

# Tower Limited

## Customer Remediation Process Update

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Tower Limited (TWR) has provided an update on its remediation process for customers affected by administrative errors in calculating multi-policy discounts. TWR now expects total costs associated with the remediation to be NZ\$11.2m excluding GST, up from NZ\$6.2m at its 1H23 result in May 2023. Remediation costs include payments to ~65,000 customers and a regulatory penalty provision. Changes to the customer remediation provision are treated as non-underlying, with a portion allocated to premiums (to cover overcharging in prior years), and the remainder going to underwriting expenses. TWR reaffirmed its FY23 underlying profit guidance range of between NZ\$7m and NZ\$10m, and we make no changes to our estimate of NZ\$8.6m. However, we reduce our reported profit estimate by -NZ\$3.8m (after tax), reflecting the provision. TWR is due to report its FY23 results on 23 November 2023. Our blended spot valuation falls by -2cps to NZ\$0.81.

NZX Code	TWR	Financials: Sep/	22A	23E	24E	25E	Valuation (x)	22A	23E	24E	25E
Share price	NZ\$0.62	Rev (NZ\$m)	418.3	472.4	554.2	615.4	PE	13.3	n/a	7.6	5.6
Spot Valuation	NZ\$0.81 (from 0.83)	NPAT* (NZ\$m)	17.7	(0.3)	30.9	42.2	EV/EBIT	n/a	n/a	n/a	n/a
Risk rating	High	EPS* (NZc)	4.7	(0.1)	8.1	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	1.1
Market cap	NZ\$235m	Imputation (%)	0	0	0	0	Cash div yld (%)	10.5	0.0	11.3	12.9
Avg daily turnover	121.0k (NZ\$78k)	*Based on normalised profits					Gross div yld (%)	10.5	0.0	11.3	12.9

### What's changed?

- **Earnings:** FY23 reported profit estimate reduced by -NZ\$3.8m to NZ\$2.0m.
- **Blended spot valuation:** Falls - 3% to NZ\$0.81.

### What caused the issue?

The remediation is due to an error in calculating multi-policy discounts, leading to overcharging some customers. First uncovered by an internal review in 2022, TWR CEO Blair Turnbull said the issue, 'relates to errors that occurred during the process of transitioning customers off a legacy platform. The majority of our customers are now on our modern digital system'. TWR self-reported the issue to the Financial Markets Authority (FMA) in October 2022 and initially set aside a NZ\$3m provision.

### A frustrating (but not unique) issue

While frustrating, administrative errors and oversights leading to customer remediation are not isolated to TWR. In recent years the FMA has intensified its scrutiny and enforcement across the financial sector, leading to an increase in the number of institutions undertaking remediation efforts to address compliance issues and enhance customer fairness. In October 2023, the FMA issued Vero Insurance NZ, a subsidiary of Suncorp Group (SUN.AX), with a NZ\$3.9m fine after it failed to apply multi-policy discounts and overcharged premiums by NZ\$9.9m over eight years (2014–2022). The fine was in addition to >NZ\$14m in customer remediation costs.

### FY23 result preview

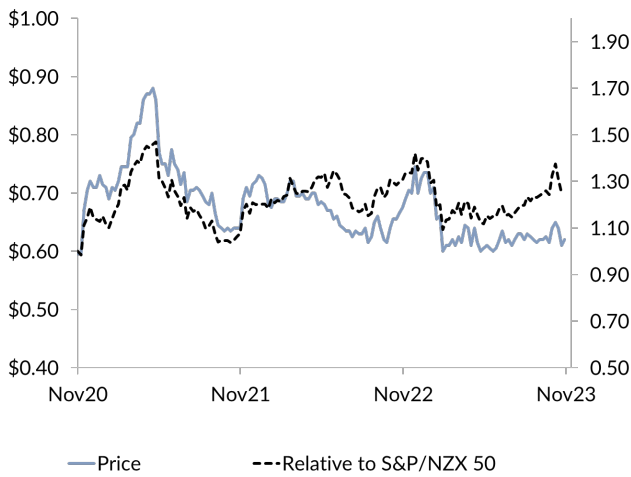
TWR is set to report its FY23 financial results on 23 November 2023. We forecast underlying profit of NZ\$8.6m, near the midpoint of management's guidance range. Points of interest within the result include: (1) GWP growth (FB: +16.4%), (2) management expense ratio (FB: 33.5%), (3) capital position, (4) dividends (FB: no 2H23 dividend), and (5) outlook commentary. In the context of a challenging FY23 year, we estimate a strong rebound in underlying profitability to NZ\$31.3m in FY24.

**Tower Limited (TWR)**

<b>Market data (NZ\$)</b>						<b>Spot valuation (NZ\$)</b>					
Priced as at 14 Nov 2023						0.62	<b>0.81</b>				
52 week high / low						0.75 / 0.57	PE relative 0.74				
Market capitalisation (NZ\$m)						235.3	P/Book relative 0.88				
						DCF 0.80					
<b>Key WACC assumptions</b>						<b>DCF valuation summary (NZ\$m)</b>					
Risk free rate						5.25%	Total firm value 457				
Equity beta						1.18	(Net debt)/cash (50)				
WACC						11.2%	Less: Capitalised operating leases (94)				
Terminal growth						1.8%	Value of equity 313				
<b>Profit and Loss Account (NZ\$m)</b>						<b>Valuation Ratios</b>					
Revenue (GEP)	2021A	2022A	2023E	2024E	2025E	2021A	2022A	2023E	2024E	2025E	
Revenue (GEP)	386.6	418.3	472.4	554.2	615.4	EV/Sales (x)	n/a	n/a	n/a	n/a	
<b>Normalised EBITDA</b>	<b>n/a</b>	<b>n/a</b>	<b>n/a</b>	<b>n/a</b>	<b>n/a</b>	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	
<b>Normalised EBIT</b>	<b>n/a</b>	<b>n/a</b>	<b>n/a</b>	<b>n/a</b>	<b>n/a</b>	PE (x)	14.2	13.3	n/a	7.6	
Net interest	n/a	n/a	n/a	n/a	n/a	Price/NTA (x)	1.1	1.4	1.4	1.3	
Associate income	0	0	0	0	0	Free cash flow yield (%)	40.1	15.5	11.9	29.7	
Tax	(9.2)	(7.5)	(2.9)	(14.6)	(19.4)	Adj. free cash flow yield (%)	40.1	15.5	11.9	29.7	
Minority interests	0.6	0.1	0	0	0	Net dividend yield (%)	8.1	10.5	0.0	11.3	
<b>Normalised NPAT</b>	<b>20.8</b>	<b>27.4</b>	<b>8.6</b>	<b>31.3</b>	<b>42.3</b>	Gross dividend yield (%)	8.1	10.5	0.0	11.3	
Abnormals/other	(1.5)	(8.5)	(6.6)	0.7	0						
<b>Reported NPAT</b>	<b>19.3</b>	<b>18.9</b>	<b>2.0</b>	<b>31.9</b>	<b>42.3</b>						
Normalised EPS (cps)	4.4	4.7	(0.1)	8.1	11.1	<b>Key Ratios</b>					
DPS (cps)	5.0	6.5	0	7.0	8.0	2021A	2022A	2023E	2024E	2025E	
						Return on assets (%)	n/a	n/a	n/a	n/a	
						Return on equity (%)	5.3	5.8	-0.1	9.7	
						Return on funds employed (%)	4.6	5.1	-0.1	8.9	
						EBITDA margin (%)	n/a	n/a	n/a	n/a	
						EBIT margin (%)	n/a	n/a	n/a	n/a	
						Capex to sales (%)	3.1	4.1	3.1	2.7	
						Capex to depreciation (%)	n/a	n/a	n/a	n/a	
						Imputation (%)	0	0	0	0	
						Pay-out ratio (%)	115	140	0	86	
						<b>Capital Structure</b>					
						2021A	2022A	2023E	2024E	2025E	
						Solvency capital	155.9	150.5	179.4	136.4	163.6
						Minimum solvency capital (MSC)	56.6	52.3	66.3	66.5	76.5
						Total regulatory capital	106.6	102.3	83.3	91.3	91.3
						Solvency ratio (%)	275	287	271	205	214
						<b>Operating Performance</b>					
						2021A	2022A	2023E	2024E	2025E	
						Gross written premium	396.0	445.6	518.9	589.4	641.4
						<b>Gross earned premium</b>	<b>386.6</b>	<b>418.3</b>	<b>472.4</b>	<b>554.2</b>	<b>615.4</b>
						Reinsurance premium	(58.8)	(66.3)	(89.1)	(85.0)	(93.4)
						<b>Net earned premium</b>	<b>327.9</b>	<b>352.1</b>	<b>383.4</b>	<b>469.2</b>	<b>522.0</b>
						Net claims expense	(202.3)	(224.9)	(294.3)	(328.4)	(359.9)
						* 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)	(148.9)
						<b>Underwriting profit</b>	<b>27.2</b>	<b>23.6</b>	<b>(13.3)</b>	<b>30.5</b>	<b>46.8</b>
						Investment and other revenue	0.2	1.2	14.1	15.9	15.8
						Financing and other costs	(0.4)	(0.9)	(0.9)	(0.9)	(1.0)
						<b>Profit before tax (from continuing operations)</b>	<b>27.6</b>	<b>25.2</b>	<b>2.5</b>	<b>45.5</b>	<b>61.6</b>
						Tax expense	(9.2)	(7.5)	(2.9)	(14.6)	(19.4)
						<b>Profit after taxation</b>	<b>18.4</b>	<b>17.7</b>	<b>-0.3</b>	<b>30.9</b>	<b>42.2</b>
						NPAT (from discontinued operation)	(0.2)	5.1	2.3	1.1	0.1
						<b>NPAT (Reported)</b>	<b>18.2</b>	<b>22.8</b>	<b>2.0</b>	<b>31.9</b>	<b>42.3</b>
						<b>Key ratios</b>					
						Total GWP growth %	5.0%	12.5%	16.5%	13.6%	8.8%
						Total claims ratio %	54.3%	54.1%	66.2%	63.2%	62.5%
						MER %	37.1%	36.0%	33.5%	30.2%	28.5%
						Combined ratio %	91.4%	90.1%	100.5%	93.4%	91.0%

\* 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](http://www.forsythbarr.co.nz/corporate-news-events/cesg-report)

**Figure 1. Price performance**



Source: Forsyth Barr analysis

**Figure 2. 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%

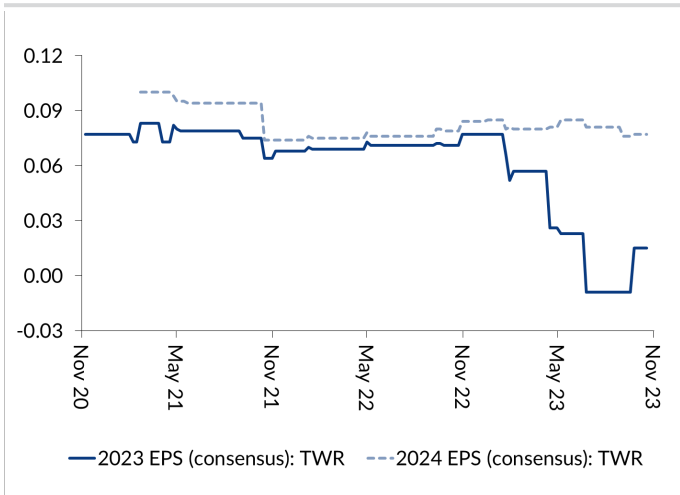
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

**Figure 3. 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
(metrics re-weighted to reflect TWR's balance date - September)										
Tower Ltd	TWR NZ	NZ\$0.62	NZ\$235	<0x	7.6x	n/a	n/a	n/a	n/a	11.3%
Heartland Group Holdings *	HGH NZ	NZ\$1.62	NZ\$1,159	11.5x	9.6x	n/a	n/a	n/a	n/a	7.5%
Insurance Australia Group	IAG AT	A\$5.79	A\$14,058	16.9x	15.8x	n/a	n/a	n/a	10.2x	4.8%
Suncorp Group	SUN AT	A\$13.32	A\$16,920	14.1x	12.3x	n/a	43.2x	n/a	49.3x	5.7%
QBE INSURANCE GROUP	QBE AT	US\$9.87	US\$14,748	12.7x	9.1x	n/a	n/a	n/a	8.2x	6.0%
<b>Compco Average:</b>				<b>13.8x</b>	<b>11.7x</b>	<b>n/a</b>	<b>43.2x</b>	<b>n/a</b>	<b>22.6x</b>	<b>6.0%</b>
<b>EV = Mkt cap+net debt+lease liabilities+min interests-investments</b>				<b>TWR Relative:</b>		<b>n/a</b>	<b>-35%</b>	<b>n/a</b>	<b>n/a</b>	<b>88%</b>

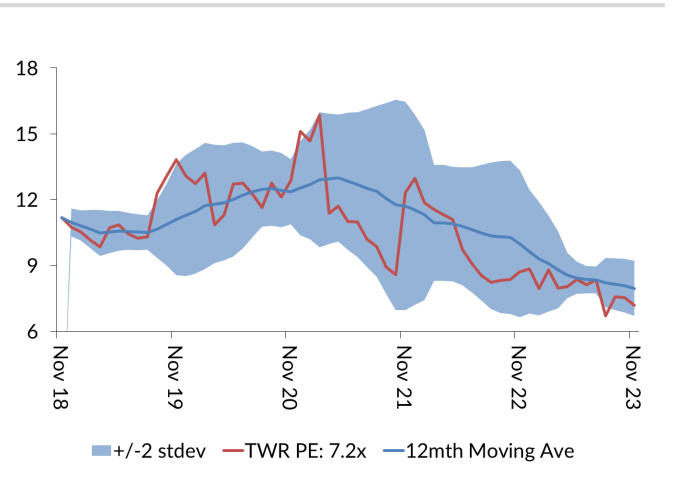
Source: \*Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (TWR) companies fiscal year end

**Figure 4. Consensus EPS momentum (NZ\$)**



Source: Forsyth Barr analysis

**Figure 5. One year forward PE (x)**



Source: Forsyth Barr analysis

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