WALT DISNEY CO/
Form 10-Q
February 05, 2008

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 December 29, 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, 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	X	Accelerated filer	__
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 X

There were 1,883,005,437 shares of common stock outstanding as of February 1, 2008.

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	
	December 29, 2007	December 30, 2006
Revenues	**$ 10,452**	$ 9,581
Costs and expenses	**(8,419)**	(7,907)
Gains on sales of equity investments		1,052
Net interest expense	**(123)**	(157)
Equity in the income of investees	**123**	121
Income from continuing operations before income taxes and minority interests	**2,033**	2,690
Income taxes	**(759)**	(1,009)
Minority interests	**(24)**	(5)
Income from continuing operations	**1,250**	1,676
Discontinued operations, net of tax		25
Net income	**$ 1,250**	$ 1,701
Diluted earnings per share:		
Earnings per share, continuing operations	**0.63**	0.78
Earnings per share, discontinued operations		0.01
Earnings per share	**$ 0.63**	$ 0.79
Basic earnings per share:		
Earnings per share, continuing operations	**0.66**	0.81
Earnings per share, discontinued operations		0.01
Earnings per share [(1)]	**$ 0.66**	$ 0.83
Weighted average number of common and common equivalent shares outstanding:		
Diluted	**1,989**	2,148
Basic	**1,904**	2,059

(1) Total earnings per share may not equal the sum of the column due to rounding.

See Notes to Condensed Consolidated Financial Statements

THE WALT DISNEY COMPANY

CONDENSED CONSOLIDATED BALANCE SHEETS

(unaudited; in millions, except per share data)

	December 29, 2007	September 29, 2007
ASSETS		
Current assets		
Cash and cash equivalents	**$ 3,414**	$ 3,670
Receivables	**6,994**	5,032
Inventories	**731**	641
Television costs	**689**	559
Deferred income taxes	**862**	862
Other current assets	**578**	550
Total current assets	**13,268**	11,314
Film and television costs	**4,942**	5,123
Investments	**1,030**	995
Parks, resorts and other property, at cost		
Attractions, buildings and equipment	**30,649**	30,260
Accumulated depreciation	**(15,541)**	(15,145)
	15,108	15,115
Projects in progress	**1,076**	1,147
Land	**1,172**	1,171
	17,356	17,433
Intangible assets, net	**2,480**	2,494
Goodwill	**22,070**	22,085
Other assets	**1,626**	1,484
	$ 62,772	$ 60,928
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities		
Accounts payable and other accrued liabilities	**$ 7,084**	$ 5,949
Current portion of borrowings	**2,945**	3,280
Unearned royalties and other advances	**2,354**	2,162
Total current liabilities	**12,383**	11,391
Borrowings	**12,785**	11,892
Deferred income taxes	**2,225**	2,573
Other long-term liabilities	**3,672**	3,024
Minority interests	**1,327**	1,295
Commitments and contingencies		
Shareholders equity		
Preferred stock, $.01 par value		
Authorized 100 million shares, Issued none		
Common stock, $.01 par value		
Authorized 3.6 billion shares, Issued 2.6 billion shares at December 29, 2007 and September 29, 2007	**24,419**	24,207
Retained earnings	**25,248**	24,805

Accumulated other comprehensive loss		**(139)**		(157)
		49,528		48,855
Treasury stock, at cost, 669.0 million shares at December 29, 2007 and 637.8 million shares at September 29, 2007		**(19,148)**		(18,102)
		30,380		30,753
	$	**62,772**	$	60,928

See Notes to Condensed Consolidated Financial Statements

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THE WALT DISNEY COMPANY CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited; in millions)

	Quarter Ended	
	December 29, 2007	December 30, 2006
OPERATING ACTIVITIES OF CONTINUING OPERATIONS		
Net income	**$ 1,250**	$ 1,701
Income from discontinued operations		(25)
Depreciation and amortization	**385**	374
Gains on sales of equity investments		(1,052)
Deferred income taxes	**(46)**	(92)
Equity in the income of investees	**(123)**	(121)
Cash distributions received from equity investees	**119**	82
Minority interests	**24**	5
Net change in film and television costs	**216**	286
Equity-based compensation	**103**	138
Other	**(4)**	47
Changes in operating assets and liabilities:		
Receivables	**(1,990)**	(1,553)
Inventories	**(34)**	24
Other assets	**(17)**	77
Accounts payable and other accrued liabilities	**188**	(335)
Income taxes	**591**	936
Cash provided by continuing operations	**662**	492
INVESTING ACTIVITIES OF CONTINUING OPERATIONS		
Investments in parks, resorts and other property	**(249)**	(245)
Proceeds from sales of equity investments		1,530
Other	**(75)**	(49)
Cash (used) provided by continuing investing activities	**(324)**	1,236
FINANCING ACTIVITIES OF CONTINUING OPERATIONS		
Commercial paper borrowings, net	**(402)**	(173)
Borrowings	**854**	103
Reduction of borrowings	**(117)**	(1,135)
Repurchases of common stock	**(1,045)**	(957)
Exercise of stock options and other	**116**	425
Cash used by continuing financing activities	**(594)**	(1,737)
CASH FLOW OF DISCONTINUED OPERATIONS		
Net cash provided by operating activities of discontinued operations		24
Net cash used in investing activities of discontinued operations		
Net cash provided by financing activities of discontinued operations		11
(Decrease) / increase in cash and cash equivalents	**(256)**	26
Cash and cash equivalents, beginning of period	**3,670**	2,411
Cash and cash equivalents, end of period	**$ 3,414**	$ 2,437

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 ended December 29, 2007 are not necessarily indicative of the results that may be expected for the year ending September 27, 2008. 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 Annual Report on Form 10-K for the year ended September 29, 2007.

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.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

	Quarter Ended	
	December 29, 2007	December 30, 2006
Revenues* [(1)(2)] *:		
Media Networks	**$ 4,169**	$ 3,786
Parks and Resorts	**2,772**	2,489
Studio Entertainment	**2,641**	2,633
Consumer Products	**870**	673
	$ 10,452	$ 9,581
Segment operating income* [(1)(2)] *:		
Media Networks	**$ 908**	$ 708
Parks and Resorts	**505**	405
Studio Entertainment	**514**	603
Consumer Products	**322**	234
	$ 2,249	$ 1,950

(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 $54 million and $47 million for the quarters ended December 29, 2007 and December 30, 2006, respectively.

(2) Beginning with the first quarter fiscal 2008 financial statements, the Company began reporting Hyperion Publishing in the Media Networks segment. Previously, Hyperion Publishing had been reported in the Consumer Products segment. Prior-period amounts (which are not material) have been reclassified to conform to the current-year presentation.

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

	Quarter Ended	
	December 29, 2007	December 30, 2006
Segment operating income	**$ 2,249**	$ 1,950
Corporate and unallocated shared expenses	**(93)**	(107)
Equity-based compensation plan modification charge		(48)
Gains on sales of equity investments		1,052
Net interest expense	**(123)**	(157)
Income from continuing operations before income taxes and minority interests	**$ 2,033**	$ 2,690

3. *Acquisitions and Dispositions*

On August 1, 2007, the Company acquired all of the outstanding shares of Club Penguin Entertainment, Inc. (Club Penguin), a Canadian company that operates clubpenguin.com, an online virtual world for children. The purchase price included upfront cash consideration of approximately $350 million and additional consideration of up to $350 million that may be paid if Club Penguin achieves predefined earnings targets for calendar years 2008 and 2009. We are in the process of finalizing the valuation of the assets acquired and liabilities assumed.

On June 12, 2007, the Company completed the spin-off of its wholly-owned subsidiary, ABC Radio Holdings, Inc., and its merger into a subsidiary of Citadel Broadcasting Corporation (Citadel). Prior to the spin-off, the Company consolidated its ABC Radio business, consisting of 22 large-market radio

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

stations and the ABC Radio Network businesses, under ABC Radio Holdings, Inc. The transaction did not include the Company s ESPN Radio or Radio Disney network and station businesses. Fiscal 2007 results of the ABC Radio business have been reported as discontinued operations.

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 in the Condensed Consolidated Statement of Income.

4. *Borrowings*

During the quarter ended December 29, 2007, the Company s borrowing activity was as follows:

	September 29, 2007	Additions	Payments	Other Activity	**December 29, 2007**
Commercial paper borrowings	$ 2,686	$	$ (402)	$	**$ 2,284**
U.S. medium-term notes	6,340	750	(60)	(1)	**7,029**
Convertible senior notes	1,323				**1,323**
European medium-term notes	163				**163**
Capital Cities/ABC debt	181			(1)	**180**
Film financing	355	87	(57)		**385**
Other [(1)]	541	4	(37)	169	**677**
Euro Disney borrowings [(2)]	2,476			89	**2,565**
Hong Kong Disneyland borrowings	1,107	13		4	**1,124**
Total	$ 15,172	$ 854	$ (556)	$ 260	**$ 15,730**

(1) The increase in other activity was primarily due to the purchase of land for a Disney Vacation Club resort in Hawaii.

(2) The increase in other activity was primarily due to 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 has a 51% effective ownership interest in the operations of Euro Disney and a 43% ownership interest in the operations of Hong Kong Disneyland which are both consolidated under the provisions of FIN 46R, *Consolidation of Variable Interest Entities*.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

The following table presents a condensed consolidating balance sheet for the Company as of December 29, 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	$ 2,934	$ 480	$ 3,414
Other current assets	9,554	300	9,854
Total current assets	12,488	780	13,268
Investments	1,769	(739)	1,030
Fixed assets	12,467	4,889	17,356
Other assets	31,065	53	31,118
Total assets	$ 57,789	$ 4,983	$ 62,772
Current portion of borrowings	$ 2,529	$ 416	$ 2,945
Other current liabilities	8,881	557	9,438
Total current liabilities	11,410	973	12,383
Borrowings	9,512	3,273	12,785
Deferred income taxes and other long-term liabilities	5,724	173	5,897
Minority interest	763	564	1,327
Shareholders equity	30,380		30,380
Total liabilities and shareholders equity	$ 57,789	$ 4,983	$ 62,772

The following table presents a condensed consolidating income statement of the Company for the quarter ended December 29, 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	$ 9,877	$ 575	$ 10,452
Cost and expenses	(7,897)	(522)	(8,419)
Net interest expense	(80)	(43)	(123)
Equity in the income of investees	132	(9)	123
Income from continuing operations before income taxes and minority interests	2,032	1	2,033
Income taxes	(759)		(759)

Minority interests	(23)	(1)	(24)
Net income	$ 1,250	$	$ 1,250

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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The following table presents a condensed consolidating cash flow statement of the Company for the quarter ended December 29, 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	$ 756	$ (94)	$ 662
Investments in parks, resorts and other property	(206)	(43)	(249)
Other investing activities	(75)		(75)
Cash provided (used) by financing activities	(607)	13	(594)
Decrease in cash and cash equivalents	(132)	(124)	(256)
Cash and cash equivalents, beginning of period	3,066	604	3,670
Cash and cash equivalents, end of period	$ 2,934	$ 480	$ 3,414

6. *Pension and Other Benefit Programs*

The components of net periodic benefit cost are as follows:

	Pension Plans Quarter Ended		**Postretirement Medical Plans Quarter Ended**	
	December 29, 2007	December 30, 2006	**December 29, 2007**	December 30, 2006
Service cost	**$ 45**	$ 42	**$ 5**	$ 6
Interest cost	**81**	74	**16**	15
Expected return on plan assets	**(89)**	(76)	**(6)**	(5)
Recognized net actuarial loss	**9**	13		
Net periodic benefit cost	**$ 46**	$ 53	**$ 15**	$ 16

During the quarter ended December 29, 2007, the Company did not make any material contributions to its pension and post-retirement medical plans. Based on current actuarial projections, the Company anticipates that the funded status of the pension plans will be sufficient so that the Company will not be required to make contributions during fiscal 2008 under the funding regulations associated with the PPA. However, final funding requirements for fiscal 2008 will be determined based on our funding actuarial valuation as of January 1, 2008 which will be completed later in the fiscal year. Additionally, the Company may choose to make discretionary contributions above the minimum requirements. The Company anticipates contributing approximately $30 million during fiscal 2008 to post-retirement medical and other pension plans not subject to the PPA.

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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 December 29, 2007 and December 30, 2006, options for 39 million and 32 million shares, respectively, were excluded from the diluted earnings per share calculation as they were anti-dilutive. A reconciliation of income from continuing operations and weighted average number of common and common equivalent shares outstanding for calculating diluted earnings per share is as follows:

	Quarter Ended	
	December 29, 2007	**December 30, 2006**
Income from continuing operations	**$ 1,250**	$ 1,676
Interest expense on convertible senior notes (net of tax)	**5**	5
	$ 1,255	$ 1,681
Shares (in millions):		
Weighted average number of common shares outstanding (basic)	**1,904**	2,059
Weighted average dilutive impact of equity-based compensation awards	**40**	44
Assumed conversion of convertible senior notes	**45**	45
Weighted average number of common and common equivalent shares outstanding (diluted)	**1,989**	2,148

8. *Shareholders Equity*

The Company declared a $664 million dividend ($0.35 per share) on November 28, 2007 related to fiscal 2007, which was paid on January 11, 2008 to shareholders of record on December 7, 2007. The Company paid a $637 million dividend ($0.31 per share) during the second quarter of fiscal 2007 related to fiscal 2006.

During the quarter ended December 29, 2007, the Company repurchased 31 million shares of Disney common stock for $1.0 billion. As of December 29, 2007, the Company had remaining authorization in place to repurchase approximately 292 million additional shares, of which the Company repurchased 14 million shares for $434 million subsequent to quarter-end through February 1, 2008. The repurchase program does not have an expiration date.

The Company received proceeds of $107 million from the exercise of 5 million stock options during the quarter ended December 29, 2007.

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

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

9. *Comprehensive Income*

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

	Quarter Ended	
	December 29, 2007	December 30, 2006
Net income	**$ 1,250**	$ 1,701
Market value adjustments for investments and hedges	**11**	(12)
Pension and postretirement medical adjustments	**5**	
Foreign currency translation and other	**2**	27
Comprehensive income	**$ 1,268**	$ 1,716

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

	December 29, 2007	September 29, 2007
Market value adjustments for investments and hedges	**$ (31)**	$ (42)
Unrecognized pension and postretirement medical expense	**(274)**	(279)
Foreign currency translation and other	**166**	164
Accumulated other comprehensive loss	**$ (139)**	$ (157)

10. *Equity-Based Compensation*

The impact of stock options and restricted stock units (RSUs) on income from continuing operations is as follows:

	Quarter Ended	
	December 29, 2007	December 30, 2006
Stock option compensation expense	**$ 60**	$ 55
RSU compensation expense	**43**	35
	103	90
Equity-based compensation plan modification charge [(1)]		48
Total equity-based compensation expense	**$ 103**	$ 138

(1) 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.

Unrecognized compensation cost related to unvested stock options and RSUs totaled approximately $382 million and $344 million, respectively, as of December 29, 2007.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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In January 2008, the Company made stock compensation grants, which included its regular annual grant, consisting of 26 million stock options and 10 million RSUs, of which 2 million RSUs included market-based and/or performance conditions.

The weighted average grant date fair values (which were determined using the binomial valuation model) of options granted during the quarters ended December 29, 2007 and December 30, 2006, were $9.96 and $8.94, respectively.

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 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, and on August 22, 2007, SSI initiated proceedings in the United States Patent and Trademark Office

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(PTO) seeking, among other things, cancellation of certain Pooh trademark registrations. On February 22, 2007, the PTO suspended the first proceeding on the grounds that the relief sought is effectively duplicative of that sought in the Fourth Amended Answer, and on October 2, 2007, the Company moved to suspend the second proceeding on the same ground.

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. On September 25, 2007, the California Court of Appeal affirmed the dismissal, and on January 3, 2008, plaintiff s petition for review by the California Supreme Court was denied.

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 December 29, 2007, the remaining debt service obligation guaranteed by the Company was $64 million, of which $43 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 December 29, 2007, the remaining debt service obligation guaranteed by the Company was $386 million, of which $103 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.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

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 of $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 that the amounts recorded in the financial statements are appropriate and in accordance with FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48). See Note 13 below for more detailed information on FIN 48.

13. *New Accounting Pronouncements*

EITF 07-1

In December 2007, the FASB issued Emerging Issues Task Force Issue No. 07-1, *Accounting for Collaborative Arrangements* (EITF 07-1). EITF 07-1 defines collaborative arrangements and establishes accounting and reporting requirements for transactions between participants in the arrangement and with third parties. A collaborative arrangement is a contractual arrangement that involves a joint operating activity, for example an agreement to co-produce and distribute a motion picture with another studio. EITF 07-1 is effective for the Company s 2010 fiscal year. The Company is currently assessing the potential effect of EITF 07-1 on its financial statements.

FIN 48

In July 2006, the FASB issued 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.

The Company adopted FIN 48 at the beginning of fiscal year 2008. Applying FIN 48 to all existing tax positions upon adoption resulted in reductions of $143 million and $13 million to opening retained earnings and minority interests, respectively.

As of the beginning of fiscal 2008, the Company had unrecognized tax benefits that is, the aggregate tax effect of differences between tax return positions and the benefits recognized in our financial statements totaling $630 million which does not include accrued interest on tax exposures and is not reduced for offsetting benefits in other tax jurisdictions. Of this amount, $352 million, if recognized, would reduce our income tax expense and effective tax rate after giving effect to offsetting benefits from other tax jurisdictions.

As of the beginning of fiscal 2008, the Company had accrued $137 million in interest related to unrecognized tax benefits and additional interest of $12 million was accrued during the current quarter. The Company has accrued no penalties to date. The Company s policy is to report interest and penalties as a component of income tax expense.

THE WALT DISNEY COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

The Internal Revenue Service is currently examining the Company s income tax returns for fiscal years 2001 through 2004. The Company is also subject to state and local and foreign tax audits. In California certain issues from the 1997-99 audit cycle remain unresolved and in New York matters from 1990 through 1995 are currently on appeal before the state s highest court. With the exception of these matters, the Company is no longer subject to examination in any of its major state or foreign tax jurisdictions for years prior to 2000.

In the next twelve months, it is reasonably possible that tax controversy matters including the Internal Revenue Service examination of fiscal years 2001 through 2004, the California issues from the 1997-99 audit cycle, and the New York matters from 1990 through 1995 mentioned above as well as a California examination of fiscal years 2004 and 2005, could be resolved which would reduce our unrecognized tax benefits by $204 million either because our tax positions are sustained or because we agree to their disallowance. It is also reasonably possible that this reduction could be partially offset by new matters arising during the same period. The resolution of the aforementioned matters is not expected to have a significant impact on the Company s results of operations.

SFAS 141R

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141R, *Business Combinations* (SFAS 141R), which replaces SFAS 141, *Business Combinations*. SFAS 141R establishes principles and requirements for determining how an enterprise recognizes and measures the fair value of certain assets and liabilities acquired in a business combination, including noncontrolling interests, contingent consideration, and certain acquired contingencies. SFAS 141R also requires acquisition-related transaction expenses and restructuring costs be expensed as incurred rather than capitalized as a component of the business combination. SFAS 141R will be applicable prospectively to business combinations beginning in the Company s 2010 fiscal year.

SFAS 160

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 160, *Noncontrolling Interests in Consolidated Financial Statements An Amendment of ARB No. 51* (SFAS 160). SFAS 160 establishes accounting and reporting standards for the noncontrolling interest in a subsidiary. SFAS 160 also requires that a retained noncontrolling interest upon the deconsolidation of a subsidiary be initially measured at its fair value. SFAS 160 is effective for the Company s 2010 fiscal year. Upon adoption of SFAS 160, the Company will be required to report its noncontrolling interests as a separate component of shareholders equity. The Company will also be required to present net income allocable to the noncontrolling interests and net income attributable to the shareholders of the Company separately in its consolidated statements of income. Currently, noncontrolling interests (minority interests) are reported as a liability in the Company s statement of financial position and the related income attributable to minority interests is reflected as an expense in arriving at net income. SFAS 160 requires retroactive adoption of the presentation and disclosure requirements for existing minority interests. All other requirements of SFAS 160 shall be applied prospectively.

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. The Company is currently assessing the potential effect of SFAS 159 on its financial statements.

THE WALT DISNEY COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

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 end of the fiscal year. The Company adopted the recognition provision of SFAS 158 in fiscal year 2007. The Company has not yet adopted the measurement date provisions which are not effective until fiscal year 2009.

SFAS 157

In September 2006, the FASB issued SFAS 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. The Company is currently assessing the potential effect of SFAS 157 on its financial statements.

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

Other Financial Information

Financial Condition

Commitments and Contingencies

Other Matters

Market Risk

OVERVIEW

Our summary consolidated results are presented below:

	Quarter Ended		
(in millions, except per share data)	**December 29, 2007**	December 30, 2006	Change
Revenues	**$ 10,452**	$ 9,581	9 %
Costs and expenses	**(8,419)**	(7,907)	6 %
Gains on sales of equity investments		1,052	nm
Net interest expense	**(123)**	(157)	(22) %
Equity in the income of investees	**123**	121	2 %
Income from continuing operations before income taxes and minority interests	**2,033**	2,690	(24) %
Income taxes	**(759)**	(1,009)	(25) %
Minority interests	**(24)**	(5)	nm
Income from continuing operations	**1,250**	1,676	(25) %
Discontinued operations, net of tax		25	nm
Net income	**$ 1,250**	$ 1,701	(27) %
Diluted earnings per share	**$ 0.63**	$ 0.79	(20) %

Quarter Results

Revenues for the quarter increased 9%, or $871 million to $10.5 billion, net income decreased by 27% to $1.3 billion and diluted earnings per share decreased by 20% to $0.63.

MANAGEMENT S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

Results for the prior-year quarter included the net favorable impact of the items summarized below (amounts in millions, except per share data):

Favorable / (unfavorable) impact	Quarter ended December 30, 2006		
	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
Income from the discontinued operations of the ABC Radio business	42	25	0.01
Equity-based compensation plan modification charge	(48)	(30)	(0.01)
Total [(1)]	$ 1,046	$ 652	$ 0.30

(1) Total diluted earnings per share impact does not equal the sum of the column due to rounding.

Diluted earnings per share decreased for the quarter due to the prior-year gains and other items detailed above, partially offset by growth at the operating segments and a decrease in weighted average shares outstanding. Earnings growth at the operating segments was primarily due to higher affiliate and advertising revenues at our cable businesses, increased primetime advertising revenue at the ABC Television Network, higher guest spending and theme park attendance at Walt Disney World and Disneyland Resort Paris, improved performance of our film productions in theatrical markets and strong sales of licensed products and self-published video games at Consumer Products. These increases were partially offset by lower DVD sales and higher programming and production costs at our cable businesses.

SEASONALITY

The Company s businesses are subject to the effects of seasonality. Consequently, the operating results for the quarter ended December 29, 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 revenues are subject to seasonal advertising patterns and changes in viewership levels. 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. Certain affiliate revenues at ESPN are deferred until annual programming commitments are met, and 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 and cable programming broadcasts.

MANAGEMENT S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

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			
	December 29, 2007	December 30, 2006	Change	
(in millions)				
Revenues:				
Media Networks	**$ 4,169**	$ 3,786	10	%
Parks and Resorts	**2,772**	2,489	11	%
Studio Entertainment	**2,641**	2,633		
Consumer Products	**870**	673	29	%
	$ 10,452	$ 9,581	9	%
Segment operating income:				
Media Networks	**$ 908**	$ 708	28	%
Parks and Resorts	**505**	405	25	%
Studio Entertainment	**514**	603	(15)	%
Consumer Products	**322**	234	38	%
	$ 2,249	$ 1,950	15	%

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

	Quarter Ended			
	December 29, 2007	December 30, 2006	Change	
(in millions)				
Segment operating income	**$ 2,249**	$ 1,950	15	%
Corporate and unallocated shared expenses	**(93)**	(107)	(13)	%
Equity-based compensation plan modification charge		(48)	nm	
Gains on sales of equity investments		1,052	nm	
Net interest expense	**(123)**	(157)	(22)	%
Income from continuing operations before income taxes and minority interests	**$ 2,033**	$ 2,690	(24)	%

Depreciation expense from continuing operations is as follows:

	Quarter Ended		
			Change

(in millions)	December 29, 2007	December 30, 2006	
Media Networks			
Cable Networks	$ 22	$ 21	5 %
Broadcasting	25	22	14 %
Total Media Networks	47	43	9 %
Parks and Resorts			
Domestic	198	199	(1) %
International	82	74	11 %
Total Parks and Resorts	280	273	3 %
Studio Entertainment	9	11	(18) %
Consumer Products	5	5	
Corporate	30	33	(9) %
Total depreciation expense from continuing operations	$ 371	$ 365	2 %

MANAGEMENT S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

Media Networks

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

	Quarter Ended		
	December 29, 2007	December 30, 2006	Change
(in millions)			
Revenues:			
Cable Networks	**$ 2,412**	$ 2,136	13 %
Broadcasting	**1,757**	1,650	6 %
	$ 4,169	$ 3,786	10 %
Segment operating income:			
Cable Networks	**$ 586**	$ 461	27 %
Broadcasting	**322**	247	30 %
	$ 908	$ 708	28 %

Revenues

Media Networks revenues increased 10%, or $383 million, to $4.2 billion, consisting of a 13% increase, or $276 million, at the Cable Networks and a 6% increase, or $107 million, at Broadcasting.

Increased Cable Networks revenues were due to growth of $138 million from cable and satellite operators, $126 million in advertising revenues and $12 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 and subscriber growth primarily at ESPN and, to a lesser extent, subscriber growth at the international Disney Channels and higher contractual rates at the domestic Disney Channels and ABC Family. These increases were partially offset by higher deferrals of revenue at ESPN due to annual programming commitments. Higher advertising revenue reflected the addition of NASCAR programming at ESPN and, to a lesser extent, increases at ABC Family primarily due to higher rates. The increase in other revenues was driven by DVD sales of *High School Musical 2*.

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 $234 million related to these commitments, which are expected to be recognized in the second half of the fiscal year, compared to $181 million in the prior-year quarter. The increase in deferred revenue was primarily due to a full period of deferral in the current quarter for a contract that was signed mid-way through the first quarter of the prior year.

Increased Broadcasting revenues were primarily due to higher primetime advertising revenue at the ABC Television Network and higher sales of our own productions. The increase in primetime advertising revenues at the ABC Television Network was due to higher advertising rates and sold inventory, partially offset by the impact of lower ratings. Increased sales of our own productions reflected higher domestic syndication, DVD and international sales. Key titles included *Extreme Makeover Home Edition, Lost* and *Ugly Betty.*

Costs and Expenses

Costs and expenses at Media Networks, which consist primarily of programming rights costs, production costs, participation costs, distribution and marketing expenses, labor costs, and general and administrative costs, increased 6%, or $189 million, reflecting a 9% increase, or $157 million, at the Cable Networks, and a 2% increase, or $32 million, at Broadcasting. The increase at Cable Networks was

MANAGEMENT S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

primarily due to increased programming and production costs at ESPN driven by the addition of NASCAR and also higher programming and other costs at the international and domestic Disney Channels. This increase was partially offset by the absence of Major League Baseball programming costs at ABC Family Channel. The increase at Broadcasting was primarily due to higher production cost amortization due to increased sales of our own productions and a more expensive primetime series mix at the ABC Television Network in the current quarter.

Sports Programming Costs

The Company has various contractual commitments for the purchase of television rights for sports and other programming, including the National Football League, 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 28%, or $200 million, to $908 million for the quarter due to an increase of 27%, or $125 million, at the Cable Networks and an increase of 30%, or $75 million, at Broadcasting. The increase at the Cable Networks was primarily due to growth at ABC Family and the domestic Disney Channels. The increase at Broadcasting was primarily due to higher primetime advertising revenue at the ABC Television Network.

On November 5, 2007, members of the Writers Guild of America commenced a work stoppage. See Risk Factors on page 36 for further information regarding the impact of the work stoppage.

Parks and Resorts

Revenues

Parks and Resorts revenues increased 11%, or $283 million, to $2.8 billion due to increases of $141 million at our domestic resorts and $142 million at our international resorts.

Domestic Parks and Resorts

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

MANAGEMENT S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

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	
	December 29, 2007	December 30, 2006	**December 29, 2007**	December 30, 2006	**December 29, 2007**	December 30, 2006
Parks (Increase/decrease)						
Attendance	**4 %**	3 %	**1 %**	(5) %	**3 %**	0 %
Per Capita Guest Spending	**3 %**	7 %	**2 %**	(1) %	**3 %**	4 %
Hotels						
Occupancy	**89 %**	85 %	**91 %**	94 %	**89 %**	86 %
Available Room Nights (in thousands)	**2,136**	2,143	**200**	202	**2,336**	2,345
Per Room Guest Spending	**$ 218**	$ 217	**$ 321**	$ 286	**$ 227**	$ 223

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

International Parks and Resorts

At our international parks and resorts, revenue growth was primarily due to an increase at Disneyland Resort Paris and, to a lesser extent, Hong Kong Disneyland Resort. Revenue growth at Disneyland Resort Paris 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, real estate sales and hotel occupancy. Increased guest spending was primarily due to higher average daily room rates and increased food and beverage spending. At Hong Kong Disneyland Resort, revenue growth was primarily due to higher theme park attendance.

Costs and Expenses

Costs and expenses, which consist principally of labor, depreciation, costs of merchandise, food and beverage sold, marketing and sales expense, repairs and maintenance and entertainment, increased 9%, or $183 million. The increase in costs and expenses was due primarily to increases at Disneyland Resort Paris and Walt Disney World. The increase at Disneyland Resort Paris was primarily due to the unfavorable impact of foreign currency translation, as a result of the weakening of the U.S. dollar against the Euro, and higher real estate cost of sales. The increase at Walt Disney World was driven by volume-related expenses, labor cost inflation and new guest offerings.

Segment Operating Income

Segment operating income increased 25%, or $100 million, to $505 million reflecting increases at Walt Disney World and Disneyland Resort Paris and improved performance at Hong Kong Disneyland Resort.

Studio Entertainment

Revenues

Revenues were essentially flat at $2.6 billion compared to the prior-year quarter as a decrease of $216 million in domestic home entertainment was largely offset by increases of $158 million in worldwide theatrical distribution and $52 million in music distribution.

MANAGEMENT S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

The increase in worldwide theatrical distribution revenues was primarily due to the strong performance of current quarter titles including *Enchanted*, *National Treasure: Book of Secrets* and *Game Plan* in the domestic and international markets, and the strong performance internationally of *Ratatouille* as compared to the prior-year quarter, which included *Déjà Vu*, *The Santa Clause 3* and *The Guardian* in the domestic and international markets. The revenue growth in music distribution was driven by the strong performance of the *Hannah Montana* concert tour and *High School Musical* CDs.

Lower domestic home entertainment revenues were primarily due to a decline in unit sales reflecting the performance of current quarter titles, including *Pirates of the Caribbean: At World s End*, *Ratatouille* and *Jungle Book* Platinum release, as compared to the strong performance in the prior-year quarter of *Pirates of the Caribbean: Dead Man s Chest*, *Cars* and *Little Mermaid* Platinum release.

Costs and Expenses

Costs and expenses, which consist primarily of production cost amortization, distribution and marketing expenses, product costs and participation costs, increased 5%, or $97 million primarily due to increases in worldwide theatrical distribution and worldwide home entertainment.

The increase in worldwide theatrical distribution costs was driven by higher distribution expenses associated with the current quarter releases and higher production cost amortization driven by *Ratatouille* which was in wide release in international markets in the current quarter compared to *Cars* which was at the end of its international release in the prior-year quarter. These increases were partially offset by lower film cost write-downs.

Higher costs and expenses in worldwide home entertainment were primarily due to increased distribution expenses driven by higher marketing costs in international markets, partially offset by a decrease domestically due to lower unit sales.

Segment Operating Income

Segment operating income decreased 15%, or $89 million, to $514 million primarily due to a decrease in domestic home entertainment partially offset by increases in worldwide theatrical distribution and music distribution.

On November 5, 2007, members of the Writers Guild of America commenced a work stoppage. See Risk Factors on page 36 for further information regarding the impact of the work stoppage.

Consumer Products

Revenues

Revenues for the quarter increased 29%, or $197 million, to $870 million, primarily due to increases of $118 million at Disney Interactive Studios and $64 million at Merchandise Licensing. Growth at Disney Interactive Studios was primarily due to the success of new self-published titles based on *High School Musical* and *Hannah Montana*. Growth at Merchandise Licensing was due to higher earned royalties across multiple product categories, led by the strong performance of *Hannah Montana* and *High School Musical* merchandise.

Costs and Expenses

Costs and expenses, which consist primarily of cost of sales, salaries and benefits, marketing, and video game development, increased 25%, or $109 million, to $548 million, due to higher cost of sales and video game development costs at Disney Interactive Studios.

MANAGEMENT S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS (continued)

Operating Income

Segment operating income increased 38%, or $88 million, to $322 million, primarily due to higher earned revenues at Merchandise Licensing and increased unit sales of self-published titles at Disney Interactive Studios.

OTHER FINANCIAL INFORMATION

Corporate and Unallocated Shared Expenses

Corporate and unallocated shared expenses decreased 13%, from $107 million to $93 million, driven by a gain on the sale of an asset.

Net Interest Expense

Net interest expense is as follows:

	Quarter Ended		
(in millions)	**December 29, 2007**	December 30, 2006	Change
Interest expense	**$ (216)**	$ (188)	15 %
Interest and investment income	**93**		