Company Name: Sky Ltd
Company Ticker: SKY LN
Date: 2017-10-12
Event Description: Q1 2018 Earnings Call

Market Cap: 15926.6946359
Current PX: 926.5
YTD Change($): -62.5
YTD Change(%): -6.32

Bloomberg Estimates - EPS
Current Quarter: 0.16
Current Year: 0.656
Bloomberg Estimates - Sales
Current Quarter:
Current Year: 13640.929

Q1 2018 Earnings Call

Company Participants

- Andrew John Griffith, Group COO, CFO & Executive Director
- Jeremy Darroch, Group CEO & Executive Director

Other Participants

- Guy Richard Peddy, Head of Telecommunications, Media. And Technology
- Ian Richard Whittaker, Head of European Media Research
- Jeremy A. Dellis, MD and Senior Telecommunications Analyst
- Matthew John Walker, Research Analyst
- Patrick Thomas Wellington, MD and Head of the European Media Equity Research
- Stephen Paul Malcolm, Senior Analyst
- Thomas A Singlehurst, Director and Head of European Media Research

Presentation

Operator

Good morning, ladies and gentlemen. Welcome to the Sky Q1 call. My name is Courtney. And I'll be your coordinator for today's event. (Operator Instructions)

I will now hand you over to your host, Jeremy Darroch, to begin today's conference. Thank you.

Jeremy Darroch, Group CEO & Executive Director

Okay. Thanks, Courtney. Good morning, everybody. Thanks for joining us today. Hopefully, you've seen the results this morning. So in terms of the call, I'll take you through the headlines, Andrew will take you through more detail on our operating and financial performance. And then we'll be happy to take any questions.

So in terms of the headlines. We've made a strong start to the year. And we're continuing, I think, to make good progress on our plans across the group. Our financial results are strong: revenue grew by 5%; EBITDA is up 11%; and excluding our investments in opening up new markets, it's 15%, with the investment choices we've been making starting to come through.

We're seeing strong customer demand for our products and services. We added 160,000 new customers in the quarter, that's up about 50% versus last year. We sold more than 800,000 subscription products. And that takes the total number of subscription products in our base comfortably above 60 million. And customers made almost 10 million pay-as-you-go sports and entertainment buys, that was up 12% year-on-year.

Our investments on screen are working well. We've had an exceptionally strong quarter, actually, on screen, with viewing to Sky's channels up by 10% versus the prior year.

Some of the highlights include our homegrown drama, Riviera, which has become our highest-ever rated Sky original commission. Game of Thrones has become the most-watched series ever, averaging some 8 million viewers per episode. X Factor in Italy has got off to a good start, with additional viewing up by 7% again. And then we're pleased with the strong progress we are making in Germany and Austria with the recently launched Sky 1.

Building on this momentum, we're going to be investing 25% more this year in Sky Originals. And that means customers can look forward to 4 major original dramas each and every quarter. But, of course, this is all part of our strategy to build a more valuable content business for the longer term that provides greater differentiation on our own platforms. But at the same time, wider monetization opportunities.

It's been a strong quarter as well for innovation as we continue to enhance our products and services. So in Germany and Austria, we've now launched our new service -- new service app, Mein Sky, that we talked about a bit at our full year results. In Italy, we've added Super HD to our most popular programs, such as the X Factor and Moto GP. In the U.K., our loyalty program is doing well, over 1 million customers have signed up so far. And of course, we've changed our sports packaging lineup and given customers, we think, an even better, more flexible experience behind that. Sky Q is continuing to grow strongly. Since we launched, we've -- launched the service, we've -- we're up to something like 1.6 million customers. And of course, driving improved satisfaction and greater loyalty. And we're making it even better with the launch of a number of innovations, including voice control.

In the next few months, we'll build on the success by rolling out Sky Q to Italy. And then we'll follow that up by launching Sky Q in Germany and Austria in the first half of 2018, together with the launch of a customer loyalty program there, too.

Then, finally, customers can look forward to the launch of Sky Soundbox in November here in the U.K., which we think is going to transform the TV sound experience for our customers.

Alongside all of this work on our established businesses, we're also investing for future growth. So our entry into the U.K. mobile market is going well. We grew around 50% faster this quarter than last quarter. We added 108,000 new customers. We successfully entered 2 new territories with the launch of direct-to-consumer streaming services in both Spain and Switzerland.

So overall, we started the year well. And I'm going to hand you over now to Andrew to talk you through a bit more of the detail.

Andrew John Griffith, Group COO, CFO & Executive Director

Thanks, Jeremy. Good morning, everyone. So starting first with our largest market, the U.K. and Ireland, where this was a quarter of strong progress. We added 70,000 new customers, that's double the rate of growth against the same quarter last year. And taking total customers to 12.8 million. Revenues in the period were up 4%. And that's despite a headwind of a soft U.K. advertising market, which we estimate was down at least 2%. And our EBITDA was up 11%.

Our customers continue to see value for our investment on screens. Sky Atlantic had a standout quarter with viewing up 66%, driven by a strong performance for Game of Thrones and Tin Star, which is tracking close behind Riviera's excellent level of viewing. In sports, we saw good growth in viewing, up 6%, helped by strong audiences across the portfolio and the launch of our expanded service in July. In addition, the Mayweather-McGregor pay-per-view fight was our biggest ever.

In Germany and Austria, we had another strong quarter, adding 90,000 new customers. That's over 80% more growth than the same quarter last year and taking our total customers to above 5 million for the first time ever. Just to put that in context, since we closed the deal to buy Germany in November 2014, we'll have added over 1 million new customers and grown scale of the business by 30%.

One of our priorities in Germany is to increase the reach and scale of our channels. And we made good progress towards this, this quarter, with viewing up 45%. This was driven by Sky 1, a record 1.3 million viewers per episode to Game of Thrones. And higher sports audiences this year for the start of the new Bundesliga season. And as a result, our advertising revenues grew by a record 33%, contributing to an overall 8% increase in our German revenues. Our EBITDA in Germany was up 35%, with a really good performance in operating cost going a long way to offset the EUR 33 million increase in Bundesliga rights costs.

Turning to Italy, where we've continued to deliver revenue growth and to demonstrate good operating leverage. On screen, our viewing figures have been very positive. In entertainment, viewing to our pay channels were up 68%, whilst our free-to-air channels in Italy grew their viewing by 20%. And sports, boosted by a particularly strong performance in Formula 1, increased audiences by 5%. Overall, this strong increase in Italian audiences drove our advertising revenues to their highest-ever level. And when combined with good product growth, contributed to a 2% increase in revenues and an 8% increase in EBITDA to GBP 107 million, its highest level for five years.

Finally, consolidating each of these performances adds up to a good set of financial results for the group, with our revenue growth as a whole up 5%, that's significantly faster than the rate of growth in any of the economies we operate in or, indeed, any of our wider peer group. We had an excellent performance on efficiency, holding our operating costs flat in absolute terms on the prior year, which resulted in EBITDA for the group increasing by 11% to GBP 582 million.

Now of course, at any point in time, we're also incurring investment costs today that we expect to produce higher profits in the future. And to help give you sense of that and to show the strength of the EBITDA from the business as it is today, we split out our investment in mobile and our direct-to-consumer launch in Spain, which this period totaled GBP 24 million. And on that basis, our underlying EBITDA was up 15%.

So in summary, they're a good set of financial and operational results for the First Quarter. And with that, I'll hand you back to Jeremy.

Jeremy Darroch, Group CEO & Executive Director

Okay. Thanks, Andrew. So a few things to take away today. Firstly, it's been a strong start to the year. And we're on track as we enter the Second Quarter for the full year. We're seeing good customer demand for our products and services. Our investments on screen are working. And we're planning to scale Sky Originals this year. We've got a strong pipeline of innovation ahead as we continue to improve our products and services for customers. And we've delivered strong growth in revenues and profits, while keeping investing for the future. Now obviously, we're only 13 weeks in. And we've got our busiest trading quarter ahead of us. But we're generally pleased with the year so far.

So as we move to questions, we'd like to remind you, we're currently constrained by the Takeover Code as a result of the 21st Century Fox bid. And we're limited on what we can say about it. So we hope you'll understand if we can't answer all of your questions quite as fully as we'd like.

With that, I'll hand you back to the operator to take any questions you have.

Questions And Answers

Operator

(Operator Instructions) Okay. So our first question comes in from the line of Ian Whittaker, calling from Liberum.

Ian Richard Whittaker, Head of European Media Research

Just 2 questions. First of all, just sort of the declines you see, the trends that you're seeing in both churn and ARPU, given some of your initiatives that you put into (inaudible) sort of, of buying new products, obviously. You look at, sort of, previous years in terms of some of those metrics. They probably have been mixed from your point of view. The second thing also as well, just on the Premier League. There's been a number of reports that have suggested that piracy, by streaming of Premier League rights, has increased substantially, certainly within the U.K. market. I'm just thinking sort of how you view that in the context of your ownership of the Premier League rights and also as well sort of whether it would impact your thinking on how much to pay when we go into the next round of negotiations.

Andrew John Griffith, Group COO, CFO & Executive Director

Ian, it's Andrew. It's -- look, it's not a quarter where we break down the microeconomic detail on churn and ARPU. But we're happy with our performance. You can see that, both in terms of the volume of products customers are taking, a very strong performance in the U.K. on Sky Q, which is obviously an upsell product and is taking up the average spend of those at the top end of our base. That strategy rolls out into Italy and Germany this quarter. Then on loyalty, the reciprocal, really, which is you've taken a very successful loyalty program in Italy that we've regularly said has got churn down to record-low levels. And that's been deployed back into the U.K. and will be later deployed into Germany in 2018. And as a result of that, we're happy with the progress that we're making on loyalty in our markets, always more to do. Look, in terms of Premier League, I'll certainly talk to the piracy in streaming. This is something that we take incredibly seriously. But more importantly, the Premier League take incredibly seriously. And you see the number of initiatives this season, including them successfully obtaining a blocking injunction to go against streams at the ISP level. That's having a good effect. Again, piracy is not something that you're ever going to fully vanquish. But it is important that they take all the measures that they can and that they stay, as far as possible, one step ahead of whatever technology allows. And I know, if you talk to them, they'll talk about exactly all of the things they're doing and how important that is to them as a rights holder.

Operator

The next question comes in from the line of Patrick Wellington, calling from Morgan Stanley.

Patrick Thomas Wellington, MD and Head of the European Media Equity Research

A couple of things. Firstly, on advertising. I mean, your estimate of the U.K. TV advertising market down 2% in the September quarter is probably at the, sort of, bullish end of the scale. Do you think, given your viewing performance, did you outperform that? And do you have any remarks to make about the advertising outlook as we move into the December quarter? Then secondly, can you give us -- you're probably not going to give us any numbers on your OTT product in Spain and you haven't launched in Switzerland yet. But can you give us any idea of just how well you think that's gone to begin with, the sense of scale, the sense of ambition about where that could go and what sort of investment is required?

Jeremy Darroch, Group CEO & Executive Director

Sure. It's Jeremy here. On OTT, I mean, we're in both of those markets. You're right, it's very early days for them, we are very small. I think the team executed the initial plans well. So we're kind of happy with that. And the pickup on social media and in the press has been good. It's -- we're testing sort of new models there and also new business models, very light touch. We got mixed teams, both in the headquarters and in Madrid and on the ground in Switzerland. A different model in terms of innovation, a little bit. So we got small teams that are moving quickly. And we'll see how we go. Spain, I mean, if we get it right, over time, no reason why that couldn't be quite a big market, I don't think. It's the fifth-largest market in Europe. Its economy, at least up until now, has been growing -- is growing well and it's a big TV market with a lot of free-to-air households. So the idea to start selling some product into those household base is good. Switzerland, obviously different. But a very, very rich market, big sports market. It helps us bridge -- if you sort of think of Italy, Germany, Austria, it sort of bridges that gap. So I think they're not going to enormous markets in the short term. It will take tens of millions to open up. But I think, over time, there's no reason why they can't be attractive opportunities anchored off either the business in Germany or the business here. In terms of advertising, well, do you want to talk, Andrew?

Andrew John Griffith, Group COO, CFO & Executive Director

Yes. We'll have to see when everyone reports what the actual market does. So down at least 2% was our estimate for the quarter. And as ever, frankly, there's limited visibility on a forward view. Obviously, as we go into next calendar year, we're starting to annualize some of the decline in the market. So there may be some improvement at that point. Our own performance, against that minus 2% for the market, our revenues in the U.K. were up 4%. And I think that's both reflective of the increased value that the Sky Media as a sales house offers. So if you're trimming and optimizing your ad spend, it does still make sense to put more of that mix into Sky because we offer better value to advertisers. But also, what we've done on addressable. And so, whilst addressable obviously competes for some of the innovation spend in the market. So again, in a declining market, you've got a bit more of a headwind, we still saw double-digit growth for our AdSmart business. We've just launched this week, I think, our 10,000th campaign in addressable. And we continue to roll out that product, both in terms of its depth and breadth in the U.K., with Channel 4 -- sorry, forgive me, Channel 5 inventory now AdSmart-able on Sky, with the deal that we've done in Virgin, which in a world-first means that, in time, clients will be able to buy both across the satellite and the cable universe against a single set of addressable metrics. And obviously, we're rolling that out across our businesses to Italy and to Ireland. And it will follow the launch of Sky Q in Germany. So we're still making good progress. I think we're making our own weather in the advertising market. But we're not getting any tailwinds from growth.

Operator

The next question comes in from the line of Matthew Walker, calling from Credit Suisse.

Matthew John Walker, Research Analyst

A couple of questions, please. First is can you give us any numbers for TV net adds or subs and broadband? Did you increase broadband this quarter over last -- over -- sorry, on a like-for-like basis? And also, the investment of GBP 24 million, how much of that was Spain, how much was mobile? I'm guessing the bulk was mobile. Does that mean we should still be thinking about, say, GBP 80 million of investments for the full year in mobile and still GBP 40 million for international OTT?

Jeremy Darroch, Group CEO & Executive Director

Sure, I'll do one. That's -- Andrew, you do 2. To be honest with you, this quarter's all about TV. Broadband did grow. But it was a little bit sort of premature. Growth came from our TV, TV business. We were very focused on that. So we'll get back on the horse with broadband over the next few months.

Andrew John Griffith, Group COO, CFO & Executive Director

Yes. And on the GBP 24 million, 80% of that was mobile, as you correctly ascertained. There's no change to our full year guidance. But both of these are very sort of scalable levels of investment. They happen customer by customer, by and large. So as we go through the half, you'll be able to calibrate where we're likely to end up on the full year. We're not changing our numbers.

Matthew John Walker, Research Analyst

And just on a -- a quick follow-up, which is, I don't know if you can answer this. But you did 11% EBITDA growth. I think the cost growth was a bit skewed between the first half, second half last year. Do you think 11% is achievable for the full year this year?

Andrew John Griffith, Group COO, CFO & Executive Director

It's what we'd aspire to. But I'm not going to, after 13 weeks into a new year with, frankly, an uncertain market out there and some challenging headwinds, going to go (nap) on a full year number yet. But that would obviously be nice.

Operator

The next question comes in from the line of Tom Singlehurst, calling from Citi.

Thomas A Singlehurst, Director and Head of European Media Research

Yes, Tom here from Citigroup. I had a couple of questions, if that's okay. Actually, 3. On mobile, I'm -- I mean, I just wanted to see whether any of the new customers to the platform were mobile customers or should we think about that 108,000 being largely existing customers taking up the mobile product the first time? Second question was on Sky Sports. You talk about there being a sort of opportunity of, I think, 4 million households or people who would be interested in Sky Sports. But don't take it currently. Just interested whether that 4 million is largely people that don't take Sky at all, or is that 4 million people within the base or what the mix is? Just to see whether that's an upsell opportunity or a new customer opportunity. Then, finally, on the FAPL auction, I mean, obviously, early stages. And we'll find out when we find out. But do you think there's any chance the sort of broad structure will be changed? I mean, I think I'm right in saying that the current system is that you bid for live rights across TV and digital. Is there any scope do you think, at this stage, for digital and mobile to be separated from TV in the forthcoming auction?

Jeremy Darroch, Group CEO & Executive Director

Okay, Tom. Yes, mobile very little, it was all sort of TV. I think 3,000 stand-alone mobile customers. So tiny. Sky Sports, the 4 million, that's always been in the base, we've talked about. I mean I think there is an opportunity elsewhere, we've always talked about it in the base there. And it brings the entry-level Sky Sports down to 60p a day. I think it's great value for what you can get. It's half -- what's half the price of a cup of coffee? So that's obviously a good opportunity. The team have really been focused on landing it in our existing customers, getting the comms across. But going forward, I think a probably good upsell opportunity for the team in the U.K. In FAPL, I think, well, we have to see, as you said. In the past, they've typically been step-by-step, how they've changed. The rights, there's never really been any particularly dramatic change that they've made. Obviously, when they moved away from the single buyer, that led them to packages. But -- so we'll have to see. I mean, I think it's when you start splitting via platform, that's quite dangerous for rights holders, in my view. But that obviously will be up to them.

Operator

The next question comes in from the line of Jerry Dellis, calling from Jefferies.

Jeremy A. Dellis, MD and Senior Telecommunications Analyst

I've got 2 questions, please. Firstly, in the release, when you were talking about the sources of revenue growth in the U.K., you mentioned the benefit from increasing retail prices in phone and broadband. And I just wondered that as you analyze the 4% revenue growth in the U.K., was that price increase quite a material contributor or should we think of this revenue growth coming primarily on the TV side? Then my second question is just that BT in the market is talking a lot more about convergence and the integration between BT broadband and EE mobile. There probably is quite a significant convergence opportunity, obviously, for Sky as well, part of which you're clearly addressing through Sky Mobile. But there would appear to still be a lot of Sky TV homes who take BT Broadband, maybe 2.5 million in the U.K. And as you said earlier, you've tended to be a bit less active in the broadband market in recent quarters. I just wondered what the limiting factor is there and whether it is an ambition to scale up your activity in the broadband market, particularly with the prospect of cheaper access to fiber.

Jeremy Darroch, Group CEO & Executive Director

Yes, sure. The revenue growth was really predominately TV. So there was, I think, a bit of telco pricing there. But not much, it was predominantly TV. Yes, look, I think, on the convergence thing and the opportunity for -- in BT broadband in our homes, it's -- you're right, it's there. I think, a little bit, it's, what's the gating factors? I think a little bit what we're focused on. Got many, many different things to sell in the base and obviously, we've done a good job in terms of growing our broadband base. But it's still there. I think 5 is a good example, actually. One of the ways we can target those sorts of customers. So there's nothing particularly that stops us, I think, going after it. We have no plans to take us sort of laser focus on one area. It's more, there, just selling across the range and finding the right opportunities to persuade customers to switch to us. But I do take your point that, with fiber, that's starting to make it a little bit easier for us to do that.

Jeremy A. Dellis, MD and Senior Telecommunications Analyst

Could I just ask you a quick follow-up, please? I may have missed this. But have you given an indication as to how much of the revenue this quarter came from sort of handset sales in the Sky Mobile activity?

Jeremy Darroch, Group CEO & Executive Director

We haven't broken that out. But again, the revenue growth from mobile off the top of our head is something like GBP 30 million. So it's, again -- well, it's in that context. There was no big lump, if you like, from handset sales at all.

Operator

The next question comes in from the line of Steve Malcolm.

Stephen Paul Malcolm, Senior Analyst

I think 3 questions. But I sort of lost count here. Can I just come back on the question on the sub growth? A couple of comments you made. Within the 70,000, are you saying that part of that was broadband stand-alone growth or does the broadband growth that you mentioned just relate to products? And also, does the 3,000 mobile customers sort of parlay into that 70,000 number as well? So maybe just a little bit of color. Understand most of it will have come, I guess, from NOW and Game of Thrones. But just for those on broadband and mobile would be great. Secondly, wholesale. You've seen some sharp declines in wholesale subs in the last sort of few quarters. Obviously, nothing in the release. Could you give us an update maybe on how that's trended? And alongside that, Virgin's been pretty open in saying that they've had some success in winning triple-play customers away from you. Is that something that you're seeing? And if you are, how are you kind of targeting your offers to keep your customers and avoid that happening? And finally, just on Germany, can you just -- given the advertising number that you printed, it looks like you didn't have any ARPU growth this quarter in Germany. Can you just talk about what you're doing on pricing around the new Bundesliga contract and how we should expect ARPU to trend in Germany on the subscription side over the next few quarters?

Jeremy Darroch, Group CEO & Executive Director

Surely. Yes, I think the -- look, on the first, I think broadband was about 5% in terms of growth. So as you can say, it was small. So it came from TV. Q's done well in the quarter and now continues to do well. So we're growing at sort of the top and the bottom in terms of TV. Wholesale subs, you're right, it's a good point. There have been -- I think, wholesale subs performance has been disappointing and so we're constantly trying to find ways that we work with our wholesale providers to get them to improve. It's sort of a marginal decline. Importantly, though, for us, revenues are up. So in terms of what we get, it continues to grow. As you've seen over time, that's been a part of our business that we've really developed as a strong revenue stream. So we later see them growing their subs. But obviously, for us, these are the major impact is in terms of the revenues we're getting from them. Virgin, not really. I mean, I think -- and I think there's always going to be stuff, look, around the margin, I think, whether they're doing a bit better way, we're doing a bit better. If I look at our performance in the U.K., relative to them, I'm pretty happy in terms of that we're getting it right. In terms of German advertising and ARPU, do you want to talk about that?

Andrew John Griffith, Group COO, CFO & Executive Director

Yes. Look, you're right; we've not taken price in Germany. The opportunity on ARPU going forward and the metrics that we track are twofold. One is the landing ARPU of new customers, which significantly is increasing over time, we're doing a better job. That's really about managing discounts, that it's one of the motivations behind us moving away from those discounted 24-month contracts. So we can manage that yield better. And similarly, as we go through those long-term contracts on retention, we're also successfully taking customers up, up to closer to the run rate tariff. So that's the opportunity in Germany. I think what you can see on our advertising business is actually we're taking share. So it's less about the market, which is, overall, showing some growth. But we're actually taking share away from others in the German ad market.

Stephen Paul Malcolm, Senior Analyst

Andrew, can I just come back on the broadband? You said 5,000 within the 70,000 net sub growth. Did you grow absolute broadband products as well? Or is that not the case?

Andrew John Griffith, Group COO, CFO & Executive Director

Confused. I haven't had enough coffee this morning, forgive me.

Stephen Paul Malcolm, Senior Analyst

Your customer growth, this obviously includes the stand-alone broadband customers. But your products includes people with triple-play. So they might get rid of broadband. So I guess, just the overall product number would be helpful as well.

Andrew John Griffith, Group COO, CFO & Executive Director

I think we saw net growth in broadband products as well, getting down into the weeds.

Operator

The next question comes in from the line of Guy Peddy, calling from Macquarie.

Guy Richard Peddy, Head of Telecommunications, Media. And Technology

Very quick question here, slightly more on the technical side. With your Sky Q products and the fact that you lease or lend the Sky Q box, I don't know whether you've got any evidence of this. But what happens should a Sky Q customer churn? Do they actually return the box or do you disenable the box? I'm just intrigued as to what actually is the process should that happen.

Andrew John Griffith, Group COO, CFO & Executive Director

Look, it's a very mature process. And it's a process that obviously, a, has happened in the U.K. with Virgin and others. But also our businesses in Italy and Germany have always followed. So they've always been on a box-leasing model. So what actually happens, if a customer churns, they go into a treatment. The first thing is that we deactivate the box, it ceases to work. If they try and tune to a pay-TV channel, they get an on-screen message inviting them to contact us through one of many of the different ways you can contact us. We will also seek to reach out to the customer. Obviously, that's a great opportunity to win them back, to remind them of the value that we offer or to right-size them onto a different package that perhaps better meets their needs. If, as a result of that process, they don't rejoin, we don't reactivate the box. At that point, we will seek to send them a, effectively, a returns process. So returns supply chain, they could either put that in a courier pack and drop it off and send it to us, or in some cases, we will physically go and collect it using our field force. The collection rate is pretty good. I mean, we account for that in terms of how we amortize the boxes. But our collection rate is in excess of 80% in all of the markets that we do. I think that may be all we've got time for.

Jeremy Darroch, Group CEO & Executive Director

I think, yes, I think that's it. So I just wanted to say thanks for joining the call today. Once again, a strong First Quarter. Business is in good shape as we enter the busy Christmas period. So we're pretty much heads down now through to Christmas. And we remain on track for the full year. So look forward to talking to you the next time around. And have a good day.

Operator

Ladies and gentlemen, thank you for joining today's call. You may now replace your handsets.