FORSYTH BARR

Sky TV

UNDERPERFORM

Conviction List stock

FY19 Preview — Tough Today, Focus on Tomorrow

Sky TV (SKT) reports its FY19 result on 22 August — a continued subs and revenue decline is expected; focus will be further announcements and insights into the company's rapid strategic revolution under new CEO Martin Stewart.

Key issues to watch for:

- **Revenue / subscriber declines a given:** SKT has guided to EBIT and NPAT down -18–20% and -24–29% respectively, on the back of subs and advertising declines, the introduction of new, lower priced packages effective 1 March 2018, and removal of the HD ticket on 1 April 2019.
- **Further strategy announcements:** In the first six months under new CEO Martin Stewart SKT has made a rapid strategic about turn from short-term/defensive (clinging on to a declining satellite customer base) to long-term/offensive (embracing new technologies/platforms). We anticipate further colour on the recent Sky Sport Now app launch and RugbyPass acquisition, plus potential further announcements on new initiatives, e.g. new entertainment streaming services, sporting partnerships.
- **Higher costs:** We expect SKT's embracing of new platforms will come with additional cost. There is risk that medium-term opex will be higher than what analysts (including us) are currently forecasting. Additionally, this result may see write downs from SKT's abandonment of the new "puck" development and reassessment of SKT's considerable intangible assets.
- **Earnings guidance will be difficult:** Given the magnitude of recent changes SKT has made, and the dynamic environment in which it operates, we do not expect FY20 earnings guidance at this early stage.
- **Dividend cut:** We believe SKT will likely reduce its dividend (magnitude uncertain) given (1) the shift to a long-term/investment focus, and (2) its share price is not being rewarded for the high cash pay-out.

Investor briefing

Conference call: 11.00am (NZ time), NZ 0800 423 972, AU 1 800 590 693, Hong Kong 800 961 113, US 800 289 0459. Passcode: 072089.

Webcast: https://www.sky.co.nz/annualresults.

Figure 1. SKT FY19E forecasts

NZ$m	FY18	FY19E	% chg
Revenue	852.7	791.7	-7.2%
Reported EBITDA	285.8	232.2	-18.8%
EBIT	183.4	137.9	-24.8%
Underlying profit	479.0	90.6	-81.1%

Source: Company reports, Forsyth Barr analysis

Investment View

SKT faces considerable disruptive forces with escalating competition for both audiences and content. We expect continued material medium-term earnings declines from SKT's customers cutting or trimming bundles, declining advertising revenue, and higher content costs. Maintain UNDERPERFORM.

NZX Code	SKT
Share price	NZ$1.23
Target price	NZ$1.55
Risk rating	High
Issued shares	389.1m
Market cap	NZ$479m
Average daily turnover	876.0k (NZ$1,451k)

Share Price Performance

Financials: June	18A	19E	20E	21E
NPAT* (NZ$m)	119.0	90.6	82.8	73.6
EPS* (NZc)	30.6	23.3	21.3	18.9
EPS growth* (%)	1.3	-23.9	-8.6	-11.1
DPS (NZc)	15.0	11.0	7.0	7.0
Imputation (%)	100	100	100	100

Valuation (x)	18A	19E	20E	21E
EV/EBITDA	2.6	2.9	3.0	3.3
EV/EBIT	4.0	4.9	5.3	6.1
PE	4.0	5.3	5.8	6.5
Price / NTA	n/a	n/a	n/a	8.4
Cash dividend yield (%)	12.2	8.9	5.7	5.7
Gross dividend yield (%)	16.9	12.4	7.9	7.9

*Historic and forecast numbers based on underlying profits

Matt Henry, CFA
matt.henry@forsythbarr.co.nz
+64 9 368 0115

Matt Dunn
matt.dunn@forsythbarr.co.nz
+64 9 368 0103

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Sky Network Television Ltd (SKT) Priced as at 19 Aug 2019: NZ$1.23 June year end

Forsyth Barr valuation			
Valuation methodology			DCF
12-month target price (NZ$)*	**1.55**	**Spot valuations (NZ$)**	
Expected share price return	26.0%	1. DCF	1.56
Net dividend yield	5.7%		
Estimated 12-month return	31.7%		
Key WACC assumptions		**DCF valuation summary (NZ$m)**	
Risk free rate	2.75%	Total firm value	893
Equity beta	0.94	(Net debt)/cash	(228)
WACC	8.2%	Value of equity	665
Terminal growth	-2.0%	Shares (m)	389

Profit and Loss Account (NZ$m)	**2017A**	**2018A**	**2019E**	**2020E**	**2021E**
Sales revenue	893	853	792	764	746
Normalised EBITDA	**294**	**286**	**232**	**215**	**199**
Depreciation and amortisation	(105)	(102)	(94)	(91)	(91)
Normalised EBIT	**189**	**183**	**138**	**125**	**108**
Net interest	(20)	(18)	(12)	(9)	(5)
Associate income	-	-	-	-	-
Tax	(52)	(47)	(36)	(32)	(29)
Minority interests	0	0	0	0	0
Normalised NPAT	**118**	**119**	**91**	**83**	**74**
Abnormals/other	2	360	-	-	-
Reported NPAT	**116**	**(241)**	**91**	**83**	**74**
Normalised EPS (cps)	30.2	30.6	23.3	21.3	18.9
DPS (cps)	27.5	15.0	11.0	7.0	7.0

Growth Rates	**2017A**	**2018A**	**2019E**	**2020E**	**2021E**
Revenue (%)	-3.7	-4.6	-7.2	-3.5	-2.4
EBITDA (%)	-13.0	-2.9	-18.8	-7.2	-7.6
EBIT (%)	-20.6	-3.1	-24.8	-9.5	-13.3
Normalised NPAT (%)	-24.8	1.3	-23.9	-8.6	-11.1
Normalised EPS (%)	-24.8	1.3	-23.9	-8.6	-11.1
DPS (%)	-8.3	-45.5	-26.7	-36.4	0.0

Cash Flow (NZ$m)	**2017A**	**2018A**	**2019E**	**2020E**	**2021E**
EBITDA	**294**	**286**	**232**	**215**	**199**
Working capital change	(9)	(8)	(2)	1	3
Interest & tax paid	(41)	(65)	(47)	(42)	(34)
Other	1	1	-	-	-
Operating cash flow	**245**	**214**	**183**	**175**	**167**
Capital expenditure	(80)	(58)	(72)	(92)	(90)
(Acquisitions)/divestments	0	0	-	-	-
Other	(1)	2	-	-	-
Funding available/(required)	**165**	**157**	**111**	**84**	**78**
Dividends paid	(132)	(89)	(58)	(27)	(27)
Equity raised/(returned)	-	-	-	-	-
Increase/(decrease) in net debt	**(33)**	**(68)**	**(53)**	**(56)**	**(51)**

Balance Sheet (NZ$m)	**2017A**	**2018A**	**2019E**	**2020E**	**2021E**
Working capital	(38)	(45)	(43)	(44)	(47)
Fixed assets	238	210	199	207	210
Intangibles	1,488	1,125	1,113	1,107	1,102
Other assets	7	23	23	23	23
Total funds employed	**1,696**	**1,312**	**1,292**	**1,292**	**1,288**
Net debt/(cash)	293	228	176	120	69
Other non current liabilities	74	57	57	57	57
Shareholder's funds	1,327	1,025	1,058	1,113	1,160
Minority interests	1	1	2	2	2
Total funding sources	**1,696**	**1,312**	**1,292**	**1,292**	**1,288**

Valuation Ratios	**2017A**	**2018A**	**2019E**	**2020E**	**2021E**
EV/EBITDA (x)	2.7	2.6	2.9	3.0	3.3
EV/EBIT (x)	4.2	4.0	4.9	5.3	6.1
PE (x)	4.1	4.0	5.3	5.8	6.5
Price/NTA (x)	n/a	n/a	n/a	76.8	8.4
Free cash flow yield (%)	34.6	32.5	23.2	17.5	16.3
Net dividend yield (%)	22.4	12.2	8.9	5.7	5.7
Gross dividend yield (%)	31.1	16.9	12.4	7.9	7.9
Imputation (%)	100	100	100	100	100
Pay-out ratio (%)	91	49	47	33	37

Capital Structure	**2017A**	**2018A**	**2019E**	**2020E**	**2021E**
Interest cover EBIT (x)	9.7	10.5	12.0	13.4	19.7
Interest cover EBITDA (x)	15.0	16.3	20.1	23.2	36.2
Net debt/ND+E (%)	18.1	18.2	14.3	9.7	5.6
Net debt/EBITDA (x)	1.0	0.8	0.8	0.6	0.3

Key Ratios	**2017A**	**2018A**	**2019E**	**2020E**	**2021E**
Return on assets (%)	10.0	12.2	9.3	8.4	7.4
Return on equity (%)	8.9	11.6	8.6	7.4	6.3
Return on funds employed (%)	7.7	8.8	7.7	7.1	6.2
EBITDA margin (%)	33.0	33.5	29.3	28.2	26.7
EBIT margin (%)	21.2	21.5	17.4	16.3	14.5
Capex to sales (%)	8.9	6.8	9.2	12.0	12.0
Capex to depreciation (%)	91	72	96	122	116

Operating Performance	**2017A**	**2018A**	**2019E**	**2020E**	**2021E**
Revenue					
Subscriptions	807	779	724	698	681
Advertising	68	57	52	51	50
Installation & other revenue	18	17	15	15	15
Total revenue	**893**	**853**	**792**	**764**	**746**
Operating costs					
Programming	(349)	(328)	(323)	(320)	(322)
Subscriber related costs	(100)	(96)	(87)	(82)	(78)
Broadcasting & infrastructure	(98)	(93)	(96)	(92)	(91)
Other costs	(52)	(51)	(54)	(55)	(56)
Merger costs	(2)	-	-	-	-
Total operating costs	**(601)**	**(567)**	**(560)**	**(549)**	**(547)**
Reported EBITDA	**292**	**286**	**232**	**215**	**199**
Underlying EBITDA	**294**	**286**	**232**	**215**	**199**
Operating costs / revenue (%)					
Programming	39	38	41	42	43
Subscriber related costs	11	11	11	11	10
Broadcasting & infrastructure	11	11	12	12	12
Other costs	6	6	7	7	7
Total operating costs	**67**	**66**	**71**	**72**	**73**

Subscribers (000)					
Satellite + third party	737	688	665	646	624
OTT (Neon & Fanpass)	80	80	88	79	87
Other	8	-	-	-	-
Total	**825**	**768**	**753**	**725**	**711**
ARPU (NZ$/month)					
Traditional subcribers	83	83	81	80	81
Total	**79**	**76**	**74**	**74**	**74**

* Forsyth Barr target prices reflect valuation rolled forward at cost of equity less the next 12-months dividend

Figure 2. FY19E earnings forecasts

NZ$m	FY18	FY19E	% chg
Revenue			
Subscriptions	778.9	723.9	-7.1%
Advertising	57.0	52.4	-8.1%
Installation & other revenue	16.7	15.4	-8.2%
Total revenue	**852.7**	**791.7**	**-7.2%**
Operating expenses			
Programming	(328.1)	(323.2)	-1.5%
Subscriber related costs	(95.6)	(86.8)	-9.2%
Broadcasting & infrastructure	(92.6)	(95.8)	3.5%
Other costs	(50.7)	(53.7)	6.0%
Total operating costs	**(566.9)**	**(559.5)**	**-1.3%**
EBITDA	**285.8**	**232.2**	**-18.8%**
Depreciation & amortisation	(102.4)	(94.2)	-8.0%
EBIT	**543.4**	**137.9**	**-74.6%**
Interest	(17.5)	(11.5)	-34.1%
Net profit before tax	**525.9**	**126.4**	**-76.0%**
Tax	(46.6)	(35.5)	-23.7%
Minority interests	(0.3)	(0.3)	0.0%
Net profit after tax	**479.0**	**90.6**	**-81.1%**
Underlying profit	**119.0**	**90.6**	**-23.9%**
Underlying EPS (cps)	30.6	23.3	-23.9%
Dividend (cps)	15.0	15.0	0.0%
Subscribers (000)	768	753	-1.9%
Traditional ARPU (NZ$/month)	83.1	80.8	-2.8%
Total ARPU (NZ$/month)	76.3	74.2	-2.8%

Source: Company reports, Forsyth Barr analysis

Investment summary

We believe Sky TV (SKT) will struggle to avoid the considerable disruptive forces from escalating competition for both audiences and content. We expect continued material medium-term earnings declines from customers cutting or trimming bundles, declining advertising revenue, and higher content costs. We rate as UNDERPERFORM.

Business quality

- **No longer a monopoly:** Barriers to distributing content have collapsed, and SKT's positioning has moved from monopoly pay TV provider to facing intense competition from numerous global and local competitors. It is facing a revenue bleed from subscriber attrition, an increasing weighting of lower value streaming customers, customers' trimming bundles, effective price cuts, and declining advertising revenue.
- **Reinventing itself for a digital world:** In the first six months under new CEO Martin Stewart SKT has made a rapid strategic about turn from short-term/defensive (clinging on to a declining satellite customer base) to long-term/offensive (embracing new technologies/platforms) including recently launching the Sky Sport Now app and acquiring RugbyPass. Confidence in SKT's long-term outlook is difficult in such a dynamic and changeable industry.

Earnings and cash flow outlook

- **Near-term earnings declines inevitable:** In the face of escalating competition SKT saw an acceleration of subscriber losses since FY17. SKT has reduced prices and is investing in subscription video on demand (SVOD) products. SKT's SVOD viewership is trailing the competition, and SVOD subscribers are of significantly lower value than its traditional satellite base.
- **Likely content cost inflation:** SKT will likely face genuine competition for content for the first time. Potential challengers include local (e.g. Spark/Lightbox) and international (e.g. Netflix, Amazon) players, and existing content providers (e.g. Disney, HBO, Showtime, NZ Rugby, NRL) distributing directly to consumers.

Financial structure

- **Strong balance sheet:** We expect SKT to continue to reduce debt off an already solid FY19E net debt/EBITDA 0.8x.
- **Dividend cut:** We believe SKT will likely lower its dividend (magnitude uncertain) given (1) the shift to a long-term/investment focus, and (2) its share price is not being rewarded for the high cash pay-out.

Risk factors

- **Continued subscriber losses, ARPU pressures and/or rising content costs:** Including from increased competition from SVOD providers, and/or new entrants.

Company description

SKT is NZ's dominant pay-TV company, broadcasting a range of sports, entertainment, movies and news content over satellite and over-the-top (internet delivered) platforms. It also operates the Prime TV free-to-air channel.

Figure 3. SKT subscribers

Source: Company reports, Forsyth Barr analysis

Figure 4. SKT programming costs

Source: Company reports, Forsyth Barr analysis

Figure 5. Substantial Shareholders

Shareholder	Latest Holding
Kiltearn Partners	12.4%
Jupiter Asset Management	9.9%
ACC	6.2%
Harris & Associates LP	6.1%

Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

Figure 6. International Compcos

Company	Code	Price	Mkt Cap	PE		EV/EBITDA		EV/EBIT		Cash D/Yld
(metrics re-weighted to reflect SKT's balance date - June)			(m)	2019E	2020E	2019E	2020E	2019E	2020E	2020E
Sky TV	**SKT NZ**	**NZ$1.23**	**NZ$479**	**5.3x**	**5.8x**	**3.0x**	**3.3x**	**5.1x**	**5.7x**	**5.7%**
Spark NZ *	SPK NZ	NZ$3.98	NZ$7,308	18.5x	17.6x	7.9x	7.8x	14.5x	13.9x	5.5%
NZME *	NZM NZ	NZ$0.50	NZ$98	5.7x	6.4x	3.8x	4.0x	7.0x	7.7x	5.0%
Seven Group Holdings	SVW AT	A$15.69	A$5,325	11.4x	10.9x	8.4x	8.0x	10.7x	10.3x	3.0%
ITV PLC	ITV LN	£1.07	£4,303	8.7x	8.2x	7.7x	7.6x	8.6x	8.0x	7.1%
DISH Network Corp	DISH US	US$31.96	US$15,020	11.3x	15.5x	11.0x	12.7x	14.8x	17.0x	0.0%
Liberty Global PLC	LBTYA US	US$26.04	US$18,829	<0x	<0x	10.3x	10.2x	51.3x	40.5x	n/a
Astro Malaysia Holdings Bhd	ASTRO MK	RM1.40	RM7,300	13.9x	11.6x	5.4x	6.0x	10.3x	9.4x	6.9%
			Compco Average:	**11.6x**	**11.7x**	**7.8x**	**8.0x**	**16.7x**	**15.3x**	**4.6%**
EV = Current Market Cap + Actual Net Debt			**SKT Relative:**	**-54%**	**-51%**	**-61%**	**-59%**	**-69%**	**-63%**	**+24%**

Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (SKT) companies fiscal year end

Figure 7. Consensus EPS Momentum

Source: Forsyth Barr analysis, Bloomberg

Figure 8. 12 Month Forward PE

Source: Forsyth Barr analysis

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