Disney & Pixar: Building a Magic Kingdom of Animation

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Building and Sustaining a Successful Enterprise
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From the first glimpse of the fairytale amusement park as a three foot tall child, to the excitement sparked by the flash of the castle across a big screen, to the everlasting joy of wearing a pair of Mickey Mouse ears, everyone has felt the magical touch of The Walt Disney Company. Since their start in the 1920s, Disney has captured the masses through a magnitude of channels of entertainment including media, animation, parks and resorts, and consumer products. Every creative character, fun-filled toy, charming story line, and thrilling theme park ride developed by Disney's most brilliant minds come together to give it the well-deserved reputation of the happiest place on earth.

While their prominence seems apparent to fans worldwide, their position of power hasn't always been secure. Over the years, they've faced threats from competitors, notably in animation from Pixar Inc. While Disney lived in the world of hand-drawn animation, it turned out there was a happier place on earth, and that place was the world of computer-generated animation. Pixar was the first to use this CG technology, and it took off faster than Disney could keep up.

**Once Upon A Time...**

On October 16, 1923, the dream of Disney was born as Walt Disney himself signed the initial contract, creating what was then named The Disney Brothers Studio. From here, they produced a series of cartoons before going public in 1940. They made their debut in the field of animation with their first animated film, *Snow White and the Seven Dwarfs*. Their journey had many other milestones as they aired their first
television show, opened their first theme park, and established their own radio station and television channel.\(^1\) It seemed the momentum couldn’t be stopped, and there was almost no medium of entertainment that Disney left untouched.

The revenue kept pouring in, but the majority of it did not come from the movies themselves, as box office sales were not the largest source of income. Instead, the biggest moneymakers were the products that utilized the movies’ characters. Disney really profited off of TV showings, merchandise sales, video games, pay-per-view and on-demand cable channels, and most importantly, home video sales, their largest revenue segment.\(^2\) This indicates that animation itself is not Disney’s core competence. However, the animated films were still integral to Disney’s financial success, seeing as it was the characters and storylines that facilitated all of these profitable channels.

**The Culture Behind the Castle**

The enchanted culture cultivated by Disney’s products is only possible due to the corporate culture behind the scenes. The attitude at Disney, while certainly valuing creativity, is not always as sugar-coated as their externally exuded atmosphere would suggest. Disney brainstorms from within, drawing on the ideas of all workers, from the animation specialists to the secretaries. Three times a year, anyone in the company can pitch their latest and greatest ideas, but once they do they brace themselves for the honest feedback that executives promise to provide. This collectivity is thought to make the best ideas emerge from the depth of the company.
The collective nature of the company is present, but only under a strong hierarchy, which was established to maintain a good sense of judgment and ensure quality leaders who will choose other quality leaders within their departments. The hierarchy is not meant to be condescending, and they work to make employees feel chosen for projects rather than assigned in order to keep morale high.³

The standards at Disney are high in every regard, including employee performance. The good and the bad of the employees’ work is publicized, and compensation for animators is paid in part based on the success of the final product. Strict deadlines are also upheld, not to be stifling but rather to be encouraging and prevent overthinking.⁴ When all of these ideals and values come together, the culture is what makes the dreams come true for the consumers.

**The Past of Pixar**

Pixar was born out of a company called Lucasfilm and was established as the Pixar we know today when Steve Jobs purchased the Computer Graphics Division in 1986. At the time, it consisted of only about 44 people, but they included two of Pixar’s most brilliant minds, Ed Catmull and John Lasseter. The company grew and issued their IPO in 1995, following its release of Toy Story as part of its alliance with Disney at the time.⁵ By 2006, they had an essentially perfect record in animation and had earned 20 Academy Awards for their various films. That year marked a “20 year unrivaled creative track record” for the company.⁶ It seemed that they were unstoppable.
The Culture Under the Spotlight

“Collective creativity” is the overarching theme of Pixar’s culture, as stated by Pixar’s President, Ed Catmull. The team at Pixar believes that every part of the process, not just the animation, should be in the hands of creative people. They recognize that the probability of success lies in the talent of the employees and not in the quality of the idea. As Catmull puts it, “If you give a good idea to a mediocre team, they'll screw it up. But if you give a mediocre idea to a great team, they'll make it work.” This illustrates that Pixar views their employees, a resource of the company, as an enabler to the successful development of films, the company’s process. To keep their brilliant minds sharp, Pixar employees are expected to be constantly learning. To promote this, they have set up their very own Pixar University that focuses on education and career development for its employees. They go to great lengths to avoid complacency within the company and strive to stay up to date with academic advances in the world.  

Along with the collectivity at Pixar comes communication, as all employees are encouraged to provide open feedback to each other during the entire process. Sharing of unfinished projects allows for fine tuning before a final product is completed, thus eliminating imperfections and ensuring the highest possible quality. There are groups and systems within the company that facilitate this feedback such as the Brain Trust, which is composed of Lasseter and eight other directors who meet to improve aspects of films before they are released, and The Dailies, which are snippets of released
footage at the end of each day commonly used in movie production. These serve as checkpoints to keep the production on track and up to par. Another means of feedback occurs after the final product is released. Post-mortems help to analyze retrospectively what was successful about a film and what could have been better. Pixar values this type of consideration more than other companies, illuminating the priority they place on quality. 9

Pixar’s process differed significantly from the majority of animation studios at the time. Most studios would hire staff specifically for the current movie they were working on. These writers and animators would be invested in the success of the film to which they were assigned, but not particularly committed to the company’s success. Pixar, on the other hand, hired an animation staff and kept it consistent for a span of their movies. In the words of Lowell Singer, Disney’s Senior Vice President of Investor Relations, “Pixar recreated old Hollywood.” Their animators worked for Pixar as a company, not as free agents, and therefore felt compelled to create success not through a single movie but through the duration of movies produced over time. 10 This was a major contributor to Pixar’s successful streak and helped them establish an esteemed reputation. It is apparent from this process that their priority is the company’s long-term success rather than the short term success of any single film.

Disney Finds a Friend in Pixar

In 1991, these two animation giants joined forces in a new partnership. Under the agreement, Pixar would write the storylines and make the movies while Disney
would contribute advice, finance the production, and handle the distribution of the final product. Pixar would end up earning 10 to 15 percent of the total profits made from the film. They agreed to make three films together, and the result was a great success. Toy Story, one of the joint productions, was the first computer-animated feature film and ended up being the highest grossing film in the United States in 1995, the year it was released. 11

Toy Story was a red flag to Disney that their alliance with Pixar was a clear advantage to the company, and it prompted them to seek further collaboration before other competitors, such as DreamWorks or Warner Bros, tried to capture Pixar’s talent. In 1997, the partnership was renewed in a deal that was set out to last for the next decade. Disney and Pixar would make 5 movies together, and this time, Pixar’s share of the profits would increase to 50%. Additionally, Disney bought one million shares of Pixar, thereby owning 5% of the company and showing their deep investment in the alliance. 12

The arrangement seemed to be mutually beneficial. Pixar’s stock price rose significantly after the 1997 deal, and they were able to improve their movies with the financing and guidance of Disney. From the other side, Pixar generated 45% of Disney’s operating income and 7% of its total earnings per share between the years of 2000 and 2005. 13
The benefits to Disney became glaringly clear when Pixar cut off the arrangement in 2004 to pursue profits from their movies independently. For Pixar, the break made their stock rise even more, while it had the opposite effect on Disney's stock. Following this, Disney was forced to scale back their animation workforce. They made attempts at adopting computer-generated (CG) technology themselves, but this required a steep learning curve for its current animators. Efforts were also made to gain the rights to help other animation companies distribute their films, as had been done with Pixar, but this alone did not make up for the deficit in the animation unit. It was at this point that Disney had to formulate a plan to revive their lagging animation.14

**Disruption of Disney: Pixar's Dream Come True**

Pixar was able to execute a disruptive strategy to succeed as an emergent in the animated film industry. The company utilized three different software systems in their animation process. Marionette was used for animation of character detail, RenderMan created texture and color in the animated objects, and Ringmaster sequenced the animation and kept projects organized. Since these were developed internally, Pixar had full ownership of the three technology interfaces. The software proved to be an extremely valuable asset, as Pixar was able to sell the RenderMan technology to multiple other animation companies, and these sales became their main source of revenue early on in Pixar's history.15
While Pixar was developing and mastering the use of the new technology for computer-generated animation, Disney proceeded to use hand-drawn animation for their films. Historically, the animation industry required a great amount of artistic skill that was hard to acquire, in addition to high fixed costs of production. It is for this reason that Disney was able to dominate for so long: the barriers to entry were high. Using the traditional animation process, a movie could take three to four years to complete. \(^{16}\) This timeline was not conducive to entrants building up their profit quickly enough to support their venture.

The CG technology enabled Pixar to disrupt this industry by eliminating the artistic skill necessary and reducing production time. With the technology, the same animated models could be easily edited for different scenes of the movie, instead of having to redraw each scenario separately. Their approach can be classified as low end disruption to the animation industry, because they were making films of lower quality but doing so faster and more conveniently, thereby competing on the performance metrics of production time and ease of production.

Computer-generated animation may not have been the lowest cost solution, but it made financial sense with Pixar’s disruptive strategy, as it allowed them to enter the market without employing the high-cost artists needed for hand drawn animation. It also enabled them to release movies more quickly to build up revenue in their early stages, thus overcoming the main barrier to entry. In just two years, from 2002 to 2004, they increased their revenue by about 30% through films, showing that they
were able to beat the usual three to four year production time. The revenue from software sales also helped them survive and stay afloat as an entrant (See Exhibit 1). Pixar continued to move up-market until the quality of their films began to equal and even overtake that of Disney’s animated films (See Exhibit 2). Disney, as the incumbent, recognized Pixar’s rising success and knew that they had to respond or risk being fully disrupted in the animation field, a key driver of revenue.

**Revive to Stay Alive**

Without Pixar on their side, Disney realized just how serious their disruptive potential was. From Disney’s point of view, there were a couple options they could pursue in order to recharge their animation department. It was clear that although they weren’t gaining much revenue from animation currently, shutting it down wasn’t an option, as their other main sources of revenue were dependent upon the intellectual property generated by the films. It is always better to try to develop a service or skill internally if possible before considering a merger or acquisition, as this is generally most authentic and cost effective. For this situation, that would mean investing in the CG technology and using time and resources to train animation artists to use it proficiently. Disney did make an attempt at this approach, but found it was hard to retrain the artists who were so accustomed to the current method of animation. Their deeply rooted culture made the system resistant to change. Additionally, since animated films themselves were not Disney’s core competence, they would need to consider if the cost of developing a new in-house animation unit
would be profitable in the long run, or if it would distract from their other departments.

A different option would be to seek out a new animation company to partner with in place of Pixar. The risk in this scenario is that one of Disney’s competitors might snatch up Pixar, who was clearly the current leader in animation. This would strengthen another incumbent and would pose stiff competition for Disney.

If Disney was confident that some sort of relationship with Pixar was the right approach, they had two main options. First, they could try to renegotiate an alliance similar to the previous structure of the partnership. However, with Pixar’s heightening demands, it might be difficult to come to an agreement that would be pleasing and profitable to both sides. The most recent agreement gave Pixar 50% of the total profits, and it is doubtful that Disney would have been willing to give up much more than that, meaning that a new alliance would most likely not have been economically beneficial for Disney.

That brought Disney to a final option: to acquire Pixar in full. Animation was not Disney’s core competence, but it was integral to their core sources of revenue based on the films’ characters and storylines. For this reason, it made sense to acquire a new animation unit from the outside. In terms of Harvard Business Review's The New M&A Playbook, Disney was looking to “reinvent their business model” which could be accomplished by acquiring a new set of processes, such as those of Pixar.
**Disney’s Decision: How does the glass slipper fit?**

In evaluating Disney’s values, it was clear that this was a business move that fit well with their goals and mission. The company stated that they aim to invest their capital in business strategies that give them the edge they need to develop content, in this case animated films, that is proprietary and profitable, and that is superior to the competition. It was also apparent that the two companies’ priorities aligned. At the basis of animation, both Disney and Pixar simply aimed to produce high-quality, profitable films (See Exhibit 3). This shared goal signified that an acquisition had potential for success.

Before moving forward with the acquisition, Disney had to decide how they would incorporate Pixar into their business model. They could absorb them into the Walt Disney Company and completely integrate the acquired resources, or they could leave them as an independent entity. The answer to this dilemma lies in the reason for the acquisition. If, from Disney’s point of view, the main value of Pixar resided in its resources, the correct decision would have been to dissolve their currently existing structure and absorb their technology, employees, and intellectual property into Disney’s organizational structure. On the other hand, if it was believed that the main value of Pixar was their creative processes, then Disney would do best to leave Pixar as its own functioning unit.

The resources that Pixar brought to the table were clearly valuable (See Exhibit 3). The CG technology reduced production time and had the potential to increase quality.
However, a technology itself cannot be disruptive and would always be vulnerable to commoditization, reducing its value and leveling the playing field in terms of competition. Therefore, this resource alone was not enough to justify an acquisition on Disney’s part. The employees at Pixar were another resource that Disney planned to retain. However, the creativity of the employees was associated with the Pixar process even more so than being classified as a resource.

Disney realized that it was not the CG technology that made every one of Pixar’s animated film a success; it was the talent and the creative process that accomplished that. Their culture of collective creativity, as discussed previously, was the differentiating factor between Pixar and other animation studios, and it gave them their competitive edge. If Disney were to dissolve the current methods, they would dissolve with them the recipe for success. It quickly became clear that this acquisition was meant to revive Disney’s business model by capitalizing on Pixar’s process, not on their resources alone.

The concerns about the acquisition centered mainly around the culture clash that might occur. It was known that Pixar worked at a slower pace than Disney, and while Disney would be tempted to accelerate their process, this might jeopardize the quality of the films produced. Though both companies had what they defined as a “collective” culture, they executed the collectivity differently. Disney generally had more structure, such as top-down feedback and enforced guidelines, that Pixar may find stifling. This was an important consideration in deciding how to execute the
acquisition with minimal cultural tension. Additionally, with the dramatic rise of Pixar’s stock valuation, the purchase would be quite pricey for Disney. 

There were also some reservations about how having Steve Jobs on the Board of Directors would change the dynamic and decisions of the group.

**Pixar: Entering a Whole New World**

For Pixar, being acquired by Disney was certainly not defeat. They were excited to benefit from the profits Disney earned through its unique assets, including their theme parks and merchandise. Pixar knew that Disney was ahead of them in terms of distribution abilities and outlets, and the acquisition would allow Pixar to capitalize on and have control over their own intellectual property in more ways than they previously could, which was one of their main priorities (See Exhibit 3).

Furthermore, it was one of Disney’s priorities to capitalize on that same intellectual property through their existing distribution channels. It seemed that the acquisition could simultaneously fulfill the two companies’ priorities.

Disney technically already had the rights to produce sequels of movies made under the Disney and Pixar alliance, and Pixar often worried that the quality of the sequels would not be up to their standards, as it was hard to produce a sequel without the minds of those who were behind the original. In reality, even Disney recognized that it would be in the best interests of both companies that the sequels be a joint production to maximize their quality, content, and profitability. The acquisition would make this possible.
In terms of choosing Disney over their competitors, Jobs felt confident that Disney would give them the strongest advantage and stated that “Disney is the only company with animation in their DNA.” Although Disney’s animation had been lagging recently, Pixar knew that they held it as a priority within their company, showing further synergy between the companies’ focuses.

Additionally, Disney and Pixar could both acknowledge the ease that would come with consolidating their separate sets of shareholders. They were previously trying to please their individual investors while in the alliance, and combining them would solidify a common goal. In an even more general sense, the collective creative base would expand and allow for greater innovation, development, and risk-taking than either company could achieve alone.

**The Acquisition: To Infinity and Beyond**

In 2006, the acquisition was made official as the Walt Disney Company purchased Pixar Inc. at a valuation of $7.4 billion. Shareholders received 2.3 shares of Disney for every share of Pixar. Additionally, Disney issued 225 million new shares, making the total number of shares on the market 400 million.

As discussed previously, Disney recognized that Pixar was successful through its creative process, and was therefore devoted to preserving this. In the words of Disney’s CEO Bob Iger, the Walt Disney Company was “committed to seeing to it that
Pixar is allowed to exist in the form it has existed.” Both of the current animation studios would remain in place, keeping their facilities and operations the same. In terms of production, Disney and Pixar would each aim to make one movie per year, however, since quality was the priority over quantity, this was not a hard set number.

Pixar’s creative talent was arguably its most valuable asset, both as a resource and a driver of their process, and Disney knew they must keep this. They restructured their positions to incorporate Pixar’s most brilliant minds. Ed Catmull, Pixar’s president, became the president of the new joint animation unit. Ed had been an integral part of nurturing creativity at Pixar, and it was he who originally dreamt of making a computer animated film. John Lasseter transitioned from being Pixar’s executive vice president to assuming the role of Chief Creative Officer of the new studios as well as the Principal Creative Adviser of the Disney Imagineering department. This allowed his creativity to be utilized not only for animated films, but also for Disney’s other assets including theme parks and attractions. Lastly, Steve Jobs, Pixar’s chairmen and CEO, was granted a position on the Disney Board of Directors and also became the largest shareholder of the joint company. 

**The Happily Ever After**

An analysis of the resources, processes, and priorities of Pixar and Disney can be used to evaluate the appropriateness and success of the acquisition (See Exhibit 3). In terms of resources, it was clear that each company had assets that the other desired, therefore suggesting a mutual gain from the acquisition. Differences began to arise in
the processes of the companies, leading to the conclusion that Pixar should be left independent following the acquisition in order to preserve the value of their creative talent and movie-making process. Disney came to this conclusion and executed the integration of Pixar accordingly.

The timing of the acquisition also enabled its success. The companies provided each other with reciprocal advantages. Pixar was ready to improve and expand their influence and Disney allowed them to do just that. From Disney’s end, Lowell Singer observed that Pixar “energized the creatives in the company” and that they “made Disney cool again.” This is something intangible that Disney could not have accomplished on its own.

The years of success for The Walt Disney Company that followed the acquisition are a testament to the sound decision that was made. The operating income from the studio entertainment segment of the company had sharply plummeted from 2004 to 2005, but after the acquisition it showed an immense upswing, increasing by about 250% from 2005 to 2006 and by another 65% from 2006 to 2007 (See Exhibit 5). Even though it was still the second smallest segment, it was no longer dragging the company down; rather it added to their total income significantly.

Their shareholders also experienced the victory of the acquisition through their stock value. The total earnings per share increased by 36% between 2005 and 2006 and
then by 41% between 2006 and 2007, demonstrating the heightened profitability of the company (See Exhibit 4).

The advantages gained by both Disney and Pixar can still be seen today. Even the most recent release from Walt Disney Animation Studios, *Frozen*, was a huge success, showing that the acquisition accomplished its intended job not only in the short term, but with lasting improvements for the companies involved.

Disney was able to do what so many incumbents are unable to, which was to acknowledge a threat to their company and respond in a timely and effective manner. By knowing their core competence, assessing where the true value of Pixar lied, and incorporating Pixar into The Walt Disney Company in a way that would preserve that value and be consistent with their core competence, they were able to not only salvage their animation unit, but turn it into a major asset for revenue growth, both immediately after the acquisition and for years to come.
**Exhibit 1:** Pixar Income Statement

**PIXAR**

**STATEMENTS OF INCOME**

<table>
<thead>
<tr>
<th>Fiscal Years Ended</th>
<th>December 28, 2002</th>
<th>January 3, 2004</th>
<th>January 1, 2005</th>
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<tbody>
<tr>
<td>Revenue:</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Film</td>
<td>$ 193,591</td>
<td>$ 250,383</td>
<td>$ 260,831</td>
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<tr>
<td>Software</td>
<td>8,133</td>
<td>12,115</td>
<td>12,641</td>
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<tr>
<td><strong>Total revenue</strong></td>
<td><strong>201,724</strong></td>
<td><strong>262,498</strong></td>
<td><strong>273,472</strong></td>
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</table>

*(In thousands, except per share data)*

Source: Pixar Annual Report 2005, [http://www.secinfo.com/d14D5a.z1KQg.htm#bslb](http://www.secinfo.com/d14D5a.z1KQg.htm#bslb)
**Exhibit 2:** Disruption Diagram

![Disruption Diagram](image)

**Exhibit 3:** Resources, Processes, Priorities (RPP) Analysis

*italics = commonalities*

<table>
<thead>
<tr>
<th>Company</th>
<th>Disney</th>
<th>Pixar</th>
</tr>
</thead>
</table>
| **Resources** | - Unique Assets (theme parks)  
- Rights to Pixar sequels  
- Distribution outlets  
- Skilled animation artists | - Creative Talent  
- CG Technology and knowledge to use it  
- Intellectual Property |
| **Processes** | - *Collective approach to brainstorming*  
- **Hand-Drawn animation process**  
- Employee performance standards and performance publicized  
- Compensation partially based on performance  
- Deadlines are enforced, timelines kept | - *Collective approach to brainstorming*  
- **Computer-generated animation process**  
- Keep animators consistent across span of movies (as opposed to free agents)  
- Storytelling methods  
- Constant Feedback Provided, including post-mortem feedback  
- The Brain Trust and Dailies |
| **Priorities** | - *Produce high-quality, profitable movies*  
- Capitalize on characters and storylines through other channels | - *Produce high-quality, profitable movies*  
- Ensure that intellectual property is not misused  
- Long term success of the company as opposed to short term success of a film |
Exhibit 5: Disney's Annual Financial Review 2007

<table>
<thead>
<tr>
<th></th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
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<tbody>
<tr>
<td><strong>Revenues</strong>&lt;sup&gt;(a)&lt;/sup&gt;</td>
<td></td>
<td></td>
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<tr>
<td>Media Networks</td>
<td>$10,360</td>
<td>$11,202</td>
<td>$12,637</td>
<td>$14,100</td>
<td>$15,046</td>
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<td>Parks and Resorts</td>
<td>6,412</td>
<td>7,750</td>
<td>9,023</td>
<td>9,925</td>
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<td>Studio Entertainment</td>
<td>7,364</td>
<td>8,713</td>
<td>7,587</td>
<td>7,529</td>
<td>7,491</td>
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<td>Consumer Products</td>
<td>2,344</td>
<td>2,511</td>
<td>2,127</td>
<td>2,193</td>
<td>2,342</td>
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<tr>
<td><strong>Total Revenues</strong></td>
<td>$26,480</td>
<td>$30,176</td>
<td>$31,374</td>
<td>$33,747</td>
<td>$35,510</td>
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<td><strong>Segment Operating Income</strong>&lt;sup&gt;(a)&lt;/sup&gt;</td>
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<td></td>
<td></td>
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<tr>
<td>Media Networks</td>
<td>$1,156</td>
<td>$2,380</td>
<td>$3,040</td>
<td>$3,480</td>
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<td>Parks and Resorts</td>
<td>946</td>
<td>1,077</td>
<td>1,178</td>
<td>1,534</td>
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<td>Studio Entertainment</td>
<td>620</td>
<td>662</td>
<td>207</td>
<td>729</td>
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<tr>
<td>Consumer Products</td>
<td>389</td>
<td>547</td>
<td>543</td>
<td>618</td>
<td>631</td>
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<tr>
<td><strong>Total Segment Operating Income</strong></td>
<td>$3,311</td>
<td>$4,666</td>
<td>$4,968</td>
<td>$6,361</td>
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Diluted earnings per share from continuing operations before the cumulative effect of accounting changes:

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<th>2006</th>
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<tr>
<td>Earnings per share, discontinued operations</td>
<td>$0.59</td>
<td>$1.07</td>
<td>$1.19</td>
<td>$1.60</td>
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<tr>
<td>Cumulative effect of accounting changes per share</td>
<td>$0.06</td>
<td>$0.05</td>
<td>$0.05</td>
<td>$0.03</td>
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<tr>
<td>Diluted earnings per share&lt;sup&gt;(a)&lt;/sup&gt;</td>
<td>$0.42</td>
<td>$1.12</td>
<td>$1.22</td>
<td>$1.64</td>
<td>$2.25</td>
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Cash provided by continuing operations:

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<th>2003</th>
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<th>2006</th>
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<tr>
<td>Free cash flow&lt;sup&gt;(a)&lt;/sup&gt;</td>
<td>$1,727</td>
<td>$2,811</td>
<td>$2,326</td>
<td>$4,668</td>
<td>$3,832</td>
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<sup>(a)</sup>During fiscal 2007, the Company concluded the spin-off of the ABC Radio business and now reports ABC Radio as discontinued operations for all periods presented. Previously, the ABC Radio business was included in the Media Networks segment. Prior period information has been reclassified to conform to the current presentation.

<sup>(a)</sup>Aggregate segment operating income and free cash flow are not financial measures defined by Generally Accepted Accounting Principles (GAAP). Reconciliations of non-GAAP financial measures to equivalent GAAP financial measures are available at the end of this Review.

<sup>(a)</sup>Diluted earnings per share may not equal the sum of the column due to rounding.

<sup>(a)</sup>The fiscal 2007 results include gains from the sale of E! Entertainment and Us Weekly ($0.31 per diluted share), favorable adjustments related to prior-year income tax matters ($0.03 per diluted share), and income from the discontinued operations of the ABC Radio business ($0.01 per diluted share), partially offset by an equity-based compensation plan modification charge ($0.01 per diluted share). Collectively, these items resulted in a net benefit of $0.33 per diluted share. The fiscal 2006 results include income from the discontinued operations of the ABC Radio business ($0.03 per diluted share), gains on sales of a Spanish cable equity investment and Discover Magazine ($0.02 per diluted share), favorable adjustments related to prior-year income tax matters ($0.02 per diluted share) and a net benefit associated with the completion of the Pixar acquisition ($0.01 per diluted share). Collectively, these items resulted in a net benefit of $0.09 per diluted share and a net benefit associated with the completion of the Pixar acquisition ($0.01 per diluted share). Excluding these items, EPS increased 24% to $1.92 in 2007 from $1.55 in 2006.

Exhibit 4: Analysis of Financial Condition, 2007

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

CONSOLIDATED RESULTS

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<tr>
<th></th>
<th>2007</th>
<th>2006</th>
<th>2005</th>
<th>% change</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>vs.</td>
</tr>
<tr>
<td>Revenues</td>
<td>$35,510</td>
<td>$33,747</td>
<td>$31,374</td>
<td>5%</td>
</tr>
<tr>
<td>Costs and expenses</td>
<td>(28,729)</td>
<td>(28,392)</td>
<td>(27,443)</td>
<td>1%</td>
</tr>
<tr>
<td>Gains on sales of equity investments and businesses</td>
<td>1,052</td>
<td>70</td>
<td>26</td>
<td>&gt;100%</td>
</tr>
<tr>
<td>Restructuring and impairment (charges) and other credits, net</td>
<td>—</td>
<td>18</td>
<td>(32)</td>
<td>(100%)</td>
</tr>
<tr>
<td>Net interest expense</td>
<td>(593)</td>
<td>(592)</td>
<td>(597)</td>
<td>—</td>
</tr>
<tr>
<td>Equity in the income of investees</td>
<td>485</td>
<td>473</td>
<td>483</td>
<td>3%</td>
</tr>
<tr>
<td>Income from continuing operations before income taxes, minority interests and the cumulative effect of accounting change</td>
<td>7,725</td>
<td>5,324</td>
<td>3,811</td>
<td>45%</td>
</tr>
<tr>
<td>Income taxes</td>
<td>(2,874)</td>
<td>(1,837)</td>
<td>(1,174)</td>
<td>56%</td>
</tr>
<tr>
<td>Minority interests</td>
<td>(177)</td>
<td>(183)</td>
<td>(177)</td>
<td>(3%)</td>
</tr>
<tr>
<td>Income from continuing operations before the cumulative effect of accounting change</td>
<td>4,874</td>
<td>3,304</td>
<td>2,460</td>
<td>41%</td>
</tr>
<tr>
<td>Discontinued operations, net of tax</td>
<td>13</td>
<td>70</td>
<td>109</td>
<td>(81%)</td>
</tr>
<tr>
<td>Cumulative effect of accounting change</td>
<td>—</td>
<td>—</td>
<td>(36)</td>
<td>nm</td>
</tr>
<tr>
<td>Net income</td>
<td>$4,687</td>
<td>$3,374</td>
<td>$2,533</td>
<td>39%</td>
</tr>
</tbody>
</table>

Diluted Earnings per share:

- Earnings per share, continuing operations before the cumulative effect of accounting change: $2.24 vs. $1.60 vs. $1.19 (40% vs. 34%)
- Earnings per share, discontinued operations: $0.01 vs. $0.03 vs. $0.05 (67% vs. 40%)
- Cumulative effect of accounting change per share: $0.02 vs. $0.02 vs. $0.02 (nm vs. nm)
- Earnings per share: $2.25 vs. $1.64 vs. $1.22 (37% vs. 34%)

Basic Earnings per share:

- Earnings per share, continuing operations before the cumulative effect of accounting change: $2.33 vs. $1.65 vs. $1.21 (41% vs. 34%)
- Earnings per share, discontinued operations: $0.01 vs. $0.03 vs. $0.05 (67% vs. 40%)
- Cumulative effect of accounting change per share: $0.02 vs. $0.02 vs. $0.02 (nm vs. nm)
- Earnings per share: $2.34 vs. $1.68 vs. $1.25 (39% vs. 34%)

Weighted average number of common and common equivalent shares outstanding:

- Diluted: 2,092 vs. 2,076 vs. 2,089
- Basic: 2,004 vs. 2,005 vs. 2,028

Source: The Walt Disney Company 2007 Annual Report
Endnotes:

9) Ibid.
10) Phone Conversation with Lowell Simmons, Senior Vice President of Investor Relations at The Walt Disney Company
12) Ibid.
13) Ibid.
14) Ibid.
21) Ibid.
22) Ibid.
24) Ibid.
26) Ibid.