

Tower Limited

Tidy Up Continues With Solomon Islands Sale

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Tower (TWR) has announced the conditional agreement to sell its Solomon Islands business to Trans Pacific Assurance Limited (TPA) for around SBD\$17m or NZ\$3.3m. The Solomon Islands business was the smallest of TWR's Pacific operations, and the sale aligns with TWR's strategy to streamline operations, enhance the digital customer experience, and narrow its risk appetite. Given the Solomon Islands business was sub-scale, we expect the divestment to reduce TWR's overall complexity and improve efficiency. This transaction is set to be completed this calendar year, subject to necessary regulatory approvals and reinsurance coverage confirmations. The sale marginally aids TWR's capital position, which has been under some pressure from the two significant catastrophe events earlier in FY23. Our blended valuation lifts +6% to NZ\$0.84, primarily due to the re-rating of peer group multiples, and we make minor adjustments to our earnings estimates.

NZX Code	TWR	Financials: Sep/	22A	23E	24E	25E	Valuation (x)	22A	23E	24E	25E
Share price	NZ\$0.63	Rev (NZ\$m)	418.3	485.2	563.1	622.3	PE	13.5	24.3	6.6	5.3
Spot Valuation	NZ\$0.84 (from 0.79)	NPAT* (NZ\$m)	17.7	9.8	36.2	44.8	EV/EBIT	n/a	n/a	n/a	n/a
Risk rating	High	EPS* (NZc)	4.7	2.6	9.5	11.8	EV/EBITDA	n/a	n/a	n/a	n/a
Issued shares	379.5m	DPS (NZc)	6.5	2.5	7.0	8.0	Price / NTA	1.4	1.4	1.2	1.1
Market cap	NZ\$239m	Imputation (%)	0	0	0	0	Cash div yld (%)	10.3	4.0	11.1	12.7
Avg daily turnover	135.8k (NZ\$88k)	*Based on normalised profits					Gross div yld (%)	10.3	4.0	11.1	12.7

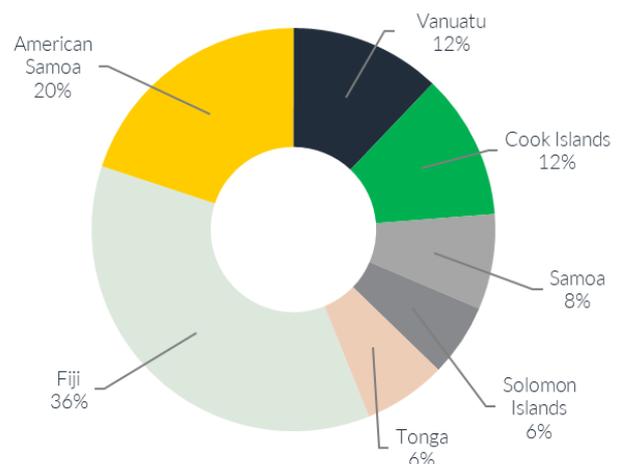
Solomon Islands business to be sold and follows the PNG sale in June 2022

The transaction values TWR's Solomon Islands business at approximately SB\$17m, with the final amount pending adjustments for any fluctuations in gross written premiums (GWP), exchange rates, and capital requirements. TWR's business in the Solomon Islands, its smallest Pacific operation, contributed GWP of NZ\$2.9m and a NPAT of NZ\$0.1m during FY22. The sale price of NZ\$3.3m represents a +25% premium on the net asset value of NZ\$2.6m as of 30 September 2022. The transaction forms part of TWR's move towards delivering an enhanced digital and data-driven experience to its personal lines and SME customers. It also further simplifies TWR's business in the Pacific after the sale of its PNG subsidiary to Alpha Insurance Limited for NZ\$9.7m in June 2022. We concur with TWR that the sale appears to be positive for staff, customers, and shareholders.

The completion date of the transaction is contingent on the duration required for regulatory approvals. Whilst it is feasible for completion to occur by the conclusion of FY23 (September 2023), approvals from multiple regulators are necessary – specifically in New Zealand, Papua New Guinea, and the Solomon Islands. Hence, settlement appears more likely to be in TWR's 1Q24, being the last quarter of calendar 2023. The sale should generate a net gain of around +NZ\$0.7m, which we include in our FY24 estimates.

The prospective buyer, TPA, is a privately-owned general insurance company based in PNG. As part of the acquisition, TPA plans to offer positions to all four members of TWR's Solomon Islands staff, integrating the newly acquired business into its existing business.

Figure 1. TWR – Pacific Islands GWP Country Split (FY22)



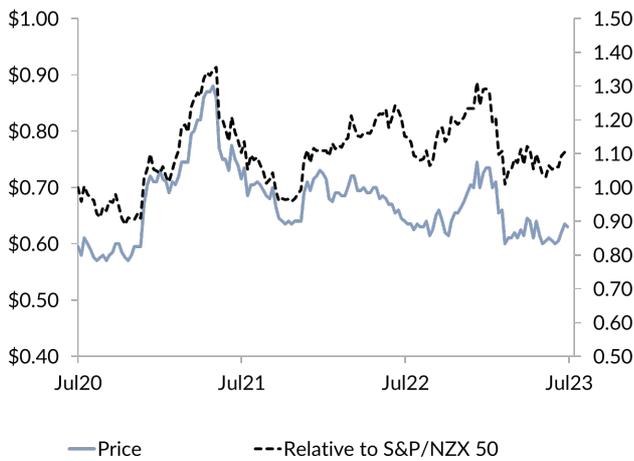
Source: Company, Forsyth Barr analysis, excluding the PNG business, which TWR sold.

Tower Limited (TWR)

Market data (NZ\$)						Spot valuation (NZ\$)					0.84
Priced as at 03 Jul 2023					0.63	PE relative					0.81
52 week high / low					0.75 / 0.57	P/Book relative					0.88
Market capitalisation (NZ\$m)					239.1	DCF					0.84
Key WACC assumptions						DCF valuation summary (NZ\$m)					
Risk free rate					4.50%	Total firm value					478
Equity beta					1.15	(Net debt)/cash					(45)
WACC					10.4%	Less: Capitalised operating leases					(106)
Terminal growth					1.8%	Value of equity					328
Profit and Loss Account (NZ\$m)						Valuation Ratios					
Revenue (GEP)	2021A	2022A	2023E	2024E	2025E	2021A	2022A	2023E	2024E	2025E	
Normalised EBITDA	n/a	n/a	n/a	n/a	n/a	EV/Sales (x)	n/a	n/a	n/a	n/a	n/a
Depreciation and amortisation	n/a	n/a	n/a	n/a	n/a	EV/EBITDA (x)	n/a	n/a	n/a	n/a	n/a
Normalised EBIT	n/a	n/a	n/a	n/a	n/a	EV/EBIT (x)	n/a	n/a	n/a	n/a	n/a
Net interest	n/a	n/a	n/a	n/a	n/a	PE (x)	14.4	13.5	24.3	6.6	5.3
Associate income	0	0	0	0	0	Price/NTA (x)	1.2	1.4	1.4	1.2	1.1
Tax	(9.2)	(7.5)	(5.3)	(16.6)	(20.5)	Free cash flow yield (%)	39.5	15.2	19.5	33.4	31.7
Minority interests	0.6	0.1	0	0	0	Adj. free cash flow yield (%)	39.5	15.2	19.5	33.4	31.7
Normalised NPAT	20.8	27.4	10.7	36.2	44.8	Net dividend yield (%)	7.9	10.3	4.0	11.1	12.7
Abnormals/other	(1.5)	(8.5)	1.2	0.7	0	Gross dividend yield (%)	n/a	10.3	4.0	11.1	12.7
Reported NPAT	19.3	18.9	11.9	36.9	44.8	Key Ratios					
Normalised EPS (cps)	4.4	4.7	2.6	9.5	11.8	2021A	2022A	2023E	2024E	2025E	
DPS (cps)	5.0	6.5	2.5	7.0	8.0	Return on assets (%)	n/a	n/a	n/a	n/a	n/a
						Return on equity (%)	5.3	5.8	3.2	11.0	12.5
						Return on funds employed (%)	4.6	5.1	2.9	10.1	11.7
						EBITDA margin (%)	n/a	n/a	n/a	n/a	n/a
						EBIT margin (%)	n/a	n/a	n/a	n/a	n/a
						Capex to sales (%)	3.1	4.1	3.0	2.7	2.5
						Capex to depreciation (%)	n/a	n/a	n/a	n/a	n/a
						Imputation (%)	n/a	0	0	0	0
						Pay-out ratio (%)	115	140	97	73	68
						Capital Structure					
						2021A	2022A	2023E	2024E	2025E	
						Solvency capital	155.9	150.5	179.4	136.4	170.3
						Minimum solvency capital (MSC)	56.6	52.3	66.3	66.5	77.4
						Total regulatory capital	106.6	102.3	83.3	91.3	91.3
						Solvency ratio (%)	275	287	271	205	220
						Operating Performance					
						2021A	2022A	2023E	2024E	2025E	
						Gross written premium	396.0	445.6	524.7	601.6	643.1
						Gross earned premium	386.6	418.3	485.2	563.1	622.3
						Reinsurance premium	(58.8)	(66.3)	(84.1)	(95.1)	(104.3)
						Net earned premium	327.9	352.1	401.0	468.1	518.0
						Net claims expense	(202.3)	(224.9)	(291.3)	(314.8)	(348.7)
						* includes Large event claims of	(13.9)	(19.0)	(50.0)	(42.0)	(44.0)
						Management & sales expenses	(123.3)	(129.9)	(140.2)	(150.9)	(156.6)
						Underwriting profit	27.2	23.6	3.5	38.4	49.9
						Investment and other revenue	0.2	1.2	13.5	15.4	16.3
						Financing and other costs	(0.4)	(0.9)	(0.9)	(0.9)	(1.0)
						Profit before tax (from continuing operations)	27.6	25.2	15.2	52.9	65.3
						Tax expense	(9.2)	(7.5)	(5.3)	(16.6)	(20.5)
						Profit after taxation	18.4	17.7	9.8	36.2	44.8
						NPAT (from discontinued operation)	(0.2)	5.1	2.1	0.7	0
						NPAT (Reported)	18.2	22.8	11.9	36.9	44.8
						Key ratios					
						Total GWP growth %	5.0%	12.5%	17.8%	14.6%	6.9%
						Total claims ratio %	54.3%	54.1%	64.2%	59.6%	60.1%
						MER %	37.1%	36.0%	35.0%	32.2%	30.2%
						Combined ratio %	91.4%	90.1%	99.1%	91.8%	90.4%
Balance Sheet (NZ\$m)											
Working capital	2021A	2022A	2023E	2024E	2025E						
Fixed assets	148.0	183.2	238.0	272.8	291.7						
Intangibles	9.4	5.4	3.7	2.2	1.1						
Right of use asset	120.6	132.5	136.1	135.3	135.1						
Other assets	25.6	23.3	20.7	18.1	15.6						
Total funds employed	314.8	295.6	295.6	295.6	295.6						
Net debt/(cash)	618.4	640.0	694.1	724.2	739.0						
Lease liability	(116.1)	(84.5)	(117.4)	(170.6)	(215.9)						
Other liabilities	39.4	35.1	31.2	27.3	23.4						
Shareholder's funds	342.5	383.5	471.0	536.9	572.5						
Minority interests	349.9	306.0	309.4	330.6	359.1						
Total funding sources	2.7	0	0	0	0						
	618.4	640.0	694.1	724.2	739.0						

* Forsyth Barr target prices reflect valuation rolled forward at cost of equity less the next 12-months dividend** Information on Forsyth Barr's Carbon and ESG (CESG) ratings can be found at www.forsythbarr.co.nz/corporate-news-events/cesg-report

Figure 2. Price performance



Source: Forsyth Barr analysis

Figure 3. Substantial shareholders

Shareholder	Latest Holding
Bain Capital Credit LP	20.0%
ACC	9.6%
Salt Funds Management	8.0%
Investment Services Group	5.4%
NZ Funds Management	5.2%

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

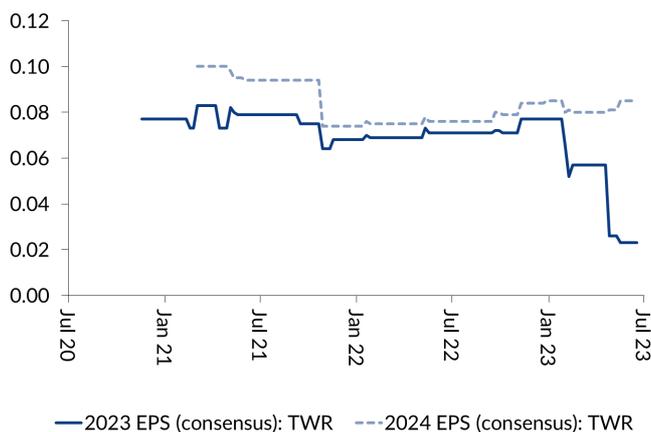
Figure 4. International valuation comparisons

Company	Code	Price	Mkt Cap (m)	PE 2023E	PE 2024E	EV/EBITDA 2023E	EV/EBITDA 2024E	EV/EBIT 2023E	EV/EBIT 2024E	Cash Yld 2024E
Tower Ltd	TWR NZ	NZ\$0.63	NZ\$239	24.3x	6.6x	n/a	n/a	n/a	n/a	11.1%
Heartland Group Holdings *	HGH NZ	NZ\$1.70	NZ\$1,206	11.1x	9.9x	n/a	n/a	n/a	n/a	7.1%
Insurance Australia Group	IAG AT	A\$5.70	A\$13,919	24.0x	15.3x	n/a	n/a	n/a	10.7x	4.9%
Suncorp Group	SUN AT	A\$13.49	A\$17,086	13.3x	12.7x	n/a	n/a	n/a	48.6x	6.0%
QBE INSURANCE GROUP	QBE AT	US\$10.44	US\$15,576	13.2x	9.7x	n/a	n/a	n/a	8.8x	5.6%
Compco Average:				15.4x	11.9x	n/a	n/a	n/a	22.7x	5.9%
TWR Relative:				58%	-45%	n/a	n/a	n/a	n/a	88%

EV = Mkt cap+net debt+lease liabilities+min interests-investments

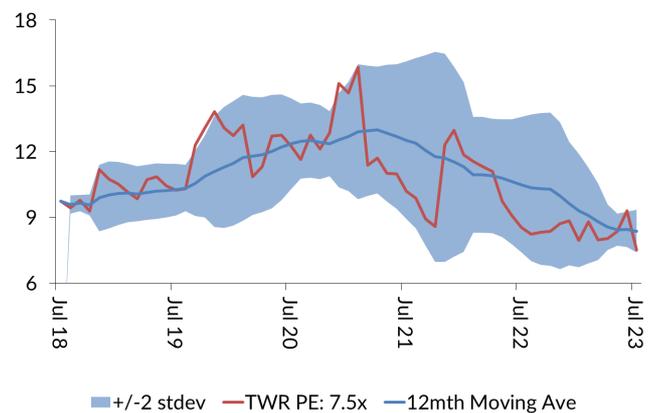
Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (TWR) companies fiscal year end

Figure 5. Consensus EPS momentum (NZ\$)



Source: Forsyth Barr analysis

Figure 6. One year forward PE (x)



Source: Forsyth Barr analysis

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