

Tower Limited

Guidance Upgrades Galore

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Tower (TWR) has delivered another guidance upgrade, reflecting lower business-as-usual (BAU) claims performance and robust GWP growth. Underlying NPAT for FY24 is now expected to be greater than NZ\$45m, up from previous guidance of greater than NZ\$40m and +6% ahead of our prior estimate (normalising for differences in our large events claims forecast). While TWR continues to benefit from benign weather in New Zealand, a fourth profit upgrade for FY24 also demonstrates: (1) TWR's improved scale and efficiency during this hardening insurance cycle, and (2) the success of targeted risk-based pricing initiatives, particularly in motor. Despite rallying strongly in recent months, TWR still trades at just 7.6x and 6.0x our FY25 and FY26 earnings estimates, respectively. We consider these as undemanding multiples to pay in light of: (1) ongoing operational improvements/growth, (2) the inherent upside risk to future earnings due to its conservative provisioning of large events, and (3) its potential NZX50 inclusion later in 2024. Offsetting better operational metrics is our expectation of lower investment returns as interest rates fall. Our blended spot valuation falls -6cps to NZ\$1.44.

NZX Code	TWR	Financials: Sep/	23A	24E	25E	26E	Valuation (x)	23A	24E	25E	26E
Share price	NZ\$1.12	Rev (NZ\$m)	487.6	567.6	641.9	712.5	PE	59.9	6.6	7.6	6.0
Spot Valuation	NZ\$1.44 (from 1.50)	NPAT* (NZ\$m)	7.1	64.8	55.6	70.3	EV/EBIT	n/a	n/a	n/a	n/a
Risk rating	High	EPS* (NZc)	1.9	17.1	14.7	18.5	EV/EBITDA	n/a	n/a	n/a	n/a
Issued shares	379.5m	DPS (NZc)	0.0	9.0	9.5	12.0	Price / NTA	8.8	2.7	2.6	2.3
Market cap	NZ\$425m	Imputation (%)	0	0	50	100	Cash div yld (%)	0.0	8.0	8.5	10.7
Avg daily turnover	227.1k (NZ\$178k)	*Based on normalised profits					Gross div yld (%)	0.0	8.0	10.1	14.9

What's changed?

- **Earnings:** Our underlying NPAT estimates lift +23% in FY24, rise +1% in FY25 and fall -5% in FY26
- **Blended spot valuation:** Falls -5% to NZ\$1.44 on weaker investment returns and a derate in peer multiples.

A fourth operational upgrade in twelve months

TWR's strong upgrade cycle continues. Underlying NPAT guidance for FY24 has been upgraded to 'greater than NZ\$45m', less than two months after TWR guided to 'greater than NZ\$40m'. The key driver of this latest upgrade is stronger-than-expected BAU claims performance (albeit specifics were not provided), reflecting lower motor claims frequency due to the benign weather environment and the positive impact of targeted underwriting actions in its motor book. Robust GWP growth has also contributed, with growth now expected to be at the upper end or above guidance of +10% to +15%. We lift our estimate from +15% GWP growth to +15.5%. We now foresee 2H25 dividends and beyond as fully imputed, with accumulated tax losses potentially being exhausted by this time.

Large events luck continues and inherent upside from large events probability grows

Despite less than two months until the end of FY24 and zero large events recorded to date, TWR has conservatively retained its full NZ\$45m large events allowance for FY24. Underlying NPAT, therefore, could be up to +NZ\$32m above guidance if no events occur in the remainder of the period. We, however, lower our expectations of large events for FY25 from NZ\$20.5m to NZ\$10m. While the lack of events in FY24 is likely a one-off, the probability-weighted distribution of large events implies earnings upside risk for future periods. TWR sets its large events allowances (which we incorporate in FY25 forecasts and beyond in full) using a >90% confidence interval. Investors must recognise the risk posed by large events (particularly given frequency and severity are arguably increasing). However, we see investors being compensated for this risk, with TWR trading at 7.6x FY25 PE and the balance of probability around large events skewed in its favour. TWR has several avenues for utilising the one-off lift in profits, including: (1) special dividends, (2) building a capital buffer for future large events, (3) buybacks, or (4) investing in targeted M&A.

Tower Limited (TWR)

Market data (NZ\$)						Spot valuation (NZ\$)						
Priced as at 08 Aug 2024						1.12	PE relative					1.51
52 week high / low						1.14 / 0.58	P/Book relative					1.21
Market capitalisation (NZ\$m)						425.0	DCF					1.60
Key WACC assumptions						DCF valuation summary (NZ\$m)						
Risk free rate						5.00%	Total firm value					731
Equity beta						1.18	(Net debt)/cash					(29)
WACC						11.0%	Less: Capitalised operating leases					(95)
Terminal growth						1.8%	Value of equity					607
Profit and Loss Account (NZ\$m)						Valuation Ratios						
Revenue (Insurance revenue)	2022A	2023A	2024E	2025E	2026E	2022A	2023A	2024E	2025E	2026E		
Revenue (Insurance revenue)	430.7	487.6	567.6	641.9	712.5	EV/Sales (x)	0.2	0.3	0.2	0.1	0.1	
Normalised EBITDA	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	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	PE (x)	12.1	59.9	6.6	7.6	6.0	
Net interest	n/a	n/a	n/a	n/a	n/a	Price/NTA (x)	2.4	8.8	2.7	2.6	2.3	
Associate income	0	0	0	0	0	Free cash flow yield (%)	8.7	-2.1	13.1	11.0	14.1	
Tax	(7.5)	(5.2)	(26.0)	(22.7)	(27.3)	Adj. free cash flow yield (%)	8.7	-2.1	13.1	11.0	14.1	
Minority interests	0	0	0	0	0	Net dividend yield (%)	5.8	0.0	8.0	8.5	10.7	
Normalised NPAT	17.5	2.6	60.6	55.6	70.3	Gross dividend yield (%)	5.8	0.0	8.0	10.1	14.9	
Abnormals/other	1.4	(3.6)	3.6	-	-	Key Ratios						
Reported NPAT	18.9	(1.0)	64.2	55.6	70.3	2022A	2023A	2024E	2025E	2026E		
Normalised EPS (cps)	9.2	1.9	17.1	14.7	18.5	Return on assets (%)	n/a	n/a	n/a	n/a	n/a	
DPS (cps)	6.5	-	9.0	9.5	12.0	Return on equity (%)	11.5	4.8	25.4	21.0	24.3	
Growth Rates						2022A	2023A	2024E	2025E	2026E		
Revenue (%)	9.1	13.2	16.4	13.1	11.0	Return on funds employed (%)	10.1	3.8	22.4	18.9	22.4	
EBITDA (%)	n/a	n/a	n/a	n/a	n/a	EBITDA margin (%)	n/a	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	n/a	
Normalised NPAT (%)	44.0	-79.7	>100	-14.2	26.5	Capex to sales (%)	3.9	2.5	3.9	3.6	3.3	
Normalised EPS (%)	60.1	-79.7	>100	-14.2	26.5	Capex to depreciation (%)	n/a	n/a	n/a	n/a	n/a	
Ordinary DPS (%)	30.0	-100.0	n/a	5.6	26.3	Imputation (%)	0	0	0	50	100	
						Pay-out ratio (%)	70	0	53	65	65	
Cash Flow (NZ\$m)						Underlying Performance						
EBITDA	2022A	2023A	2024E	2025E	2026E	2022A	2023A	2024E	2025E	2026E		
EBITDA	n/a	n/a	n/a	n/a	n/a	Gross written premium	457.3	526.8	608.5	675.4	749.7	
Working capital change	n/a	n/a	n/a	n/a	n/a	Insurance revenue	430.7	487.6	567.6	641.9	712.5	
Interest & tax paid	0	0	0	0	0	Reinsurance Premium	(62.3)	(69.5)	(85.1)	(94.7)	(103.3)	
Other	0	0	0	0	0	Net insurance revenue	368.4	418.1	482.5	547.2	609.2	
Operating cash flow	59.8	10.0	83.9	75.8	90.1	Net claims expense - BAU	(176.5)	(230.2)	(240.3)	(279.1)	(307.7)	
Capital expenditure	(16.8)	(12.0)	(21.9)	(22.9)	(23.8)	Net claims expense - Large events	(19.0)	(38.2)	(20.5)	(50.0)	(55.0)	
(Acquisitions)/divestments	(6.1)	(5.9)	-	-	-	Large event reinsurance reinstatement	-	(17.4)	-	-	-	
Other	(13.8)	(1.3)	(48.4)	(11.9)	(24.6)	Management expenses	(120.6)	(123.9)	(139.3)	(138.8)	(143.6)	
Funding available/(required)	23.1	(9.2)	13.6	41.1	41.7	Commission	(8.8)	(10.1)	(9.3)	(10.6)	(11.8)	
Dividends paid	(20.0)	(15.2)	(11.4)	(40.8)	(40.8)	Net insurance service expense	(324.9)	(419.8)	(409.4)	(478.5)	(518.0)	
Equity raised/(returned)	(30.6)	-	-	-	-	Insurance service result	43.5	(7.9)	73.1	68.8	91.2	
(Increase)/decrease in net debt	(27.6)	(24.4)	2.2	0.3	0.9	Investment and other revenue	1.1	14.3	19.3	16.3	13.3	
						Net insurance finance expense	-	(1.1)	(1.6)	(6.7)	(6.8)	
Balance Sheet (NZ\$m)						Other income (costs)	1.3	0.2	2.9	(3.5)	(3.6)	
Working capital	2022A	2023A	2024E	2025E	2026E	Net insurance and investment result	46.0	11.5	90.8	78.3	97.7	
Working capital	183.2	(1.6)	12.4	14.5	16.0	Other income	0.4	2.7	(2.3)	(3.2)	(3.2)	
Fixed assets	5.4	6.3	8.0	9.6	11.2	Profit before taxation (from cont. ops)	25.0	7.8	86.6	78.3	97.7	
Intangibles	132.5	98.5	98.8	99.6	100.7	Tax expense	(7.5)	(5.2)	(26.0)	(22.7)	(27.3)	
Right of use asset	23.3	23.2	19.9	17.0	14.6	Profit after taxation	17.5	2.6	60.6	55.6	70.3	
Other assets	295.6	287.8	315.4	320.9	338.9	NPAT (from discontinued operation)	1.4	(3.6)	3.6	-	-	
Total funds employed	640.0	414.2	454.5	461.6	481.5	NPAT (Reported)	18.9	(1.0)	64.2	55.6	70.3	
Net debt/(cash)	(84.5)	(64.0)	(63.1)	(63.4)	(64.3)	Key ratios						
Lease liability	35.1	32.6	26.4	20.0	13.5	2022A	2023A	2024A	2025A	2026A		
Other liabilities	383.5	299.0	235.8	240.2	242.8	Total GWP growth %	13.2%	15.2%	15.5%	11.0%	11.0%	
Shareholder's funds	306.0	146.6	255.3	264.7	289.5	MER %	35.1%	32.0%	30.8%	27.3%	25.5%	
Minority interests	-	-	-	-	-	Combined ratio %	88.2%	100.4%	84.8%	87.4%	85.0%	
Total funding sources	640.0	414.2	454.5	461.6	481.5	Solvency ratio (%)	205%	139%	149%	140%	135%	

* 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

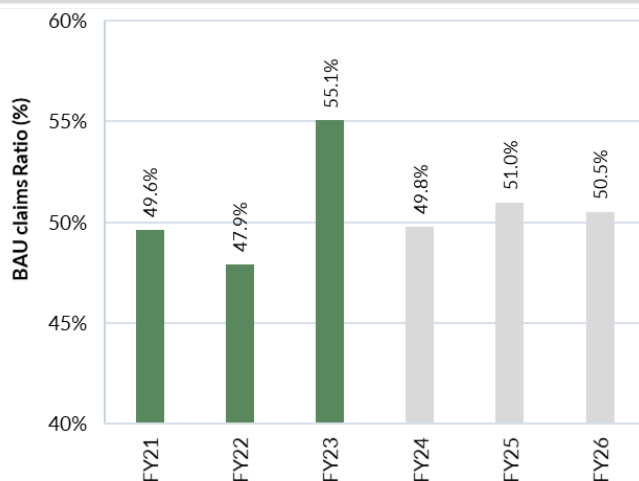
TWR noted with this upgrade that ‘business-as-usual (BAU) claims performance has been stronger than expected’ and ‘gross written premium (GWP) growth is expected to be at the top end of, or exceed, current GWP guidance of 10% to 15%’. Accordingly, we reduce our BAU claims expense in FY24 and increase our GWP growth estimates from +15% to +15.5%. As such, our underlying NPAT estimate increases from NZ\$42.5m to NZ\$47.3m (when normalising for our lower large events allowance) or NZ\$72.3m when using our lower NZ\$10.0m large events allowance estimate. Our underlying NPAT estimate lifts +23% in FY24, rises +1% in FY25, and falls -5% in FY26 as interest rates fall, reducing investment returns (see Figures 1 and 3 below). These changes see our expectations for FY24 dividends per share (DPS) also lift from NZ8cps to NZ9cps. We now estimate that accumulated tax losses could be fully exhausted by the end of 1H25, depending on large events claims. This may allow dividends to be fully imputed from 2H25 onwards.

Figure 1. Earnings revisions (NZ\$m) – transitioning to the new reporting standards

	FY24			FY25			FY26		
	Old	New	Change	Old	New	Change	Old	New	Change
Gross written premium	606.7	608.5	+0%	674.4	675.4	+0%	752.5	749.7	(0%)
Insurance revenue	559.1	567.6	+2%	640.5	641.9	+0%	713.4	712.5	(0%)
Reinsurance expense	(84.6)	(85.1)	+1%	(100.2)	(94.7)	(5%)	(109.8)	(103.3)	(6%)
Net insurance revenue	474.4	482.5	+2%	540.4	547.2	+1%	603.6	609.2	+1%
Net claims expense – BAU	(244.1)	(240.3)	(2%)	(285.4)	(279.1)	(2%)	(313.6)	(307.7)	(2%)
Net claims expense – Large events	(20.5)	(-10.0)	(-51%)	(50.0)	(50.0)	+0%	(55.0)	(55.0)	+0%
Large event reinsurance reinstatement	-	-	n/a	-	-	n/a	-	-	n/a
Management expenses	(137.9)	(139.3)	+1%	(138.7)	(138.8)	+0%	(140.6)	(143.6)	+2%
Net Commission Expense	(7.5)	(9.3)	+25%	(8.4)	(10.6)	+25%	(9.4)	(11.8)	+25%
Net insurance service expense	(409.9)	(398.9)	(0%)	(482.6)	(478.5)	(1%)	(518.5)	(518.0)	(0%)
Insurance service result	64.5	83.6	+30%	57.8	68.8	+19%	85.1	91.2	+7%
Net Investment Income	18.2	19.5	+7%	20.1	16.3	(19%)	19.6	13.3	(32%)
Net insurance finance expense	-	(4.5)	n/a	-	(3.2)	n/a	-	(3.2)	n/a
Other income (costs)	(1.0)	2.9	n/a	(1.0)	(3.5)	n/a	(1.0)	(3.6)	n/a
Profit before tax	81.9	101.5	+24%	76.8	78.3	+2%	103.7	97.7	(6%)
Tax expense	(23.2)	(29.2)	+26%	(21.8)	(22.7)	+4%	(29.3)	(27.3)	(7%)
Profit after taxation from discontinued operation	-	-	n/a	-	-	n/a	-	-	n/a
Underlying Profit after tax	58.7	72.3	+23%	55.0	55.6	+1%	74.4	70.3	(5%)
Canterbury impact	(0.8)	(0.8)	+0%	-	-	n/a	-	-	n/a
Other non-underlying items	0.2	0.2	+0%	-	-	n/a	-	-	n/a
Reported Profit after tax	58.1	71.7	+24%	55.0	55.6	+1%	74.4	70.3	(5%)

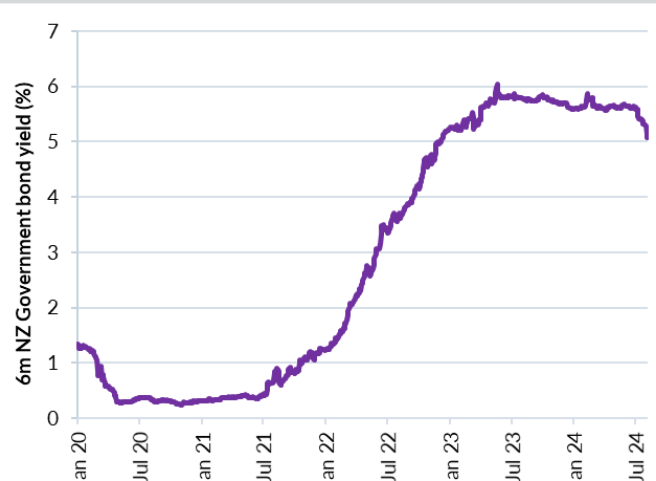
Source: Forsyth Barr analysis

Figure 2. TWR – BAU claims ratio (excluding large events)



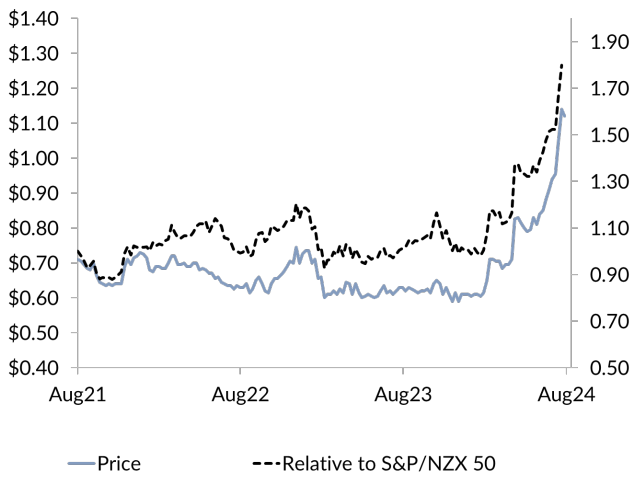
Source: Company, Forsyth Barr analysis

Figure 3. New Zealand six-month government bond yield



Source: Refinitiv Datastream, 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	7.0%
Pacific International Insurance Pty Ltd	5.8%
NZ Funds Management	5.2%

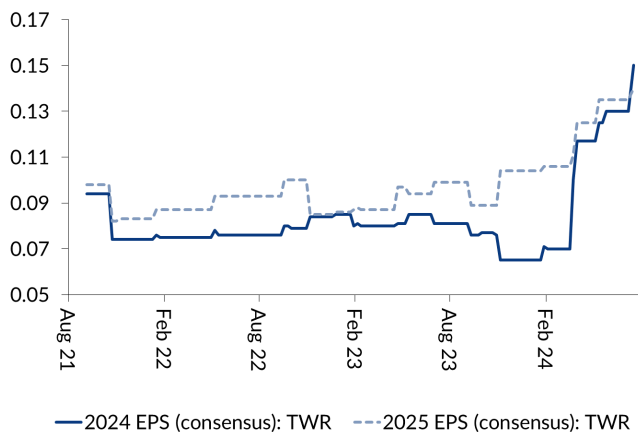
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 6. International valuation comparisons

Company	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\$1.12	NZ\$425	6.6x	7.6x	n/a	n/a	n/a	n/a	8.5%
Heartland Group Holdings *	HGH NZ	NZ\$1.09	NZ\$1,014	9.4x	8.9x	n/a	n/a	n/a	n/a	7.2%
Insurance Australia Group	IAG AT	A\$7.24	A\$17,161	18.5x	17.4x	n/a	n/a	n/a	11.7x	4.2%
Suncorp Group	SUN AT	A\$17.20	A\$21,884	16.1x	16.2x	n/a	n/a	n/a	55.8x	4.8%
QBE INSURANCE GROUP	QBE AT	US\$11.30	US\$16,972	10.6x	9.5x	n/a	n/a	n/a	8.6x	6.4%
Compco Average:				13.6x	13.0x	n/a	n/a	n/a	25.3x	5.7%
EV = Mkt cap+net debt+lease liabilities+min interests-investments				TWR Relative:		-52%	-41%	n/a	n/a	50%

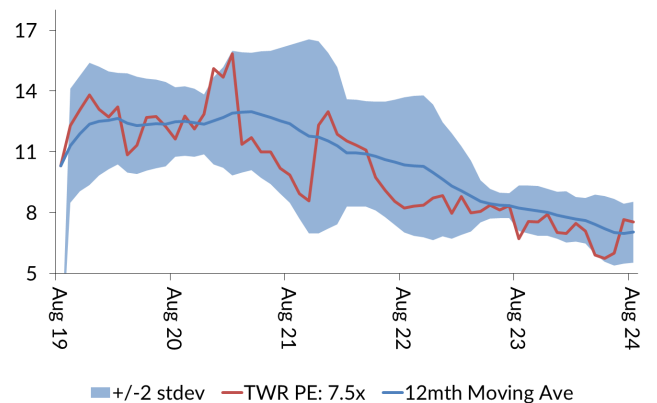
Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (TWR) companies fiscal year end

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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