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NEW ZEALAND EQUITY RESEARCH INSURANCE GENERAL INSURANCE
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Tower Limited Calm Claims Help Elevate Profit Projections

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Tower (TWR) has upgraded FY24 guidance for the third time in the past six months, reflecting continued operational improvements and a benign claims environment. Underlying NPAT is now expected to be >NZ\$40m, +14% ahead of the prior guidance of >NZ\$35m and slightly ahead of our prior estimate (normalising for our lower large events assumption of NZ\$20.5m). Management continues to conservatively assume full utilisation of its NZ\$45m large events allowance in FY24 despite no large events thus far in the year. As such, earnings will likely be significantly above this new FY24 guidance if there are limited large events in the year's final four months. We consider this update constructive for building market confidence around the medium-term targets provided at its ASM in February 2024. Our blended spot valuation of NZ\$1.50 is materially above the current share price. Still, it represents just ~8.2x the midpoint of TWR's FY26 underlying NPAT target range of NZ\$60m to NZ\$80m, which we see as potentially conservative (FB: NZ\$74.4m).

NZX Code	TWR	Financials: Sep/	23A	24E	25E	26E	Valuation (x)	23A	24E	25E	26E
Share price	NZ\$0.85	Rev (NZ\$m)	470.8	559.1	640.5	713.4	PE	n/a	5.6	5.9	4.3
Spot Valuation	NZ\$1.50 (from 1.46)	NPAT* (NZ\$m)	2.4	57.9	55.0	74.4	EV/EBIT	n/a	n/a	n/a	n/a
Risk rating	High	EPS* (NZc)	0.6	15.2	14.5	19.6	EV/EBITDA	n/a	n/a	n/a	n/a
Issued shares	379.5m	DPS (NZc)	0.0	7.0	8.0	9.0	Price / NTA	2.0	1.7	1.6	1.5
Market cap	NZ\$323m	Imputation (%)	0	0	0	100	Cash div yld (%)	0.0	8.2	9.4	10.6
Avg daily turnover	159.5k (NZ\$109k)	*Based on normalised profits				Gross div yld (%)	0.0	8.2	9.4	14.7	

What's changed?

- Earnings: Our FY24 underlying NPAT estimate increases +5% on lower BAU claims. FY25 and FY26 are largely unchanged.
- Blended spot valuation: Increases +3% to NZ\$1.50.

Third guidance upgrade in six months

TWR has now upgraded FY24 underlying NPAT guidance three times in the last six months, with the range moving from 'between NZ\$22m and NZ\$27m' to 'greater than NZ\$40m'. Pleasingly, these upgrades have been driven by a mix of both operational performance improvements and benign weather events. TWR, however, partially attributed this most recent guidance upgrade to two months of benign weather, implying lower-than-expected business-as-usual (BAU) claims.

Further upside remains if there are no large events in the remaining four months of FY24

Despite two storms in May, TWR has yet to experience a 'large event' in FY24. However, management has chosen to conservatively retain its full NZ\$45m large events allowance in providing guidance. In a scenario with zero large events in the remaining four months of the year, FY24 underlying NPAT would be at least NZ\$72m (post the after-tax impact of unwinding the large events allowance).

Operational performance building credibility in the market

Following FY23's large events, TWR has recognised the need to reduce the volatility of its earnings and build confidence in the market through conservatism. Multiple profit upgrades in FY24 endorse this strategy and help strengthen the credibility of TWR's medium-term targets. We expect TWR to re-rate as the market gains comfort around these targets, implying significant share price upside given the low multiple base, with TWR trading on just ~4.6x the midpoint of the FY26 underlying NPAT target range versus its tenyear average 24-month forward PE of 8.3x. TWR's Australasian insurance peers trade on 24-month forward PE multiples between ~10x and ~16x. **NOTE: Our earnings forecasts do not yet incorporate the new IFRS 17 and Interim Solvency Standard 2023 (ISS) standards, and remain subject to the prior IFRS 4 accounting basis.** See the Appendix for more information.

Tower Limited (TWR)

Market data (NZ\$)					
Priced as at 11 Jun 2024					0.85
52 week high / low					0.85/0.58
Market capitalisation (NZ\$m)					322.6
Key WACC assumptions					
Risk free rate					5.00%
Equity beta					1.18
WACC Terminal growth					11.0% 1.8%
Terminal growth					1.8%
Profit and Loss Account (NZ\$m)	2022A	2023A	2024E	2025E	2026E
Revenue (GEP)	409.6	470.8	559.1	640.5	713.4
Normalised EBITDA	n/a	n/a	n/a	n/a	n/a
Depreciation and amortisation Normalised EBIT	n/a	n/a	n/a	n/a	
Net interest	n/a n/a	n/a n/a	n/a n/a	n/a n/a	n/a n/a
Associate income	0	11/a 0	0	0	11/a 0
Tax	(7.5)	(5.1)	(23.2)	(21.8)	(29.3)
Minority interests	0.1	(3.1)	(23.2)	(21.0)	(27.3)
Normalised NPAT	27.4	7.6	58.7	55.0	74.4
Abnormals/other	(8.5)	(8.8)	(0.6)	0	0
Reported NPAT	18.9	(1.2)	58.1	55.0	74.4
Normalised EPS (cps)	4.6	0.6	15.2	14.5	19.6
DPS (cps)	6.5	0	7.0	8.0	9.0
Growth Rates	2022A	2023A	2024E	2025E	2026E
Revenue (%)	5.9	14.9	18.8	14.6	11.4
EBITDA (%)	n/a	n/a	n/a	n/a	n/a
EBIT (%)	n/a	n/a	n/a	n/a	n/a
Normalised NPAT (%)	-4.9	-86.6	>100	-4.9	35.1
Normalised EPS (%)	5.6	-86.6	>100	-4.9	35.1
Ordinary DPS (%)	30.0	-100.0	n/a	14.3	12.5
Cash Flow (NZ\$m)	2022A	2023A	2024E	2025E	2026E
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	59.8	10.0	141.7	99.7	99.7
Capital expenditure	(17.3)	(12.0)	(18.2)	(18.6)	(19.1)
(Acquisitions)/divestments Other	(6.1)	(5.9)	0	0	0
Funding available/(required)	(21.1) 15.3	(1.3)	(8.1) 115.5	(9.0) 72.0	(10.1) 70.6
Dividends paid	(20.0)	(9.2) (15.2)	(26.6)	(30.4)	(34.2)
Equity raised/(returned)	(20.0)	(13.2)	(20.0)	(30.4)	(34.2)
(Increase)/decrease in net debt	(35.4)	(24.4)	88.9	41.7	36.4
Balance Sheet (NZ\$m)	2022A	2023A	2024E	2025E	2026E
Working capital	183.2	336.8	503.2	559.3	
Fixed assets	5.4	6.3	8.1	9.7	11.4
Intangibles	132.5	138.5	145.6	152.6	159.3
Right of use asset	23.3	23.2	20.6	18.0	15.4
Other assets	295.6	286.7	371.1	410.7	445.3
Total funds employed	640.0	791.4	1,048.6	1,150.3	1,255.5
Net debt/(cash)	(84.5)	(64.0)	(68.5)	(70.5)	(72.4)
Lease liability	35.1	32.6	28.7	24.8	20.9
Other liabilities	383.5	526.5	755.6	838.4	934.0
Shareholder's funds	306.0	296.3	332.8	357.6	373.0
Minority interests	0	0	0	0	0
Total funding sources * Forsyth Barr target prices reflect va	640.0	791.4	1,048.6	1,150.3	1,255.5

Spot valuation (NZ\$) 1.50 PF relative 171 P/Book relative 1.05 DCF 1.75 DCF valuation summary (NZ\$m) Total firm value 754 (Net debt)/cash (31) Less: Capitalised operating leases (48) Value of equity 675 Valuation Ratios 2022A 2023A 2024E 2025E 2026E EV/Sales (x) 0.0 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) 18.4 >100x 5.6 5.9 4.3 Price/NTA (x) 1.7 1.9 2.0 1.5 1.6 Free cash flow vield (%) 11.3 -27 35.8 22.3 219 Adi, free cash flow vield (%) 11.3 -2.7 35.8 22.3 219 Net dividend yield (%) 7.6 0.0 8.2 9.4 10.6 Gross dividend yield (%) 7.6 0.0 8.2 9.4 14.7 2022A 2025F Key Ratios 2023A 2024F 2026F Return on assets (%) n/a n/a n/a n/a n/a 5.7 0.8 17.4 15.4 19.9 Return on equity (%) Return on funds employed (%) 5.0 0.7 15.7 14.0 18.3 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 (%) 4.2 2.5 3.2 2.9 2.7 Capex to depreciation (%) n/a n/a n/a n/a n/a 100 Imputation (%) 0 0 0 0 Pay-out ratio (%) 141 0 46 55 46 **Capital Structure** 2022A 2023A 2024E 2025E 2026E Solvency capital 1559 1505 1794 1364 1454 Minimum solvency capital (MSC) 56.6 52.3 66.3 66.5 91.6 Total regulatory capital 106.6 102.3 83.3 91.3 91.3 Solvency ratio (%) 275 287 271 205 160 **Underlying Performance** 2022A 2023A 2024E 2025F 2026F Gross written premium 436.6 511.5 606.7 674.4 752.5 Gross earned premium 430.7 470.8 559.1 640.5 713.4 (100.2)Reinsurance premium (695)(695)(84.6)(109.8)Net earned premium 361.2 416.3 474.5 540.4 603.6 Net claims expense (195.5) (269.3) (264.6) (335.4) (368.6) * includes Large event claims of (19.0) (38.2) (20.5) (50.0) (55.0) Management & sales expenses (129.9) (151.4)(145.4) (147.2)(149.9) Underwriting profit 35.8 (4.4) 64.6 57.8 85.1 Investment and other revenue 1.1 14.3 18.2 20.1 19.6 Financing and other costs 1.3 2.3 (1.0) (1.0)(1.0)Profit before tax (from continuing operations) 38.2 12.2 81.9 76.8 103.7 Tax expense (10.9)(4.6)(23.2)(21.8)(29.3)Profit after taxation 27.3 7.6 58.7 55.0 74.4 NPAT (from discontinued operation) (4.5) (9.8) (0.6) 0 0 55.0 NPAT (Reported) 22.8 -2.2 58.1 74.4 Key ratios Total GWP growth % 10.2% 17.2% 18.6% 11.2% 11.6% Total claims ratio % 54.1% 64.7% 55.8% 62.1% 61.1% MER % 36.0% 32.2% 30.6% 27.2% 24.8% 90.1% 101.1% Combined ratio % 86.4% 89.3% 85.9%

* Forsyth Barr target prices reflect valuation rolled forward at cost of equity less the next 12months 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

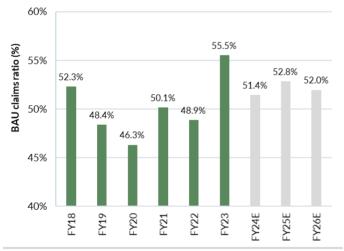
TWR attributed this guidance upgrade to 'a continuation of positive trading conditions, including unseasonably benign weather in the past two months', implying that BAU claims are now tracking below normal ranges. Accordingly, we reduce our BAU claims expense in FY24, which sees our underlying NPAT estimate increase by +5% to NZ\$58.7m (or equivalent to NZ\$42.5m on TWR's metrics, normalising for our lower large events allowance). We make minimal changes to our forecasts in FY25 and FY26, given the relatively one-off nature of favourable weather impacts in the past two months. A full earnings revision table is not included as we are in the process of adjusting our modelling for TWR's new reporting presentation, see the Appendix.

Figure 1. Summary estimates versus management guidance

	FY24 Estimate	FY24 Mgt	FY25 Estimate	FY25 Mgt	FY26 Estimate	FY26 Mgt	
		guidance		guidance		guidance	
GWP growth (%)	+15%	+10% to +15%	+11%	+10% to +15%	+12%	+10% to +15%	
Large events expense (NZ\$m)	\$20.5m	\$43m	\$50m	\$50m	\$55m	\$55m	
MER	30.6%	30% to 32%	27.2%	<28%	24.8%	<26%	
Combined operating ratio (%)	86.4%	<93%	89.3%	<91%	85.9%	<87%	
Underlying NPAT (NZ\$m)	\$58.7m	>\$40m	\$55.0m	\$40m to \$60m	\$74.4m	\$60m to \$80m	
ROE (%)	14.8%	n/a	14.1%	12% to 15%	17.7%	>15%	

Source: Company, Forsyth Barr analysis

Figure 2. TWR's BAU claims ratio has benefitted from benign weather in FY24 after spiking in FY23



Source: Company, Forsyth Barr analysis



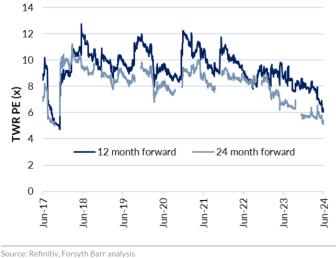


Figure 3. There have been significant FY24 earnings guidance upgrades in the last six months



Source: Bloomberg, Forsyth Barr analysis

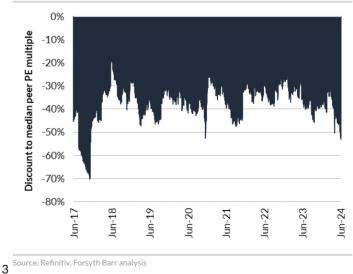


Figure 5. ... And its valuation discount to its peers is widening

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Appendix

TWR has transitioned its financial reporting to NZ IFRS 17 and the Interim Solvency Standard (ISS) for 1H24. These new accounting and solvency standards significantly alter the presentation and disclosure of financial statements. Still, our analysis and TWR's disclosed view from its 15 May 2024 announcement show it does not materially impact the company's strategic direction, profitability, or dividend policies. The two key changes are:

- Effective from 1 October 2023, Tower Limited implemented the NZ IFRS 17 Insurance Contracts (IFRS 17), a mandatory accounting standard for all insurance companies, aimed at improving the transparency and consistency of financial reporting, with its 1H24 result marking the first interim reporting period under this new standard.
- The Reserve Bank of New Zealand introduced the Interim Solvency Standard 2023 (ISS) effective from 1 October 2023, replacing the Non-Life Solvency Standard (NLSS). In addition, it is currently consulting on a proposed second amendment expected in TWR's FY25. This proposed amendment could materially impact TWR's regulatory solvency position, potentially reducing the solvency margin to levels similar to those under the NLSS, although these changes will not take effect until formally implemented.

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Figure 6. Price performance



Figure 7. 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

Source: Forsyth Barr analysis

Figure 8. 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)	2024E 2025E		2024E	2025E	2024E	2025E	2025E
Tower Ltd	TWR NZ	NZ\$0.85	NZ\$323	5.6x	5.9x	n/a	n/a	n/a	n/a	9.4%
Heartland Group Holdings *	HGH NZ	NZ\$0.98	NZ\$912	8.5x	8.0x	n/a	n/a	n/a	n/a	8.0%
Insurance Australia Group	IAG AT	A\$6.56	A\$15,549	17.7x	16.0x	n/a	n/a	n/a	10.4x	4.6%
Suncorp Group	SUN AT	A\$16.53	A\$21,031	15.7x	15.6x	n/a	n/a	n/a	54.9x	5.0%
QBE INSURANCE GROUP	QBE AT	US\$12.23	US\$18,373	11.2x	10.1x	n/a	n/a	n/a	8.8x	5.7%
			Compco Average:	13.2x	12.4x	n/a	n/a	n/a	24.7x	5.8%
EV = Mkt cap+net debt+lease liabilities+min interests-investments			TWR Relative:	-58%	-53%	n/a	n/a	n/a	n/a	61%

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

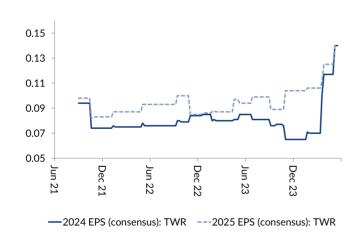
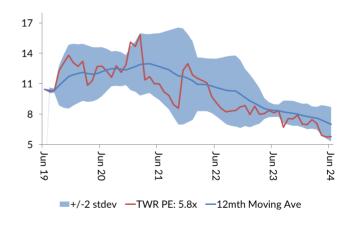


Figure 9. Consensus EPS momentum (NZ\$)

Figure 10. One year forward PE (x)



Source: Forsyth Barr analysis

Source: Forsyth Barr analysis



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