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NEW ZEALAND EQUITY RESEARCH | MEDIA | PAY-TELEVISION OPERATOR
19 MARCH 2020

Sky TV
Play Suspended, Guidance Withdrawn

MATT HENRY CFA
matthew.henry@forsythbarr.co.nz
+64 9 368 0115

ASHTON OLDS
ashton.olds@forsythbarr.co.nz
+64 9 368 0127

NEUTRAL

The challenge Sky TV (SKT) faces to transform its businesses has been compounded by COVID-19 and the almost total freeze in global sport. SKT has withdrawn its FY20 revenue and earnings guidance, adding to the company's already considerable medium-term earnings uncertainty. Furthermore, SKT, which has already recognised it requires "a strengthened capital structure" to execute on its transformation strategy, remains likely *cum* equity raising. All that said, SKT share price has dramatically de-rated. At the current level investors are effectively paying option value for the potential SKT is successful in repositioning itself as NZ's aggregator of sporting content in a streaming world. We believe long-term there is likely a role for a sport content aggregator in NZ, and SKT is positioned to potentially fill that role. We upgrade to NEUTRAL.

NZX Code	SKT
Share price	NZ$0.28
Target price	NZ$0.35
Risk rating	High
Issued shares	436.0m
Market cap	NZ$122m
Avg daily turnover	808.3k (NZ$804k)

Financials: Jun/	19A	20E	21E	22E
NPAT* (NZ$m)	97.0	14.3	9.2	17.5
EPS* (NZc)	24.9	3.4	2.1	4.0
EPS growth* (%)	-18.5	-86.5	-37.0	89.9
DPS (NZc)	7.5	0.0	0.0	0.0
Imputation (%)	100	100	100	100
*Based on normalised profits				

Valuation (x)	19A	20E	21E	22E
EV/EBITDA	1.4	1.9	2.1	2.3
EV/EBIT	2.2	7.6	10.6	10.0
PE	1.1	8.3	13.2	7.0
Price / NTA	n/a	n/a	n/a	n/a
Cash div yld (%)	26.8	0.0	0.0	0.0
Gross div yld (%)	37.2	0.0	0.0	0.0

Suspension of play adds to earnings pressures

SKT has withdrawn its FY20 revenue and EBITDA guidance given COVID-19's disruption of global sport. We understand the majority of the immediate impact has come from declines in advertising and commercial subscription revenue, with a modest number of mass market subscribers cutting sport from their bundles. SKT is able to recover some of the content costs of cancelled events, however (1) many events have only been "postponed" (for now), not cancelled, and (2) the sums able to be recovered sound like they are modest. SKT stated it is "taking decision actions" in response to the revenue hit, cutting opex and deferring "non-essential" capex but these have not been quantified.

The risk for SKT is that some of the revenue impact is not temporary. Customer attrition and bundle trimming trends may be accelerated. Revenue from financially distressed corporate advertisers and commercial subscribers may not bounce back quickly. Given both the structural pressures on SKT's earnings and the substantial uncertainty around the current environment, there is a high margin of error to our SKT forecasts. It is clear, however, that the revenue and earnings direction is down.

Cum equity raising

In its interim report SKT stated directors were "reviewing (SKT's) funding structure ... given the investments required under the transformation programme and maturity of the NZ$100m bond in March 2021". Certainly the current net debt/net debt + market cap of 66% is not sustainable. Some form of equity raising appears highly likely.

Challenges not lost on the share price

The magnitude of the challenges faced by SKT is not lost on the share price, which is down -96% from its peak. 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, at the current share price (1) investors are effectively only paying option value for the potential SKT's transformation programme is able to deliver a sustainable business long-term, and (2) we view the investment risks as more balanced.

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Sky Network Television Ltd (SKT)

Priced as at 18 Mar 2020 (NZ$)	**0.28**

12-month target price (NZ$)*	**0.35**
Expected share price return	25.0%
Net dividend yield	0.0%
Estimated 12-month return	25.0%

Spot valuations (NZ$)	
1. DCF	0.38

Key WACC assumptions	
Risk free rate	2.00%
Equity beta	0.94
WACC	7.6%
Terminal growth	-2.0%

DCF valuation summary (NZ$m)	
Total firm value	637
(Net debt)/cash	(188)
Less: Capitalised operating leases	(285)
Value of equity	165

Profit and Loss Account (NZ$m)	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Sales revenue	852.7	795.1	738.9	724.7	725.2
Normalised EBITDA	**285.8**	**240.9**	**164.7**	**151.7**	**142.3**
Depreciation and amortisation	(102.4)	(92.9)	(122.9)	(120.9)	(109.8)
Normalised EBIT	**183.4**	**147.9**	**41.8**	**30.8**	**32.5**
Net interest	(17.5)	(12.4)	(17.8)	(17.5)	(7.7)
Associate income	0	0	0	0	0
Tax	(46.6)	(24.5)	(9.4)	(3.7)	(7.0)
Minority interests	0.3	0.3	0.3	0.3	0.3
Normalised NPAT	**119.0**	**97.0**	**14.3**	**9.2**	**17.5**
Abnormals/other	(360.0)	(718.9)	0	0	0
Reported NPAT	**(241.0)**	**(608.2)**	**14.3**	**9.2**	**17.5**
Normalised EPS (cps)	30.6	24.9	3.4	2.1	4.0
DPS (cps)	15.0	7.5	0	0	0

Valuation Ratios	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
EV/EBITDA (x)	1.3	1.4	1.9	2.1	2.3
EV/EBIT (x)	2.1	2.2	7.6	10.6	10.0
PE (x)	0.9	1.1	8.3	13.2	7.0
Price/NTA (x)	n/a	n/a	n/a	n/a	n/a
Free cash flow yield (%)	127.3	83.3	37.9	49.9	53.8
Net dividend yield (%)	53.6	26.8	0.0	0.0	0.0
Gross dividend yield (%)	74.4	37.2	0.0	0.0	0.0

Capital Structure	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Interest cover EBIT (x)	10.5	11.9	2.4	1.8	4.2
Interest cover EBITDA (x)	16.3	19.4	9.3	8.7	18.5
Net debt/ND+E (%)	18.2	34.9	36.7	33.0	27.0
Net debt/EBITDA (x)	0.8	0.8	1.2	1.2	1.0

Growth Rates	**2018A**	**2019A**	**2020A**	**2021A**	**2022A**
Revenue (%)	-4.6	-6.8	-7.1	-1.9	0.1
EBITDA (%)	-2.9	-15.7	-31.6	-7.9	-6.2
EBIT (%)	-3.1	-19.3	-71.7	-26.4	5.6
Normalised NPAT (%)	0.7	-18.5	-85.2	-35.7	89.9
Normalised EPS (%)	0.7	-18.5	-86.5	-37.0	89.9
Ordinary DPS (%)	-45.5	-50.0	-100.0	n/a	n/a

Key Ratios	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Return on assets (%)	12.2	19.2	4.9	3.8	3.5
Return on equity (%)	11.6	27.7	4.1	2.6	4.7
Return on funds employed (%)	8.8	13.3	3.4	3.2	4.0
EBITDA margin (%)	33.5	30.3	22.3	20.9	19.6
EBIT margin (%)	21.5	18.6	5.7	4.2	4.5
Capex to sales (%)	6.8	9.6	10.0	10.0	9.0
Capex to depreciation (%)	72	108	73	72	70
Imputation (%)	100	100	100	100	100
Pay-out ratio (%)	49	30	0	0	0

Cash Flow (NZ$m)	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
EBITDA	**285.8**	**240.9**	**164.7**	**151.7**	**142.3**
Working capital change	(8.3)	(11.5)	(6.6)	2.8	3.3
Interest & tax paid	(64.8)	(48.5)	(38.0)	(21.1)	(14.7)
Other	0.8	(2.8)	0	0	0
Operating cash flow	**213.6**	**178.0**	**120.1**	**133.4**	**130.9**
Capital expenditure	(58.2)	(76.3)	(73.9)	(72.5)	(65.3)
(Acquisitions)/divestments	0.0	0.2	(21.6)	0	0
Other	1.8	7.6	(38.9)	(35.0)	(28.0)
Funding available/(required)	**157.2**	**109.5**	**(14.3)**	**25.9**	**37.6**
Dividends paid	(88.9)	(66.9)	0	0	0
Equity raised/(returned)	0	0	0	0	0
(Increase)/decrease in net debt	**68.3**	**42.6**	**(14.3)**	**25.9**	**37.6**

Operating Performance	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Revenue					
Subscriptions	778.9	728.4	683.5	671.5	665.8
Advertising	57.0	51.8	40.2	38.6	45.4
Installation & other revenue	16.7	15.0	15.1	14.6	14.0
Total revenue	**852.7**	**795.1**	**738.9**	**724.7**	**725.2**
Operating costs					
Programming	(328.1)	(320.8)	(349.3)	(365.3)	(381.4)
Subscriber related costs	(95.6)	(88.3)	(101.5)	(100.2)	(98.1)
Broadcasting & infrastructure	(92.6)	(95.8)	(81.7)	(80.1)	(75.5)
Other costs	(50.7)	(49.3)	(41.7)	(27.5)	(28.0)
Total operating costs	**(566.9)**	**(554.3)**	**(574.2)**	**(573.0)**	**(583.0)**
Reported EBITDA	**285.8**	**240.9**	**164.7**	**151.7**	**142.3**

Balance Sheet (NZ$m)	**2018A**	**2019A**	**2020E**	**2021E**	**2022E**
Working capital	(45)	(39)	(32)	(35)	(38)
Fixed assets	210	163	162	159	153
Intangibles	1,125	446	453	440	431
Right of use asset	0	0	58	34	178
Other assets	23	7	7	7	7
Total funds employed	**1,312**	**577**	**647**	**605**	**729**
Net debt/(cash)	228	188	202	176	139
Lease liability	0	0	67	42	186
Other liabilities	57	37	26	26	26
Shareholder's funds	1,025	350	349	358	376
Minority interests	1	1	2	2	2
Total funding sources	**1,312**	**577**	**647**	**605**	**729**

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

Investment Summary

Whilst we expect disruptive pressures on SKT's earnings will not abate any time soon, at the current share price investors are effectively only paying option value for the potential SKT is successful in repositioning itself as NZ's aggregator of sporting content in a streaming world. We view the investment risks as balanced; 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 year under new CEO Martin Stewart SKT has made a rapid strategic about turn from short-term/defensive (clinging 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 and Lightbox. Forecasting SKT's long-term outlook is difficult in such a dynamic industry.

Earnings and cashflow 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, growth investments by SKT, and the impact of COVID-19 disruptions of global sport.

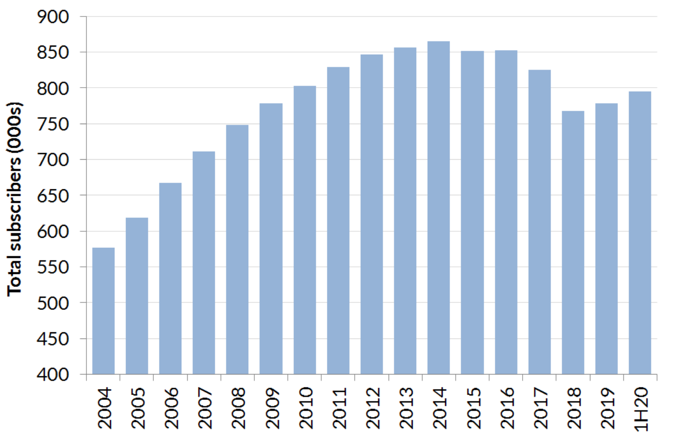
Financial structure

- **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.
- **Bond refinancing question:** SKT's NZ$100m bond matures in March 2021. SKT has said it is "reviewing its funding structure" and some form of equity raising appears highly likely.

Risk factors

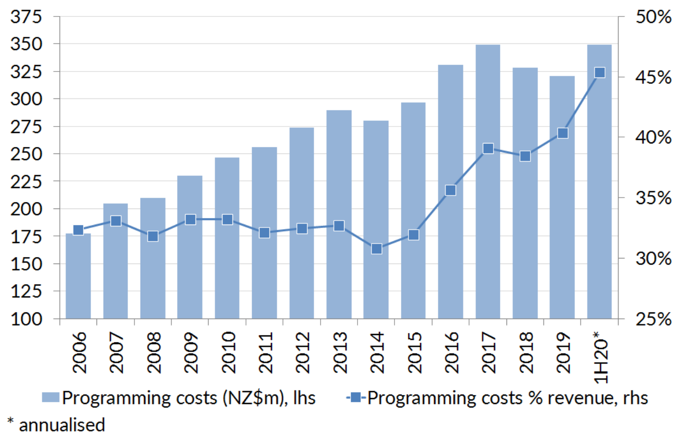
- **Continued subscriber losses, ARPU pressures and/or rising content costs:** SKT is facing increasingly intense competition for audiences and content including from local (e.g. TVNZ, Spark Sport) and international (e.g. Netflix, Amazon, Disney+, Apple) players, and existing content providers (e.g.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

Figure 1. SKT subscribers



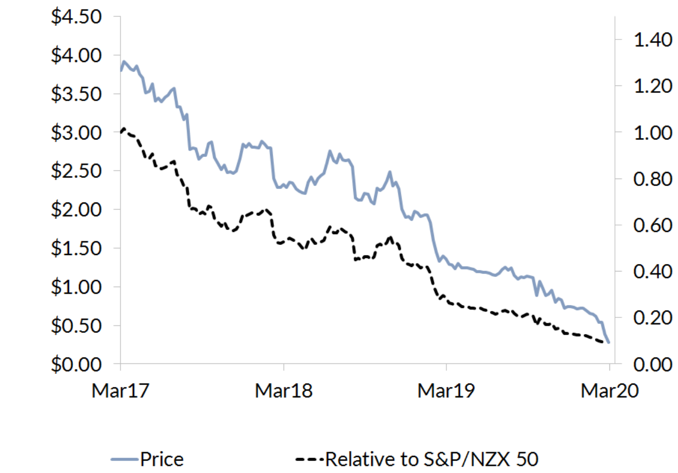
Source: Company reports, Forsyth Barr analysis

Figure 2. SKT programming costs



Source: Company reports, Forsyth Barr analysis

Figure 3. Price performance



Source: 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%

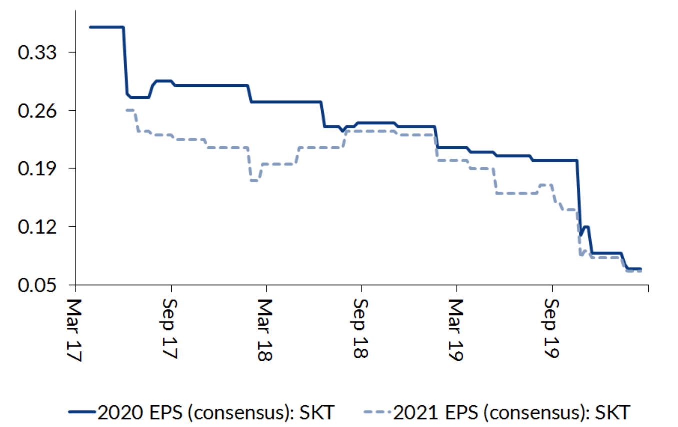
Source: NZX, Forsyth Barr analysis, NOTE: based on SSH notices only

Figure 5. International valuation comparisons

Company	Code	Price	Mkt Cap	PE		EV/EBITDA		EV/EBIT		Cash Yld
(metrics re-weighted to reflect SKT's balance date - June)			(m)	2020E	2021E	2020E	2021E	2020E	2021E	2021E
Sky TV	**SKT NZ**	**NZ$0.28**	**NZ$122**	**8.3x**	**13.2x**	**1.9x**	**2.0x**	**7.4x**	**10.1x**	**0.0%**
Spark NZ *	SPK NZ	NZ$4.14	NZ$7,605	18.9x	18.2x	8.1x	8.0x	14.2x	13.9x	6.0%
NZME *	NZM NZ	NZ$0.28	NZ$54	3.3x	3.7x	2.0x	2.1x	4.0x	4.5x	0.0%
SEVEN GROUP HOLDINGS	SVW AT	A$11.68	A$3,964	8.4x	7.6x	6.8x	6.4x	8.9x	8.4x	4.2%
ITV PLC	ITV LN	£0.59	£2,372	4.8x	4.6x	4.7x	4.5x	6.1x	5.9x	13.6%
DISH NETWORK CORP-A	DISH US	US$18.28	US$9,561	7.3x	8.9x	8.4x	8.9x	11.5x	12.7x	0.0%
LIBERTY GLOBAL PLC-A	LBTYA US	US$16.32	US$9,789	<0x	<0x	6.6x	6.4x	33.3x	25.8x	0.0%
ASTRO MALAYSIA HOLDINGS BHD	ASTRO MK	RM0.83	RM4,328	6.4x	6.6x	4.1x	4.2x	6.4x	6.5x	11.3%
			Compco Average:	**8.2x**	**8.3x**	**5.8x**	**5.8x**	**12.1x**	**11.1x**	**5.0%**
EV = Current Market Cap + Actual Net Debt			**SKT Relative:**	**2%**	**60%**	**-68%**	**-65%**	**-39%**	**-9%**	**-100%**

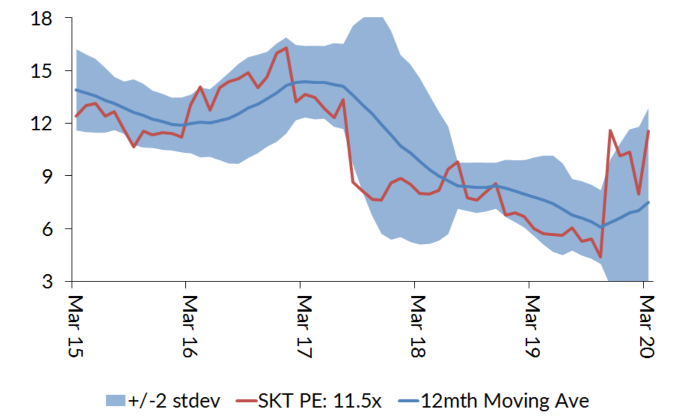
Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (SKT) companies fiscal year end

Figure 6. Consensus EPS momentum (NZ$)



Source: Forsyth Barr analysis

Figure 7. One year forward PE (x)



Source: Forsyth Barr analysis

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