Tower
A Tower of Strength

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We initiate coverage of Tower (TWR), a New Zealand based pure-play general insurer, focussed predominately on personal lines insurance throughout New Zealand and the Pacific Islands. TWR has approximately 300k customers, NZ$385m gross written premiums (GWP) and has a 9% share of New Zealand personal lines market. After many tough years for shareholders, we believe today TWR is on the cusp of delivering increasing returns on equity through a combination of improving operational performance and improving capital management. We estimate TWR has a 7.8% 12 month forward cash dividend yield and despite recent strength in the share price we see further upside based on our NZ$0.96 spot valuation.

NZX Code	TWR
Share price	NZ$0.74
Spot Valuation	NZ$0.96
Risk rating	Medium
Issued shares	421.6m
Market cap	NZ$312m
Avg daily turnover	305.6k (NZ$194k)

Financials: Sep/	20A	21E	22E	23E
NPAT* (NZ$m)	28.0	27.6	33.2	38.7
EPS* (NZc)	6.7	6.5	7.9	9.2
EPS growth* (%)	-13.8	-2.5	20.3	16.6
DPS (NZc)	0.0	5.6	6.0	6.5
Imputation (%)	0	0	25	100
*Based on normalised profits				

Valuation (x)	20A	21E	22E	23E
PE	11.0	11.3	9.4	8.1
EV/EBIT	n/a	n/a	n/a	n/a
EV/EBITDA	n/a	n/a	n/a	n/a
Price / NTA	1.4	1.4	1.4	1.4
Cash div yld (%)	0.0	7.6	8.1	8.8
Gross div yld (%)	0.0	7.6	8.9	12.3

Legacy risks finally resolved, dividend restored

In late November 2020, almost 10 years on from the Canterbury earthquakes, TWR announced it had reached a settlement agreement with the Earthquake Commission (EQC) regarding an outstanding receivable resulting from the Canterbury Earthquakes. The settlement represents the last major outstanding legacy risk for the company. The funds from EQC further strengthen TWR's capital position (as previously the receivable was excluded from TWR's solvency calculations) and paved the way for dividends to resume after a five year intermission.

Foundations set for growth and innovation

Five years ago TWR embarked on a transformation to reposition itself as a digital challenger brand, including implementing a new cloud-based IT platform, product rationalisation and simplification, and a push to digital and data. Today, with 90% of customers migrated to the new platform and over 70% of workloads now cloud-based, TWR is just starting to realise the resulting productivity and efficiency benefits.

TWR is well positioned to accelerate its growth and leverage its existing cost base:
1. The products and processes are now such that TWR can scale with ease, as evident by three bolt-on acquisitions made recently.
2. New CEO commenced in August 2020, with a strong pedigree in large-scale digital and data innovation.
3. TWR has a very strong solvency position, with excess cash ready and waiting to be deployed into further bolt-on acquisitions.

Despite the recent rally in share price, we still see decent upside

Since November 2020 TWR has announced a raft of good news which has driven a good rally in TWR's share price, however, TWR continues to trade at a discount relative to peers. Given legacy risks are now resolved and TWR is on the cusp of improving return on equity, we believe the stage is now set for multiple expansion. As TWR delivers on its digital strategy and its return on equity improves, we expect TWR to trade more in-line with peers. For now, we assume TWR's discount to peers multiples will reduce by 50%, forming our base valuation of NZ$0.96 per share. Adjusting key operational assumptions and the assumed P/E multiples, results in a bear and bull valuation of NZ$0.53 and NZ$1.70 respectively, an attractive risk skew. Based on our FY21E dividend of NZ5.7cps, TWR's 12 month forward cash dividend yield of 7.8% is second highest in NZ under Forsyth Barr's coverage, with our base case valuation implying a cash yield of 6.1%, still leagues above the market median of 3.2%.

Tower Limited (TWR)

Market Data (NZ$)	
Priced as at 12 Mar 2021	**0.740**
52 week high / low	0.76 / 0.54
Market capitalisation (NZ$m)	312.0

Spot valuations (NZ$)	**0.96**
1. PE relative	1.02
2. PB relative	0.89
3. n/a	n/a

Key WACC assumptions	
Risk free rate	2.30%
Equity beta	1.20
WACC	10.5%
Terminal growth	1.5%

DCF valuation summary (NZ$m)	
Total firm value	n/a
(Net debt)/cash	n/a
Less: Capitalised operating leases	n/a
Value of equity	n/a

Profit and Loss Account (NZ$m)	2019A	2020A	2021E	2022E	2023E
Sales revenue	345.0	380.5	398.5	420.4	439.2
Normalised EBITDA	**n/a**	**n/a**	**n/a**	**n/a**	**n/a**
Depreciation and amortisation	n/a	n/a	n/a	n/a	n/a
Normalised EBIT	**n/a**	**n/a**	**n/a**	**n/a**	**n/a**
Net interest	n/a	n/a	n/a	n/a	n/a
Associate income	0	0	0	0	0
Tax	n/a	n/a	n/a	n/a	n/a
Minority interests	0.2	0.4	0.3	0.4	0.4
Normalised NPAT	**27.3**	**28.0**	**27.6**	**33.2**	**38.7**
Abnormals/other	(10.7)	(16.1)	(1.8)	(1.4)	(1.1)
Reported NPAT	**16.6**	**11.9**	**25.8**	**31.8**	**37.6**
Normalised EPS (cps)	7.8	6.7	6.5	7.9	9.2
DPS (cps)	0	0	5.6	6.0	6.5

Valuation Ratios	2019A	2020A	2021E	2022E	2023E
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)	9.5	11.0	11.3	9.4	8.1
Price/NTA (x)	1.4	1.4	1.4	1.4	1.4
Free cash flow yield (%)	7.9	6.1	30.4	18.8	20.2
Net dividend yield (%)	0.0	0.0	7.6	8.1	8.8
Gross dividend yield (%)	0.0	0.0	7.6	8.9	12.3

Key Ratios	2019A	2020A	2021E	2022E	2023E
Return on assets (%)	n/a	n/a	n/a	n/a	n/a
Return on equity (%)	9.4	8.1	7.9	9.4	10.6
Return on funds employed (%)	0.0	0.0	0.0	0.0	0.0
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 (%)	10.9	2.8	3.9	3.9	3.9
Capex to depreciation (%)	n/a	n/a	n/a	n/a	n/a
Imputation (%)	0	0	0	25	100
Pay-out ratio (%)	0	0	86	76	71

Growth Rates	2019A	2020A	2021E	2022E	2023E
Revenue (%)	6.8	10.3	4.7	5.5	4.5
EBITDA (%)	n/a	n/a	n/a	n/a	n/a
EBIT (%)	n/a	n/a	n/a	n/a	n/a
Normalised NPAT (%)	>100	2.7	-1.5	20.3	16.6
Normalised EPS (%)	84.7	-13.8	-2.5	20.3	16.6
Ordinary DPS (%)	n/a	n/a	n/a	6.0	9.4

Capital Structure	2019A	2020A	2021E	2022E	2023E
Solvency capital	155.9	150.5	193.2	196.5	205.0
Minimum solvency capital	56.6	52.3	52.8	52.8	52.8
Total regulatory capital	106.6	102.3	101.8	102.8	102.8
Solvency ratio (%)	275	287	366	372	389

Cash Flow (NZ$m)	2019A	2020A	2021E	2022E	2023E
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	**24.6**	**18.9**	**95.0**	**58.7**	**63.0**
Capital expenditure	(37.6)	(10.5)	(15.5)	(16.3)	(17.1)
(Acquisitions)/divestments	0	(9.5)	(14.0)	0	0
Other	(42.0)	(9.4)	(10.2)	(2.8)	(2.9)
Funding available/(required)	**(55.0)**	**(10.5)**	**55.3**	**39.6**	**43.0**
Dividends paid	0	0	(23.8)	(25.2)	(27.6)
Equity raised/(returned)	0	44.9	0	0	0
(Increase)/decrease in net debt	**(55.0)**	**34.4**	**31.5**	**14.4**	**15.4**

Operating Performance	2019A	2020A	2021E	2022E	2023E
Gross written premium	356.8	385.1	400.9	423.0	441.9
Gross earned premium	**345.0**	**380.5**	**398.5**	**420.4**	**439.2**
Reinsurance expense	(55.0)	(57.2)	(59.7)	(61.2)	(63.8)
Net earned premium	**290.0**	**323.3**	**338.7**	**359.2**	**375.4**
Net claims expense	(140.3)	(149.7)	(164.4)	(173.8)	(181.6)
Large event claims expense	(1.3)	(9.7)	(14.0)	(15.2)	(15.8)
Management and sales expenses	(116.0)	(126.6)	(123.6)	(125.7)	(127.6)
Underwriting profit	32.4	37.3	36.7	44.5	50.3
Investment and other revenue	7.0	6.4	3.4	3.6	5.7
Financing costs	(0.3)	(1.1)	(0.4)	(0.4)	(0.4)
Underlying profit before tax	**39.1**	**42.6**	**39.8**	**47.8**	**55.6**
Income tax expense	(11.6)	(14.1)	(11.9)	(14.2)	(16.6)
Underlying profit after tax	**27.5**	**28.5**	**27.9**	**33.5**	**39.1**
Abnormals	(10.7)	(16.2)	(1.8)	(1.4)	(1.1)
Reported profit / (loss) after tax	**16.8**	**12.3**	**26.2**	**32.1**	**37.9**

Balance Sheet (NZ$m)	2019A	2020A	2021E	2022E	2023E
Working capital	171.6	184.1	142.7	144.5	151.0
Fixed assets	9.1	10.0	10.9	11.8	12.7
Intangibles	106.7	119.6	129.5	133.0	134.8
Right of use asset	0	7.2	14.0	11.7	9.4
Other assets	278.1	277.6	284.7	284.7	284.7
Total funds employed	**565.5**	**598.6**	**581.8**	**585.8**	**592.6**
Net debt/(cash)	(47.1)	(80.1)	(111.6)	(126.0)	(141.4)
Lease liability	0	8.7	14.8	12.0	9.1
Other liabilities	319.9	322.9	329.1	343.4	358.2
Shareholder's funds	290.9	345.0	347.0	353.5	363.5
Minority interests	1.8	2.2	2.5	2.9	3.2
Total funding sources	**565.5**	**598.6**	**581.8**	**585.8**	**592.6**

Key ratios					
Tower Direct GWP Growth	9.2%	13.7%	8.4%	6.8%	5.0%
Partnership GWP Growth	2.9%	2.8%	3.4%	4.0%	4.0%
GWP growth %	6.2%	7.9%	4.1%	5.5%	4.5%
Total claims ratio %	49%	49%	53%	53%	53%
MER %	40%	39%	36%	35%	34%
Combined ratio %	89%	88%	89%	88%	87%

Executive summary

We initiate coverage of Tower (TWR) with a base (spot) valuation of NZ$0.96 per share. TWR has recently shed its remaining legacy risks and having largely completed its migration of customers and processes to a digital-first strategy, the foundations are set for scale benefits. With attractive industry dynamics, the company's very strong solvency position and appetite for further bolt-on acquisitions, we expect premium growth and operating leverage to drive relatively strong earnings growth and improving returns. For the first time in many years, we believe risks are weighted to the upside and TWR now just needs to deliver on expectations to restore investor sentiment.

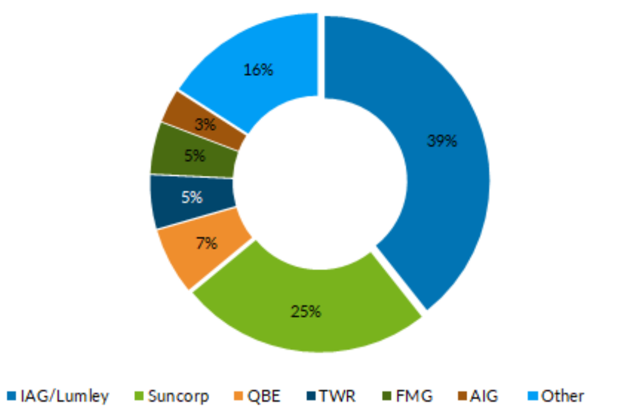
Investment thesis

Favourable industry dynamics

TWR represents an established brand in an attractive industry landscape:

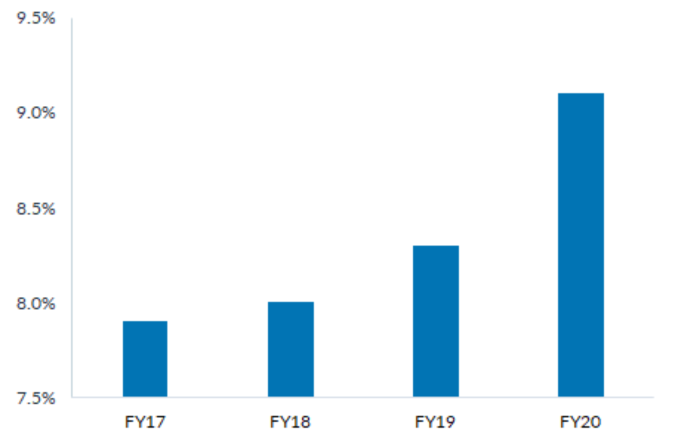
- Reasonable barriers to entry exist
- The industry has remained largely unchanged over the last five years, with TWR's acquisition of Youi NZ in FY20 helping boost its market share
- The industry has a good history of passing through material increases in reinsurance and claims costs. Recent commentary from major competitors suggests the current pricing environment remains strong.

Figure 1. NZ General Insurance Market



Source: Forsyth Barr analysis, ICNZ. Based on 12 month business to 30 September 2019

Figure 2. TWR NZ Personal Lines Market Share



Source: Forsyth Barr analysis

Relatively strong earnings growth, driven by scale efficiencies, push to digital and bolt-on acquisitions

We are more conservative than management on FY21 large events claims risk and consequently see the company missing its guidance for 5% growth in underlying earnings (based on no further bolt-on acquisitions, which is unlikely in our view) along with its NZ6cps dividend based on 60–80% payout relative to cash earnings.

Despite this, we still consider TWR to have attractive earnings growth (without assuming any additional acquisitions). We forecast ~11% annualised underlying earnings growth over the next three years (vs ~8% median three year annualised EPS growth estimate for Forsyth Barr's S&P/NZX50 constituents under coverage, relative to FY20 base), with contribution from both revenue growth and operating leverage:

- The market dynamics remain supportive for reasonable organic growth, TWR is still to report a full year contribution from its recent Youi NZ and Club Marine bolt-on acquisitions, and we expect TWR to expand its product range in coming months (with EV, scooter, pet and travel insurance all under development vs. a refined product suite currently of home & contents, motor, and marine)
- Over the last couple of years TWR has transformed its processes and products, and made a push into digital and data. 90% of customers have been migrated to the new cloud-based platform and 70% of workflow is now cloud-based. At the recent trading update from the company in February 2021, the company's management expense ratio (MER) improved from 39% to 37% yoy, and implies management and sales expenses remained flat despite the ongoing investment in the business vs pcp — the first time management and sales expenses haven't increased in at least three years. We expect continued MER improvement as the company

leverages its existing cost base (cost to acquire a Direct customer is 13% vs an MER for the Direct business of 34%), and improves its cost base with the power of digital and data driving efficiencies (e.g. from self-service, targeted digital marketing, digital processes etc)

- With three recent bolt-on acquisitions under its belt, TWR has demonstrated that its new cloud-based platform can scale with ease and with retention reportedly remaining high, indicates the migration is equally seamless from a customer perspective. This bodes well for further bolt-on acquisitions and reduces the likelihood of execution errors, in our view. Any additional acquisitions are expected to provide an additional kicker to our earnings estimates

New CEO to accelerate digital and data strategy

New CEO, Blair Turnbull, commenced in August 2020 and is a strong and timely appointment by the TWR board. Having spent the last six years repositioning Aviva Group in the UK as a leading player in digital, direct and data, Blair has a proven global track record in large-scale digital and data innovation, and delivering disruptive, customer-focussed models. TWR's digital and data strategy is currently leading the NZ market and combined with TWR's internal digital expertise and strategic priority to "Partner Everywhere" will likely see TWR's digital offering remain well placed, despite competitors having deeper pockets.

Strong capital position — dividends restored and firepower remains for bolt-on acquisitions

TWR has a very strong solvency position, currently sitting at ~368% minimum solvency capital (MSC) requirements. The company has recently announced it will be resuming dividends and based on its dividend policy of 60–80% payout of cash earnings, our estimate of 12 month forward cash dividend yield of 7.8% places it as the 2nd highest yielding stock in NZ under Forsyth Barr's coverage.

We estimate at FY21E TWR has potentially NZ$61m of surplus capital (c.15cps) over and above an assumed 250% target MSC, with the Board clear on its capital management priorities; it will continue to seek bolt-on acquisitions aligned to its personal and small to medium sized commercial lines of business, or failing that will consider returning capital to shareholders to optimise capital management.

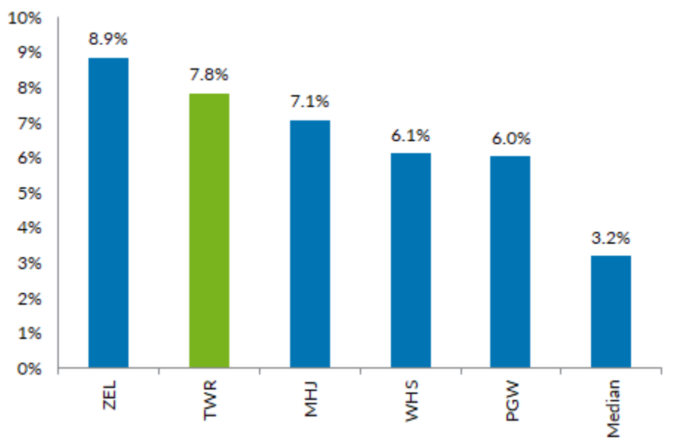
Based on our estimates (with no contribution from unannounced acquisitions or additional capital management other than the revised dividend policy), we see TWR's return on equity improving to 11% over the next three years. Any acquisitions or capital management is expected to drive further improvements in return on equity.

Figure 3. Very strong capital solvency

Financial year ending Sept (NZ$m)	FY19	FY20	FY20 adj.
Actual solvency capital	156	150	192
Minimum solvency capital	57	52	52
Solvency margin	**99**	**98**	**140**
Solvency ratio	**275%**	**287%**	**368%**

. Source: Forsyth Barr analysis. Note: FY20 adj. reflects the solvency as at FY20 adjusted for the $42m EQC receivable which has since settled.

Figure 4. 2nd highest 12 month forward cash dividend yield in NZ



Source: Forsyth Barr analysis. Median reflects median of Forsyth Barr universe.

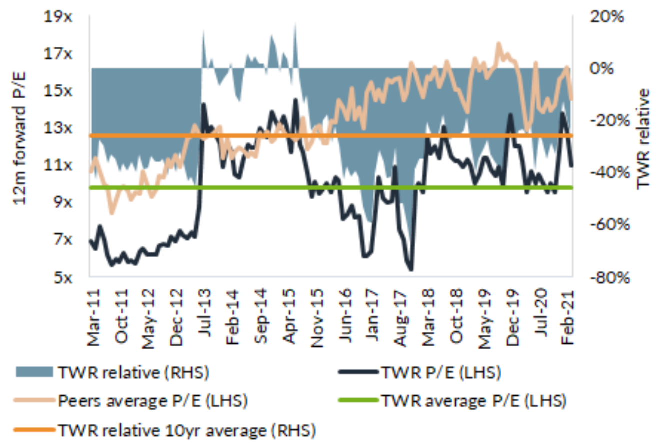
Despite the recent rally in share price, we still see decent upside

Our base case valuation for TWR is NZ$0.96/share (spot) based on a relative P/E and P/B valuation.

With news of TWR resolving its legacy issues and with improving returns in sight, TWR has recently seen its trading multiples expand (for example, its 12 month forward P/E multiple has gone from sub 10x pre news flow in November 2020, to ~11x today on our estimates and compares to a 10-year average of 9.8x) but still remains at a chunky discount to peers. Given legacy risks have been resolved and the expectation for improving operating performance and capital management to drive improving return on equity, we believe the stage is set for further multiple expansion and for TWR to re-rate more inline with peers. For now, we assume this discount vs peers narrows by 50% but will look to revise this as TWR delivers on its digital strategy and return on equity improves.

Flexing our operational assumptions (again, no assumed contribution from unannounced acquisitions) under bear and bull case scenarios and adjusting our applied P/E multiple +- 20%, results in a bear valuation of NZ$0.53 vs a bull valuation of NZ$1.70, an attractive risk skew.

Figure 5. Despite recent rally, discount to peers remains



Source: Forsyth Barr analysis

Figure 6. Blended P/E, P/B relative valuation

NZ$m	P/E	P/B	Valuation
12-month forward NPAT	**28.8**		
P/E Median Multiple of Peers	14.7x		
Assumed Discount vs Peers	-13%		
Resulting P/E Multiple Applied	**12.8x**		
Value	369		
Surplus Cash assumption	61		
Gross Value	**430**		
Shares on Issue (m)	421.6		
P/E Valuation (NZ$/share)	**1.02**		
Forward BV per share		**0.83**	
P/B Median Multiple of Peers		1.26x	
Assumed Discount vs Peers		-15%	
Resulting P/B Multiple Applied		**1.1x**	
P/B Valuation (NZ$/share)		**0.89**	
Blended valuation (spot, NZ$/share)			**0.96**

Source: Forsyth Barr analysis

Key risks

- **Insurance industry environment.** The industry that TWR operates within involves the assumption and subsequent transfer in part of risk (via reinsurance). Changes in frequency and severity of customer claims, which may result from inflation, natural disasters or other events, can affect TWR's capital position, consistency of earnings and the achievement of targets. TWR's earnings and solvency position is dependent on availability of reinsurance, which may change overtime
- **Climate change.** There is a clear trend of increasing frequency and severity of natural disasters (excluding earthquakes), driven in part by climate change. TWR has an extensive reinsurance programme currently, including catastrophe cover and aggregate cover for storms and other large events, which helps transfer risk, but the high variability in large event claims means there is potential for high earnings volatility. Climate change is expected to dramatically change the insurance industry over the medium term, including pricing adjustments and availability of insurance and reinsurance, which may also result in changing behaviour of competitors and increased public scrutiny
- **Business transformation.** TWR is continuing to migrate its customers to its new IT platform. While largely progressed, TWR has a checkered track record of delivering on IT projects and promised benefits. There remains the risk that the current digital and data strategy does not achieve the operational performance improvements as expected
- **Regulatory risk**
  - The RBNZ is currently reviewing the Insurance (Prudential Supervision) Act 2010 and solvency standards, with the potential for solvency requirements to be increased
  - The Financial Markets (Conduct of Institutions) Amendment Bill is currently in its second reading. This Bill proposes to establish a new conduct regime for financial institutions, amends the Financial Markets Conduct Act 2013 to ensure that certain financial institutions and their intermediaries comply with a principle of fair conduct and associated duties and regulations
  - There is the risk of competition regulation or Commerce Commission intervention on the industry, with Treasury directed to investigate pricing and access issues in property insurance markets back in September 2019 (no further public update has since been provided)
- **Investments returns.** TWR invests funds collected as premiums and provided by shareholders to ensure it can meet its obligations to pay claims and expenses. The majority of investments are in investment grade supranational and government bonds, and term deposits. Changes in investment returns can affect profitability
- **Acquisition risk**. TWR is likely to make acquisitions in the future, presenting the risk that they overpay and/or do not achieve the expected results of an acquisition, which has the potential to destroy shareholder value
- **Canterbury earthquake claims.** While the number of Canterbury earthquake claims continues to reduce steadily, there continues to be new over-cap claims from the EQC

- **Systems, security, compliance and data privacy.** The information systems used by TWR could suffer material malfunction, disruption or security breach
- **Competition risk.** A change in the competitive environment could cause a change in pricing and/or increasing switching between providers in the market, which could cause margin compression or customer losses

Near term catalysts — within next 12 months

Positive

- Bolt-on acquisition announcements
- Amended licence condition, removing NZ$50m minimum MSC condition
- Potential Bain Capital sell-down, improving liquidity
- Product and innovation releases
- Large adverse events claims lower than expected

Negative

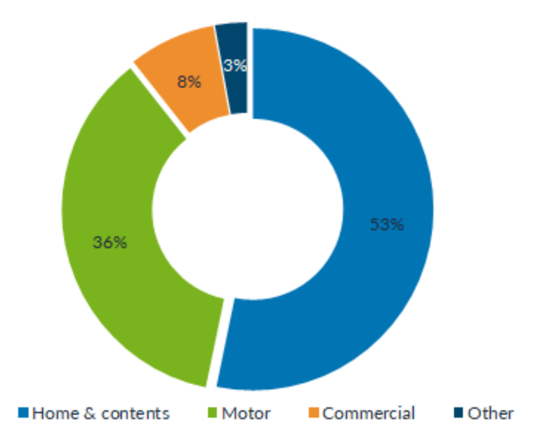
- Large adverse events, such as floods, storms, fires (but neutral on our forecasts as we assume reinsurance excess triggered)
- Treasury pricing review
- Consultation on RBNZ prudential review, if capital requirements increased

Company overview

Born and bred in New Zealand, TWR has been supporting New Zealand communities with their insurance needs for over 150 years. More recently, from November 2012 to August 2014, through a series of transactions TWR divested its Health, Investment and Life insurance businesses, transforming TWR from a composite insurer into a pure-play general insurer. See Appendix A for details of corporate history.

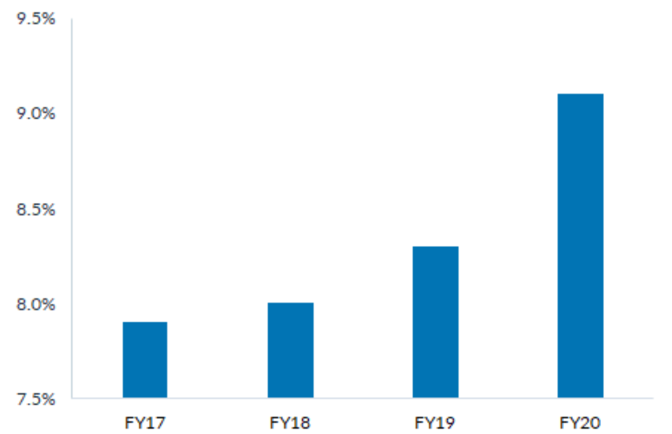
Today TWR operates across New Zealand and the Pacific Islands, providing personal lines insurance (including home & contents, motor, and recently added marine to its product suite) and SME insurance for ~ 300k customers and has ~9.2% market share of NZ personal lines market.

Figure 7. Split of Gross Written Premium by Product



Source: Forsyth Barr analysis

Figure 8. TWR's Market Share of NZ's Personal Lines Market



Source: Forsyth Barr analysis

The company has recently repositioned itself as a contemporary, challenger brand underpinned by a customer-focussed, digital-first strategy to successfully compete in the 21st-century insurance marketplace. Its purpose is to "deliver beautifully simple and rewarding experiences that [its] customers rave about, every time".

TWR has an insurer financial strength rating of 'A-' (Excellent) and a long-term issuer credit rating of 'A-', both with outlook stable, as affirmed by international rating agency AM Best Company Inc. These ratings of TWR reflect its balance sheet strength, which AM Best categorises as very strong, as well as its adequate operating performance, neutral business profile and appropriate enterprise risk management.

Figure 9. SWOT Analysis

Strengths	Weaknesses
▪ Established brand with strong brand recognition	▪ Concentrated industry, with IAG and Suncorp at over 60% market share
▪ Industry has exhibited strong premium growth, passing through material increases in reinsurance costs and general claims inflation	▪ Earnings and solvency heavily dependent on availability and pricing of reinsurance
▪ Reasonable barriers to entry	▪ Customer satisfaction ratings below industry average
▪ Customers relatively sticky (for now)	▪ Catastrophe events
▪ Robust financial flexibility & prudent reinsurance programme	▪ Price comparisons becoming increasingly easy
▪ IT transformation complete & largely derisked. Fully cloudbased, simplified and highly agile	▪ Mature market (limited growth but equally a positive as it detracts new entrants)
▪ Product rationalisation complete	

Opportunities	Threats
▪ Potential to add new product and increase cross-sell	▪ Climate change
▪ Partnership opportunities	▪ Autonomous vehicles
▪ Improving customer satisfaction with digital capabilities	▪ Electric vehicles
▪ Opportunity to bundle with other utility services	▪ Competition is large and well capitalised
▪ Increased risk-based pricing	▪ Commerce Commision review of sector
▪ Sector-wide poor customer understanding/engagement	▪ Amazon, Tesla or other FinTech type offering
	▪ Increased capital requirements

Source: Forsyth Barr analysis

Canterbury earthquakes — 10 years on

10 years on from the Canterbury earthquakes, TWR is finally in a position where key uncertainties relating to the Canterbury earthquakes have been resolved, with the company (& sector as a whole) better positioned to manage future catastrophe events.

A recap of the tragic events

From September 2010 to December 2011, the Canterbury region in NZ's South Island suffered a punishing sequence of earthquakes and thousands of aftershocks, resulting in tragic loss of life and substantial destruction to Christchurch and surrounding areas.

The Canterbury earthquakes comprised of four major earthquakes (see table below), 11 other "damage-causing" events (for the purpose of claims) and almost 18,000 aftershocks. The earthquakes were the largest and most damaging natural disasters encountered in NZ's history.

Figure 10. Major Canterbury Earthquakes 2010/2011

Date	Location	Magnitude
4 September 2010	Near Darfield, 35km west of the outskirts of Christchurch	7.1
22 February 2011	Hillsbourgh, 10km south of the Christchurch CBD	6.3
13 June 2011	Redcliffs, Christchurch	5.7, 6.0
23 December 2011	Two earthquakes at South New Brighton, Christchurch	5.8, 5.9

Source: Forsyth Barr analysis, GeoNet

The RBNZ estimates final claims costs are likely to come in at a whopping ~NZ$38b (roughly double what was estimated back in 2011), with more than NZ$36b paid to date, and ranks as one of the largest insured catastrophe events worldwide. Based on RBNZ's estimates, reinsurance funded 72% of the cost of insurance claims for 20 property insurers (excluding the EQC and Lloyd's), but many insurers had insufficient existing reinsurance and capital to fully fund claim costs, with companies having to purchase after the event reinsurance and/or capital injections from shareholders/parent (or government bailout in the case of Southern Response, formerly AMI).

Hard lessons but sector has responded and is better positioned to manage future events

While NZ has a history of earthquakes (roughly 20,000 recorded each year, the majority of which are relatively minor), the insurance industry and the NZ Government and associated entities were not equipped to efficiently and effectively deal with the scale and complexity of the Canterbury earthquakes. Even by international standards, the complexity was unprecedented with ongoing earthquake events and extensive and severe liquefaction damage, but regardless there were major failings across the sector.

The sector as a whole has made key adjustments which see insurers, and the communities of NZ, better positioned to manage any future catastrophes.

New partnership model with EQC and private insurers to improve customer experience, data sharing and increased claims capacity

In November 2020 the EQC and most private insurers, including TWR, announced a partnership whereby from 2Q2021 private insurers will manage the total claim for anyone with home insurance whose home or land is damaged in a natural disaster (including the EQC portion up to the statutory capped level of damage).

The new arrangement streamlines the insurance process for a natural disaster; allowing customers to deal with their insurer who will assess, manage and settle their claims.

The experience of the Canterbury earthquakes highlighted NZ's dual insurance system was previously inefficient and frustrating for homeowners, with customers often required to make two claims — one to EQC up to a capped level of the damage and the other to their private insurers for top-up cover losses. This duplication of claims management is sighted by many as a major factor that led to the Canterbury earthquakes claims taking significantly longer than normal to settle.

The partnership builds on the model used following the 2016 Kaikoura earthquake (and Northland floods in July 2020) which resulted in simplified and faster claims resolution and a higher claimant satisfaction rate. Claim satisfaction rates after the Kaikoura event was at 70% — higher than the average 50% in other events where the EQC was involved, and significantly higher than 43% for the Canterbury earthquakes.

Reinsurance materially increased

Insurers and the EQC have substantially increased their reinsurance cover for catastrophe events post the Canterbury earthquakes.

Focussing on TWR, the company's reinsurance programme for FY21 provides catastrophe cover of NZ$812m (with first NZ$10m covered by TWR), to protect against a modelled 1-in-1,000 years whole of portfolio catastrophe loss as now required by the RBNZ. In addition, TWR takes out an additional NZ$20m aggregate reinsurance cover for large events which fall outside the catastrophe reinsurance programme and tends to cover weather events in New Zealand and across the Pacific (with the first NZ$14m covered by TWR). This compares to original reinsurance ceilings of ~NZ$325m at the time of the Canterbury earthquakes.

Move to sum insured residential cover

At the time of the Canterbury earthquakes, most residential insurance in NZ was provided on a “full replacement” basis. If a house were destroyed in a fire or natural disaster, the insurer was responsible for demolishing the wreckage, clearing the site and building a new house to the same size, standard and specifications as the home's condition when new. This compares to most countries basing house insurance policies on a maximum specified amount (e.g. in Australia and the UK) or excluding protection against certain types of natural disasters (e.g. in the USA flood and earthquake cover is typically excluded).

Since the Canterbury earthquakes, most residential insurers in NZ have since moved to fixed sum (or “sum insured”) policies. The move to a sum insured market provides insurers and reinsurers a better understanding of the exposure they face and caps the amount an insurer will pay on extensive damage.

TWR and Vero, however, also offer full replacement cover for total loss from fire, reflecting the low magnitude and costs historically associated with total loss claims with fire and thus the ability to get reinsurance cover.

Increasing use of risk-based pricing

Better data and increasingly sophisticated modelling is being applied to price risk and reducing the cross-subsidisation of risk. Risk-based pricing means that insurance policy holders facing greater risk, such as those in areas more prone to natural disaster and severe weather-related risks, pay more for insurance cover than policy holders in other areas. For example, due to higher earthquake risk a Wellington homeowner looking to insure their home for NZ$800k and their contents for NZ$140k would face annual premiums of ~NZ$3,500 vs NZ$1,600 for the same policy in Auckland.

TWR first introduced earthquake risk-based pricing in April 2018. In conjunction with ongoing knowledge sharing with customers regarding risk profiles, TWR intends to extend its pricing to reflect flood risk later this year. Risk mitigation (e.g. construction of low-damage designed houses) in time will also increasingly feed into risk-based pricing. An example of this today is TWR requires cyclone certificate from an approved engineer before home insurance in the Pacific is extended to include cyclone cover.

Risk-based pricing will continue to evolve, particularly as climate risk escalates. Such pricing supports the efficiency and stability of the insurance sector, as well as providing important pricing signals to communities around the personal cost of climate risk.

Legacy risks resolved, remaining claims manageable

As a major insurer in NZ, TWR alone estimates it has incurred cumulative claims in relation to the Canterbury earthquakes of NZ$983m, with the cumulative after tax impact (after reinsurance recoveries) of NZ$196m as at 30 September 2020.

TWR continues to make steady progress with the settlement of claims, with 59 claims open of a total ~15,000 claims settled to-date. While it is likely to take several years to finalise all residual claims, net outstanding claims now represent a manageable NZ$31m (including an additional NZ$5m risk margin over and above the provision based on a 75th percentile of sufficiency).

In November 2020, TWR announced it had reached a settlement with the EQC in relation to its Canterbury earthquake receivables. TWR has since received NZ$43m after disbursement to reinsurers and costs, with a residual NZ$9.5m after tax impairment recorded in the FY20 results, and follows the settlement with Peak Re in FY18, where TWR received NZ$22m of the NZ$44m claimed under its reinsurance contract. The settlement with the EQC is a major milestone; representing the closure of the last major outstanding risk for the company in relation to the Canterbury earthquakes and allows the company to focus its attention on its growth ambitions.

Competitive landscape

Attractive industry landscape for incumbents

Concentrated market

The New Zealand General Insurance (GI) market is verging on highly concentrated and has seen little change in competitive dynamics for the last five years, with the top six insurers writing ~84% of all premiums and has an HHI greater than 2,250. The NZ Personal Lines market is very similar in competitive dynamics; four insurers write almost 80% of all premiums and have an HHI of at least 2,160.

Figure 11. Key players in the NZ General Insurance sector, as at 30 September 2019

Company	Est. Market Share — NZ GI	Est. Market Share — NZ Personal Lines	Key Brands	Key Partners
IAG/Lumley	39%	39%	Includes State, NZI, AMI and Lumley brands	BNZ, Westpac, ASB
Suncorp	25%	23%	Vero and AA brands	ANZ, AMP, Warehouse Money
QBE	7%	n/a	Corporate and commerical insurance	
TWR	5%	8%		TSB, TradeMe
FMG	5%	8%	NZ-owned Farmers' Mutual Group	
AIG	3%	n/a	Corporate and commerical insurance	
Other	16%	22%	Other small players	

Source: Forsyth Barr analysis, ICNZ data, company releases

Note: The Herfindahl-Hirschman Index ('HHI') is a measure of market concentration, ranging from 0 to 10,000. A market with an HHI of 1,500 -2,500 is considered to be moderately concentrated marketplace, and an HHI of 2,500 or great to be a highly concentrated marketplace

Probably not the first choice of market for rational new entrants looking to expand organically

The NZ personal lines insurance market is considered mature and highly penetrated by OECD standards.

- Based on Insurance Council of NZ (ICNZ) data, 98% of New Zealand housing stock has house insurance, reflecting our exposure to natural hazards (such as earthquakes) and requirements from most banks for comprehensive insurance as a mortgage condition.
- Based on data going back to 2013, ICNZ survey data suggest at any time around 93–97% of drivers are insured. While NZ doesn't have compulsory car insurance, a high proportion of vehicles are financed, with insurance a key requirement.

Reasonable barriers to entry

If the highly concentrated, highly penetrated and relatively small market size is not enough of a deterrant for new errants, the sector also exhibits reasonable barriers to entry.

1. Pricing/claims data is a particularly important factor for house & contents (H&C) insurance. The submissions of key industry participants opposing applications for clearance of proposed major M&A activity in the sector provide great insight into these barriers:
   1. "*The Canterbury earthquakes gave rise to a wealth of information for existing insurers, allowing existing insurers to very specifically assess risks based on various factors such as soil type, location etc...In Suncorp's view, proprietary knowledge of H&C risks gives incumbents a significant market advantage over new entrants, one that is not easily replicable by new entrants without incurring substantial costs*" (Suncorp's submission on IAG's 2014 proposed acquisition of Lumley, which was subsequently approved by the Commerce Commerce).
   2. "*In order to enter into the markets in any meaningful way, and to expand, insurance companies need underwriting data in order to understand, properly price and manage the risks in the market....Insurance companies can only obtain "in-market" data through experience in a market. The more experience and exposure an insurer has in a market, the better an insurer can understand risk by having access to more accurate information and more accurate pricing. This leads to less assumptions in the modelling — which in turn leads to a requirement to hold less capital — which in turn leads to lower prices while maintaining a satisfactory return on capital. The underwriting data is closely guarded by incumbents and not available to competitors. As a result, incumbent insurers already enjoy a significant advantage over new entrants to price and manage risk. Accordingly, new entrants face higher risks in a market until they can obtain greater quantity and quality of underwriting data to make better informed decisions*" (AIG Insurance NZ's submission on Vero's 2017 proposed acquisition of TWR, which was subsequently declined clearance by the Commerce Commission).

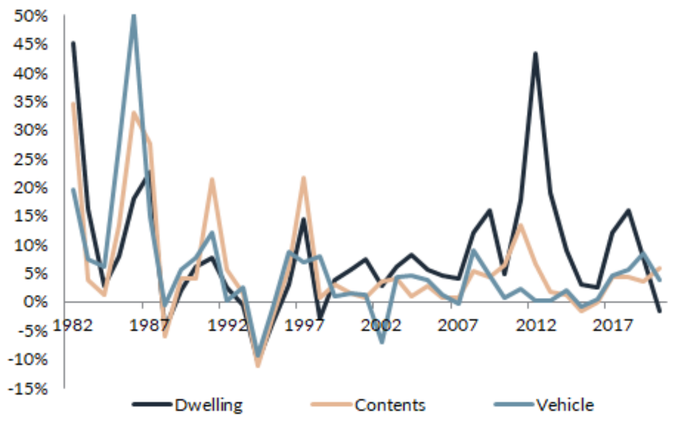
2. Regulatory barriers, with the need for insurers to hold minimum prescribed capital levels based on underwriting exposure. The current RBNZ review of solvency standards and the potential for stricter capital requirements will only further enforce the existing moat and the dominance of the top industry players given their current strong capital positions
3. Requirement for scale to reduce reinsurance costs

Strong premium growth

The industry has historically exhibited strong premium growth, both on a gross and net premium basis (i.e. net of reinsurance costs), with insurers passing through material increases in reinsurance costs and in large covering claims inflation.

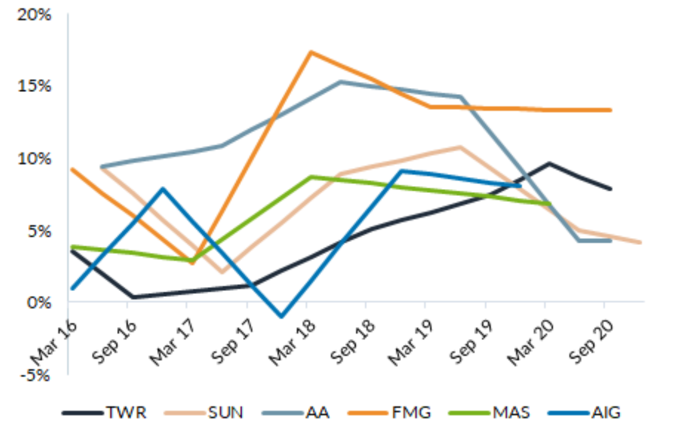
Recent commentary from SUN and IAG suggest the pricing environment remains favourable, but note IAG plans to grow at least in line with the industry, growing customer numbers not just rate increases. As IAG's NZ consumer business has been growing below key peers and the industry generally, this may suggest there is heightened risk the pricing cycle is about to turn.

Figure 12. Annual insurance CPI



Source: Forsyth Barr analysis, StatsNZ

Figure 13. Net Written Premium growth of leading NZ GIs



Source: Forsyth Barr analysis. NB: [1] TWR normalised for Youi acquisition. [2] IAG excluded given distortion from new reinsurance quota share agreements initiated in 2016 and 2018.

But risks should not be overlooked

Potential for government intervention

The Productivity Commission's 2019 review ranked the Financial and Insurance services industry as one of the least competitive industries, alongside the Supermarket sector, which has recently been placed under investigation. In November 2020 the government announced the Supermarket sector is undergoing a 12 month study by the Commerce Commission, with the scope including a review into the structure and competition of the grocery industry at the wholesale and retail levels, the pricing practices and grocery procurement practices of the major grocery retailers, and the price, quality, product range and service offerings for customers.

Back in September 2019 Treasury was directed to investigate pricing and access issues in property insurance (particularly in Wellington) given moves by insurers to risk-based pricing. However, there has since been no update to this investigation and some industry players believe this has been bumped in priority due to COVID-19 issues.

Big Tech push into insurance, potential to dethrone incumbents globally

FinTech developments in the NZ market to-date have been limited, but they represent a threat to the traditional incumbent players in part by reducing barriers to entry.

Smart devices in the home and increasing smarts in cars over time may provide sufficient data to prudently price risks. Tesla, for instance, has launched auto insurance and in 2020 expanded its offering beyond its California test-market.

Amazon is rumoured to be preparing for the potential wide-spread entry into motor insurance. In July 2020, Amazon entered the Indian motor insurance distribution business by joining forces with digital insurance startup Acko General Insurance. As part of the partnership, the e-commerce company's payment arm Amazon Pay is offering two- and four-wheeler insurance policies of the general insurance firm to its Indian customers. Amazon claims that customers will be able to get new policies set up and purchased in less than two minutes and without the need for any traditional paperwork. Amazon Pay is popular in India, and the service will likely grow in other countries as Amazon extends its reach via things like cashier-less supermarkets.

Transformation largely complete, now for growth and innovation

Transforming the core

About five years ago TWR embarked on a transformation to reposition itself as a digital challenger brand, underpinned by a customer focussed digital first strategy. The transformation process has been multi faceted, and while still ongoing, recent news flow highlights the potential.

Product rationalised and simplified

Five years ago TWR had 350 different policy versions and 150 different on-sale products. The complexity made it hard for both staff and customers, consequently impacting sales and customer satisfaction.

As at late 2020 TWR had reduced its NZ products down to a core set of 12 plain language products while the Pacific business is still in the throes of product rationalisation. Product rationalisation and simplification of product offering was required to unlock the company's digital strategy, which in aggregate is expected to drive productivity and efficiency improvements.

New cloud-based IT platform

After some 20 years of starting various IT projects only to have them impaired and having to start over, the IT of TWR (like many NZ insurers and other history rich traditional businesses) was a complex array of platforms, with bolt-ons and dozens of ancillary systems, weighing down the organisation with significant complexity and unnecessary costs.

In FY18, under previous CEO Richard Harding, the Board approved the investment in EIS, a new core cloud-based digital insurance platform, to help drive top line growth and cost out (this messaging has since changed & is discussed in our Financials section). In November 2019, after approximately 1.5 years and ~NZ$50m later, TWR completed its Microsoft Azure cloud-based implementation of EIS, with full digital integration and began the process of migrating its core customers across to the new platform.

As of late February 2021, over 270,000 customer policies (~90%) have been migrated to the new cloud-based platform, representing almost all of Tower Direct customers and the majority of its Partnership customers. The company has recently started to migrate its Pacific customers and expects to be fully migrated to EIS by the back end of 2022 (due to renewal profile).

Over 70% of workloads at TWR are now cloud-based. In 2020 four legacy systems were decommissioned with another four to be decommissioned this year, leaving another two to complete beyond that. This consistency of systems and use of the cloud means that all team members are now on the same operating systems, enabling sharing of work across locations to drive efficiency. TWR is leveraging its Pacific hub in Fiji to support claims and service operations for NZ Direct and Partnerships which supports work-load flexibility, demand spikes and a lower cost to serve.

The simplification of products and process has removed complexity for frontline teams and is expected to see material improvements in the customer experience.

Other key benefits to be seen from TWR's new IT platform include the ability to:

- Create and deliver a unique customer experience
- Quickly deliver simple, customer focussed products
- Target specific, profitable customer segments through granular and automated pricing and underwriting
- Charge fairer and more accurate premiums through improved access to, and use of, internal and external data
- Easily experiment with products and pricing
- Rationalise products and reduce claims costs by improving the customer claims journey and overall claims management
- Increasingly move customer engagement online and add value through improved employee engagement

Push to digital and data

NZ insurers generally are late to the digital game but TWR is now making good strides. TWR has set the foundations to leverage digital, unlock the potential of data analytics and increasing automation which over time will revolutionize TWR's entire operations (from products, underwriting, customer engagement and claims management).

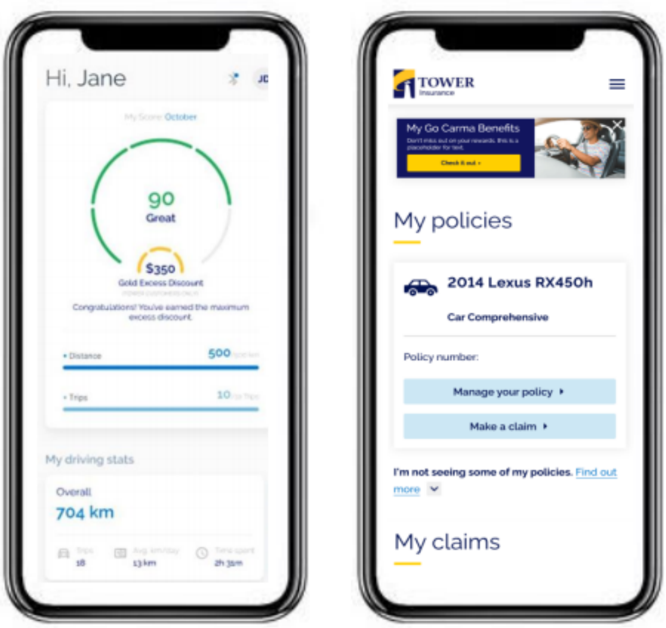
In insurance the “holy grail” is pricing risk accurately, with data the key for underwriting accuracy and agility. TWR introduced risk-based pricing for earthquakes in April 2018, which provided competitive opportunity in lower risk areas (such as Auckland), and delivered fairer, more equitable pricing across all of NZ. Today, TWR has partnerships with the likes of Corelogic and the University of

Auckland's Science Faculty, allowing greater data sophistication, and is expected to see TWR continue to lead the industry with ongoing refinements to risk-based pricing, including the likely launch of flood-based pricing later this year.

Recent innovations include:

1. TWR's GoCarma app which allows customers to understand their driving behaviour and be rewarded for driving safely
2. In FY20 TWR launched straight through claims processes that enable low value, low risk claims to be sent straight through to suppliers, enabling Tower to reduce costs and customer wait times
3. TWR's bundle builder, which offers fully digital discounts for holding multiple TWR policies (vs competitor offerings which require contacting a call centre)

TWR's digital and data strategy is expected to improve its ability to attract new customers (better pricing, better experience) and deepen relationships with existing customers (remove friction points, build engagement and improve retention, allow targeted marketing and cross selling opportunities), driving scale and efficiencies for the business.



Early days but bolt-ons and trading update highlight potential

Three deals and counting

Since implementing its new IT platform TWR has secured three deals, highlighting TWR now has a proven model to migrate customers to its new 100% cloud-based tech platform, and scale with ease:

1. The acquisition of Youi NZ's ~34,000 inforce polices for NZ$13m, which settled on 31 December 2019 and is now fully migrated, with retention reportedly strong
2. Referral agreement for Club Marine's Pleasure Craft Insurance customers effective 1 December 2020, with the potential on renewal of adding another 15,000 risks and NZ$8m in GWPs to TWR's business
3. The acquisition of the ANZ legacy portfolio representing NZ$40m of GWP for NZ$14m cash. This business was historically underwritten by TWR, but this transaction will see the portfolio brought into the Tower Direct business (vs under the Partnership business previously)

First signs of efficiency gains emerging

At the recent trading update for the four months to 31 January 2021, TWR announced 6% growth in GWP and a 2% improvement in its MER to 37% vs the same period last year. Despite the growth in the business, this equates to management and sales expenses remaining flat vs pcp, the first time in at least three years. The ability for customers to self-service, and the ongoing removal of legacy technology from the business were quoted as supporting an improvement in TWR's MER.

CEO Blair, the secret sauce to unlock TWR's digital potential?

Blair Turnbull commenced as CEO for TWR on 1 August 2020.

Most recently, Blair was the Managing Director, UK Digital (UKD), UK & International with Aviva Group, where he successfully repositioned Aviva as an award-winning player in digital, direct and data, achieving significant innovation accolades along the way, including Aviva UKD been awarded Insurance Times, Digital and Innovator of the year in 2017 & 2018. Between 2015 and 2019 when the UK market was achieving single digit annual growth, Aviva's UK Digital business doubled in scale. Prior to that, Blair was Executive General Manager, Wealth and Insurance at ASB Bank.

While NZ companies generally have had a poor track record with external management appointments, our first impressions of Blair are positive and his experience is well suited for TWR. Blair has a proven track record in large-scale digital and data innovation and delivering disruptive customer focussed model. Blair's appointment is particularly timely; the platform is now in place and Blair's expertise is expected to energise the business and accelerate TWR's digital journey.

Strong capital position — dividends confirmed and firepower remains

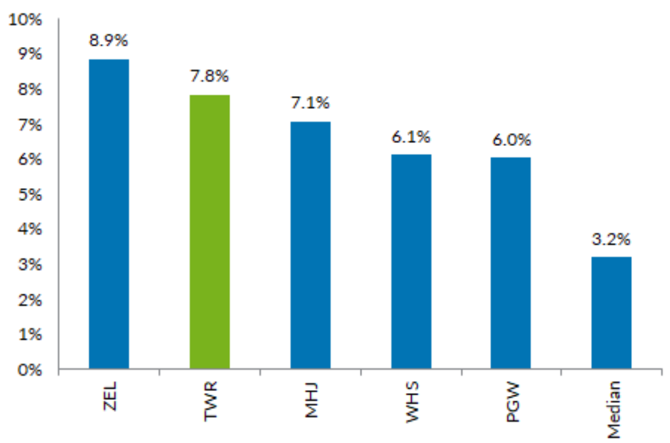
Dividends resuming

Following a five year hiatus and strong statements over recent years that dividends were imminent, TWR confirmed in February 2021 that it will re-establish the payment of dividends.

TWR's updated dividend policy is for 60%–80% of cash earnings where prudent to do so, with cash earnings defined as Reported Full Year Net Profit After Tax adjusted for acquisition amortisation and unusual items. The company announced an indicative interim dividend of 2.5cps (to be confirmed at the 1H21 results due out in May 2021) with the indicative combined full year dividend of 6cps (to be confirmed at the time of the FY21 results due out in November 2021), subject to the company achieving its FY21 guidance and the continuation of positive trends in the business.

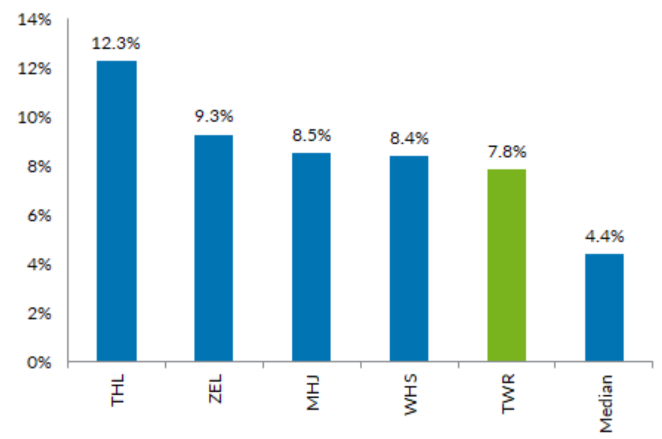
As we will discuss in the Financial section, we see the company missing its guidance for 5% growth in underlying earnings and consequently its dividend also falling short of the indicative 6cps in FY21 should the company stick to its 60–80% payout policy. Given the strength of TWR's balance sheet, we assume a 2.5c dividend in 1H21 (based on a 73% payout ratio, and consistent with guidance and dividend policy) and a 3.15cps dividend in the 2H21 (based on a 100% payout ratio) to give an FY21 dividend of NZ5.65cps. Based on our estimates, TWR has a 12 month forward cash dividend yield of 7.8%, and places TWR up with Z Energy as the top yielding stocks under Forsyth Barr's coverage. Note: TWR's dividend will not be imputed initially as the company is not expected to start paying tax until FY22 or potentially longer depending on the company's acquisition profile. We assume the dividend will be 25% imputed in FY22, increasing to 100% thereafter.

Figure 14. 12 month forward cash dividend yield vs. other high yielding NZ equities



Source: Forsyth Barr analysis. Median reflects median of Forsyth Barr Universe

Figure 15. 12 month forward gross dividend yield vs. other high yielding NZ equities



Source: Forsyth Barr analysis. Median reflects median of Forsyth Barr Universe

Legacy risks resolved, capital largely unshackled and ready to be deployed

Given TWR's strong capital position and legacy risks now resolved, capital management is expected to be an increasing driver of value going forward.

The Board is explicit in its capital priorities:

- Maintain a strong solvency position to ensure TWR is well placed and sustainable for the future
- Consistent and stable approach to ordinary dividends
- Actively pursue opportunities that deliver growth at scale using the TWR digital and data platform
  - Recent Youi NZ, Club Marine and ANZ deals are good examples of the opportunities available to TWR to grow its personal (and SME) business and leverage its existing cloud-based, digital platform
- Optimised capital management, and will consider a return of capital as the company will not hold unnecessary capital

Firepower remains for further bolt on acquisitions or capital returns

Based on TWR's solvency position as at 30 September 2020, adjusted for the NZ$42m cash now received from the EQC (which was previously excluded from the solvency calculations), TWR has NZ$140m solvency margin/368% solvency ratio.

While the company has not explicitly stated a revised minimum solvency capital (MSC) target solvency ratio, we note:

- The company has historically targeted a range of 180–200%
- The company still has a minimum NZ$50m solvency margin as a condition of its licence

We expect TWR to be in dialogue shortly (if not presently) with the RBNZ regarding when this condition may be amended given the uncertainty around Canterbury risks has materially abated. In the meantime, TWR will have to hold a minimum solvency of NZ$102m/196% solvency margin and the company is expected to err on the side of prudence, likely targeting a buffer in excess of this (e.g. 250% in the interim).

Assuming a 250% MSC target, at FY21E we estimate that TWR has an additional ~NZ$61m (equivalent to 15cps) of surplus capital (over and above our FY21E dividend of 5.65cps and accounting for the NZ$14m cash cost of the ANZ deal) to be deployed in future acquisitions, or failing that, to be returned to shareholders. Should it become appropriate for the company to move to a 200% MSC target, FY21E surplus cash increases to ~NZ$88m.

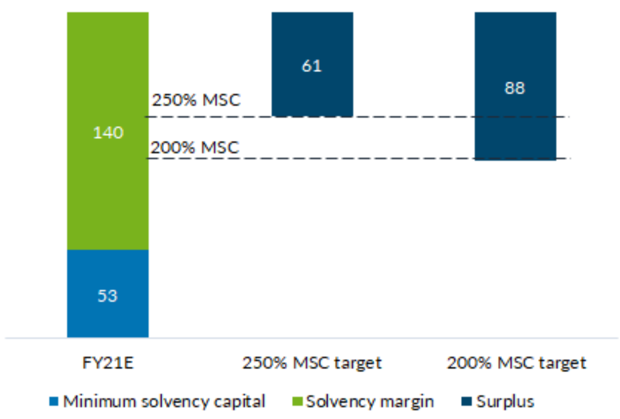
Figure 16. Solvency capital (NZ$m, NZ Parent)

Financial year ending Sept	FY19A	FY20A	FY20 adj.	FY21E
Actual solvency capital	156	150	192	193
Minimum solvency capital	57	52	52	53
Solvency margin	**99**	**98**	**140**	**140**
Solvency ratio	**275%**	**287%**	**368%**	**366%**

Source: Forsyth Barr analysis

Note: FY20 adj. reflects the solvency as at 30 September 2020 adjusted for the $42m EQC receivable which has since settled.

Figure 17. Awash with excess capital (NZ$m)



Source: Forsyth Barr analysis

Financials

Simple story in theory, just have to deliver

We don't require any heroic assumptions to get quite excited about the financial prospects for TWR. While we are more conservative than management on FY21 earnings given the risks around large events claims, we estimate that TWR could deliver ~11% 3-year CAGR in underlying profit after tax, with any future bolt-on acquisitions providing a further kicker to top line growth and operating leverage.

Figure 18. Key financial assumptions and resulting ratios

Financial y/e September	FY18A	FY19A	FY20A	FY21E	FY22E	FY23E	
Operating Performance							
Gross written premium	**336.1**	**356.8**	**385.1**	**400.9**	**423.0**	**441.9**	
Gross earned premium	323.1	345.0	380.5	398.5	420.4	439.2	
Reinsurance expense	(53.1)	(55.0)	(57.2)	(59.7)	(61.2)	(63.8)	
Net earned premium	**270.0**	**290.0**	**323.3**	**338.7**	**359.2**	**375.4**	
Net claims expense	(141.2)	(140.3)	(149.7)	(164.4)	(173.8)	(181.6)	
Large event claims expense	(11.0)	(1.3)	(9.7)	(14.0)	(15.2)	(15.8)	
Management and sales expenses	(105.4)	(116.0)	(126.6)	(123.6)	(125.7)	(127.6)	
Underwriting profit	**12.4**	**32.4**	**37.3**	**36.7**	**44.5**	**50.3**	
Investment and other revenue	7.2	7.0	6.4	3.4	3.6	5.7	
Financing costs	(0.6)	(0.3)	(1.1)	(0.4)	(0.4)	(0.4)	
Underlying profit before tax	**19.0**	**39.1**	**42.6**	**39.8**	**47.8**	**55.6**	
Income tax expense	(5.5)	(11.6)	(14.1)	(11.9)	(14.2)	(16.6)	
Underlying profit after tax	**13.5**	**27.5**	**28.5**	**27.9**	**33.5**	**39.1**	
Abnormals	(20.2)	(10.7)	(16.2)	(1.8)	(1.4)	(1.1)	
Reported profit/(loss) after tax	**-6.7**	**16.8**	**12.3**	**26.2**	**32.1**	**37.9**	
Key financial assumptions and resulting ratios							
Tower Direct GWP growth	n/a	9.2%	13.7%	8.4%	6.8%	5.0%	
Partnership GWP growth	n/a	2.9%	2.8%	3.4%	4.0%	4.0%	
Pacific GWP growth	-0.3%	3.7%	-5.8%	-10.1%	3.0%	3.0%	
Total GWP growth	**7.6%**	**6.2%**	**10.3%**	**4.7%**	**5.5%**	**4.5%**	(1)
Claims ratio excluding large events	52.3%	48.4%	46.3%	48.5%	48.4%	48.4%	(2)
Large events claims ratio	3.3%	0.4%	2.5%	3.5%	3.6%	3.6%	(3)
Total claims ratio	**56%**	**49%**	**49%**	**53%**	**53%**	**53%**	
MER	**39%**	**40%**	**39%**	**36%**	**35%**	**34%**	(4)
Combined ratio	**95%**	**89%**	**88%**	**89%**	**88%**	**87%**	
Underlying profit after tax growth	**-25%**	**104%**	**4%**	**-2%**	**20%**	**16%**	
EPS (cps)	- 2.1	4.7	2.9	6.1	7.5	8.9	
Cash EPS for divi calculation (cps)				6.6	8.0	9.4	
DPS (cps)				**5.6**	**6.0**	**6.5**	(5)
Payout				86%	75%	70%	
Underlying ROE	**6%**	**10%**	**9%**	**8%**	**10%**	**11%**	(5)
Reported ROE	-3%	6%	4%	8%	9%	10%	(5)

Source: Forsyth Barr analysis

(1) Organic GWP growth expected to continue in line with historic growth

In the New Zealand business, we assume the Tower Direct business continues to grow broadly inline with its organic growth rates achieved historically but are more positive on the Partnership business with legacy issues resolved (ANZ portfolio will move into the Direct business and has historically been a drag on growth as neither ANZ or TWR could target customers for the past 10 years).

The Pacific business is currently hampered both at a macro level with a large proportion of the economy decimated by COVID-19 travel restrictions, but also due to TWR initiating product rationalisation and portfolio de-risking. The Pacific remains a large growth opportunity with penetration in the single figures, and we assume TWR can return to growth from FY22. The Pacific story is further aided by EIS and the move to digital acquisition is expected to dramatically improve the ease of business in the Pacific. We estimate that TWR will return to 2019 GWP levels in early FY25.

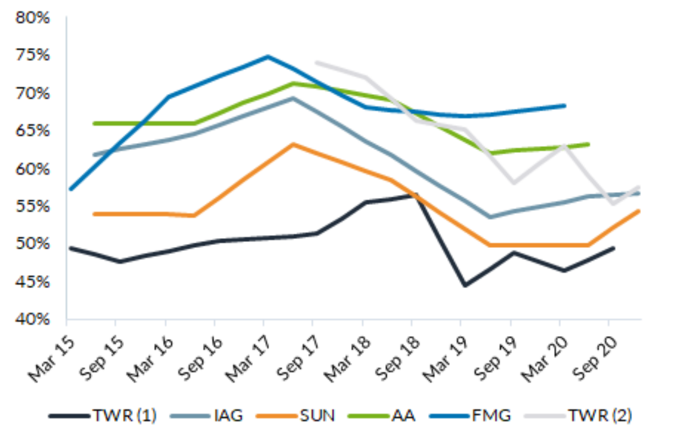
There is opportunity for upside risk to these assumptions as the company builds out its product set and develops deeper relationships with customers. Current products under development include insurance for electric vehicles and scooters, pet and travel insurance. TWR currently has 2 policies per individual and should the company target 3 to 1 in the medium term this potentially represents ~50% growth opportunity.

(2) Claims ratio is already very respectable

Comparing expense ratios across industry players is problematic given different classifications. For the purpose of this illustration, we focus on IFRS reported claims expense ratio (i.e. TWR (2) in the below chart, with claims ratio being net claims expense divided by net earned premium); TWR is broadly inline with IAG despite less benefits from diversification, which in our view indicates that TWR already exhibits reasonable underwriting and pricing discipline.

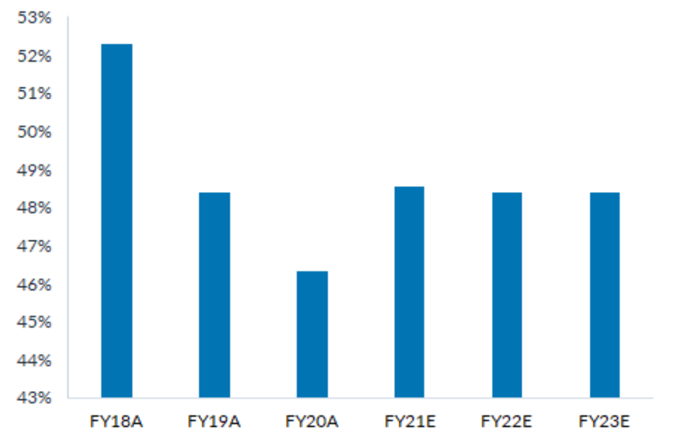
For now we assume TWR will maintain its claims ratio (excluding large events) consistent with the median achieved over the last three years, but note that there is the opportunity for upside risk to these assumptions as TWR implements new data practices to support risk selection and to enable it to monitor its porfolio more accurately.

Figure 19. TWR's Claims Ratio vs Peers



Source: Forsyth Barr analysis. Note: 1) Based on TWR's underlying net claims expense, 2) Based on IFRS net claims expenses.

Figure 20. TWR's Claims Ratio (excluding large events)



Source: Forsyth Barr analysis

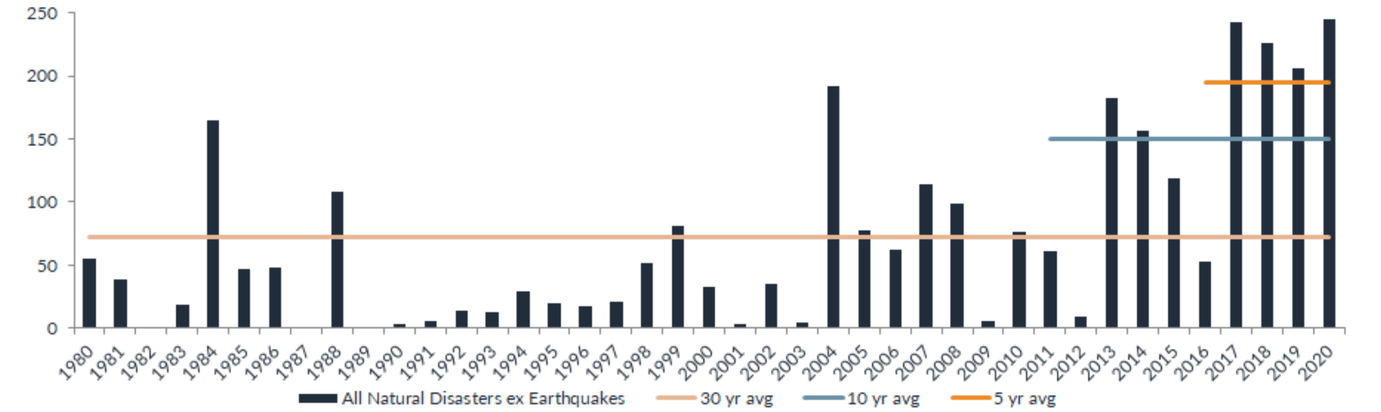
3) We are more conservative than management on FY21 large events claims risk

In February 2021, management reiterated its FY21 guidance for underlying Net Profit After Tax (NPAT) guidance of at least a 5% improvement on FY20, based on current level of actual large events claims of NZ$10m for the full year (i.e. NZ$10m incurred in the first four months of the financial year, with no further large events claims provided for under management's guidance for the remaining eight months of the year).

The magnitude of large events claims expense is very volatile, with a median of NZ$3.7m over the last six interims and a coefficient of variation of 76%. We assume large claims expenses continue to follow similar trends to that over the last six interim periods with the remaining eight months of FY21 seeing TWR trigger its aggregate reinsurance cover at NZ$14m. If we instead were to assume no further large claims for the remaining eight months of FY21, we estimate 5% underlying NPAT growth, consistent with management's guidance.

There is a clear trend of increasing cost of natural disasters (ex earthquakes) in NZ, driven in part by climate change, as illustrated in the figure below. As a base case we assume large events claims expenses will likely continue at elevated levels going forward.

Figure 21. Industry-wide Annual Cost of All Natural Distasters ex Earthquakes in NZ (CPI inflated, NZ$m)



Source: Forsyth Barr analysis, ICNZ data

4) Expectations set for improving MER

Comparisons of management expense and sales ratios (MER) across the industry are problematic but a broad comparison of industry combined ratios (i.e. underwriting profit divided by net earned premium, so capturing MER as well as claims loss ratios) paints a sufficient picture that TWR's cost structure has been a drag on operating performance.

Under the stewardship of the new CEO, Blair Turnbull, there has been a clear pivot in messaging around potential cost benefits as a result of TWR's new digital-first, cloud-based platform. Under the prior CEO the project was promised to deliver significant cost savings shortly on implementation, whereas more recently, while the company is still targeting improvements in its MER overtime, the story centres predominately around growth and scalability of existing infrastructure and allocation of corporate cost overheads over a larger base of business.

We see TWR's improvement in MER being driven by multiple drivers, key being:

- Increased scale. For instance, based on the cost to acquire a customer (of net earned premium) of 13% for the Tower Direct business and 39% group MER as at FY20, assuming no other improvements in its cost base, +NZ$15m/+4% growth in GWP would see TWR's MER drop ~100bps
- Acceleration of its data and digital strategy, for instance we expect further improvements from digital marketing (in FY20 we saw the cost to acquire a customer drop from 15% to 13% yoy for Tower Direct), lower handling costs as processes move online and become increasingly digital and customers increasingly self-service. EIS and digital acquisition will dramatically improve the cost base of the Pacific business
- Lower cost to serve with support teams in the Pacific and Rotorua (vs predominately Auckland before)
- Lower commission payments following the acquisition of the ANZ portfolio in February 2021

Figure 22. Economics of increasing scale on MER (NZ$m)

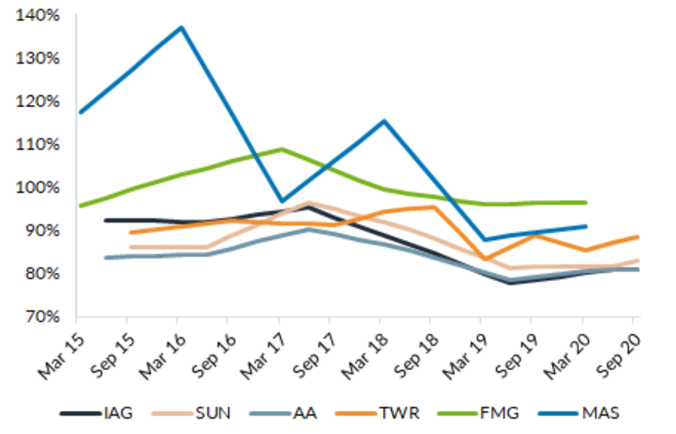
	FY20	Different GWP growth scenarios		
GWP Growth		**$15**	**$30**	**$45**
GWP growth %		**4%**	**8%**	**12%**
Cost to acquire - Direct (% of NEP)	13%			
Cost to acquire		1.6	3.3	4.9
GWP	385	400	415	430
NEP	323	336	348	361
Mgmt & Sales Expenses	(127)	(128)	(130)	(131)
growth %		1%	3%	4%
MER	**39.2%**	**38.2%**	**37.3%**	**36.4%**
Improvement in MER (bps)		**97**	**188**	**272**

Source: Forsyth Barr analysis

We are encouraged by the recent 2% improvement in MER to 37% per the recent trading update in February 2021, and assume TWR can achieve its target of moving the Group towards the 34% MER of its Tower Direct business by FY23, while continuing to grow its digital and data capabilties of the business (MER includes both the technology expenses of the business as well as the amortisation of capitalised software & intangibles).

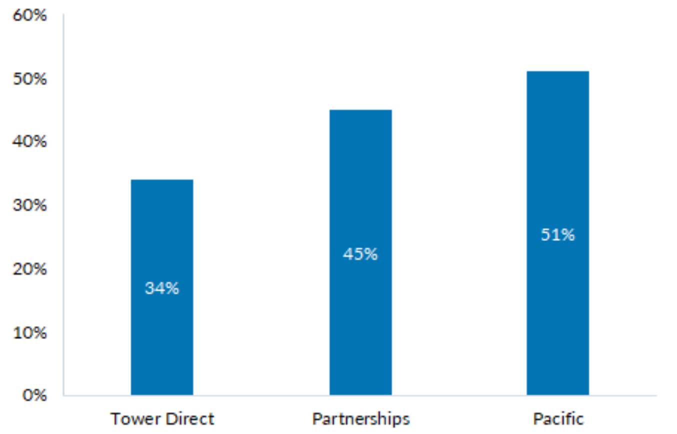
The key question we have is, to what extent will TWR's digital and data strategy be able to restore customer satisfaction and drive an improvement in customer relationships, as measured by the number of policies per customer and customer retention (Tower Direct was 82% in FY20). This will be an area of future work we will explore, but again, like many of these assumptions the risk is skewed to the upside (or in the case of the MER, lower).

Figure 23. CORs across the leading NZ Personal Insurers



Source: Forsyth Barr analysis

Figure 24. FY20 MER by TWR's Business Unit



Source: Forsyth Barr analysis

5) Underlying ROE and Dividends

In recent years TWR's return metrics have been hampered by legacy risks which have seen the company hold high levels of capital. These legacy issues are now all resolved and the board has announced that dividends are expected to resume in FY21 and has been particularly clear with its intentions to put excess capital to work via acquisitions or failing that, return it to shareholders.

Although we expect to see further acquisition announcements in the coming months, our assumptions specified do not assume any unannounced acquisitions or return of capital over and above its stated dividend policy. Based on improving operational performance alone, we see TWR's underlying return on equity (ROE) improving from ~9% in FY20A to ~11% in FY23E. If TWR deploys its ~NZ$61m of estimated surplus capital (assuming 250% MSC targets) into acquisitions, we estimate that its ROE could improve to mid to high teen levels (based on acquisition multiples of ~0.8x GWP).

As previously discussed, we expect TWR to miss its FY21 guidance for 5% growth in underlying profit, and consequently, based on its dividend payout policy of 60–80%, expect the company to miss its indicative dividend of 6cps for FY21. However, given the strength of TWR's balance sheet, we wouldn't be surprised for the company to apply some leniency when setting its dividend in FY21 and assume a 2.5c dividend in 1H21 (based on a 73% payout ratio, and consistent with guidance and dividend policy) and a 3.15cps dividend in the 2H21 (based on a 100% payout ratio, and falls short of the 4cps indicated) to give an FY21 dividend of NZ5.65cps (vs indicative FY21 dividend of 6cps, subject to the company achieving its FY21 guidance).

For subsequent years, we assume TWR's dividend remains consistent with its 60–80% payout policy and reverts overtime to the middle of this range, while providing a growing dividend stream in the interim.

Valuation

We value TWR at NZ$0.96 (spot) based on relative P/E and P/B ratios, and sense check via relative ROE vs peers and justified P/B ratio.

Our relative valuation of TWR focusses on its most closest comparables, being the Australian listed general insurers, IAG, Suncorp and QBE, as well as NZ listed bank, Heartland.

Risks resolved, improving returns in sight = stage set for multiple expansion

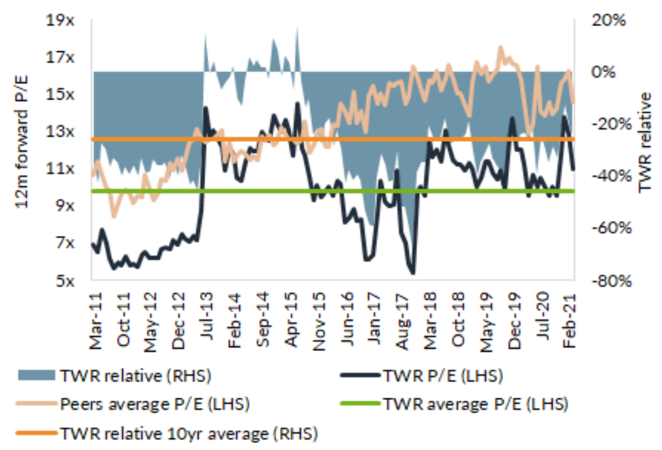
Over the last 10 years TWR has traded at a ~26% average discount relative to peers on a 12month forward P/E basis. TWR traded inline with peers during August 2013 to May 2015, only to sharply diverge as the costs and risks surrounding the Canterbury earthquakes started to escalate (including materially increasing its provisioning for expected claim costs in relation to the Canterbury earthquake, the first announcement of which was in May 2015, increased solvency requirements from the RBNZ and subsequent disputes with PeakRe and EQC over receivables relating to the Canterbury earthquakes).

These risks have now been resolved, with the settlement with the EQC in November 2020 representing the last major outstanding legacy risk for the company. Combined with the expectation for improving operating performance and capital management to drive improving return on equity, we believe the stage is now set for TWR's multiples to expand and TWR to re-rate inline with peers.

The raft of good news from the company since November 2020 has seen TWR's 12 month forward P/E multiple expand from broadly in-line with 10-year averages and sub 10x to ~11x on our estimates today, while its discount relative to peers remains more stubborn, sitting at ~25% vs 10-year average discount of ~26%.

In setting our base case valuation, we reference the median trading multiples of peers and assume a 50% reduction in the discount relative to peers currently being priced. Over time we expect to further reduce and ultimately remove this discount relative to peers as TWR delivers on its digital strategy and return on equity improves.

Figure 25. No re-rating despite good news



Source: Forsyth Barr analysis

Figure 26. Blended P/E, P/B relative valuation

NZ$m	P/E	P/B	Valuation
12-month forward NPAT	**28.8**		
P/E Median Multiple of Peers	14.7x		
Assumed Discount vs Peers	-13%		
Resulting P/E Multiple Applied	**12.8x**		
Value	369		
Surplus Cash assumption	61		
Gross Value	**430**		
Shares on Issue (m)	421.6		
P/E Valuation (NZ$/share)	**1.02**		
Forward BV per share		**0.83**	
P/B Median Multiple of Peers		1.26x	
Assumed Discount vs Peers		-15%	
Resulting P/B Multiple Applied		**1.1x**	
P/B Valuation (NZ$/share)		**0.89**	
Blended valuation (spot, NZ$/share)			**0.96**

Source: Forsyth Barr analysis

Figure 27. Valuation metrics of closest peers

	Market Cap	Cash Div Yield (%)	PE (x)		P/B (x)		P/NTA (x)		ROE %	
Company	**(NZ$m)**	**1-yr fwd**	**1-yr fwd**	**2-yr fwd**	**1-yr fwd**	**2-yr fwd**	**1-yr fwd**	**2-yr fwd**	**1-yr fwd**	**2-yr fwd**
Tower	**307**	**7.8**	**11.0**	**9.1**	**0.9**	**0.9**	**1.4**	**1.3**	**8.3**	**9.8**
Heartland	1,069	4.9	12.4	12.2	1.3	1.3	n/a	n/a	11.1	10.6
Insurance Australia	12,191	1.5	15.8	14.8	1.8	1.7	3.7	3.4	11.4	12.8
Suncorp	14,490	4.9	14.8	13.9	1.1	1.0	1.7	1.6	7.9	7.6
QBE Insurance	15,311	0.4	14.5	11.4	1.2	1.1	2.3	2.2	7.9	12.0
Peer Median		**3.2**	**14.7**	**13.0**	**1.3**	**1.2**	**2.3**	**2.2**	**9.5**	**11.3**
Tower relative to peers		**146%**	**-25%**	**-30%**	**-30%**	**-27%**	**-40%**	**-39%**	**-13%**	**-13%**

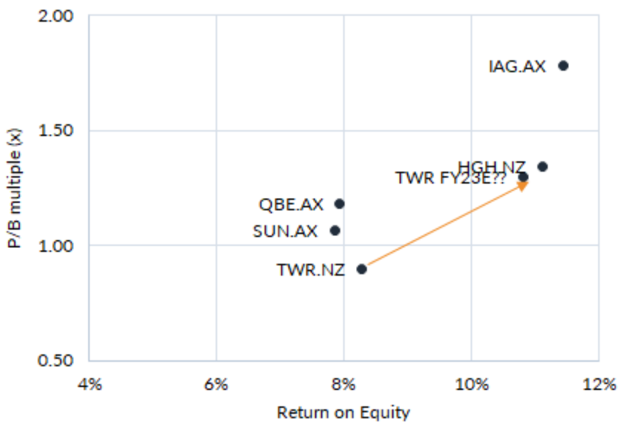
,Source: Forsyth Barr analysis, Thomson Reuters

All peers are currently trading within 1 standard deviation of their long-run historical P/E, and their P/Es relative to their respective broader local equity indicies (i.e. S&P/NZX50G and S&P/ASX200) are at a discount vs long-run averages. Combined with applying a discount to the peer median, we are comfortable that we're not pegging our P/E valuation of TWR to inflated multiples.

Consistent with Forsyth Barr's strategy report, *Still a One Way Bet? Updated WACC Assumptions*, published 12 February 2021 we apply the following key fundamental assumptions to determine TWR's justified P/B ratio; a risk free rate of 2.3%, a market risk premium of 5.5% together with an assumed beta of 1.2x (which includes a premium due to liquidity, and compares to Forsyth Barr's 1.27 beta assumed in its valuation of Heartland Bank), resulting in a CAPM cost of equity of 8.9%.

Based on our estimates, and without any accounting for unannounced acquisitions, we forecast TWR's ROE to improve from 9% in FY20 to ~11% in FY23. A justified P/B based on our 12month forward assumptions is 0.9x broadly in-line with where TWR is trading today, but if we focus on our FY23E ROE of 11%, the justified P/B ratio is 1.3x and highlights that as TWR delivers on expectations it should trade up in-line with peers. As previously discussed, we expect to see TWR make acquisition announcements over the coming year to utilise (at least in part) its ~NZ$61m surplus capital, which is expected to result in further improvement in TWR's ROE.

Figure 28. 12m forward ROE vs P/B



Source: Forsyth Barr analysis, Thomson Reuters

Figure 29. Favourable Bull/Bear skew

	12m forward NPAT (NZ$M)	P/E Multiple (x)	P/E Valn (NZ$/share)
Bull	42.9	15.3	1.70
Base	28.8	12.8	1.02
Bear	15.3	10.6	0.53
		Bull: Base	3.2:1

Source: Forsyth Barr analysis

Flexing key operational assumptions, such as GWP growth, claims expense ratios, & MER, (again, no assumed contribution from unannounced acquisitions) under bear and bull case scenarios and adjusting our applied P/E multiple +- 20%, results in a bear valuation of NZ$0.53 vs a bull valuation of NZ$1.70, an attractive risk skew.

Figure 30. Key Forecasts under bear, base and bull scenarios

	Base case				FY23E			
Financial y/e September	**FY20A**	**FY21E**	**FY22E**	**FY23E**	**Bear**	**Base**	**Bull**	
Operating Performance								
Gross written premium	385.1	400.9	423.0	441.9	416.9	441.9	467.6	
Net earned premium	**323.3**	**338.7**	**359.2**	**375.4**	**354.2**	**375.4**	**397.2**	
Net claims expense	(149.7)	(164.4)	(173.8)	(181.6)	(191.1)	(181.6)	(176.2)	
Large event claims expense	(9.7)	(14.0)	(15.2)	(15.8)	(16.6)	(15.8)	(15.0)	
Management and sales expenses	(126.6)	(123.6)	(125.7)	(127.6)	(127.5)	(127.6)	(127.1)	
Underwriting profit	**37.3**	**36.7**	**44.5**	**50.3**	**19.0**	**50.3**	**78.8**	
Investment and other revenue	6.4	3.4	3.6	5.7	5.5	5.7	5.9	
Financing costs	(1.1)	(0.4)	(0.4)	(0.4)	(0.4)	(0.4)	(0.4)	
Underlying profit before tax	42.6	39.8	47.8	55.6	24.1	55.6	84.3	
Underlying profit after tax	**28.5**	**27.9**	**33.5**	**39.1**	**16.9**	**39.1**	**59.2**	
Reported profit / (loss) after tax	12.3	26.2	32.1	37.9	15.8	37.9	58.1	
Key financial ratios								
Total GWP growth	10.3%	4.7%	5.5%	4.5%	2.7%	4.7%	6.7%	*
Claims ratio excluding large events	46.3%	48.5%	48.4%	48.4%	53.9%	48.4%	44.4%	
Large events claims ratio	2.5%	3.5%	3.6%	3.6%	4.0%	3.6%	3.2%	
Total claims ratio	49%	53%	53%	53%	59%	53%	48%	
MER	39.2%	36.5%	35%	34%	36.0%	34.0%	32.0%	
Combined ratio	88%	89%	88%	87%	95%	87%	80%	
Underlying profit after tax growth	4%	-2%	20%	16%	-16%	11%	28%	*
Underlying ROE	9%	8%	10%	11%	5%	11%	16%	
EPS (cps)	2.9	6.1	7.5	8.9	3.7	8.9	13.7	
DPS (cps)	0.0	5.6	6.0	6.5	2.9	6.5	9.9	

Source: Forsyth Barr analysis. Note: *Growth figures are annual growth for the first four columns and three year CAGR for the last three columns

Appendix A — Company history of events

Figure 31. Company history

Date	Event
1869	Government Life Insurance Office (Government Life) was created in NZ, with initial capital provided by the NZ Government
1953	Government Life became a separate statutory body with the passing of the Government Life Insurance Act in 1953
1987	Renamed Tower Corporation
1990	Ownership was conferred to its policyholders with the passing of the Tower Corporation Act, allowing Tower to be owned as a mutual association
1999	Tower was demutualised in 1999 and subsequently Tower Limited was listed on the ASX and NZX
2006	Tower's New Zealand and Australian businesses were separated
....	....
Sep 2010 - Dec 2011	Canterbury catastrophic earthquakes
Nov 2011	Tower announces intention to acquire AMI Insurance, but outbid by IAG who acquires AMI for NZ$380m in Dec 2011
Nov 2012	Tower sold its health insurance business to nib for ~NZ$102m
Feb 2013	Tower sold its investment business to Fisher Funds for NZ$79m
Apr 2013	NZ$120m capital returned to shareholders and repaid bonds of NZ$81.8m with sale proceeds
May 2013	Tower divested most of its Life insurance business to Fidel Life for ~NZ$189m
Sep 2013	GPG sold its 33.6% stake in TWR
Jul 2014	Tower sells residual life insurance business to Foundation Life (NZ) Holdings for NZ$36m
Sep 2014	FY2015 first year as a pure-play general insurer
Feb 2017	Canadian Fairfax Financial Holdings launches takeover for Tower
Feb 2017 - Jun 2017	Suncorp lobbies rival bid for Tower, secures 19.99% stake
Jul 2017	Commerce Commission rejects Suncorp bid
Nov 2017	Suncorp withdraws legal appeal against Commerce Commission decision and cancels bid for Tower
Nov 2017	Launched NZ$71m rights issue to manage risk around Chch, fund IT and digital investment and repay BNZ facility
Feb 2018	Tower reaches settlement with Peak Re, with TWR to receive NZ$22m of the NZ$43.75m claimed under the reinsurance contract
Mar 2018	Suncorp sells 19.99% shareholding to Bain Capital Credit
Apr 2018	Tower introduces risk-based pricing for earthquake
May 2018	Tower Board approves NZ$33.5m IT transformation investment
Sep 2019	Tower launches NZ$47m entitlement offer to 1) fund Youi NZ portfolio acquisition (NZ$13m for 34k inforce policies), 2) facilitate change in RBNZ licence condition to exclude EQC receivable from TWR's solvency calculations
Nov 2019	Completed delivery of new IT platform, customer migration underway
Aug 2020	Blair Turnbull commences as new CEO
Sep 2020	Simplified corporate structure, with entity amalgamation. Tower Insurance Limited remains as the amalgamated company, but has changed its name to Tower Limited.
Nov 2020	Tower and EQC reach settlement, Tower to receive NZ$42m, NZ$9.5m written off (after tax adjustment)
Dec 2020	Tower secures referral agreement for Club Marine's Pleasure Craft Insurance customers, potentially adding another 15k risks and NZ$8m GWP to Tower's business
Feb 2021	Tower acquires the ANZ legacy portfolio for NZ$14m cash. Tower already underwrites this business but will now be migrated to Tower's Direct platform and Tower will end future commission payments to ANZ
Feb 2021	Tower announces the return of dividends, with intention to confirm and pay a dividend with its 1H21 results in May

Source: Forsyth Barr analysis

Appendix B — Board and management

Board of Directors

- **Mr Michael Stiassny (Chair, Independent)** joined the Tower Board as a Non-Executive Director of the Company effective 12 October 2012 and was appointed as Chair of Tower in March 2013. Michael is a Chartered Fellow of The Institute of Directors in NZ (Inc) (CFInstD) and is also past President of the Institute of Directors. He is a Fellow of Chartered Accountants Australia and New Zealand (retired). He has both a Commerce and Law degree. He is currently chairman of Ngati Whatua Orakei Whai Rawa Ltd and a director of a number of other companies.
- **Mr Graham Stuart (Independent)** was appointed to the Tower Board as a Non-Exectuive Director in May 2012. Graham is an experienced director, based in Auckland. His current directorships include Chair of EROAD Limited, Independent Director of NorthWest Healthcare Property Management Limited, Director of VinPro Limited. Graham has over 30 years' experience in senior executive and governance roles in New Zealand and internationally. The latest being the Sealord Group of which he was Chief Executive Officer for 7 years. Graham has a Bachelor of Commerce (First Class Hons) from the University of Otago, a Master of Science from Massachusetts Institute of Technology and is a Fellow of Chartered Accountants Australia and New Zealand.
- **Marcus Nagel (Non-independent)** has significant insurance industry experience. For a decade he has performed senior leadership roles for Zurich in Europe and globally. In his last role at Zurich, he served as the Chief Executive Officer of Zurich Germany managing both life insurance and general insurance businesses. He has also held the position of Vice Chairman of the joint venture with ADAC, Germany's largest Automotive Club, Chairman of the direct insurer DA Direct and Chairman of the life insurer, Zurich Deutscher Herold. Prior to that he also managed the independent financial adviser/broker business for Zurich Global Life. Marcus holds a Masters Degree in Banking and Finance from Goethe University in Frankfurt, Germany and Master of International Management from the Arizona State University Thunderbird School of Global Management in Arizona, United States of America. In January 2019 Marcus was nominated by Bain Capital Credit LP (Bain Capital) to represent Bain Capital's 19.99% equity stake in Tower.
- **Steve Smith (Independent)** has been a professional Director since 2004 and was appointed to the Tower Board in May 2012. He has over 35 years of business experience, including being a specialist corporate finance partner at a leading New Zealand accountancy firm. He has a Bachelor of Commerce and Diploma in Business from the University of Auckland, is a member of Chartered Accountants Australia and New Zealand and a Chartered Fellow of the Institute of Directors in New Zealand (Inc). Steve is Chairman of Pascaro Investments Ltd, and a Director of Rimu S.A. (Chile) and the National Foundation for the Deaf Inc.
- **Warren Lee (Independent)** was appointed to the Tower Board in May 2015. Warren has extensive experience in the international financial services industry. Warren's two most recent executive positions were Chief Executive Officer of the Victorian Funds Management Corporation and Chief Executive Officer, Australia and New Zealand for AXA Asia Pacific Holdings Limited. Warren is currently a non-executive director of MetLife Limited, MyState Limited and Go Hold Limited. He has a Bachelor of Commerce from the University of Melbourne and is a member of Chartered Accountants Australia and New Zealand
- **Wendy Thorpe (Independent)** was appointed to the Tower Board in March 2018. Wendy has had an extensive executive career in Financial Services leading technology and operations in insurance and wealth management. Her most recent executive role was as Group Executive, Operations for AMP Ltd, and she was previously Chief Operations Officer and Chief Information Officer for AXA in Australia. Wendy is also Chair of Online Education Services, and a Non Executive Director of Ausgrid, Peoples' Choice Credit Union, Epworth Healthcare and Very Special Kids. Wendy has a Bachelor of Arts from LaTrobe University, a Bachelor of Business from Swinburne University and a Graduate Diploma in Applied Finance and Investment from the Securities Institute of Australia. She completed the Advanced Management Program at Harvard Business School, is a Fellow of the Financial Services Institute of Australasia and a Graduate member of the Australian Institute of Company Directors.

Key Management

- **Mr Blair Turnbull** was appointed Tower's Chief Executive Officer in August 2020. Blair has over 25 years' experience in the financial services industry, largely focussed on insurance in New Zealand, Asia Pacific and the United Kingdom. Most recently, Blair was Managing Director, UK Digital, UK & International with Aviva Group, and prior to that, was Executive General Manager, Wealth and Insurance at ASB Bank. Blair brings extensive international experience to Tower's business with a proven global track record in large-scale digital and data innovation, and delivering disruptive, customer-focussed models.
- **Mr Jeff Wright** was appointed as Tower's Chief Financial Officer in September 2017. Jeff has over 30 years insurance and financial services expertise largely in Australia. Jeff has previously worked as Chief Financial Officer at Territory Insurance Office in Australia, the Northern Territory government owned bank, general insurance and motor accident compensation body sold to Allianz in 2015. He has also held other senior financial roles with Allianz and Suncorp in Australia

- **Mr Peter Muggleston** was appointed as Tower's Chief Digital and Data Officer in December 2018. Peter Muggleston is one of New Zealand's most respected IT leaders with extensive experience leading significant digital and technology transformation programmes at some of New Zealand's most well-known companies. These companies include ASB, Sovereign Assurance, Peace Software, Fletcher Challenge and Foodstuffs North Island, where he won the CIO of the Year award in 2015. Peter's track record in digital transformation and leadership will be highly beneficial to the business as they embark on replacing their legacy system as part of their transformation process.
- **Mr Ron Mudaliar** was appointed as Tower's Chief Underwriting Officer in August 2019. Ron joined Tower as Head of Underwriting in October 2016 with more than 30 years' experience in the insurance industry in New Zealand, London and India. Ron's previous roles include executive management of large operational teams (150+), risk and compliance overview of operational and sales teams, NZ Integration Lead for merger of two large Australian general insurers and managing large portfolios of intermediated and partner businesses. Ron has led business ownership of large transformation programmes predominantly for migration of legacy business to new products and platforms.
- **Ms Jane Hardy** was appointed as Tower's Chief Claims and Service Officer in March 2019. Her previous experience has been delivering customer experience and digital transformations across large service organisations and government agencies. During her nine years at ACC, Jane led operational teams responsible for thousands of customers interactions weekly and led strategic programmes of change that transformed how customers interacted with ACC. Prior to her senior operational leadership roles, Jane led technology teams responsible for digital, data and information so has a good grounding in how future technologies can improve the outcomes for customers and an organisation
- **Ms Michelle McBride** was appointed Tower's Chief People Officer in November 2019. Michelle comes to Tower with a mandate to continue to drive cultural change in line with the ambitions of the business. She brings to her role significant International experience leading cultural change across a range of financial services, insurance and telecommunications organisations, having held senior roles at major businesses such as Vodafone, BNZ, Southern Cross Health Insurance and most recently, Westpac. Michelle has delivered a number of high-profile transformation programmes and led cultural change that has enabled companies to deliver on their strategy through improved performance.
- **Mr Richard McIntosh** joined Tower in April 2016 as General Counsel before being promoted to the role of Chief Risk and Legal Officer in January 2021. Richard has over 20 years of experience in the financial services. Prior to joining Tower, Richard was with AIA New Zealand for nine years holding the roles of Compliance Manager and then General Counsel responsible for the Risk and Compliance function. He has also held roles at HSBC New Zealand and at the Financial Conduct Authority in the United Kingdom.
- **Ms Michelle James** was appointed MD — Tower Direct in March 2016. Michelle has around 20 years' experience in executive and senior leadership roles on both sides of the Tasman, specialising in transformation and the creation of high performing service organisations. Having returned to New Zealand in 2011, she joins us from Spark Digital where she was the executive responsible for the organisation's turnaround programme. During her 13 years in Australia, Michelle held a number of senior customer service and product leadership roles at Telstra Corporation as well as leading significant cross company transformation and simplification programmes. Prior to that she held a variety of customer service and operational leadership roles at Telecom New Zealand.
- **Ms Paula ter Brake** was appointed MD — Tower Pacific in June 2019. Paula has over 20 years' experience in the financial services and consulting industries. She has worked globally in retail banking, consumer lending and advisory with a consistent focus on strategy, distribution and turnaround, including a number of years as Global Distribution Leader for GE Money. Paula ran her own corporate advisory business in Europe for a decade, providing buy side due diligence to global investors and regulatory change implementation for regulators following the Global Financial Crisis. Paula is a Member of the Institute of Directors and is an experienced independent director, having served on both listed and NGO Boards for over 15 years including recently Chairing the Audit, Risk and Compliance Committees for an ASX top 200 corporate.

Appendix C — Regulation overview

Insurers and insurance in New Zealand is based on the 'twin peaks' model with the Reserve Bank of New Zealand (RBNZ) administering prudential regulation and the Financial Markets Authority (FMA) administering conduct regulation.

Prudential regulation

The RBNZ regulates insurers under the Insurance (Prudential Supervision) Act 2010 (IPSA), which sets out licensing and prudential requirements for anyone carrying out insurance business in NZ. This includes the RBNZ issuing solvency standards, which specify minimum amounts of capital that insurers must hold.

New Zealand's location on the Pacific 'ring of fire' makes it vulnerable to a variety of natural catastrophes, and to multiple-catastrophe events. As a direct result of the Canterbury earthquakes, the solvency standards imposed under IPSA have addressed New Zealand's unique risks from exogenous shocks by requiring insurers to hold sufficient capital reserve or reinsurance to cover their liabilities for a 1-in-1,000 year catastrophe event (effective from 2016), which is more stringent than normal international practice (typically 1-in-200 or -250 year event) and compares to 1-in-500 year event previously.

Following multiple stop/starts over recent years, the RBNZ recommenced a review of the IPSA and associated solvency standard's in October 2020. RBNZ envisages a staggered process of implementing changes, with ultimate completion estimated by 2024. The solvency standard's review will include any necessary revisions required for new accounting standard for insurance contracts, IFRS 17 *Insurance Contracts*, which comes into force from 1 January 2023. Likely changes include a "ladder of intervention" solvency framework, where "rungs" of the ladder open up regulatory powers and/or represent triggers for specific supervisory intervention (vs today's binary framework where an insurer with a solvency ratio 100% or great is considered solvent, while a solvency ratio below 100% is considered insolvent).

Conduct regulation

The Financial Markets Authority (FMA) monitors and regulates insurer conduct in New Zealand, to ensure that insurers and the insured are able to transact with confidence in a fair, efficient and transparent way. They include an implied duty of good faith on both parties, arising from the need for trust and disclosure so that insurance markets can function effectively.

The Financial markets (Conduct of Institutions) Amendment Bill is current in its second reading. This Bill proposes to establish a new conduct regime for financial institutions, mends the Financial Markets Conduct Act 2013 to ensure that certain financial institutions and their intermediaries comply with a principle of fair conduct and associated duties and regulations.

Other market reform

In November 2019 the Government agreed to reform insurance contract law (currently spread throughout six statutes), with an exposure draft Bill for consultation expected to be released in mid-2021.

Industry Standards

In addition to government regulation, The Insurance Council of New Zealand (ICNZ) has a Fair Insurance Code that sets industry best practice standard for all members (e.g. requires its members to act ethically and to be financially sound). Most major insurers are members of the ICNZ. Members are subject to independent review by the ICNZ.

Treasury pricing review

Back in September 2019, Treasury was directed to investigate pricing and access issues in property insurance markets (residential, commercial and multi-unit buildings), but there has been no public update since.

The basis for the review was due to the apparent large price increases and challenges accessing insurance in some areas and for certain property types. This reflects a combination of factors; the increased risk of earthquakes in New Zealand following the Canterbury earthquakes, the under-reinsurance of NZ and relatively benign natural events in NZ in the years before the Canterbury earthquakes and also the tightening reinsurance market globally.

As insurers increasingly move to price risk prudently (i.e. risk-based pricing), particularly with reference to climate risk, we would expect increasing properties will see significant premium inflation and overtime increasing accessibility issues. Insurers are uniquely positioned to raise awareness of climate risks and help communities mitigate and adapt to climate hazards, but affordability is likely to be called into question and will likely force government solutions.

Appendix D — The Earthquake Commission

The Earthquake Commission

The Earthquake Commission (EQC) is a NZ Crown entity, established under the Earthquake Commission Act 1993 (EQC Act). EQC's primary objectives are to administer the insurance against natural disaster damage as provided for under the EQC Act, facilitate research and education about matters relevant to natural disaster damage, and to manage the Natural Disaster Fund (the Fund) including the arrangement of reinsurance.

The Act lists natural disasters as:

1. An earthquake, natural landslip, volcanic eruption, hydrothermal activity or tsunami
2. Natural disaster fire, which is caused by a natural disaster
3. In the case only of residential land, a storm or flood

EQC is required to provide insurance cover for natural disaster damage to all NZ residential properties where that property is privately insured against fire. In effect, almost all NZ homes are covered by EQC as 98% of NZ housing stock has house insurance. EQC covers the first loss for damage to homes caused by natural disaster, up to a specified cap (residential building cover is currently capped at $150,000 plus GST but is under review by Treasury), with private insurers topping up payments in accordance with people's insurance policies.

EQC levies are included in the cost of private insurance. Home owners pay the levy to their private insurance company, which passes it on to EQC. The maximum annual cost for the levy is $345 (+GST) per insured property and EQC collects premiums of ~$450m p.a.

The Natural Disaster Fund

The Natural Disaster Fund (NDF) was depleted following settlement of claims arising from the 2010/11 Canterbury earthquake sequence and the Kaikōura earthquake. Under section 16 of the Earthquake Commission Act 1993, if there is insufficient money in the NDF to meet the EQC's liabilities, the government will provide the funds needed to meet the shortfall. For the first time, during 2018/19 EQC drew on this Crown guarantee and has since received $240m (excluding GST) in order to continue its claims settlement programme.

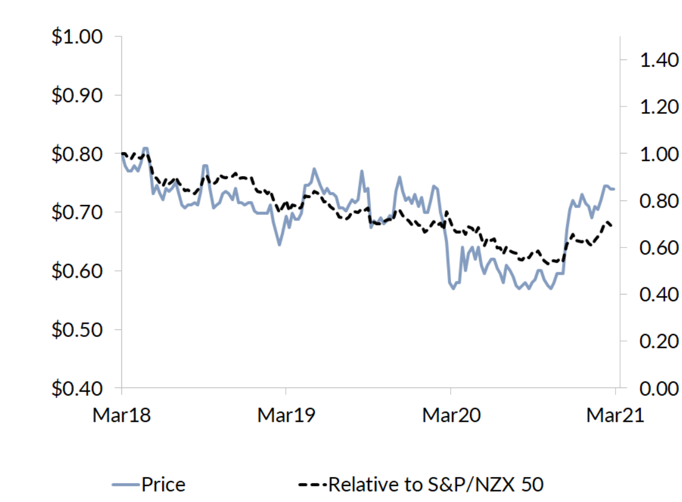
Public Inquiry into the EQC in relation to the Canterbury earthquakes

In 2018, the government established the Public Inquiry into the Earthquake Commission (the Public Inquiry). Its role was to independently examine the role and work of EQC in the aftermath of the 2010/11 Canterbury earthquake sequence and ensure the lessons learned can be applied to improve the response to future events.

Chaired by Dame Silvia Cartwright, the Report of the Public Inquiry was publicly released in April 2020, making 70 recommendations, directed at both EQC (47) and the Government (23).

In August 2020, the government committed to implementing all of the recommendations in the Inquiry's report. This includes modernising the EQC Act, with legislation expected to be introduced in the middle of 2021.

Figure 32. Price performance



Source: Forsyth Barr analysis

Figure 33. Substantial shareholders

Shareholder	Latest Holding
Bain Capital Credit LP	20.0%
Salt Funds Management	11.4%
ACC	9.7%
Investment Services Group	7.6%

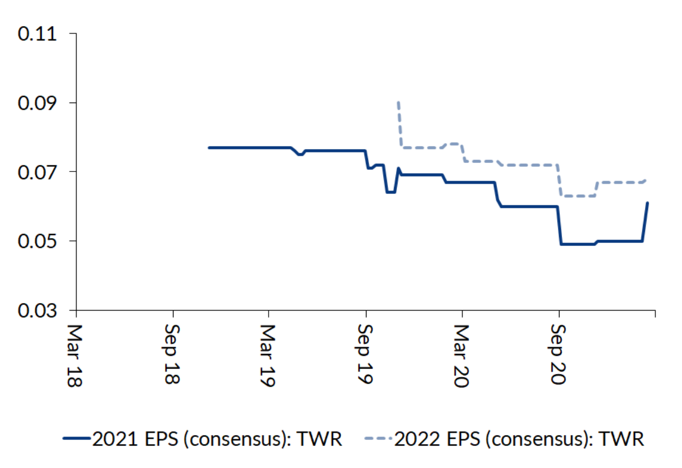
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 34. 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)	2021E	2022E	2021E	2022E	2021E	2022E	2022E
Tower Ltd	**TWR NZ**	**NZ$0.74**	**NZ$312**	**11.3x**	**9.4x**	**n/a**	**n/a**	**n/a**	**n/a**	**8.1%**
HEARTLAND GROUP HOLDINGS *	HGH NZ	NZ$1.84	NZ$1,073	13.2x	13.0x	n/a	n/a	n/a	n/a	4.6%
INSURANCE AUSTRALIA GROUP	IAG AT	A$4.62	A$11,389	17.6x	15.0x	n/a	n/a	n/a	10.7x	5.3%
SUNCORP GROUP	SUN AT	A$10.57	A$13,536	14.8x	14.4x	n/a	n/a	n/a	54.1x	5.3%
QBE INSURANCE GROUP	QBE AT	US$9.63	US$14,206	13.2x	16.6x	n/a	n/a	n/a	11.0x	3.6%
			Compco Average:	**14.7x**	**14.8x**	**n/a**	**n/a**	**n/a**	**25.2x**	**4.7%**
EV = Current Market Cap + Actual Net Debt			**TWR Relative:**	**-23%**	**-36%**	**n/a**	**n/a**	**n/a**	**n/a**	**71%**

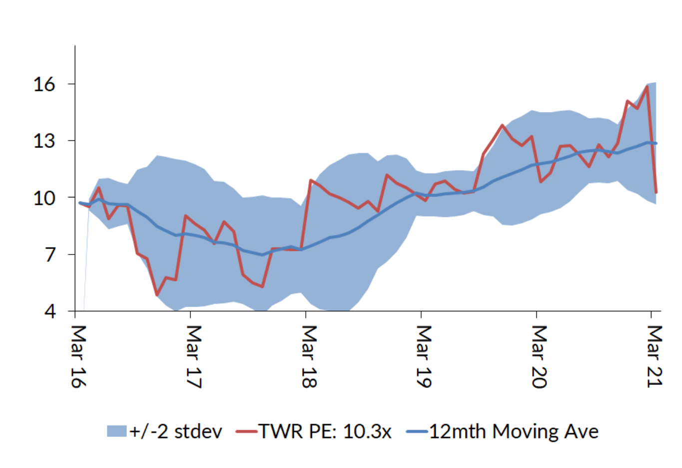
Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (TWR) companies fiscal year end

Figure 35. Consensus EPS momentum (NZ$)



Source: Forsyth Barr analysis

Figure 36. One year forward PE (x)



Source: Forsyth Barr analysis

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