

Sky TV

1H21 Result – Down but Not Out

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NEUTRAL 

Sky TV's (SKT) 1H21 result had something for everyone. There are clear signs that the erosion of the core satellite subscriber base is slowing in the 11th hour. With a net loss of "only" ~10,000 subscribers in the first half, exclusively attributed to the legacy reseller book, a future with largely stable satellite subscribers is, for the first time since the arrival of Netflix in NZ, imaginable. However, the other side of the equation, ARPU, experienced its most severe decline on record, leaving core satellite revenues down -9% YoY. Another victory like this and the war is lost. SKT gave a comprehensive explanation for the drop in satellite ARPU, attributing the lion's share to one off items. Looking ahead, we believe the pace of decline in satellite revenues will slow and to be almost offset by growth in streaming revenues. With stabilising revenues we expect the focus to shift to costs. With this note we transfer coverage of SKT from Matt Henry to Aaron Ibbotson.

NZX Code	SKT	Financials: Jun/	20A	21E	22E	23E	Valuation (x)	20A	21E	22E	23E
Share price	NZ\$0.17	NPAT* (NZ\$m)	56.7	47.1	25.7	28.3	PE	2.0	6.5	11.8	10.7
Target price	NZ\$0.18	EPS* (NZc)	8.6	2.7	1.5	1.6	EV/EBIT	5.9	4.4	7.2	6.7
Risk rating	High	EPS growth* (%)	-65.4	-68.8	-45.3	10.1	EV/EBITDA	2.2	1.8	2.1	2.2
Issued shares	1746.3m	DPS (NZc)	0.0	0.0	1.5	1.6	Price / NTA	6.0	2.8	2.5	2.4
Market cap	NZ\$304m	Imputation (%)	100	100	100	100	Cash div yld (%)	0.0	0.0	8.6	9.2
Avg daily turnover	3,796k (NZ\$613k)	*Based on normalised profits					Gross div yld (%)	0.0	0.0	12.0	12.8

What's changed?

- **Earnings:** EBITDA +30%/+25%/+25% in FY21/22/23
- **Target price:** Increased to NZ\$0.18 (from NZ\$0.16)

Streaming; acquired or not, is becoming an increasingly meaningful part of the puzzle

Since the acquisition of Lightbox in early 2020 and RugbyPass in 2019, there has been a level of ambiguity with regards to both the number of "true" subscribers and the level of organic growth in streaming. SKT's 1H21 result added some much needed clarity on both. Since the August 2020 update SKT has added ~37,000 (+12%) streaming customers organically and now has ~350,000 paying subscribers providing what we believe will be a relatively stable ARPU of ~NZ\$18. One lost satellite customer is worth about 4 new streaming customers. With the combination of Lightbox and Neon, and a relatively competitively priced sports streaming offering, stabilising total subscription revenues are within reach. Our (increased) FY23 subscription revenues are only down -1% vs FY22.

Programming costs; it's not only about sports

SKT reported an NZ\$19m 1H21 reduction in sports rights cost due to COVID-19 related discounts; the key driver for the strong 1H result. Going forward, we expect both a reversal of these temporary savings along with increased rugby programming rights costs following the commencement of the new rugby rights contract (1 January 2021). But it is not only sport rights that are driving programming costs. The landscape for non-sports rights has changed dramatically in a short few years. With the ability to go direct to consumers at minimal costs large content creators such as Disney and Discovery have a different counterfactual today vs just two years ago. SKT has responded to this changed landscape by introducing co-exclusivity, a new concept which we understand involves SKT paying less (than they otherwise would have had to) by giving up the exclusive rights to the content in NZ. We have low visibility on both the cost side of this arrangement as well as the potential cannibalisation of subscribers that this may result in, but with sports rights costs relatively transparent, we believe the focus will increase on other programming costs.

Sky Network Television Ltd (SKT)

 Priced as at 23 Feb 2021 (NZ\$) 0.17

12-month target price (NZ\$)*	0.18
Expected share price return	5.9%
Net dividend yield	5.9%
Estimated 12-month return	11.8%

Key WACC assumptions

Risk free rate	2.30%
Equity beta	1.88
WACC	10.6%
Terminal growth	-2.0%

Spot valuations (NZ\$)

1. DCF	0.18
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DCF valuation summary (NZ\$m)

Total firm value	459
(Net debt)/cash	8
Less: Capitalised operating leases	(332)
Value of equity	135

Profit and Loss Account (NZ\$m)	2019A	2020A	2021E	2022E	2023E
Sales revenue	795.1	747.6	709.0	695.1	684.7
Normalised EBITDA	240.9	192.5	182.9	133.3	132.8
Depreciation and amortisation	(92.9)	(119.3)	(108.8)	(93.6)	(90.0)
Normalised EBIT	147.9	73.2	74.1	39.7	42.8
Net interest	(12.4)	(13.7)	(8.3)	(3.6)	(3.1)
Associate income	0	0	0	0	0
Tax	(24.5)	(10.5)	(18.5)	(10.1)	(11.1)
Minority interests	0.3	0.2	0.2	0.2	0.2
Normalised NPAT	97.0	56.7	47.1	25.7	28.3
Abnormals/other	(718.9)	(205.7)	0	0	0
Reported NPAT	(608.2)	(156.9)	47.1	25.7	28.3
Normalised EPS (cps)	24.9	8.6	2.7	1.5	1.6
DPS (cps)	7.5	0	0	1.5	1.6

Valuation Ratios	2019A	2020A	2021E	2022E	2023E
EV/EBITDA (x)	2.1	2.2	1.8	2.1	2.1
EV/EBIT (x)	3.4	5.8	4.3	7.0	6.5
PE (x)	0.7	2.0	6.3	11.5	10.5
Price/NTA (x)	n/a	5.8	2.8	2.4	2.4
Free cash flow yield (%)	34.3	34.0	32.6	26.5	21.0
Net dividend yield (%)	44.1	0.0	0.0	8.8	9.4
Gross dividend yield (%)	61.3	0.0	0.0	12.3	13.1

Capital Structure	2019A	2020A	2021E	2022E	2023E
Interest cover EBIT (x)	11.9	5.3	8.9	10.9	13.7
Interest cover EBITDA (x)	19.4	14.0	22.0	36.6	42.6
Net debt/ND+E (%)	34.9	-2.2	-23.5	-37.8	-42.3
Net debt/EBITDA (x)	0.8	n/a	n/a	n/a	n/a

Growth Rates	2019A	2020A	2021A	2022A	2023A
Revenue (%)	-6.8	-6.0	-5.2	-2.0	-1.5
EBITDA (%)	-15.7	-20.1	-5.0	-27.1	-0.4
EBIT (%)	-19.3	-50.5	1.2	-46.4	7.8
Normalised NPAT (%)	-18.5	-41.6	-17.0	-45.3	10.1
Normalised EPS (%)	-18.5	-65.4	-68.8	-45.3	10.1
Ordinary DPS (%)	-50.0	-100.0	n/a	n/a	6.7

Key Ratios	2019A	2020A	2021E	2022E	2023E
Return on assets (%)	19.2	8.7	9.8	5.5	4.3
Return on equity (%)	27.7	15.2	11.2	5.9	6.5
Return on funds employed (%)	13.3	12.8	14.4	8.4	9.6
EBITDA margin (%)	30.3	25.7	25.8	19.2	19.4
EBIT margin (%)	18.6	9.8	10.4	5.7	6.2
Capex to sales (%)	9.6	7.6	7.0	8.0	8.0
Capex to depreciation (%)	108	64	62	81	81
Imputation (%)	100	100	100	100	100
Pay-out ratio (%)	30	0	0	102	99

Cash Flow (NZ\$m)	2019A	2020A	2021E	2022E	2023E
EBITDA	240.9	192.5	182.9	133.3	132.8
Working capital change	(11.5)	22.7	(9.5)	14.9	(1.4)
Interest & tax paid	(48.5)	(39.5)	(26.8)	(13.8)	(14.3)
Other	(2.8)	(18.4)	0	0	0
Operating cash flow	178.0	157.3	146.5	134.4	117.1
Capital expenditure	(76.3)	(56.5)	(49.6)	(55.6)	(54.8)
(Acquisitions)/divestments	0.2	(18.2)	6.8	0	0
Other	7.6	(37.2)	(31.5)	(27.6)	(24.4)
Funding available/(required)	109.5	45.5	72.1	51.2	37.9
Dividends paid	(66.9)	0	0	(12.2)	(27.9)
Equity raised/(returned)	0	150.0	0	0	0
(Increase)/decrease in net debt	42.6	195.5	72.1	38.9	10.0

Operating Performance	2019A	2020A	2021E	2022E	2023E
Revenue					
Subscriptions	728.4	687.3	654.7	642.8	634.7
Advertising	51.8	45.2	39.7	38.1	36.2
Installation & other revenue	15.0	15.1	14.6	14.2	13.8
Total revenue	795.1	747.6	709.0	695.1	684.7
Operating costs					
Programming	(320.8)	(335.5)	(320.6)	(363.5)	(355.0)
Subscriber related costs	(88.3)	(101.9)	(87.6)	(86.4)	(85.5)
Broadcasting & infrastructure	(95.8)	(70.3)	(67.1)	(63.6)	(61.7)
Other costs	(49.3)	(47.5)	(50.8)	(48.3)	(49.7)
Total operating costs	(554.3)	(555.2)	(526.2)	(561.8)	(551.9)
Reported EBITDA	240.9	192.5	182.9	133.3	132.8

Balance Sheet (NZ\$m)	2019A	2020A	2021E	2022E	2023E
Working capital	(39)	(57)	(47)	(62)	(60)
Fixed assets	163	125	112	108	106
Intangibles	446	323	313	311	311
Right of use asset	0	97	79	63	346
Other assets	7	12	4	4	4
Total funds employed	577	500	461	424	705
Net debt/(cash)	188	(8)	(80)	(119)	(129)
Lease liability	0	73	61	49	340
Other liabilities	37	23	22	22	22
Shareholder's funds	350	374	421	434	435
Minority interests	1	1	1	2	2
Total funding sources	577	463	425	388	669

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

Earnings changes and charts

2H21 guidance looks conservative

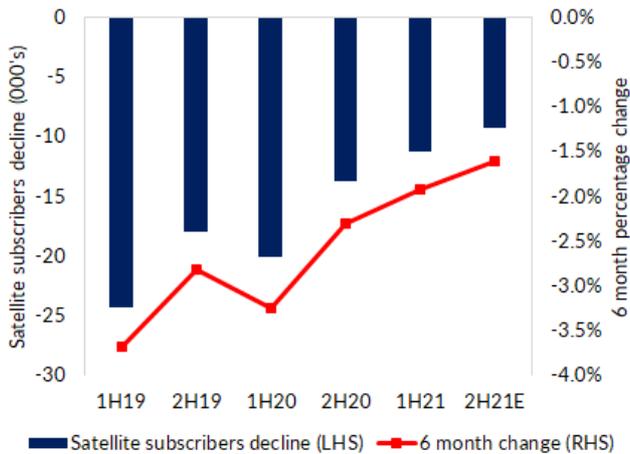
We have upgraded our earnings estimates for FY21–FY23. Our FY21 forecasts are slightly ahead of the top end of the guidance for both EBITDA and NPAT. However, we believe investor focus is squarely on the outward years.

Figure 1. Forecast earnings changes (NZ\$m)

	FY21E			FY22E			FY23E		
	Old	New	Change	Old	New	Change	Old	New	Change
Revenue	700.9	709.0	1.2%	674.8	695.1	3.0%	658.8	684.7	3.9%
EBITDA	140.6	182.9	30.1%	106.5	133.3	25.1%	106.0	132.8	25.3%
EBIT	40.5	74.1	82.7%	16.2	39.7	145.5%	18.3	42.8	133.6%
Adjusted NPAT	22.8	47.1	106.2%	8.7	25.7	194.2%	10.7	28.3	164.4%
Adjusted EPS (cps)	1.3	2.7	106.2%	0.5	1.5	194.2%	0.6	1.6	164.4%
Dividend (cps)	0.0	0.0	n/a	0.5	1.5	200.0%	0.6	1.6	166.7%
Satellite subscribers (000's)	556.0	564.8	1.6%	528.2	547.8	3.7%	501.8	531.4	5.9%

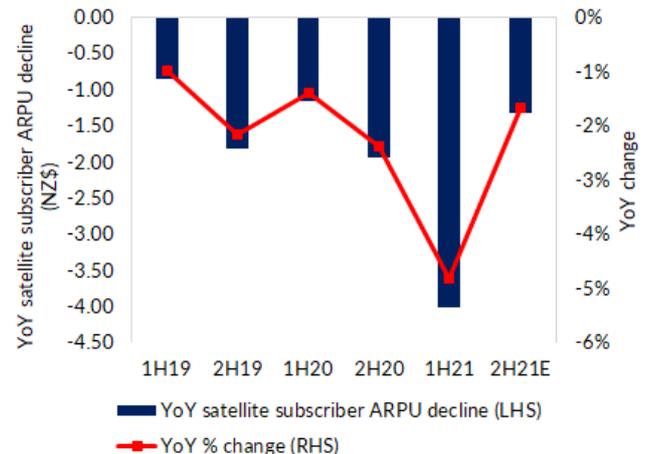
Source: Forsyth Barr analysis

Figure 2. Satellite subscribers in decline but improving



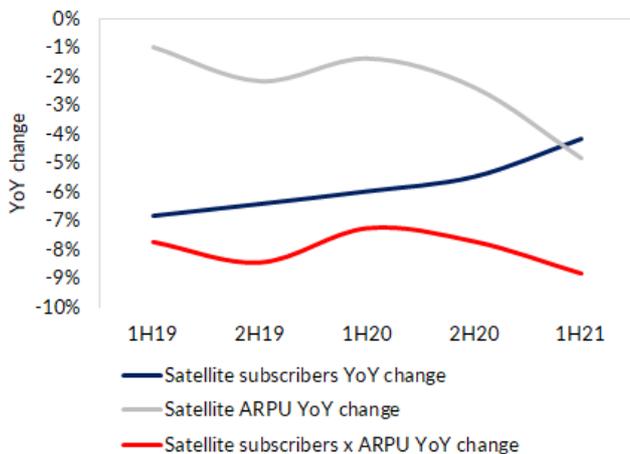
Source: Forsyth Barr analysis, Company reports

Figure 3. ARPU remains in decline; exacerbated by COVID-19



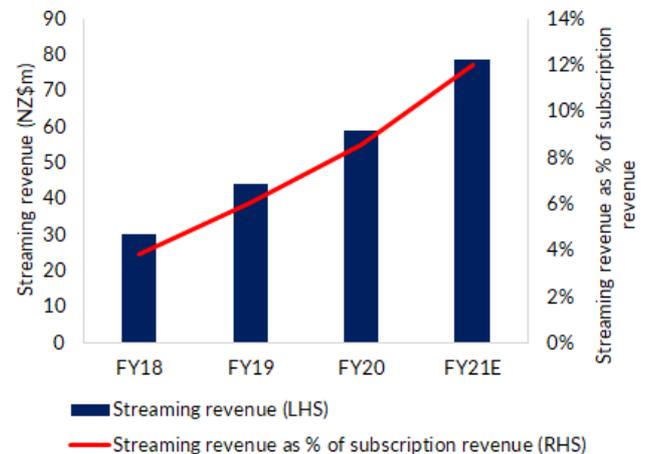
Source: Forsyth Barr analysis, Company reports

Figure 4. SKT's satellite ARPU and subscribers struggle



Source: Forsyth Barr analysis, Company reports

Figure 5. Streaming becoming a more important puzzle piece



Source: Forsyth Barr analysis, Company reports

Figure 6. Price performance


Source: Forsyth Barr analysis

Figure 7. Substantial shareholders

Shareholder	Latest Holding
Jupiter Asset Management	9.0%
ACC	8.4%
Kiltearn Partners	5.9%
UBS	5.3%
Black Crane Asia Pacific Opportunities Fund	5.1%

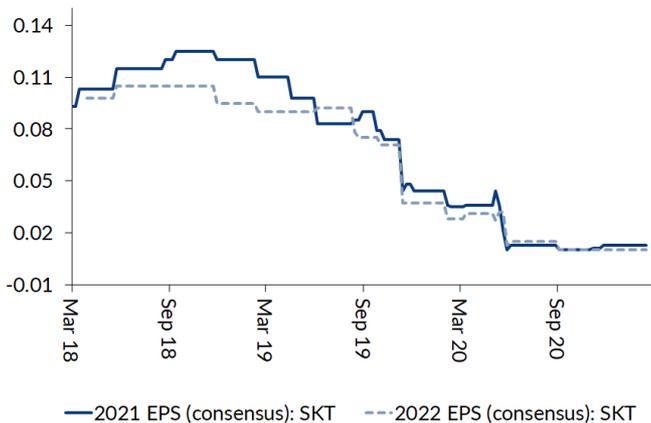
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 8. International valuation comparisons

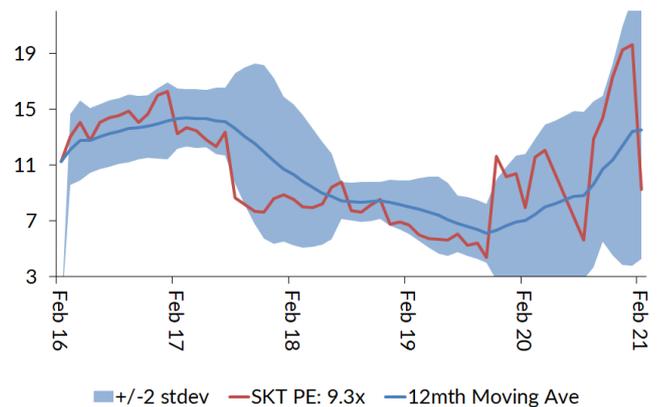
Company (metrics re-weighted to reflect SKT's balance date - June)	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash Yld 2022E
				2021E	2022E	2021E	2022E	2021E	2022E	
Sky TV	SKT NZ	NZ\$0.17	NZ\$304	6.5x	11.8x	1.6x	2.2x	4.0x	7.5x	8.6%
SPARK NZ*	SPK NZ	NZ\$4.69	NZ\$8,685	21.1x	20.3x	9.1x	8.8x	15.9x	15.2x	5.3%
NZME	NZM NZ	NZ\$0.88	NZ\$174	8.7x	8.0x	4.9x	4.9x	8.9x	8.4x	n/a
SEVEN GROUP HOLDINGS	SVW AT	A\$22.64	A\$7,683	15.9x	13.9x	10.9x	9.8x	14.4x	12.9x	2.3%
ITV PLC	ITV LN	£1.11	£4,466	11.4x	9.9x	8.9x	8.0x	13.3x	11.0x	5.1%
DISH NETWORK CORP-A	DISH US	US\$33.21	US\$17,474	11.0x	14.5x	9.8x	9.7x	14.0x	14.9x	n/a
LIBERTY GLOBAL PLC-A	LBTYA US	US\$25.94	US\$14,937	10.7x	25.8x	5.9x	5.7x	13.5x	13.7x	n/a
ASTRO MALAYSIA HOLDINGS BHD	ASTRO MK	RM0.92	RM4,797	9.5x	9.6x	4.8x	4.8x	7.9x	8.0x	7.6%
			Compco Average:	12.6x	14.6x	7.7x	7.4x	12.6x	12.0x	5.1%
			SKT Relative:	-49%	-19%	-79%	-70%	-68%	-38%	70%

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 9. Consensus EPS momentum (NZ\$)


Source: Forsyth Barr analysis

Figure 10. One year forward PE (x)


Source: Forsyth Barr analysis

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