

Tower Limited

Clear Sky at Night, Tower's Delight

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Tower (TWR) has upgraded its FY24 underlying earnings guidance, with strong gross written premium (GWP) growth and better-than-expected claims driving robust year-to-date trading. TWR now expects to be at the positive end of, or above, its previous guidance ranges of: (1) NZ\$22m to NZ\$27m in underlying profit, (2) GWP growth of +10% to +15%, and (3) combined operating ratio of 95% to 97%. Updated guidance (and our forecasts) assume full utilisation of TWR's conservative NZ\$45m large events allowance, providing significant upside risk to earnings given that no large events were recorded in the year's first four months. Our FY24 underlying profit estimate rises +8% to NZ\$27.6m. TWR trades on an undemanding FY24 PE multiple of 9.0x and at a material discount to its Australasian insurance and financials peer group. We think TWR offers attractive risk-reward at these levels. Our blended spot valuation rises +6cps to NZ\$1.00 on improved GWP growth, lower claims, and a mild uplift in investment return expectations.

NZX Code	TWR	Financials: Sep/	23A	24E	25E	26E	Valuation (x)	23A	24E	25E	26E
Share price	NZ\$0.66	Rev (NZ\$m)	470.8	550.0	621.7	677.9	PE	n/a	9.0	5.0	4.5
Spot Valuation	NZ\$1.00 (from 0.94)	NPAT* (NZ\$m)	2.4	27.6	49.8	55.4	EV/EBIT	n/a	n/a	n/a	n/a
Risk rating	High	EPS* (NZc)	0.6	7.3	13.1	14.6	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	1.6	1.5	1.4	1.4
Market cap	NZ\$249m	Imputation (%)	0	0	0	100	Cash div yld (%)	0.0	6.1	12.2	13.7
Avg daily turnover	113.0k (NZ\$68k)	*Based on normalised profits					Gross div yld (%)	0.0	6.1	12.2	19.1

What's changed?

- **Earnings:** FY24 underlying profit increased by +8% to NZ\$27.6m, FY25 +4%, and FY26 +1% assisted by investment returns
- **Spot valuation:** Rises +6% to NZ\$1.00 on improved earnings after a +5% lift due to WACC inputs, changed on 12 February 2024.

FY24 guidance upgraded

While TWR's new guidance was broadly in line with our expectations, we lift our FY24 GWP growth estimate from +14% to +15% and marginally reduce our FY24 claims ratio to reflect a normalisation in motor claims frequency. We also update our investment returns to reflect current market pricing. These changes mean our FY24 underlying profit estimate rises +8% to NZ\$27.6m, consistent with TWR's guidance.

Earnings upside from large events

Despite recording no large events in the first four months of the year, TWR has retained its NZ\$45m large events allowance for FY24. While we continue to incorporate the full allowance into our numbers at this stage, probability dictates that the likelihood of full utilisation must decrease as time passes. Further, since FY18 ~76% of TWR's large events costs have been incurred during the year's first half (~67% when normalising for FY23). Given these two factors and TWR's (already conservative) large events allowance, we believe there is significant upside risk to underlying profit guidance in FY24 from underutilisation of the allowance. We expect TWR to update its large events allowance at its 1H24 result.

Valuation remains compelling

TWR trades at 9.0x PE on FY24 and 5.0x on FY25 estimates. In the context of (1) significant upside risk to FY24 earnings from underutilisation of the large events allowance, (2) robust forecast GWP growth, and (3) improving cost-to-income ratios from increased scale and efficiency, TWR appears to be materially undervalued at these levels whilst the strategic review is ongoing.

Tower Limited (TWR)

Market data (NZ\$)						Spot valuation (NZ\$)						
Priced as at 14 Feb 2024						0.66	PE relative					0.96
52 week high / low						0.66 / 0.57	P/Book relative					0.87
Market capitalisation (NZ\$m)						250.5	DCF					1.18
Key WACC assumptions						DCF valuation summary (NZ\$m)						
Risk free rate						5.00%	Total firm value					540
Equity beta						1.18	(Net debt)/cash					(44)
WACC						11.0%	Less: Capitalised operating leases					(48)
Terminal growth						1.8%	Value of equity					449
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	550.0	621.7	677.9	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)	14.3	>100x	9.1	5.0		
Net interest	n/a	n/a	n/a	n/a	n/a	Price/NTA (x)	1.4	1.6	1.5	1.4		
Associate income	0	0	0	0	0	Free cash flow yield (%)	14.5	-3.5	18.7	27.8		
Tax	(7.5)	(5.1)	(11.1)	(19.7)	(21.9)	Adj. free cash flow yield (%)	14.5	-3.5	18.7	27.8		
Minority interests	0.1	0	0	0	0	Net dividend yield (%)	9.8	0.0	6.1	12.1		
Normalised NPAT	27.4	7.6	27.6	49.8	55.4	Gross dividend yield (%)	9.8	0.0	6.1	12.1		
Abnormals/other	(8.5)	(8.8)	1.1	0	0	Key Ratios						
Reported NPAT	18.9	(1.2)	28.7	49.8	55.4	2022A	2023A	2024E	2025E	2026E		
Normalised EPS (cps)	4.6	0.6	7.3	13.1	14.6	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	9.2	15.5		
Growth Rates						2022A	2023A	2024E	2025E	2026E		
Revenue (%)	5.9	14.9	16.8	13.0	9.0	Return on funds employed (%)	5.0	0.7	8.2	14.1		
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	80.1	11.4	Capex to sales (%)	4.2	2.5	3.3	3.0		
Normalised EPS (%)	5.6	-86.6	>100	80.1	11.4	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	100		
						Pay-out ratio (%)	141	0	55	61		
Cash Flow (NZ\$m)						Capital Structure						
2022A	2023A	2024E	2025E	2026E	2022A	2023A	2024E	2025E	2026E			
EBITDA	n/a	n/a	n/a	n/a	n/a	Solvency capital	155.9	150.5	179.4	136.4		
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		
Interest & tax paid	0	0	0	0	0	Total regulatory capital	106.6	102.3	83.3	91.3		
Other	0	0	0	0	0	Solvency ratio (%)	275	287	271	205		
Operating cash flow	59.8	10.0	72.8	97.1	74.6	Underlying Performance						
Capital expenditure	(17.3)	(12.0)	(18.2)	(18.6)	(19.1)	2022A	2023A	2024E	2025E	2026E		
(Acquisitions)/divestments	(6.1)	(5.9)	0	0	0	Gross written premium	436.6	511.5	588.4	655.0		
Other	(21.1)	(1.3)	(7.9)	(8.8)	(9.4)	Gross earned premium	430.7	470.8	550.0	621.7		
Funding available/(required)	15.3	(9.2)	46.8	69.7	46.2	Reinsurance premium	(69.5)	(69.5)	(88.4)	(98.9)		
Dividends paid	(20.0)	(15.2)	(15.2)	(30.4)	(34.2)	Net earned premium	361.2	416.3	461.6	522.8		
Equity raised/(returned)	(30.6)	0	0	0	0	Net claims expense	(195.5)	(269.3)	(297.6)	(328.9)		
(Increase)/decrease in net debt	(35.4)	(24.4)	31.6	39.3	12.0	* includes Large event claims of	(19.0)	(38.2)	(45.0)	(51.0)		
Balance Sheet (NZ\$m)						Management & sales expenses	(129.9)	(151.4)	(138.1)	(139.7)		
2022A	2023A	2024E	2025E	2026E	2022A	2023A	2024E	2025E	2026E			
Working capital	183.2	336.8	299.1	332.9	356.2	Underwriting profit	35.8	(4.4)	25.9	54.2		
Fixed assets	5.4	6.3	7.2	7.8	8.4	Investment and other revenue	1.1	14.3	13.8	16.3		
Intangibles	132.5	138.5	138.3	138.6	139.2	Financing and other costs	1.3	2.3	(1.0)	(1.0)		
Right of use asset	23.3	23.2	20.6	18.0	15.4	Profit before tax (from continuing operations)	38.2	12.2	38.8	69.5		
Other assets	295.6	286.7	316.7	354.0	365.5	Tax expense	(10.9)	(4.6)	(11.1)	(19.7)		
Total funds employed	640.0	791.4	782.0	851.4	884.8	Profit after taxation	27.3	7.6	27.6	49.8		
Net debt/(cash)	(84.5)	(64.0)	(65.6)	(67.6)	(68.2)	NPAT (from discontinued operation)	(4.5)	(9.8)	1.1	0		
Lease liability	35.1	32.6	28.7	24.8	20.9	NPAT (Reported)	22.8	-2.2	28.7	49.8		
Other liabilities	383.5	526.5	517.0	574.0	613.3	Key ratios						
Shareholder's funds	306.0	296.3	301.8	320.1	318.7	Total GWP growth %	10.2%	17.2%	15.0%	11.3%		
Minority interests	0	0	0	0	0	Total claims ratio %	54.1%	64.7%	64.5%	62.9%		
Total funding sources	640.0	791.4	782.0	851.4	884.8	MER %	36.0%	32.2%	29.9%	26.7%		
						Combined ratio %	90.1%	101.1%	94.4%	89.0%		

* 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

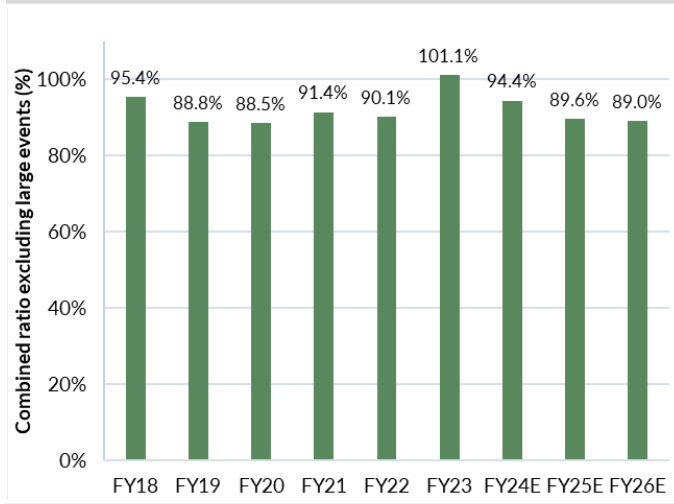
Figure 1. Earnings revisions

	FY24			FY25			FY26		
	Old	New	Change	Old	New	Change	Old	New	Change
Gross written premium	583.3	588.4	+1%	655.0	655.0	(0%)	700.9	700.8	(0%)
Gross earned premium	547.4	550.0	+0%	619.2	621.7	+0%	678.0	677.9	(0%)
Reinsurance Expense	(87.9)	(88.4)	+0%	(98.5)	(98.9)	+0%	(107.1)	(107.1)	+0%
Net earned premium	459.5	461.6	+0%	520.7	522.8	+0%	570.9	570.8	(0%)
Net Claims Expense	(253.2)	(252.6)	(0%)	(278.3)	(277.9)	(0%)	(308.2)	(307.8)	(0%)
Large event claims expense	(45.0)	(45.0)	+0%	(51.0)	(51.0)	+0%	(55.0)	(55.0)	+0%
Management expenses	(130.9)	(130.9)	+0%	(131.7)	(131.6)	(0%)	(136.6)	(136.6)	(0%)
Net Commission Expense	(7.2)	(7.2)	+0%	(8.1)	(8.1)	+0%	(8.8)	(8.8)	+0%
Underwriting profit	23.1	25.9	+12%	51.6	54.2	+5%	62.3	62.6	+0%
Net Investment Income	13.8	13.8	+1%	16.1	16.3	+1%	15.5	15.8	+2%
Other income (costs)	(1.0)	(1.0)	n/a	(1.0)	(1.0)	n/a	(1.0)	(1.0)	n/a
Profit before tax	35.9	38.8	+8%	66.7	69.5	+4%	76.8	77.4	+1%
Tax expense	(10.3)	(11.1)	+8%	(19.0)	(19.7)	+4%	(21.8)	(21.9)	+1%
Profit after taxation from discontinued operation	-	-	n/a	-	-	n/a	-	-	n/a
Underlying Profit after tax	25.6	27.6	+8%	47.8	49.8	+4%	55.0	55.4	+1%
Canterbury impact on outstanding claims	-	-	n/a	-	-	n/a	-	-	n/a
Other non-underlying items	1.1	1.1	n/a	-	-	n/a	-	-	n/a
Reported Profit after tax	26.6	28.7	+8%	47.8	49.8	+4%	55.0	55.4	+1%

Source: Forsyth Barr analysis

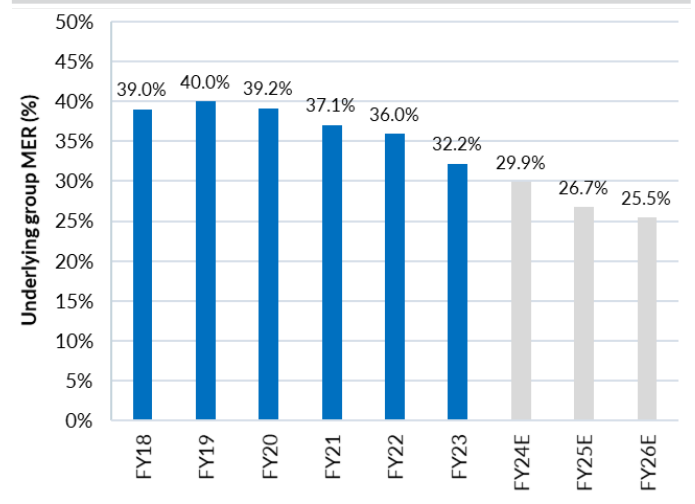
Key charts

Figure 2. TWR – Combined ratio excluding large events



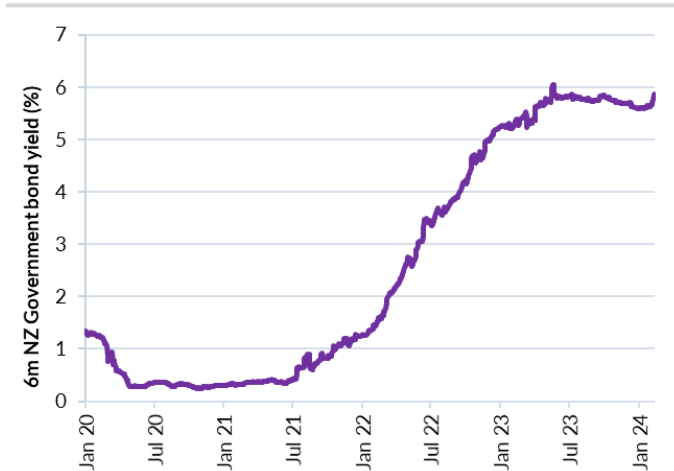
Source: Forsyth Barr analysis

Figure 3. TWR – Underlying group MER (%)



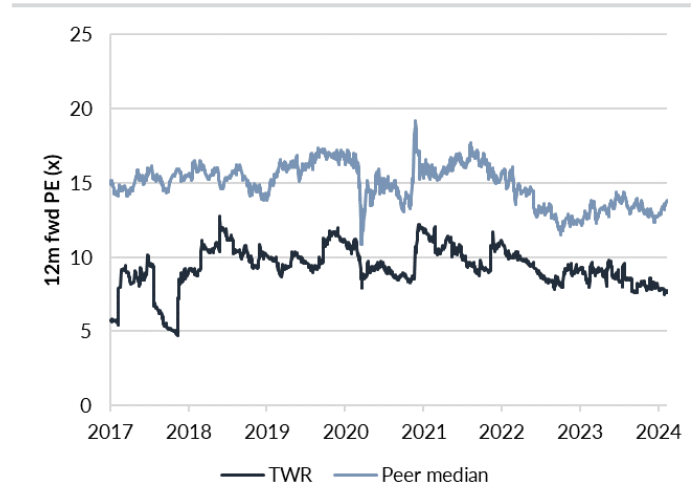
Source: Forsyth Barr analysis

Figure 4. Six month NZ Government bond yield



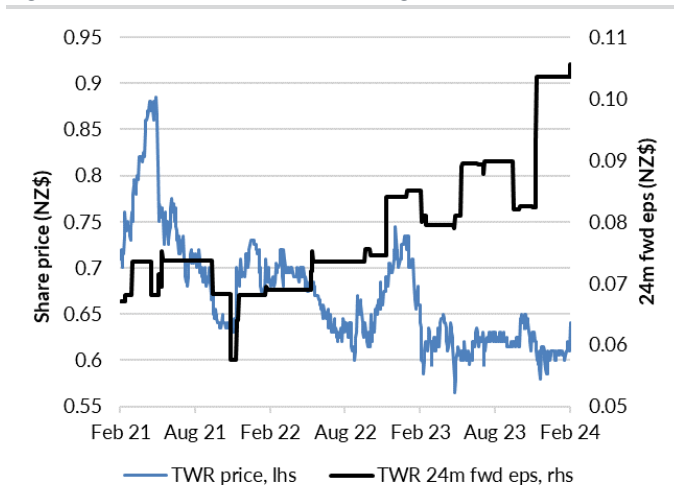
Source: Refinitiv datastream, Forsyth Barr analysis

Figure 5. TWR and peer median 12m fwd PE multiples



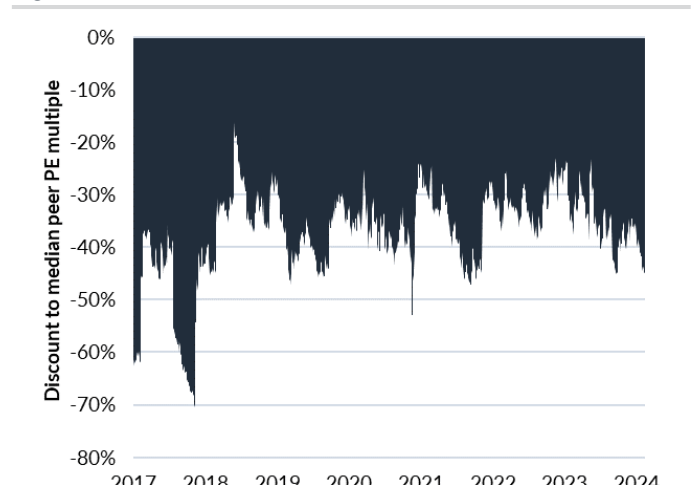
Source: Refinitiv datastream, Forsyth Barr analysis

Figure 6. TWR's share price has diverged from its 24m fwd eps



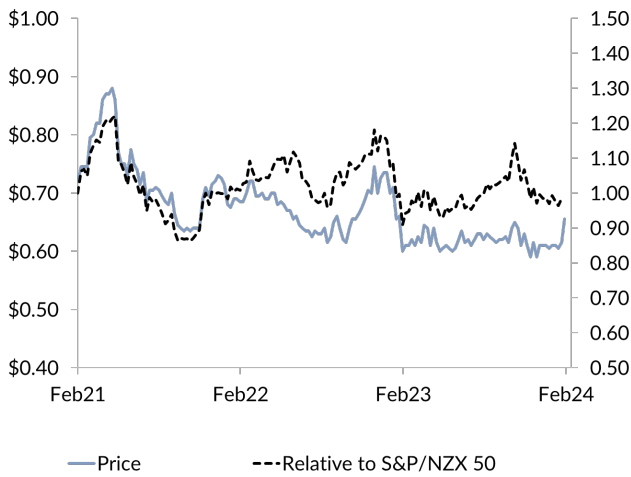
Source: Bloomberg, Forsyth Barr analysis

Figure 7. ... and its discount to peer multiples has widened



Source: Refinitiv datastream, Forsyth Barr analysis

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%

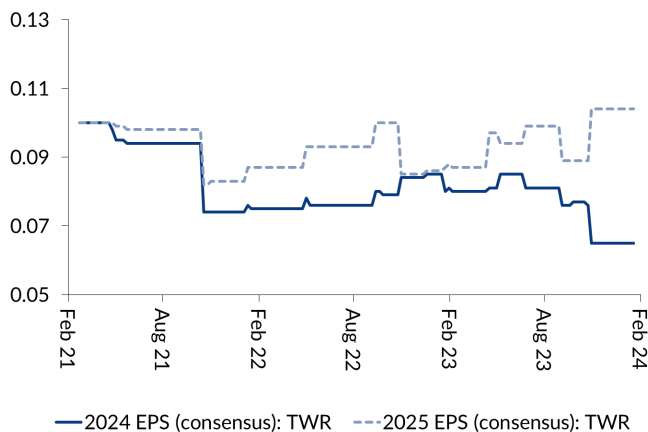
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 10. International valuation comparisons

Company	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash Yld
(metrics re-weighted to reflect TWR's balance date - September)										
				2024E	2025E	2024E	2025E	2024E	2025E	2025E
Tower Ltd	TWR NZ	NZ\$0.66	NZ\$249	9.0x	5.0x	n/a	n/a	n/a	n/a	12.2%
Heartland Group Holdings *	HGH NZ	NZ\$1.22	NZ\$873	8.7x	6.9x	n/a	n/a	n/a	n/a	9.9%
Insurance Australia Group	IAG AT	A\$6.29	A\$15,106	17.1x	15.5x	n/a	n/a	n/a	9.8x	4.8%
Suncorp Group	SUN AT	A\$14.42	A\$18,311	13.4x	13.1x	n/a	42.1x	n/a	48.0x	5.7%
QBE INSURANCE GROUP	QBE AT	US\$10.90	US\$16,286	10.0x	9.2x	n/a	n/a	n/a	8.9x	5.6%
Compco Average:				12.3x	11.2x	n/a	42.1x	n/a	22.2x	6.5%
EV = Mkt cap+net debt+lease liabilities+min interests-investments				TWR Relative:		-27%	-55%	n/a	n/a	87%

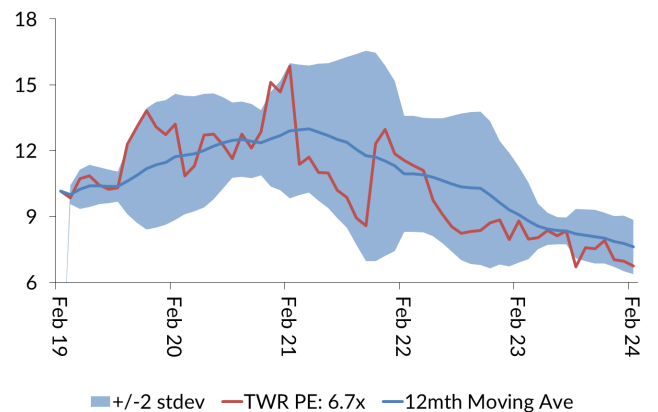
Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (TWR) companies fiscal year end

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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