

Tower

Steady as She Goes – But Growing

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Tower (TWR) held its ASM and gave an upbeat update to the market on business performance, the capital return, Tongan eruption impacts and solid underlying business growth. IRD and shareholder approval for the NZ\$30.4m capital return has now been granted and will be paid in mid-March 2022, via a 1:10 cancellation at NZ\$0.72. Management also reaffirmed guidance for FY22 for underlying net profit after tax (NPAT) in the range of NZ\$21m to NZ\$25m, including NZ\$20m of aggregate large event costs. Tower said 1Q22 gross written premium (GWP) grew +12% over the same period last year, an impressive performance. **We raise our FY22 estimate for underlying NPAT by +2.3% to NZ\$24m and our blended spot valuation +NZ\$0.03 from NZ\$0.86 to NZ\$0.89.**

NZX Code	TWR	Financials: Sep/	21A	22E	23E	24E	Valuation (x)	21A	22E	23E	24E
Share price	NZ\$0.70	NPAT* (NZ\$m)	18.7	23.0	29.2	32.8	PE	15.9	12.9	10.2	9.1
Spot Valuation	NZ\$0.89 (from 0.86)	EPS* (NZc)	4.4	5.4	6.9	7.8	EV/EBIT	n/a	n/a	n/a	n/a
Risk rating	Medium	EPS growth* (%)	55.4	22.9	27.1	12.2	EV/EBITDA	n/a	n/a	n/a	n/a
Issued shares	421.6m	DPS (NZc)	5.0	5.0	5.3	5.5	Price / NTA	1.3	1.3	1.3	1.3
Market cap	NZ\$297m	Imputation (%)	0	0	85	100	Cash div yld (%)	7.1	7.1	7.4	7.8
Avg daily turnover	342.8k (NZ\$256k)	*Based on normalised profits					Gross div yld (%)	7.1	7.1	9.9	10.8

Business update

As expected, TWR reconfirmed its guidance for the year ending 31 March 2022. Management's actions to take a more conservative stance by including NZ\$20m of aggregate large event costs in its estimates are now showing benefits. TWR continues to move to lower its perceived risk despite operating in a challenging environment. The reaffirmation of FY22 underlying NPAT in the range of NZ\$21m to NZ\$25m was aided by fewer severe natural events and lower motor and large house claims. In 1Q22, TWR experienced growth in GWP of +12% over the same period last year, some of which related to inflation-based rating adjustments. This solid performance reflects TWR's ongoing drive for new product delivery, its direct strategy working well, and new partnership deals. Customer numbers grew by +6,000 over the first quarter to 310,000. The next likely update from TWR will be at the HY22 results, to be released late May 2022.

Earnings upgrade

We have upgraded our FY22 forecasts for GWP by +2.2%, from NZ\$439m to NZ\$449m, reflecting the strength seen in the 1Q22. With some other minor changes, our underlying NPAT forecast now sits at NZ\$24.0m, +2.3% versus our prior forecast of NZ\$23.5m.

Tongan eruption update

TWR is still assessing the effects of the Hunga-Tonga-Hunga-Ha'apai eruption and the subsequent tsunami in Tonga, with a clearer picture 1–2 months away. Reinsurance provides up to NZ\$873m of cover for catastrophe events like this. The reinsurance excess of \$11.25m is within the NZ\$20m of aggregate large event costs that TWR has set aside this year. TWR has received 66 claims to date but it remains in the very early stages of assessment. Claims often take a considerable amount of time to be received.

Capital return approved

TWR's proposed non-taxable capital return of \$30.4m has received IRD approval and now shareholder approval at the ASM. It will occur via a scheme of arrangement, a 1:10 cancellation for NZ\$0.72 per share. TWR expects final Court orders to be received in late February 2022, with the payment likely to be made in mid-March 2022 (at a date to be determined).

Tower Limited (TWR)

Market data (NZ\$)						Spot valuation (NZ\$)					
Priced as at 02 Feb 2022						0.71					
52 week high / low						0.89 / 0.57					
Market capitalisation (NZ\$m)						299.4					
Key WACC assumptions						DCF valuation summary (NZ\$m)					
Risk free rate						2.30%					
Equity beta						1.15					
WACC						9.8%					
Terminal growth						1.5%					
Profit and Loss Account (NZ\$m)						Valuation Ratios					
	2020A	2021A	2022E	2023E	2024E		2020A	2021A	2022E	2023E	2024E
Sales revenue	372.6	395.5	426.9	462.2	491.3	EV/EBITDA (x)	n/a	n/a	n/a	n/a	n/a
Normalised EBITDA	n/a	n/a	n/a	n/a	n/a	EV/EBIT (x)	n/a	n/a	n/a	n/a	n/a
Depreciation and amortisation	n/a	n/a	n/a	n/a	n/a	PE (x)	24.9	16.0	13.0	10.3	9.1
Normalised EBIT	n/a	n/a	n/a	n/a	n/a	Price/NTA (x)	1.3	1.3	1.4	1.3	1.3
Net interest	n/a	n/a	n/a	n/a	n/a	Free cash flow yield (%)	6.3	33.7	16.9	18.6	20.5
Associate income	0	0	0	0	0	Net dividend yield (%)	0.0	7.0	7.0	7.4	7.7
Tax	n/a	n/a	n/a	n/a	n/a	Gross dividend yield (%)	0.0	7.0	7.0	9.8	10.8
Minority interests	0.4	0.6	0.3	0	0						
Normalised NPAT	11.9	18.7	23.0	29.2	32.8	Key Ratios	2020A	2021A	2022E	2023E	2024E
Abnormals/other	0	0	0	0	0	Return on assets (%)	n/a	n/a	n/a	n/a	n/a
Reported NPAT	11.9	18.7	23.0	29.2	32.8	Return on equity (%)	3.4	5.4	6.6	8.2	9.0
Normalised EPS (cps)	2.9	4.4	5.4	6.9	7.8	Return on funds employed (%)	0.0	0.0	0.0	0.0	0.0
DPS (cps)	0	5.0	5.0	5.3	5.5	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	2020A	2021A	2022E	2023E	2024E	Capex to sales (%)	2.8	3.0	3.1	2.9	2.8
Revenue (%)	8.0	6.2	7.9	8.3	6.3	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	85	100
EBIT (%)	n/a	n/a	n/a	n/a	n/a	Pay-out ratio (%)	0	113	92	76	71
Normalised NPAT (%)	-28.2	57.1	22.9	27.1	12.2						
Normalised EPS (%)	-39.7	55.4	22.9	27.1	12.2	Capital Structure	2020A	2021A	2022E	2023E	2024E
Ordinary DPS (%)	n/a	n/a	0.0	5.0	4.8	Solvency capital	155.9	150.5	179.4	199.0	205.7
						Minimum solvency capital (MSC)	56.6	52.3	66.3	66.3	66.3
Cash Flow (NZ\$m)	2020A	2021A	2022E	2023E	2024E	Total regulatory capital	106.6	102.3	83.3	91.3	91.3
EBITDA	n/a	n/a	n/a	n/a	n/a	Solvency ratio (%)	275	287	271	300	310
Working capital change	n/a	n/a	n/a	n/a	n/a						
Interest & tax paid	0	0	0	0	0	Operating Performance	2020A	2021A	2022E	2023E	2024E
Other	0	0	0	0	0	Gross written premium	377.2	404.7	449.1	475.3	507.3
Operating cash flow	18.9	100.9	50.7	55.6	61.4	Gross earned premium	372.6	395.5	426.9	462.2	491.3
Capital expenditure	(10.5)	(12.0)	(13.4)	(13.6)	(13.8)	Reinsurance premium	(57.2)	(62.2)	(66.6)	(72.2)	(77.2)
(Acquisitions)/divestments	(9.5)	(14.4)	(4.4)	0	0	Net earned premium	315.3	333.3	360.4	390.0	414.1
Other	(9.4)	(24.5)	7.3	7.7	7.7	Net claims expense	(181.1)	(204.3)	(218.3)	(236.5)	(251.6)
Funding available/(required)	(10.5)	49.9	40.2	49.7	55.3	* includes Large event claims of	(9.7)	(13.9)	(20.0)	(22.0)	(24.0)
Dividends paid	0	(10.5)	(21.1)	(22.1)	(23.2)	Management & sales expenses	(126.6)	(123.3)	(132.4)	(136.5)	(140.7)
Equity raised/(returned)	44.9	0	0	0	0	Underwriting profit	31.8	28.0	31.7	39.0	43.8
(Increase)/decrease in net debt	34.4	39.4	19.1	27.6	32.1	Investment and other revenue	6.4	1.3	3.3	5.3	5.7
						Financing and other costs	(1.1)	(0.4)	(0.5)	(0.5)	(0.5)
Balance Sheet (NZ\$m)	2020A	2021A	2022E	2023E	2024E	Profit before tax	20.3	28.5	34.5	43.8	49.0
Working capital	184.1	146.9	154.4	163.4	174.4	Tax expense	(7.9)	(9.1)	(11.5)	(14.6)	(16.2)
Fixed assets	10.0	9.4	10.5	11.6	12.7	Profit after taxation (Reported)	12.3	19.3	23.0	29.2	32.8
Intangibles	119.6	120.6	128.2	128.5	129.5	Abnormals	(1.3)	(1.1)	0	0	0
Right of use asset	7.2	25.6	23.2	20.8	18.4	Comprehensive profit	11.0	18.2	23.0	29.2	32.8
Other assets	277.6	314.8	314.8	314.8	314.8						
Total funds employed	598.6	617.3	631.1	639.1	649.8	Key ratios					
Net debt/(cash)	(80.1)	(116.1)	(135.3)	(162.9)	(194.9)	Tower Direct GWP growth %	13.7%	26.4%	12.3%	5.0%	6.5%
Lease liability	8.7	39.4	46.7	54.4	62.0	Partnership GWP growth %	2.8%	-30.0%	12.0%	8.0%	8.0%
Other liabilities	322.9	344.3	368.0	388.9	414.4	Total GWP growth %	5.7%	7.3%	11.0%	5.8%	6.7%
Shareholder's funds	345.0	346.9	348.5	355.6	365.2	Total claims ratio %	49%	54%	54%	55%	55%
Minority interests	2.2	2.8	3.1	3.1	3.1	MER %	39%	37%	37%	35%	34%
Total funding sources	598.6	617.3	631.1	639.1	649.8	Combined ratio %	88%	91%	91%	90%	89%

Earnings and valuation upgrade

Following the strength seen in 1Q22, we have upgraded our FY22 forecasts for GWP by +2.2%, from NZ\$439m to NZ\$449m. With some minor changes to other expense lines, our new underlying NPAT forecast now sits at NZ\$24.0m, +2.3% versus our prior forecast of NZ\$23.5m. This includes NZ\$20m for large event claims expenses. Our new estimates remain within management's reaffirmed guidance for FY22 for underlying NPAT in the range of NZ\$21m to NZ\$25m.

Figure 1. Underlying earnings forecast revisions

NZ\$m	FY22E			FY23E		
	Old	New	Change	Old	New	Change
Operating performance						
Gross written premium	438.7	448.6	2.2%	464.3	474.7	2.2%
Gross earned premium	422.6	427.5	1.2%	452.7	462.8	2.2%
Reinsurance expense	(65.9)	(66.6)	1.0%	(70.9)	(72.2)	1.9%
Net earned premium	356.7	360.9	1.2%	381.8	390.6	2.3%
Net claims expense	(173.7)	(176.1)	1.4%	(187.0)	(192.2)	2.8%
Large event claims expense	(20.0)	(20.0)	0.0%	(22.0)	(22.0)	0.0%
Management and sales expenses	(131.6)	(132.6)	0.8%	(135.6)	(136.7)	0.9%
Underwriting profit	31.4	32.3	2.6%	37.2	39.6	6.3%
Investment and other revenue	3.3	3.3	0.6%	5.3	5.3	1.1%
Financing costs	-	-	n/a	-	-	n/a
Underlying profit before tax	34.7	35.6	2.5%	42.5	44.9	5.7%
Income tax expense	(11.2)	(11.5)	2.8%	(13.8)	(14.6)	6.3%
Underlying profit after tax	23.5	24.0	2.3%	28.7	30.3	5.4%
Reported profit /(loss) after tax	22.4	23.0	2.4%	27.7	29.2	5.6%

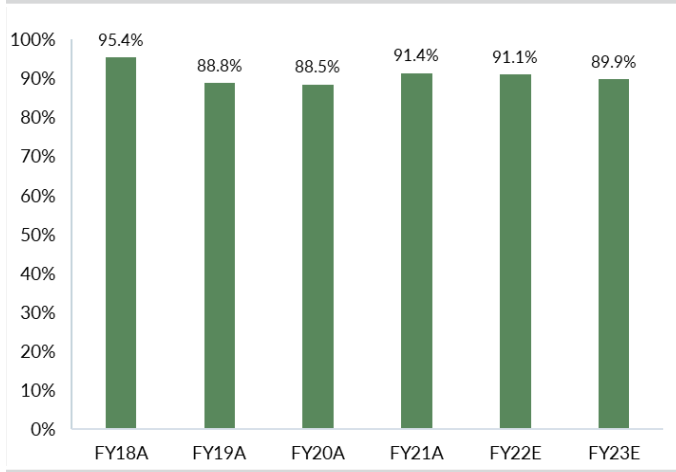
Source: Forsyth Barr analysis

Valuation

Our blended spot valuation increases +NZ\$0.03 (+3.5%) from NZ\$0.86 to NZ\$0.89 using a combination of peer group price-to-earnings (P/E) comparisons, peer group price-to-book (P/B) comparisons, and our discounted cash flow (DCF) valuation while setting aside an additional NZ\$10m for unforeseen Christchurch earthquake claims.

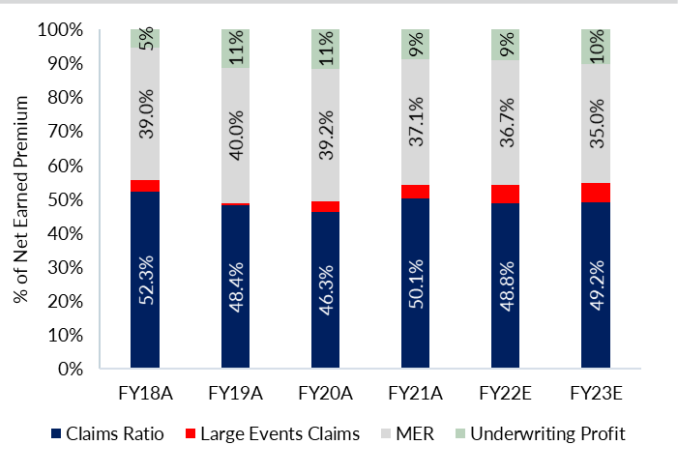
Key charts

Figure 2. TWR Combined ratio excluding large events



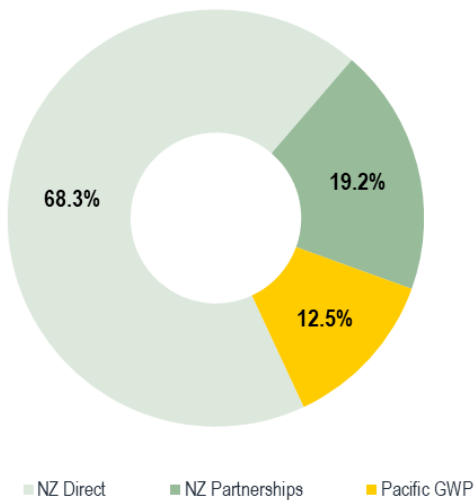
Source: Company data, Forsyth Barr analysis

Figure 3. TWR Combined ratio components



Source: Company data, Forsyth Barr analysis

Figure 4. TWR GWP Segmental Split (FY22E)



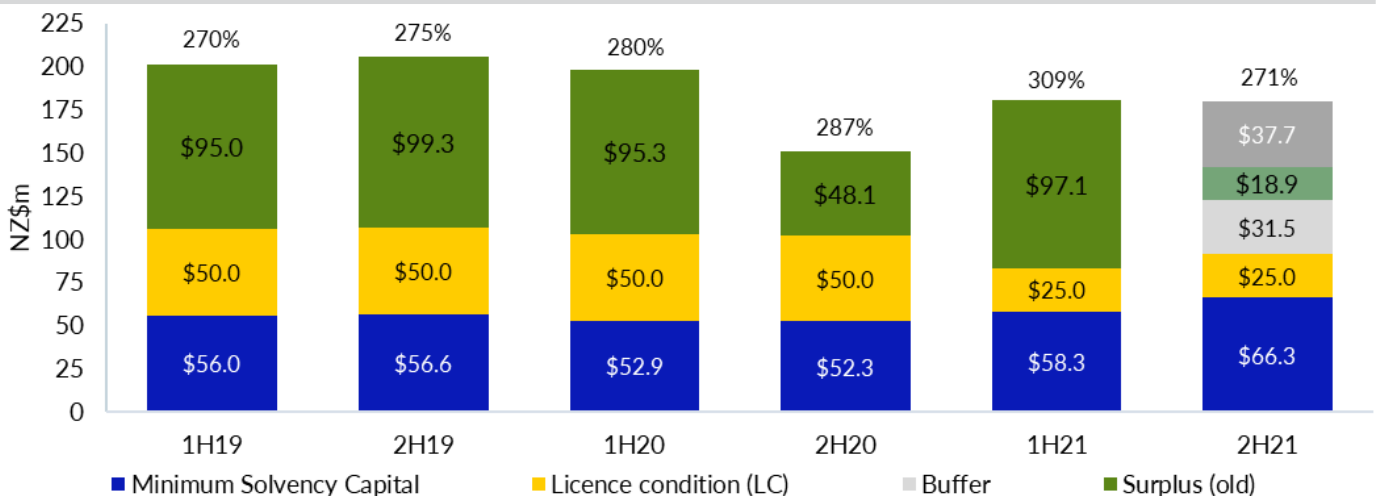
Source: Company data, Forsyth Barr analysis

Figure 5. TWR Pacific Islands GWP



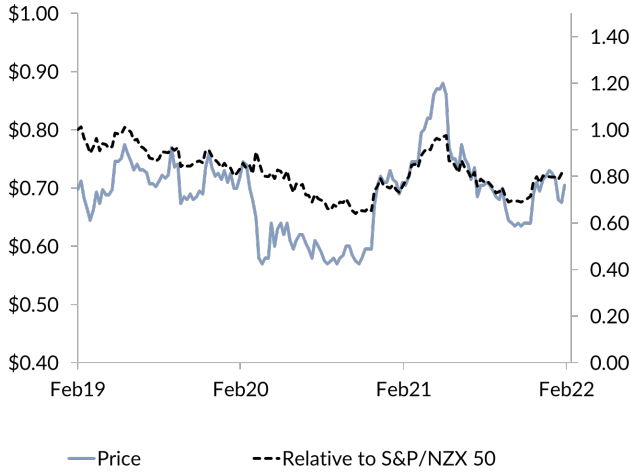
Source: Company data, Forsyth Barr analysis

Figure 6. TWR Solvency Position



Source: Company data, Forsyth Barr analysis

Figure 7. Price performance



Source: Forsyth Barr analysis

Figure 8. Substantial shareholders

Shareholder	Latest Holding
Bain Capital Credit LP	20.0%
ACC	8.4%
Salt Funds Management	7.0%
Investment Services Group	6.5%
NZ Funds Management	5.2%

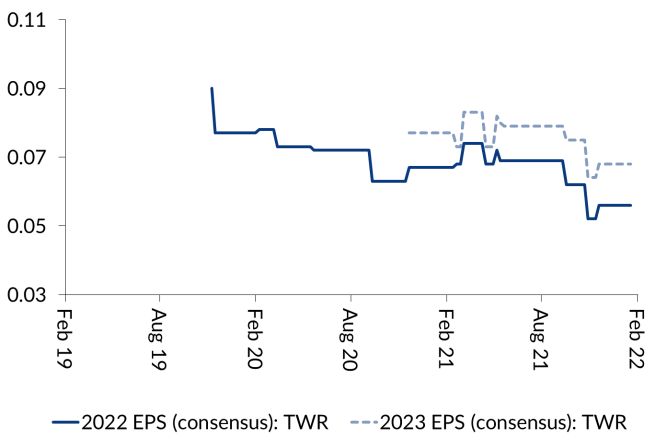
Source: NZX, Forsyth Barr analysis, NOTE: based on SPH notices only

Figure 9. 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)										
				2022E	2023E	2022E	2023E	2022E	2023E	2023E
Tower Ltd	TWR NZ	NZ\$0.71	NZ\$297	12.9x	10.2x	n/a	n/a	n/a	n/a	7.4%
Heartland Group Holdings *	HGH NZ	NZ\$2.42	NZ\$1,427	15.0x	14.3x	n/a	n/a	n/a	n/a	5.2%
Insurance Australia Group	IAG AT	A\$4.34	A\$10,699	18.4x	14.1x	n/a	n/a	n/a	9.7x	5.6%
Suncorp Group	SUN AT	A\$11.22	A\$14,166	15.7x	13.0x	n/a	n/a	n/a	45.7x	6.2%
QBE INSURANCE GROUP	QBE AT	US\$8.10	US\$11,953	12.3x	10.8x	n/a	n/a	n/a	7.8x	5.7%
Compc Average:				15.4x	13.0x	n/a	n/a	n/a	21.1x	5.7%
EV = Current Market Cap + Actual Net Debt				TWR Relative:		-16%	-22%	n/a	n/a	32%

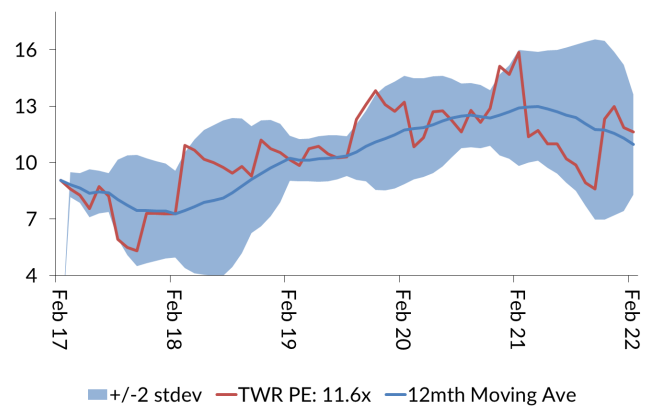
Source: *Forsyth Barr analysis, Bloomberg Consensus, Compc metrics re-weighted to reflect headline (TWR) companies fiscal year end

Figure 10. Consensus EPS momentum (NZ\$)



Source: Forsyth Barr analysis

Figure 11. One year forward PE (x)



Source: Forsyth Barr analysis

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