

Tower Limited

Strategic Progress on Multiple Fronts

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Tower Limited (TWR) has concluded its strategic review, which began in December 2023, to optimise its capital structure and enhance shareholder value. TWR looked at a wide range of potential opportunities, including partnerships, risk transfers, alternative ownership and capital structures. As part of the conclusion of the strategic review, TWR has proposed a NZ\$45m capital return (~1/10th of the current share count at market price; in addition to ordinary dividends) to shareholders through a mandatory share buyback, pending necessary approvals. Furthermore, TWR has reaffirmed its FY24 guidance for an underlying NPAT expected to exceed NZ\$45m (still utilising the full NZ\$45m pre-tax large events allowance), and is forecasting a final dividend of NZ5cps. The Reserve Bank of New Zealand (RBNZ) has removed the additional solvency margin requirement that was initially set due to the Canterbury earthquakes (CEQ), recognising TWR's now robust capital position. Our revised spot valuation increases by +26 cents to NZ\$1.70. TWR's market valuation remains very undemanding, trading at just 7.1x FY25 PE. If execution continues as we expect, further capital returns are likely to occur in future years, alongside its already strong dividends, with a forecast FY25 gross yield of 11%.

NZX Code	TWR	Financials: Sep/	23A	24E	25E	26E	Valuation (x)	23A	24E	25E	26E
Share price	NZ\$1.14	Rev (NZ\$m)	487.6	567.6	641.9	712.5	PE	60.9	5.4	7.1	5.6
Spot Valuation	NZ\$1.70 (from 1.44)	NPAT* (NZ\$m)	7.1	79.5	54.4	69.2	EV/EBIT	n/a	n/a	n/a	n/a
Risk rating	High	EPS* (NZc)	1.9	20.9	16.0	20.3	EV/EBITDA	n/a	n/a	n/a	n/a
Issued shares	379.5m	DPS (NZc)	0.0	8.0	10.5	13.0	Price / NTA	9.0	2.5	2.8	2.4
Market cap	NZ\$433m	Imputation (%)	0	0	50	100	Cash div yld (%)	0.0	7.0	9.2	11.4
Avg daily turnover	237.3k (NZ\$192k)	*Based on normalised profits					Gross div yld (%)	0.0	7.0	11.0	15.8

What's changed?

- **Earnings:** We lift our EPS estimates by +10% in FY24 on removal of our large event claim allowance, and up by +11% in FY25 and FY26 taking into account the proposed capital return (and lower share count) but subsequently lower investment earnings.
- **Spot valuation:** Our spot valuation rises +18% to NZ\$1.70, reflecting the removal of FB's additional provision for CEQ, peer multiple re-rating and capital return. This represents a 10.3x one-year forward PE, against SUN trading on 16x and IAG at 17.7x.

Guidance maintained and dividend announced

TWR has reaffirmed its FY24 guidance, maintaining its underlying NPAT >NZ\$45m forecast. With only three weeks till the end of TWR's FY24, we remove our NZ\$10m large events allowance provision, lifting our underlying NPAT estimate to NZ\$79.5m. TWR has forecast a final 5cps dividend, and as such, we lower our estimate by 1cps to 5cps unimputed to match this forecast. TWR's dividend policy remains 60% to 80% of adjusted earnings. We anticipate TWR to announce its FY24 result on Thursday, 28 November 2024.

Capital return and RBNZ's removal of license condition

In August 2024, the RBNZ took the significant step of removing the last NZ\$15m additional solvency margin requirement initially imposed on TWR in the aftermath of the Christchurch earthquakes. This decision likely reflects a recognition of TWR's: 1) strengthened capital position, 2) risk assessment frameworks, and 3) the move by TWR to a 90% confidence interval on the remaining CEQ provision of NZ\$21.4m at 1H24. The removal of this solvency margin comes at a pivotal time when TWR has experienced a period of particularly benign large events and below-average business-as-usual (BAU) claims. This favourable claims environment has contributed substantially to profitability, prompting TWR to propose a substantial return of capital to its shareholders. The planned capital return (via a scheme of arrangement) will involve a mandatory share buyback worth NZ\$45m (~NZ 12 cps) and will be subject to all the normal approvals (IRD/Board/court/shareholder). A shareholder vote will be sought at TWR's ASM in mid-February 2025.

Tower Limited (TWR)

Market data (NZ\$)						Spot valuation (NZ\$)					
Priced as at 06 Sep 2024						1.14	1.70				
52 week high / low						1.15 / 0.58	PE relative				
Market capitalisation (NZ\$m)						432.6	P/Book relative				
						DCF					
						2.01					
Key WACC assumptions						DCF valuation summary (NZ\$m)					
Risk free rate						5.00%	Total firm value				
Equity beta						1.18	(Net debt)/cash				
WACC						11.0%	(45)				
Terminal growth						1.8%	Value of equity				
						694					
Profit and Loss Account (NZ\$m)						Valuation Ratios					
Revenue (Insurance revenue)	2022A	2023A	2024E	2025E	2026E	2022A	2023A	2024E	2025E	2026E	
Revenue (Insurance revenue)	430.7	487.6	567.6	641.9	712.5	EV/Sales (x)	0.2	0.3	0.2	0.1	
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)	12.3	60.9	5.4	7.1	
Net interest	n/a	n/a	n/a	n/a	n/a	Price/NTA (x)	2.4	9.0	2.5	2.8	
Associate income	0	0	0	0	0	Free cash flow yield (%)	8.6	-2.0	16.9	11.4	
Tax	(7.5)	(5.2)	(32.3)	(22.6)	(27.2)	Adj. free cash flow yield (%)	8.6	-2.0	16.9	11.4	
Minority interests	0	0	0	0	0	Net dividend yield (%)	5.7	0.0	7.0	9.2	
Normalised NPAT	17.5	2.6	75.3	55.2	70.0	Gross dividend yield (%)	5.7	0.0	7.0	11.0	
Abnormals/other	1.4	(3.6)	3.6	-	-						
Reported NPAT	18.9	(1.0)	78.9	55.2	70.0	Key Ratios					
Normalised EPS (cps)	9.2	1.9	20.9	16.0	20.3	2022A	2023A	2024E	2025E	2026E	
DPS (cps)	6.5	-	8.0	10.5	13.0	Return on assets (%)	n/a	n/a	n/a	n/a	
						Return on equity (%)	12.7	4.8	29.4	22.7	
						Return on funds employed (%)	11.1	3.8	25.9	19.7	
						EBITDA margin (%)	n/a	n/a	n/a	n/a	
						EBIT margin (%)	n/a	n/a	n/a	n/a	
						Capex to sales (%)	3.9	2.5	3.9	3.6	
						Capex to depreciation (%)	n/a	n/a	n/a	n/a	
						Imputation (%)	0	0	0	50	
						Pay-out ratio (%)	70	0	38	66	
						2022A	2023A	2024E	2025E	2026E	
						Gross written premium	457.3	526.8	608.5	675.4	749.7
						Insurance revenue	430.7	487.6	567.6	641.9	712.5
						Reinsurance Premium	(62.3)	(69.5)	(85.1)	(94.7)	(103.3)
						Net insurance revenue	368.4	418.1	482.5	547.2	609.2
						Net claims expense - BAU	(176.5)	(230.2)	(240.3)	(279.1)	(307.7)
						Net claims expense - Large events	(19.0)	(38.2)	-	(50.0)	(55.0)
						Large event reinsurance reinstatement	-	(17.4)	-	-	-
						Management expenses	(120.6)	(123.9)	(139.3)	(138.8)	(143.6)
						Commission	(8.8)	(10.1)	(9.3)	(10.6)	(11.8)
						Net insurance service expense	(324.9)	(419.8)	(388.9)	(478.5)	(518.0)
						Insurance service result	43.5	(7.9)	93.6	68.8	91.2
						Investment and other revenue	1.1	14.3	19.7	15.0	12.0
						Net insurance finance expense	-	(1.1)	(1.6)	(6.7)	(6.8)
						Other income (costs)	1.3	0.2	2.9	(3.5)	(3.6)
						Net insurance and investment result	46.0	11.5	111.8	77.0	96.4
						Other income	0.4	2.7	(2.3)	(2.4)	(2.4)
						Profit before taxation (from cont. ops)	25.0	7.8	107.5	77.8	97.2
						Tax expense	(7.5)	(5.2)	(32.3)	(22.6)	(27.2)
						Profit after taxation	17.5	2.6	75.3	55.2	70.0
						NPAT (from discontinued operation)	1.4	(3.6)	3.6	-	-
						NPAT (Reported)	18.9	(1.0)	78.9	55.2	70.0
						Key ratios					
						2022A	2023A	2024A	2025A	2026A	
						Total GWP growth %	13.2%	15.2%	15.5%	11.0%	11.0%
						MER %	35.1%	32.0%	30.8%	27.3%	25.5%
						Combined ratio %	88.2%	100.4%	80.6%	87.4%	85.0%
						Solvency ratio (%)	205%	139%	159%	129%	125%
Cash Flow (NZ\$m)						Underlying Performance					
EBITDA	2022A	2023A	2024E	2025E	2026E	2022A	2023A	2024E	2025E	2026E	
EBITDA	n/a	n/a	n/a	n/a	n/a	Gross written premium	457.3	526.8	608.5	675.4	
Working capital change	n/a	n/a	n/a	n/a	n/a	Insurance revenue	430.7	487.6	567.6	641.9	
Interest & tax paid	0	0	0	0	0	Reinsurance Premium	(62.3)	(69.5)	(85.1)	(94.7)	
Other	0	0	0	0	0	Net insurance revenue	368.4	418.1	482.5	547.2	
Operating cash flow	59.8	10.0	98.2	75.6	90.3	Net claims expense - BAU	(176.5)	(230.2)	(240.3)	(279.1)	
Capital expenditure	(16.8)	(12.0)	(21.9)	(22.9)	(23.8)	Net claims expense - Large events	(19.0)	(38.2)	-	(50.0)	
(Acquisitions)/divestments	(6.1)	(5.9)	-	-	-	Large event reinsurance reinstatement	-	(17.4)	-	-	
Other	(13.8)	(1.3)	(61.8)	(17.1)	(25.3)	Management expenses	(120.6)	(123.9)	(139.3)	(138.8)	
Funding available/(required)	23.1	(9.2)	14.5	35.6	41.1	Commission	(8.8)	(10.1)	(9.3)	(10.6)	
Dividends paid	(20.0)	(15.2)	(11.4)	(34.9)	(40.0)	Net insurance service expense	(324.9)	(419.8)	(388.9)	(478.5)	
Equity raised/(returned)	(30.6)	-	-	(45.0)	-	Insurance service result	43.5	(7.9)	93.6	68.8	
(Increase)/decrease in net debt	(27.6)	(24.4)	3.1	(44.3)	1.2	Investment and other revenue	1.1	14.3	19.7	15.0	
						Net insurance finance expense	-	(1.1)	(1.6)	(6.7)	
						Other income (costs)	1.3	0.2	2.9	(3.5)	
						Net insurance and investment result	46.0	11.5	111.8	77.0	
						Other income	0.4	2.7	(2.3)	(2.4)	
						Profit before taxation (from cont. ops)	25.0	7.8	107.5	77.8	
						Tax expense	(7.5)	(5.2)	(32.3)	(22.6)	
						Profit after taxation	17.5	2.6	75.3	55.2	
						NPAT (from discontinued operation)	1.4	(3.6)	3.6	-	
						NPAT (Reported)	18.9	(1.0)	78.9	55.2	
						Balance Sheet (NZ\$m)					
2022A	2023A	2024E	2025E	2026E	2022A	2023A	2024E	2025E	2026E		
Working capital	(7.5)	(1.6)	12.4	14.5	16.0	Total GWP growth %	13.2%	15.2%	15.5%	11.0%	
Fixed assets	5.4	6.3	8.0	9.6	11.2	MER %	35.1%	32.0%	30.8%	27.3%	
Intangibles	94.7	98.5	98.8	99.6	100.7	Combined ratio %	88.2%	100.4%	80.6%	87.4%	
Right of use asset	23.3	23.2	20.3	17.4	14.5	Solvency ratio (%)	205%	139%	159%	129%	
Other assets	288.2	287.8	331.8	345.6	367.8						
Total funds employed	404.1	414.2	471.3	486.7	510.2						
Net debt/(cash)	(84.5)	(64.0)	(64.0)	(19.7)	(20.9)						
Lease liability	35.1	32.6	29.4	26.2	22.9						
Other liabilities	177.3	299.0	235.8	240.2	242.8						
Shareholder's funds	276.3	146.6	270.0	240.0	265.3						
Minority interests	-	-	-	-	-						
Total funding sources	404.1	414.2	471.3	486.7	510.2						

* 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

We lift our FY24 underlying NPAT estimate by +10% to NZ\$79.5m, reflecting the removal of our prior NZ\$10m large events allowance, with only three weeks to go before the end of the financial year. We understand TWR has had no large events in the year to date. Taking into account the >NZ\$45m underlying NPAT guidance, the impact of releasing 100% of TWR's pre-tax NZ\$45m large events allowance presents a like-for-like comparison of >NZ\$77.4m underlying NPAT, if no large events occur in the next three weeks. This means our FY24 estimate is only +3% ahead of TWR's implied guidance (see Figure 3).

Following the inclusion of the proposed capital return being paid out (anticipated in March 2025), our FY25 underlying NPAT estimate falls -2% to NZ\$54.4m, but remains at the higher-end of management guidance (NZ\$40m to NZ\$60m) despite our GWP growth estimate being at the lower-end of guidance. This is due to our expectations of ongoing improvements in BAU claims, operational improvements, and expectations of progress on reinsurance costs since TWR initially set these targets. Our revised investment earnings estimates fall -8% in FY25 and -10% in FY26, due to the capital return and movement in interest rate expectations. Our FY26 numbers also fall -2%, and sit in the middle of management's NZ\$60m to NZ\$80m range at NZ\$69.2m.

Figure 1. FB forecasts against management's medium-term guidance

	FY24 Estimate	FY24 Mgt guidance	FY25 Estimate	FY25 Mgt guidance	FY26 Estimate	FY26 Mgt guidance
GWP growth (%)	+16%	+10% to +15%	+11%	+10% to +15%	+11%	+10% to +15%
Large events allowance (NZ\$m)	\$0m	\$45m	\$50m	\$50m	\$55m	\$55m
MER	30.8%	30% to 32%	27.3%	<28%	25.5%	<26%
Combined operating ratio (%)	80.6%	95% to 97%	87.4%	<91%	85.0%	<87%
Underlying NPAT (NZ\$m)	\$79.5m	Above \$45m	\$54.4m	\$40m to \$60m	\$69.2m	\$60m to \$80m
ROE (%)	22.7%	n/a	15.8%	12% to 15%	19.9%	>15%

Source: Company, Forsyth Barr analysis

Figure 2. Earnings revisions

	FY24			FY25			FY26		
	Old	New	Change	Old	New	Change	Old	New	Change
Gross written premium	608.5	608.5	+0%	675.4	675.4	+0%	749.7	749.7	+0%
Insurance revenue	567.6	567.6	+0%	641.9	641.9	+0%	712.5	712.5	+0%
Reinsurance expense	(85.1)	(85.1)	+0%	(94.7)	(94.7)	+0%	(103.3)	(103.3)	+0%
Net insurance revenue	482.5	482.5	+0%	547.2	547.2	+0%	609.2	609.2	+0%
Net claims expense - BAU	(240.3)	(240.3)	+0%	(279.1)	(279.1)	+0%	(307.7)	(307.7)	+0%
Net claims expense - Large events	(10.0)	-	(100%)	(50.0)	(50.0)	+0%	(55.0)	(55.0)	+0%
Large event reinsurance reinstatement	-	-	n/a	-	-	n/a	-	-	n/a
Management expenses	(139.3)	(139.3)	+0%	(138.8)	(138.8)	+0%	(143.6)	(143.6)	+0%
Net Commission Expense	(9.3)	(9.3)	+0%	(10.6)	(10.6)	+0%	(11.8)	(11.8)	+0%
Net insurance service expense	(398.9)	(388.9)	(3%)	(478.5)	(478.5)	+0%	(518.0)	(518.0)	+0%
Insurance service result	83.6	93.6	+12%	68.8	68.8	+0%	91.2	91.2	+0%
Net Investment Income	19.5	19.7	+1%	16.2	15.0	(8%)	13.4	12.0	(10%)
Net insurance finance expense	(4.5)	(4.5)	+0%	(3.2)	(3.2)	+0%	(3.2)	(3.2)	+0%
Other income (costs)	2.9	2.9	n/a	(3.5)	(3.5)	n/a	(3.6)	(3.6)	n/a
Profit before tax	101.5	111.8	+10%	78.2	77.0	(2%)	97.7	96.4	(1%)
Tax expense	(29.2)	(32.3)	+11%	(22.7)	(22.6)	(1%)	(27.4)	(27.2)	(1%)
Profit after taxation from discontinued operation	-	-	n/a	-	-	n/a	-	-	n/a
Underlying Profit after tax	72.3	79.5	+10%	55.6	54.4	(2%)	70.4	69.2	(2%)
Canterbury impact	(0.8)	(0.8)	+0%	-	-	n/a	-	-	n/a
Other non-underlying items	0.2	0.2	+0%	-	-	n/a	-	-	n/a
Reported Profit after tax	71.7	78.9	+10%	55.6	55.2	(1%)	70.4	70.0	(1%)
EPS	18.9	20.8	+10%	14.6	16.2	+11%	18.5	20.6	+11%

Source: Forsyth Barr analysis

Figure 3. TWR – Implied guidance relative to estimates

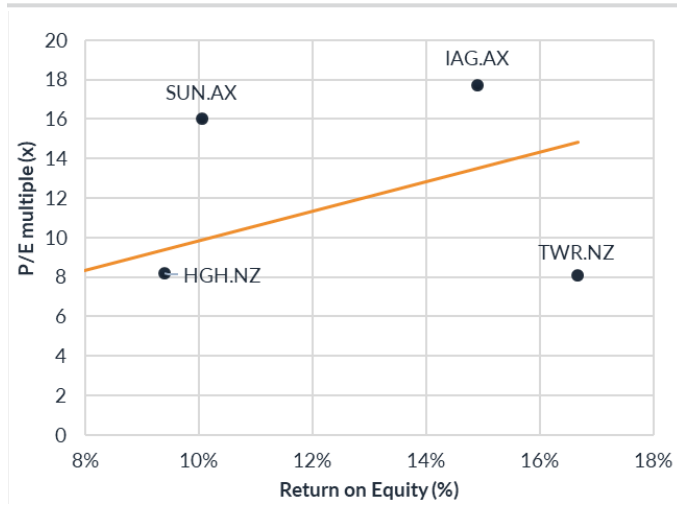
Variable	NZ\$m	Comment
TWR's reaffirmed FY24 underlying NPAT guidance	>NZ\$45m	Underlying NPAT expected to be greater than NZ\$45m This includes NZ\$45m pretax large events allowance
Impact of releasing 100% of large events allowance * (1 - tax rate)	NZ\$45m 72%	No large events to date with three weeks until balance date
Post tax impact	+NZ\$32.4m	
Implied TWR FY24 underlying NPAT guidance (adjusted)	>NZ\$77.4m	
Forsyth Barr FY24 underlying NPAT	NZ\$79.5m	
Upside	+3%	

Source: Forsyth Barr analysis

Valuation appeal remains compelling

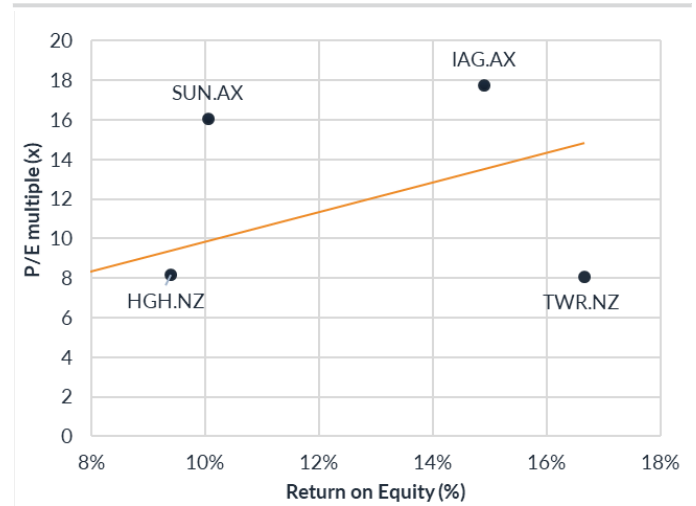
We consider that TWR remains compellingly cheap in comparison with its Australian peers, IAG and Suncorp (SUN). At the NZ\$1.14 market price, TWR trades on just 6.9x one-year forward PE, which appears unwarranted given the exceptional operating performance improvements evidenced in recent years. On the same measure, SUN is trading at 16x and IAG at 17.7x. Our revised spot valuation of NZ\$1.70, which represents a 10.3x one-year forward PE, is +49% ahead of the current share price and continues to include an arbitrary discount to these peers, which we have been gradually unwinding. We anticipate further reductions in these discounts in the future as the delivery of core business progress continues.

Figure 4. TWR – Relevant Australasian financials – P/E versus ROE one-year forward



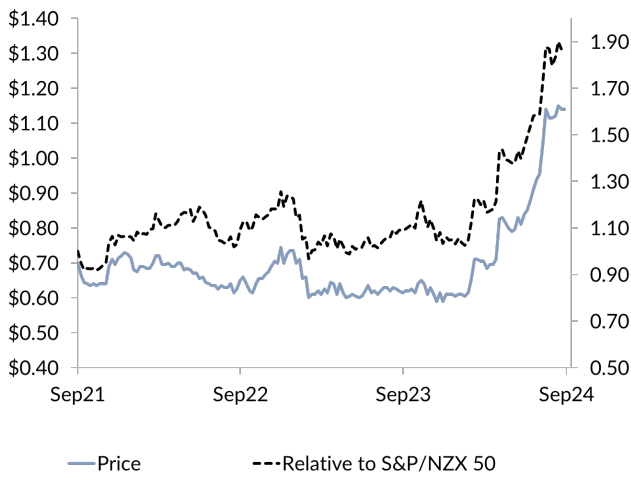
Source: Forsyth Barr analysis

Figure 5. TWR – Relevant Australasian financials – P/E versus ROE two-year forward



Source: Forsyth Barr analysis

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	7.0%
Pacific International Insurance Pty Ltd	5.8%
NZ Funds Management	5.2%

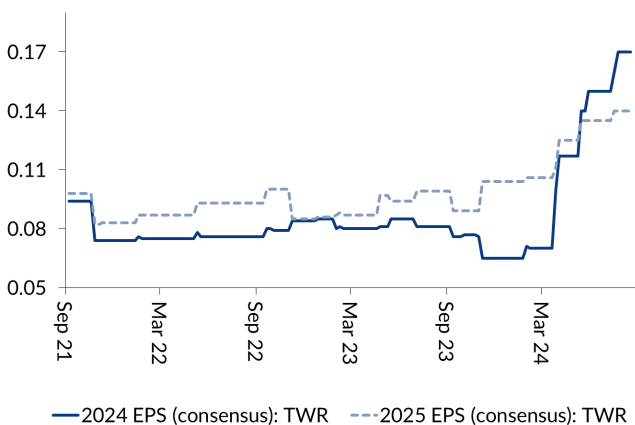
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

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\$1.14	NZ\$433	5.4x	7.1x	n/a	n/a	n/a	n/a	9.2%
Heartland Group Holdings *	HGH NZ	NZ\$1.08	NZ\$1,005	9.8x	9.3x	n/a	n/a	n/a	n/a	5.9%
Insurance Australia Group	IAG AT	A\$7.55	A\$17,895	19.7x	18.0x	n/a	n/a	n/a	11.8x	4.1%
Suncorp Group	SUN AT	A\$17.67	A\$22,482	18.5x	17.2x	n/a	n/a	n/a	14.8x	4.5%
QBE INSURANCE GROUP	QBE AT	US\$10.68	US\$16,049	10.6x	9.5x	n/a	n/a	n/a	8.3x	7.0%
Compco Average:				14.7x	13.5x	n/a	n/a	n/a	11.6x	5.4%
EV = Mkt cap+net debt+lease liabilities+min interests-investments				TWR Relative:		-63%	-47%	n/a	n/a	71%

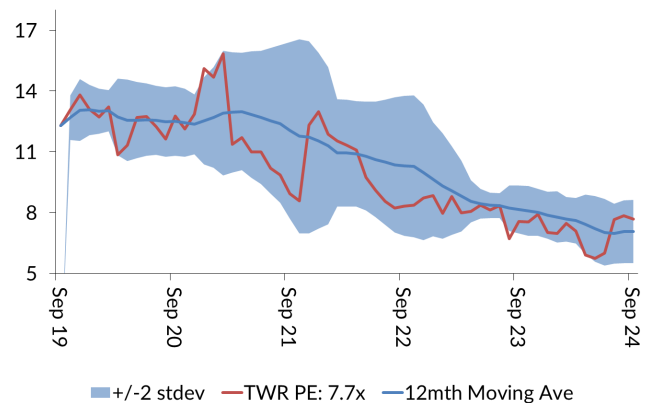
Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (TWR) companies fiscal year end

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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