

Tower Limited

Positive FY25 Reinsurance Outcome

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Tower (TWR) has placed its reinsurance programme for FY25 under significantly more favourable terms than our prior expectations. The structure of TWR's reinsurance programme for FY25 is broadly unchanged, and provides cover for three large events. However, the cost of reinsurance cover is expected to decline to 11.7% of total income, from 13.9% in FY24. While we had expected a marginal decline in reinsurance costs as a percentage of revenue, this is a better-than-anticipated outcome. The positive step change in reinsurance costs reflects: (1) improved capacity in reinsurance markets following a year of benign weather, and (2) growing recognition of TWR's risk-based pricing capability. TWR has also secured several multi-year agreements with reinsurers, which should reduce reinsurance cover volatility in future periods. We make cuts to our reinsurance cost estimates for FY25 and FY26, leading to earnings upgrades. Our blended spot valuation rises +8cps to NZ\$1.78, representing ~10x our new underlying EPS estimate for FY25.

NZX Code	TWR	Financials: Sep/	23A	24E	25E	26E	Valuation (x)	23A	24E	25E	26E
Share price	NZ\$1.23	Rev (NZ\$m)	487.6	563.9	630.3	695.8	PE	65.5	5.9	7.1	5.8
Spot Valuation	NZ\$1.78 (from 1.70)	NPAT* (NZ\$m)	7.1	78.5	59.1	71.4	EV/EBIT	n/a	n/a	n/a	n/a
Risk rating	High	EPS* (NZc)	1.9	20.7	17.4	21.0	EV/EBITDA	n/a	n/a	n/a	n/a
Issued shares	379.5m	DPS (NZc)	0.0	8.0	11.5	13.5	Price / NTA	9.7	2.7	2.9	2.5
Market cap	NZ\$465m	Imputation (%)	0	0	50	100	Cash div yld (%)	0.0	6.5	9.4	11.0
Avg daily turnover	248.7k (NZ\$206k)	*Based on normalised profits					Gross div yld (%)	0.0	6.5	11.2	15.3

What's changed?

- **Earnings:** FY24 underlying NPAT falls -1%. FY25 and FY26 underlying NPAT increases +8% and +3% respectively.
- **Spot valuation:** Rises +5% to NZ\$1.78.

Reinsurance programme successfully placed for FY25

TWR's reinsurance programme for FY25 (beginning 1 October 2024) will provide cover for three large events, similar to the structure in place for FY24. It will have cover of up to NZ\$800m for two individual events (up from NZ\$750m in FY24) and up to NZ\$85m for a third event (up from NZ\$75m in FY24). The excess on the first two events has increased to NZ\$18.75m per event for FY25, up from NZ\$16.9m in FY24, reflecting the roll-off of historic multi-year arrangements. However, the excess for a third event will be unchanged at NZ\$20m. Overall, we view the FY25 reinsurance programme as incrementally positive for TWR, particularly due to the significantly lower cost relative to our prior expectations.

Multi year deals in place

Pleasingly, TWR has secured several multi-year agreements with reinsurers as part of its FY25 reinsurance programme. These agreements should de-risk cost volatility in future periods. Further, we view the timing of these deals as fortuitous, given reinsurance markets have stabilised over the last twelve months, as capacity and risk appetite have grown against a backdrop of benign weather.

Valuation still compelling, catalysts in sight

TWR trades at just ~7x our updated underlying NPAT estimate for FY25 of NZ\$59.1m. We continue to view its valuation appeal as compelling relative to its Australasian insurance peers (and competitors) SUN and IAG, which trade on FY25 PE multiples of 18.6x and 18.9x respectively. There are also catalysts to come from: (1) the NZ\$45m capital return, (2) likely NZX50 inclusion later in 2024, and (3) the potential for an upgrade in its FY25 guidance at the release of its FY24 result on 28 November 2024.

Tower Limited (TWR)

Market data (NZ\$)						Spot valuation (NZ\$)					
Priced as at 23 Sep 2024					1.23	PE relative				1.94	
52 week high / low					1.25 / 0.58	P/Book relative				1.35	
Market capitalisation (NZ\$m)					466.8	DCF				2.04	
Key WACC assumptions						DCF valuation summary (NZ\$m)					
Risk free rate					5.00%	Total firm value				770	
Equity beta					1.18	(Net debt)/cash				(21)	
WACC					11.0%	Less: Capitalised operating leases				(45)	
Terminal growth					1.8%	Value of equity				704	
Profit and Loss Account (NZ\$m)						Valuation Ratios					
Revenue (Insurance revenue)	430.7	487.6	563.9	630.3	695.8	EV/Sales (x)	0.3	0.3	0.3	0.2	0.2
Normalised EBITDA	n/a	n/a	n/a	n/a	n/a	EV/EBITDA (x)	n/a	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	n/a
Normalised EBIT	n/a	n/a	n/a	n/a	n/a	PE (x)	13.3	65.7	5.9	7.1	5.9
Net interest	n/a	n/a	n/a	n/a	n/a	Price/NTA (x)	2.6	9.7	2.7	3.0	2.5
Associate income	0	0	0	0	0	Free cash flow yield (%)	8.0	-1.9	15.7	11.5	14.0
Tax	(7.5)	(5.2)	(31.8)	(24.1)	(27.8)	Adj. free cash flow yield (%)	8.0	-1.9	15.7	11.5	14.0
Minority interests	0	0	0	0	0	Net dividend yield (%)	5.3	0.0	6.5	9.3	11.0
Normalised NPAT	17.5	2.6	74.2	59.1	71.4	Gross dividend yield (%)	5.3	0.0	6.5	11.2	15.2
Abnormals/other	1.4	(3.6)	3.6	-	-						
Reported NPAT	18.9	(1.0)	77.9	59.1	71.4	Key Ratios					
Normalised EPS (cps)	9.2	1.9	20.7	17.4	21.0	Return on assets (%)	n/a	n/a	n/a	n/a	n/a
DPS (cps)	6.5	-	8.0	11.5	13.5	Return on equity (%)	12.7	4.8	29.2	24.5	26.9
						Return on funds employed (%)	11.1	3.8	25.6	21.3	23.9
Growth Rates						EBITDA margin (%)	n/a	n/a	n/a	n/a	n/a
Revenue (%)	9.1	13.2	15.6	11.8	10.4	EBIT margin (%)	n/a	n/a	n/a	n/a	n/a
EBITDA (%)	n/a	n/a	n/a	n/a	n/a	Capex to sales (%)	3.9	2.5	3.9	3.6	3.4
EBIT (%)	n/a	n/a	n/a	n/a	n/a	Capex to depreciation (%)	n/a	n/a	n/a	n/a	n/a
Normalised NPAT (%)	44.0	-79.7	>100	-24.7	20.9	Imputation (%)	0	0	0	50	100
Normalised EPS (%)	44.0	-79.7	>100	-16.0	20.9	Pay-out ratio (%)	70	0	39	66	64
Ordinary DPS (%)	30.0	-100.0	n/a	43.8	17.4						
Cash Flow (NZ\$m)						Underlying Performance					
EBITDA	n/a	n/a	n/a	n/a	n/a	Gross written premium	457.3	526.8	601.0	659.6	732.1
Working capital change	n/a	n/a	n/a	n/a	n/a	Insurance revenue	430.7	487.6	563.9	630.3	695.8
Interest & tax paid	0	0	0	0	0	Reinsurance Premium	(62.3)	(69.5)	(89.0)	(83.3)	(92.1)
Other	0	0	0	0	0	Net insurance revenue	368.4	418.1	474.8	547.0	603.8
Operating cash flow	59.8	10.0	98.3	79.6	92.3	BAU claims expense	(176.5)	(230.2)	(236.5)	(273.5)	(300.4)
Capital expenditure	(16.8)	(12.0)	(21.9)	(22.8)	(23.7)	Large events claim expense	(19.0)	(38.2)	-	(50.0)	(55.0)
(Acquisitions)/divestments	(6.1)	(5.9)	-	-	-	Reinsurance reinstatement	-	(17.4)	-	-	-
Other	(13.8)	(1.3)	(61.9)	(19.4)	(25.0)	Management expenses	(120.6)	(123.9)	(136.9)	(138.8)	(143.6)
Funding available/(required)	23.1	(9.2)	14.5	37.4	43.6	Commission	(8.8)	(10.1)	(9.3)	(10.6)	(11.8)
Dividends paid	(20.0)	(15.2)	(11.4)	(36.6)	(42.5)	Net insurance service expense	(324.9)	(419.8)	(382.7)	(472.9)	(510.7)
Equity raised/(returned)	(30.6)	-	-	(45.0)	-	Insurance service result	43.5	(7.9)	92.1	74.1	93.0
(Increase)/decrease in net debt	(27.6)	(24.4)	3.1	(44.1)	1.1	Investment and other revenue	1.1	14.3	19.7	15.0	12.2
						Net insurance finance expense	-	(1.1)	(1.6)	(5.9)	(6.0)
Balance Sheet (NZ\$m)						Other income (costs)	1.3	0.2	2.9	(2.7)	(2.8)
Working capital	(7.5)	(1.6)	12.3	14.1	15.7	Net result	46.0	11.5	110.3	83.2	99.2
Fixed assets	5.4	6.3	7.9	9.5	11.1	Other income	0.4	2.7	(2.3)	(2.4)	(2.4)
Intangibles	94.7	98.5	98.8	99.6	100.7	Profit before taxation	25.0	7.8	106.1	83.2	99.2
Right of use asset	23.3	23.2	20.3	17.4	14.5	Tax expense	(7.5)	(5.2)	(31.8)	(24.1)	(27.8)
Other assets	288.2	287.8	331.9	348.1	369.8	Profit after taxation	17.5	2.6	74.2	59.1	71.4
Total funds employed	404.1	414.2	471.2	488.7	511.7	NPAT (from discontinued ops)	1.4	(3.6)	3.6	-	-
Net debt/(cash)	(84.5)	(64.0)	(64.0)	(19.8)	(21.0)	NPAT (Reported)	18.9	(1.0)	77.9	59.1	71.4
Lease liability	35.1	32.6	29.4	26.2	22.9						
Other liabilities	177.3	299.0	236.8	241.2	244.5	Key ratios					
Shareholder's funds	276.3	146.6	269.0	241.1	265.2	Total GWP growth %	13.2%	15.2%	15.5%	11.0%	11.0%
Minority interests	-	-	-	-	-	MER %	35.1%	32.0%	30.8%	27.3%	25.7%
Total funding sources	404.1	414.2	471.2	488.7	511.7	Combined ratio %	88.2%	100.4%	80.5%	86.5%	84.6%
						Solvency ratio (%)	205%	139%	158%	128%	125%

* 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

Following TWR's successful reinsurance placement for FY25, we modestly increase our reinsurance expense for FY24, but make cuts in FY25 and FY26 due to better-than-expected guidance. We note that there are other costs included in the 'reinsurance expense' line, relating to smaller insurance lines, including pets and travel. These are excluded from TWR's guidance for reinsurance costs, estimated to be 11.7% of total income in FY25. We make a series of other changes, partially reflecting the impact of TWR's divestitures (in agriculture and the Pacific Islands) which were not fully factored into our numbers on closer analysis. Our new underlying NPAT estimate for FY25 is NZ\$59.1m, at the top end of management's guidance range of NZ\$40m to NZ\$60m.

Figure 1. Earnings revisions

	FY24			FY25			FY26		
	Old	New	Change	Old	New	Change	Old	New	Change
Gross written premium	608.5	601.0	(1%)	675.4	659.6	(2%)	749.7	732.1	(2%)
Insurance revenue	567.6	563.9	(1%)	641.9	630.3	(2%)	712.5	695.8	(2%)
Reinsurance expense	(85.1)	(89.0)	+5%	(94.7)	(83.3)	(12%)	(103.3)	(92.1)	(11%)
Net insurance revenue	482.5	474.8	(2%)	547.2	547.0	(0%)	609.2	603.8	(1%)
Net claims expense - BAU	(240.3)	(236.5)	(2%)	(279.1)	(273.5)	(2%)	(307.7)	(300.4)	(2%)
Net claims expense - Large events	-	-	n/a	(50.0)	(50.0)	+0%	(55.0)	(55.0)	+0%
Large event reinsurance reinstatement	-	-	n/a	-	-	n/a	-	-	n/a
Management expenses	(139.3)	(136.9)	(2%)	(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	(388.9)	(382.7)	(2%)	(478.5)	(472.9)	(1%)	(518.0)	(510.7)	(1%)
Insurance service result	93.6	92.1	(2%)	68.8	74.1	+8%	91.2	93.0	+2%
Net Investment Income	19.7	19.6	(1%)	14.9	15.0	+0%	12.1	12.2	+1%
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)	(2.7)	n/a	(3.6)	(2.8)	n/a
Profit before tax	111.8	110.2	(1%)	77.0	83.2	+8%	96.4	99.2	+3%
Tax expense	(32.3)	(31.8)	(1%)	(22.6)	(24.1)	+7%	(27.2)	(27.8)	+2%
Profit after taxation from discontinued operation	-	-	n/a	-	-	n/a	-	-	n/a
Underlying Profit after tax	79.5	78.4	(1%)	54.4	59.1	+8%	69.2	71.4	+3%
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	78.9	77.8	(1%)	54.4	59.1	+8%	69.2	71.4	+3%
EPS	20.8	20.5	(1%)	16.2	17.4	+7%	20.6	21.0	+2%

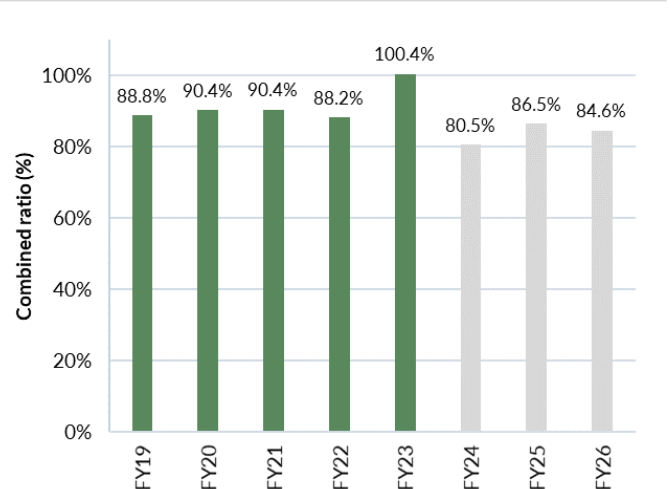
Source: Forsyth Barr analysis

Figure 2. TWR – Underlying reinsurance ratio*



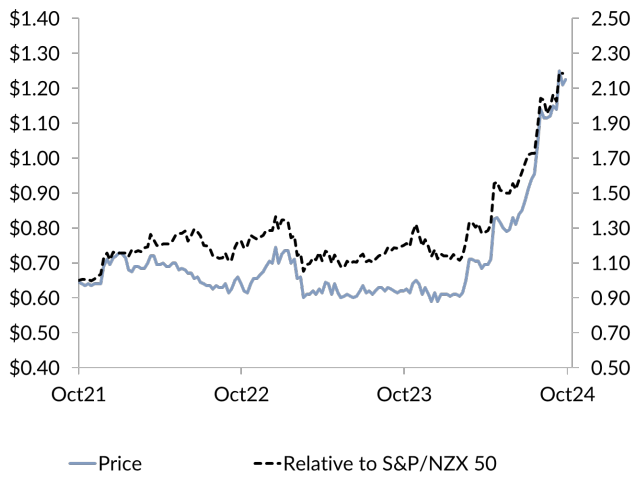
Source: Company, Forsyth Barr analysis *Calculated as a % of GEP versus 'total income' which is GWP

Figure 3. TWR – Underlying combined ratio



Source: Company, Forsyth Barr analysis

Figure 4. Price performance



Source: Forsyth Barr analysis

Figure 5. 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%

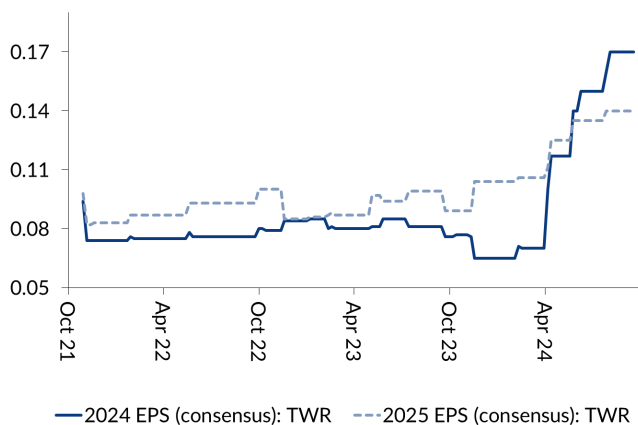
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 6. 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\$1.23	NZ\$465	5.9x	7.1x	n/a	n/a	n/a	n/a	9.4%
Heartland Group Holdings *	HGH NZ	NZ\$1.02	NZ\$956	9.3x	8.8x	n/a	n/a	n/a	n/a	6.3%
Insurance Australia Group	IAG AT	A\$7.68	A\$18,203	20.1x	18.3x	n/a	n/a	n/a	12.3x	4.0%
Suncorp Group	SUN AT	A\$18.21	A\$23,169	19.0x	17.7x	n/a	16.2x	n/a	15.2x	4.4%
QBE INSURANCE GROUP	QBE AT	US\$11.35	US\$17,056	11.3x	10.2x	n/a	n/a	n/a	8.7x	6.6%
Compco Average:				14.9x	13.8x	n/a	16.2x	n/a	12.1x	5.3%
EV = Mkt cap+net debt+lease liabilities+min interests-investments				TWR Relative:		-60%	-49%	n/a	n/a	77%

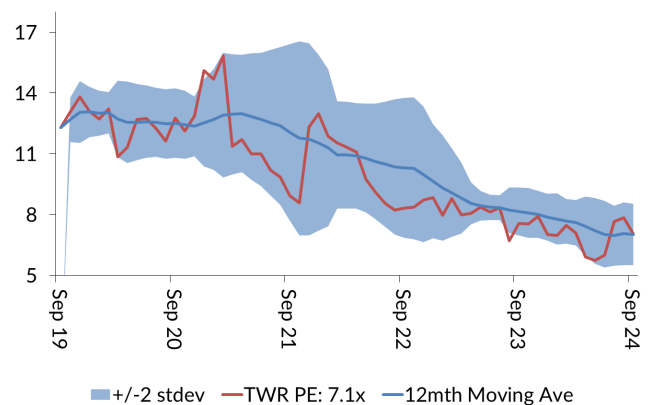
Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (TWR) companies fiscal year end

Figure 7. Consensus EPS momentum (NZ\$)



Source: Forsyth Barr analysis

Figure 8. One year forward PE (x)



Source: Forsyth Barr analysis

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