

# Sky TV

## FY20 – Something for Everyone

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**NEUTRAL** 

Sky TV's (SKT) FY20 provided something for everyone. For the bulls, SKT delivered strong cost control and impressive free cash flow (FCF) in the 2H, further buttressing the recently recapitalised balance sheet. For the bears, there remains little tangible evidence that SKT can meaningfully offset its sharply declining satellite revenue. Questions remain as to what the economics of SKT's business model looks like in an increasingly streaming world – we doubt many were answered in today's result. Maintain NEUTRAL.

NZX Code	SKT	Financials: Jun/	20A	21E	22E	23E	Valuation (x)	20A	21E	22E	23E
Share price	NZ\$0.15	NPAT* (NZ\$m)	56.7	22.8	8.7	10.7	PE	1.7	11.3	29.6	24.1
Target price	NZ\$0.16	EPS* (NZc)	8.6	1.3	0.5	0.6	EV/EBIT	4.8	5.6	12.4	10.9
Risk rating	High	EPS growth* (%)	-65.4	-84.9	-61.7	22.5	EV/EBITDA	1.8	1.6	1.9	1.9
Issued shares	1746.3m	DPS (NZc)	0.0	0.0	0.5	0.6	Price / NTA	5.1	2.8	2.4	2.2
Market cap	NZ\$258m	Imputation (%)	100	100	100	100	Cash div yld (%)	0.0	0.0	3.4	4.1
Avg daily turnover	3,182k (NZ\$735k)	*Based on normalised profits					Gross div yld (%)	0.0	0.0	4.7	5.6

### A difficult bridge to a streaming world

SKT's FY20 was largely in line with expectation and company guidance, but reiterated the transformation challenges the company faces. Unsurprisingly, COVID-19 has had an impact on advertising (compounding a downward trend) and commercial (hospitality, accommodation) revenue. Of more structural significance, high value satellite subscriber revenue continued to fall sharply, down -8% or -NZ\$48m. SKT continues to struggle to find a meaningful offset. Streaming revenue did increase by +34%/NZ\$15m, however, the bulk came from the acquisitions of RugbyPass and Lightbox – we estimate organic growth over the year was only c.NZ\$2–3m. EBITDA (ex. impacts of IFRS 16 accounting changes and one-off costs) declined -NZ\$89m or -32%.

### Impressive free cash flow

SKT reacted rapidly to the COVID-19 impacts, cutting opex (incl. 18% of labour) and capex, as well as benefitting from reduced programming (rights and production) costs due to less live sport. The 2H highlight was the strong FCF (albeit helped significantly by working capital timing) taking SKT to a NZ\$8m net cash position at year end. We expect FCF to remain healthy near-term.

FY21 guidance was upgraded from that provided at May's equity raise (now revenue -6–12% to NZ\$660–700m, underlying EBITDA -27–35% to \$125–140m, underlying NPAT -51–63% to NZ\$15–20m). We continue to view SKT's guidance as conservative (understandable given the current uncertain backdrop) and our forecasts sit slightly above the top end of the range.

### Uncertainty ahead, with a broad range of potential outcomes

SKT is endeavouring to position itself as NZ's aggregator of sporting and entertainment content in a streaming world. We believe, that long-term, SKT is positioned to potentially fill that role, however, the economics remain highly uncertain. Uptake of streaming is not yet close to offsetting the decline in satellite. SKT plans to offer broadband from early CY21, however, competition is intense (>80 competitors) and capturing material margin will not be easy. Near-term, SKT's earnings will also be pressured by the lift in SANZAAR/NZ Rugby broadcast rights to c.NZ\$110m pa vs. the current c.NZ\$60–70m starting in 2021. We recognise there is a wide margin of error to any valuation assessment of SKT, but at the current share price we (1) believe investors are effectively paying option value for SKT's potential to formulate a long-term sustainable business model, and (2) view the investment risks as balanced; NEUTRAL.

**Sky Network Television Ltd (SKT)**

Priced as at 10 Sep 2020 (NZ\$)						0.15						
<b>12-month target price (NZ\$)*</b>						<b>0.16</b>	<b>Spot valuations (NZ\$)</b>					
Expected share price return						6.7%	1. DCF					0.15
Net dividend yield						0.8%						
Estimated 12-month return						7.5%						
<b>Key WACC assumptions</b>						<b>DCF valuation summary (NZ\$m)</b>						
Risk free rate						1.30%	Total firm value					648
Equity beta						0.98	(Net debt)/cash					8
WACC						6.3%	Less: Capitalised operating leases					(398)
Terminal growth						-2.0%	Value of equity					258
<b>Profit and Loss Account (NZ\$m)</b>						<b>Valuation Ratios</b>						
	2019A	2020A	2021E	2022E	2023E		2019A	2020A	2021E	2022E	2023E	
Sales revenue	795.1	747.6	700.9	674.8	658.8	EV/EBITDA (x)	2.0	1.8	1.6	1.9	1.9	
<b>Normalised EBITDA</b>	<b>240.9</b>	<b>192.5</b>	<b>140.6</b>	<b>106.5</b>	<b>106.0</b>	EV/EBIT (x)	3.2	4.8	5.7	12.6	11.1	
Depreciation and amortisation	(92.9)	(119.3)	(100.0)	(90.4)	(87.6)	PE (x)	0.6	1.7	11.5	30.0	24.5	
<b>Normalised EBIT</b>	<b>147.9</b>	<b>73.2</b>	<b>40.5</b>	<b>16.2</b>	<b>18.3</b>	Price/NTA (x)	n/a	5.2	2.9	2.5	2.2	
Net interest	(12.4)	(13.7)	(8.5)	(3.7)	(3.1)	Free cash flow yield (%)	38.8	38.5	29.5	20.2	16.6	
Associate income	0	0	0	0	0	Net dividend yield (%)	50.0	0.0	0.0	3.3	4.0	
Tax	(24.5)	(10.5)	(9.0)	(3.5)	(4.3)	Gross dividend yield (%)	69.4	0.0	0.0	4.6	5.6	
Minority interests	0.3	0.2	0.2	0.2	0.2	<b>Capital Structure</b>						
<b>Normalised NPAT</b>	<b>97.0</b>	<b>56.7</b>	<b>22.8</b>	<b>8.7</b>	<b>10.7</b>	Interest cover EBIT (x)	11.9	5.3	4.8	4.3	5.8	
Abnormals/other	(718.9)	(205.7)	0	0	0	Interest cover EBITDA (x)	19.4	14.0	16.5	28.6	33.8	
<b>Reported NPAT</b>	<b>(608.2)</b>	<b>(156.9)</b>	<b>22.8</b>	<b>8.7</b>	<b>10.7</b>	Net debt/ND+E (%)	34.9	-2.2	-17.9	-25.0	-29.0	
Normalised EPS (cps)	24.9	8.6	1.3	0.5	0.6	Net debt/EBITDA (x)	0.8	n/a	n/a	n/a	n/a	
DPS (cps)	7.5	0	0	0.5	0.6	<b>Key Ratios</b>						
<b>Growth Rates</b>							2019A	2020A	2021E	2022E	2023E	
Revenue (%)	-6.8	-6.0	-6.3	-3.7	-2.4	Return on assets (%)	19.2	8.7	5.3	2.2	1.8	
EBITDA (%)	-15.7	-20.1	-27.0	-24.2	-0.5	Return on equity (%)	27.7	15.2	5.8	2.2	2.7	
EBIT (%)	-19.3	-50.5	-44.6	-60.1	13.2	Return on funds employed (%)	13.3	12.8	7.6	3.2	3.9	
Normalised NPAT (%)	-18.5	-41.6	-59.7	-61.7	22.5	EBITDA margin (%)	30.3	25.7	20.1	15.8	16.1	
Normalised EPS (%)	-18.5	-65.4	-84.9	-61.7	22.5	EBIT margin (%)	18.6	9.8	5.8	2.4	2.8	
Ordinary DPS (%)	-50.0	-100.0	n/a	n/a	20.0	Capex to sales (%)	9.6	7.6	7.1	8.0	8.0	
<b>Cash Flow (NZ\$m)</b>							2019A	2020A	2021E	2022E	2023E	
<b>EBITDA</b>	<b>240.9</b>	<b>192.5</b>	<b>140.6</b>	<b>106.5</b>	<b>106.0</b>	Capex to depreciation (%)	108	64	65	74	71	
Working capital change	(11.5)	22.7	3.7	7.7	(2.3)	Imputation (%)	100	100	100	100	100	
Interest & tax paid	(48.5)	(39.5)	(17.4)	(7.2)	(7.4)	Pay-out ratio (%)	30	0	0	100	98	
Other	(2.8)	(18.4)	0	0	0	<b>Operating Performance</b>						
<b>Operating cash flow</b>	<b>178.0</b>	<b>157.3</b>	<b>127.0</b>	<b>107.0</b>	<b>96.3</b>	<b>Revenue</b>						
Capital expenditure	(76.3)	(56.5)	(49.8)	(54.0)	(52.7)	Subscriptions	728.4	687.3	644.2	620.5	605.1	
(Acquisitions)/divestments	0.2	(18.2)	6.8	0	0	Advertising	51.8	45.2	43.3	41.6	41.6	
Other	7.6	(37.2)	(31.7)	(27.8)	(24.6)	Installation & other revenue	15.0	15.1	13.4	12.7	12.1	
<b>Funding available/(required)</b>	<b>109.5</b>	<b>45.5</b>	<b>52.2</b>	<b>25.2</b>	<b>19.0</b>	<b>Total revenue</b>	<b>795.1</b>	<b>747.6</b>	<b>700.9</b>	<b>674.8</b>	<b>658.8</b>	
Dividends paid	(66.9)	0	0	(5.2)	(8.7)	<b>Operating costs</b>						
Equity raised/(returned)	0	150.0	0	0	0	Programming	(320.8)	(335.5)	(356.1)	(368.8)	(354.8)	
<b>(Increase)/decrease in net debt</b>	<b>42.6</b>	<b>195.5</b>	<b>52.2</b>	<b>20.0</b>	<b>10.2</b>	Subscriber related costs	(88.3)	(101.9)	(88.8)	(86.1)	(83.4)	
<b>Balance Sheet (NZ\$m)</b>							2019A	2020A	2021E	2022E	2023E	
Working capital	(39)	(57)	(60)	(68)	(66)	Broadcasting & infrastructure	(95.8)	(70.3)	(67.0)	(63.9)	(64.2)	
Fixed assets	163	125	127	131	134	Other costs	(49.3)	(47.5)	(48.5)	(49.4)	(50.4)	
Intangibles	446	323	305	293	285	<b>Total operating costs</b>	<b>(554.3)</b>	<b>(555.2)</b>	<b>(560.3)</b>	<b>(568.3)</b>	<b>(552.8)</b>	
Right of use asset	0	97	82	69	384	<b>Reported EBITDA</b>	<b>240.9</b>	<b>192.5</b>	<b>140.6</b>	<b>106.5</b>	<b>106.0</b>	
Other assets	7	12	4	4	4							
<b>Total funds employed</b>	<b>577</b>	<b>500</b>	<b>457</b>	<b>429</b>	<b>741</b>							
Net debt/(cash)	188	(8)	(60)	(80)	(90)							
Lease liability	0	73	61	50	369							
Other liabilities	37	23	22	22	22							
Shareholder's funds	350	374	397	400	402							
Minority interests	1	1	1	2	2							
<b>Total funding sources</b>	<b>577</b>	<b>463</b>	<b>420</b>	<b>393</b>	<b>704</b>							

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

## Result summary

Figure 1. Result summary

NZ\$m	FY19	FY20	% chg	Forbar	% diff
<b>Revenue</b>					
Satellite subscriptions	629.8	582.0	-7.6%	584.9	-0.5%
Streaming subscriptions	98.6	105.4	6.9%	98.7	6.8%
Advertising	51.8	45.2	-12.8%	40.2	12.3%
Installation & other revenue	15.0	15.1	1.2%	15.1	0.2%
<b>Total revenue</b>	<b>795.1</b>	<b>747.6</b>	<b>-6.0%</b>	<b>738.9</b>	<b>1.2%</b>
<b>Operating expenses</b>					
Programming	(320.8)	(335.5)	4.6%	(338.7)	-0.9%
Subscriber related costs	(88.3)	(101.9)	15.4%	(96.8)	5.2%
Broadcasting & infrastructure	(95.8)	(70.3)	-26.7%	(72.1)	-2.5%
Other costs	(49.3)	(47.5)	-3.7%	(38.4)	23.7%
<b>Total operating costs</b>	<b>(554.3)</b>	<b>(555.2)</b>	<b>0.2%</b>	<b>(546.0)</b>	<b>1.7%</b>
<b>EBITDA</b>	<b>240.9</b>	<b>192.5</b>	<b>-20.1%</b>	<b>192.9</b>	<b>-0.2%</b>
Depreciation & amortisation	(92.9)	(119.3)	28.4%	(117.7)	1.4%
<b>EBIT (before sig. items)</b>	<b>148.0</b>	<b>73.1</b>	<b>-50.6%</b>	<b>75.2</b>	<b>-2.7%</b>
Significant items	(718.9)	(205.7)	na	(28.2)	na
<b>EBIT</b>	<b>(570.9)</b>	<b>(132.6)</b>	<b>na</b>	<b>47.0</b>	<b>na</b>
Interest	(12.4)	(13.7)	10.4%	(13.5)	1.4%
<b>Net profit before tax</b>	<b>(583.4)</b>	<b>(146.3)</b>	<b>na</b>	<b>33.4</b>	<b>-537.5%</b>
Tax	(24.5)	(10.5)	-57.2%	(13.0)	-19.8%
Minority interests	(0.3)	(0.2)	-35.5%	(0.3)	-35.5%
<b>Net profit after tax</b>	<b>(608.2)</b>	<b>(157.0)</b>	<b>na</b>	<b>20.1</b>	<b>-881.8%</b>
<b>Underlying profit</b>	<b>97.0</b>	<b>40.8</b>	<b>-57.9%</b>	<b>40.4</b>	<b>1.1%</b>
Underlying EPS (cps)	24.9	6.2	-75.1%	6.1	1.1%
Dividend (cps)	7.5	0.0	-100.0%	0.0	na

Source: Forsyth Barr analysis, Company reports

## 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 and entertainment 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:** Under new management 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, acquiring RugbyPass and Lightbox, and planning to launch broadband services. 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.

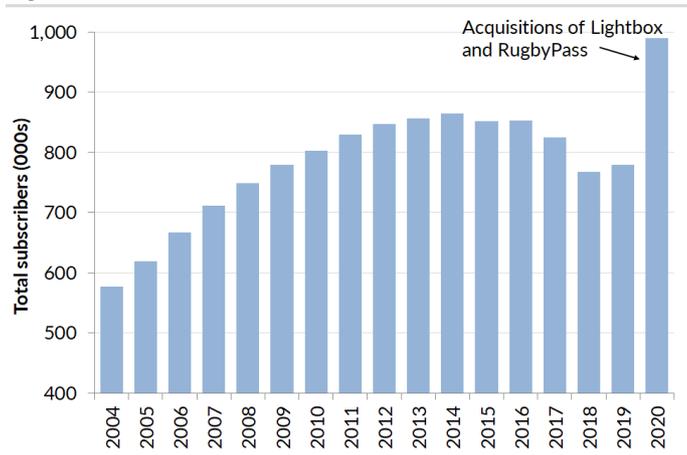
### Financial structure

- **Nil dividend:** SKT terminated its dividend ahead of potential near-term investment opportunities and sports rights contracting. It plans to revisit its dividend policy in FY22.
- **Bond refinancing question:** SKT's recent equity raising recapitalised its balance sheet. It had a net NZ\$8m cash balance as at FY20 year end.

### Risk factors

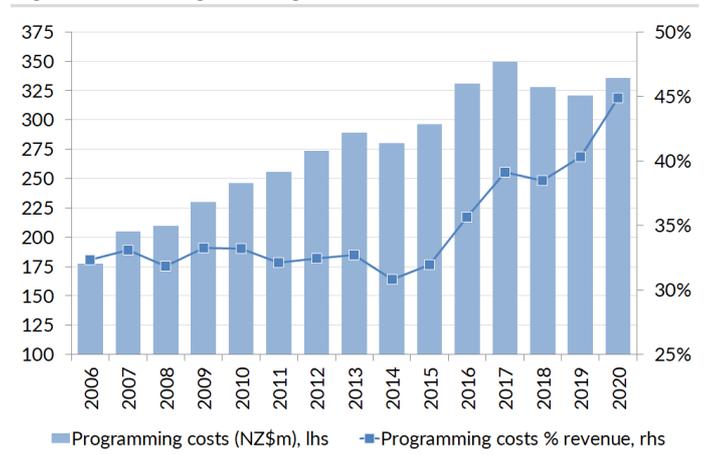
- **Continued subscriber losses, ARPU pressures and/or rising content costs:** SKT is facing increasingly intense competition for audiences and content including from local (e.g. TVNZ, Spark Sport) and international (e.g. Netflix, Amazon, Disney+, Apple) players, and existing content providers (e.g.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

Figure 2. SKT subscribers



Source: Company reports, Forsyth Barr analysis

Figure 3. SKT programming costs



Source: Company reports, Forsyth Barr analysis

**Figure 4. Price performance**


Source: Forsyth Barr analysis

**Figure 5. Substantial shareholders**

Shareholder	Latest Holding
Jupiter Asset Management	10.8%
ACC	9.4%
Kiltearn Partners	7.0%
UBS	5.3%
Black Crane Asia Pacific Opportunities Fund	5.1%

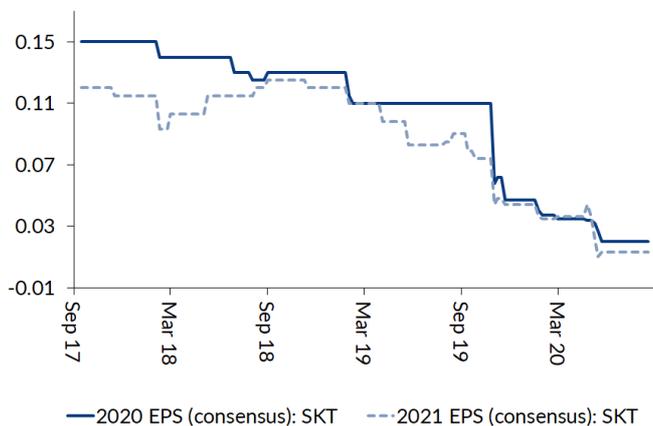
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

**Figure 6. International valuation comparisons**

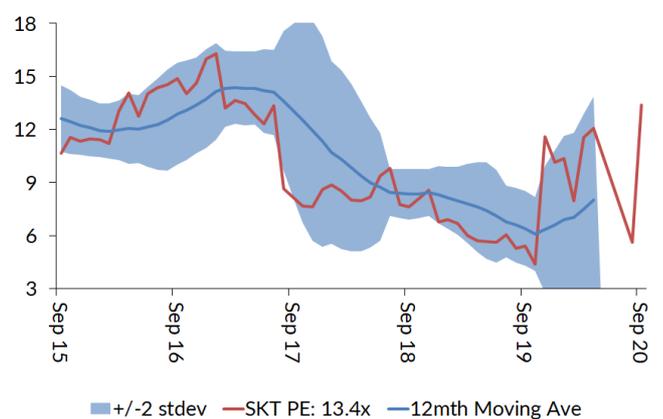
Company (metrics re-weighted to reflect SKT's balance date - June)	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash Yld 2022E
				2021E	2022E	2021E	2022E	2021E	2022E	
Sky TV	SKT NZ	NZ\$0.15	NZ\$258	11.3x	29.6x	1.8x	2.4x	6.2x	15.5x	3.4%
SPARK NZ *	SPK NZ	NZ\$4.82	NZ\$8,845	22.5x	20.7x	9.4x	8.9x	16.7x	15.4x	5.0%
NZME	NZM NZ	NZ\$0.40	NZ\$79	4.9x	4.9x	3.8x	3.9x	7.4x	7.6x	n/a
SEVEN GROUP HOLDINGS	SVW AT	A\$17.51	A\$5,942	13.5x	11.8x	9.2x	8.5x	12.5x	11.3x	2.8%
ITV PLC	ITV LN	£0.63	£2,520	7.0x	6.0x	5.9x	5.3x	7.2x	6.3x	9.8%
DISH NETWORK CORP-A	DISH US	US\$33.17	US\$17,424	15.0x	16.7x	10.9x	11.5x	12.7x	12.2x	0.0%
LIBERTY GLOBAL PLC-A	LBTYA US	US\$21.97	US\$12,901	>50x	>50x	7.1x	8.1x	22.4x	22.8x	0.0%
ASTRO MALAYSIA HOLDINGS BHD	ASTRO MK	RM0.77	RM4,015	8.1x	8.2x	4.6x	4.7x	7.5x	7.7x	8.6%
<b>Compcpo Average:</b>				<b>11.8x</b>	<b>11.4x</b>	<b>7.3x</b>	<b>7.3x</b>	<b>12.3x</b>	<b>11.9x</b>	<b>4.4%</b>
<b>SKT Relative:</b>				<b>-4%</b>	<b>160%</b>	<b>-75%</b>	<b>-68%</b>	<b>-50%</b>	<b>30%</b>	<b>-23%</b>

EV = Current Market Cap + Actual Net Debt

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

**Figure 7. Consensus EPS momentum (NZ\$)**


Source: Forsyth Barr analysis

**Figure 8. One year forward PE (x)**


Source: Forsyth Barr analysis

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