NEW ZEALAND EQUITY RESEARCH | INSURANCE | GENERAL INSURANCE
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Tower Limited
Wild Weather Weighs but Growth Continues

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Tower Limited's (TWR) market update reflects an exceptionally unusual year of weather in New Zealand and across the Pacific. TWR now expects the Auckland and Upper North Island weather event to have an ultimate cost on its policies of NZ$195m to NZ$225m (up significantly from the previous estimate of between NZ$95m and NZ$125m) and the Cyclone Gabrielle event to cost anywhere from NZ$55m to NZ$75m. For each of these events, costs above NZ$11.9m are covered by TWR's reinsurance programme. Meanwhile, a Category 4 and Category 5 cyclone struck Vanuatu between 1 March and 5 March 2023, at an estimated cost to TWR of NZ$10m, net of reinsurance claims. TWR reduced its FY23 NPAT guidance to between NZ$8m–NZ$13m from a range of NZ$18m–NZ$23m, a ~50% downgrade at the midpoint. It now expects a reported net loss after taxation for 1H23 of circa -NZ$3m on 25 May 2023, and will not pay a half-year dividend. The new guidance reflects increased reinstatement costs for reinsurance arrangements and an increase in the FY23 large events allowance from NZ$40m to NZ$50m, mainly in the wake of the Vanuatu cyclones. TWR increased its FY23 guidance for GWP growth to a range of between +15% and +20% from a range of +10% to +15% as it 1) passes on inflationary and reinsurance costs onto customers, and 2) gains market share. Our blended spot valuation rises +1% to NZ$0.79.

NZX Code	TWR
Share price	NZ$0.58
Spot Valuation	NZ$0.79 (from 0.78)
Risk rating	High
Issued shares	379.5m
Market cap	NZ$220m
Avg daily turnover	140.3k (NZ$92k)

Financials: Sep/	22A	23E	24E	25E
Rev (NZ$m)	418.3	485.2	564.6	625.3
NPAT* (NZ$m)	17.7	9.9	36.6	44.8
EPS* (NZc)	4.7	2.6	9.6	11.8
DPS (NZc)	6.5	2.5	7.0	8.0
Imputation (%)	0	0	0	0
*Based on normalised profits				

Valuation (x)	22A	23E	24E	25E
PE	12.5	22.3	6.0	4.9
EV/EBIT	n/a	n/a	n/a	n/a
EV/EBITDA	n/a	n/a	n/a	n/a
Price / NTA	1.3	1.3	1.1	1.0
Cash div yld (%)	11.2	4.3	12.1	13.8
Gross div yld (%)	11.2	4.3	12.1	13.8

What's changed?

- **Earnings:** Our underlying NPAT estimates fall -47% to NZ$10.8m in FY23, lift +4% to NZ$36.6m in FY24 and rise +20% to NZ$44.8m in FY25.
- **Spot valuation:** Rises +1cps to NZ$0.79.

March cyclones make for an exceptional year of events

On 27 January 2023, Auckland and other regions in the upper North Island of NZ experienced heavy rainfall, which led to catastrophic flooding and landslides. The second round of estimates from PERILS, as at 3 May 2023, for the total insurance cost of the event are at least NZ$1.75b. Soon after, on 6 February 2023, Cyclone Gabrielle struck the east of the North Island, causing damage which led to in excess of 40,000 claims for damages at a minimum cost to insurers of NZ$1.16b. We consider these two industry estimates as likely conservative. Cyclones Judy and Kevin, which struck Vanuatu in early March 2023, are the latest in a string of unprecedented weather events which have caused widespread damage and disruption in TWR's key geographies in FY23.

Earnings and valuation update

In the wake of TWR's market update we reduce our FY23 underlying profit after tax forecast by -47% from NZ$20.2m to NZ$10.8m, primarily driven by a NZ$10m (+25%) increase in the large claims expense following the Vanuatu cyclones. However, operational leverage from increased GWP growth estimates in later years flows through to a +4% and +20% rise in our underlying NPAT estimates in FY24 and FY25, respectively. Our spot DCF valuation rises to NZ$0.83, +12% despite the material downgrade in FY23. Looking past FY23, TWR appears undervalued relative to its peer group. If TWR can achieve our FY24 reported NPAT forecast of NZ$36.6m, representing EPS of 9.6 cents, it would be trading on ~6x earnings, well below the peer average of ~11x.

Tower Limited (TWR)

Market data (NZ$)	
Priced as at 08 May 2023	**0.58**
52 week high / low	0.75 / 0.58
Market capitalisation (NZ$m)	220.1

Key WACC assumptions	
Risk free rate	4.50%
Equity beta	1.10
WACC	10.1%
Terminal growth	1.8%

Profit and Loss Account (NZ$m)	2021A	2022A	2023E	2024E	2025E
Revenue (GEP)	386.6	418.3	485.2	564.6	625.3
Normalised EBITDA	**n/a**	**n/a**	**n/a**	**n/a**	**n/a**
Depreciation and amortisation	n/a	n/a	n/a	n/a	n/a
Normalised EBIT	**n/a**	**n/a**	**n/a**	**n/a**	**n/a**
Net interest	n/a	n/a	n/a	n/a	n/a
Associate income	0	0	0	0	0
Tax	(9.2)	(7.5)	(5.4)	(16.8)	(20.5)
Minority interests	0.6	0.1	0	0	0
Normalised NPAT	**20.8**	**27.4**	**10.8**	**36.6**	**44.8**
Abnormals/other	(1.5)	(8.5)	1.2	0	0
Reported NPAT	**19.3**	**18.9**	**12.0**	**36.6**	**44.8**
Normalised EPS (cps)	4.4	4.7	2.6	9.6	11.8
DPS (cps)	5.0	6.5	2.5	7.0	8.0

Growth Rates	2021A	2022A	2023E	2024E	2025E
Revenue (%)	3.8	8.2	16.0	16.4	10.8
EBITDA (%)	n/a	n/a	n/a	n/a	n/a
EBIT (%)	n/a	n/a	n/a	n/a	n/a
Normalised NPAT (%)	49.1	-4.0	-44.2	>100	22.6
Normalised EPS (%)	49.1	6.7	-44.2	>100	22.6
Ordinary DPS (%)	n/a	30.0	-61.5	>100	14.3

Cash Flow (NZ$m)	2021A	2022A	2023E	2024E	2025E
EBITDA	**n/a**	**n/a**	**n/a**	**n/a**	**n/a**
Working capital change	n/a	n/a	n/a	n/a	n/a
Interest & tax paid	0	0	0	0	0
Other	0	0	0	0	0
Operating cash flow	**98.1**	**59.8**	**68.4**	**103.2**	**98.8**
Capital expenditure	(12.0)	(17.3)	(14.7)	(15.1)	(15.4)
(Acquisitions)/divestments	(14.4)	(6.1)	(4.1)	0	0
Other	(24.9)	(21.1)	(7.1)	(8.2)	(8.8)
Funding available/(required)	**46.8**	**15.3**	**42.5**	**79.9**	**74.6**
Dividends paid	(8.9)	(20.0)	(9.5)	(26.6)	(30.4)
Equity raised/(returned)	0	(30.6)	0	0	0
(Increase)/decrease in net debt	**37.9**	**(35.4)**	**33.0**	**53.3**	**44.3**

Balance Sheet (NZ$m)	2021A	2022A	2023E	2024E	2025E
Working capital	148.0	183.2	238.0	274.2	293.1
Fixed assets	9.4	5.4	3.7	3.7	3.7
Intangibles	120.6	132.5	136.1	135.3	135.1
Right of use asset	25.6	23.3	20.7	18.1	15.6
Other assets	314.8	295.6	295.6	295.6	295.6
Total funds employed	**618.4**	**640.0**	**694.1**	**727.0**	**743.1**
Net debt/(cash)	(116.1)	(84.5)	(117.5)	(170.8)	(215.1)
Lease liability	39.4	35.1	31.2	27.3	23.4
Other liabilities	342.5	383.5	471.0	539.3	575.1
Shareholder's funds	349.9	306.0	309.5	331.2	359.6
Minority interests	2.7	0	0	0	0
Total funding sources	**618.4**	**640.0**	**694.1**	**727.0**	**743.1**

* 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

Spot valuation (NZ$)	**0.79**
PE relative	0.75
P/Book relative	0.79
DCF	0.83

DCF valuation summary (NZ$m)	
Total firm value	452
(Net debt)/cash	(32)
Less: Capitalised operating leases	(90)
Value of equity	330

Valuation Ratios	2021A	2022A	2023E	2024E	2025E
EV/Sales (x)	n/a	n/a	n/a	n/a	n/a
EV/EBITDA (x)	n/a	n/a	n/a	n/a	n/a
EV/EBIT (x)	n/a	n/a	n/a	n/a	n/a
PE (x)	13.3	12.5	22.3	6.0	4.9
Price/NTA (x)	1.1	1.3	1.3	1.1	1.0
Free cash flow yield (%)	42.9	16.6	21.2	36.3	33.9
Adj. free cash flow yield (%)	42.9	16.6	21.2	36.3	33.9
Net dividend yield (%)	8.6	11.2	4.3	12.1	13.8
Gross dividend yield (%)	n/a	11.2	4.3	12.1	13.8

Key Ratios	2021A	2022A	2023E	2024E	2025E
Return on assets (%)	n/a	n/a	n/a	n/a	n/a
Return on equity (%)	5.3	5.8	3.2	11.0	12.5
Return on funds employed (%)	4.6	5.1	2.9	10.1	11.6
EBITDA margin (%)	n/a	n/a	n/a	n/a	n/a
EBIT margin (%)	n/a	n/a	n/a	n/a	n/a
Capex to sales (%)	3.1	4.1	3.0	2.7	2.5
Capex to depreciation (%)	n/a	n/a	n/a	n/a	n/a
Imputation (%)	n/a	0	0	0	0
Pay-out ratio (%)	115	140	96	73	68

Capital Structure	2021A	2022A	2023E	2024E	2025E
Solvency capital	155.9	150.5	179.4	136.4	170.3
Minimum solvency capital (MSC)	56.6	52.3	66.3	66.5	77.4
Total regulatory capital	106.6	102.3	83.3	91.3	91.3
Solvency ratio (%)	275	287	271	205	220

Operating Performance	2021A	2022A	2023E	2024E	2025E
Gross written premium	396.0	445.6	524.7	604.5	646.2
Gross earned premium	**386.6**	**418.3**	**485.2**	**564.6**	**625.3**
Reinsurance premium	(58.8)	(66.3)	(84.1)	(95.5)	(105.2)
Net earned premium	**327.9**	**352.1**	**401.0**	**469.1**	**520.1**
Net claims expense	(202.3)	(224.9)	(291.3)	(315.2)	(349.6)
* includes Large event claims of	(13.9)	(19.0)	(50.0)	(42.0)	(44.0)
Management & sales expenses	(123.3)	(129.9)	(140.2)	(151.5)	(157.9)
Underwriting profit	27.2	23.6	3.5	38.4	50.0
Investment and other revenue	0.2	1.2	13.6	15.9	16.3
Financing and other costs	(0.4)	(0.9)	(0.9)	(0.9)	(1.0)
Profit before tax (from continuing operations)	**27.6**	**25.2**	**15.2**	**53.4**	**65.4**
Tax expense	(9.2)	(7.5)	(5.4)	(16.8)	(20.5)
Profit after taxation	**18.4**	**17.7**	**9.9**	**36.6**	**44.8**
NPAT (from discontinued operation)	(0.2)	5.1	2.1	0	0
NPAT (Reported)	**18.2**	**22.8**	**12.0**	**36.6**	**44.8**

Key ratios	2021A	2022A	2023E	2024E	2025E
Total GWP growth %	5.0%	12.5%	17.8%	15.2%	6.9%
Total claims ratio %	54.3%	54.1%	64.2%	59.5%	60.0%
MER %	37.1%	36.0%	35.0%	32.3%	30.4%
Combined ratio %	91.4%	90.1%	99.1%	91.8%	90.4%

Earnings revisions

We revise our FY23 underlying NPAT estimate downwards by -47% from NZ$20.2m to NZ$10.8m (within the new guidance range of NZ$8m–NZ$13m). This includes a NZ$10m increase (+25% to NZ$50m) to the FY23 large event claims expense following the cyclones in Vanuatu. Our FY23 reported profit estimate is NZ$12.0m, with gains on sales from TWR's Suva building (+NZ$1.1m) and its Papua New Guinea subsidiary (+NZ$2.1m); partially offset by ~NZ$2m in estimated costs relating to further new claims from the Christchurch earthquakes (due to further inflationary costs and new claims passed on by EQC).

We now anticipate GWP growth will be stronger than previously modelled as TWR continues to successfully pass on inflationary costs to customers and generate market share gains. Our GWP estimates for FY23 now see growth of +17.8% over FY22 (within the new +15%–+20% GWP growth guidance) and FY24 rises +15.2% on FY23, meaning GWP in dollar terms increases by +2% in FY23, +3% in FY24, and +3% in FY25 relative to our prior estimates.

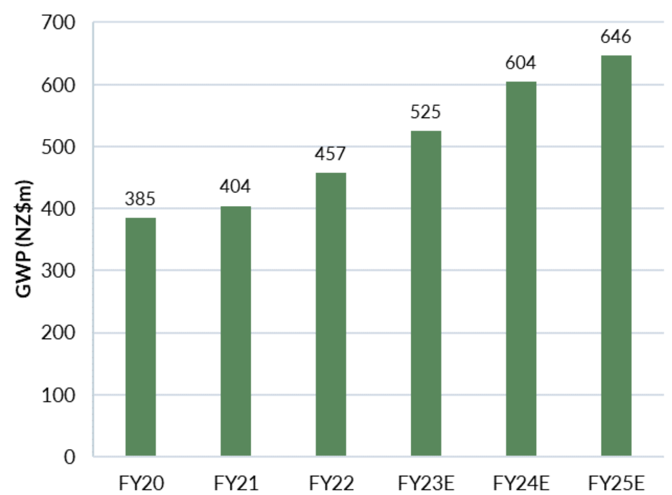
Given the operational leverage and benefits of scale from increased GWP plus higher estimates for investment income, our underlying NPAT forecasts in FY24 and FY25 rise +4% and +20%, respectively. Our estimates for FY23 assume the full NZ$50m in large event claims are utilised, and NZ$42m and NZ$44m in FY24 and FY25, respectively. These large event claims estimates remain well above recent averages, providing scope for an improved year if a more normalised incidence of storms occur.

Figure 1. Earnings revisions (NZ$m)

	FY23E			FY24E			FY25E		
	Old	New	Change	Old	New	Change	Old	New	Change
Gross written premium	512.4	524.7	2%	585.6	604.5	3%	626.0	646.2	3%
Gross earned premium	479.0	485.2	1%	549.0	564.6	3%	605.8	625.3	3%
Reinsurance expense	(81.8)	(84.1)	3%	(92.1)	(95.5)	4%	(101.0)	(105.2)	4%
Net earned premium	397.2	401.0	1%	456.9	469.1	3%	504.7	520.1	3%
Net claims expense	(202.1)	(207.3)	3%	(230.1)	(237.1)	3%	(266.2)	(268.3)	1%
Large event claims expense	(40.0)	(50.0)	25%	(40.0)	(42.0)	5%	(42.0)	(44.0)	5%
Management and sales expenses	(139.0)	(140.2)	1%	(150.0)	(151.5)	1%	(155.9)	(157.9)	1%
Underwriting profit	**16.1**	**3.5**	**-79%**	**36.8**	**38.4**	**4%**	**40.6**	**50.0**	**23%**
Investment and other revenue	14.5	13.6	-6%	15.3	15.9	4%	15.0	16.3	9%
Financing costs	(0.9)	(0.9)	0%	(0.9)	(0.9)	0%	(1.0)	(1.0)	0%
Underlying profit before tax	29.7	16.1	-46%	51.1	53.4	4%	54.6	65.4	20%
Income tax expense	(9.5)	(5.4)	-43%	(16.1)	(16.8)	4%	(17.2)	(20.5)	19%
Underlying profit after tax	**20.2**	**10.8**	**-47%**	**35.0**	**36.6**	**4%**	**37.4**	**44.8**	**20%**
Reported profit / (loss) after tax	**22.4**	**12.0**	**-47%**	**35.0**	**36.6**	**4%**	**37.4**	**44.8**	**20%**

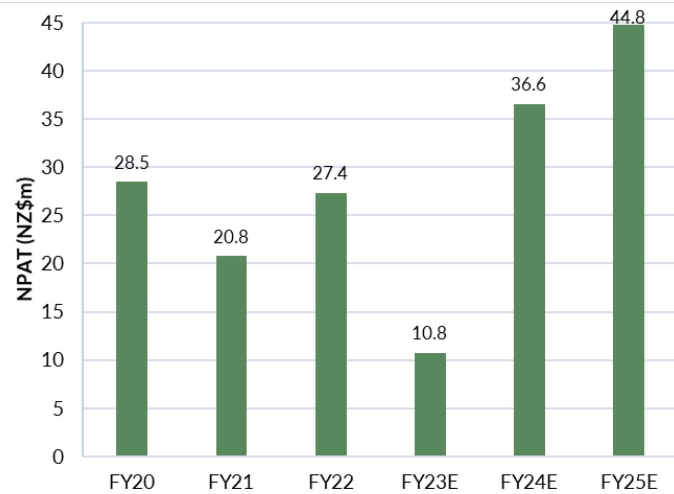
Source: Forsyth Barr analysis

Figure 2. TWR – Underlying GWP NZ$m



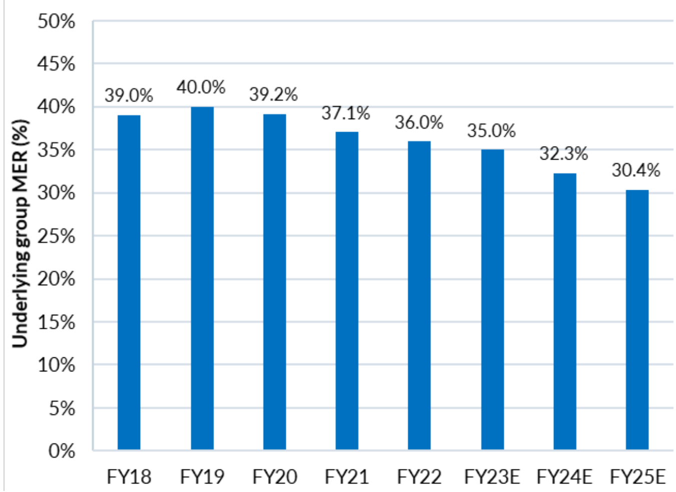
Source: Forsyth Barr analysis

Figure 3. TWR – Underlying NPAT NZ$m



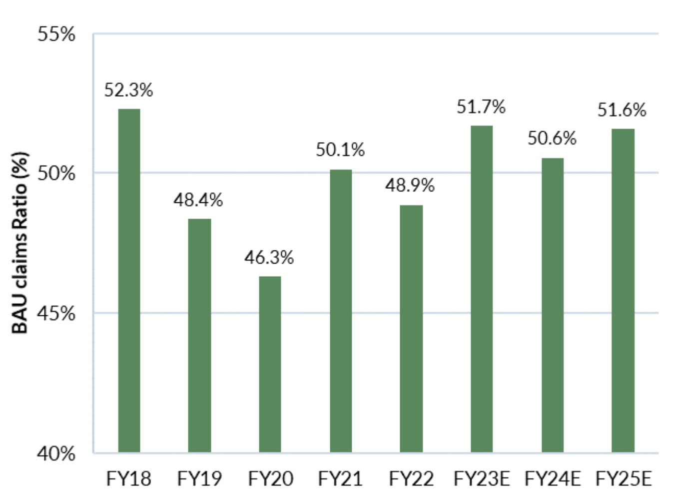
Source: Forsyth Barr analysis

Figure 4. TWR – Underlying group MER (%)



Source: Forsyth Barr analysis

Figure 5. TWR – BAU claims ratio (excluding large events)



Source: Forsyth Barr analysis

Judy and Kevin exacerbate claims — Vanuatu cyclones

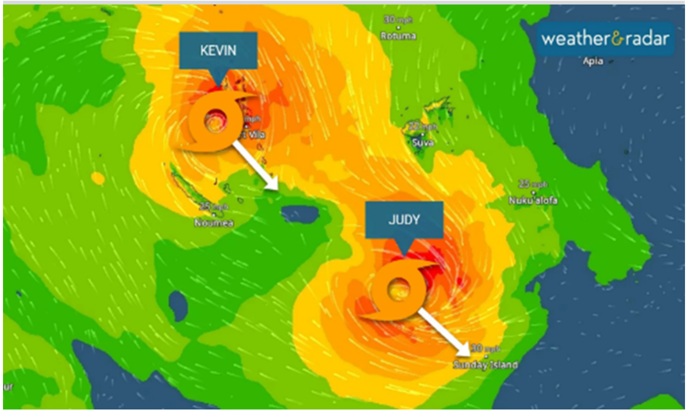
Between 1 March 2023 and 5 March 2023, cyclone Judy (a category 4) and cyclone Kevin (a category 5) struck Vanuatu within 48 hours. The cyclones caused widespread damage in the northwest and northeast of Vanuatu, impacting 200,000 people, representing over 60% of the country's population. The consecutive cyclones displaced at least 5,000 people as strong winds and flooding wreaked havoc on the island nation. Although cyclones and extreme weather events are not infrequent in the Pacific, Judy and Kevin struck Port Vila, Vanuatu's capital, exacerbating the damage. It is estimated that one in every five homes in Vanuatu were significantly damaged.

TWR received 250 claims from the consecutive cyclone events and expects a net financial impact of -NZ$10m after reinsurance costs.

Figure 6. Damage in Port Vila after Cyclone Judy

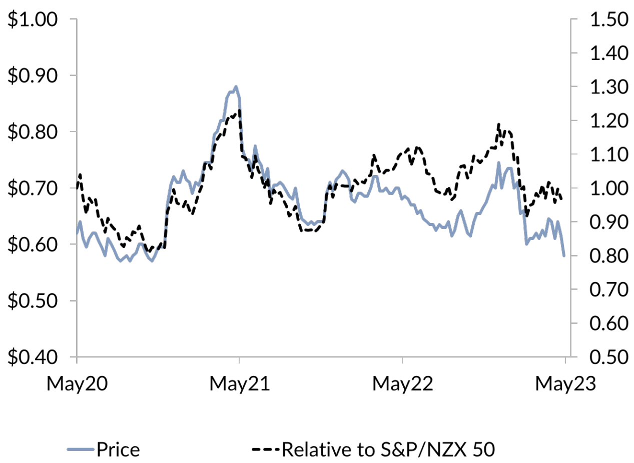
Source: RNZ, World Vision

Figure 7. Cyclones Judy and Kevin both struck within 48 hours



Source: Weather and Radar

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%
Investment Services Group	5.4%
NZ Funds Management	5.2%

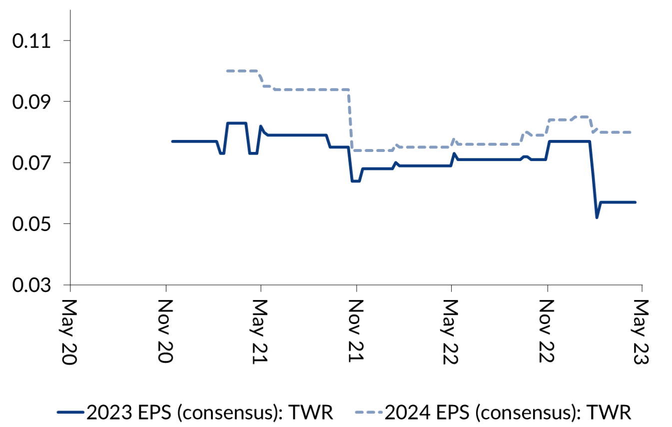
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 10. International valuation comparisons

Company	Code	Price	Mkt Cap	PE		EV/EBITDA		EV/EBIT		Cash Yld
(metrics re-weighted to reflect TWR's balance date - September)			(m)	2023E	2024E	2023E	2024E	2023E	2024E	2024E
Tower Ltd	**TWR NZ**	**NZ$0.58**	**NZ$220**	**22.3x**	**6.0x**	**n/a**	**n/a**	**n/a**	**n/a**	**12.1%**
Heartland Group Holdings *	HGH NZ	NZ$1.54	NZ$1,093	10.0x	8.9x	n/a	n/a	n/a	n/a	7.9%
Insurance Australia Group	IAG AT	A$4.96	A$12,152	19.9x	13.2x	n/a	n/a	n/a	9.6x	5.6%
Suncorp Group	SUN AT	A$12.50	A$15,832	12.6x	12.2x	n/a	52.3x	n/a	51.7x	6.4%
QBE INSURANCE GROUP	QBE AT	US$10.36	US$15,458	12.6x	9.6x	n/a	n/a	n/a	8.4x	5.3%
			Compco Average:	**13.8x**	**11.0x**	**n/a**	**52.3x**	**n/a**	**23.2x**	**6.3%**
EV = Mkt cap+net debt+lease liabilities+min interests-investments			**TWR Relative:**	**62%**	**-45%**	**n/a**	**n/a**	**n/a**	**n/a**	**92%**

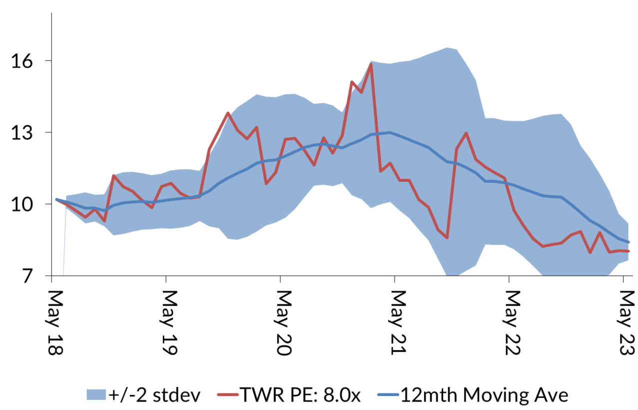
Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (TWR) companies fiscal year end

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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