

Tower Limited

ASM Positively Surprises

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Tower (TWR) provided a robust FY24 trading update and upbeat FY25 and FY26 guidance at its ASM. Operational metrics for the first four months of FY24 were in-line or ahead of our expectations, with positive developments in: (1) gross written premium (GWP) growth, (2) customer growth, (3) business-as-usual (BAU) claims, (4) management expense ratio (MER), and (5) large events. This strong trading led TWR to upgrade FY24 underlying earnings guidance on 14 February 2024 to the upper end or above the NZ\$22m–NZ\$27m range in underlying NPAT. TWR provided underlying profit guidance ranges of between NZ\$40m–NZ\$60m for FY25, and between NZ\$60m–NZ\$80m for FY26. We adjust our short-term estimates marginally and increase our FY26 estimates substantially to better align with TWR's guidance range. Our blended spot valuation rises +15cps to NZ\$1.15.

NZX Code	TWR	Financials: Sep/	23A	24E	25E	26E	Valuation (x)	23A	24E	25E	26E
Share price	NZ\$0.70	Rev (NZ\$m)	470.8	556.7	638.1	713.4	PE	n/a	9.9	5.3	3.8
Spot Valuation	NZ\$1.15 (from 1.00)	NPAT* (NZ\$m)	2.4	26.8	50.2	70.1	EV/EBIT	n/a	n/a	n/a	n/a
Risk rating	High	EPS* (NZc)	0.6	7.1	13.2	18.5	EV/EBITDA	n/a	n/a	n/a	n/a
Issued shares	379.5m	DPS (NZc)	0.0	4.0	8.0	9.0	Price / NTA	1.7	1.7	1.5	1.4
Market cap	NZ\$266m	Imputation (%)	0	0	0	100	Cash div yld (%)	0.0	5.7	11.4	12.9
Avg daily turnover	111.5k (NZ\$68k)	*Based on normalised profits					Gross div yld (%)	0.0	5.7	11.4	17.9

What's changed?

- **Earnings:** Underlying NPAT estimates for FY24 and FY25 move -3% and +1% respectively, while FY26 rises +27%
- **Spot valuation:** Our blended spot valuation raises +15% to NZ\$1.15.

Solid FY24 trading across the array of metrics

TWR provided an update for FY24 after upgrading underlying profit guidance on 14 February 2024. Performance on several key metrics in the year's first four months was provided, with: (1) GWP rising +21% to NZ\$194m, (2) customer numbers growing from 315,000 to 319,000, (3) a BAU claims ratio of 54% (up from 52% in the prior comparable period [pcp]) but down from 59% in the final four months of FY23, (4) a management expense ratio (MER) of 31% (versus 35% in the pcp), and (5) no large events in the period.

First look at FY25 and FY26 guidance sees scale and normalising BAU claims drive earnings growth

TWR shared first-time FY25 and FY26 targets, and expects to deliver underlying NPAT of between NZ\$40m–NZ\$60m in FY25, and between NZ\$60m–NZ\$80m in FY26. At the midpoint, FY25 guidance aligned with our prior estimate of NZ\$49.8m, but we lift our GWP estimates resulting in our underlying NPAT rising by +1% to NZ\$50.2m. TWR's targets necessitate a substantial +27% lift to our FY26 underlying NPAT estimate, from NZ\$55.4m prior now to NZ\$70.1m, resulting from MER reductions and BAU claims normalising faster than our earlier expectations. We make minor changes in estimates to align our large events allowances in FY25 and FY26, using TWR's forecasts of NZ\$50m and NZ\$55m, respectively.

Valuation remains compelling

TWR appears cheap despite rallying by +15% during February 2024. At its last price of NZ\$0.70, TWR trades at ~4x the midpoint of its FY26 underlying NPAT guidance compared with peers Suncorp (SUN) and Insurance Australia Group (IAG), trading on ~13x and ~14x FY26 consensus earnings estimates, respectively. TWR trades at a -43% discount to its peers on a one-year forward PE basis, wider than its seven-year average of -37% (see Figure 3). Our blended valuation of NZ\$1.15 implies >60% upside from today's price.

Tower Limited (TWR)

Market data (NZ\$)						Spot valuation (NZ\$)						
Priced as at 21 Feb 2024						0.70	PE relative					0.98
52 week high / low						0.70 / 0.57	P/Book relative					0.89
Market capitalisation (NZ\$m)						265.6	DCF					1.58
Key WACC assumptions						DCF valuation summary (NZ\$m)						
Risk free rate						5.00%	Total firm value					693
Equity beta						1.18	(Net debt)/cash					(44)
WACC						11.0%	Less: Capitalised operating leases					(48)
Terminal growth						1.8%	Value of equity					601
Profit and Loss Account (NZ\$m)						Valuation Ratios						
Revenue (GEP)	2022A	2023A	2024E	2025E	2026E	2022A	2023A	2024E	2025E	2026E		
Revenue (GEP)	409.6	470.8	556.7	638.1	713.4	EV/Sales (x)	n/a	n/a	n/a	n/a		
Normalised EBITDA	n/a	n/a	n/a	n/a	n/a	EV/EBITDA (x)	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		
Normalised EBIT	n/a	n/a	n/a	n/a	n/a	PE (x)	15.2	>100x	9.9	5.3		
Net interest	n/a	n/a	n/a	n/a	n/a	Price/NTA (x)	1.5	1.7	1.7	1.5		
Associate income	0	0	0	0	0	Free cash flow yield (%)	13.7	-3.3	18.3	26.6		
Tax	(7.5)	(5.1)	(10.8)	(19.9)	(27.7)	Adj. free cash flow yield (%)	13.7	-3.3	18.3	26.6		
Minority interests	0.1	0	0	0	0	Net dividend yield (%)	9.3	0.0	5.7	11.4		
Normalised NPAT	27.4	7.6	26.8	50.2	70.1	Gross dividend yield (%)	9.3	0.0	5.7	11.4		
Abnormals/other	(8.5)	(8.8)	1.1	0	0	Key Ratios						
Reported NPAT	18.9	(1.2)	27.8	50.2	70.1	2022A	2023A	2024E	2025E	2026E		
Normalised EPS (cps)	4.6	0.6	7.1	13.2	18.5	Return on assets (%)	n/a	n/a	n/a	n/a		
DPS (cps)	6.5	0	4.0	8.0	9.0	Return on equity (%)	5.7	0.8	8.9	15.8		
Growth Rates						2022A	2023A	2024E	2025E	2026E		
Revenue (%)	5.9	14.9	18.2	14.6	11.8	Return on funds employed (%)	5.0	0.7	8.0	14.3		
EBITDA (%)	n/a	n/a	n/a	n/a	n/a	EBITDA margin (%)	n/a	n/a	n/a	n/a		
EBIT (%)	n/a	n/a	n/a	n/a	n/a	EBIT margin (%)	n/a	n/a	n/a	n/a		
Normalised NPAT (%)	-4.9	-86.6	>100	87.7	39.6	Capex to sales (%)	4.2	2.5	3.3	2.9		
Normalised EPS (%)	5.6	-86.6	>100	87.7	39.6	Capex to depreciation (%)	n/a	n/a	n/a	n/a		
Ordinary DPS (%)	30.0	-100.0	n/a	100.0	12.5	Imputation (%)	0	0	0	100		
Cash Flow (NZ\$m)						2022A	2023A	2024E	2025E	2026E		
EBITDA	n/a	n/a	n/a	n/a	n/a	Pay-out ratio (%)	141	0	57	60		
Working capital change	n/a	n/a	n/a	n/a	n/a	Capital Structure						
Interest & tax paid	0	0	0	0	0	2022A	2023A	2024E	2025E	2026E		
Other	0	0	0	0	0	Solvency capital	155.9	150.5	179.4	136.4		
Operating cash flow	59.8	10.0	74.9	98.3	98.4	Minimum solvency capital (MSC)	56.6	52.3	66.3	66.5		
Capital expenditure	(17.3)	(12.0)	(18.2)	(18.6)	(19.1)	Total regulatory capital	106.6	102.3	83.3	91.3		
(Acquisitions)/divestments	(6.1)	(5.9)	0	0	0	Solvency ratio (%)	275	287	271	205		
Other	(21.1)	(1.3)	(8.1)	(9.0)	(10.1)	Underlying Performance						
Funding available/(required)	15.3	(9.2)	48.7	70.7	69.2	2022A	2023A	2024E	2025E	2026E		
Dividends paid	(20.0)	(15.2)	(15.2)	(30.4)	(34.2)	Gross written premium	436.6	511.5	602.0	674.2		
Equity raised/(returned)	(30.6)	0	0	0	0	Gross earned premium	430.7	470.8	556.7	638.1		
(Increase)/decrease in net debt	(35.4)	(24.4)	33.5	40.3	35.1	Reinsurance premium	(69.5)	(69.5)	(90.5)	(102.8)		
Balance Sheet (NZ\$m)						2022A	2023A	2024E	2025E	2026E		
Working capital	183.2	336.8	306.0	342.7	382.5	Net earned premium	361.2	416.3	466.2	535.3		
Fixed assets	5.4	6.3	7.2	7.8	8.4	Net claims expense	(195.5)	(269.3)	(302.4)	(337.3)		
Intangibles	132.5	138.5	139.4	140.5	141.9	* includes Large event claims of	(19.0)	(38.2)	(45.0)	(50.0)		
Right of use asset	23.3	23.2	20.6	18.0	15.4	Management & sales expenses	(129.9)	(151.4)	(139.2)	(143.2)		
Other assets	295.6	286.7	318.5	356.8	390.1	Underwriting profit	35.8	(4.4)	24.7	54.8		
Total funds employed	640.0	791.4	791.7	865.8	938.4	Investment and other revenue	1.1	14.3	13.9	16.4		
Net debt/(cash)	(84.5)	(64.0)	(65.7)	(67.7)	(69.5)	Financing and other costs	1.3	2.3	(1.0)	(1.0)		
Lease liability	35.1	32.6	28.7	24.8	20.9	Profit before tax (from continuing operations)	38.2	12.2	37.6	70.2		
Other liabilities	383.5	526.5	528.6	590.4	657.6	Tax expense	(10.9)	(4.6)	(10.8)	(19.9)		
Shareholder's funds	306.0	296.3	300.1	318.3	329.4	Profit after taxation	27.3	7.6	26.8	50.2		
Minority interests	0	0	0	0	0	NPAT (from discontinued operation)	(4.5)	(9.8)	1.1	0		
Total funding sources	640.0	791.4	791.7	865.8	938.4	NPAT (Reported)	22.8	-2.2	27.8	50.2		
Key ratios						2022A	2023A	2024E	2025E	2026E		
						Total GWP growth %	10.2%	17.2%	17.7%	12.0%		
						Total claims ratio %	54.1%	64.7%	64.9%	63.0%		
						MER %	36.0%	32.2%	29.9%	26.7%		
						Combined ratio %	90.1%	101.1%	94.7%	86.3%		

* Forsyth Barr target prices reflect valuation rolled forward at cost of equity less the next 12-months dividend** Information on Forsyth Barr's Carbon and ESG (CESG) ratings can be found at www.forsythbarr.co.nz/corporate-news-events/cesg-report

Earnings revisions

Figure 1. Earnings revisions

	FY24			FY25			FY26		
	Old	New	Change	Old	New	Change	Old	New	Change
Gross written premium	588.4	602.0	+2%	655.0	674.2	+3%	700.8	752.5	+7%
Gross earned premium	550.0	556.7	+1%	621.7	638.1	+3%	677.9	713.4	+5%
Reinsurance Expense	(88.4)	(90.5)	+2%	(98.9)	(102.8)	+4%	(107.1)	(113.3)	+6%
Net earned premium	461.6	466.2	+1%	522.8	535.3	+2%	570.8	600.0	+5%
Net Claims Expense	(252.6)	(257.4)	+2%	(277.9)	(287.3)	+3%	(307.8)	(313.6)	+2%
Large event claims expense	(45.0)	(45.0)	+0%	(51.0)	(50.0)	(2%)	(55.0)	(55.0)	+0%
Management expenses	(130.9)	(131.9)	+1%	(131.6)	(134.8)	+2%	(136.6)	(139.7)	+2%
Net Commission Expense	(7.2)	(7.3)	+1%	(8.1)	(8.3)	+2%	(8.8)	(9.3)	+5%
Underwriting profit	25.9	24.7	(5%)	54.2	54.8	+1%	62.6	82.4	+32%
Net Investment Income	13.8	13.9	+0%	16.3	16.4	+1%	15.8	16.4	+4%
Other income (costs)	(1.0)	(1.0)	n/a	(1.0)	(1.0)	n/a	(1.0)	(1.0)	n/a
Profit before tax	38.8	37.6	(3%)	69.5	70.2	+1%	77.4	97.8	+26%
Tax expense	(11.1)	(10.8)	(3%)	(19.7)	(19.9)	+1%	(21.9)	(27.7)	+26%
Underlying Profit after tax	27.6	26.8	(3%)	49.8	50.2	+1%	55.4	70.1	+27%
Canterbury impact	-	-	n/a	-	-	n/a	-	-	n/a
Other non-underlying items	1.1	1.1	n/a	-	-	n/a	-	-	n/a
Reported Profit after tax	28.7	27.8	(3%)	49.8	50.2	+1%	55.4	70.1	+27%

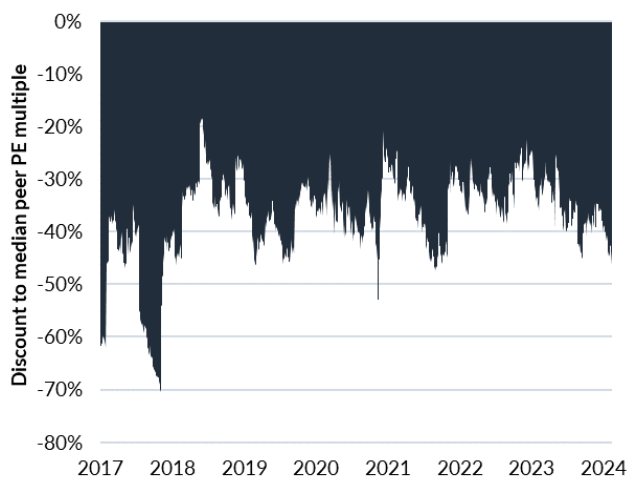
Source: Forsyth Barr analysis

Figure 2. Estimates versus guidance

	FY24 Estimate	FY24 Guidance	FY25 Estimate	FY25 Guidance	FY26 Estimate	FY26 Guidance
GWP growth (%)	+14%	+10% to +15%	+12%	+10% to +15%	+12%	+10% to +15%
Large events allowance (NZ\$m)	45m	45m	50m	50m	55m	55m
MER (%)	29.9%	30% to 32%	26.7%	<28%	24.8%	<26%
Combined operating ratio (%)	94.7%	95% to 97%	89.8%	<91%	86.3%	<87%
Underlying NPAT (NZ\$m)	26.8	Upper end of \$22m to \$27m or above	50.2	\$40m to \$60m	70.1	\$60m to \$80m
ROE (%)	8.0%	n/a	13.6%	12% to 15%	17.5%	>15%

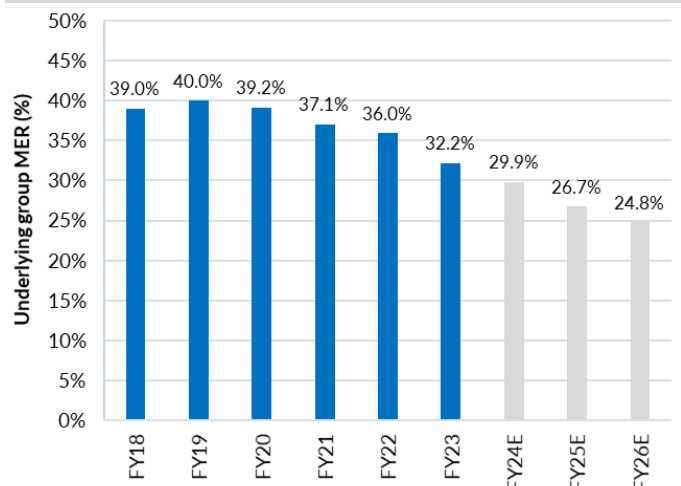
Source: Company, Forsyth Barr analysis

Figure 3. TWR – Discount to peers (one year forward)



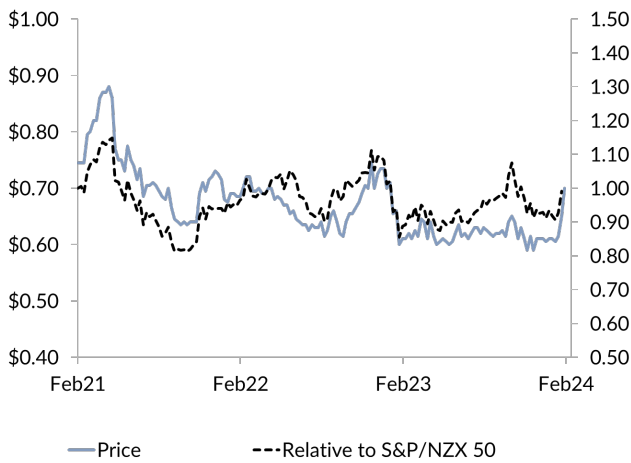
Source: Refinitiv datastream, Forsyth Barr analysis

Figure 4. TWR – Underlying group MER (%)



Source: Company, Forsyth Barr analysis

Figure 5. Price performance



Source: Forsyth Barr analysis

Figure 6. Substantial shareholders

Shareholder	Latest Holding
Bain Capital Credit LP	20.0%
ACC	9.6%
Salt Funds Management	8.0%
Pacific International Insurance Pty Ltd	5.8%
NZ Funds Management	5.2%

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

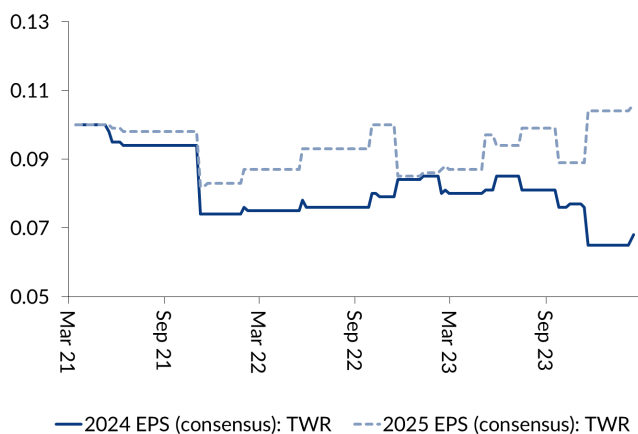
Figure 7. International valuation comparisons

Company	Code	Price	Mkt Cap (m)	PE 2024E	PE 2025E	EV/EBITDA 2024E	EV/EBITDA 2025E	EV/EBIT 2024E	EV/EBIT 2025E	Cash Yld 2025E
Tower Ltd	TWR NZ	NZ\$0.70	NZ\$266	9.9x	5.3x	n/a	n/a	n/a	n/a	11.4%
Heartland Group Holdings *	HGH NZ	NZ\$1.27	NZ\$908	9.1x	7.2x	n/a	n/a	n/a	n/a	9.5%
Insurance Australia Group	IAG AT	A\$6.12	A\$14,686	16.7x	15.1x	n/a	n/a	n/a	9.8x	4.9%
Suncorp Group	SUN AT	A\$14.43	A\$18,324	13.4x	13.1x	n/a	42.1x	n/a	48.0x	5.7%
QBE INSURANCE GROUP	QBE AT	US\$10.70	US\$15,982	10.0x	9.1x	n/a	n/a	n/a	8.0x	6.1%
Compco Average:				12.3x	11.1x	n/a	42.1x	n/a	21.9x	6.6%
TWR Relative:				-19%	-52%	n/a	n/a	n/a	n/a	74%

EV = Mkt cap+net debt+lease liabilities+min interests-investments

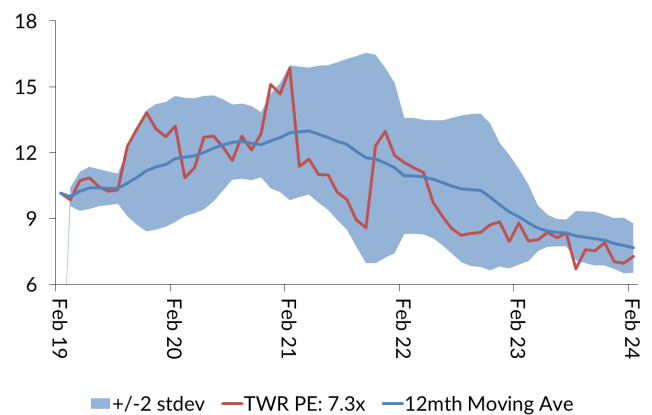
Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (TWR) companies fiscal year end

Figure 8. Consensus EPS momentum (NZ\$)



Source: Forsyth Barr analysis

Figure 9. One year forward PE (x)



Source: Forsyth Barr analysis

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