

Tower Limited

Benign is Divine

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Tower (TWR) has experienced a positive reversal of fortunes, with its 1H24 likely including zero large events. The absence of large events means: (1) TWR is likely to report an exceptionally strong 1H24 result, and (2) there is significant upside risk to FY24 guidance of 'the upper end or above the NZ\$22m–NZ\$27m range in underlying NPAT'. TWR's guidance includes NZ\$45m of large events allowance, and we estimate none was utilised in 1H24. Accordingly, we adjust our forecasts by reducing our FY24 large events allowance -50%, choosing to be conservative despite large events having historically been heavily skewed to the 1H. We also reduce our business as usual (BAU) claims ratio to account for premium growth and a continued normalisation of motor claims, seeing our FY24 underlying profit estimate lift by +84% to NZ\$49.2m. TWR trades at a large discount to its peer group. We view the widening valuation gap as increasingly unjustified, especially given the upside risk to FY24 earnings expectations. Our blended spot valuation increases by +22% to NZ\$1.41.

NZX Code	TWR	Financials: Sep/	23A	24E	25E	26E	Valuation (x)	23A	24E	25E	26E
Share price	NZ\$0.69	Rev (NZ\$m)	470.8	556.7	638.1	713.4	PE	n/a	5.3	5.1	3.7
Spot Valuation	NZ\$1.41 (from 1.15)	NPAT* (NZ\$m)	2.4	49.2	51.3	71.2	EV/EBIT	n/a	n/a	n/a	n/a
Risk rating	High	EPS* (NZc)	0.6	13.0	13.5	18.7	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	1.7	1.4	1.2	1.2
Market cap	NZ\$262m	Imputation (%)	0	0	0	100	Cash div yld (%)	0.0	5.8	11.6	13.0
Avg daily turnover	115.2k (NZ\$72k)	*Based on normalised profits					Gross div yld (%)	0.0	5.8	11.6	18.1

What's changed?

- **Earnings:** FY24 underlying NPAT rises +84%. FY25 and FY26 increase +2% and +1% respectively on stronger investment returns.
- **Spot valuation:** Increases +22% to NZ\$1.41, as we start unwinding discounts placed on TWR relative to its peers.

A stellar 1H24 result likely on 28 May 2024

TWR is likely to report a stellar H24 result on 28 May 2024. We anticipate tailwinds from: (1) the lack of large events in the period, (2) continued strong GWP growth, (3) robust investment returns, (4) a normalisation in claims frequency and severity, and (5) further improvements in the management expense ratio (MER). Assuming a business as usual (BAU) claims ratio of 52.1% and MER of 29.6%, we forecast underlying NPAT of NZ\$35.1m. While not included in our forecasts, the strong 1H24 result may allow sufficient capital recovery for TWR to declare an interim dividend.

Benign weather boosts FY24

We estimate that TWR experienced no large events in the 1H24 period that ended on 31 March 2024. Given this fortunate position, we expect TWR to provide an update regarding its large events allowance for FY24 at its 1H24 result or earlier. A partial unwind of the allowance is a near certainty, especially in the context of ~81% of TWR's large events costs occurring in 1H periods since FY18, and the worst 2H large events expense since FY18 being only NZ\$4.6m. Nevertheless, we expect TWR to be conservative and retain a significant allowance. Reflecting this, we reduce our FY24 large events allowance -50% to NZ\$22.5m.

Valuation support increasing

TWR trades at just 5.2x 12-month forward underlying earnings on our updated estimates, offering substantial upside to peers IAG on 16.3x and SUN on ~15.1x. Over the last seven years TWR has traded on an average 12-month forward PE of 9.4x and at an average discount to its peers of -37%, meaning TWR trades below its historical valuation ranges. We find this difficult to reconcile given TWR's improving business fundamentals, with increased scale driving improved efficiency and returns.

Tower Limited (TWR)

Market data (NZ\$)						Spot valuation (NZ\$)						
Priced as at 11 Apr 2024						0.69	PE relative					1.58
52 week high / low						0.72 / 0.57	P/Book relative					0.95
Market capitalisation (NZ\$m)						261.8	DCF					1.69
Key WACC assumptions						DCF valuation summary (NZ\$m)						
Risk free rate						5.00%	Total firm value					734
Equity beta						1.18	(Net debt)/cash					(44)
WACC						11.0%	Less: Capitalised operating leases					(48)
Terminal growth						1.8%	Value of equity					642
Profit and Loss Account (NZ\$m)						Valuation Ratios						
Revenue (GEP)	2022A	2023A	2024E	2025E	2026E	2022A	2023A	2024E	2025E	2026E		
Revenue (GEP)	409.6	470.8	556.7	638.1	713.4	EV/Sales (x)	n/a	n/a	n/a	n/a		
Normalised EBITDA	n/a	n/a	n/a	n/a	n/a	EV/EBITDA (x)	n/a	n/a	n/a	n/a		
Depreciation and amortisation	n/a	n/a	n/a	n/a	n/a	EV/EBIT (x)	n/a	n/a	n/a	n/a		
Normalised EBIT	n/a	n/a	n/a	n/a	n/a	PE (x)	15.0	>100x	5.3	5.1		
Net interest	n/a	n/a	n/a	n/a	n/a	Price/NTA (x)	1.5	1.7	1.4	1.2		
Associate income	0	0	0	0	0	Free cash flow yield (%)	13.9	-3.4	30.5	27.5		
Tax	(7.5)	(5.1)	(19.5)	(20.3)	(28.1)	Adj. free cash flow yield (%)	13.9	-3.4	30.5	27.5		
Minority interests	0.1	0	0	0	0	Net dividend yield (%)	9.4	0.0	5.8	11.6		
Normalised NPAT	27.4	7.6	49.2	51.3	71.2	Gross dividend yield (%)	9.4	0.0	5.8	11.6		
Abnormals/other	(8.5)	(8.8)	1.1	0	0	Key Ratios						
Reported NPAT	18.9	(1.2)	50.3	51.3	71.2	2022A	2023A	2024E	2025E	2026E		
Normalised EPS (cps)	4.6	0.6	13.0	13.5	18.7	Return on assets (%)	n/a	n/a	n/a	n/a		
DPS (cps)	6.5	0	4.0	8.0	9.0	Return on equity (%)	5.7	0.8	14.9	14.6		
Growth Rates						2022A	2023A	2024E	2025E	2026E		
Revenue (%)	5.9	14.9	18.2	14.6	11.8	Return on funds employed (%)	5.0	0.7	13.4	13.4		
EBITDA (%)	n/a	n/a	n/a	n/a	n/a	EBITDA margin (%)	n/a	n/a	n/a	n/a		
EBIT (%)	n/a	n/a	n/a	n/a	n/a	EBIT margin (%)	n/a	n/a	n/a	n/a		
Normalised NPAT (%)	-4.9	-86.6	>100	4.3	38.7	Capex to sales (%)	4.2	2.5	3.3	2.9		
Normalised EPS (%)	5.6	-86.6	>100	4.3	38.7	Capex to depreciation (%)	n/a	n/a	n/a	n/a		
Ordinary DPS (%)	30.0	-100.0	n/a	100.0	12.5	Imputation (%)	0	0	0	0		
						Pay-out ratio (%)	141	0	31	59		
Cash Flow (NZ\$m)						2022A	2023A	2024E	2025E	2026E		
EBITDA	n/a	n/a	n/a	n/a	n/a	Capital Structure	2022A	2023A	2024E	2025E		
Working capital change	n/a	n/a	n/a	n/a	n/a	Solvency capital	155.9	150.5	179.4	136.4		
Interest & tax paid	0	0	0	0	0	Minimum solvency capital (MSC)	56.6	52.3	66.3	66.5		
Other	0	0	0	0	0	Total regulatory capital	106.6	102.3	83.3	91.3		
Operating cash flow	59.8	10.0	106.1	99.8	99.4	Solvency ratio (%)	275	287	271	205		
Capital expenditure	(17.3)	(12.0)	(18.2)	(18.6)	(19.1)	Underlying Performance						
(Acquisitions)/divestments	(6.1)	(5.9)	0	0	0	2022A	2023A	2024E	2025E	2026E		
Other	(21.1)	(1.3)	(8.1)	(9.0)	(10.1)	Gross written premium	436.6	511.5	602.0	674.2		
Funding available/(required)	15.3	(9.2)	79.8	72.1	70.2	Gross earned premium	430.7	470.8	556.7	638.1		
Dividends paid	(20.0)	(15.2)	(15.2)	(30.4)	(34.2)	Reinsurance premium	(69.5)	(69.5)	(90.5)	(102.8)		
Equity raised/(returned)	(30.6)	0	0	0	0	Net earned premium	361.2	416.3	466.2	535.3		
(Increase)/decrease in net debt	(35.4)	(24.4)	64.7	41.8	36.1	Net claims expense	(195.5)	(269.3)	(271.9)	(337.3)		
Balance Sheet (NZ\$m)						* includes Large event claims of	(19.0)	(38.2)	(22.5)	(50.0)		
Working capital	183.2	336.8	306.0	342.7	382.5	Management & sales expenses	(129.9)	(151.4)	(139.2)	(143.2)		
Fixed assets	5.4	6.3	7.2	7.8	8.4	Underwriting profit	35.8	(4.4)	55.2	54.8		
Intangibles	132.5	138.5	139.4	140.5	141.9	Investment and other revenue	1.1	14.3	14.6	17.9		
Right of use asset	23.3	23.2	20.6	18.0	15.4	Financing and other costs	1.3	2.3	(1.0)	(1.0)		
Other assets	295.6	286.7	348.1	387.8	422.1	Profit before tax (from continuing operations)	38.2	12.2	68.7	71.7		
Total funds employed	640.0	791.4	821.3	896.8	970.4	Tax expense	(10.9)	(4.6)	(19.5)	(20.3)		
Net debt/(cash)	(84.5)	(64.0)	(67.2)	(69.3)	(71.1)	Profit after taxation	27.3	7.6	49.2	51.3		
Lease liability	35.1	32.6	28.7	24.8	20.9	NPAT (from discontinued operation)	(4.5)	(9.8)	1.1	0		
Other liabilities	383.5	526.5	528.6	590.4	657.6	NPAT (Reported)	22.8	-2.2	50.3	51.3		
Shareholder's funds	306.0	296.3	331.2	350.9	363.0	Key ratios						
Minority interests	0	0	0	0	0	Total GWP growth %	10.2%	17.2%	17.7%	12.0%		
Total funding sources	640.0	791.4	821.3	896.8	970.4	Total claims ratio %	54.1%	64.7%	58.3%	63.0%		
						MER %	36.0%	32.2%	29.9%	26.7%		
						Combined ratio %	90.1%	101.1%	88.2%	89.8%		

* 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

Earnings revisions

We reduce our FY24 large events allowance by -50% to NZ\$22.5m and our net claims expense for FY24 by -3% to better reflect the impact of rate increases and the ongoing normalisation in motor claims. In aggregate, these changes increase our underlying profit estimate for FY24 by +84%. Increased capital levels in 1H24 flow through to higher investment returns in FY25 and FY26, leading to underlying NPAT increases of +2% and +1%, respectively.

Figure 1. Earnings revisions

	FY24			FY25			FY26		
	Old	New	Change	Old	New	Change	Old	New	Change
Gross written premium	602.0	602.0	+0%	674.2	674.2	+0%	752.5	752.5	+0%
Gross earned premium	556.7	556.7	+0%	638.1	638.1	+0%	713.4	713.4	+0%
Reinsurance Expense	(90.5)	(90.5)	+0%	(102.8)	(102.8)	+0%	(113.3)	(113.3)	+0%
Net earned premium	466.2	466.2	+0%	535.3	535.3	+0%	600.0	600.0	+0%
Net Claims Expense	(257.4)	(249.4)	(3%)	(287.3)	(287.3)	+0%	(313.6)	(313.6)	+0%
Large event claims expense	(45.0)	(22.5)	(50%)	(50.0)	(50.0)	+0%	(55.0)	(55.0)	+0%
Management expenses	(131.9)	(131.9)	+0%	(134.8)	(134.8)	+0%	(139.7)	(139.7)	+0%
Net Commission Expense	(7.3)	(7.3)	+0%	(8.3)	(8.3)	+0%	(9.3)	(9.3)	+0%
Underwriting profit	24.7	55.2	+124%	54.8	54.8	+0%	82.4	82.4	+0%
Net Investment Income	13.9	14.6	+5%	16.4	17.9	+9%	16.4	17.8	+9%
Other income (costs)	(1.0)	(1.0)	n/a	(1.0)	(1.0)	n/a	(1.0)	(1.0)	n/a
Profit before tax	37.6	68.7	+83%	70.2	71.7	+2%	97.8	99.2	+1%
Tax expense	(10.8)	(19.5)	+81%	(19.9)	(20.3)	+2%	(27.7)	(28.1)	+1%
Underlying Profit after tax	26.8	49.2	+84%	50.2	51.3	+2%	70.1	71.2	+1%
Non-underlying items	1.1	1.1	n/a	-	-	n/a	-	-	n/a
Reported Profit after tax	27.8	50.3	+81%	50.2	51.3	+2%	70.1	71.2	+1%
DPS (cents)	4.0	4.0	+0%	8.0	8.0	+0%	9.0	9.0	+0%

Source: Forsyth Barr analysis

Figure 2. Forsyth Barr estimates versus management guidance

	FY24 Estimate	FY24 Mgt guidance	FY25 Estimate	FY25 Mgt guidance	FY26 Estimate	FY26 Mgt guidance
GWP growth (%)	+14%	+10% to +15%	+12%	+10% to +15%	+12%	+10% to +15%
Large events allowance (NZ\$m)	\$22.5m	\$45m	\$50m	\$50m	\$55m	\$55m
MER	29.9%	30% to 32%	26.7%	<28%	24.8%	<26%
Combined operating ratio (%)	88.2%	95% to 97%	89.8%	<91%	86.3%	<87%
Underlying NPAT (NZ\$m)	\$49.2m	Upper end of \$22m to \$27m or above	\$51.3m	\$40m to \$60m	\$71.2m	\$60m to \$80m
ROE (%)	14.7%	n/a	13.9%	12% to 15%	17.8%	>15%

Source: Company, Forsyth Barr analysis

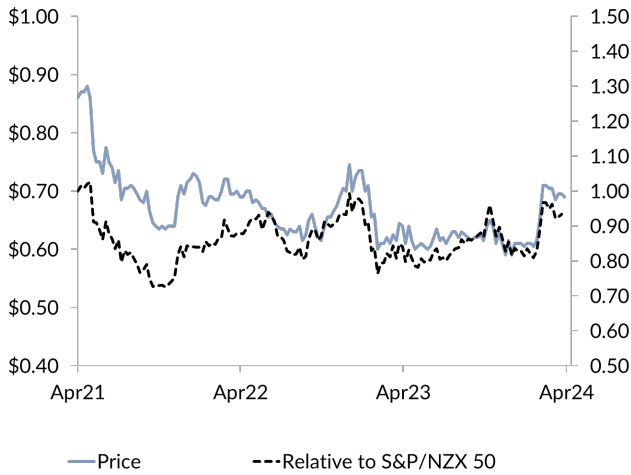
1H24 result preview

Figure 3. 1H24 result preview

	1H23 Actual	1H24 Forecast	Change
Gross written premium	245.0	290.5	+19%
Gross earned premium	233.0	276.0	+18%
Reinsurance Expense	(32.2)	(42.8)	+33%
Net earned premium	200.9	233.2	+16%
Net Claims Expense	(103.6)	(121.5)	+17%
Large event claims expense	(33.9)	-	(100%)
Large claims reinsurance reinstatement	(3.4)	-	n/a
Management expenses	(65.6)	(65.0)	(1%)
Net Commission Expense	(5.0)	(4.1)	(18%)
Underwriting profit	(10.6)	42.5	n/a
Net Investment Income	6.3	7.0	+11%
Other income (costs)	0.3	(0.5)	n/a
Profit before tax	(4.0)	49.0	n/a
Tax expense	0.7	(13.9)	n/a
Profit after taxation from discontinued operation	-	-	n/a
Underlying Profit after tax	(3.3)	35.1	n/a
Canterbury impact on outstanding claims	(1.0)	-	n/a
Other non-underlying items	(0.8)	1.1	n/a
Reported Profit after tax	(5.1)	36.4	n/a

Source: Company, Forsyth Barr analysis

Figure 4. Price performance



Source: Forsyth Barr analysis

Figure 5. 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%

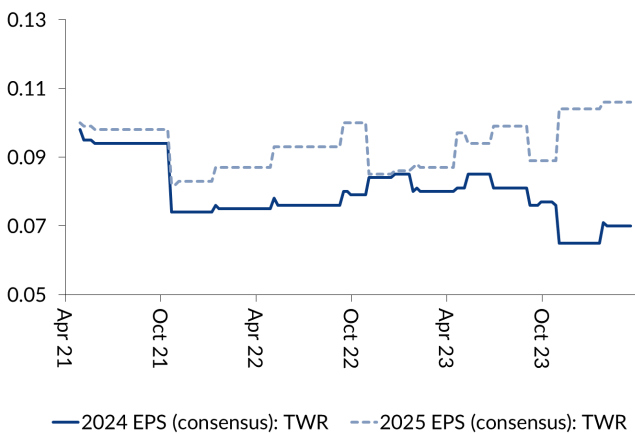
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 6. International valuation comparisons

Company (metrics re-weighted to reflect TWR's balance date - September)	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash Yld	
				2024E	2025E	2024E	2025E	2024E	2025E		
Tower Ltd	TWR NZ	NZ\$0.69	NZ\$262	5.3x	5.1x	n/a	n/a	n/a	n/a	11.6%	
Heartland Group Holdings *	HGH NZ	NZ\$1.22	NZ\$878	10.5x	10.0x	n/a	n/a	n/a	n/a	6.5%	
Insurance Australia Group	IAG AT	A\$6.40	A\$15,370	17.2x	15.6x	n/a	n/a	n/a	10.3x	4.7%	
Suncorp Group	SUN AT	A\$16.25	A\$20,642	15.3x	15.1x	n/a	n/a	n/a	57.0x	5.1%	
QBE INSURANCE GROUP	QBE AT	US\$11.82	US\$17,692	10.9x	10.0x	n/a	n/a	n/a	8.6x	5.2%	
Compco Average:				13.5x	12.7x	n/a	n/a	n/a	25.3x	5.4%	
EV = Mkt cap+net debt+lease liabilities+min interests-investments				TWR Relative:	-61%	-60%	n/a	n/a	n/a	n/a	116%

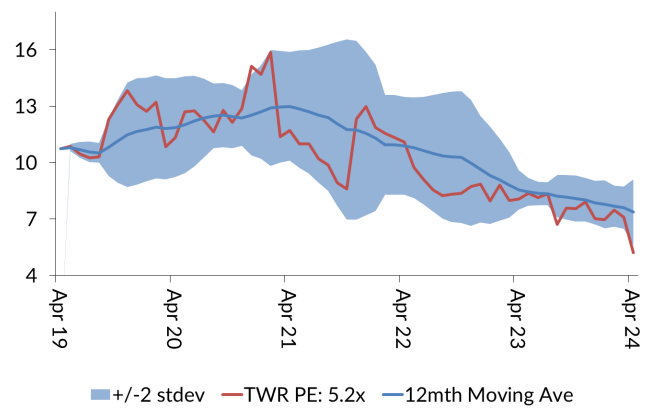
Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (TWR) companies fiscal year end

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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