

Sky TV

NEUTRAL

FY19 Result — A Fighting Chance; Raise to NEUTRAL

There was a lot to be learned from Sky TV's (SKT) result — we already knew (1) SKT is battling disruption and the revolution to streaming, (2) the economics of streaming are substantially more challenging than traditional satellite, but (3) under new CEO Martin Stewart SKT has made a rapid strategic shift from defensive to offensive. This shift is necessary to give SKT a fighting chance at being relevant long-term, but it does mean increased near-term investment and lower cash flow to shareholders. We believe (1) long-term there is likely a role for a sporting content aggregator in NZ, (2) SKT is strongly positioned to fill that role, and (3) the share price does not unreasonably reflect what the economics of that position may look like. We upgrade to NEUTRAL.

What's changed?

- **Earnings:** Going down medium-term, but pace and magnitude highly uncertain. FY20/21/22E EBITDA +2%/flat/-2%.

Battling disruption ...

SKT reported FY19 revenue and EBITDA down -7% and -16% respectively, highlighting the ongoing pressure on SKT from the revolution to a (lower margin) streaming world. Positively, subscriber numbers ticked higher for the first time in three years, up +1%, but beneath the headline higher value satellite customers declined by -7% vs. strong growth in lower value streaming +50%. ARPU fell -3.7% on the transition to streaming, SKT's satellite repricing, and satellite customers trimming bundles (traditional ARPU -3%).

... means heightened near- and long-term uncertainty

SKT emphasised it expects these pressures to continue and be exacerbated by content cost inflation (the share price was already telling us that), and provided minimal detail on any revenue, opex, or capex expectations. Whilst frustrating for analysts trying to populate models, it simply reflects the uncertain and dynamic environment in which SKT is operating. Also reflecting this and its considerable investment intentions, SKT terminated its dividend (it will revisit once it has greater certainty around the business's cash flows). There is currently considerable uncertainty over SKT's near- and long-term earnings.

SKT in with a fighting chance of living up to the current share price

SKT's share price reflects this uncertainty and already implies a substantial reduction in long-term earnings. We do not profess to have a conviction view on what the long-term future holds for SKT, and we recognise there is a wide margin of error to any valuation assessment. That said, we do believe (1) long-term there is likely a role for a sporting content aggregator in NZ, (2) SKT's starting point and its revised strategy positions it strongly to fill that role, and (3) the current share price is not an unreasonable reflection of what the economics of that position may look like.

Investment View

Whilst we expect disruptive pressures on SKT's earnings will not abate any time soon, we also believe the company is well positioned to evolve into a sport-focussed streaming service long-term. In our view, the current share price is not an unreasonable reflection of that proposition. NEUTRAL.

NZX Code	SKT
Share price	NZ\$1.18
Target price	NZ\$1.25
Risk rating	High
Issued shares	389.1m
Market cap	NZ\$459m
Average daily turnover	875.1k (NZ\$1,438k)

Share Price Performance



Financials: June	19A	20E	21E	22E
NPAT* (NZ\$m)	110.7	88.5	79.8	73.1
EPS* (NZc)	28.5	21.4	19.3	17.6
EPS growth* (%)	-7.0	-24.7	-10.1	-8.4
DPS (NZc)	7.5	0.0	0.0	0.0
Imputation (%)	100	100	100	100

Valuation (x)	19A	20E	21E	22E
EV/EBITDA	2.8	2.7	2.8	3.1
EV/EBIT	4.5	4.5	4.8	5.6
PE	4.1	5.5	6.1	6.7
Price / NTA	n/a	n/a	5.4	n/a
Cash dividend yield (%)	6.4	0.0	0.0	0.0
Gross dividend yield (%)	8.8	0.0	0.0	0.0

*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

Sky Network Television Ltd (SKT)

Priced as at 22 Aug 2019: NZ\$1.18

June year end

Forsyth Barr valuation		Valuation Ratios					2018A	2019A	2020E	2021E	2022E
Valuation methodology	DCF	EV/EBITDA (x)	2.5	2.8	2.7	2.8	3.1				
		EV/EBIT (x)	3.9	4.5	4.5	4.8	5.6				
12-month target price (NZ\$)*	1.25	Spot valuations (NZ\$)	PE (x)	3.9	4.1	5.5	6.1	6.7			
Expected share price return	5.9%	1. DCF	1.20	Price/NTA (x)	n/a	n/a	>100x	5.4	2.9		
Net dividend yield	0.0%			Free cash flow yield (%)	33.8	22.1	23.8	20.3	19.7		
Estimated 12-month return	5.9%			Net dividend yield (%)	12.7	6.4	0.0	0.0	0.0		
				Gross dividend yield (%)	17.7	8.8	0.0	0.0	0.0		
Key WACC assumptions		DCF valuation summary (NZ\$m)		Imputation (%)	100	100	100	100	100		
Risk free rate	2.00%	Total firm value	655	Pay-out ratio (%)	49	26	0	0	0		
Equity beta	0.94	(Net debt)/cash	(188)								
WACC	7.6%	Value of equity	468	Capital Structure	2018A	2019A	2020E	2021E	2022E		
Terminal growth	1.5%	Shares (m)	389	Interest cover EBIT (x)	10.5	11.9	15.0	33.6	n/a		
				Interest cover EBITDA (x)	16.3	19.4	24.9	58.0	n/a		
Profit and Loss Account (NZ\$m)	2018A	2019A	2020E	2021E	2022E	Net debt/ND+E (%)	18.2	34.9	17.7	0.3	-17.7
Sales revenue	853	795	769	749	730	Net debt/EBITDA (x)	0.8	0.8	0.4	0.0	n/a
Normalised EBITDA	286	241	220	198	178						
Depreciation and amortisation	(102)	(93)	(87)	(83)	(79)	Key Ratios	2018A	2019A	2020E	2021E	2022E
Normalised EBIT	183	148	132	115	99	Return on assets (%)	12.2	19.2	17.7	15.6	13.7
Net interest	(18)	(12)	(9)	(3)	3	Return on equity (%)	11.6	31.6	20.2	15.4	12.4
Associate income	-	-	-	-	-	Return on funds employed (%)	8.8	13.3	17.3	15.4	14.0
Tax	(47)	(24)	(35)	(31)	(29)	EBITDA margin (%)	33.5	30.3	28.6	26.5	24.4
Minority interests	0	0	0	0	0	EBIT margin (%)	21.5	18.6	17.2	15.3	13.6
Normalised NPAT	119	111	88	80	73	Capex to sales (%)	6.8	9.6	10.0	10.0	9.0
Abnormals/other	360	719	-	-	-	Capex to depreciation (%)	72	108	111	109	98
Reported NPAT	(241)	(608)	88	80	73						
Normalised EPS (cps)	30.6	28.5	21.4	19.3	17.6	Operating Performance	2018A	2019A	2020E	2021E	2022E
DPS (cps)	15.0	7.5	-	-	-	Revenue					
						Subscriptions	779	728	704	686	669
Growth Rates	2018A	2019A	2020E	2021E	2022E	Advertising	57	52	50	48	47
Revenue (%)	-4.6	-6.8	-3.3	-2.5	-2.6	Installation & other revenue	17	15	15	15	14
EBITDA (%)	-2.9	-15.7	-8.8	-9.7	-10.2	Total revenue	853	795	769	749	730
EBIT (%)	-3.1	-19.3	-10.6	-13.2	-13.7	Operating costs					
Normalised NPAT (%)	1.3	-7.0	-20.1	-9.8	-8.4	Programming	(328)	(321)	(316)	(318)	(335)
Normalised EPS (%)	1.3	-7.0	-24.7	-10.1	-8.4	Subscriber related costs	(96)	(88)	(84)	(79)	(75)
DPS (%)	-45.5	-50.0	-100.0	n/a	n/a	Broadcasting & infrastructure	(93)	(96)	(99)	(102)	(90)
						Other costs	(51)	(49)	(50)	(51)	(52)
Cash Flow (NZ\$m)	2018A	2019A	2020E	2021E	2022E	Merger costs	-	-	-	-	-
EBITDA	286	241	220	198	178	Total operating costs	(567)	(554)	(549)	(551)	(552)
Working capital change	(8)	(11)	10	4	4	Reported EBITDA	286	241	220	198	178
Interest & tax paid	(65)	(49)	(43)	(35)	(26)	Underlying EBITDA	286	241	220	198	178
Other	1	(3)	-	-	-	Operating costs / revenue (%)					
Operating cash flow	214	178	186	168	156	Programming	38	40	41	42	46
Capital expenditure	(58)	(76)	(77)	(75)	(66)	Subscriber related costs	11	11	11	11	10
(Acquisitions)/divestments	0	0	(16)	-	-	Broadcasting & infrastructure	11	12	13	14	12
Other	2	8	-	-	-	Other costs	6	6	7	7	7
Funding available/(required)	157	110	94	93	91	Total operating costs	66	70	71	74	76
Dividends paid	(89)	(67)	-	-	-	Subscribers (000)					
Equity raised/(returned)	-	-	-	-	-	Satellite + third party	688	665	646	624	598
Increase/(decrease) in net debt	(68)	(43)	(94)	(93)	(91)	OTT (Neon & Fanpass)	80	88	79	87	96
						Other	-	-	-	-	-
Balance Sheet (NZ\$m)	2018A	2019A	2020E	2021E	2022E	Total	768	779	787	794	802
Working capital	(45)	(39)	(49)	(53)	(57)	ARPU (NZ\$/month)					
Fixed assets	210	163	163	162	154	Traditional subscribers	83	81	80	81	81
Intangibles	1,125	446	435	428	423	Total	78	75	71	69	66
Other assets	23	7	7	7	7						
Total funds employed	1,312	577	556	544	526						
Net debt/(cash)	228	188	94	1	(89)						
Other non current liabilities	57	37	37	37	37						
Shareholder's funds	1,025	350	439	518	592						
Minority interests	1	1	2	2	2						
Total funding sources	1,312	577	572	559	542						

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

Result analysis

Figure 1. FY19 result analysis

NZ\$m	FY18	FY19	% chg	Forbar	% diff	
Revenue						
Subscriptions	778.9	728.4	-6.5%	723.9	0.6%	Subscribers +1% but ARPU -4% on more lower value streaming subs, customers trimming bundles, and satellite repricing.
Advertising	57.0	51.8	-9.2%	52.4	-1.2%	Weak advertising market, compounded by declining viewership.
Installation & other revenue	16.7	15.0	-10.5%	15.4	-2.6%	Fewer satellite installations.
Total revenue	852.7	795.1	-6.8%	791.7	0.4%	
Operating expenses						
Programming	(328.1)	(320.8)	-2.2%	(323.2)	-0.8%	Up to 40.3% of revenue vs. 38.5% in pcp reflecting fixed cost content rights costs.
Subscriber related costs	(95.6)	(88.3)	-7.6%	(86.8)	1.7%	Decline in labour costs and fewer decoder repairs.
Broadcasting & infrastructure	(92.6)	(95.8)	3.6%	(95.8)	0.1%	Higher costs to support OTT products and deliver on-demand content.
Other costs	(50.7)	(49.3)	-2.6%	(53.7)	-8.1%	
Total operating costs	(566.9)	(554.3)	-2.2%	(559.5)	-0.9%	
EBITDA	285.8	240.9	-15.7%	232.2	3.8%	
Depreciation & amortisation	(102.4)	(92.9)	-9.3%	(94.2)	-1.4%	Aging decoder base and less decoder installations.
EBIT (before sig. items)	183.4	148.0	-19.3%	137.9	7.3%	
Significant items	(360.0)	(718.9)	na	0.0	na	Goodwill impairment NZ\$670m, "puck" write-off NZ\$38m, content write-off and consulting & redundancies NZ\$11m.
EBIT	(176.6)	(570.9)	na	137.9	na	
Interest	(17.5)	(12.4)	-28.9%	(11.5)	7.8%	Bank debt down -NZ\$42m.
Net profit before tax	(194.1)	(583.4)	na	126.4	-561.5%	
Tax	(46.6)	(24.5)	-47.5%	(35.5)	-31.1%	
Minority interests	(0.3)	(0.3)	13.8%	(0.3)	13.8%	
Net profit after tax	(241.0)	(608.2)	na	90.6	-771.3%	
Underlying profit	119.0	97.0	-18.5%	90.6	7.1%	
Underlying EPS (cps)	30.6	24.9	-18.5%	23.3	7.1%	
Dividend (cps)	15.0	7.5	-50.0%	11.0	-31.8%	Dividends terminated. No final dividend paid.
Subscribers (000)	768	779	1.4%	753	3.5%	Satellite -7% offset streaming +50%.
Traditional ARPU (NZ\$/month)	83.1	81.0	-2.5%	80.8	0.2%	Customers trimming bundles, satellite package repricing.
Total ARPU (NZ\$/month)	77.7	74.8	-3.7%	74.2	0.9%	A higher proportion of lower value OTT/streaming subs.

Source: Company reports, Forsyth Barr analysis

Investment summary

Whilst we expect disruptive pressures on SKT's earnings will not abate any time soon, we also believe the company is well positioned to evolve into a sport-focussed streaming service long-term. In our view, the current share price is not an unreasonable reflection of that proposition. **NEUTRAL.**

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. Forecasting 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 has seen significant subscriber, ARPU, and advertising revenue erosion. SKT has emphasised it expects these pressures to continue medium-term and be exacerbated by content cost inflation as key content rights are re-contracted, and other growth investments by SKT.

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.

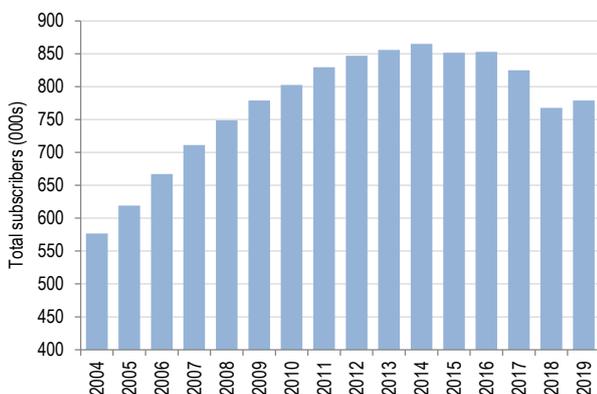
Financial structure

- **Nil dividend:** SKT terminated its dividend ahead of potential near-term investment opportunities and sports rights contracting. It will revisit it once it has greater certainty around the business's cash flows.
- **Strong balance sheet:** We expect healthy free cash flow to continue to lower debt off an already solid FY19 net debt/EBITDA 0.8x.

Risk factors

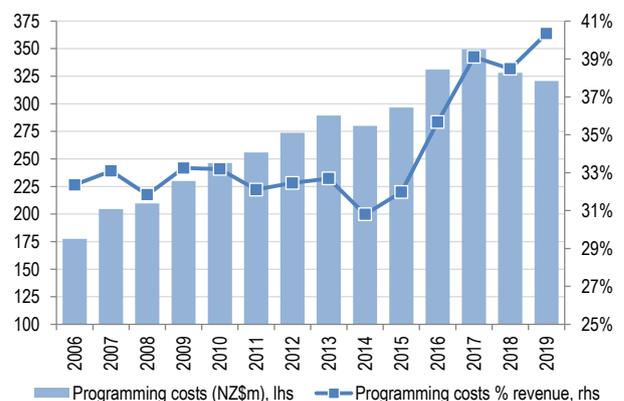
- **Continued subscriber losses, ARPU pressures and/or rising content costs:** SKT is facing increasingly intense competition for audiences and content including from local (e.g. TVNZ, Spark/Lightbox) and international (e.g. Netflix, Amazon) players, and existing content providers (e.g. Disney+, and potentially HBO, Showtime, or sporting bodies such as NZ Rugby or the NRL) distributing directly to consumers.

Figure 2. SKT subscribers



Source: Company reports, Forsyth Barr analysis

Figure 3. SKT programming costs



Source: Company reports, Forsyth Barr analysis

Figure 4. Substantial Shareholders

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

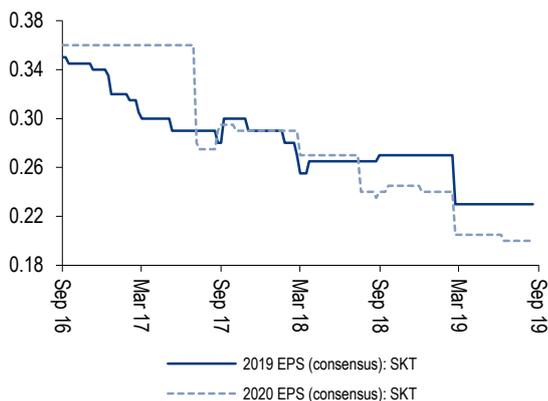
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

Figure 5. International Compcos

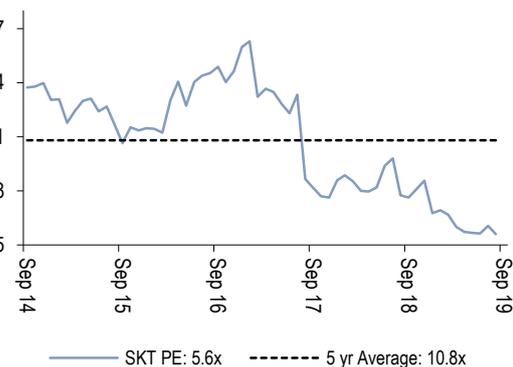
Company	Code	Price	Mkt Cap	PE		EV/EBITDA		EV/EBIT		Cash D/Yld
<i>(metrics re-weighted to reflect SKT's balance date - June)</i>										
			(m)	2020E	2021E	2020E	2021E	2020E	2021E	2021E
Sky TV	SKT NZ	NZ\$1.18	NZ\$459	5.5x	6.1x	2.9x	3.3x	4.9x	5.6x	0.0%
Spark NZ *	SPK NZ	NZ\$4.19	NZ\$7,694	18.5x	18.3x	8.1x	8.1x	14.3x	14.3x	6.0%
NZME *	NZM NZ	NZ\$0.53	NZ\$104	6.8x	6.3x	4.1x	4.2x	7.9x	7.7x	4.7%
Seven Group Holdings	SVW AT	A\$17.13	A\$5,813	12.1x	10.9x	8.1x	7.5x	10.9x	9.5x	2.9%
ITV PLC	ITV LN	£1.11	£4,452	8.4x	8.1x	7.8x	7.6x	8.3x	7.9x	7.4%
DISH Network Corp	DISH US	US\$31.87	US\$14,978	15.5x	19.4x	12.7x	14.3x	17.0x	18.6x	0.0%
Liberty Global PLC	LBTYA US	US\$26.26	US\$19,016	<0x	<0x	10.3x	10.1x	38.8x	33.0x	n/a
Astro Malaysia Holdings Bhd	ASTRO MK	RM1.45	RM7,561	12.0x	11.9x	6.1x	6.2x	9.6x	9.6x	6.7%
Compco Average:				12.2x	12.5x	8.2x	8.3x	15.3x	14.4x	4.6%
SKT Relative:				-55%	-51%	-64%	-61%	-68%	-61%	-100%

EV = Current Market Cap + Actual Net Debt

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

Figure 6. Consensus EPS Momentum


Source: Forsyth Barr analysis, Bloomberg

Figure 7. 12 Month Forward PE


Source: Forsyth Barr analysis

Not personalised financial advice: The recommendations and opinions in this publication do not take into account your personal financial situation or investment goals. The financial products referred to in this publication may not be suitable for you. If you wish to receive personalised financial advice, please contact your Forsyth Barr Investment Adviser. The value of financial products may go up and down and investors may not get back the full (or any) amount invested. Past performance is not necessarily indicative of future performance. Disclosure statements for Forsyth Barr Investment Advisers are available on request and free of charge. **Disclosure:** Forsyth Barr Limited and its related companies (and their respective directors, officers, agents and employees) ("Forsyth Barr") may have long or short positions or otherwise have interests in the financial products referred to in this publication, and may be directors or officers of, and/or provide (or be intending to provide) investment banking or other services to, the issuer of those financial products (and may receive fees for so acting). Forsyth Barr is not a registered bank within the meaning of the Reserve Bank of New Zealand Act 1989. Forsyth Barr may buy or sell financial products as principal or agent, and in doing so may undertake transactions that are not consistent with any recommendations contained in this publication. Forsyth Barr confirms no inducement has been accepted from the researched entity, whether pecuniary or otherwise, in connection with making any recommendation contained in this publication. **Analyst Disclosure Statement:** In preparing this publication the analyst(s) may or may not have a threshold interest in the financial products referred to in this publication. For these purposes a threshold interest is defined as being a holder of more than \$50,000 in value or 1% of the financial products on issue, whichever is the lesser. In preparing this publication, non-financial assistance (for example, access to staff or information) may have been provided by the entity being researched. **Disclaimer:** This publication has been prepared in good faith based on information obtained from sources believed to be reliable and accurate. However, that information has not been independently verified or investigated by Forsyth Barr. Forsyth Barr does not make any representation or warranty (express or implied) that the information in this publication is accurate or complete, and, to the maximum extent permitted by law, excludes and disclaims any liability (including in negligence) for any loss which may be incurred by any person acting or relying upon any information, analysis, opinion or recommendation in this publication. Forsyth Barr does not undertake to keep current this publication; any opinions or recommendations may change without notice. Any analyses or valuations will typically be based on numerous assumptions; different assumptions may yield materially different results. Nothing in this publication should be construed as a solicitation to buy or sell any financial product, or to engage in or refrain from doing so, or to engage in any other transaction. Other Forsyth Barr business units may hold views different from those in this publication; any such views will generally not be brought to your attention. This publication is not intended to be distributed or made available to any person in any jurisdiction where doing so would constitute a breach of any applicable laws or regulations or would subject Forsyth Barr to any registration or licensing requirement within such jurisdiction. **Terms of use:** Copyright Forsyth Barr Limited. You may not redistribute, copy, revise, amend, create a derivative work from, extract data from, or otherwise commercially exploit this publication in any way. By accessing this publication via an electronic platform, you agree that the platform provider may provide Forsyth Barr with information on your readership of the publications available through that platform.