

Tower Limited

Goodbye FY23 Floods, Hello FY24

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TWR reported a mixed FY23 with strong Gross Written Premium (GWP) growth offset by higher Business as Usual (BAU) and large events claims costs. Underlying profit was NZ\$7.6m, slightly behind our estimate of NZ\$8.6m, and no 2H23 dividend was declared. The focus of the result was efficiency gains and outlook commentary. TWR's management expense ratio (MER) fell -3.6% to 32.2% in FY23, demonstrating the benefits of: 1) digitalisation, 2) operational efficiency from scale, and 3) a simplified strategy. The fall in MER exceeded expectations, as did TWR's FY25 target for MER to be <28%. TWR's maiden FY24 underlying profit guidance range of NZ\$22m to NZ\$27m was beneath our estimate of NZ\$31.3m, primarily driven by a conservative NZ\$45m large events allowance (we had forecast NZ\$42m). However, guidance for GWP growth of 10% to 15% in FY24 and FY25, and combined ratio (<91% in FY25) both imply a buoyant medium-term view relative to our forecasts. We reduce our FY24 underlying profit estimate to NZ\$25.5m to align with TWR's guidance range but increase our estimates from FY25 to FY33. We now forecast a 4cps unimputed FY24 dividend. Our blended spot valuation rises +13% to NZ\$0.92, given higher long-term forecasts driven by efficiency improvements.

NZX Code	TWR	Financials: Sep/	23A	24E	25E	26E	Valuation (x)	23A	24E	25E	26E
Share price	NZ\$0.62	Rev (NZ\$m)	470.8	547.4	619.2	678.0	PE	99.2	9.1	4.9	4.2
Spot Valuation	NZ\$0.92 (from 0.81)	NPAT* (NZ\$m)	2.4	25.6	47.8	55.0	EV/EBIT	n/a	n/a	n/a	n/a
Risk rating	High	EPS* (NZc)	0.6	6.7	12.6	14.5	EV/EBITDA	n/a	n/a	n/a	n/a
Issued shares	379.5m	DPS (NZc)	0.0	4.0	8.0	9.0	Price / NTA	1.5	1.5	1.3	1.3
Market cap	NZ\$233m	Imputation (%)	0	0	0	100	Cash div yld (%)	0.0	6.5	13.0	14.6
Avg daily turnover	120.7k (NZ\$78k)	*Based on normalised profits					Gross div yld (%)	0.0	6.5	13.0	20.3

What's changed?

- **Earnings:** Our FY24 Underlying NPAT estimate falls -18% to NZ\$25.5m, while FY25 and FY26 rise +13% and +18% respectively
- **Spot valuation:** Our spot valuation rises +11cps to NZ\$0.92, driven by long-run MER improvements.

Positive core business and market improvements continue

TWR's core business showed improvements in several areas over the year. Customer numbers grew +3.6% to 321k from a year ago. MER fell to 32.2% in FY23 from 35.8% in FY22, demonstrating continued cost control and operating leverage. TWR's investment income was +NZ\$14.3m and is now a significant contributor to earnings (~6.1% running yield as at 30 September 2023). The BAU claims ratio was elevated at 55.5% but we expect this to return to more normal levels as TWR re-prices elevated motor claims from motor theft and cost inflation.

First look FY24 and FY25 guidance

TWR's initial guidance for FY24 sees GWP growth of between +10% to +15% (in-line with our estimate), NZ\$45m of large event allowance, an MER of 30% to 32%, and 95% to 97% combined ratio. This equates to an underlying NPAT between NZ\$22m and NZ\$27m. TWR also provided medium-term guidance for FY25 GWP growth of between +10% to +15%, ~NZ\$51m of large event allowance, an MER of <28%, and a combined ratio of <91%.

Continuing to simplify the strategy

TWR is set to exit its commercial rural insurance business, with its rural customers being referred to fellow insurer Aon. TWR's rural book had generated ~NZ\$9m in GWP. TWR has suggested it is looking to sell its Vanuata business, or ~NZ\$6m in GWP.

Tower Limited (TWR)

Market data (NZ\$)						Spot valuation (NZ\$)						
Priced as at 23 Nov 2023						0.62	PE relative	0.81				
52 week high / low						0.75 / 0.57	P/Book relative	0.83				
Market capitalisation (NZ\$m)						235.3	DCF	1.11				
Key WACC assumptions						DCF valuation summary (NZ\$m)						
Risk free rate						5.25%	Total firm value	514				
Equity beta						1.18	(Net debt)/cash	(44)				
WACC						11.2%	Less: Capitalised operating leases	(46)				
Terminal growth						1.8%	Value of equity	424				
Profit and Loss Account (NZ\$m)						Valuation Ratios						
Revenue (GEP)	2022A	2023A	2024E	2025E	2026E	678.0	EV/Sales (x)	2022A	2023A	2024E	2025E	2026E
Normalised EBITDA	n/a	n/a	n/a	n/a	n/a	n/a	EV/EBITDA (x)	n/a	n/a	n/a	n/a	n/a
Depreciation and amortisation	n/a	n/a	n/a	n/a	n/a	n/a	EV/EBIT (x)	n/a	n/a	n/a	n/a	n/a
Normalised EBIT	n/a	n/a	n/a	n/a	n/a	n/a	PE (x)	13.4	>100x	9.2	4.9	4.3
Net interest	n/a	n/a	n/a	n/a	n/a	n/a	Price/NTA (x)	1.4	1.5	1.5	1.3	1.4
Associate income	0	0	0	0	0	0	Free cash flow yield (%)	15.5	-3.8	18.0	29.2	19.4
Tax	(7.5)	(5.1)	(10.3)	(19.0)	(21.8)	(21.8)	Adj. free cash flow yield (%)	15.5	-3.8	18.0	29.2	19.4
Minority interests	0.1	0	0	0	0	0	Net dividend yield (%)	10.5	0.0	6.5	12.9	14.5
Normalised NPAT	27.4	7.6	25.6	47.8	55.0	55.0	Gross dividend yield (%)	10.5	0.0	6.5	12.9	20.2
Abnormals/other	(8.5)	(8.8)	1.1	0	0	0						
Reported NPAT	18.9	(1.2)	26.6	47.8	55.0	55.0	Key Ratios					
Normalised EPS (cps)	4.6	0.6	6.7	12.6	14.5	14.5	2022A	2023A	2024E	2025E	2026E	
DPS (cps)	6.5	0	4.0	8.0	9.0	9.0	Return on assets (%)	n/a	n/a	n/a	n/a	n/a
							Return on equity (%)	5.7	0.8	8.5	15.2	17.6
							Return on funds employed (%)	5.0	0.7	7.6	13.8	16.1
							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 (%)	4.2	2.5	3.3	3.0	2.8
							Capex to depreciation (%)	n/a	n/a	n/a	n/a	n/a
							Imputation (%)	0	0	0	0	100
							Pay-out ratio (%)	141	0	59	64	62
							Capital Structure					
							2022A	2023A	2024E	2025E	2026E	
							Solvency capital	155.9	150.5	179.4	136.4	145.4
							Minimum solvency capital (MSC)	56.6	52.3	66.3	66.5	91.6
							Total regulatory capital	106.6	102.3	83.3	91.3	91.3
							Solvency ratio (%)	275	287	271	205	160
							Underlying Performance					
							2022A	2023A	2024E	2025E	2026E	
							Gross written premium	436.6	511.5	583.3	655.0	700.9
							Gross earned premium	430.7	470.8	547.4	619.2	678.0
							Reinsurance premium	(69.5)	(69.5)	(87.9)	(98.5)	(107.1)
							Net earned premium	361.2	416.3	459.5	520.7	570.9
							Net claims expense	(195.5)	(269.3)	(298.2)	(329.3)	(363.2)
							* includes Large event claims of	(19.0)	(38.2)	(45.0)	(51.0)	(55.0)
							Management & sales expenses	(129.9)	(151.4)	(138.1)	(139.8)	(145.5)
							Underwriting profit	35.8	(4.4)	23.1	51.6	62.3
							Investment and other revenue	1.1	14.3	13.8	16.1	15.5
							Financing and other costs	1.3	2.3	(1.0)	(1.0)	(1.0)
							Profit before tax (from continuing operations)	38.2	12.2	35.9	66.7	76.8
							Tax expense	(10.9)	(4.6)	(10.3)	(19.0)	(21.8)
							Profit after taxation	27.3	7.6	25.6	47.8	55.0
							NPAT (from discontinued operation)	(4.5)	(9.8)	1.1	0	0
							NPAT (Reported)	22.8	-2.2	26.6	47.8	55.0
							Key ratios					
							2022A	2023A	2024E	2025E	2026E	
							Total GWP growth %	10.2%	17.2%	14.0%	12.3%	7.0%
							Total claims ratio %	54.1%	64.7%	64.9%	63.2%	63.6%
							MER %	36.0%	32.2%	30.1%	26.9%	25.5%
							Combined ratio %	90.1%	101.1%	95.0%	90.1%	89.1%
Balance Sheet (NZ\$m)												
Working capital	2022A	2023A	2024E	2025E	2026E	356.3						
Fixed assets	5.4	6.3	7.2	7.8	8.4	8.4						
Intangibles	132.5	138.5	138.3	138.6	139.2	139.2						
Right of use asset	23.3	23.2	20.6	18.0	15.4	15.4						
Other assets	295.6	286.7	312.5	348.9	359.9	359.9						
Total funds employed	640.0	791.4	775.1	846.3	879.2	879.2						
Net debt/(cash)	(84.5)	(64.0)	(65.4)	(67.3)	(67.9)	(67.9)						
Lease liability	35.1	32.6	28.7	24.8	20.9	20.9						
Other liabilities	383.5	526.5	512.6	574.1	613.3	613.3						
Shareholder's funds	306.0	296.3	299.2	314.7	312.8	312.8						
Minority interests	0	0	0	0	0	0						
Total funding sources	640.0	791.4	775.1	846.3	879.2	879.2						

* 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

FY23 result summary

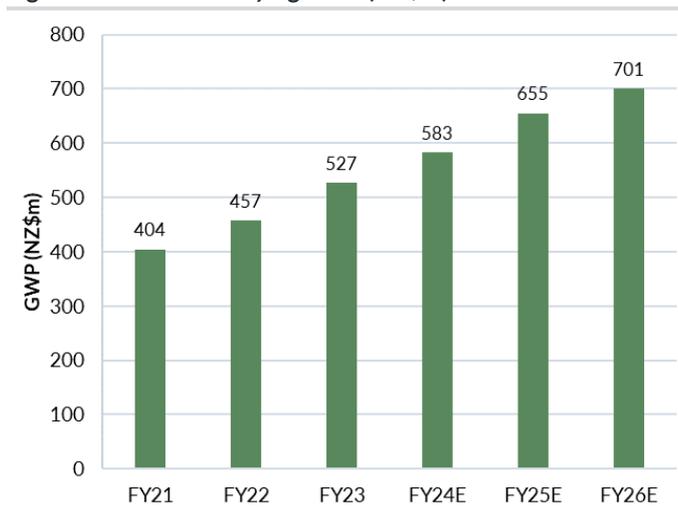
TWR's FY23 result delivered a reported NPAT loss of -NZ\$1.2m, relative to NZ\$18.9m profit in the prior year. Underlying profit after tax was NZ\$7.6m, down from NZ\$27.3m in FY22. The difference between underlying and reported numbers was due to the provision for remediation to multi-policy holders (-NZ\$6.6m), additional Christchurch earthquake provisions (-NZ\$1.2m), and other non-underlying costs (-NZ\$3.7m) net of gains on the sale of its Papua New Guinea subsidiary and its building in Suva (NZ\$2.7m). At the top line, reported GWP was NZ\$527m, up +17% on last year excluding TWR's Papua New Guinea operations. The significant uplift in GWP was driven primarily by rate increases (75% of growth). Underlying GWP was NZ\$528.8m, up +15.6% on the FY22 reported figure. TWR has seen a continued improvement in the MER, falling to 32.2% in FY23 from the 35.8% seen in FY22. TWR's solvency position has started to recover and was 159% at the balance date: well below the 205% a year ago before the two large storm events. Given the lack of earnings, and the as yet recovered capital position as at 30 September 2023, no final dividend was declared.

Figure 1. TWR—comparison of FY22 and FY23 results

	FY22 Actual	FY23 Actual	Change
Gross written premium	457.3	526.8	+15%
Gross earned premium	430.7	485.8	+13%
Reinsurance Expense	(69.5)	(69.5)	+0%
Net earned premium	361.2	416.3	+15%
Net Claims Expense	(176.5)	(231.1)	+31%
Large event claims expense	(19.0)	(38.2)	+101%
Large event reinsurance reinstatement	-	(17.4)	n/a
Management expenses	(120.6)	(125.7)	+4%
Net Commission Expense	(9.3)	(8.3)	(6%)
Underwriting profit	35.8	(4.4)	n/a
Net Investment Income	1.1	14.3	n/a
Other income (costs)	1.3	2.3	n/a
Profit before tax	38.2	12.2	n/a
Tax expense	(10.9)	(4.6)	(58%)
Profit after taxation from discontinued operation	-	-	n/a
Underlying Profit after tax	27.3	7.6	(73%)
Canterbury impact on outstanding claims	(5.5)	(1.2)	n/a
Other non-underlying items	(3.0)	(7.6)	n/a
Reported Profit after tax	18.9	(1.2)	n/a

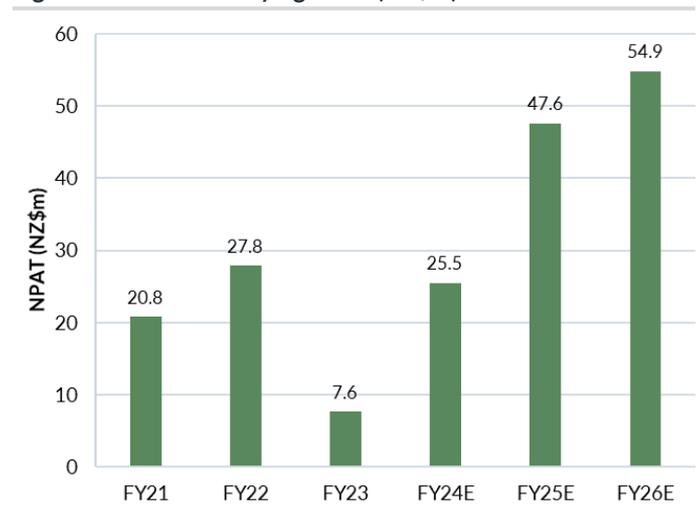
Source: Company, Forsyth Barr analysis

Figure 2. TWR—Underlying GWP (NZ\$m)



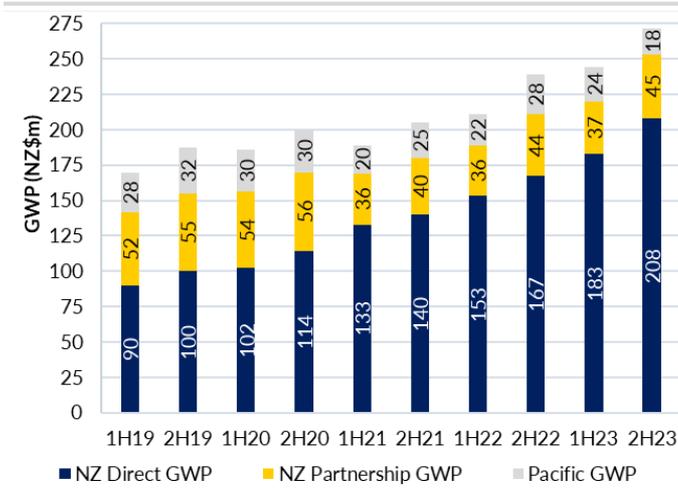
Source: Company, Forsyth Barr analysis

Figure 3. TWR—Underlying NPAT (NZ\$m)



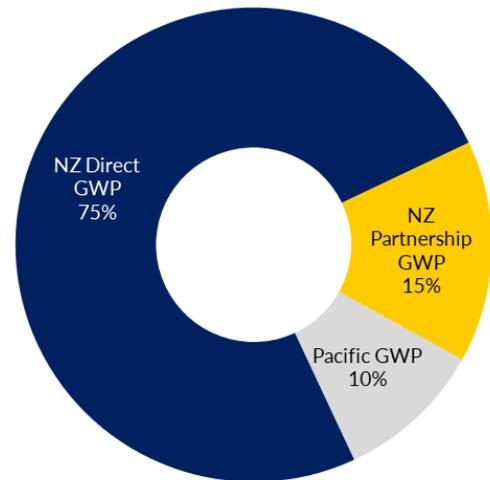
Source: Company, Forsyth Barr analysis

Figure 4. TWR—GWP by division (half-on-half)



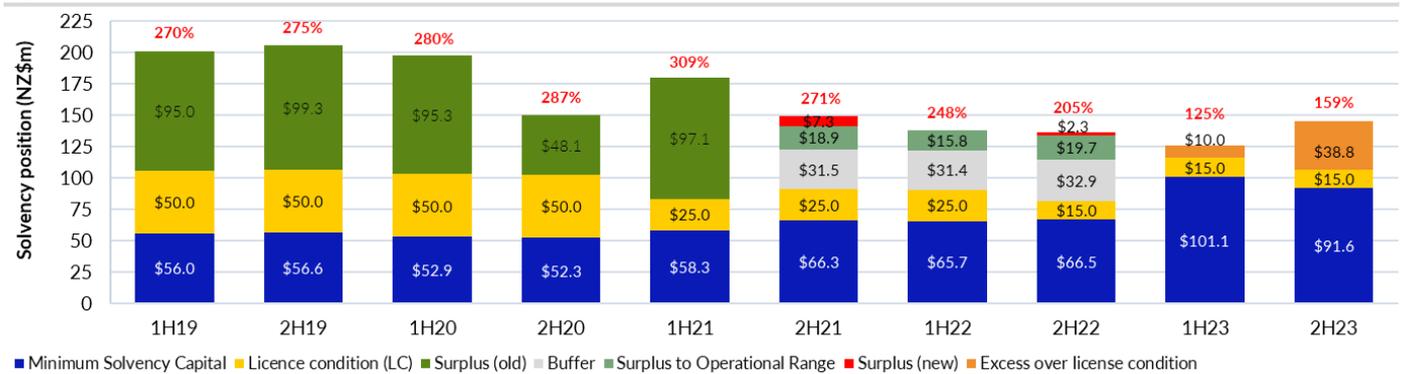
Source: Company data, Forsyth Barr analysis

Figure 5. TWR—GWP segmental split (1H23 estimate)



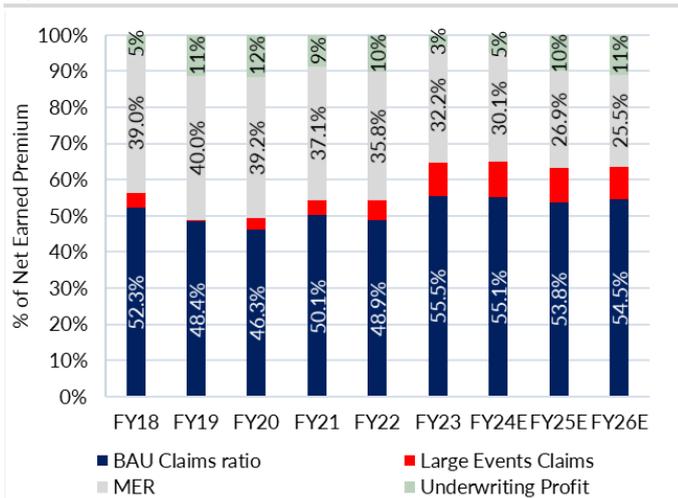
Source: Company data, Forsyth Barr analysis

Figure 6. TWR—Solvency position over time (NZ\$m)



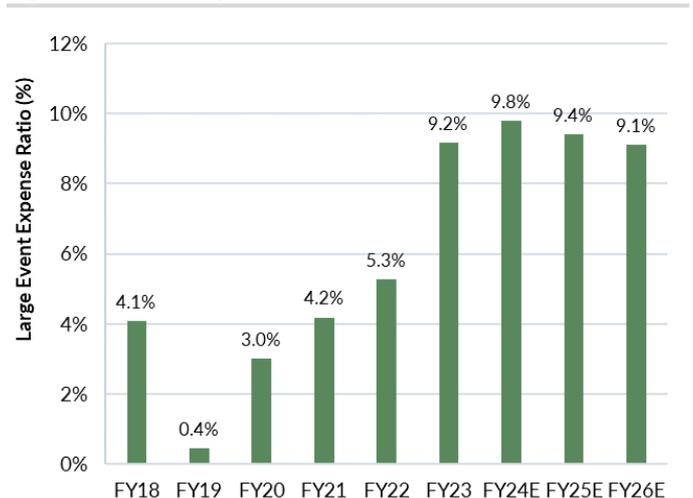
Source: Company data, Forsyth Barr analysis

Figure 7. TWR—Combined ratio components



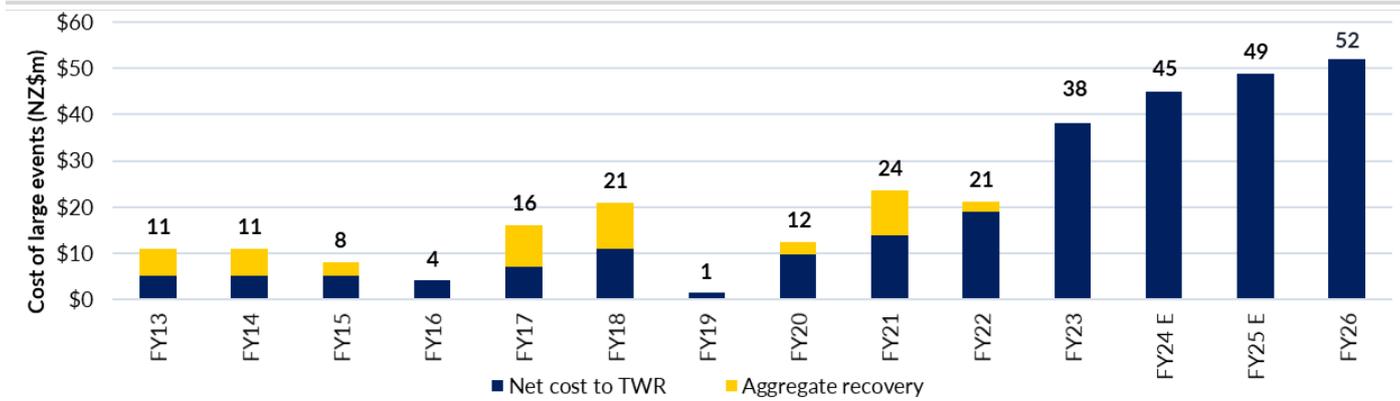
Source: Company data, Forsyth Barr analysis

Figure 8. TWR—Large event expense ratio (%)



Source: Company data, Forsyth Barr analysis

Figure 9. Ultimate estimated cost of large events (NZ\$m)—excluding reinsurance premium costs



Source: Company data, Forsyth Barr analysis

Earnings revisions

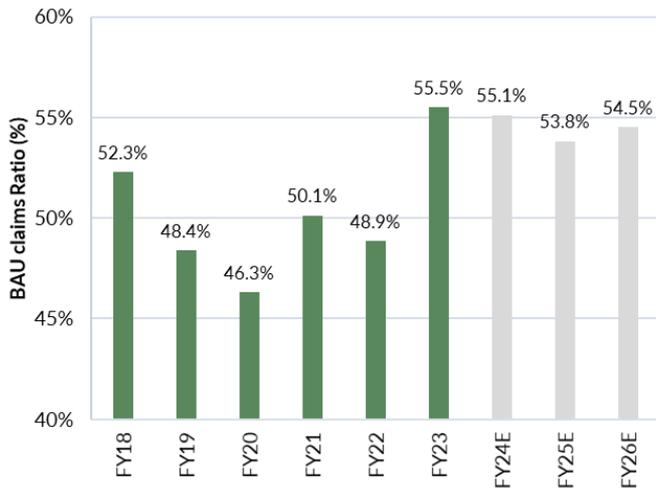
We decrease our FY24 underlying profit estimate by -17% to reflect TWR's guidance. However, for FY24 and FY25 we increase our underlying profit estimates by +13% and +18% respectively. This reflects stronger GWP growth assumptions in FY25 and greater operational efficiencies, partially offset by increases to our large events allowances. We lift our large events allowances by +7%, +11%, and +13% over FY24, FY25, and FY26 to match TWR's more cautious view. TWR stated that the FY24 allowance is conservative and represents a >90% confidence interval (CI) of sufficiency. TWR has issued maiden FY24 underlying profit guidance in a range of NZ\$22m to NZ\$27m.

Figure 10. Earnings revisions

	FY24			FY25			FY26		
	Old	New	Change	Old	New	Change	Old	New	Change
Gross written premium	589.4	583.3	(1%)	641.4	655.0	+2%	675.5	700.9	+4%
Gross earned premium	556.2	547.4	(2%)	615.4	619.2	+1%	658.4	678.0	+3%
Reinsurance Expense	(85.3)	(87.9)	+3%	(93.4)	(98.5)	+5%	(99.8)	(107.1)	+7%
Net earned premium	470.9	459.5	(2%)	522.0	520.7	(0%)	558.6	570.9	+2%
Net Claims Expense	(255.6)	(253.2)	(1%)	(282.3)	(278.3)	(1%)	(304.6)	(308.2)	+1%
Large event claims expense	(42.0)	(45.0)	+7%	(44.0)	(51.0)	+16%	(46.0)	(55.0)	+20%
Management expenses	(131.9)	(130.9)	(1%)	(137.9)	(131.7)	(4%)	(143.2)	(136.6)	(5%)
Net Commission Expense	(10.4)	(7.2)	(31%)	(11.0)	(8.1)	(27%)	(11.8)	(8.8)	(25%)
Underwriting profit	31.0	23.1	(25%)	46.8	51.6	+10%	53.0	62.3	+18%
Net Investment Income	16.0	13.8	(14%)	15.8	16.1	+2%	15.8	15.5	(2%)
Other income (costs)	(0.9)	(1.0)	n/a	(1.0)	(1.0)	n/a	(1.0)	(1.0)	n/a
Profit before tax	46.1	35.9	(22%)	61.6	66.7	+8%	67.8	76.8	+13%
Tax expense	(14.8)	(10.3)	(30%)	(19.4)	(19.0)	(2%)	(21.3)	(21.8)	+2%
Profit after taxation from discontinued operation	-	-	n/a	-	-	n/a	-	-	n/a
Underlying Profit after tax	31.3	25.6	(18%)	42.2	47.8	+13%	46.5	55.0	+18%
Canterbury impact on outstanding claims	-	-	n/a	-	-	n/a	-	-	n/a
Other non-underlying items	0.7	1.1	n/a	-	-	n/a	-	-	n/a
Reported Profit after tax	31.9	26.6	(17%)	42.3	47.8	+13%	46.5	55.0	+18%

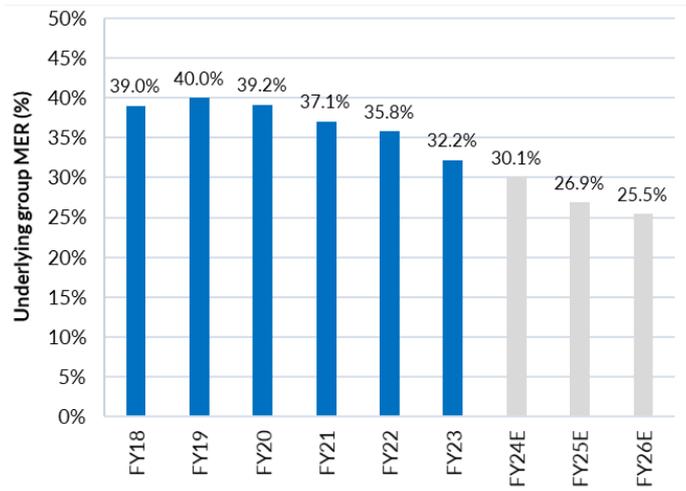
Source: Forsyth Barr analysis

Figure 11. TWR—BAU claims ratio (excluding large events)



Source: Company, Forsyth Barr analysis

Figure 12. TWR—Underlying group MER (%)



Source: Company, Forsyth Barr analysis

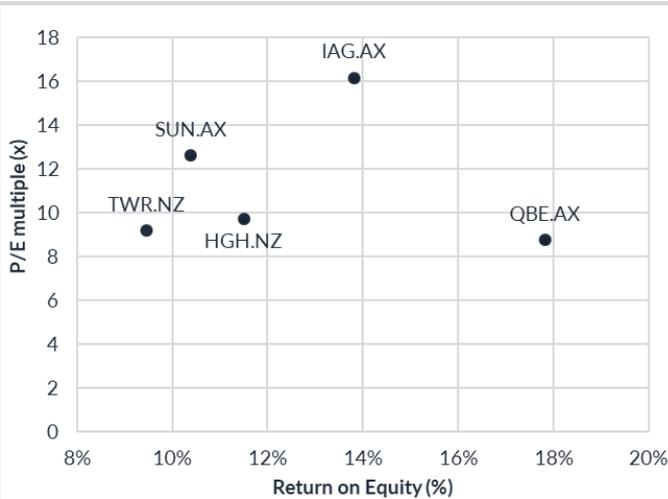
Sector ratios (of relevant peers)

Figure 13. TWR—Comparables table

Ticker	Bal Date	Company	Share Price	Market Cap (NZ\$m)	PE (x)		Gross yield (%)		P/B (x)		ROE %	
					1-yr fwd	2-yr fwd	1-yr fwd	2-yr fwd	1-yr fwd	2-yr fwd	1-yr fwd	2-yr fwd
TWR.NZ	30/09/2024	Tower	0.62	233	9.2	4.3	0.9	0.7	0.7	9.5	14.9	
IAG.AX	30/06/2024	Insurance Australia	5.85	15,409	16.2	14.8	2.9	2.1	2.0	13.8	14.3	
SUN.AX	30/06/2024	Suncorp Group	13.74	18,961	12.7	12.1	6.2	1.3	1.3	10.4	10.6	
QBE.AX	31/12/2023	QBE Insurance	15.23	24,717	8.8	8.4	3.0	1.4	1.3	17.8	17.3	
HGH.NZ	30/06/2024	Heartland Group	1.67	1,194	9.7	8.9	9.6	1.1	1.1	11.5	12.2	
Peer Median					12.7	10.5	4.6	1.4	1.3	12.7	13.3	

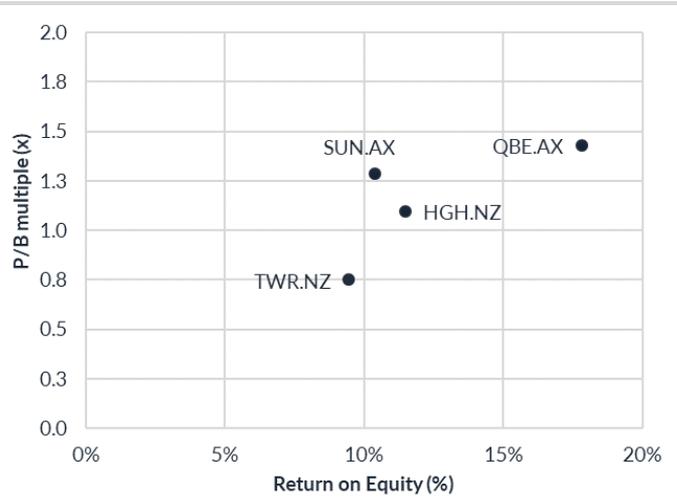
Source: Refinitiv, Forsyth Barr analysis

Figure 14. TWR—Relevant Australasian financials—P/E versus ROE one-year forward



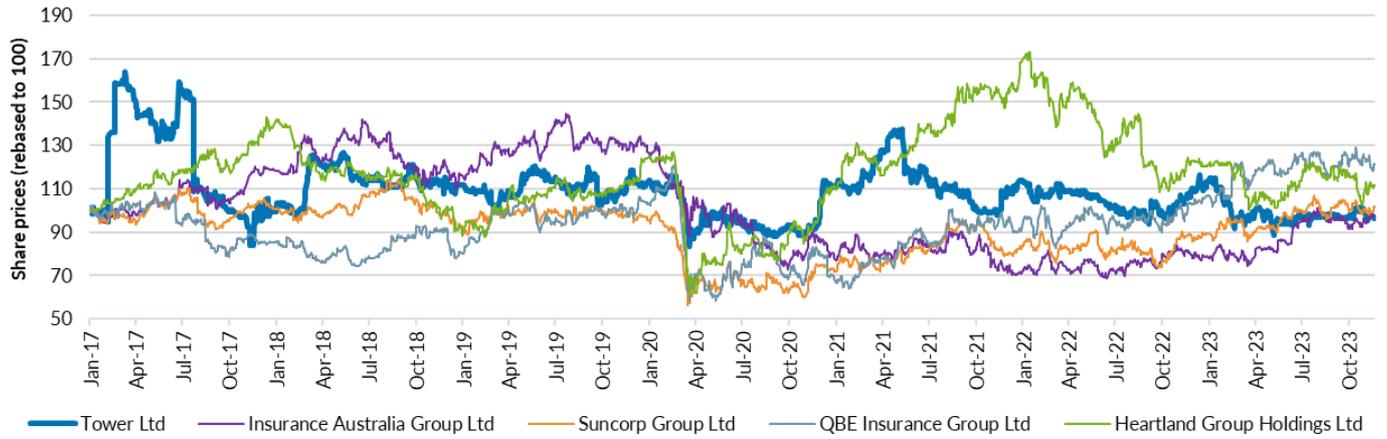
Source: Refinitiv, Forsyth Barr analysis

Figure 15. TWR—Relevant Australasian financials—Price to Book versus ROE one-year forward



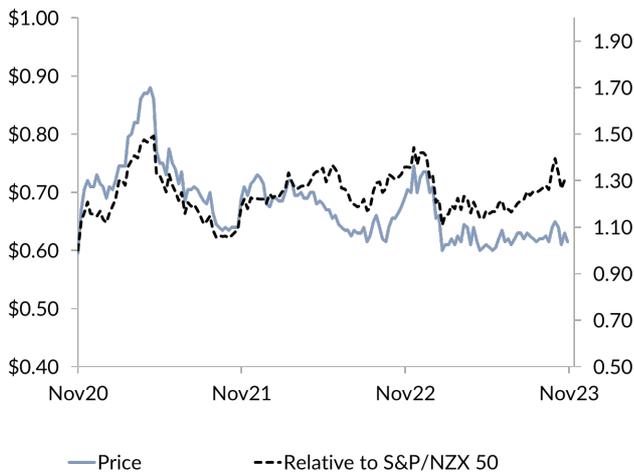
Source: Refinitiv, Forsyth Barr analysis

Figure 16. TWR—Sector performance of relevant comparables



Source: Refinitiv, Forsyth Barr analysis

Figure 17. Price performance



Source: Forsyth Barr analysis

Figure 18. Substantial shareholders

Shareholder	Latest Holding
Bain Capital Credit LP	20.0%
ACC	9.6%
Salt Funds Management	8.0%
Pacific International Insurance Pty Ltd	5.8%
NZ Funds Management	5.2%

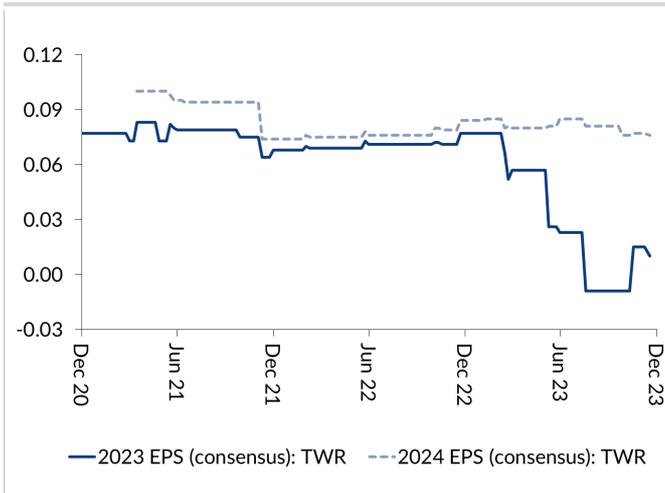
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 19. International valuation comparisons

Company	Code	Price	Mkt Cap (m)	PE 2024E	PE 2025E	EV/EBITDA 2024E	EV/EBITDA 2025E	EV/EBIT 2024E	EV/EBIT 2025E	Cash Yld 2025E
(metrics re-weighted to reflect TWR's balance date - September)										
Tower Ltd	TWR NZ	NZ\$0.62	NZ\$233	9.1x	4.9x	n/a	n/a	n/a	n/a	13.0%
Heartland Group Holdings *	HGH NZ	NZ\$1.65	NZ\$1,180	9.8x	8.8x	n/a	n/a	n/a	n/a	7.7%
Insurance Australia Group	IAG AT	A\$5.89	A\$14,281	16.1x	14.4x	n/a	n/a	n/a	9.5x	5.2%
Suncorp Group	SUN AT	A\$13.49	A\$17,136	12.5x	12.1x	n/a	42.0x	n/a	47.9x	6.3%
QBE INSURANCE GROUP	QBE AT	US\$9.75	US\$14,571	9.0x	8.3x	n/a	n/a	n/a	7.5x	6.8%
Compco Average:				11.8x	10.9x	n/a	42.0x	n/a	21.6x	6.5%
EV = Mkt cap+net debt+lease liabilities+min interests-investments				TWR Relative:		-23%	-55%	n/a	n/a	100%

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

Figure 20. Consensus EPS momentum (NZ\$)



Source: Forsyth Barr analysis

Figure 21. One year forward PE (x)



Source: Forsyth Barr analysis

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