

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 ten-year 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.

Earnings revisions

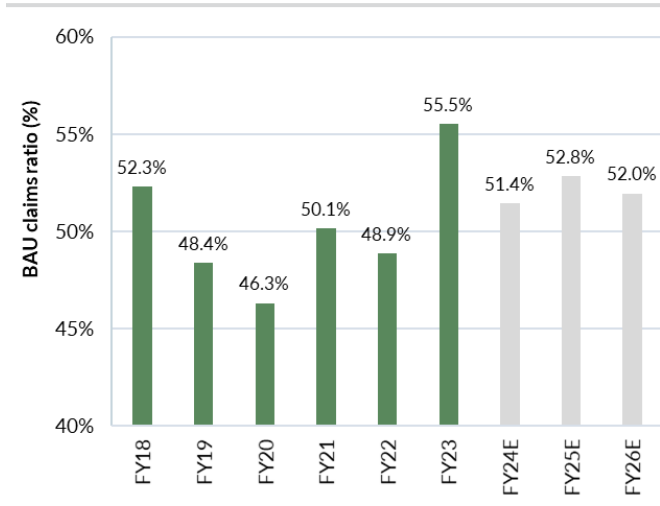
TWR attributed this guidance upgrade to ‘a continuation of positive trading conditions, including unseasonably benign weather in the past two months’, implying that BAU claims are now tracking below normal ranges. Accordingly, we reduce our BAU claims expense in FY24, which sees our underlying NPAT estimate 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 guidance	FY25 Estimate	FY25 Mgt guidance	FY26 Estimate	FY26 Mgt 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%

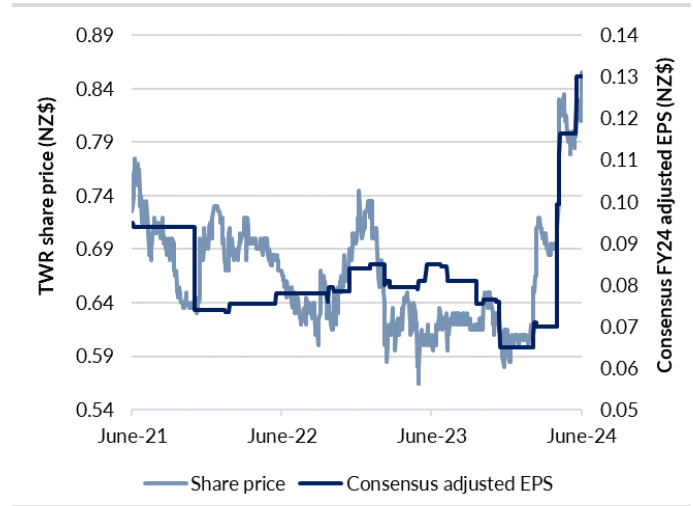
Source: Company, Forsyth Barr analysis

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



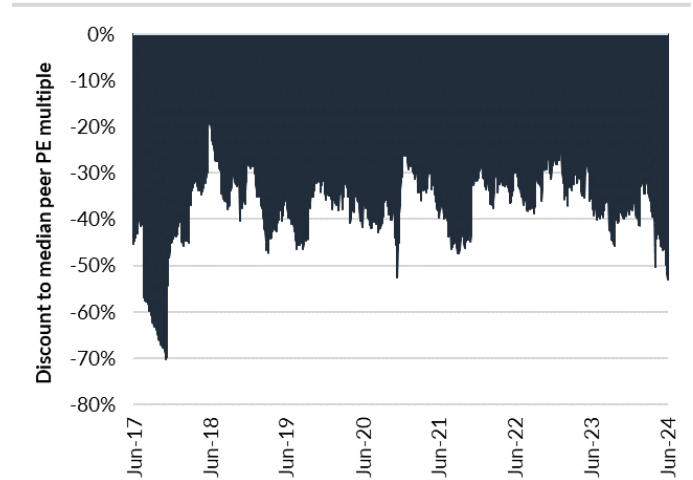
Source: Bloomberg, Forsyth Barr analysis

Figure 4. TWR trades at just ~6x 12-month forward PE ...



Source: Refinitiv, Forsyth Barr analysis

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



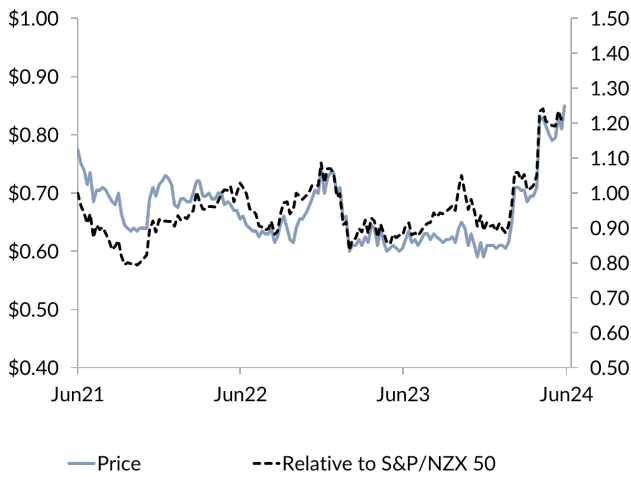
Source: Refinitiv, Forsyth Barr analysis

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.

Figure 6. Price performance



Source: Forsyth Barr analysis

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%

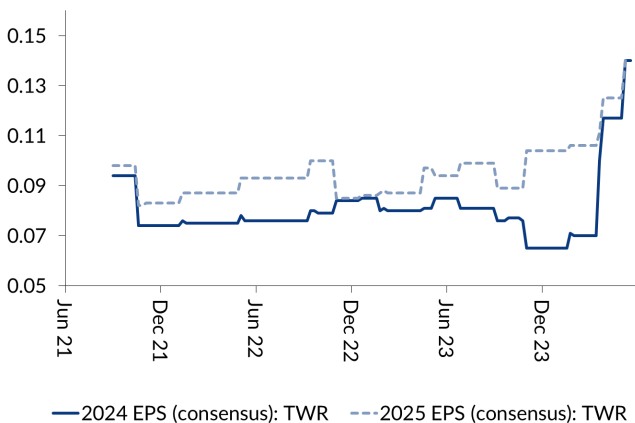
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 8. International valuation comparisons

Company	Code	Price	Mkt Cap (m)	PE 2024E	PE 2025E	EV/EBITDA 2024E	EV/EBITDA 2025E	EV/EBIT 2024E	EV/EBIT 2025E	Cash Yld 2025E
(metrics re-weighted to reflect TWR's balance date - September)										
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	61%

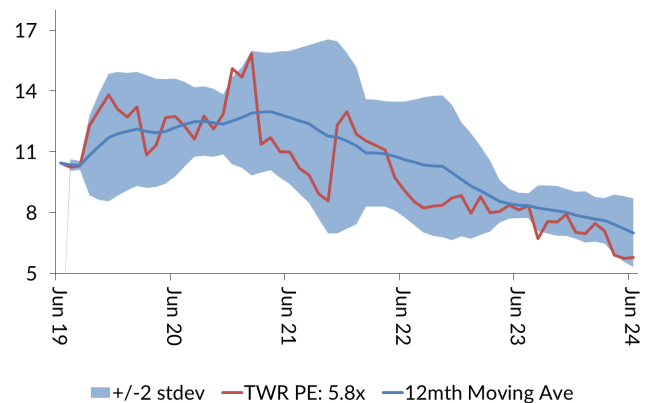
Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (TWR) companies fiscal year end

Figure 9. Consensus EPS momentum (NZ\$)



Source: Forsyth Barr analysis

Figure 10. One year forward PE (x)



Source: Forsyth Barr analysis

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