

Tower Limited

It's Raining Upgrades

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Tower (TWR) has updated its FY24 guidance. Underlying NPAT is now expected to be 'greater than NZ\$35m', up from 'the top end of or exceeding a range of between NZ\$22m and NZ\$27m'. The improved outlook has been driven by lower-than-expected business-as-usual (BAU) claims and stronger gross written premium (GWP) growth due to favourable retention. TWR has chosen to be conservative, with new guidance continuing to assume the full utilisation of its NZ\$45m large events allowance despite: (1) the absence of large events in 1H24, and (2) large events historically being skewed to the 1H. Adjusting for our expectation that half (NZ\$22.5m) of the allowance will be released, TWR's new guidance implies at least a +4% upgrade to our prior estimates. We increase our estimates by reducing our BAU claims ratio and forecasting stronger GWP growth in FY24, which sees our blended spot valuation rise +3cps to NZ\$1.44. Despite recent share price strength, TWR trades at an undemanding 12-month forward PE of 5.9x, significantly below its Australasian insurance peers.

NZX Code	TWR	Financials: Sep/	23A	24E	25E	26E	Valuation (x)	23A	24E	25E	26E
Share price	NZ\$0.83	Rev (NZ\$m)	470.8	559.1	640.5	713.4	PE	n/a	6.1	5.9	4.3
Spot Valuation	NZ\$1.44 (from 1.41)	NPAT* (NZ\$m)	2.4	52.0	53.2	72.7	EV/EBIT	n/a	n/a	n/a	n/a
Risk rating	High	EPS* (NZc)	0.6	13.7	14.0	19.1	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	2.0	1.7	1.5	1.5
Market cap	NZ\$315m	Imputation (%)	0	0	0	100	Cash div yld (%)	0.0	4.8	9.6	10.8
Avg daily turnover	142.7k (NZ\$92k)	*Based on normalised profits					Gross div yld (%)	0.0	4.8	9.6	15.1

What's changed?

- **Earnings:** Underlying NPAT increases +6% in FY24, +4% in FY25, and +2% in FY26.
- **Blended spot valuation:** Rises +2% to NZ\$1.44.

Upgrade driven by improved operational performance

TWR has now upgraded FY24 guidance twice in the last ~two months. Pleasingly, both upgrades have been driven by improved operational performance in the business. The two key drivers of improved performance have been (1) lower-than-expected business-as-usual claims, namely due to a normalisation in the frequency of motor claims, and (2) stronger-than-anticipated GWP growth because of favourable retention.

Remaining conservative on large events

In our last note on 12 April 2024, we reduced our FY24 large events allowance -50%. We felt this was reasonable given there were zero large events in 1H24, and large events have been weighted to the 1H historically. TWR has opted for a conservative approach, retaining its full NZ\$45m large events allowance in its updated FY24 guidance. Normalising TWR's guidance for our large events allowance (NZ\$22.5m), management's new guidance implies a greater than +4% increase on our prior FY24 underlying NPAT estimate. We subsequently upgrade our estimates by +6% in FY24.

Valuation remains undemanding

Despite rallying ~+39% YTD, TWR trades at just 5.9x our 12-month forward underlying NPAT estimate. Australasian insurance peers Insurance Australia Group (IAG) and Suncorp (SUN) trade on much higher multiples of 16.4x and 14.9x, respectively. We continue to view TWR as offering strong value at these levels. Against our blended spot valuation of NZ\$1.44, TWR trades at ~10.3x normalised FY25 earnings, a minor premium to its seven-year average, 12-month forward PE of 9.4x.

Tower Limited (TWR)

Market data (NZ\$)						Spot valuation (NZ\$)				
Priced as at 17 Apr 2024					0.83	PE relative				1.66
52 week high / low					0.83 / 0.57	P/Book relative				0.96
Market capitalisation (NZ\$m)					315.0	DCF				1.70
Key WACC assumptions						DCF valuation summary (NZ\$m)				
Risk free rate					5.00%	Total firm value				735
Equity beta					1.18	(Net debt)/cash				(44)
WACC					11.0%	Less: Capitalised operating leases				(48)
Terminal growth					1.8%	Value of equity				644
Profit and Loss Account (NZ\$m)						Valuation Ratios				
Revenue (GEP)	2022A	2023A	2024E	2025E	2026E	2022A	2023A	2024E	2025E	2026E
Normalised EBITDA	n/a	n/a	n/a	n/a	n/a	EV/Sales (x)	n/a	0.0	n/a	n/a
Depreciation and amortisation	n/a	n/a	n/a	n/a	n/a	EV/EBITDA (x)	n/a	n/a	n/a	n/a
Normalised EBIT	n/a	n/a	n/a	n/a	n/a	EV/EBIT (x)	n/a	n/a	n/a	n/a
Net interest	n/a	n/a	n/a	n/a	n/a	PE (x)	18.0	>100x	6.1	5.9
Associate income	0	0	0	0	0	Price/NTA (x)	1.8	2.0	1.7	1.5
Tax	(7.5)	(5.1)	(20.6)	(21.1)	(28.7)	Free cash flow yield (%)	11.6	-2.8	36.5	22.4
Minority interests	0.1	0	0	0	0	Adj. free cash flow yield (%)	11.6	-2.8	36.5	22.4
Normalised NPAT	27.4	7.6	52.0	53.2	72.7	Net dividend yield (%)	7.8	0.0	4.8	9.6
Abnormals/other	(8.5)	(8.8)	1.1	0	0	Gross dividend yield (%)	7.8	0.0	4.8	9.6
Reported NPAT	18.9	(1.2)	53.1	53.2	72.7	Key Ratios				
Normalised EPS (cps)	4.6	0.6	13.7	14.0	19.1	2022A	2023A	2024E	2025E	2026E
DPS (cps)	6.5	0	4.0	8.0	9.0	Return on assets (%)	n/a	n/a	n/a	n/a
						Return on equity (%)	5.7	0.8	15.5	14.9
						Return on funds employed (%)	5.0	0.7	14.0	13.6
						EBITDA margin (%)	n/a	n/a	n/a	n/a
						EBIT margin (%)	n/a	n/a	n/a	n/a
						Capex to sales (%)	4.2	2.5	3.2	2.9
						Capex to depreciation (%)	n/a	n/a	n/a	n/a
						Imputation (%)	0	0	0	0
						Pay-out ratio (%)	141	0	29	57
						Capital Structure				
						2022A	2023A	2024E	2025E	2026E
						Solvency capital	155.9	150.5	179.4	136.4
						Minimum solvency capital (MSC)	56.6	52.3	66.3	66.5
						Total regulatory capital	106.6	102.3	83.3	91.3
						Solvency ratio (%)	275	287	271	205
						Underlying Performance				
						2022A	2023A	2024E	2025E	2026E
						Gross written premium	436.6	511.5	606.7	674.4
						Gross earned premium	430.7	470.8	559.1	640.5
						Reinsurance premium	(69.5)	(69.5)	(91.4)	(104.3)
						Net earned premium	361.2	416.3	467.7	536.2
						Net claims expense	(195.5)	(269.3)	(269.5)	(333.3)
						* includes Large event claims of	(19.0)	(38.2)	(22.5)	(50.0)
						Management & sales expenses	(129.9)	(151.4)	(139.2)	(146.0)
						Underwriting profit	35.8	(4.4)	59.0	56.9
						Investment and other revenue	1.1	14.3	14.6	18.4
						Financing and other costs	1.3	2.3	(1.0)	(1.0)
						Profit before tax (from continuing operations)	38.2	12.2	72.6	74.2
						Tax expense	(10.9)	(4.6)	(20.6)	(21.1)
						Profit after taxation	27.3	7.6	52.0	53.2
						NPAT (from discontinued operation)	(4.5)	(9.8)	1.1	0
						NPAT (Reported)	22.8	-2.2	53.1	53.2
						Key ratios				
						2022A	2023A	2024E	2025E	2026E
						Total GWP growth %	10.2%	17.2%	18.6%	11.2%
						Total claims ratio %	54.1%	64.7%	57.6%	62.2%
						MER %	36.0%	32.2%	29.8%	27.2%
						Combined ratio %	90.1%	101.1%	87.4%	86.0%

* 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

Key tables and charts

Figure 1. Normalising for large events, TWR's new guidance implies single digit upgrades to our old FY24 estimates

	NZ\$m	Comment
TWR's new FY24 underlying NPAT guidance	35	Underlying NPAT expected to be greater than NZ\$35m
Large events allowance retained	45	
Impact of releasing 50% of large events allowance * (1 - tax rate)	22.5	Forsyth Barr estimate based on absence of events in 1H24 and historical 1H skew
Post tax impact	72%	NZ corporate tax rate
	16.2	
Implied FY24 underlying NPAT	51.2	
Old Forsyth Barr FY24 underlying NPAT	49.2	
Upside	4%	At least 4% upside given guidance for >NZ\$35m
New Forsyth Barr FY24 underlying NPAT	52	Slightly ahead of the bottom end of guidance (assuming 50% of large events allowance released)

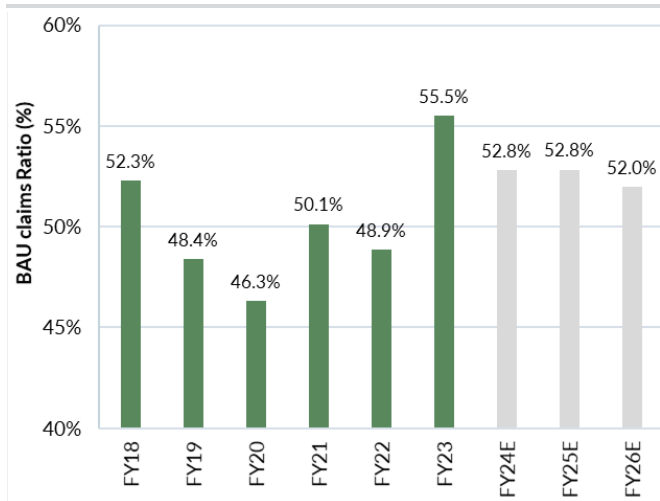
Source: Company, Forsyth Barr analysis

Figure 2. TWR – 12 month forward PE



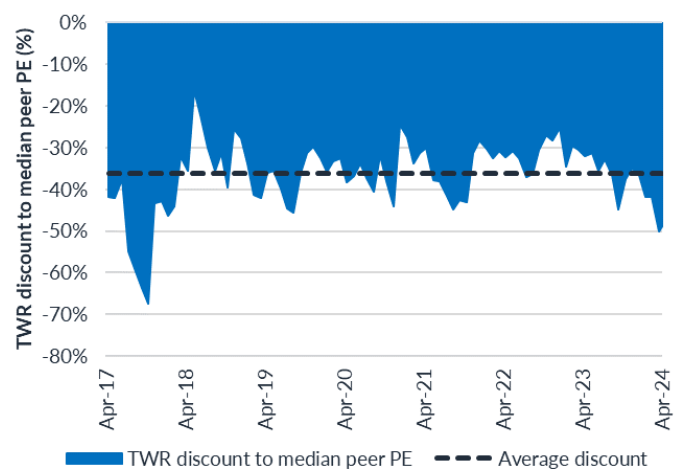
Source: Refinitiv, Forsyth Barr analysis

Figure 4. TWR – BAU claims ratio (excluding large events)



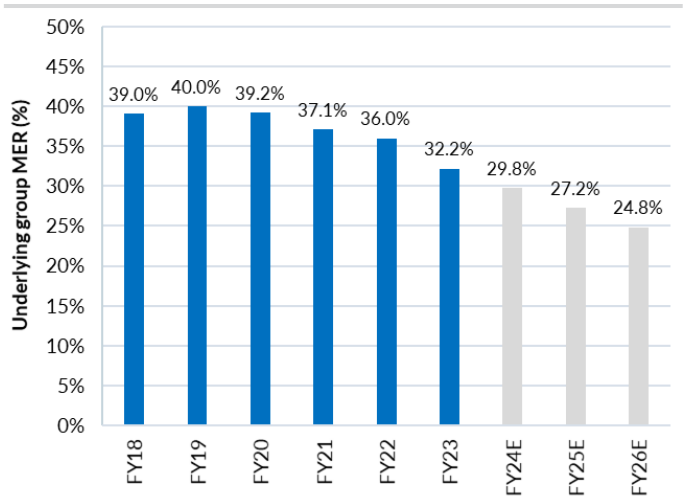
Source: Company, Forsyth Barr analysis

Figure 3. TWR – discount to median 12-month forward peer PE



Source: Refinitiv, Forsyth Barr analysis. Peers include IAG, HGH, SUN and QBE.

Figure 5. TWR – Underlying group MER (%)



Source: Company, Forsyth Barr analysis

Earnings revisions

Figure 6. Earnings revisions

	FY24			FY25			FY26		
	Old	New	Change	Old	New	Change	Old	New	Change
Gross written premium	602.0	606.7	+1%	674.2	674.4	+0%	752.5	752.5	(0%)
Gross earned premium	556.7	559.1	+0%	638.1	640.5	+0%	713.4	713.4	+0%
Reinsurance Expense	(90.5)	(91.4)	+1%	(102.8)	(104.3)	+2%	(113.3)	(114.0)	+1%
Net earned premium	466.2	467.7	+0%	535.3	536.2	+0%	600.0	599.4	(0%)
Net Claims Expense	(249.4)	(247.0)	(1%)	(287.3)	(283.3)	(1%)	(313.6)	(311.5)	(1%)
Large event claims expense	(22.5)	(22.5)	+0%	(50.0)	(50.0)	+0%	(55.0)	(55.0)	+0%
Management expenses	(131.9)	(131.8)	(0%)	(134.8)	(137.7)	+2%	(139.7)	(139.6)	(0%)
Net Commission Expense	(7.3)	(7.3)	+0%	(8.3)	(8.4)	+0%	(9.3)	(9.3)	(0%)
Underwriting profit	55.2	59.0	+7%	54.8	56.9	+4%	82.4	84.0	+2%
Net Investment Income	14.6	14.6	+0%	17.9	18.4	+3%	17.8	18.3	+3%
Other income (costs)	(1.0)	(1.0)	n/a	(1.0)	(1.0)	n/a	(1.0)	(1.0)	n/a
Profit before tax	68.7	72.6	+6%	71.7	74.2	+4%	99.2	101.3	+2%
Tax expense	(19.5)	(20.6)	+6%	(20.3)	(21.1)	+4%	(28.1)	(28.7)	+2%
Underlying Profit after tax	49.2	52.0	+6%	51.3	53.2	+4%	71.2	72.7	+2%
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	50.3	53.1	+6%	51.3	53.2	+4%	71.2	72.7	+2%
EPS		13.7			14.0			19.1	

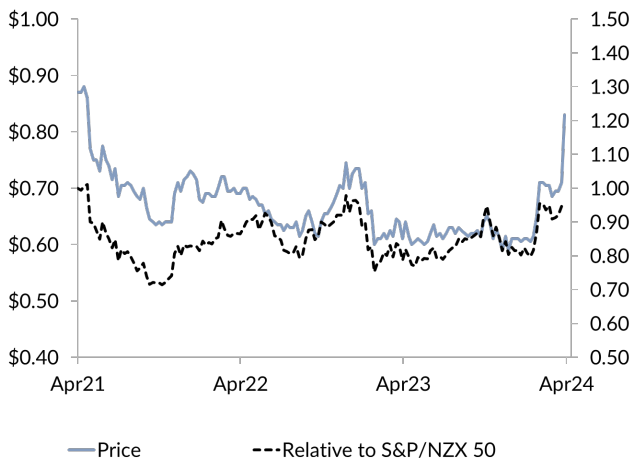
Source: Forsyth Barr analysis

Figure 7. Estimates versus management guidance

	FY24 Estimate	FY24 Mgt guidance	FY25 Estimate	FY25 Mgt guidance	FY26 Estimate	FY26 Mgt guidance
GWP growth (%)	+15%	+10% to +15%	+11%	+10% to +15%	+12%	+10% to +15%
Large events allowance (NZ\$m)	\$22.5m	\$45m	\$50m	\$50m	\$55m	\$55m
MER	29.8%	30% to 32%	27.2%	<28%	24.8%	<26%
Combined operating ratio (%)	87.4%	95% to 97%	89.4%	<91%	86.0%	<87%
Underlying NPAT (NZ\$m)	\$52.0m	Above \$35m	\$53.2m	\$40m to \$60m	\$72.7m	\$60m to \$80m
ROE (%)	15.5%	n/a	14.4%	12% to 15%	18.2%	>15%

Source: Company, Forsyth Barr analysis

Figure 8. Price performance



Source: Forsyth Barr analysis

Figure 9. 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

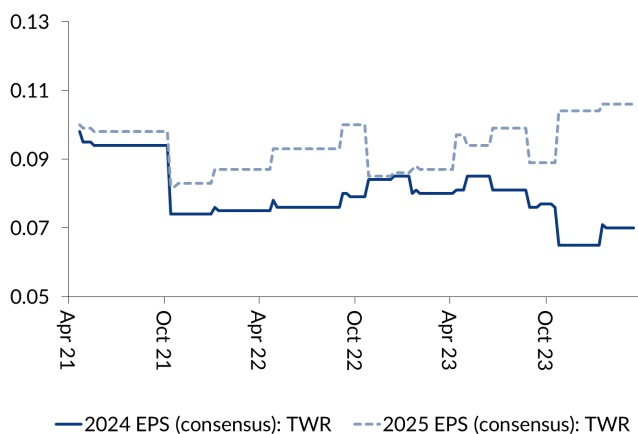
Figure 10. International valuation comparisons

Company	Code	Price	Mkt Cap (m)	PE		EV/EBITDA		EV/EBIT		Cash Yld 2025E
				2024E	2025E	2024E	2025E	2024E	2025E	
Tower Ltd	TWR NZ	NZ\$0.83	NZ\$315	6.1x	5.9x	n/a	n/a	n/a	n/a	9.6%
Heartland Group Holdings *	HGH NZ	NZ\$1.12	NZ\$818	9.7x	9.1x	n/a	n/a	n/a	n/a	7.0%
Insurance Australia Group	IAG AT	A\$6.45	A\$15,490	17.3x	15.7x	n/a	n/a	n/a	10.4x	4.7%
Suncorp Group	SUN AT	A\$16.23	A\$20,650	15.2x	15.0x	n/a	n/a	n/a	54.7x	5.2%
QBE INSURANCE GROUP	QBE AT	US\$11.52	US\$17,242	10.7x	9.8x	n/a	n/a	n/a	8.4x	5.3%
Compco Average:				13.2x	12.4x	n/a	n/a	n/a	24.5x	5.5%
TWR Relative:				-54%	-52%	n/a	n/a	n/a	n/a	74%

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

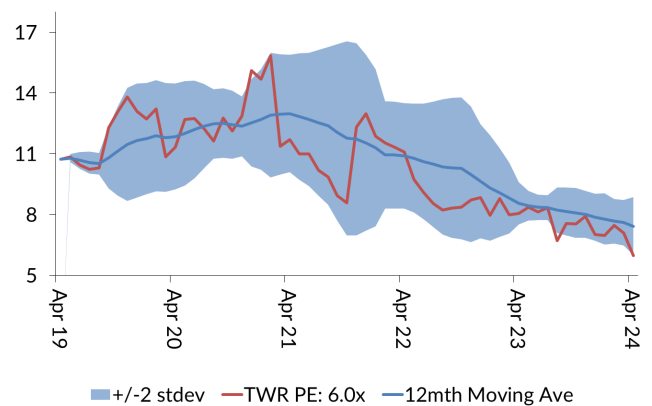
Source: *Forsyth Barr analysis, Bloomberg Consensus, Compco metrics re-weighted to reflect headline (TWR) companies fiscal year end

Figure 11. Consensus EPS momentum (NZ\$)



Source: Forsyth Barr analysis

Figure 12. One year forward PE (x)



Source: Forsyth Barr analysis

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