

Sky TV

UNDERPERFORM

Media Too Tough for Benefit of the Doubt; Cut to UNDERPERFORM

We doubt Sky TV's (SKT) FY20 revenue guidance, down -3-6%, would have surprised the market. But we suspect the magnitude of cost escalation, translating into EBITDA (like-for-like) down a substantial -32-40%, will have. We understand what SKT's new management team is trying to achieve — position the company to be NZ's aggregator of sporting content in a streaming world. Even if SKT is successful in achieving this goal, the economics of "success" remains highly uncertain. In our view, (1) the market is pricing earnings to stabilise around FY20E levels, which, (2) in an industry being buffeted by disruption and intense competition for subscribers and content, feels optimistic. We downgrade to UNDERPERFORM.

What's changed?

- **Earnings:** Dramatic changes. FY20/21/22E EPS down -61%/-66%/-55%.
- **Target Price:** Cut to NZ80c.

Cost in

SKT is a largely fixed cost business, facing declining revenue, and investing to try to stay relevant in a disrupted, and now global, industry. The lift in cost has come from: (1) organisational change including restructuring and rebranding, (2) content and production, including rights from and support for sporting bodies, and (3) the acquisition of Rugby Pass. We understand around one-third of the cost increases are one-off in nature.

Figure 1. FY20 guidance

	FY19	IFRS 16	FY19 adjusted	FY20 guidance	yoy % chg
Revenue	795		795	750-770	-3-6%
Opex	554		514	560-600	+10-18%
EBITDA	241	40	281	170-190	-32-40%

Source: Company reports, Forsyth Barr analysis

Battling disruption and revolution to streaming

The escalation in costs highlights how aggressive SKT is now being in attempting to reposition itself for the modern environment. Whilst this shift is necessary to give SKT a fighting chance at being relevant long-term, the magnitude of the expected EBITDA decline highlights the challenge of streaming economics with its low barriers to entry, and global scale competitors. SKT has lifted its focus on sport, again understandable given sport is more localised than general entertainment. But SKT also faces cost pressure in that category from (1) sporting codes demanding broader and deeper coverage, and (2) competition from Spark Sport, whose recent six-year contract to broadcast NZ Cricket means SKT will, going forward, have to assume bidding for all key content is competitive.

Investment View

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

NZX Code	SKT
Share price	NZ\$0.89
Target price	NZ\$0.80
Risk rating	High
Issued shares	436.0m
Market cap	NZ\$388m
Average daily turnover	928.8k (NZ\$1,214k)

Share Price Performance



Financials: June	19A	20E	21E	22E
NPAT* (NZ\$m)	97.0	34.8	27.0	32.8
EPS* (NZc)	24.9	8.2	6.2	7.5
EPS growth* (%)	-18.5	-67.3	-24.1	21.7
DPS (NZc)	7.5	0.0	0.0	0.0
Imputation (%)	100	100	100	100

Valuation (x)	19A	20E	21E	22E
EV/EBITDA	2.5	3.0	3.2	3.3
EV/EBIT	4.0	8.8	10.9	10.1
PE	3.6	10.9	14.4	11.8
Price / NTA	n/a	n/a	n/a	n/a
Cash dividend yield (%)	8.4	0.0	0.0	0.0
Gross dividend yield (%)	11.7	0.0	0.0	0.0

*Historic and forecast numbers based on underlying profits

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Sky Network Television Ltd (SKT)

Priced as at 18 Nov 2019: NZ\$0.89

June year end

Forsyth Barr valuation					Valuation Ratios					2018A	2019A	2020E	2021E	2022E
Valuation methodology					DCF	EV/EBITDA (x)				2.3	2.5	3.0	3.2	3.3
12-month target price (NZ\$)*					0.80	Spot valuations (NZ\$)				3.5	4.0	8.8	10.9	10.1
Expected share price return					-10.1%	1. DCF				2.9	3.6	10.9	14.4	11.8
Net dividend yield					0.0%	0.78				n/a	n/a	n/a	n/a	n/a
Estimated 12-month return					-10.1%					Free cash flow yield (%)				
										40.0	26.2	16.5	11.1	12.3
										Net dividend yield (%)				
										16.9	8.4	0.0	0.0	0.0
										Gross dividend yield (%)				
										23.4	11.7	0.0	0.0	0.0
										Imputation (%)				
										100	100	100	100	100
										Pay-out ratio (%)				
										49	30	0	0	0
Key WACC assumptions					DCF valuation summary (NZ\$m)					Capital Structure				
Risk free rate					2.00%	Total firm value				498				
Equity beta					0.94	(Net debt)/cash				(188)				
WACC					7.6%	Value of equity				310				
Terminal growth					0.0%	Shares (m)				436				
										Operating Performance				
										Revenue				
										Subscriptions				
										Advertising				
										Installation & other revenue				
										Total revenue				
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Investment summary

We believe Sky TV (SKT) will struggle to avoid the considerable disruptive forces from escalating competition for both audiences and content. In our view, the market is pricing earnings to stabilise around FY20E levels, which given the highly challenging backdrop feels optimistic. **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 year 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 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, and cost increases. 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.

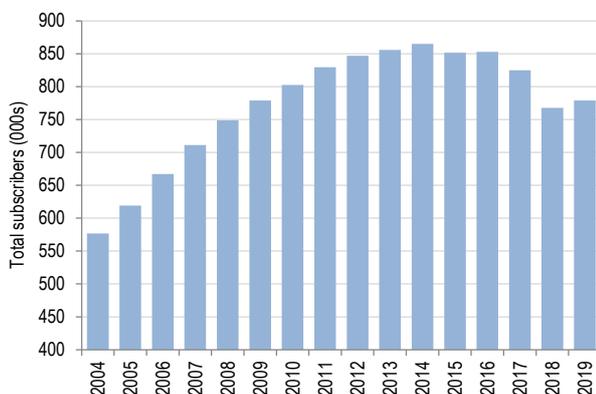
Financial structure

- **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

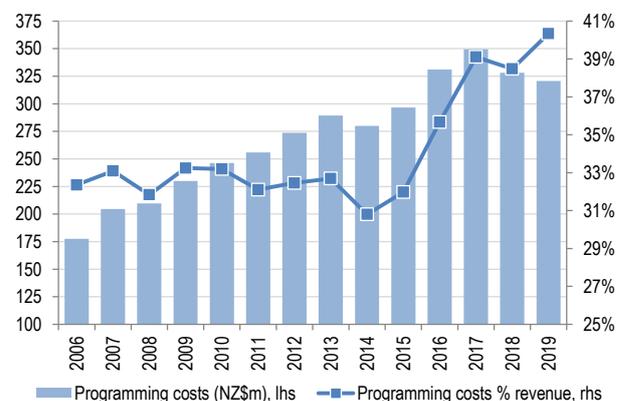
- **Continued subscriber losses, ARPU pressures and/or rising content costs:** SKT is facing increasingly intense competition for audiences and content including from local (e.g. TVNZ, Spark Sport/Lightbox) and international (e.g. Netflix, Amazon, Disney+, Apple) players, and existing content providers (e.g. Disney+, and potentially HBO, Showtime, or sporting bodies such as 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
Jupiter Asset Management	9.9%
Kiltearn Partners	8.9%
ACC	7.2%
RugbyPass Investors, LLC	6.1%
New Zealand Rugby Union	5.0%

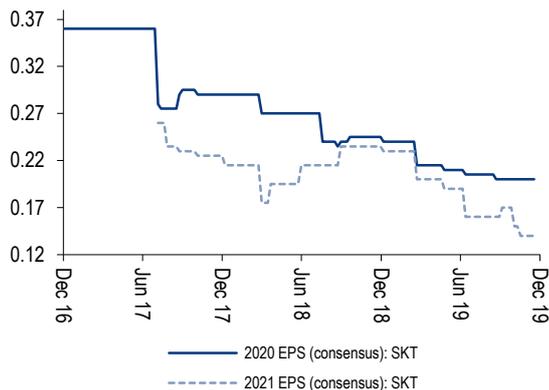
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

Figure 5. International Compcos

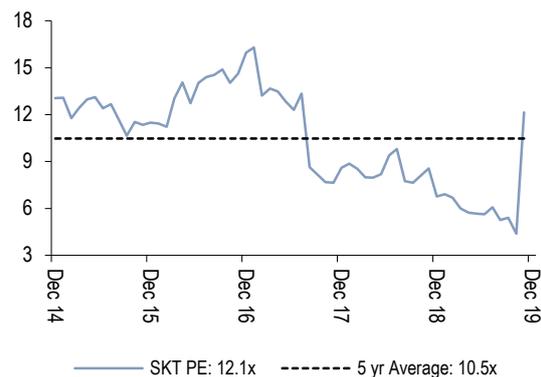
Company	Code	Price	Mkt Cap	PE		EV/EBITDA		EV/EBIT		Cash D/Yld
<i>(metrics re-weighted to reflect SKT's balance date - June)</i>										
			(m)	2020E	2021E	2020E	2021E	2020E	2021E	2021E
Sky TV	SKT NZ	NZ\$0.89	NZ\$388	10.9x	14.4x	3.2x	3.5x	9.1x	11.8x	0.0%
Spark NZ *	SPK NZ	NZ\$4.51	NZ\$8,285	19.9x	19.7x	8.6x	8.7x	15.3x	15.2x	5.5%
NZME *	NZM NZ	NZ\$0.42	NZ\$81	5.2x	5.5x	2.8x	2.9x	5.9x	6.2x	5.3%
Seven Group Holdings	SVW AT	A\$19.20	A\$6,516	13.1x	12.4x	8.9x	8.3x	12.0x	11.1x	2.5%
ITV PLC	ITV LN	£1.35	£5,440	10.2x	10.1x	9.0x	8.9x	9.5x	9.2x	6.0%
DISH Network Corp	DISH US	US\$36.08	US\$17,790	16.1x	19.1x	13.0x	13.9x	17.9x	19.1x	2359.0%
Liberty Global PLC	LBTYA US	US\$22.61	US\$13,919	<0x	<0x	7.4x	7.4x	30.7x	26.3x	0.0%
Astro Malaysia Holdings Bhd	ASTRO MK	RM1.42	RM7,405	11.4x	11.3x	5.9x	6.1x	9.3x	9.3x	6.9%
Compcro Average:				12.7x	13.0x	8.0x	8.0x	14.4x	13.8x	340.8%
SKT Relative:				-14%	+11%	-60%	-56%	-36%	-14%	-100%

EV = Current Market Cap + Actual Net Debt

Source: *Forsyth Barr analysis, Bloomberg Consensus, Compcro 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

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