestic resorts and $82 million at our international resorts.

MANAGEMENT S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

Domestic Parks and Resorts

At our domestic parks and resorts, revenue growth was primarily due to increased guest spending, theme park attendance, and vacation club ownership sales at Walt Disney World. Increased guest spending was due to higher ticket prices, increased food, beverage and merchandise spending, and higher average room rates.

The following table presents attendance, per capita theme park guest spending and hotel statistics for our domestic properties:

	East Coast Six Months Ended		West Coast Six Months Ended		Total Domestic Six Months Ended	
	March 31, 2007	April 1, 2006	**March 31, 2007**	April 1, 2006	**March 31, 2007**	April 1, 2006
Parks						
(Increase/decrease)						
Attendance	**5 %**	4 %	**(2) %**	17 %	**3 %**	8 %
Per Capita Guest Spending	**5 %**	(1) %	**1 %**	13 %	**4 %**	3 %
Hotels						
Occupancy	**86 %**	84 %	**90 %**	92 %	**87 %**	85 %
Available Room Nights (in thousands)	**4,300**	4,415	**405**	404	**4,705**	4,819
Per Room Guest Spending	**$ 220**	$ 214	**$ 290**	$ 272	**$ 226**	$ 219

Per room guest spending consists of the average daily hotel room rate as well as guest spending on food, beverages and merchandise at the hotels.

International Parks and Resorts

At our international parks and resorts, revenue growth was primarily due to the favorable impact of foreign currency translation as a result of the weakening of the U.S. dollar against the Euro, and higher theme park attendance, guest spending, and hotel occupancy at Disneyland Resort Paris. These revenue increases were partially offset by lower theme park attendance and guest spending at Hong Kong Disneyland Resort.

Costs and Expenses

Costs and expenses increased 5%, or $212 million. The increase in costs and expenses primarily reflected increases at Walt Disney World and at Disneyland Resort Paris. The increase at Walt Disney World was primarily due to labor cost inflation, new guest offerings, increased marketing, and volume-related costs, partially offset by lower pension and postretirement medical costs. The increase at Disneyland Resort Paris was driven by the unfavorable impact of foreign currency translation as a result of the weakening of the U.S. dollar against the Euro, labor cost inflation, marketing, and volume-related costs.

Segment Operating Income

Segment operating income increased 12%, or $70 million, to $659 million, primarily due to increases at Walt Disney World and Disneyland Resort Paris, partially offset by a decline at Hong Kong Disneyland Resort.

Studio Entertainment

Revenues

Revenues increased 10%, or $364 million, to $4.2 billion primarily due to an increase of $664 million in worldwide home entertainment partially offset by a decrease of $366 million in worldwide theatrical distribution.

The increase in worldwide home entertainment revenues was primarily due to increased DVD unit sales resulting from the strong performance of current-period titles including *Pirates of the Caribbean: Dead Man s Chest*, Disney/Pixar s *Cars* and *Little Mermaid* Platinum release. Lower worldwide theatrical distribution revenues were

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MANAGEMENT S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

primarily due to the strong performance of *The Chronicles of Narnia: The Lion, The Witch and The Wardrobe* and *Chicken Little* in the prior-year six months compared to the current period titles, which included *Déjà vu* and *Wild Hogs.*

Costs and Expenses

Costs and expenses decreased 6%, or $200 million primarily due to a decrease in worldwide theatrical distribution partially offset by an increase in worldwide home entertainment.

Lower costs and expenses in worldwide theatrical distribution were driven by lower distribution costs, participation costs, production cost amortization and film cost write-downs. Distribution costs were lower as the prior-year period included higher profile films that had extensive marketing campaigns. The decrease in participation costs and production cost amortization was driven by the strong prior-year performance including The Chronicles of Narnia: The Lion, The Witch and The Wardrobe. The increase at worldwide home entertainment was driven by higher participation costs and production cost amortization due to increased unit sales in the current-period.

Segment Operating Income

Segment operating income increased $564 million, to $839 million, due to an improvement at worldwide home entertainment.

Consumer Products

Revenues

Revenues increased 2%, or $24 million, to $1.2 billion, primarily due to higher earned royalties across multiple product categories at Merchandise Licensing, which included the strong performance of *Cars* merchandise. Higher revenues were partially offset by lower contractual minimum guarantee revenues.

Costs and Expenses

Costs and expenses increased 3%, or $28 million, driven by an increase at Disney Interactive Studios due to increased product development spending.

Operating Income

Segment operating income decreased 4%, or $14 million, to $360 million, as higher earned royalties at Merchandise Licensing were more than offset by lower contractual minimum guarantee revenues and increased product development spending at Disney Interactive Studios.

OTHER FINANCIAL INFORMATION

Net Interest Expense

Net interest expense is as follows:

	Quarter Ended			Six Months Ended		
(in millions)	**March 31, 2007**	April 1, 2006	Change	**March 31, 2007**	April 1, 2006	Change
Interest expense	**$ (167)**	$ (187)	(11) %	**$ (355)**	$ (368)	(4) %
Interest and investment income	**37**	42	(12) %	**68**	60	13 %

Net interest expense	**$ (130)**	$	(145)	(10)	%	**$ (287)**	$	(308)	(7)	%

Interest expense decreased 11% for the quarter and 4% for the six months driven by lower average debt balances. For the six months, lower interest expense was partially offset by the write-off of remaining debt issuance costs for quarterly interest bonds, which were redeemed during the first quarter of fiscal 2007.

MANAGEMENT S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

Interest and investment income increased for the six months primarily due to increased interest income from higher cash balances, partially offset by a $12 million recovery in the second quarter of fiscal 2006 in connection with the Company s leveraged lease investment with United Airlines which had been written off previously.

Income Taxes

The effective income tax rate is as follows:

	Quarter Ended			Six Months Ended		
	March 31, 2007	April 1, 2006	Change	**March 31, 2007**	April 1, 2006	Change
Effective Income Tax Rate	**38.7 %**	35.2 %	3.5 ppt	**38.0 %**	35.8 %	2.2 ppt

The effective income tax rate increased for the quarter and six months due to an adjustment to previously recognized tax benefits with respect to Hong Kong Disneyland and a reduction in the benefit from the exclusion of certain foreign source income.

The exclusion of certain foreign source income was repealed on a phase-out basis as part of the *American Jobs Creation Act of 2004.* No exclusion is available for transactions originating after the first quarter of fiscal 2007.

Minority Interests

Minority interest expense is as follows:

	Quarter Ended	Change	**Six Months Ended**	Change
(in millions)				