

WALT DISNEY CO/
Form 10-Q
August 09, 2016

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 Commission File Number 1-11605
July 2, 2016

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 ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

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

Large accelerated filer ☐ Accelerated filer ☒ Non-accelerated filer ☐ Smaller reporting company ☐

Non-accelerated filer (do not check if smaller reporting company) ☐ Smaller reporting company ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ☐ No ☒

There were 1,607,101,183 shares of common stock outstanding as of August 3, 2016.

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		Nine Months Ended	
	July 2, 2016	June 27, 2015	July 2, 2016	June 27, 2015
Revenues:				
Services	\$ 12,113	\$ 11,308	\$ 35,906	\$ 32,587
Products	2,164	1,793	6,584	6,366
Total revenues	14,277	13,101	42,490	38,953
Costs and expenses:				
Cost of services (exclusive of depreciation and amortization)	(5,946)	(5,547)	(18,568)	(17,224)
Cost of products (exclusive of depreciation and amortization)	(1,255)	(1,116)	(4,120)	(3,785)
Selling, general, administrative and other	(2,305)	(2,101)	(6,467)	(6,117)
Depreciation and amortization	(626)	(575)	(1,838)	(1,751)
Total costs and expenses	(10,132)	(9,339)	(30,993)	(28,877)
Restructuring and impairment charges	(44)	—	(125)	—
Interest expense, net	(70)	(12)	(161)	(62)
Equity in the income of investees	152	212	776	630
Income before income taxes	4,183	3,962	11,987	10,644
Income taxes	(1,471)	(1,323)	(4,089)	(3,533)
Net income	2,712	2,639	7,898	7,111
Less: Net income attributable to noncontrolling interests	(115)	(156)	(278)	(338)
Net income attributable to The Walt Disney Company (Disney)	\$ 2,597	\$ 2,483	\$ 7,620	\$ 6,773
Earnings per share attributable to Disney:				
Diluted	\$ 1.59	\$ 1.45	\$ 4.63	\$ 3.95
Basic	\$ 1.60	\$ 1.46	\$ 4.66	\$ 3.99
Weighted average number of common and common equivalent shares outstanding:				
Diluted	1,631	1,711	1,647	1,714
Basic	1,621	1,696	1,636	1,699
Dividends declared per share	\$ 0.71	\$ 0.66	\$ 1.42	\$ 1.81
See Notes to Condensed Consolidated Financial Statements				

THE WALT DISNEY COMPANY
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
 (unaudited; in millions)

	Quarter Ended		Nine Months Ended	
	July 2, 2016	June 27, 2015	July 2, 2016	June 27, 2015
Net income	\$2,712	\$2,639	\$7,898	\$7,111
Other comprehensive income/(loss), net of tax:				
Market value adjustments for investments	(7)	(11)	(11)	(81)
Market value adjustments for hedges	(84)	(109)	(313)	155
Pension and postretirement medical plan adjustments	28	43	110	121
Foreign currency translation and other	(84)	20	(143)	(159)
Other comprehensive income/(loss)	(147)	(57)	(357)	36
Comprehensive income	2,565	2,582	7,541	7,147
Less: Net income attributable to noncontrolling interests	(115)	(156)	(278)	(338)
Less: Other comprehensive (income)/loss attributable to noncontrolling interests	47	(4)	79	28
Comprehensive income attributable to Disney	\$2,497	\$2,422	\$7,342	\$6,837
See Notes to Condensed Consolidated Financial Statements				

THE WALT DISNEY COMPANY
CONDENSED CONSOLIDATED BALANCE SHEETS

(unaudited; in millions, except per share data)

	July 2, 2016	October 3, 2015
ASSETS		
Current assets		
Cash and cash equivalents	\$5,227	\$4,269
Receivables	8,958	8,019
Inventories	1,354	1,571
Television costs and advances	1,231	1,170
Deferred income taxes	—	767
Other current assets	847	962
Total current assets	17,617	16,758
Film and television costs	6,091	6,183
Investments	3,228	2,643
Parks, resorts and other property		
Attractions, buildings and equipment	49,526	42,745
Accumulated depreciation	(26,275)	(24,844)
	23,251	17,901
Projects in progress	2,371	6,028
Land	1,243	1,250
	26,865	25,179
Intangible assets, net	6,995	7,172
Goodwill	27,802	27,826
Other assets	2,316	2,421
Total assets	\$90,914	\$88,182
LIABILITIES AND EQUITY		
Current liabilities		
Accounts payable and other accrued liabilities	\$8,719	\$7,844
Current portion of borrowings	5,312	4,563
Unearned royalties and other advances	4,041	3,927
Total current liabilities	18,072	16,334
Borrowings	15,129	12,773
Deferred income taxes	4,076	4,051
Other long-term liabilities	5,491	6,369
Commitments and contingencies (Note 10)		
Equity		
Preferred stock, \$.01 par value, Authorized – 100 million shares, Issued – none	—	—
Common stock, \$.01 par value, Authorized – 4.6 billion shares, Issued – 2.9 billion shares at July 2, 2016 and 2.8 billion shares at October 3, 2015	35,683	35,122
Retained earnings	64,321	59,028
Accumulated other comprehensive loss	(2,699)	(2,421)
	97,305	91,729
Treasury stock, at cost, 1.2 billion shares	(53,112)	(47,204)
Total Disney Shareholders' equity	44,193	44,525
Noncontrolling interests	3,953	4,130
Total equity	48,146	48,655
Total liabilities and equity	\$90,914	\$88,182

See Notes to Condensed Consolidated Financial Statements

4

THE WALT DISNEY COMPANY
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
 (unaudited; in millions)

	Nine Months Ended	
	July 2, 2016	June 27, 2015
OPERATING ACTIVITIES		
Net income	\$7,898	\$7,111
Depreciation and amortization	1,838	1,751
Gains on sales of investments	(27)	(89)
Deferred income taxes	885	(167)
Equity in the income of investees	(776)	(630)
Cash distributions received from equity investees	594	553
Net change in film and television costs and advances	(224)	(623)
Equity-based compensation	305	309
Other	403	214
Changes in operating assets and liabilities:		
Receivables	(821)	(229)
Inventories	214	48
Other assets	(87)	(274)
Accounts payable and other accrued liabilities	(628)	(507)
Income taxes	(188)	114
Cash provided by operations	9,386	7,581
INVESTING ACTIVITIES		
Investments in parks, resorts and other property	(3,691)	(3,061)
Sales of investments	44	143
Acquisitions	(400)	—
Other	(179)	(137)
Cash used in investing activities	(4,226)	(3,055)
FINANCING ACTIVITIES		
Commercial paper borrowings, net	(216)	2,352
Borrowings	4,046	181
Reduction of borrowings	(672)	(2,006)
Dividends	(1,168)	(1,948)
Repurchases of common stock	(5,908)	(2,823)
Proceeds from exercise of stock options	216	292
Contributions from noncontrolling interest holders	—	1,012
Other	(389)	(301)
Cash used in financing activities	(4,091)	(3,241)
Impact of exchange rates on cash and cash equivalents	(111)	(231)
Change in cash and cash equivalents	958	1,054
Cash and cash equivalents, beginning of period	4,269	3,421
Cash and cash equivalents, end of period	\$5,227	\$4,475
See Notes to Condensed Consolidated Financial Statements		

THE WALT DISNEY COMPANY
CONDENSED CONSOLIDATED STATEMENTS OF EQUITY
(unaudited; in millions)

	Quarter Ended July 2, 2016			June 27, 2015		
	Disney Shareholders	Non- controlling Interests	Total Equity	Disney Shareholders	Non- controlling Interests	Total Equity
Beginning balance	\$44,124	\$ 3,886	\$48,010	\$46,038	\$ 3,699	\$49,737
Comprehensive income	2,497	68	2,565	2,422	160	2,582
Equity compensation activity	235	—	235	219	—	219
Dividends	(1,145)	—	(1,145)	(1,115)	—	(1,115)
Common stock repurchases	(1,517)	—	(1,517)	(1,035)	—	(1,035)
Contributions	—	—	—	—	183	183
Distributions and other	(1)	(1)	(2)	(10)	(54)	(64)
Ending balance	\$44,193	\$ 3,953	\$48,146	\$46,519	\$ 3,988	\$50,507
See Notes to Condensed Consolidated Financial Statements						

THE WALT DISNEY COMPANY
CONDENSED CONSOLIDATED STATEMENTS OF EQUITY
(unaudited; in millions)

	Nine Months Ended July 2, 2016			June 27, 2015		
	Disney Shareholders	Non- controlling Interests	Total Equity	Disney Shareholders	Non- controlling Interests	Total Equity
Beginning balance	\$44,525	\$ 4,130	\$48,655	\$44,958	\$ 3,220	\$48,178
Comprehensive income	7,342	199	7,541	6,837	310	7,147
Equity compensation activity	557	—	557	642	—	642
Dividends	(2,313)	—	(2,313)	(3,063)	—	(3,063)
Common stock repurchases	(5,908)	—	(5,908)	(2,823)	—	(2,823)
Contributions	—	—	—	—	1,012	1,012
Distributions and other	(10)	(376)	(386)	(32)	(554)	(586)
Ending balance	\$44,193	\$ 3,953	\$48,146	\$46,519	\$ 3,988	\$50,507
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. We believe that we have included all normal recurring adjustments necessary for a fair presentation of the results for the interim period. Operating results for the nine months ended July 2, 2016 are not necessarily indicative of the results that may be expected for the year ending October 1, 2016. Certain reclassifications have been made in the prior-year financial statements to conform to the current-year presentation.

These financial statements should be read in conjunction with the Company's 2015 Annual Report on Form 10-K. The Company enters into relationships or investments with other entities that may be a variable interest entity (VIE). A VIE is consolidated in the financial statements if the Company has the power to direct activities that most significantly impact the economic performance of the VIE and has the obligation to absorb losses or the right to receive benefits from the VIE that could potentially be significant to the VIE (as defined by ASC 810-10-25-38). Disneyland Paris, Hong Kong Disneyland Resort (HKDL) and Shanghai Disney Resort (collectively the International Theme Parks) are VIEs. Company subsidiaries (the Management Companies) have management agreements with the International Theme Parks, which provide the Management Companies, subject to certain protective rights of joint venture partners, with the ability to direct the day-to-day operating activities and the development of business strategies that we believe most significantly impact the economic performance of the International Theme Parks. In addition, the Management Companies receive management fees under these arrangements that we believe could be significant to the International Theme Parks. Therefore, the Company has consolidated the International Theme Parks in its 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. Fiscal 2015 segment financial information has been restated to reflect the combination of the Consumer Products and Interactive segments into a single segment effective at the beginning of fiscal 2016.

Segment operating results reflect earnings before corporate and unallocated shared expenses, restructuring and impairment charges, interest income/(expense), income taxes and noncontrolling interests. Segment operating income includes equity in the income of investees. Corporate and unallocated shared expenses principally consist of corporate functions, executive management and certain unallocated administrative support functions.

Equity in the income of investees is included in segment operating income as follows:

	Quarter Ended		Nine Months Ended	
	July 2, June 27, 2016 2015		July 2, June 27, 2016 2015	
Media Networks				
Cable Networks	\$ 197	\$ 220	\$ 586	\$ 685
Broadcasting	(43)	(8)	(139)	(55)
Equity in the income of investees included in segment operating income	154	212	\$ 447	\$ 630
Vice Gain	—	—	332	—

Edgar Filing: WALT DISNEY CO/ - Form 10-Q

Other	(2) —	(3) —
Total equity in the income of investees	\$152 \$ 212	\$776 \$ 630

During the nine months ended July 2, 2016, the Company recognized its share of a net gain recorded by A&E Television Networks (A&E), a joint venture owned 50% by the Company, in connection with A&E's acquisition of an interest in Vice

THE WALT DISNEY COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

Group Holding, Inc. (Vice) (Vice Gain). The Company's \$332 million share of the Vice Gain is recorded in "Equity in the income of investees" in the Condensed Consolidated Statement of Income but is not included in segment operating income. See Note 3 for further discussion of the transaction.

	Quarter Ended		Nine Months Ended	
	July 2, 2016	June 27, 2015	July 2, 2016	June 27, 2015
Revenues ⁽¹⁾ :				
Media Networks	\$5,906	\$5,768	\$18,031	\$17,438
Parks and Resorts	4,379	4,131	12,588	11,801
Studio Entertainment	2,847	2,040	7,630	5,583
Consumer Products & Interactive Media	1,145	1,162	4,241	4,131
	\$14,277	\$13,101	\$42,490	\$38,953
Segment operating income ⁽¹⁾ :				
Media Networks	\$2,372	\$2,378	\$6,083	\$5,974
Parks and Resorts	994	922	2,599	2,293
Studio Entertainment	766	472	2,322	1,443
Consumer Products & Interactive Media	324	348	1,541	1,437
	\$4,456	\$4,120	\$12,545	\$11,147

⁽¹⁾ Studio Entertainment segment revenues and operating income include an allocation of Consumer Products & Interactive Media revenues, which is meant to reflect royalties on sales of merchandise based on certain film properties. The increase to Studio Entertainment revenues and operating income and corresponding decrease to Consumer Products & Interactive Media revenues and operating income totaled \$131 million and \$109 million for the quarters ended July 2, 2016 and June 27, 2015, respectively, and \$573 million and \$387 million for the nine months ended July 2, 2016 and June 27, 2015, respectively.

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

	Quarter Ended		Nine Months Ended	
	July 2, 2016	June 27, 2015	July 2, 2016	June 27, 2015
Segment operating income	\$4,456	\$4,120	\$12,545	\$11,147
Corporate and unallocated shared expenses	(159)	(146)	(457)	(441)
Restructuring and impairment charges	(44)	—	(125)	—
Interest expense, net	(70)	(12)	(161)	(62)
Vice Gain	—	—	332	—
Infinity Charge ⁽¹⁾	—	—	(147)	—
Income before income taxes	\$4,183	\$3,962	\$11,987	\$10,644

In the second quarter of fiscal 2016, the Company decided to discontinue its Infinity console game business, which ⁽¹⁾is reported in the Consumer Products & Interactive Media segment, and recorded a charge primarily to write down inventory. The charge also included severance and other asset impairments. The charge was reported in Cost of products in the Condensed Consolidated Statement of Income.

THE WALT DISNEY COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

3. Acquisitions

Vice/A&E

Vice is a media company targeting a millennial audience through news and pop culture content and creative brand integration. During the first quarter of fiscal 2016, A&E acquired an 8% interest in Vice in exchange for a 49.9% interest in one of A&E's cable channels, H2, which has been rebranded as Viceland and programmed with Vice content. As a result of this exchange, A&E recognized a net non-cash gain based on the estimated fair value of H2. The Company's share of the Vice Gain totaled \$332 million and was recorded in "Equity in the income of investees" in the Condensed Consolidated Statement of Income in the first quarter of fiscal 2016. At July 2, 2016, A&E had a 20% interest in Vice.

In addition, during the first quarter of fiscal 2016, the Company acquired an 11% interest in Vice for \$400 million of cash.

The Company accounts for its interests in A&E and Vice as equity method investments.

Maker Studios

On May 7, 2014, the Company acquired Maker Studios, Inc. (Maker), a leading network of online video content, for approximately \$500 million of cash consideration. Maker shareholders were eligible to receive up to \$450 million of additional cash upon Maker's achievement of certain performance targets for calendar years 2014 and 2015. At the date of the acquisition, the Company recorded a \$198 million liability for the fair value of the contingent consideration (determined by a probability weighting of potential payouts). In fiscal 2015, the Company paid \$105 million, and in January 2016, the Company made a final payment of \$70 million for the contingent consideration.

4. Borrowings

During the nine months ended July 2, 2016, the Company's borrowing activity was as follows:

	October 3, 2015	Borrowings	Payments	Other Activity	July 2, 2016
Commercial paper with original maturities less than three months ⁽¹⁾	\$ 2,330	\$ —	\$(583)	\$ 4	\$ 1,751
Commercial paper with original maturities greater than three months	100	4,051	(3,684)	5	472
U.S. medium-term notes	13,873	2,987	(500)	13	16,373
International Theme Parks borrowings ⁽²⁾	319	855	—	(133)	1,041
Foreign currency denominated debt and other ⁽³⁾	714	192	(172)	70	804
Total	\$ 17,336	\$ 8,085	\$(4,939)	\$ (41)	\$ 20,441

⁽¹⁾ Borrowings and payments are reported net.

⁽²⁾ The other activity is primarily the conversion of HKDL debt into equity and the impact of changes in foreign currency exchange rates. See Note 5 for further discussion of the transaction.

⁽³⁾ The other activity is primarily market value adjustments for debt with qualifying hedges.

The Company has bank facilities with a syndicate of lenders to support commercial paper borrowings. The following is a summary of the bank facilities at July 2, 2016:

	Committed Capacity	Capacity Used	Unused Capacity
Facility expiring March 2017	\$ 1,500	\$ —	\$ 1,500
Facility expiring March 2019	2,250	—	2,250
Facility expiring March 2021	2,250	—	2,250
Total	\$ 6,000	\$ —	\$ 6,000

The Company had bank facilities for \$1.5 billion and \$2.25 billion, which were expiring in March 2016 and June 2017, respectively. These facilities were refinanced in the second quarter of fiscal 2016 and the maturities were

extended to March 2017 and 2021, respectively. All of the above bank facilities allow for borrowings at LIBOR-based rates plus a spread depending on the credit default swap spread applicable to the Company's debt, subject to a cap and floor that vary with the Company's debt rating assigned by Moody's Investors Service and Standard and Poor's. The spread above LIBOR can range

THE WALT DISNEY COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

from 0.23% to 1.63%. The Company also has the ability to issue up to \$800 million of letters of credit under the facility expiring in March 2019, which if utilized, reduces available borrowings under this facility. As of July 2, 2016, \$189 million of letters of credit were outstanding, of which none were issued under this facility. The facilities contain only one financial covenant, relating to interest coverage, which the Company met on July 2, 2016 by a significant margin, and specifically exclude certain entities, including the International Theme Parks, from any representations, covenants, or events of default.

On July 7, 2016, the Company issued \$2.0 billion in debt under its U.S. medium-term note program. The proceeds will be used for general corporate purposes.

Interest expense, net

Interest and investment income and interest expense are reported net in the Condensed Consolidated Statements of Income and consist of the following (net of capitalized interest):

	Quarter Ended		Nine Months Ended	
	July 2, June 27, 2016 2015		July 2, June 27, 2016 2015	
Interest expense	\$(88)	\$(62)	\$(235)	\$(197)
Interest and investment income	18	50	74	135
Interest expense, net	\$(70)	\$(12)	\$(161)	\$(62)

Interest and investment income includes gains and losses on the sale of publicly and non-publicly traded investments, investment impairments and interest earned on cash and cash equivalents and certain receivables.

Realized net gains on publicly and non-publicly traded investments are as follows:

	Quarter Ended		Nine Months Ended	
	July 2, June 27, 2016 2015		July 2, June 27, 2016 2015	
Publicly traded	\$—	\$ 31	\$—	\$ 79
Non-publicly traded	—	1	26	8
Realized net gains	\$—	\$ 32	\$26	\$ 87

5. International Theme Park Investments

At July 2, 2016, the Company had an 81% effective ownership interest in the operations of Disneyland Paris, a 47% ownership interest in the operations of HKDL and a 43% ownership interest in the operations of Shanghai Disney Resort, all of which are VIEs consolidated in the Company's financial statements. See Note 1 for the Company's policy on consolidating VIEs.

THE WALT DISNEY COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

The following tables present summarized balance sheet information for the Company as of July 2, 2016 and October 3, 2015, reflecting the impact of consolidating the International Theme Parks balance sheets.

	As of July 2, 2016		
	Before International Theme Parks Consolidation	International Theme Parks and Adjustments	Total
Cash and cash equivalents	\$4,249	\$ 978	\$5,227
Other current assets	12,031	359	12,390
Total current assets	16,280	1,337	17,617
Investments/Advances	8,141	(4,913)	3,228
Parks, resorts and other property	17,775	9,090	26,865
Other assets	43,118	86	43,204
Total assets	\$85,314	\$ 5,600	\$90,914
Current portion of borrowings	\$5,312	\$ —	\$5,312
Other current liabilities	11,373	1,387	12,760
Total current liabilities	16,685	1,387	18,072
Borrowings	14,088	1,041	15,129
Deferred income taxes and other long-term liabilities	9,341	226	9,567
Equity	45,200	2,946	48,146
Total liabilities and equity	\$85,314	\$ 5,600	\$90,914
	As of October 3, 2015		
	Before International Theme Parks Consolidation	International Theme Parks and Adjustments	Total
Cash and cash equivalents	\$3,488	\$ 781	\$4,269
Other current assets	12,237	252	12,489
Total current assets	15,725	1,033	16,758
Investments/Advances	7,505	(4,862)	2,643
Parks, resorts and other property	17,431	7,748	25,179
Other assets	43,540	62	43,602
Total assets	\$84,201	\$ 3,981	\$88,182
Current portion of borrowings	\$4,562	\$ 1	\$4,563
Other current liabilities	11,331	440	11,771
Total current liabilities	15,893	441	16,334
Borrowings	12,454	319	12,773
Deferred income taxes and other long-term liabilities	10,225	195	10,420
Equity	45,629	3,026	48,655
Total liabilities and equity	\$84,201	\$ 3,981	\$88,182

THE WALT DISNEY COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

The following table presents summarized income statement information of the Company for the nine months ended July 2, 2016, reflecting the impact of consolidating the International Theme Parks income statements.

	Before International Theme Parks Consolidation ⁽¹⁾	International Theme Parks and Adjustments	Total
Revenues	\$ 41,013	\$ 1,477	\$42,490
Cost and expenses	(29,049)	(1,944)	(30,993)
Restructuring and impairment charges	(125)	—	(125)
Interest expense, net	(121)	(40)	(161)
Equity in the income of investees	443	333	776
Income before income taxes	12,161	(174)	11,987
Income taxes	(4,089)	—	(4,089)
Net income	\$ 8,072	\$ (174)	\$7,898

In the nine months ended July 2, 2016, royalty and management fees from the International Theme Parks totaling ⁽¹⁾ \$108 million are included in Revenues, and our share of the net income/(loss) of the International Theme Parks is included in Equity in the income of investees.

The following table presents summarized cash flow statement information of the Company for the nine months ended July 2, 2016, reflecting the impact of consolidating the International Theme Parks cash flow statements.

	Before International Theme Parks Consolidation	International Theme Parks and Adjustments	Total
Cash provided by operations	\$ 9,161	\$ 225	\$9,386
Investments in parks, resorts and other property	(2,002)	(1,689)	(3,691)
Cash (used in)/provided by other investing activities	(1,353)	818	(535)
Cash (used in)/provided by financing activities	(4,946)	855	(4,091)
Impact of exchange rates on cash and cash equivalents	(99)	(12)	(111)
Change in cash and cash equivalents	761	197	958
Cash and cash equivalents, beginning of period	3,488	781	4,269
Cash and cash equivalents, end of period	\$ 4,249	\$ 978	\$5,227

Disneyland Paris

During calendar 2015, Disneyland Paris completed a recapitalization consisting of the following:

In February 2015, Disneyland Paris completed a €0.4 billion equity rights offering of which the Company funded €0.2 billion. The Company purchased shares that were unsubscribed by other Disneyland Paris shareholders, which increased the Company's effective ownership by approximately four percentage points.

In February 2015, the Company converted €0.6 billion of its loans to Disneyland Paris into equity at a conversion price of €1.25 per share. The conversion increased the Company's effective ownership by an additional 23 percentage points. In addition, Disneyland Paris repaid €0.3 billion that was outstanding under then existing lines of credit from the Company. These lines of credit have been replaced by a new €0.4 billion line of credit from the Company bearing interest at EURIBOR plus 2% and maturing in 2023. There is €40 million outstanding under the new line of credit at July 2, 2016. As of July 2, 2016, the total outstanding balance of loans provided by the Company to Disneyland Paris was €1.0 billion.

•

In September 2015, the Company completed a mandatory tender offer to the other Disneyland Paris shareholders and acquired €0.1 billion in shares at €1.25 per share, which increased the Company's effective ownership by an additional eight percentage points.

THE WALT DISNEY COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

In November 2015, to offset the dilution caused by the loan conversion Disneyland Paris shareholders purchased €0.05 billion in shares from the Company at €1.25 per share, which decreased the Company's effective ownership by four percentage points.

As of July 2, 2016, the Company had an 81% effective ownership interest in Disneyland Paris.

Hong Kong Disneyland Resort

At July 2, 2016, the Government of the Hong Kong Special Administrative Region (HKSAR) and the Company had 53% and 47% equity interests in HKDL, respectively. HKSAR holds a right to receive additional shares over time to the extent HKDL exceeds certain return on asset performance targets. The amount of additional shares HKSAR can receive is capped on both an annual and cumulative basis and could decrease the Company's equity interest by up to an additional seven percentage points over a period no shorter than 16 years.

HKDL is building a third hotel at the resort, which is expected to open in 2017 and cost approximately \$550 million. To fund the construction, the Company contributed \$219 million of equity and HKSAR converted an equal amount of its outstanding loan to HKDL into equity. Additionally, the Company and HKSAR will provide shareholder loans of up to approximately \$149 million and \$104 million, respectively. The loans will mature on dates from fiscal 2022 through fiscal 2025 and bear interest at a rate of three month HIBOR plus 2%. At July 2, 2016, the outstanding balances of these loans provided by the Company and HKSAR were \$62 million and \$41 million, respectively.

Shanghai Disney Resort

On June 16, 2016, Shanghai Disney Resort opened in the Pudong district of Shanghai. The resort includes a theme park, two hotels and a retail, dining and entertainment complex.

Shanghai Disney Resort is owned through two joint venture companies, in which Shanghai Shendi (Group) Co., Ltd (Shendi) owns 57% and the Company owns 43%. A management company, in which the Company has a 70% interest and Shendi a 30% interest, is responsible for operating Shanghai Disney Resort. The investment in Shanghai Disney Resort has been funded in accordance with each shareholder's ownership percentage, with approximately 67% from equity contributions and 33% from shareholder loans. As of July 2, 2016, the outstanding balance of loans provided by the Company and Shendi to Shanghai Disney Resort were 5.0 billion yuan (\$747 million) and 6.3 billion yuan (\$954 million), respectively.

6. Pension and Other Benefit Programs

The components of net periodic benefit cost are as follows:

	Pension Plans				Postretirement Medical Plans			
	Quarter Ended		Nine Months Ended		Quarter Ended		Nine Months Ended	
	July 2, 2016	June 27, 2015	July 2, 2016	June 27, 2015	July 2, 2016	June 27, 2015	July 2, 2016	June 27, 2015
Service costs	\$80	\$82	\$239	\$248	\$2	\$4	\$8	\$11
Interest costs	115	129	344	391	16	17	46	51
Expected return on plan assets	(186)	(178)	(560)	(534)	(12)	(10)	(34)	(29)
Amortization of prior-year service costs	3	4	10	12	(1)	—	(1)	(1)
Recognized net actuarial loss	61	62	182	185	2	3	6	8
Net periodic benefit cost	\$73	\$99	\$215	\$302	\$7	\$14	\$25	\$40

During the nine months ended July 2, 2016, the Company made \$887 million of contributions to its pension and postretirement medical plans. The Company currently does not expect to make any additional material contributions to its pension and postretirement medical plans during the remainder of fiscal 2016. However, final funding amounts

for fiscal 2016 will be assessed based on our January 1, 2016 funding actuarial valuation, which will be available by the end of the fourth quarter of fiscal 2016.

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 (Awards). A reconciliation of the weighted average number of common and common equivalent shares outstanding and Awards excluded from the diluted earnings per share calculation, as they were anti-dilutive, are as follows:

	Quarter Ended		Nine Months Ended	
	July 2, June 27, 2016 2015		July 2, June 27, 2016 2015	
Shares (in millions):				
Weighted average number of common and common equivalent shares outstanding (basic)	1,621	1,696	1,636	1,699
Weighted average dilutive impact of Awards	10	15	11	15
Weighted average number of common and common equivalent shares outstanding (diluted)	1,631	1,711	1,647	1,714
Awards excluded from diluted earnings per share	4	—	6	5

8. Equity

The Company paid the following dividends in fiscal 2016 and 2015:

Per Share	Total Paid	Payment Timing	Related to Fiscal Period
\$0.71	\$1.1 billion	Fourth Quarter of Fiscal 2016	First Half 2016
\$0.71	\$1.2 billion	Second Quarter of Fiscal 2016	Second Half 2015
\$0.66	\$1.1 billion	Fourth Quarter of Fiscal 2015	First Half 2015
\$1.15	\$1.9 billion	Second Quarter of Fiscal 2015	2014

During the nine months ended July 2, 2016, the Company repurchased 57 million shares of its common stock for \$5.9 billion. As of July 2, 2016, the Company had remaining authorization in place to repurchase approximately 298 million additional shares. The repurchase program does not have an expiration date.

THE WALT DISNEY COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

The following table summarizes the changes in each component of accumulated other comprehensive income (loss) (AOCI) including our proportional share of equity method investee amounts, net of 37% estimated tax:

	Market Value Adjustments		Unrecognized	Foreign	AOCI
	Investments, net	Cash Flow Hedges	Pension and Postretirement Medical Expense	Currency Translation and Other	
Balance at April 2, 2016	\$ 9	\$ 105	\$ (2,415)	\$ (298)	\$(2,599)
Quarter Ended July 2, 2016:					
Unrealized gains (losses) arising during the period	(7)	(49)	(13)	(37)	(106)
Reclassifications of net (gains) losses to net income	—	(35)	41	—	6
Balance at July 2, 2016	\$ 2	\$ 21	\$ (2,387)	\$ (335)	\$(2,699)
Balance at March 28, 2015	\$ 30	\$ 468	\$ (2,118)	\$ (223)	\$(1,843)
Quarter Ended June 27, 2015:					
Unrealized gains (losses) arising during the period	9	(16)	—	16	9
Reclassifications of net (gains) losses to net income	(20)	(93)	43	—	(70)
Balance at June 27, 2015	\$ 19	\$ 359	\$ (2,075)	\$ (207)	\$(1,904)
Balance at October 3, 2015	\$ 13	\$ 334	\$ (2,497)	\$ (271)	\$(2,421)
Nine Months Ended July 2, 2016:					
Unrealized gains (losses) arising during the period	(11)	(170)	(15)	(64)	(260)
Reclassifications of net (gains) losses to net income	—	(143)	125	—	(18)
Balance at July 2, 2016	\$ 2	\$ 21	\$ (2,387)	\$ (335)	\$(2,699)
Balance at September 27, 2014	\$ 100	\$ 204	\$ (2,196)	\$ (76)	\$(1,968)
Nine Months Ended June 27, 2015:					
Unrealized gains (losses) arising during the period	(31)	343	(9)	(131)	172
Reclassifications of net (gains) losses to net income	(50)	(188)	130	—	(108)
Balance at June 27, 2015	\$ 19	\$ 359	\$ (2,075)	\$ (207)	\$(1,904)

THE WALT DISNEY COMPANY
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited; tabular dollars in millions, except for per share data)

Details about AOCI components reclassified to net income are as follows:

Gains/(losses) in net income:	Affected line item in the Condensed Consolidated Statements of Income:	Quarter Ended		Nine Months Ended	
		July 2, 2016	June 27, 2015	July 2, 2016	June 27, 2015
Investments, net	Interest expense, net	\$ —	\$ 31	\$ —	\$ 79
Estimated tax	Income taxes	—	(11)	—	(29)
		—	20	—	50
Cash flow hedges	Primarily revenue	56	148	228	299
Estimated tax	Income taxes	(21)	(55)	(85)	(111)
		35	93	143	188
Pension and postretirement medical expense	Costs and expenses	(65)	(68)	(199)	(206)
Estimated tax	Income taxes	24	25	74	76
		(41)	(43)	(125)	(130)

Total reclassifications for the period \$ (6) \$ 70 \$ 18 \$ 108

At July 2, 2016 and October 3, 2015, the Company held available-for-sale investments in unrecognized gain positions totaling \$10 million and \$21 million, respectively, and no investments in significant unrecognized loss positions.

9. Equity-Based Compensation

Compensation expense related to stock options, stock appreciation rights and restricted stock units (RSUs) is as follows:

	Quarter Ended		Nine Months Ended	
	July 2, 2016	June 27, 2015	July 2, 2016	June 27, 2015
Stock options/rights ⁽¹⁾	\$ 26	\$ 25	\$ 72	\$ 77
RSUs	74	71	233	233
Total equity-based compensation expense ⁽²⁾	\$ 100	\$ 96	\$ 305	\$ 310
Equity-based compensation expense capitalized during the period	\$ 18	\$ 13	\$ 52	\$ 42

⁽¹⁾ Includes stock appreciation rights.

Equity-based compensation expense is net of capitalized equity-based compensation and excludes amortization of previously capitalized equity-based compensation costs. During the quarter and nine months ended July 2, 2016,

⁽²⁾ amortization of previously capitalized equity-based compensation totaled \$21 million and \$55 million, respectively. During the quarter and nine months ended June 27, 2015, amortization of previously capitalized equity-based compensation totaled \$12 million and \$30 million, respectively.

Unrecognized compensation cost related to unvested stock options/rights and RSUs totaled approximately \$162 million and \$597 million, respectively, as of July 2, 2016.

The weighted average grant date fair values of options issued during the nine months ended July 2, 2016 and June 27, 2015 were \$31.08 and \$22.64, respectively.

During the nine months ended July 2, 2016, the Company made equity compensation grants consisting of 3.8 million stock options and 3.3 million RSUs.

THE WALT DISNEY COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

10. Commitments and Contingencies

Legal Matters

Beef Products, Inc. v. American Broadcasting Companies, Inc. On September 13, 2012, plaintiffs filed an action in South Dakota state court against certain subsidiaries and employees of the Company and others, asserting claims for defamation arising from alleged false statements and implications, statutory and common law product disparagement and tortious interference with existing and prospective business relationships. The claims arise out of ABC News reports published in March and April 2012 about a product, Lean Finely Textured Beef, that was included in ground beef and hamburger meat. Plaintiffs' complaint sought actual and consequential damages in excess of \$400 million (which in March 2016 they asserted could be as much as \$1.9 billion), statutory damages (including treble damages) pursuant to South Dakota's Agricultural Food Products Disparagement Act, and punitive damages. Trial is set for June 2017. At this time, the Company is not able to predict the ultimate outcome of this matter, nor can it estimate the range of possible loss.

The Company, together with, in some instances, certain of its directors and officers, is a defendant or codefendant in various other legal actions involving copyright, breach of contract and various other claims incident to the conduct of its businesses.

Management does not believe that the Company has incurred a probable material loss by reason of any of the above actions.

Contractual Guarantees

The Company has guaranteed 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 will be responsible to fund the shortfall. As of July 2, 2016, the remaining debt service obligation guaranteed by the Company was \$321 million, of which \$56 million was principal. To the extent that tax revenues exceed the debt service payments in subsequent periods, the Company would be reimbursed for any previously funded shortfalls. To date, tax revenues have exceeded the debt service payments for these bonds.

Long-Term Receivables and the Allowance for Credit Losses

The Company has accounts receivable with original maturities greater than one year related to the sale of television program rights and vacation ownership units. Allowances for credit losses are established against these receivables as necessary.

The Company estimates the allowance for credit losses related to receivables from the sale of television programs based upon a number of factors, including historical experience and the financial condition of individual companies with which we do business. The balance of television program sales receivables recorded in other non-current assets, net of an immaterial allowance for credit losses, was \$0.9 billion as of July 2, 2016. The activity in the current period related to the allowance for credit losses was not material.

The Company estimates the allowance for credit losses related to receivables from sales of its vacation ownership units based primarily on historical collection experience. Estimates of uncollectible amounts also consider the economic environment and the age of receivables. The balance of mortgage receivables recorded in other non-current assets, net of a related allowance for credit losses of approximately 4%, was approximately \$0.7 billion as of July 2, 2016. The activity in the current period related to the allowance for credit losses was not material.

Income Taxes

During the nine months ended July 2, 2016, the Company decreased its gross unrecognized tax benefits by \$58 million to \$854 million, including an \$18 million decrease to income tax expense.

In the next twelve months, it is reasonably possible that our unrecognized tax benefits could change due to resolutions of open tax matters. These resolutions would reduce our unrecognized tax benefits by approximately \$152 million, of which \$46 million would reduce our income tax expense and effective tax rate if recognized.

THE WALT DISNEY COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

11. Fair Value Measurements

Fair value is defined as the amount that would be received for selling an asset or paid to transfer a liability in an orderly transaction between market participants and is classified in one of the following three categories:

Level 1 - Quoted prices for identical instruments in active markets

Level 2 - Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets

Level 3 - Valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable

The Company's assets and liabilities measured at fair value are summarized in the following tables by fair value measurement Level:

Fair Value Measurement at July 2, 2016				
	Level 1	Level 2	Level 3	Total
Assets				
Investments	\$17	\$—	\$—	\$17
Derivatives				
Interest rate	—	192	—	192
Foreign exchange	—	839	—	839
Other	—	6	—	6
Liabilities				
Derivatives				
Foreign exchange	—	(539)	—	(539)
Other	—	(9)	—	(9)
Total recorded at fair value	\$17	\$489	\$—	\$506
Fair value of borrowings	\$—	\$19,958	\$1,539	\$21,497

Fair Value Measurement at October 3, 2015				
	Level 1	Level 2	Level 3	Total
Assets				
Investments	\$36	\$—	\$—	\$36
Derivatives				
Interest rate	—	101	—	101
Foreign exchange	—	910	—	910
Liabilities				
Derivatives				
Foreign exchange	—	(178)	—	(178)
Other	—	(38)	—	(38)
Other	—	—	(96)	(96)
Total recorded at fair value	\$36	\$795	\$(96)	\$735
Fair value of borrowings	\$—	\$17,036	\$752	\$17,788

The fair values of Level 2 derivatives are primarily determined by internal discounted cash flow models that use observable inputs such as interest rates, yield curves and foreign currency exchange rates. Counterparty credit risk,

which is mitigated by master netting agreements and collateral posting arrangements with certain counterparties, did not have a material impact on derivative fair value estimates.

Level 2 borrowings, which include commercial paper and U.S. medium-term notes, are valued based on quoted prices for similar instruments in active markets.

THE WALT DISNEY COMPANY
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited; tabular dollars in millions, except for per share data)

The fair value of the Level 3 other liabilities represented the estimated fair value of the contingent consideration for Maker, which was settled in the second quarter of fiscal 2016.

Level 3 borrowings, which include International Theme Park borrowings and other foreign currency denominated borrowings, are generally valued based on historical market transactions, prevailing market interest rates and the Company's current borrowing cost and credit risk.

The Company's financial instruments also include cash, cash equivalents, receivables and accounts payable. The carrying values of these financial instruments approximate the fair values.

The Company also has assets that are required to be recorded at fair value on a non-recurring basis when the estimated future cash flows provide indicators that the asset may be impaired. During the quarter and nine months ended July 2, 2016, the Company recorded film production impairment charges of \$49 million and \$79 million, respectively. At July 2, 2016, the aggregate carrying value of the films for which we prepared the fair value analyses in fiscal 2016 was \$254 million. The impairment charges are reported in "Cost of services" and "Restructuring and impairment charges" in the Consolidated Statements of Income. The film impairment charges reflected the excess of the unamortized costs of the impaired films over their estimated fair value using discounted cash flows, which is a Level 3 valuation technique.

12. Derivative Instruments

The Company manages its exposure to various risks relating to its ongoing business operations according to a risk management policy. The primary risks managed with derivative instruments are interest rate risk and foreign exchange risk.

The Company's derivative positions measured at fair value are summarized in the following tables:

	As of July 2, 2016			
	Current Assets	Other Assets	Other Accrued Liabilities	Other Long- Term Liabilities
Derivatives designated as hedges				
Foreign exchange	\$295	\$ 262	\$ (201)	\$ (185)
Interest rate	—	192	—	—
Other	3	3	(7)	(2)
Derivatives not designated as hedges				
Foreign exchange	186	96	(144)	(9)
Gross fair value of derivatives	484	553	(352)	(196)
Counterparty netting	(218)	(281)	336	163
Cash collateral received	(190)	(80)	—	—
Net derivative positions	\$76	\$ 192	\$ (16)	\$ (33)

THE WALT DISNEY COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

	As of October 3, 2015			
	Current Assets	Other Assets	Other Accrued Liabilities	Other Long- Term Liabilities
Derivatives designated as hedges				
Foreign exchange	\$406	\$ 271	\$ (54)	\$ (17)
Interest rate	—	101	—	—
Other	—	—	(18)	(3)
Derivatives not designated as hedges				
Foreign exchange	146	87	(102)	(5)
Other	—	—	—	(17)
Gross fair value of derivatives	552	459	(174)	(42)
Counterparty netting	(136)	(56)	169	23
Cash collateral received	(238)	(191)	—	—
Net derivative positions	\$178	\$ 212	\$ (5)	\$ (19)

Interest Rate Risk Management

The Company is exposed to the impact of interest rate changes primarily through its borrowing activities. The Company's objective is to mitigate the impact of interest rate changes on earnings and cash flows and on the market value of its borrowings. In accordance with its policy, the Company targets its fixed-rate debt as a percentage of its net debt between a minimum and maximum percentage. The Company typically uses pay-floating and pay-fixed interest rate swaps to facilitate its interest rate management activities.

The Company designates pay-floating interest rate swaps as fair value hedges of fixed-rate borrowings effectively converting fixed-rate borrowings to variable rate borrowings indexed to LIBOR. As of July 2, 2016 and October 3, 2015, the total notional amount of the Company's pay-floating interest rate swaps was \$7.5 billion and \$6.4 billion, respectively. The following table summarizes adjustments related to fair value hedges included in "Interest expense, net" in the Condensed Consolidated Statements of Income.

	Quarter Ended		Nine Months Ended	
	July 2, 2016	June 27, 2015	July 2, 2016	June 27, 2015
Gain (loss) on interest rate swaps	\$ 30	\$ (31)	\$ 79	\$ 13
Gain (loss) on hedged borrowings	(30)	31	(79)	(13)

In addition, during the quarter and nine months ended July 2, 2016, the Company realized net benefits of \$24 million and \$73 million, respectively, in "Interest expense, net" related to pay-floating interest rate swaps. During the quarter and nine months ended June 27, 2015, the Company realized net benefits of \$23 million and \$72 million, respectively, in "Interest expense, net" related to pay-floating interest rate swaps.

The Company may designate pay-fixed interest rate swaps as cash flow hedges of interest payments on floating-rate borrowings. Pay-fixed swaps effectively convert floating-rate borrowings to fixed-rate borrowings. The unrealized gains or losses from these cash flow hedges are deferred in AOCI and recognized in interest expense as the interest payments occur. The Company did not have pay-fixed interest rate swaps that were designated as cash flow hedges of interest payments at July 2, 2016 or at October 3, 2015 and gains and losses related to pay-fixed swaps recognized in earnings for the nine months ended July 2, 2016 and June 27, 2015 were not material.

Foreign Exchange Risk Management

The Company transacts business globally and is subject to risks associated with changing foreign currency exchange rates. The Company's objective is to reduce earnings and cash flow fluctuations associated with foreign currency exchange rate changes, enabling management to focus on core business issues and challenges.

The Company enters into option and forward contracts that change in value as foreign currency exchange rates change to protect the value of its existing foreign currency assets, liabilities, firm commitments and forecasted but not firmly committed

21

THE WALT DISNEY COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

foreign currency transactions. In accordance with policy, the Company hedges its forecasted foreign currency transactions for periods generally not to exceed four years within an established minimum and maximum range of annual exposure. The gains and losses on these contracts offset changes in the U.S. dollar equivalent value of the related forecasted transaction, asset, liability or firm commitment. The principal currencies hedged are the euro, Japanese yen, Canadian dollar and British pound. Cross-currency swaps are used to effectively convert foreign currency-denominated borrowings into U.S. dollar denominated borrowings.

The Company designates foreign exchange forward and option contracts as cash flow hedges of firmly committed and forecasted foreign currency transactions. As of July 2, 2016 and October 3, 2015, the notional amounts of the Company's net foreign exchange cash flow hedges were \$5.5 billion and \$6.5 billion, respectively. Mark-to-market gains and losses on these contracts are deferred in AOCI and are recognized in earnings when the hedged transactions occur, offsetting changes in the value of the foreign currency transactions. Gains and losses recognized related to ineffectiveness for the nine months ended July 2, 2016 and June 27, 2015 were not material. Net deferred gains recorded in AOCI for contracts that will mature in the next twelve months totaled \$91 million.

Foreign exchange risk management contracts with respect to foreign currency denominated assets and liabilities are not designated as hedges and do not qualify for hedge accounting. The notional amounts of these foreign exchange contracts at July 2, 2016 and October 3, 2015 were \$3.7 billion and \$3.3 billion, respectively. The following table summarizes the net foreign exchange gains or losses recognized on foreign currency denominated assets and liabilities and the net foreign exchange gains or losses on the foreign exchange contracts we entered into to mitigate our exposure with respect to foreign currency denominated assets and liabilities for the nine months ended July 2, 2016 and June 27, 2015 by the corresponding line item in which they are recorded in the Condensed Consolidated Statements of Income.

	Costs and Expenses		Interest expense, net	
Quarter Ended:	July 2, 2016	June 27, 2015	July 2, 2016	June 27, 2015
Net gains (losses) on foreign currency denominated assets and liabilities	\$(75)	\$ 52	\$(2)	\$ (4)
Net gains (losses) on foreign exchange risk management contracts not designated as hedges	52	(41)	1	4
Net gains (losses)	\$(23)	\$ 11	\$(1)	\$ —
Nine Months Ended:				
Net gains (losses) on foreign currency denominated assets and liabilities	\$(29)	\$(496)	\$(7)	\$ 27
Net gains (losses) on foreign exchange risk management contracts not designated as hedges	(32)	474	5	(25)
Net gains (losses)	\$(61)	\$(22)	\$(2)	\$ 2

Commodity Price Risk Management

The Company is subject to the volatility of commodities prices and the Company designates certain commodity forward contracts as cash flow hedges of forecasted commodity purchases. Mark-to-market gains and losses on these contracts are deferred in AOCI and are recognized in earnings when the hedged transactions occur, offsetting changes in the value of commodity purchases. The notional amount of these commodities contracts at July 2, 2016 and October 3, 2015 and related gains or losses recognized in earnings for the nine months ended July 2, 2016 and June 27, 2015 were not material.

Risk Management – Other Derivatives Not Designated as Hedges

The Company enters into certain other risk management contracts that are not designated as hedges and do not qualify for hedge accounting. These contracts, which include certain swap contracts, are intended to offset economic exposures of the Company and are carried at market value with any changes in value recorded in earnings. The

notional amount and fair value of these contracts at July 2, 2016 and October 3, 2015 were not material. The related gains or losses recognized in earnings were not material for the nine months ended July 2, 2016 and June 27, 2015.

THE WALT DISNEY COMPANY
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
 (unaudited; tabular dollars in millions, except for per share data)

Contingent Features and Cash Collateral

The Company has master netting arrangements by counterparty with respect to certain derivative financial instrument contracts. The Company may be required to post collateral in the event that a net liability position with a counterparty exceeds limits defined by contract and that vary with the Company's credit rating. In addition, these contracts may require a counterparty to post collateral to the Company in the event that a net receivable position with a counterparty exceeds limits defined by contract and that vary with the counterparty's credit rating. If the Company's or the counterparty's credit ratings were to fall below investment grade, such counterparties or the Company would also have the right to terminate our derivative contracts, which could lead to a net payment to or from the Company for the aggregate net value by counterparty of our derivative contracts. The aggregate fair values of derivative instruments with credit-risk-related contingent features in a net liability position by counterparty were \$48 million and \$7 million on July 2, 2016 and October 3, 2015, respectively.

13. Restructuring and Impairment Charges

The Company recorded \$44 million of restructuring and impairment charges in the current quarter primarily consisting of asset impairments associated with shutting down certain international film production operations in the Studio Entertainment segment. The Company recorded \$125 million of restructuring and impairment charges in the current nine-month period consisting of the current quarter charges and an investment impairment and contract termination and severance costs related to the Media Networks segment in the prior quarters.

14. New Accounting Pronouncements

Stock Compensation - Employee Share-based Payments

In March 2016, the Financial Accounting Standards Board (FASB) issued guidance to amend certain aspects of accounting for employee share-based awards, including accounting for income taxes related to those transactions. This guidance will require recognizing excess tax benefits and deficiencies (that result from an increase or decrease in the fair value of an award from grant date to the vesting date or exercise date) on share-based compensation arrangements in the tax provision, instead of in equity as under the current guidance. In addition, these amounts will be classified as an operating activity in the statement of cash flows, instead of as a financing activity. The Company reported excess tax benefits of approximately \$0.3 billion in both fiscal 2015 and 2014. In addition, cash paid for shares withheld to satisfy employee taxes will be classified as a financing activity, instead of as an operating activity. Cash paid for employee taxes was approximately \$0.3 billion in both fiscal 2015 and 2014. The guidance is effective beginning in the first quarter of the Company's 2018 fiscal year (with early adoption permitted) and is required to be adopted as follows:

• Prospectively for the recognition of excess tax benefits and deficiencies in the tax provision

• Retrospectively or prospectively for the classification of excess tax benefits and deficiencies in the statement of cash flows

• Retrospectively for the classification of cash paid for shares withheld to satisfy employee taxes in the statement of cash flows

The fiscal 2015 and 2014 amounts of excess tax benefits and cash paid for employee taxes are not necessarily indicative of future amounts that may arise in years following implementation of the new accounting pronouncement.

Leases

In February 2016, the FASB issued a new lease accounting standard, which requires the present value of committed operating lease payments to be recorded as right-of-use lease assets and lease liabilities on the balance sheet. As of October 3, 2015, the Company had an estimated \$3.3 billion in undiscounted future minimum lease commitments.

The Company is currently assessing the impact of the new guidance on its financial statements. The guidance is required to be adopted retrospectively, and is effective beginning in the first quarter of the Company's 2020 fiscal year (with early adoption permitted).

Income Taxes

In November 2015, the FASB issued guidance to simplify the presentation of deferred income taxes by reporting the net amount of deferred tax assets and liabilities on a jurisdiction by jurisdiction basis as non-current on the balance sheet. The Company adopted the provisions of this guidance on a prospective basis in the first quarter of fiscal 2016 by reclassifying \$0.8 billion in current assets to non-current liabilities.

THE WALT DISNEY COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

Revenue from Contracts with Customers

In May 2014, the FASB issued guidance that replaces the existing accounting standards for revenue recognition with a single comprehensive five-step model. The core principle is to recognize revenue upon the transfer of goods or services to customers at an amount that reflects the consideration expected to be received. Since its issuance, the FASB has amended several aspects of the new guidance including provisions that address revenue recognition associated with the licensing of intellectual property. The new guidance, including the amendments, is effective beginning with the first quarter of the Company's 2019 fiscal year (with early adoption permitted beginning fiscal year 2018). The guidance may be adopted either by restating all years presented in the Company's financial statements or by recording the impact of adoption as an adjustment to retained earnings at the beginning of the year of adoption. The Company is assessing the potential impact this guidance will have on its financial statements.

15. Subsequent Events

Hulu

At the end of the third quarter, the Company had a 33% interest in Hulu, LLC (Hulu), a joint venture owned one-third each by the Company, Twenty-First Century Fox, Inc. and Comcast Corporation. In August 2016, Time Warner, Inc. (TW) acquired a 10% interest in the venture from Hulu for \$583 million diluting the Company's ownership interest to 30%. For not more than 36 months, TW may put its shares to Hulu or Hulu may call the shares from TW under certain limited circumstances arising from regulatory review. The Company and Twenty-First Century Fox, Inc. have agreed to make capital contributions of up to approximately \$300 million each if required to fund the repurchase of shares from TW.

BAMTech

In August 2016, the Company acquired a 15% interest in BAMTech, LLC (BAMTech), an entity which holds Major League Baseball's streaming technology and content delivery businesses, for \$450 million. The Company is committed to acquire an additional 18% for \$557 million in January 2017. The Company will account for its interest in BAMTech as an equity method investment.

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:

Consolidated Results and Non-segment Items

Seasonality

Segment Results

Corporate and Unallocated Shared Expenses

Significant Developments

Financial Condition

Commitments and Contingencies

Other Matters

Market Risk

CONSOLIDATED RESULTS AND NON-SEGMENT ITEMS

Our summary consolidated results are presented below:

	Quarter Ended		% Change		Nine Months Ended		% Change	
(in millions, except per share data)	July 2, 2016	June 27, 2015	Better/ (Worse)		July 2, 2016	June 27, 2015	Better/ (Worse)	
Revenues:								
Services	\$12,113	\$11,308	7	%	\$35,906	\$32,587	10	%
Products	2,164	1,793	21	%	6,584	6,366	3	%
Total revenues	14,277	13,101	9	%	42,490	38,953	9	%
Costs and expenses:								
Cost of services (exclusive of depreciation and amortization)	(5,946)	(5,547)	(7)	%	(18,568)	(17,224)	(8)	%
Cost of products (exclusive of depreciation and amortization)	(1,255)	(1,116)	(12)	%	(4,120)	(3,785)	(9)	%
Selling, general, administrative and other	(2,305)	(2,101)	(10)	%	(6,467)	(6,117)	(6)	%
Depreciation and amortization	(626)	(575)	(9)	%	(1,838)	(1,751)	(5)	%
Total costs and expenses	(10,132)	(9,339)	(8)	%	(30,993)	(28,877)	(7)	%
Restructuring and impairment charges	(44)	—	nm		(125)	—	nm	
Interest expense, net	(70)	(12)	>(100)	%	(161)	(62)	>(100)	%
Equity in the income of investees	152	212	(28)	%	776	630	23	%
Income before income taxes	4,183	3,962	6	%	11,987	10,644	13	%
Income taxes	(1,471)	(1,323)	(11)	%	(4,089)	(3,533)	(16)	%
Net income	2,712	2,639	3	%	7,898	7,111	11	%
Less: Net income attributable to noncontrolling interests	(115)	(156)	26	%	(278)	(338)	18	%
Net income attributable to Disney	\$2,597	\$2,483	5	%	\$7,620	\$6,773	13	%
Diluted earnings per share attributable to Disney	\$1.59	\$1.45	10	%	\$4.63	\$3.95	17	%

MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS — (continued)

Quarter Results

Diluted earnings per share attributable to Disney (EPS) increased 10% from \$1.45 to \$1.59 due to improved segment operating results and a decrease in weighted average shares outstanding as a result of our share repurchase program, partially offset by a higher income tax rate and a decrease in investment gains. Segment operating results benefited from growth in both products and services, which was partially offset by the impact of foreign currency translation due to the movement of the U.S. dollar against major currencies including the impact of our hedging program (FX Impact).

Revenues

Service revenues for the quarter increased 7%, or \$0.8 billion, to \$12.1 billion, which included an unfavorable FX Impact. Aside from the unfavorable FX Impact, growth was driven by higher theatrical distribution revenues. The increase in service revenues also benefited from higher fees from Multi-channel Video Distributors (MVPDs) (Affiliate Fees), guest spending growth at our domestic parks and resorts and revenues from Shanghai Disney Resort, which opened in the current quarter.

Product revenues for the quarter increased 21%, or \$0.4 billion, to \$2.2 billion due to volume growth and higher net effective pricing at our home entertainment distribution business.

Costs and expenses

Cost of services for the quarter increased 7%, or \$0.4 billion, to \$5.9 billion, which included a favorable FX impact. Aside from the favorable FX Impact, the increase was due to higher film cost amortization, increased media networks sports programming costs and production cost write-downs and costs at Shanghai Disney Resort. These increases were partially offset by lower infrastructure costs at our domestic parks and resorts.

Cost of products for the quarter increased 12%, or \$0.1 billion, to \$1.3 billion due to higher home entertainment volumes and costs at Shanghai Disney Resort, partially offset by lower interactive game product development spending.

Selling, general, administrative and other costs increased 10%, or \$0.2 billion, to \$2.3 billion, which included a favorable FX impact. Aside from the favorable FX Impact, the increase was primarily due to higher theatrical marketing costs driven by more titles in release and marketing and pre-opening expenses at Shanghai Disney Resort, partially offset by lower marketing costs at our domestic parks and resorts.

Depreciation and amortization costs increased 9%, or \$51 million, to \$0.6 billion primarily driven by higher depreciation at our domestic parks and resorts and the impact of Shanghai Disney Resort.

Restructuring and impairment charges

The Company recorded \$44 million of restructuring and impairment charges in the current quarter primarily consisting of asset impairments associated with shutting down certain international film production operations in the Studio Entertainment segment.

Interest expense, net

Interest expense, net is as follows:

(in millions)	Quarter Ended			% Change Better/(Worse)
	July 2, 2016	June 27, 2015		
Interest expense	\$(88)	\$(62)	(42))%
Interest and investment income	18	50	(64))%
Interest expense, net	\$(70)	\$(12)	>(100))%

The increase in interest expense was due to higher average debt balances, partially offset by higher capitalized interest driven by the development of Shanghai Disney Resort.

The decrease in interest and investment income for the quarter was due to gains on sales of investments in the prior-year quarter.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS — (continued)

Equity in the income of investees

Equity in the income of investees decreased \$60 million to \$152 million for the quarter due to higher equity losses from Hulu and lower equity income from A&E. Higher equity losses from Hulu were due to increased programming, marketing and labor costs, partially offset by higher subscription and advertising revenues. Lower equity income from A&E was due to a decrease in advertising revenue and the impact of converting the H2 channel to Viceland. The decreases at A&E were partially offset by lower programming costs.

Effective Income Tax Rate

Quarter Ended		
July 2, June 27, Change		
2016	2015	Better/(Worse)

Effective income tax rate 35.2% 33.4 % (1.8) ppt

The increase in the effective income tax rate for the quarter was primarily due to an increase in foreign losses for which we are not recognizing a tax benefit.

Noncontrolling Interests

(in millions)	Quarter Ended		
	July 2, June 27, % Change		
	2016	2015	Better/(Worse)
Net income attributable to noncontrolling interests	\$115	\$156	26 %

The decrease in net income attributable to noncontrolling interests for the quarter was primarily due to higher pre-opening expenses at Shanghai Disney Resort and lower results at Disneyland Paris, partially offset by higher results at ESPN.

Net income attributable to noncontrolling interests is determined on income after royalties and management fees, financing costs and income taxes.

Nine-Month Results

EPS for the nine-month period increased 17% from \$3.95 to \$4.63 due to improved segment operating results, a decrease in weighted average shares outstanding as a result of our share repurchase program and the Vice Gain at A&E (See Note 3 to the Condensed Consolidated Financial Statements). These increases were partially offset by the Infinity Charge (See Note 2 to the Condensed Consolidated Financial Statements), a higher income tax rate, current period restructuring and impairment charges and lower investment gains. Segment operating results benefited from growth in both products and services, which was partially offset by an unfavorable FX Impact.

Revenues

Service revenues for the nine-month period increased 10%, or \$3.3 billion, to \$35.9 billion, which included an unfavorable FX Impact. Aside from the unfavorable FX Impact, growth was driven by higher theatrical distribution revenues. The increase in service revenues also benefited from merchandise and game licensing revenue growth, increases in guest spending and attendance at our domestic parks and resorts, higher Affiliate Fees and advertising revenue growth.

Product revenues for the nine-month period increased 3%, or \$0.2 billion, to \$6.6 billion, which included an unfavorable FX Impact. Aside from the unfavorable FX Impact, growth was primarily due to increases in guest spending and food, beverage and merchandise volumes at our domestic parks and resorts and higher home entertainment volumes, partially offset by lower console game volumes.

Costs and expenses

Cost of services for the nine-month period increased 8%, or \$1.3 billion, to \$18.6 billion, which included a favorable FX Impact. Aside from the favorable FX Impact, the increase was primarily due to higher film cost amortization, increased media programming costs and production cost amortization and domestic parks and resorts labor and other cost inflation.

Cost of products for the nine-month period increased 9%, or \$0.3 billion, to \$4.1 billion, which included a favorable FX Impact. Aside from the favorable FX Impact, the increase was due to the Infinity Charge, home entertainment volume growth and higher volumes and cost inflation at our domestic parks and resorts.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS — (continued)

Selling, general, administrative and other costs for the nine-month period increased 6%, or \$0.4 billion, to \$6.5 billion, which included a favorable FX Impact. Aside from the favorable FX Impact, the increase was due to higher theatrical marketing costs driven by more titles in release and marketing and pre-opening expenses at Shanghai Disney Resort, partially offset by lower marketing costs at our domestic parks and resorts.

Depreciation and amortization costs for the nine-month period increased 5%, or \$87 million, to \$1.8 billion due to higher depreciation associated with new attractions at our domestic parks and resorts and the impact of Shanghai Disney Resort.

Restructuring and impairment charges

The Company recorded \$125 million of restructuring and impairment charges in the current nine-month period for impairments and contract termination and severance costs in the Media Networks and Studio Entertainment segments.

Interest expense, net

Interest expense, net is as follows:

	Nine Months		
	Ended		
	July 2,	June 27,	% Change
(in millions)	2016	2015	Better/(Worse)
Interest expense	\$(235)	\$(197)	(19)%
Interest and investment income	74	135	(45)%
Interest expense, net	\$(161)	\$(62)	>(100)%

The increase in interest expense for the nine-month period was due to higher average debt balances, partially offset by higher capitalized interest driven by the development of Shanghai Disney Resort.

The decrease in interest and investment income for the nine-month period was due to lower gains on the sales of investments.

Equity in the income of investees

Equity in the income of investees increased 23%, or \$146 million, to \$776 million for the nine-month period due to the \$332 million Vice Gain (\$0.13 of EPS) (See Note 3 to the Condensed Consolidated Financial Statements). The benefit of the Vice Gain was partially offset by lower operating results at A&E and a higher loss at Hulu. The decrease at A&E was due to lower advertising revenue and the impact of converting the H2 channel to Viceland. The increased loss at Hulu was due to higher programming, marketing and labor costs, partially offset by growth in subscription and advertising revenues.

Effective Income Tax Rate

	Nine Months		
	Ended		
	July 2,	June 27,	Change
	2016	2015	Better/(Worse)
Effective income tax rate	34.1%	33.2%	(0.9) ppt

The increase in the effective income tax rate for the nine months was due to an increase in foreign losses for which we are not recognizing a tax benefit.

Noncontrolling Interests

	Nine Months		
	Ended		
	July 2,	June 27,	% Change
(in millions)	2016	2015	Better/(Worse)
Net income attributable to noncontrolling interests	\$278	\$338	18%

The decrease in net income attributable to noncontrolling interests for the nine-month period was primarily due to higher pre-opening expenses at Shanghai Disney Resort and a decrease from Disneyland Paris, partially offset by higher results at ESPN. The decrease at Disneyland Paris was due to higher operating losses, partially offset by a

decrease in the noncontrolling interests' ownership.

28

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 nine months ended July 2, 2016 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 revenues are subject to seasonal advertising patterns, changes in viewership levels and timing of program sales. In general, advertising revenues are somewhat higher during the fall and somewhat lower during the summer months. Affiliate revenues are typically collected ratably throughout the year.

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 & Interactive Media revenues are influenced by seasonal consumer purchasing behavior, which generally results in increased revenues during the Company's first fiscal quarter, and the timing and performance of theatrical and game releases and cable programming broadcasts.

SEGMENT RESULTS

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

(in millions)	Quarter Ended		% Change		Nine Months Ended		% Change	
	July 2, 2016	June 27, 2015	Better/ (Worse)		July 2, 2016	June 27, 2015	Better/ (Worse)	
Revenues:								
Media Networks	\$5,906	\$5,768	2	%	\$18,031	\$17,438	3	%
Parks and Resorts	4,379	4,131	6	%	12,588	11,801	7	%
Studio Entertainment	2,847	2,040	40	%	7,630	5,583	37	%
Consumer Products & Interactive Media	1,145	1,162	(1)	%	4,241	4,131	3	%
	\$14,277	\$13,101	9	%	\$42,490	\$38,953	9	%
Segment operating income:								
Media Networks	\$2,372	\$2,378	—	%	\$6,083	\$5,974	2	%
Parks and Resorts	994	922	8	%	2,599	2,293	13	%
Studio Entertainment	766	472	62	%	2,322	1,443	61	%
Consumer Products & Interactive Media	324	348	(7)	%	1,541	1,437	7	%
	\$4,456	\$4,120	8	%	\$12,545	\$11,147	13	%

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:

(in millions)	Quarter Ended		% Change Better/ (Worse)	Nine Months Ended		% Change Better/ (Worse)
	July 2, 2016	June 27, 2015		July 2, 2016	June 27, 2015	
Segment operating income	\$4,456	\$4,120	8 %	\$12,545	\$11,147	13 %
Corporate and unallocated shared expenses	(159)	(146)	(9) %	(457)	(441)	(4) %
Restructuring and impairment charges	(44)	—	nm	(125)	—	nm
Interest expense, net	(70)	(12)	>(100) %	(161)	(62)	>(100) %
Vice Gain ⁽¹⁾	—	—	nm	332	—	nm
Infinity Charge ⁽²⁾	—	—	nm	(147)	—	nm
Income before income taxes	\$4,183	\$3,962	6 %	\$11,987	\$10,644	13 %

⁽¹⁾ See Note 3 to the Condensed Consolidated Financial Statements for a discussion of the Vice Gain.

⁽²⁾ See Note 2 to the Condensed Consolidated Financial Statements for a discussion of the Infinity Charge.

Depreciation expense is as follows:

(in millions)	Quarter Ended		% Change Better/ (Worse)	Nine Months Ended		% Change Better/ (Worse)
	July 2, 2016	June 27, 2015		July 2, 2016	June 27, 2015	
Media Networks						
Cable Networks	\$37	\$ 39	5 %	\$111	\$ 114	3 %
Broadcasting	23	24	4 %	68	71	4 %
Total Media Networks	60	63	5 %	179	185	3 %
Parks and Resorts						
Domestic	313	279	(12) %	949	865	(10) %
International	113	84	(35) %	283	258	(10) %