

Tower Limited

FY23 Updated for Final Large Event Costs

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Tower (TWR) has revised its FY23 guidance and now expects underlying profit after tax to be between NZ\$7m and NZ\$10m, up +NZ\$8m at the midpoint. The upgraded guidance reflects lower-than-expected costs relating to large events for the period. TWR's previous guidance, issued in July 2023, assumed full utilisation of a NZ\$50m large events allowance. However, based on preliminary unaudited results, large event costs are likely to total only NZ\$38m. GWP for FY23 is expected to be NZ\$526m (FB: NZ\$526m), representing growth of +~17%. We adjust our large events allowance to reflect TWR's updated guidance, which means our underlying profit after tax estimate increases from NZ\$0.3m to NZ\$8.6m. TWR will report its full set of FY23 results on 23 November 2023. Our blended spot valuation rises +4% to NZ\$0.83.

NZX Code	TWR	Financials: Sep/	22A	23E	24E	25E	Valuation (x)	22A	23E	24E	25E
Share price	NZ\$0.65	Rev (NZ\$m)	418.3	476.4	556.2	615.4	PE	13.8	71.6	7.8	5.8
Spot Valuation	NZ\$0.83 (from 0.80)	NPAT* (NZ\$m)	17.7	3.4	31.3	42.3	EV/EBIT	n/a	n/a	n/a	n/a
Risk rating	High	EPS* (NZc)	4.7	0.9	8.2	11.1	EV/EBITDA	n/a	n/a	n/a	n/a
Issued shares	379.5m	DPS (NZc)	6.5	0.0	7.0	8.0	Price / NTA	1.4	1.4	1.3	1.2
Market cap	NZ\$245m	Imputation (%)	0	0	0	0	Cash div yld (%)	10.1	0.0	10.9	12.4
Avg daily turnover	124.7k (NZ\$81k)	*Based on normalised profits					Gross div yld (%)	10.1	0.0	10.9	12.4

What's changed?

- **Earnings:** FY23 underlying profit after tax increases by +NZ\$8.3m with minor changes to FY24 and FY25 estimates.
- **Blended spot valuation:** Rises by +3cps to NZ\$0.83.

Positive large events result

TWR's guidance provided on 19 July 2023 assumed NZ\$50m of large events costs for the period. However, reduced claims costs relative to expectations from the Vanuatu cyclones, advantageous foreign exchange movements, and no further large events have meant total large events costs are now expected to be NZ\$38m. Unwinding the pre-tax NZ\$12m from the large events allowance provides a ~NZ\$8.3m post-tax boost to profitability. We retain our large events allowance estimates of NZ\$42m and NZ\$44m in FY24 and FY25 respectively. These forecasts reflect our expectations for GWP growth in subsequent periods.

Implications for capital and dividends

In prior reports we have noted that a 2H23 dividend is highly unlikely and flagged some risk to a 1H24 dividend being paid. While undeniably positive, the updated FY23 profit guidance, in our view, will not be enough to allow TWR's capital position to recover in time for a 2H23 dividend to be paid. However, this could mean that a 1H24 dividend becomes more likely, albeit this remains at risk and dependent on capital recovery and 1H24 earnings. We forecast 7cps of unimputed dividends in FY24.

Rising interest rates necessitate a change to WACC inputs

Given recent interest rate movements, we have increased our risk-free rate input assumption to ~5.25%, up ~+75bps from ~4.5%. Our WACC for TWR increases by ~+60bp to 11.2%. Changes to the WACC and other valuation inputs reduced our blended spot valuation marginally by -1cps to NZ\$0.80 prior to today's earnings upgrades. Earnings upgrades lift our blended spot valuation by +3cps to NZ\$0.83 meaning the net impact of valuation changes since our last report is +2cps.

Tower Limited (TWR)

Market data (NZ\$)						Spot valuation (NZ\$)					0.83
Priced as at 16 Oct 2023					0.65	PE relative					0.76
52 week high / low					0.75 / 0.57	P/Book relative					0.91
Market capitalisation (NZ\$m)					246.7	DCF					0.82
Key WACC assumptions						DCF valuation summary (NZ\$m)					
Risk free rate					5.25%	Total firm value					459
Equity beta					1.18	(Net debt)/cash					(45)
WACC					11.2%	Less: Capitalised operating leases					(95)
Terminal growth					1.8%	Value of equity					319
Profit and Loss Account (NZ\$m)						Valuation Ratios					
Revenue (GEP)	2021A	2022A	2023E	2024E	2025E	2021A	2022A	2023E	2024E	2025E	
Revenue (GEP)	386.6	418.3	476.4	556.2	615.4	EV/Sales (x)	n/a	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	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)	14.9	14.0	72.1	7.9	5.8
Net interest	n/a	n/a	n/a	n/a	n/a	Price/NTA (x)	1.2	1.4	1.4	1.3	1.2
Associate income	0	0	0	0	0	Free cash flow yield (%)	38.2	14.8	14.0	27.9	31.0
Tax	(9.2)	(7.5)	(4.1)	(14.8)	(19.4)	Adj. free cash flow yield (%)	38.2	14.8	14.0	27.9	31.0
Minority interests	0.6	0.1	0	0	0	Net dividend yield (%)	7.7	10.0	0.0	10.8	12.3
Normalised NPAT	20.8	27.4	8.6	31.3	42.3	Gross dividend yield (%)	n/a	10.0	0.0	10.8	12.3
Abnormals/other	(1.5)	(8.5)	(2.8)	0.7	0						
Reported NPAT	19.3	18.9	5.8	31.9	42.3	Key Ratios					
Normalised EPS (cps)	4.4	4.7	0.9	8.2	11.1	2021A	2022A	2023E	2024E	2025E	
DPS (cps)	5.0	6.5	0	7.0	8.0	Return on assets (%)	n/a	n/a	n/a	n/a	n/a
						Return on equity (%)	5.3	5.8	1.1	9.7	12.2
Growth Rates						Return on funds employed (%)	4.6	5.1	1.0	8.9	11.4
2021A	2022A	2023E	2024E	2025E		EBITDA margin (%)	n/a	n/a	n/a	n/a	n/a
Revenue (%)	3.8	8.2	13.9	16.7	10.7	EBIT margin (%)	n/a	n/a	n/a	n/a	n/a
EBITDA (%)	n/a	n/a	n/a	n/a	n/a	Capex to sales (%)	3.1	4.1	3.1	2.7	2.5
EBIT (%)	n/a	n/a	n/a	n/a	n/a	Capex to depreciation (%)	n/a	n/a	n/a	n/a	n/a
Normalised NPAT (%)	49.1	-4.0	-80.7	>100	35.2	Imputation (%)	n/a	0	0	0	0
Normalised EPS (%)	49.1	6.7	-80.7	>100	35.2	Pay-out ratio (%)	115	140	0	85	72
Ordinary DPS (%)	n/a	30.0	-100.0	n/a	14.3						
Cash Flow (NZ\$m)						Capital Structure					
2021A	2022A	2023E	2024E	2025E		2021A	2022A	2023E	2024E	2025E	
EBITDA	n/a	n/a	n/a	n/a	n/a	Solvency capital	155.9	150.5	179.4	136.4	168.6
Working capital change	n/a	n/a	n/a	n/a	n/a	Minimum solvency capital (MSC)	56.6	52.3	66.3	66.5	77.1
Interest & tax paid	0	0	0	0	0	Total regulatory capital	106.6	102.3	83.3	91.3	91.3
Other	0	0	0	0	0	Solvency ratio (%)	275	287	271	205	219
Operating cash flow	98.1	59.8	56.4	92.0	100.5	Operating Performance					
Capital expenditure	(12.0)	(17.3)	(14.7)	(15.1)	(15.4)	2021A	2022A	2023E	2024E	2025E	
(Acquisitions)/divestments	(14.4)	(6.1)	(4.1)	0	0	Gross written premium	396.0	445.6	522.9	589.4	641.4
Other	(24.9)	(21.1)	(7.1)	(8.0)	(8.7)	Gross earned premium	386.6	418.3	476.4	556.2	615.4
Funding available/(required)	46.8	15.3	30.5	68.9	76.4	Reinsurance premium	(58.8)	(66.3)	(89.1)	(85.3)	(93.4)
Dividends paid	(8.9)	(20.0)	0	(26.6)	(30.4)	Net earned premium	327.9	352.1	387.4	470.9	522.0
Equity raised/(returned)	0	(30.6)	0	0	0	Net claims expense	(202.3)	(224.9)	(294.3)	(329.6)	(359.9)
(Increase)/decrease in net debt	37.9	(35.4)	30.5	42.4	46.0	* includes Large event claims of	(13.9)	(19.0)	(38.0)	(42.0)	(44.0)
						Management & sales expenses	(123.3)	(129.9)	(131.9)	(142.3)	(148.8)
Balance Sheet (NZ\$m)						Underwriting profit	27.2	23.6	(8.3)	31.0	46.8
2021A	2022A	2023E	2024E	2025E		Investment and other revenue	0.2	1.2	14.1	16.0	15.9
Working capital	148.0	183.2	237.2	267.3	290.9	Financing and other costs	(0.4)	(0.9)	(0.9)	(0.9)	(1.0)
Fixed assets	9.4	5.4	3.7	2.2	1.1	Profit before tax (from continuing operations)	27.6	25.2	7.5	46.1	61.7
Intangibles	120.6	132.5	136.1	135.3	135.1	Tax expense	(9.2)	(7.5)	(4.1)	(14.8)	(19.4)
Right of use asset	25.6	23.3	20.7	18.1	15.6	Profit after taxation	18.4	17.7	3.4	31.3	42.3
Other assets	314.8	295.6	295.6	295.6	295.6	NPAT (from discontinued operation)	(0.2)	5.1	2.3	0.7	0
Total funds employed	618.4	640.0	693.3	718.7	738.2	NPAT (Reported)	18.2	22.8	5.8	31.9	42.3
Net debt/(cash)	(116.1)	(84.5)	(115.0)	(157.4)	(203.4)	Key ratios					
Lease liability	39.4	35.1	31.2	27.3	23.4	Total GWP growth %	5.0%	12.5%	17.4%	12.7%	8.8%
Other liabilities	342.5	383.5	469.4	526.5	571.0	Total claims ratio %	54.3%	54.1%	66.2%	63.2%	62.5%
Shareholder's funds	349.9	306.0	307.7	322.3	347.2	MER %	37.1%	36.0%	33.5%	30.2%	28.5%
Minority interests	2.7	0	0	0	0	Combined ratio %	91.4%	90.1%	100.5%	93.4%	91.0%
Total funding sources	618.4	640.0	693.3	718.7	738.2						

* 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

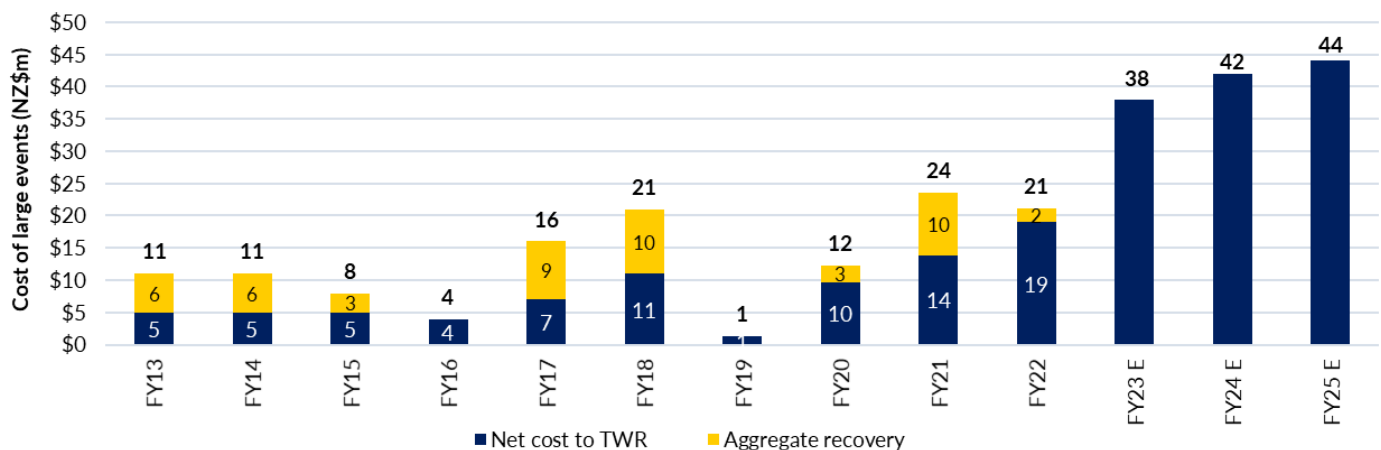
Earnings revisions

Figure 1. Earnings revisions

NZ\$m	FY23			FY24			FY25		
	Old	New	Change	Old	New	Change	Old	New	Change
Gross written premium	526.0	526.0	+0%	589.4	589.4	+0%	641.4	641.4	+0%
Gross earned premium	479.6	479.6	+0%	556.2	556.2	+0%	615.4	615.4	+0%
Reinsurance Expense	(86.0)	(86.0)	+0%	(85.3)	(85.3)	+0%	(93.4)	(93.4)	+0%
Net earned premium	393.7	393.7	+0%	470.9	470.9	+0%	522.0	522.0	+0%
Net Claims Expense	(222.4)	(222.4)	+0%	(255.6)	(255.6)	+0%	(282.4)	(282.4)	+0%
Large event claims expense	(50.0)	(38.0)	(24%)	(42.0)	(42.0)	+0%	(44.0)	(44.0)	+0%
Management expenses	(122.6)	(122.6)	+0%	(131.9)	(131.9)	+0%	(137.8)	(137.8)	+0%
Net Commission Expense	(9.2)	(9.2)	+0%	(10.4)	(10.4)	+0%	(11.0)	(11.0)	+0%
Underwriting profit	(14.0)	(2.0)	n/a	31.0	31.0	+0%	46.8	46.8	+0%
Net Investment Income	14.1	14.1	+0%	15.7	16.0	+2%	15.7	15.9	+2%
Other income (costs)	0.6	0.6	+0%	(0.9)	(0.9)	n/a	(1.0)	(1.0)	n/a
Profit before tax	0.7	12.7	+0%	45.8	46.1	+1%	61.5	61.7	+0%
Tax expense	(0.4)	(4.1)	+0%	(14.7)	(14.8)	+1%	(19.4)	(19.4)	+0%
Profit after taxation from discontinued operation	-	-	n/a	-	-	n/a	-	-	n/a
Underlying Profit after tax	0.3	8.6	n/a	31.1	31.3	+1%	42.1	42.3	+0%
Canterbury impact on outstanding claims	(2.0)	(2.0)	+0%	-	-	n/a	-	-	n/a
Other non-underlying items	(0.8)	(0.8)	+0%	0.7	0.7	n/a	-	-	n/a
Reported Profit after tax	(2.5)	5.8	+0%	31.8	31.9	+1%	42.1	42.3	+0%

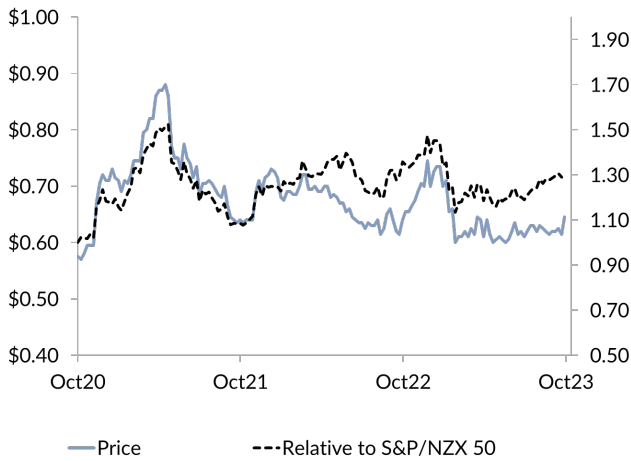
Source: Company data, Forsyth Barr analysis

Figure 2. TWR—Ultimate estimated cost of large events excluding reinsurance premium costs (NZ\$m)



Source: Company data, Forsyth Barr analysis

Figure 3. Price performance



Source: Forsyth Barr analysis

Figure 4. 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

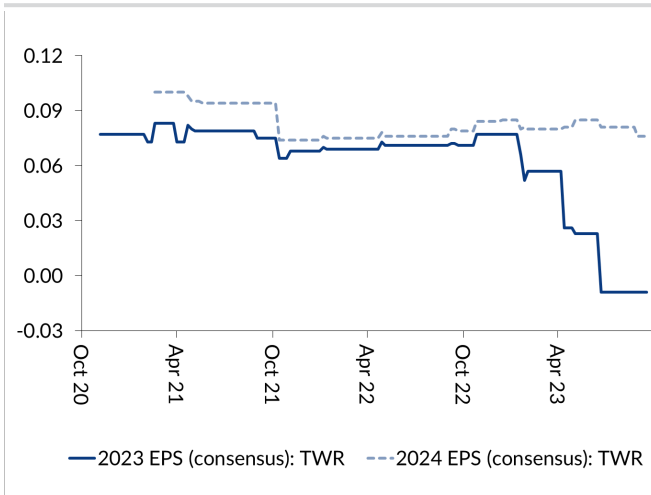
Figure 5. International valuation comparisons

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\$0.65	NZ\$245	71.6x	7.8x	n/a	n/a	n/a	n/a	10.9%
Heartland Group Holdings *	HGH NZ	NZ\$1.78	NZ\$1,273	12.6x	10.6x	n/a	n/a	n/a	n/a	6.8%
Insurance Australia Group	IAG AT	A\$5.68	A\$13,840	16.6x	15.8x	n/a	n/a	n/a	10.0x	4.9%
Suncorp Group	SUN AT	A\$13.97	A\$17,746	14.8x	12.9x	n/a	43.6x	n/a	49.8x	5.5%
QBE INSURANCE GROUP	QBE AT	US\$10.11	US\$15,103	13.0x	9.4x	n/a	n/a	n/a	8.5x	5.6%
Compco Average:				14.3x	12.2x	n/a	43.6x	n/a	22.8x	5.7%
TWR Relative:				402%	-36%	n/a	n/a	n/a	n/a	91%

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

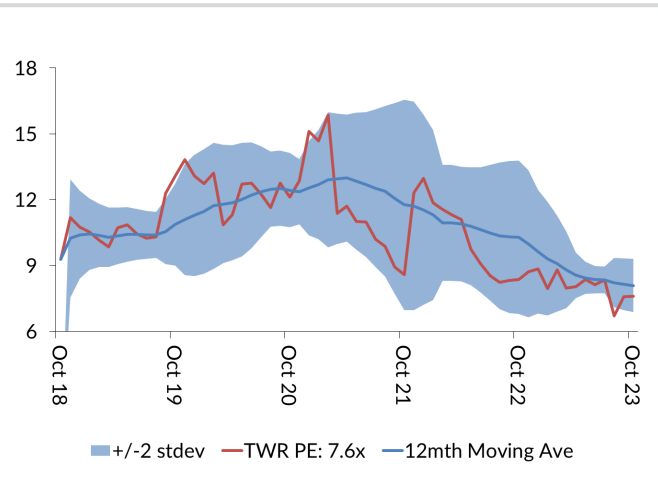
Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (TWR) companies fiscal year end

Figure 6. Consensus EPS momentum (NZ\$)



Source: Forsyth Barr analysis

Figure 7. One year forward PE (x)



Source: Forsyth Barr analysis

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