Tower FY23 Results Announcement Script

Slide 1 – 2023 Full Year Results

Michael Stiassny

Mōrena, good morning and thank you for making the time to join us for this investor call and presentation of our 2023 full year results.

Slide 2 - Agenda

With me in Auckland is our Chief Executive Officer, Blair Turnbull and our Chief Financial Officer, Paul Johnston who will take you through the results and answer your questions.

Slide 3 – Chairman's update

The word 'unprecedented' gets bandied around plenty these days, but is an appropriate description for what the global insurance industry has faced in 2023.

A raft of catastrophic weather events worldwide not only highlighted the immediate impacts of climate change, but also put all insurance businesses on notice that the risk environment in which we operate is irrevocably altered.

Risk-based pricing continues to be Tower's best protection to address these issues and has enabled us to remain resilient, withstanding the challenges the year served up.

Resilience to challenges

Tower has been the poster child for risk-based pricing in New Zealand. We were the first to implement risk-based pricing for inland flooding, and we continue to expand hazard modelling to other climate-related risks. Our view remains that risk and pricing transparency is not only fairer to customers but is in the best interests of our shareholders.

It has certainly proven to be a compelling factor in securing a comprehensive reinsurance programme for FY24 at competitive rates. This is crucial as reinsurance provides protection from volatility caused by large events, maintains flexibility to enable Tower's growth and supports strong solvency.

However, while risk-based pricing successfully underpins Tower's competitive pricing, robust underwriting, continued growth, and response to issues arising from climate change, it is not a cure-all for all challenges.

Insurance remains critical

Ideally, comprehensive insurance would be affordable and accessible for all. Unfortunately, the twin challenges of an inflationary environment and increasing risks from climate change make this unrealistic.

The unpalatable truth is that not everyone is – or will be – able to afford to insure their home in the way they do now.

However, the New Zealand market enjoys strong insurance penetration and people will be loath to give up all protection. So, while affordability is currently presenting challenges, the desire and need for insurance will not dissipate. Our view is that fortune will favour those insurers who can pivot and adapt, something that Tower has the digital capability and proven ability to do.

Tower will continue to innovate by developing cost-effective alternatives to traditional, comprehensive insurance cover. In the future, options likely to be offered in New Zealand include parametric cover, which has already been successfully trialled in the Pacific, and named perils policies which only cover certain hazards - for example, offering fire only policies in flood-prone areas.

This approach is already common in many other parts of the world and, while it will take some getting used to, it will likely become a necessary replacement to comprehensive cover for at least some New Zealanders.

In short, Tower's continued resilience will be fostered through innovation and meeting the market where it is at... not where we would like it to be.

Well positioned

Despite the obstacles of 2023, Tower continues to be well positioned for long term growth.

Looking ahead, Tower's sharp focus is on continuing to deliver strong, sustainable growth via its rating approach and customer experience. Careful risk selection and risk-based pricing expansion will remain at the forefront of our strategy.

Tower's solvency margin is $53.8m which is above RBNZ's minimum solvency capital. And, although this is below historical levels, it will continue to increase in FY24 as catastrophe event claims are settled.

The fundamentals remain strong.

[pause]

I would like to welcome Mike Cutter who has recently joined the Board and thank Blair for his contribution as an interim Board member. Mike brings extensive global governance and executive experience in the financial services sector that will be invaluable as Tower continues to evolve.

Finally, on behalf of the Board, our sincere thanks to the entire Tower team – from the frontline to management – for digging deep in tough times to deliver on our strategy while supporting our customers and communities.

I'll now hand over to Blair and Paul, who will take you through the results and outlook before we take questions.

Blair Turnbull

Slide 4 – Business update

Kia ora, thank you Michael and good morning, everyone.

Thank you for joining us for our 2023 full year financial results.

Slide 5 – Results summary

Here is a summary of our results, which overall demonstrate Tower's resilience through a challenging year.

I will talk through these points in more detail shortly, but first, an overview of our performance this year.

Slide 6 – Our performance – Business performance impacted by catastrophe events

Gross written premium for the year to 30 September increased to $527 million, up 17% on the same period last year. This was driven by strong rating actions, as well as continuing customer acquisition and retention.

Customer numbers increased to 321,000, up from 310,000 in FY22.

Increasing inflation and a higher frequency of motor claims have contributed to an increase in the BAU claims ratio to 55.5% compared to 48.9% in FY22. Tower is continuing to apply targeted rating and underwriting actions to address these challenges.

We are pleased to see our management expense ratio improve again to 32.2% versus 36% in FY22, thanks to our disciplined cost control and improved efficiencies through digitisation and increasing scale.

Large event costs totalled $55.6m, up from $19m in FY22. These costs include the additional reinsurance cover purchased to reinstate our reinsurance arrangements following the two New Zealand catastrophe events earlier this year.

Given these large events costs, our solvency ratio decreased to 159% from 205% in FY22, but remains in a solid position, which Paul will talk to shortly.

Despite these challenges, we are reporting an underlying profit after tax of $7.6 million, down from an underlying profit of $27.3m in the full year 2022.

Reported FY23 loss was $1.2m compared to an $18.9m profit in FY22.

On the basis of these results Tower will not pay a full year dividend in FY23.

Slide 7 – Catastrophic and large weather events

As you can see in this graph large events costs have been rising steadily in recent years.

Tower is monitoring these trends and has important mitigations in place to help manage these risks. Our robust reinsurance arrangements have provided protection from catastrophe events this year. We estimate reinsurance will cover more than $200m of customers' claims for both catastrophe events combined.

As at 20 November we had completed approximately 84% of claims for the New Zealand weather events and 88% of claims for the Vanuatu cyclones. We are working hard to close the remainder.

To help mitigate large events impacts in FY24 we have purchased cover for two catastrophe events up to $750m each as well as prepaid cover for a third event up to $75m.

We have also included a large events allowance of $45m within our guidance. This allowance has been calculated with an estimated 90% confidence the outcome will be below or up to this level.

We now plan for a higher frequency and intensity of large events in both our financials and our operations.

Slide 8 – Managing impacts of inflation

While we respond to the challenges presented by climate change, including increasing reinsurance and other weather-related costs, Tower has also been actively managing the impacts of inflation.

Tower’s dynamic rating ability saw monthly inflation-based rate changes and other pricing activity total 77 rate changes in the year.

We are also continuing to improve the accuracy of existing customers’ sum insured amounts (and therefore their pricing). In New Zealand, for the second year running, nearly 100% of our house customers’ sums insured were updated automatically as part of their renewal offer, mainly using data from the Cordell calculator. This helps customers choose a suitable level of cover.

As we have noted earlier this year, motor theft is a continuing challenge in New Zealand therefore we continue to increase premiums and excesses for vehicle models that are being stolen more regularly.

This chart demonstrates the annual growth in Tower's average premium, after taking into account changes to excesses and sum insured amounts. The substantial annual growth highlights the impact of technical premium increases and how these flow through to Gross Written Premium.

Increases to home insurance premiums were moderated by the change in the EQC cap which became effective from 1 October 2022.

We are also continuing to address the challenges presented by inflation through strong, disciplined underwriting.

Following the New Zealand large events in January and February this year, we introduced manual underwriting for landslide risks and automated underwriting on sea surge risks.

Risk ratings for these hazards will be presented to customers in My Tower in the coming months.

We are also targeting good risks, like new build homes, with competitive rates.

On the motor side we continue to improve our data by taking a more granular approach to rating factors that are proven to influence claims frequency and severity.

This helps predict the likelihood of claims and possible customer behaviours, with greater accuracy.

We are also exploring new telematic options.

Ultimately this is all about getting the right risks at the right price for the right customers.

Slide 9 – Delivering on our strategy

I am proud of Tower's resilience which has enabled us to continue delivering on our strategy this year while responding to catastrophic events and other external challenges.

Slide 10 – Our strategy

At Tower, our purpose is to inspire, shape and protect the future for the good of our customers and communities. After a year navigating the impacts of catastrophic weather events in New Zealand and Vanuatu, widespread inflation and increasing crime, our purpose is more important than ever.

In FY23 we took the opportunity to review and confirm our strategy and focus on four key areas. These are:

- delivering a leading customer experience;
- being operationally efficient and effective;
- continuing to develop our high performing culture, and;
- ensuring continued resilience.

Our focused outcomes will help lead to the new two year financial targets that Paul will talk through shortly alongside our FY24 guidance.

Slide 11 – Targeted customer and premium growth

Tower's focus on simple and rewarding customer experiences combined with consistent rating actions continues to drive strong growth, in both customers and premium.

As you can see in this chart, we are growing steadily in our core home, contents and motor product offerings with GWP reaching $527m year on year.

In the context of this high inflation environment, our 17% growth in premium reflects an appropriate mix of rating and organic growth with 75% of premium growth driven by decisive rating actions.

Our Partnerships channel is delivering positive growth with GWP from active partners in New Zealand increasing by 26% to $82m in the year.

We also continue to drive customer engagement, with our retention rate for New Zealand remaining stable at 77%. Half of our customers hold multiple policies with us and these customers stay with us for an average of eight years.

Slide 12 – Customer experience improves through digital and data

Our digital platform is improving the overall Tower experience for our customers as they increasingly adopt our online sales and service channels.

In FY23 77% of New Zealand Direct sales occurred online, up from 66% in the prior year, while 56% of New Zealand service and claims tasks were completed online, up from 50% in FY22.

Customer satisfaction for these online engagements remains strong - our combined New Zealand net promoter score for online experiences remains steady at 55%.

With our core platform now live across the Tower group we are able to flex resource up or down across Fiji and New Zealand, our two biggest markets.

Following post-covid resourcing challenges in FY22, which led to customer service challenges, we scaled up our operations, particularly through our Suva hub. This helped our call abandonment rate improve to 12%, down from 17% in FY22.

We are pleased to see My Tower registrations continue to rise, increasing by 32% this year to 264,000 registrations. We look forward to this number climbing further now that My Tower is live in all the markets where we operate.

An important part of delivering the leading customer experience we aspire to is fronting up and fixing things when we don't get them right.

As we noted in our recent market announcement, we have made substantial progress in refunding customers who did not receive their correct multi policy discounts extending back to 2016. As of 31 October we had paid $6.2m excluding GST to these customers.

Paul will talk through the financial impacts of this in more detail shortly.

Importantly we are focused on putting things right for customers and we sincerely apologise to those who have been affected.

In addition to reviewing our processes, we are also redesigning and simplifying our multi-policy discount offering.

Slide 13 – Reducing MER through simplification and digitisation

Our investments in simplifying and digitising our business continue to deliver MER improvements. And in the context of the external challenges we are managing, we are particularly pleased to have achieved yet another reduction in MER to 32.2% this year.

Contributing to this MER improvement is our increasing scale as well as the rating actions we have taken to tackle inflation and other external challenges.

With our core platform across all countries, another key driver of MER improvement is our increased digitisation which continues to lower the cost to acquire and serve customers.

The expansion of our Suva hub this year has also delivered operational efficiencies as we moved workflows between sites to manage workload peaks. In the year our Suva team answered 16% of all New Zealand calls to Tower, and we expect this portion to increase further.

Pleasingly these efficiencies have also seen our management expenses increase at below the rate of inflation.

Our commission ratio continues to improve, reducing to 1.7% in the year from 2.2% in FY22 thanks to legacy portfolio purchases and commission terms focused on referral arrangements.

Slide 14 – Profit impacted by record events and claims inflation

Despite the unprecedented year of weather events, record inflation and crime, our underlying core business remains profitable.

This is due to our actions to streamline the business, continuous efficiencies through digitisation, and targeted customer growth.

Slide 15 – Financial performance title slide – Paul Johnston

I will now hand you over to our chief financial officer Paul Johnston who will take you through the details of our financial performance this year.

Slide 16 – Group underlying financial performance

Thank you, Blair.

Looking at the consolidated results, we can see that growth in GWP has been strong, increasing by $69.5m, or 17%, on FY22. This growth was predominantly driven by rating actions and excludes Tower's Papua New Guinea subsidiary which was sold during the year.

Increased motor frequency, along with high inflation and a higher number of small weather events contributed to our BAU loss ratio increasing 6.6% to 55.5%.

Large events costs totalled $55.6m and included net claim costs of $38.2m and reinsurance reinstatement costs of $17.4m.

Pleasingly, the MER improved to 32.2% as a result of expense efficiencies and scale.

Higher yields have seen net investment income increase by $13.1m to $14.3m.

Underlying NPAT before large events was $7.6m down from $27.3m in the prior year, reflecting the catastrophic weather events experienced in FY23.

Including large events costs we have reported a net loss after tax of $1.2m.

This was impacted by non-underlying transactions which include an increase to the CEQ valuation, tax adjustments relating to the prior period, and an increase to the customer remediation provision. These were partially offset by gains on the sale of our Papua New Guinea subsidiary and our building in Suva.

Slide 17 – Underlying NPAT impacted by large events

Here is the bridge between underlying NPAT in FY22 of $27.3m and underlying NPAT of $7.6m in FY23.

You can see that business growth, MER and investment income have helped support this result, but large events, and the change in the BAU loss ratio have had adverse impacts this year.

Slide 18 – BAU claims challenged by motor frequency and inflation

We have been taking strong rating actions over the past two and a half years to combat rapidly increasing inflationary pressures.

However, BAU claims costs continue to be challenged by the increasing frequency of motor claims as well as inflation and supply chain capacity constraints which are impacting the severity, or cost of claims.

These are continuing to track above historical norms in New Zealand, following a more subdued period due to Covid lockdowns in previous periods.

Motor crimes tend to result in the total loss of a vehicle, so this trend of increasing motor theft contributes to both higher frequency and severity. Average New Zealand motor claims costs are now up to $3,201.

While house claims frequency in New Zealand is flat at 7.2%, the average severity is up to $3,766.

These factors have led to our BAU loss ratio increasing to 55.5%. The large events experienced this year have contributed an additional 13.4% to a total claims ratio of 68.9%.

Tower has applied targeted premium increases across motor and home to offset inflation and other increases. We also continue to work closely with supply chain partners while focusing on internal efficiencies to moderate the impact on customers as much as possible.

Slide 19 – BAU claims challenged by motor frequency and inflation

This page illustrates the increase in the loss ratio from FY22 to FY23, reflecting the increases to motor and home severity as outlined on the previous page.

Slide 20 – Continued improvement in management expenses

We are pleased to see our management expense ratio continue to reduce with an improvement over the year of 3.8% to 32.2%.

Increased scale from business growth has enabled efficiencies and a 4.8% reduction in MER with a further 0.3% decrease in net commission expenses due to the legacy portfolio purchases.

The effects of inflation were offset by cost containment measures in the year, particularly staff costs which provided a 1.1% decrease.

A 0.8 percentage increase in amortisation was due to legacy portfolio purchases and continued spend on investments to drive growth and efficiency automations.

Slide 21 – Higher investment returns as yields increase

Net investment income in FY23 increased to $14.3m before tax, this was $13.1m higher than in FY22.

This increased income reflects interest rates stabilising, resulting in higher running yields.

Tower maintains a conservative investment policy with a focus on high credit quality and liquidity bonds, and a target duration for the core investment portfolio of six months.

Our strategy has mitigated the impact on our profit from macroeconomic factors and mark to market movements in the past, and now allows us to benefit from higher interest rates, as evidenced by the running yield on the core investment portfolio increasing to 6.07% at 30 September 2023.

Our outlook for investment income is to remain near current levels over the next year.

Slide 22 – Reinsurance programme supports resilience

Tower's reinsurance strategy provides protection from volatility caused by large events and maintains financial flexibility to support growth, while underpinning strong solvency.

This resilience was realised in the year as we expect our reinsurance arrangements to cover $204m of FY23 large event claims costs.

In line with our conservative approach to reinsurance, we reinstated our reinsurance arrangements following the two catastrophe events at a cost of $17.4m.

We were very pleased with the successful placement of our reinsurance arrangements for FY24 which include catastrophe reinsurance of up to $750m for two events with an excess of $16.9m for each event. This was down from $889m in FY23 due to the EQC cap change which reduced the amount of coverage needed.

We have also purchased coverage for a third event of up to $75m with a $20m excess.

Slide 23 – Canterbury earthquake claims reducing

We are continuing to make steady progress in settling Canterbury claims with 33 closed over the year. In line with expectations, we received an additional 20 new overcap and reopened claims, bringing the total number of open claims to 23 at 30 September 2023. This was a net decrease of 13 from the end of September 2022.

FY23 has seen an adverse Canterbury earthquake P&L charge of $1.2m after tax in non-underlying items.

Some of our open CEQ claims are complex and long-term. However, the remaining gross outstanding claims provision reduced to $19.1m over the year from $24.5m at September 2022.

We continue to closely manage these outstanding claims and our specialist team is working to finalise claims as efficiently as possible.

Slide 24 - Capital and solvency position

We progressed well settling catastrophe event claims in the second half of FY23 and collecting the recoveries from reinsurers which has improved our solvency position compared to the first half. With a solvency ratio of 159%, we are now holding $53.8m above the minimum capital required for solvency. This is below our new internal target of $67.4m set in preparation for the new interim solvency standards released by RBNZ.

Our minimum solvency capital has increased from historical levels due to underlying business and claims growth, higher catastrophe risk retention, and capital required for open catastrophe claims.

We expect our solvency position to further improve in FY24 due to business profit and as catastrophe claims continue to be settled.

In FY24 solvency will be reported under the new Interim Solvency Standard with no material change in excess solvency expected.

Our A- credit rating was reaffirmed in April by AM Best.

Slide 25 – FY24 guidance

In FY24 Tower expects GWP growth - excluding revenue from sales of subsidiary operations - of between 10% and 15%.

We have set a conservative large events allowance of $45m for FY24 versus $38m in the prior year. Consistent with FY23, we will measure large events as those which have a total cost of more than $2m.

Assuming full utilisation of the large events allowance Tower anticipates underlying NPAT of between $22m and $27m.

We expect further improvements to our management expense ratio which we anticipate will be between 30% and 32% in FY24. As the rating and other actions that we have in place to address inflation begin to improve our BAU loss ratio, we expect a reduction in our combined operating ratio to between 95% and 97%.

You'll note new, medium-term targets that we are sharing with the market for the first time today. In FY25 we will be focused on delivering another 10% to 15% GWP growth, a management expense ratio of less than 28% and, a combined operating ratio of less than 91%. We are targeting a return on equity of between 12% and 15%.

Slide 26 – Looking forward

Thank you. I will now hand back to Blair who will provide an update on our priorities for FY24.

Blair Turnbull

Thank you, Paul.

Slide 27 – FY24 priorities

In line with our strategy and focus on delivering the medium-term targets Paul just highlighted, our five priorities for the coming year are clear.

I will take you through some of the actions that support these priorities in our final few slides.

Slide 28 – Leading customer experience and targeted growth

We will continue to invest in creating leading customer experiences and targeting profitable growth.

This includes adding landslide and sea surge risk ratings to our automated customer-facing quote-to-buy tool, where customers can already see their home's risk ratings for earthquake and flood hazards.

In the coming year, we anticipate a greater proportion of new business to come from home insurance policy sales as we target high quality risks. This includes a greater emphasis on new builds.

We will continue to grow organically through our existing partnerships.

And we expect the rating changes we made in FY23 to continue to flow through the portfolio as policies renew.

An important priority is to complete the multi-policy discount remediation while continuing to redesign our multi-policy discount offering. As you can see in the example on this phone screen on the slide, we are also working to give customers greater transparency of their discounts.

Slide 29 – Continuous improvement on efficiency & processes

We're focused on delivering efficiency, digitisation and process improvements.

By the end of FY25 we want digital transactions to account for 80% of all New Zealand service tasks, increasing from 55% at the end of FY23.

We will launch new house and motor assessing systems to reduce assessment times and repair costs. And we are expecting more than half of our call volumes to be answered by our team in Suva.

We will continue to streamline the business through the sale of our Solomon Islands subsidiary and exiting our New Zealand rural commercial portfolio.

It is also our intention to sell our Vanuatu business and we are going through a process of identifying a buyer. We'll update you once we have progressed this further.

Slide 30 - Investing in future resilience and sustainability

We will continue to invest in our future resilience and sustainability.

Large events are now business as usual for insurers and we will continue to protect both our financial and operational resilience by conservatively budgeting for increased large events costs while embedding large events response processes into our everyday operations.

We are scaling our parametric insurance offering by partnering with global insurtech, CelsiusPro and the United Nations to expand our pilot beyond Fiji to

Tonga. We plan to offer parametric insurance across five Pacific territories by FY25.

We are excited by the possibilities parametric insurance provides for people who may not benefit from traditional insurance products.

We are reducing our operational emissions which are now 13% below our baseline year. In FY24 we will expand our measurement of scope 3 emissions to include emissions from our underwriting activities and supply chain. While we expect the inclusion of this previously unreported data to increase Tower's total carbon emissions profile, we look forward to turning this new information into actions that contribute to a low carbon future.

Our first Climate-related Financial Disclosure is required for the 2024 financial year. We look forward to sharing more information with you then about how we are preparing for a range of possible futures shaped by climate change.

We know that sustainability issues are important to our people and customers. Our consumer research shows that for almost half (47%) of people, a commitment to sustainability and climate action matters when choosing an insurance company.

With this in mind, Tower is aiming to achieve B Corp accreditation in the coming year. B Corp is a globally recognised sustainability benchmark which measures a company's entire social and environmental impact.

Thank you for your time this morning, I will now hand back to the operator to ask for questions.