

Tower

Raining on Expectations

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Tower (TWR) has provided estimates of the impact of the recent Canterbury floods which has lifted its annual assumption for 'large events' to the maximum annual level of NZ\$14.0m versus NZ\$9.7m previously. As a result, TWR has downgraded its FY21 earnings guidance but reiterated existing dividend guidance of between 5.0cps to 5.5cps. Our forecasts have not changed materially and we remain with a spot valuation of NZ\$0.95.

NZX Code	TWR	Financials: Sep/	20A	21E	22E	23E	Valuation (x)	20A	21E	22E	23E
Share price	NZ\$0.73	NPAT* (NZ\$m)	28.0	21.6	30.7	37.0	PE	10.9	14.2	10.0	8.3
Spot Valuation	NZ\$0.95	EPS* (NZc)	6.7	5.1	7.3	8.8	EV/EBIT	n/a	n/a	n/a	n/a
Risk rating	Medium	EPS growth* (%)	-13.8	-23.6	41.9	20.5	EV/EBITDA	n/a	n/a	n/a	n/a
Issued shares	421.6m	DPS (NZc)	0.0	5.2	5.5	6.2	Price / NTA	1.4	1.4	1.4	1.3
Market cap	NZ\$308m	Imputation (%)	0	0	25	100	Cash div yld (%)	0.0	7.1	7.5	8.5
Avg daily turnover	371.3k (NZ\$264k)	*Based on normalised profits					Gross div yld (%)	0.0	7.1	8.2	11.8

What's changed?

- **Earnings:** FY21 earnings guidance was reduced to NZ\$22m–NZ\$24m (from NZ\$25m to NZ\$27)
- **Dividend:** We increase our FY21 dividend forecast from 4.9cps to 5.2cps

Canterbury flood impact lowers earnings guidance

TWR has advised it has received 164 claims and estimates the cost to be NZ\$2.8m to NZ\$3.0m pre-tax. As a result, TWR has lifted its large event assumption to the maximum level of NZ\$14m, being the point that aggregate reinsurance for large events applies (excl NZ earthquakes). TWR has lowered its FY21 guidance from NZ\$25m–NZ\$27m (with an NZ\$9.7m large event assumption) to NZ\$22m–NZ\$24m with the NZ\$14m large event assumption. The existing FY21 dividend guidance of between 5.0cps and 5.5cps has been retained.

Only minor changes to our FY21 forecasts

Our earnings have dropped very slightly as we have increased our large event forecast from NZ\$13.8m to NZ\$14.0m. Given our higher than previous guidance estimate for large events, our FY21 earnings forecast of NZ\$21.6 is in line with the low end of the new guidance range. We have lifted our FY21 dividend forecast from 4.9cps to 5.2cps. There is no change to our NZ\$0.95 spot valuation.

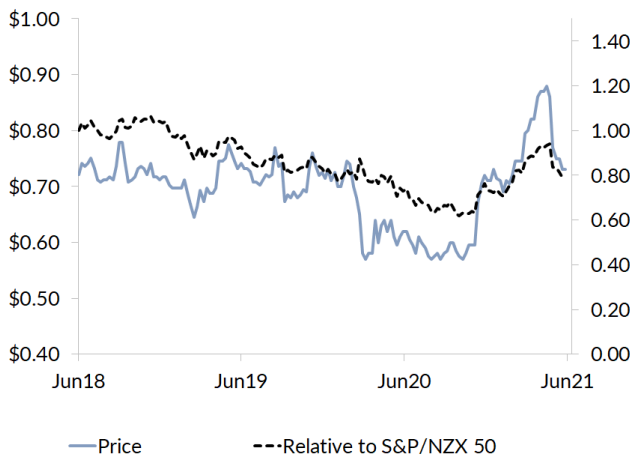
Underlying positive growth trends remain in place

While the recent 1H21 result was impacted by the short-term volatility of an insurance business, key positive trends continued with strong growth in gross written premiums and solid improvement in management expense ratios as it leverages its new digital platform. TWR also continues to successfully integrate acquisitions. Evidence over the next 12 months that its very attractive dividend yield of ~7% is sustainable and further delivery of key growth trends will continue to drive the improved investor sentiment seen over the last six months. TWR continues to trade at a substantial discount to its key listed peers as detailed in Figure 3.

Tower Limited (TWR)

Market data (NZ\$)						Spot valuations (NZ\$)					0.95
Priced as at 11 Jun 2021					0.73	1. PE relative					0.96
52 week high / low					0.89 / 0.57	2. PB relative					0.95
Market capitalisation (NZ\$m)					307.8	3. n/a					n/a
Key WACC assumptions						DCF valuation summary (NZ\$m)					
Risk free rate					2.30%	Total firm value					n/a
Equity beta					1.20	(Net debt)/cash					n/a
WACC					10.3%	Less: Capitalised operating leases					n/a
Terminal growth					1.5%	Value of equity					n/a
Profit and Loss Account (NZ\$m)						Valuation Ratios					
Sales revenue	2019A	2020A	2021E	2022E	2023E		2019A	2020A	2021E	2022E	2023E
Normalised EBITDA	n/a	n/a	n/a	n/a	n/a	EV/EBITDA (x)	n/a	n/a	n/a	n/a	n/a
Depreciation and amortisation	n/a	n/a	n/a	n/a	n/a	EV/EBIT (x)	n/a	n/a	n/a	n/a	n/a
Normalised EBIT	n/a	n/a	n/a	n/a	n/a	PE (x)	9.4	10.9	14.2	10.0	8.3
Net interest	n/a	n/a	n/a	n/a	n/a	Price/NTA (x)	1.3	1.4	1.4	1.4	1.3
Associate income	0	0	0	0	0	Free cash flow yield (%)	8.0	6.1	31.0	18.8	20.1
Tax	n/a	n/a	n/a	n/a	n/a	Net dividend yield (%)	0.0	0.0	7.1	7.5	8.5
Minority interests	0.2	0.4	0.9	0.9	0.9	Gross dividend yield (%)	0.0	0.0	7.1	8.2	11.8
Normalised NPAT	27.3	28.0	21.6	30.7	37.0	Key Ratios					
Abnormals/other	(10.7)	(16.1)	(1.3)	(1.8)	(1.4)	Return on assets (%)	n/a	n/a	n/a	n/a	n/a
Reported NPAT	16.6	11.9	20.3	28.9	35.5	Return on equity (%)	9.4	8.1	6.1	8.5	10.0
Normalised EPS (cps)	7.8	6.7	5.1	7.3	8.8	Return on funds employed (%)	0.0	0.0	0.0	0.0	0.0
DPS (cps)	0	0	5.2	5.5	6.2	EBITDA margin (%)	n/a	n/a	n/a	n/a	n/a
						EBIT margin (%)	n/a	n/a	n/a	n/a	n/a
Growth Rates						Capex to sales (%)	10.9	2.8	3.9	3.9	3.9
Revenue (%)	6.8	10.3	5.0	6.3	4.2	Capex to depreciation (%)	n/a	n/a	n/a	n/a	n/a
EBITDA (%)	n/a	n/a	n/a	n/a	n/a	Imputation (%)	0	0	0	25	100
EBIT (%)	n/a	n/a	n/a	n/a	n/a	Pay-out ratio (%)	0	0	101	75	71
Normalised NPAT (%)	>100	2.7	-22.8	41.9	20.5	Capital Structure					
Normalised EPS (%)	84.7	-13.8	-23.6	41.9	20.5	Solvency capital	2019A	2020A	2021E	2022E	2023E
Ordinary DPS (%)	n/a	n/a	n/a	5.2	13.5	Minimum solvency capital	155.9	150.5	205.4	209.0	218.1
Cash Flow (NZ\$m)						Total regulatory capital	106.6	102.3	83.3	84.4	84.4
EBITDA	n/a	n/a	n/a	n/a	n/a	Solvency ratio (%)	275	287	346	352	367
Working capital change	n/a	n/a	n/a	n/a	n/a	Operating Performance					
Interest & tax paid	0	0	0	0	0	Gross written premium	2019A	2020A	2021E	2022E	2023E
Other	0	0	0	0	0	Gross earned premium	356.8	385.1	402.3	427.6	445.6
Operating cash flow	24.6	18.9	95.5	57.9	61.8	Reinsurance expense	345.0	380.5	399.6	424.7	442.6
Capital expenditure	(37.6)	(10.5)	(15.5)	(16.5)	(17.2)	Net earned premium	(55.0)	(57.2)	(58.3)	(61.9)	(64.4)
(Acquisitions)/divestments	0	(9.5)	(14.0)	0	0	Net claims expense	290.0	323.3	341.2	362.8	378.2
Other	(42.0)	(9.4)	(35.0)	(2.8)	(2.9)	Large event claims expense	(140.3)	(149.7)	(171.0)	(178.7)	(186.3)
Funding available/(required)	(55.0)	(10.5)	30.9	38.7	41.7	Management and sales expenses	(1.3)	(9.7)	(14.0)	(15.1)	(15.8)
Dividends paid	0	0	(10.5)	(23.1)	(26.2)	Underwriting profit	(116.0)	(126.6)	(123.7)	(127.0)	(126.7)
Equity raised/(returned)	0	44.9	0	0	0	Investment and other revenue	32.4	37.3	32.4	42.1	49.5
(Increase)/decrease in net debt	(55.0)	34.4	20.4	15.6	15.6	Financing costs	7.0	6.4	1.2	2.8	4.4
Balance Sheet (NZ\$m)						Underlying profit before tax	39.1	42.6	33.6	44.9	53.9
Working capital	171.6	184.1	143.2	145.8	152.0	Income tax expense	(11.6)	(14.1)	(11.1)	(13.3)	(16.0)
Fixed assets	9.1	10.0	11.0	12.0	12.9	Underlying profit after tax	27.5	28.5	22.5	31.6	37.9
Intangibles	106.7	119.6	128.8	131.9	133.0	Abnormals	(10.7)	(16.2)	(1.3)	(1.8)	(1.4)
Right of use asset	0	7.2	14.2	11.8	9.5	Reported profit / (loss) after tax	16.8	12.3	21.2	29.8	36.5
Other assets	278.1	277.6	302.7	302.7	302.7	Key ratios					
Total funds employed	565.5	598.6	599.8	604.2	610.2	Tower Direct GWP growth %	9.2%	13.7%	10.7%	8.8%	5.0%
Net debt/(cash)	(47.1)	(80.1)	(99.1)	(114.7)	(130.3)	Partnership GWP growth %	2.9%	2.8%	2.4%	3.0%	3.0%
Lease liability	0	8.7	14.8	12.0	9.1	Total GWP growth %	6.2%	7.9%	4.5%	6.3%	4.2%
Other liabilities	319.9	322.9	327.6	343.7	357.8	Total claims ratio %	49%	49%	54%	53%	53%
Shareholder's funds	290.9	345.0	353.5	359.3	368.6	MER %	40%	39%	36%	35%	34%
Minority interests	1.8	2.2	3.0	3.9	4.9	Combined ratio %	89%	88%	91%	88%	87%
Total funding sources	565.5	598.6	599.8	604.2	610.2						

Figure 1. Price performance



Source: Forsyth Barr analysis

Figure 2. Substantial shareholders

Shareholder	Latest Holding
Bain Capital Credit LP	20.0%
Salt Funds Management	8.4%
ACC	8.4%
Investment Services Group	6.5%
NZ Funds Management	5.2%

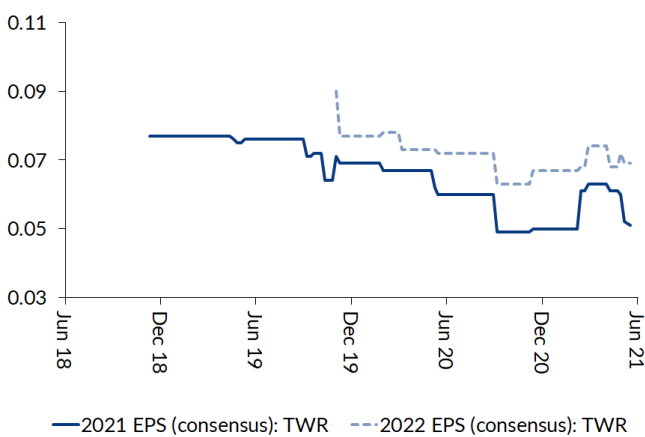
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 3. International valuation comparisons

Company	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash Yld
(metrics re-weighted to reflect TWR's balance date - September)										
				2021E	2022E	2021E	2022E	2021E	2022E	2022E
Tower Ltd	TWR NZ	NZ\$0.73	NZ\$308	14.2x	10.0x	n/a	n/a	n/a	n/a	7.5%
HEARTLAND GROUP HOLDINGS *	HGH NZ	NZ\$1.99	NZ\$1,166	13.4x	12.9x	n/a	n/a	n/a	n/a	5.6%
INSURANCE AUSTRALIA GROUP	IAG AT	A\$5.23	A\$12,892	16.8x	17.1x	n/a	n/a	n/a	12.1x	4.6%
SUNCORP GROUP	SUN AT	A\$11.29	A\$14,485	15.9x	15.9x	n/a	n/a	n/a	56.0x	5.0%
QBE INSURANCE GROUP	QBE AT	US\$11.47	US\$16,920	14.3x	18.4x	n/a	n/a	n/a	12.8x	3.3%
Compc Average:				15.1x	16.1x	n/a	n/a	n/a	26.9x	4.6%
EV = Current Market Cap + Actual Net Debt				TWR Relative:		-6%	-37%	n/a	n/a	62%

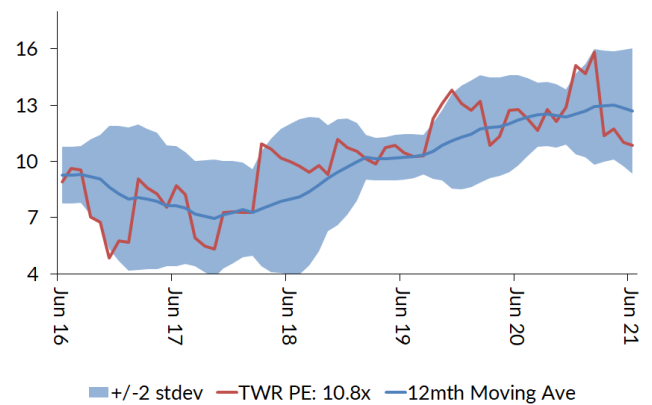
Source: *Forsyth Barr analysis, Bloomberg Consensus, Compc metrics re-weighted to reflect headline (TWR) companies fiscal year end

Figure 4. Consensus EPS momentum (NZ\$)



Source: Forsyth Barr analysis

Figure 5. One year forward PE (x)



Source: Forsyth Barr analysis

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