

Tower Limited

Sunnier Days and Good Management Deliver

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Tower (TWR) has provided final FY24 underlying NPAT guidance of NZ\$83m, +6% ahead of our prior estimate of NZ\$78.4m. TWR confirmed zero large events for FY24, and said better-than-expected business-as-usual (BAU) claims helped the underlying business performance, reflecting a period of unusually benign weather. Our general confidence continues to build around expectations for FY25, with our underlying NPAT estimate at NZ\$58.9m, which is at the top end of management's guidance range of NZ\$40m to NZ\$60m. Despite rallying strongly, TWR trades on only 8.5x 12-month forward earnings. We continue to see the valuation as compelling, especially given the structural upside risk to earnings from conservative large events provisioning. The ten-year average ratio to GWP implies ~NZ\$21m of large events in FY25 versus TWR's NZ\$50m allowance. Additionally, there are catalysts to come from the highly likely inclusion into the NZX50 index before year-end, and the NZ\$45m capital return in early 2025. Our blended spot valuation falls -1cps to NZ\$1.77.

NZX code	TWR	Financials: Sep/	23A	24E	25E	26E	Valuation (x)	23A	24E	25E	26E
Share price	NZ\$1.37	Rev (NZ\$m)	487.6	563.9	630.3	695.8	PE	73.2	6.2	8.1	6.7
Spot Valuation	NZ\$1.77 (from 1.78)	NPAT* (NZ\$m)	7.1	83.2	58.9	71.4	EV/EBIT	n/a	n/a	n/a	n/a
Risk rating	High	EPS* (NZc)	1.9	21.9	17.0	20.6	EV/EBITDA	n/a	n/a	n/a	n/a
Issued shares	379.5m	DPS (NZc)	0.0	8.0	11.0	13.5	Price / NTA	10.8	3.1	3.4	3.0
Market cap	NZ\$520m	Imputation (%)	0	0	50	100	Cash div yld (%)	0.0	5.8	8.0	9.9
Avg daily turnover	289.6k (NZ\$258k)	*Based on normalised profits					Gross div yld (%)	0.0	5.8	9.6	13.7

What's changed?

- **Earnings:** FY24 underlying NPAT increases +6% to NZ\$83m. FY25 and FY26 estimates are largely unchanged.
- **Spot valuation:** Falls -1% to NZ\$1.77, due to additional remediation costs offsetting the benefits of lower BAU claims in FY24.

Sunny is money – what a difference a year makes

We now have confirmation that TWR recorded no large events in FY24. The unwinding of the NZ\$45m large events allowance adds +NZ\$32m to TWR's underlying NPAT for the period. However, benign weather has also contributed to lower-than-expected BAU claims, with less motor accidents caused by wet weather for example. We now expect TWR to report an underlying BAU claims ratio of ~49.5% for FY24, down significantly from ~55% in FY23. While we expect some mean-reversion towards 50% in FY25 from a more normalised weather environment, we acknowledge TWR's risk-based pricing work, and efforts to reduce its exposure to motor theft and crime. Our confidence continues to build around our FY25 underlying NPAT estimate of NZ\$58.9m.

Reported profit impacted by multi-policy remediation

Reported NPAT for FY24 is expected to be NZ\$74m, -NZ\$9m lower than underlying NPAT. This reflects increased customer remediation and regulatory costs relating to TWR failing to apply multi-policy discounts over the last decade. We expect the remediation process to now be finalised, although note costs have escalated historically since TWR discovered the issue in 2022.

Valuation compelling, catalysts to come

At 8.5x 12-month forward PE, TWR trades at ~50% discount to the median of its Australasian insurance peers SUN (~17x) and IAG (~18x), versus its ten-year historic discount of -37%. TWR also trades at a -50% discount to the NZ market median PE, in line with its history. We view the magnitude of these discounts as unjustified, in light of TWR's earnings growth trajectory and operational improvements. Additionally, NZX50 index inclusion and the NZ\$45m capital return are compelling catalysts in our view.

Tower Limited (TWR)

Market data (NZ\$)						Spot valuation (NZ\$)						
Priced as at 13 Oct 2024						1.37	PE relative					1.94
52 week high / low						1.40 / 0.58	P/Book relative					1.36
Market capitalisation (NZ\$m)						519.9	DCF					2.00
Key WACC assumptions						DCF valuation summary (NZ\$m)						
Risk free rate						5.00%	Total firm value					769
Equity beta						1.18	(Net debt)/cash					(21)
WACC						11.0%	Less: Capitalised operating leases					(45)
Terminal growth						1.8%	Value of equity					703
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	563.9	630.3	695.8	EV/Sales (x)	0.4	0.5	0.4	0.3	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)	14.8	73.2	6.2	8.1	6.7	
Net interest	n/a	n/a	n/a	n/a	n/a	Price/NTA (x)	2.9	10.8	3.1	3.4	3.0	
Associate income	0	0	0	0	0	Free cash flow yield (%)	7.1	-1.7	13.4	10.3	12.6	
Tax	(7.5)	(5.2)	(30.3)	(24.1)	(27.8)	Adj. free cash flow yield (%)	7.1	-1.7	13.4	10.3	12.6	
Minority interests	0	0	0	0	0	Net dividend yield (%)	4.7	0.0	5.8	8.0	9.9	
Normalised NPAT	17.5	2.6	70.6	58.9	71.4	Gross dividend yield (%)	4.7	0.0	5.8	9.6	13.7	
Abnormals/other	1.4	(3.6)	3.6	-	-	Key Ratios						
Reported NPAT	18.9	(1.0)	74.2	58.9	71.4	2022A	2023A	2024E	2025E	2026E		
Normalised EPS (cps)	9.2	1.9	21.9	17.0	20.6	Return on assets (%)	n/a	n/a	n/a	n/a	n/a	
DPS (cps)	6.5	-	8.0	11.0	13.5	Return on equity (%)	12.7	4.8	31.4	24.8	27.3	
Growth Rates						Return on funds employed (%)	11.1	3.8	27.5	21.6	24.1	
2022A	2023A	2024E	2025E	2026E		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	-29.2	21.2	Imputation (%)	0	0	0	50	100	
Normalised EPS (%)	44.0	-79.7	>100	-22.5	21.2	Pay-out ratio (%)	70	0	36	65	66	
Ordinary DPS (%)	30.0	-100.0	n/a	37.5	22.7	Reported performance						
Cash Flow (NZ\$m)						2022A	2023A	2024E	2025E	2026E		
2022A	2023A	2024E	2025E	2026E		Gross written premium	457.3	526.8	601.0	659.6	732.1	
EBITDA	n/a	n/a	n/a	n/a	n/a	Insurance revenue	430.7	487.6	563.9	630.3	695.8	
Working capital change	n/a	n/a	n/a	n/a	n/a	Reinsurance Premium	(62.3)	(69.5)	(89.0)	(83.3)	(92.1)	
Interest & tax paid	0	0	0	0	0	Net insurance revenue	368.4	418.1	474.8	547.0	603.8	
Other	0	0	0	0	0	BAU claims expense	(176.5)	(230.2)	(235.0)	(273.5)	(300.4)	
Operating cash flow	59.8	10.0	94.6	79.5	92.3	Large events claim expense	(19.0)	(38.2)	1.9	(50.0)	(55.0)	
Capital expenditure	(16.8)	(12.0)	(21.9)	(22.8)	(23.7)	Reinsurance reinstatement	-	(17.4)	-	-	-	
(Acquisitions)/divestments	(6.1)	(5.9)	-	-	-	Management expenses	(120.6)	(123.9)	(136.9)	(138.8)	(143.6)	
Other	(13.8)	(1.3)	(58.5)	(19.4)	(25.0)	Commission	(8.8)	(10.1)	(9.3)	(10.6)	(11.8)	
Funding available/(required)	23.1	(9.2)	14.3	37.2	43.6	Net insurance service expense	(324.9)	(419.8)	(379.4)	(472.9)	(510.7)	
Dividends paid	(20.0)	(15.2)	(11.4)	(36.4)	(42.5)	Insurance service result	43.5	(7.9)	95.4	74.1	93.0	
Equity raised/(returned)	(30.6)	-	-	(45.0)	-	Investment and other revenue	1.1	14.3	19.6	14.8	12.1	
(Increase)/decrease in net debt	(27.6)	(24.4)	2.9	(44.1)	1.1	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)	
2022A	2023A	2024E	2025E	2026E		Net result	46.0	11.5	113.5	83.0	99.1	
Working capital	(7.5)	(1.6)	12.3	14.1	15.7	Other income	0.4	2.7	(10.7)	(2.4)	(2.4)	
Fixed assets	5.4	6.3	7.9	9.5	11.1	Profit before taxation	25.0	7.8	100.9	83.0	99.1	
Intangibles	94.7	98.5	98.8	99.6	100.7	Tax expense	(7.5)	(5.2)	(30.3)	(24.1)	(27.8)	
Right of use asset	23.3	23.2	20.3	17.4	14.5	Profit after taxation	17.5	2.6	70.6	58.9	71.4	
Other assets	288.2	287.8	328.5	344.6	366.4	NPAT (from discontinued ops)	1.4	(3.6)	3.6	-	-	
Total funds employed	404.1	414.2	467.7	485.2	508.3	NPAT (Reported)	18.9	(1.0)	74.2	58.9	71.4	
Net debt/(cash)	(84.5)	(64.0)	(63.8)	(19.6)	(20.8)	Key ratios						
Lease liability	35.1	32.6	29.4	26.2	22.9	2022A	2023A	2024A	2025A	2026A		
Other liabilities	177.3	299.0	236.8	241.2	244.5	Total GWP growth %	13.2%	15.2%	15.5%	11.0%	11.0%	
Shareholder's funds	276.3	146.6	265.4	237.5	261.6	MER %	35.1%	32.0%	30.8%	27.3%	25.7%	
Minority interests	-	-	-	-	-	Combined ratio %	88.2%	100.4%	80.5%	86.5%	84.6%	
Total funding sources	404.1	414.2	467.7	485.2	508.3	Solvency ratio (%)	205%	139%	156%	127%	123%	

* 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 update our FY24 estimates to align with TWR's new guidance. Our underlying NPAT estimate rises +6%, but our reported NPAT falls -5% due to increased remediation costs. We make minimal changes to our estimates in FY25 and FY26, as we view lower-than-expected BAU claims as largely one-off in nature due to benign weather. Lower BAU claims have been the key driver of improved operational performance. However, our EPS declines by -2% in FY25 and FY26 due to higher shares on issue. This is because, given the share price rise, we now see less shares bought back in the NZ\$45m capital return in early 2025.

Figure 1. Earnings revisions (NZ\$m)

	FY24			FY25			FY26		
	Old	New	Change	Old	New	Change	Old	New	Change
Gross written premium	601.0	601.0	+0%	659.6	659.6	+0%	732.1	732.1	+0%
Insurance revenue	563.9	563.9	+0%	630.3	630.3	+0%	695.8	695.8	+0%
Reinsurance expense	(89.0)	(89.0)	+0%	(83.3)	(83.3)	+0%	(92.1)	(92.1)	+0%
Net insurance revenue	474.8	474.8	+0%	547.0	547.0	+0%	603.8	603.8	+0%
Net claims expense - BAU	(236.5)	(235.0)	(1%)	(273.5)	(273.5)	+0%	(300.4)	(300.4)	+0%
Net claims expense - Large events	-	1.9	n/a	(50.0)	(50.0)	+0%	(55.0)	(55.0)	+0%
Management expenses	(136.9)	(136.9)	+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	(382.7)	(379.4)	(1%)	(472.9)	(472.9)	+0%	(510.7)	(510.7)	+0%
Insurance service result	92.1	95.4	+4%	74.1	74.1	+0%	93.0	93.0	+0%
Net Investment Income	19.7	19.6	(0%)	15.0	14.8	(2%)	12.2	12.1	(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	(2.7)	(2.7)	n/a	(2.8)	(2.8)	n/a
Profit before tax	110.3	113.5	+3%	83.2	83.0	(0%)	99.2	99.1	(0%)
Tax expense	(31.8)	(30.3)	(5%)	(24.1)	(24.1)	(0%)	(27.8)	(27.8)	(0%)
Profit after taxation from discontinued operation	-	-	n/a	-	-	n/a	-	-	n/a
Underlying Profit after tax	78.5	83.2	+6%	59.1	58.9	(0%)	71.4	71.4	+0%
Canterbury impact	(0.8)	(0.8)	+0%	-	-	n/a	-	-	n/a
Other non-underlying items	0.2	(8.2)	n/a	-	-	n/a	-	-	n/a
Reported Profit after tax	77.9	74.2	(5%)	59.1	58.9	(0%)	71.4	71.4	+0%
EPS	20.5	19.6	(5%)	17.4	17.0	(2%)	21.0	20.6	(2%)

Source: Forsyth Barr analysis

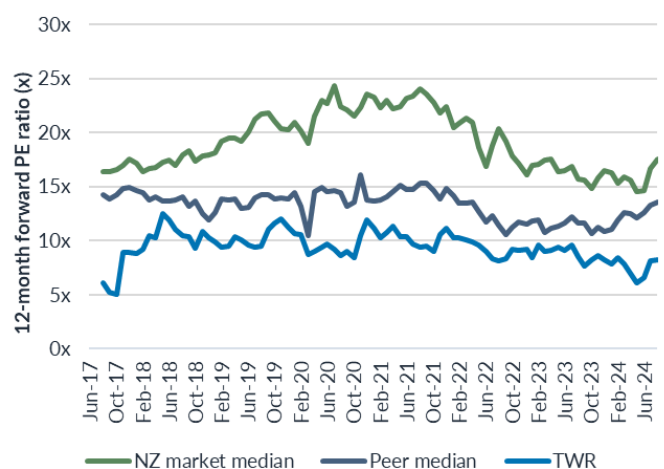
Valuation remains compelling despite strong share price performance

Figure 2. TWR trades near one standard deviation below its historical average PE of 9.2x ...



Source: Workspace, Forsyth Barr analysis

Figure 3. ... and at a widening discount to both its direct peers and the NZ market median



Source: Workspace, Forsyth Barr analysis

Additional data

Figure 4. Share price performance



Source: LSEG, Forsyth Barr analysis

Figure 5. Substantial shareholders

Shareholder	Latest Holding
Bain Capital Credit	17.8%
ACC	9.5%
NZ Funds Management	7.0%
Salt Funds Management	7.0%
Pacific International Insurance	5.8%

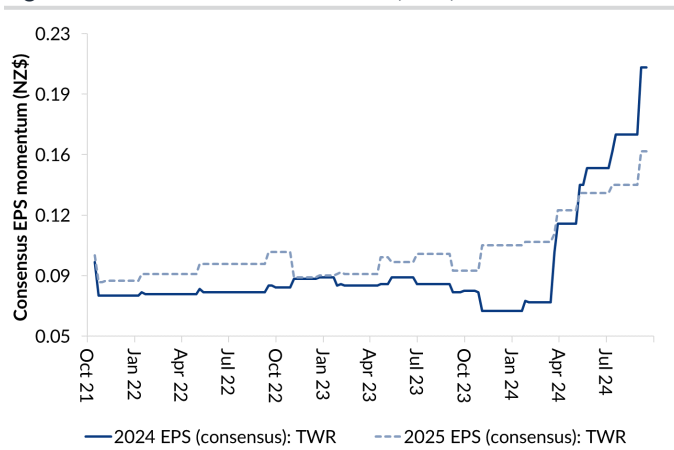
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 6. International valuation comparisons using consensus data (one and two year forward)

Company	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash Yld
				1yr	2yr	1yr	2yr	1yr	2yr	
Tower	TWR NZ	NZ\$1.37	NZ\$520	8.7x	7.2x	n/a	n/a	6.2x	n/a	7.9%
Heartland Group Holdings	HGH NZ	NZ\$1.05	NZ\$984	8.7x	6.7x	7.3x	5.9x	8.0x	6.5x	6.6%
Insurance Australia Group	IAG AT	A\$7.52	A\$17,812	17.8x	17.0x	n/a	n/a	12.6x	12.1x	4.1%
Suncorp Group	SUN AT	A\$18.08	A\$23,003	17.4x	16.1x	16.1x	15.6x	15.0x	14.9x	4.5%
QBE	QBE AT	US\$16.54	US\$24,899	14.9x	14.0x	n/a	n/a	12.5x	12.1x	4.5%

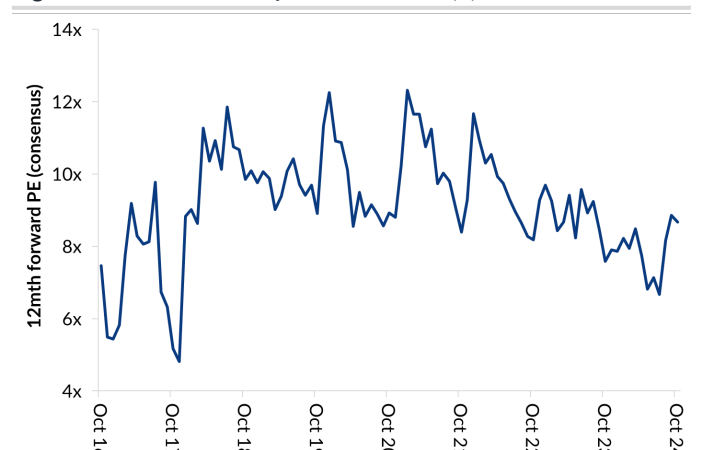
Source: Forsyth Barr analysis, Bloomberg, NOTE: all multiples based on Bloomberg consensus estimates, EV = market cap+net debt+lease liabilities+min interests-investments

Figure 7. Consensus EPS momentum (NZ\$)



Source: Bloomberg, Forsyth Barr analysis

Figure 8. Consensus one year forward PE (x)



Source: LSEG, Forsyth Barr analysis, NOTE: Data excluded when PE<0x or >75x

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