

Tower Limited

Event-Less 1H24 Sees Earnings Jump

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Tower (TWR) delivered a strong 1H24 result, aided by the absence of large events in the period and the hardening rates cycle. Gross written premium (GWP) rose +19% from 1H23 and underlying NPAT was NZ\$36.6m, in-line with our expectations. The result included a positive large event one-off of +NZ\$1.9m (a revision of the prior year) against a -NZ\$37.3m impact in 1H23. Capital has recovered sufficiently for TWR to declare an interim dividend of NZ3cps (unimputed). TWR reiterated its previous FY24 guidance for underlying NPAT to be greater than NZ\$35m, conservatively assuming the full utilisation of the large events allowance. The strategic review continues and the Chairman noted a 'range of options being considered to maximise shareholder value'. We consider this result constructive to our longer-term thesis of solid uplifts in underlying NPAT over coming years from operational efficiency and improved scale. We lift our estimate for FY24 underlying NPAT to NZ\$55.8m, utilising NZ\$20.5m (gross) of large event claims, but note upside risk to these estimates from a lower utilisation of the large events allowance. We lift our FY24 DPS forecast to 7cps, representing a cash yield of 8.5%. Our blended spot valuation rises +NZ2cps to NZ\$1.46, equating to 10x PE on our FY25 EPS estimates.

NZX Code	TWR	Financials: Sep/	23A	24E	25E	26E	Valuation (x)	23A	24E	25E	26E
Share price	NZ\$0.82	Rev (NZ\$m)	470.8	559.1	640.5	713.4	PE	n/a	5.7	5.7	4.2
Spot Valuation	NZ\$1.46 (from 1.44)	NPAT* (NZ\$m)	2.4	55.0	54.9	74.2	EV/EBIT	n/a	n/a	n/a	n/a
Risk rating	High	EPS* (NZc)	0.6	14.5	14.5	19.6	EV/EBITDA	n/a	n/a	n/a	n/a
Issued shares	379.5m	DPS (NZc)	0.0	7.0	8.0	9.0	Price / NTA	2.0	1.7	1.5	1.5
Market cap	NZ\$311m	Imputation (%)	0	0	0	100	Cash div yld (%)	0.0	8.5	9.8	11.0
Avg daily turnover	153.7k (NZ\$103k)	*Based on normalised profits					Gross div yld (%)	0.0	8.5	9.8	15.2

What's changed?

- **Earnings:** Our underlying NPAT estimate in FY24 lifts +8% to NZ\$55.8m, FY25 rises +4% to NZ\$54.9m (at the upper end of the guided range of NZ\$40m to NZ\$60m) and FY26 rises +3% to NZ\$74.2m (within the guided range of NZ\$60m to NZ\$80m).
- **Blended spot valuation:** Our blended spot valuation rises +1% to NZ\$1.46.

Positive operational momentum in 1H24

TWR's 1H24 showed good signs of operational improvements with continued expense control. The hardening rates cycle was evident in GWP growth of +19% versus 1H23 to NZ\$291m. TWR's management expense ratio (MER) fell from 35.0% in 1H23 to 31.3%. It's business as usual (BAU) claims ratio surprised positively at 49.7%, against 51.1% in 1H23. Investment income was also strong. On the negative side, customer numbers declined -1% to 309,000, but TWR attributed customer losses to predominantly motor risks it did not wish to continue with.

Earnings revised up and longer-term targets remain in place

We lift our estimates across the forecast horizon in response to trends observed and comments within TWR's 1H24 relating to: (1) insurance costs becoming more favourable, (2) strong investment returns, (3) robust BAU claims performance, and (4) changes to MER and CEQ assumptions. We note management comments that uplifts in policy pricing are moderating, with underlying 1H24 GWP growing +19%. TWR retained its +10% to +15% GWP forecast for FY25, aligning with our expectations at +15%.

NOTE: Our earnings forecasts do not yet incorporate the new IFRS 17 and Interim Solvency Standard 2023 (ISS) standards and remain subject to the prior IFRS 4 accounting basis. See the appendix for more information.

Tower Limited (TWR)

Market data (NZ\$)						Spot valuation (NZ\$)						
Priced as at 28 May 2024						0.82	PE relative					1.63
52 week high / low						0.84 / 0.58	P/Book relative					1.04
Market capitalisation (NZ\$m)						311.2	DCF					1.73
Key WACC assumptions						DCF valuation summary (NZ\$m)						
Risk free rate						5.00%	Total firm value					747
Equity beta						1.18	(Net debt)/cash					(44)
WACC						11.0%	Less: Capitalised operating leases					(48)
Terminal growth						1.8%	Value of equity					655
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	559.1	640.5	713.4	EV/Sales (x)	n/a	0.0	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)	17.8	>100x	5.7	5.7		
Net interest	n/a	n/a	n/a	n/a	n/a	Price/NTA (x)	1.8	2.0	1.7	1.5		
Associate income	0	0	0	0	0	Free cash flow yield (%)	11.7	-2.8	35.8	23.1		
Tax	(7.5)	(5.1)	(22.1)	(21.7)	(29.3)	Adj. free cash flow yield (%)	11.7	-2.8	35.8	23.1		
Minority interests	0.1	0	0	0	0	Net dividend yield (%)	7.9	0.0	8.5	9.8		
Normalised NPAT	27.4	7.6	55.8	54.9	74.2	Gross dividend yield (%)	7.9	0.0	8.5	9.8		
Abnormals/other	(8.5)	(8.8)	(0.6)	0	0	Key Ratios						
Reported NPAT	18.9	(1.2)	55.2	54.9	74.2	2022A	2023A	2024E	2025E	2026E		
Normalised EPS (cps)	4.6	0.6	14.5	14.5	19.6	Return on assets (%)	n/a	n/a	n/a	n/a		
DPS (cps)	6.5	0	7.0	8.0	9.0	Return on equity (%)	5.7	0.8	16.7	15.5		
Growth Rates						2022A	2023A	2024E	2025E	2026E		
Revenue (%)	5.9	14.9	18.8	14.6	11.4	Return on funds employed (%)	5.0	0.7	15.0	14.2		
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	-0.1	35.2	Capex to sales (%)	4.2	2.5	3.2	2.9		
Normalised EPS (%)	5.6	-86.6	>100	-0.1	35.2	Capex to depreciation (%)	n/a	n/a	n/a	n/a		
Ordinary DPS (%)	30.0	-100.0	n/a	14.3	12.5	Imputation (%)	0	0	0	0		
Cash Flow (NZ\$m)						2022A	2023A	2024E	2025E	2026E		
EBITDA	n/a	n/a	n/a	n/a	n/a	Pay-out ratio (%)	141	0	48	55		
Working capital change	n/a	n/a	n/a	n/a	n/a	Capital Structure						
Interest & tax paid	0	0	0	0	0	2022A	2023A	2024E	2025E	2026E		
Other	0	0	0	0	0	Solvency capital	155.9	150.5	179.4	136.4		
Operating cash flow	59.8	10.0	137.7	99.5	99.6	Minimum solvency capital (MSC)	56.6	52.3	66.3	66.5		
Capital expenditure	(17.3)	(12.0)	(18.2)	(18.6)	(19.1)	Total regulatory capital	106.6	102.3	83.3	91.3		
(Acquisitions)/divestments	(6.1)	(5.9)	0	0	0	Solvency ratio (%)	275	287	271	205		
Other	(21.1)	(1.3)	(8.1)	(9.0)	(10.1)	Underlying Performance						
Funding available/(required)	15.3	(9.2)	111.5	71.8	70.4	2022A	2023A	2024E	2025E	2026E		
Dividends paid	(20.0)	(15.2)	(26.6)	(30.4)	(34.2)	Gross written premium	436.6	511.5	606.7	674.4		
Equity raised/(returned)	(30.6)	0	0	0	0	Gross earned premium	430.7	470.8	559.1	640.5		
(Increase)/decrease in net debt	(35.4)	(24.4)	84.9	41.5	36.3	Reinsurance premium	(69.5)	(69.5)	(84.6)	(100.2)		
Balance Sheet (NZ\$m)						2022A	2023A	2024E	2025E	2026E		
Working capital	183.2	336.8	503.2	559.3	624.1	Net earned premium	361.2	416.3	474.5	540.4		
Fixed assets	5.4	6.3	8.1	9.7	11.4	Net claims expense	(195.5)	(269.3)	(268.4)	(335.4)		
Intangibles	132.5	138.5	145.6	152.6	159.3	* includes Large event claims of	(19.0)	(38.2)	(20.5)	(50.0)		
Right of use asset	23.3	23.2	20.6	18.0	15.4	Management & sales expenses	(129.9)	(151.4)	(145.4)	(147.2)		
Other assets	295.6	286.7	367.3	406.7	441.2	Underwriting profit	35.8	(4.4)	60.8	57.8		
Total funds employed	640.0	791.4	1,044.8	1,146.3	1,251.4	Investment and other revenue	1.1	14.3	18.1	19.9		
Net debt/(cash)	(84.5)	(64.0)	(68.3)	(70.3)	(72.1)	Financing and other costs	1.3	2.3	(1.0)	(1.0)		
Lease liability	35.1	32.6	28.7	24.8	20.9	Profit before tax (from continuing operations)	38.2	12.2	77.8	76.6		
Other liabilities	383.5	526.5	755.6	838.4	934.0	Tax expense	(10.9)	(4.6)	(22.1)	(21.7)		
Shareholder's funds	306.0	296.3	328.8	353.4	368.6	Profit after taxation	27.3	7.6	55.8	54.9		
Minority interests	0	0	0	0	0	NPAT (from discontinued operation)	(4.5)	(9.8)	(0.6)	0		
Total funding sources	640.0	791.4	1,044.8	1,146.3	1,251.4	NPAT (Reported)	22.8	-2.2	55.2	54.9		
Key ratios						2022A	2023A	2024E	2025E	2026E		
Total GWP growth %						10.2%	17.2%	18.6%	11.2%	11.6%		
Total claims ratio %						54.1%	64.7%	56.6%	62.1%	61.1%		
MER %						36.0%	32.2%	30.6%	27.2%	24.8%		
Combined ratio %						90.1%	101.1%	87.2%	89.3%	85.9%		

* 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

1H24 results summary

TWR delivered a solid 1H24 result with underlying net profit of NZ\$36.6m, clearly helped by no large events in the period. In fact, due to a revision of prior periods' large events allowances, a positive contribution of +NZ\$1.9m was seen, as the prior Vanuatu volcanic eruption allowance was positively revised down. Evidence of the hardening rates cycle was clear, with gross written premium (GWP) of NZ\$291m up +19% on 1H23. 1H24 reported NPAT was +NZ\$36m (EPS of NZ9.5cps) vs a -NZ\$5.1m loss in 1H23. Customer numbers declined by -1% to 309,000 as TWR removed motor risks it did not wish to continue with. TWR's MER fell from 35.0% in 1H23 to 31.3%, and is now down an impressive -700 bps over four years, showing the benefits of scale and operational efficiency. Business as usual (BAU) claims ratio surprised on the positive side at 49.7% against the 51.1% in 1H23. Investment income was strong, producing NZ\$10m in 1H24, with the core investment book yielding 5.67% as of 31 March 2024. There was an NZ\$0.8m charge due to further Canterbury earthquake claims (CEQ) with NZ\$21.4m of outstanding claims provision – now assessed at a 90% confidence interval (CI) – versus NZ\$23.4m as of FY24. Only 21 outstanding claims related to the CEQ event remain. As expected, this was partially offset by a gain from the sale of the Solomon Islands business.

Solvency capital recovers enough to declare a 1H24 dividend

Capital has recovered sufficiently after solid operational earnings and TWR successfully closing 97% of claims from the Auckland Anniversary and Cyclone Gabrielle catastrophe events last year, enabling TWR to pay an interim dividend of NZ3cps (unimputed). The Board looks to continue to pay out 60% to 80% of cash earnings where prudent to do so. Capital recovered to a 162% solvency ratio against the 139% at the end of FY23, as reported under the new Interim Solvency Standard (ISS). TWR noted that the RBNZ is consulting on a proposed second amendment to the ISS. This is expected to be announced and effective for TWR's FY25 financial year. Management said these standards will 'likely have a material impact on TWR's regulatory solvency position, and will reduce the solvency margin'.

Figure 1. TWR – Results table (hybrid IFRS and management underlying numbers and using 1H23 restated accounts in NZ\$m)

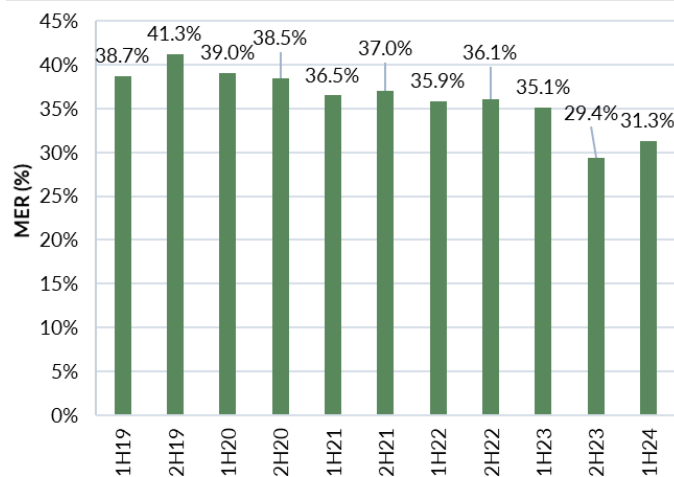
	1H23 (restated) underlying profit	1H24 underlying profit	Change
Gross written premium	245.0	290.6	+19%
Insurance revenue	233.8	274.6	+17%
Reinsurance expense	(32.2)	(41.8)	+30%
Net insurance revenue	201.7	232.8	+15%
Net claims expense - BAU	(103.0)	(115.8)	+12%
Net claims expense - large events	(33.9)	1.9	n/a
Large event reinsurance reinstatement	(3.4)	-	n/a
Management and sales expenses	(64.7)	(68.3)	+6%
Net commission expense	(5.8)	(4.5)	(22%)
Net insurance service expense	(210.8)	(186.7)	(11%)
Reinsurance and other recoveries - BAU	-	-	
Reinsurance and other recoveries - large events	-	-	
Net income from reinsurance contracts held	-	-	
Insurance service result	(9.1)	46.1	n/a
Net investment income	6.3	10.0	+59%
Net insurance finance expense	(0.7)	(1.7)	n/a
Other income and expenses	(0.9)	(0.9)	+0%
Underlying loss before tax	(4.4)	53.5	n/a
Income tax expense	0.8	(16.8)	n/a
Profit after tax from discontinued operations	-	-	n/a
Underlying net loss after tax (NPAT)	(3.7)	36.6	n/a
Canterbury impact (net of tax)	(0.6)	(0.8)	n/a
All other non-underlying costs (net of tax)	(0.8)	0.2	n/a
Reported loss after tax	(5.1)	36.0	n/a

Source: Company, Forsyth Barr analysis

FY24 outlook and earnings revisions

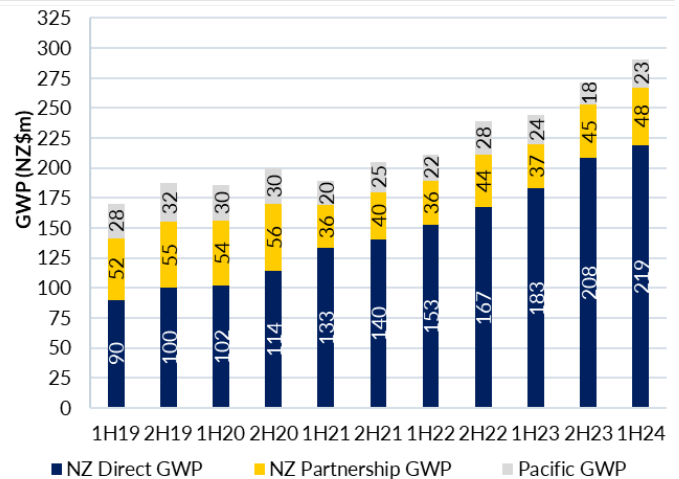
In its results call TWR suggested reinsurance markets were looking more favourable for 2H24. Given the +NZ\$1.9m reversal in the Vanuatu allowance, TWR's FY24 guidance for large events allowance is now NZ\$43m, down from the prior NZ\$45m. Management noted that BAU claims were 'very benign in 1H24' at a 49.7% claims ratio versus 51.1% in 1H23, but the company said this was back within the target range. However, we anticipate that the 2H24 BAU claims ratio will exceed that experienced in this interim period, given that winter falls within the second half. These improvements have seen TWR's FY24 forecast for the combined operating ratio fall from its previous guide of 95% to 97% to under 93% now. Given the move to a 90% CI on CEQ claims, TWR has said this result will be the last that specific details will be released on the Christchurch earthquakes.

Figure 2. TWR – Group MER as a % of NEP (interim periods)



Source: Company, Forsyth Barr analysis

Figure 3. TWR – GWP by division (interim periods)



Source: Company, Forsyth Barr analysis

Earnings revisions

We lift our expectations for investment returns and make amendments to our estimates for: (1) BAU claims lowered, (2) large events allowances down slightly from NZ\$22.5m to NZ\$20.5m, (3) management expenses up slightly, (4) reinsurance costs reduced slightly in the medium term, and (5) incorporate the extra costs of CEQ. We lift our FY24 DPS forecast to NZ7cps from NZ4cps.

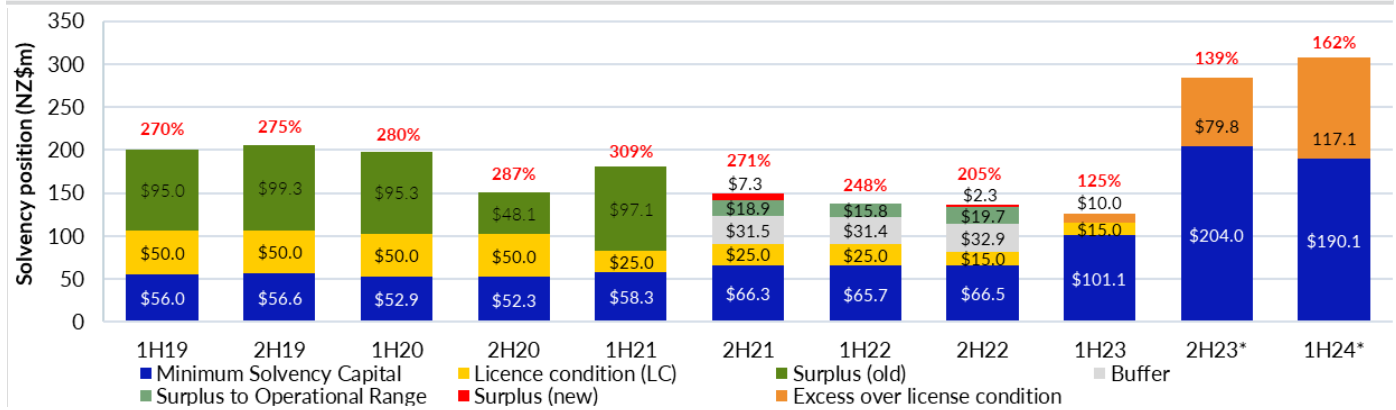
Figure 4. Earnings revisions

	FY24 Estimate	FY24 Mgt guidance	FY25 Estimate	FY25 Mgt guidance	FY26 Estimate	FY26 Mgt guidance
GWP growth (%)	+15%	+10% to +15%	+11%	+10% to +15%	+12%	+10% to +15%
Large events allowance (NZ\$m)	\$20.5m	\$43	\$50m	\$50m	\$55m	\$55m
MER	29.8%	30% to 32%	27.2%	<28%	24.8%	<26%
Combined operating ratio (%)	85.9%	<93%	89.4%	<91%	86.0%	<87%
Underlying NPAT (NZ\$m)	\$55.8m	>\$35m	\$54.9m	\$40m to \$60m	\$74.2m	\$60m to \$80m
ROE (%)	n/a	n/a	14.2%	12% to 15%	17.7%	>15%

Source: Company, Forsyth Barr analysis

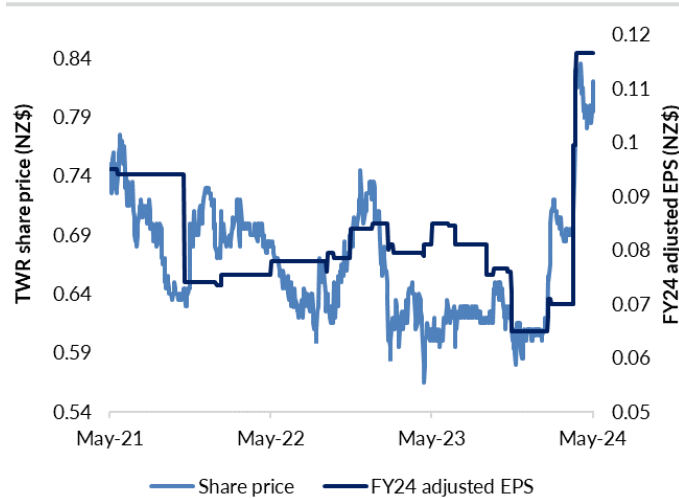
Charts

Figure 5. TWR – Solvency position over time (NZ\$m)



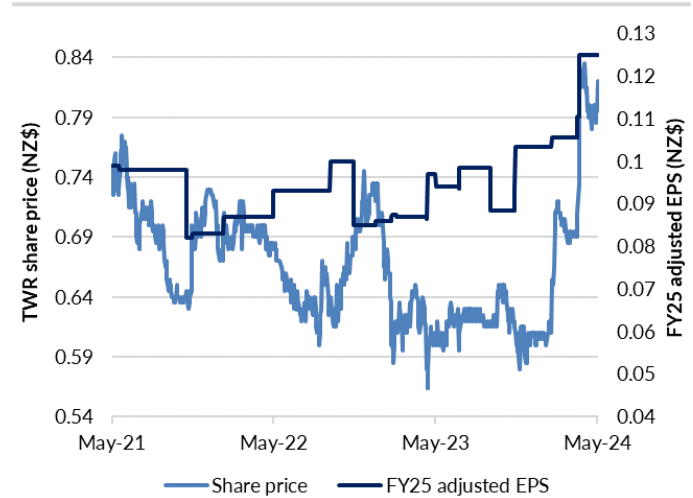
Source: Company, Forsyth Barr analysis *Reported under new ISS

Figure 6. TWR's share price vs consensus FY24 EPS expectations



Source: Bloomberg, Forsyth Barr analysis

Figure 7. TWR's share price vs consensus FY25 EPS expectations



Source: Bloomberg, Forsyth Barr analysis

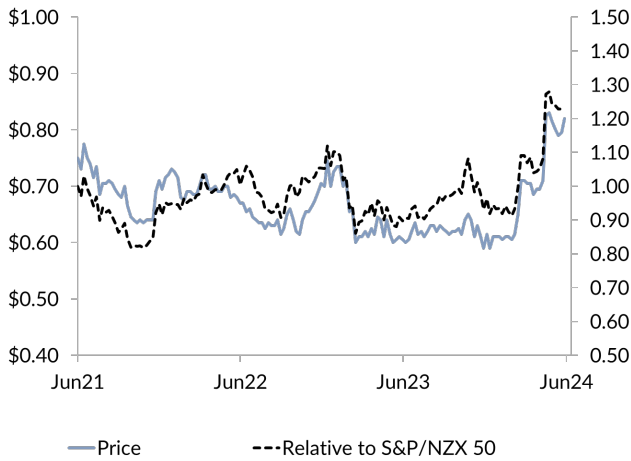
Appendix

Transition to IFRS 17 and the RBNZ's Interim Solvency Standard

TWR has transitioned its financial reporting to NZ IFRS 17 and the Interim Solvency Standard (ISS) for 1H24. These new accounting and solvency standards significantly alter the presentation and disclosure of financial statements. Still, our analysis and TWR's disclosed view from its 15 May 2024 announcement show it does not materially impact the company's strategic direction, profitability, or dividend policies. The two key changes are:

- Effective from 1 October 2023, Tower Limited implemented the **NZ IFRS 17 Insurance Contracts** (IFRS 17), a mandatory accounting standard for all insurance companies, aimed at improving the transparency and consistency of financial reporting, with its 1H24 result marking the first interim reporting period under this new standard.
- The Reserve Bank of New Zealand introduced the **Interim Solvency Standard 2023 (ISS)** effective from 1 October 2023, replacing the Non-Life Solvency Standard (NLSS). In addition, it is currently consulting on a proposed second amendment expected in TWR's FY25. This proposed amendment could materially impact TWR's regulatory solvency position, potentially reducing the solvency margin to levels similar to those under the NLSS, although these changes will not take effect until formally implemented.

Figure 8. Price performance



Source: Forsyth Barr analysis

Figure 9. 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%

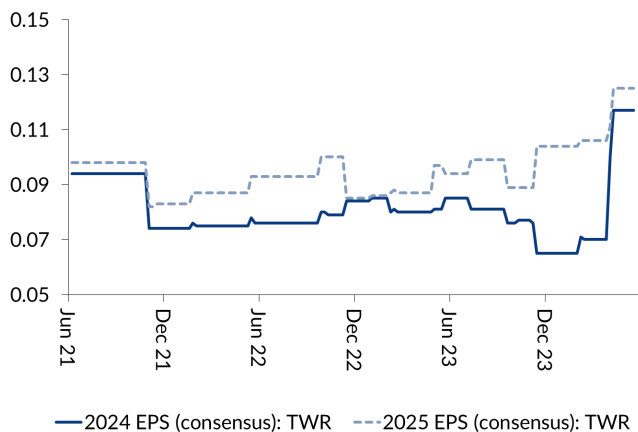
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 10. 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\$0.82	NZ\$311	5.7x	5.7x	n/a	n/a	n/a	n/a	9.8%
Heartland Group Holdings *	HGH NZ	NZ\$1.01	NZ\$940	8.7x	8.3x	n/a	n/a	n/a	n/a	7.8%
Insurance Australia Group	IAG AT	A\$6.43	A\$15,241	17.1x	15.5x	n/a	n/a	n/a	10.2x	4.7%
Suncorp Group	SUN AT	A\$16.00	A\$20,357	15.0x	14.8x	n/a	n/a	n/a	54.5x	5.2%
QBE INSURANCE GROUP	QBE AT	US\$11.79	US\$17,708	10.8x	9.8x	n/a	n/a	n/a	8.9x	5.9%
Compco Average:				12.9x	12.1x	n/a	n/a	n/a	24.6x	5.9%
EV = Mkt cap+net debt+lease liabilities+min interests-investments				TWR Relative:		-56%	-53%	n/a	n/a	65%

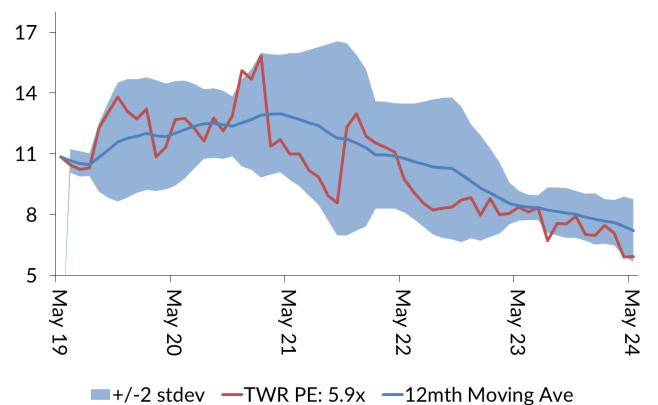
Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (TWR) companies fiscal year end

Figure 11. Consensus EPS momentum (NZ\$)



Source: Forsyth Barr analysis

Figure 12. One year forward PE (x)



Source: Forsyth Barr analysis

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