Tower HY23 Results Announcement Investor Presentation Script

Slide 1 – 2023 Half 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 half 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

In what has undoubtedly been a difficult half, Tower is reporting a loss of $5.1m, although the underlying business performance remains strong. Revenue growth and expense control have improved and – while profits have been impacted by catastrophic weather events – Tower remains resilient.

That resilience is a result of the decisive actions Tower has taken – and is continuing to strengthen – to address the three major external challenges facing our business, along with the rest of New Zealand: catastrophic weather events, inflation and motor crime.

Catastrophic events

Three catastrophic weather events in the space of three months was unprecedented and the consequences for communities across the North Island and Vanuatu are tragic. It's a sobering reminder – if one was needed – that the risk environment in which we operate is not just changing, it has changed.

Data clearly shows the frequency of large events and the severity of the damage they cause has increased over time. Tower has long been urging New Zealand to stop building in risky areas and introduced risk-based pricing to send the right signals to customers and encourage better decision-making by central and local government.

Risk-based pricing is fairer from a customer perspective and is also in the best interests of our shareholders. Risk-based pricing is Tower's best protection when it comes to ensuring continued support from reinsurers. It also underpins competitive pricing, robust underwriting, continued growth, and constructive action on issues arising from our changing climate.

Tower is expanding its risk-based pricing model to include landslide and coastal hazards this year and will continue to develop innovative products that provide affordable insurance for properties with the right risk profile.

While Tower is actively supporting the Government's Cyclone Gabrielle Recovery Taskforce and Auckland Council's Recovery Programme, our focus is on careful risk selection going forward.

[PAUSE]

No one can predict the climate future with any certainty. However, the data indicates that the catastrophic weather events we have experienced in this half are more likely to be symptomatic of a new normal, not a one-off outlier.

I've never been one to mince words and it is inevitable that sooner or later Tower and other corporates will be unable to provide insurance to everyone. It's a grim reality.

I applaud the fact the public discourse is finally moving towards the potential need for managed retreat in some locations. It is absolutely essential that these conversations are had early, and in an open and transparent manner, with the communities concerned. As a society, we need to ensure the decisions that will eventually need to be made are fully understood and supported as far as possible by the people directly affected.

In this new normal of frequent catastrophic events, risk-based pricing, together with being more selective on the risks we take on, are vital to ensure Tower can remain a resilient business. Importantly, it enables us to be competitive against the Australian duopoly and underpins continued availability of reinsurance.

[PAUSE]

Inflation and crime

Tower has been able to proactively manage inflationary pressures through targeted rating and underwriting actions, ensuring monthly rating changes mitigate reinsurance and weather-related cost increases. We have kept pace with inflation and will continue to do so.

Similarly, in the wake of increasing levels of motor crime, Tower has identified those vehicles subject to higher rates of theft and made appropriate changes to rates and excess charges.

Being able to act swiftly and decisively to address emerging issues on a granular level is at the heart of the digital transformation Tower has undergone in recent years. Flexibility and agility are fundamental to Tower's continued confidence in its ability to successfully mitigate external challenges beyond our control ... and remain resilient.

As a result, Tower expects to deliver a profit in FY23. Tower's full year underlying NPAT guidance is between $8m and $13m, with a large events allowance of $50m.

[PAUSE]

As indicated earlier this month, today we confirm that we will not be paying an interim dividend. This decision, while disappointing, reflects the Board's focus on prudent fiscal management. A decision on a full year dividend will be made when Tower's full year results are finalised.

[PAUSE]

Before I hand over to Blair, I'd like to acknowledge the Tower team. As we all recognise, it's been a particularly difficult time for communities bearing the brunt of the storms, and the team is working hard to settle claims efficiently and support affected customers.

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 half year financial results which see Tower reporting improved revenue growth and expense control, with profits impacted by catastrophic weather events.

Today's results demonstrate that we are operating in a changing climate and risk environment. As we navigate this new normal it is critical that New Zealand maintains a strong insurance industry for the future.

We intend to be here for the long term, to continue to thrive and deliver value to our customers and communities, our people and our shareholders.

The investments we've made in our technology and operational efficiencies, robust reinsurance and enhanced hazard modelling will continue to underpin our resilience and ability to address external challenges.

As Michael outlined, we are proactively managing climate related weather impacts through risk-based pricing and product innovations. And we are keeping pace with inflation via targeted rating and underwriting actions while addressing increasing vehicle theft and increasing claims costs with rating and excess changes.

I will talk through these actions shortly, but first, a summary of our performance this half.

Slide 5 – Our performance – Business performance impacted by catastrophe events

Gross Written Premium for the half year to 31 March increased to $245 million, up 15% on the same period last year. This was driven by strong rating actions to address continued inflation, additional reinsurance premiums and higher motor and other claims frequency, as well as continuing customer acquisition and retention.

Increasing motor theft and a higher frequency of motor claims post-Covid have contributed to an increase in the BAU claims ratio to 51.6% compared to 48.6% in HY22.

We are pleased to see our management expense ratio improve again to 35.1% versus 35.8% in HY22, thanks to our disciplined cost control and further efficiencies.

Excluding large events costs, our underlying profit is up 30% on HY22 to $23.6m.

Net costs for large events totalled $33.9m, up from $17.9m in HY22. We will cover these events and our actions to manage these impacts in more detail shortly.

Given these large events costs, our combined operating ratio increased to 105.3% from 94.8% in the half year 2022.

Reflecting these challenges, we are reporting an underlying net loss after tax including large events costs of $3.3 million, down from a profit of $5.4m in the first half of FY22.

Reported HY23 loss was $5.1m compared to a $3m profit in the half year 2022. This was impacted by strengthening of the residual Canterbury earthquake and multi-policy discount remediation provisions and was partially offset by the sale of Tower's Papua New Guinea subsidiary and our building in Suva.

Slide 6 – Catastrophic and large weather events

As you can see in this graph the frequency of disaster events in New Zealand has been increasing steadily since the late 1960s and then accelerating more recently.

Prior to 2023, the ten-year rolling average of large event costs for Tower was around $14m a year while 2023 looks very different with total event costs for the 12 months ending 31 March at a record high of $294m.

Tower is continuously monitoring these trends and has important mitigations in place to help manage these risks – primarily through our risk-based pricing approach and our robust reinsurance programme which has provided protection from the catastrophe events experienced in New Zealand this half.

We have completed approximately 30% of claims for the Auckland & Upper North Island weather event and Cyclone Gabrielle. Around 5% of claims for Cyclones Judy and Kevin have been settled and we are working efficiently to close the remainder.

These events are predominantly covered by reinsurance with the cost to Tower for each the Auckland & Upper North Island weather event and Cyclone Gabrielle limited to an $11.9m excess. The estimated impact of the Vanuatu cyclones is $10m net of reinsurance recoveries.

Accordingly, we have increased our FY23 large events allowance to $50m net of reinsurance recoveries, up from $40m.

Slide 7 – Managing impacts of increasing weather events

Tower is proactively managing this increasing frequency and severity of large events that are linked to our changing climate.

With our approach to risk-based pricing we are sharing information with customers about their properties so they can make informed decisions and understand their insurance needs and premiums better. Risk-based pricing is a fairer way to price insurance as customers only pay for the risks that apply to their property.

Since implementing our flood modelling in 2021 we have tested our model against the actual impacts of subsequent flood events, and these have matched closely every time. While the most recent floods were particularly severe, our testing has confirmed that they followed the patterns we had modelled, which continues to give us confidence in the accuracy of our pricing and underwriting.

Additionally, we are actively working to improve and refine our risk-based pricing to ensure we further protect the business from the volatility of weather events. Immediately following the events this first half we implemented heightened risk selection criteria for landslide risks.

We have also increased the weighting we put on the flood risk portion of customer premiums to ensure our pricing accurately reflects the changing risk profile.

In addition, we are working to expand our hazard model to include landslide and coastal hazards and we plan to implement automated pricing for these risks in the second half of 2023.

Ensuring our product development and innovation supports climate change resilience and action is also a priority as this will ensure we continue to offer relevant insurance products well into the future.

For example, we are planning to expand our parametric insurance pilot in Fiji to also cover cyclone hazards in Tonga and Samoa. Our Cyclone Response Cover provides a lower value rapid cash pay-out when a customer is impacted by a high wind speed cyclone event, regardless of damage and without the need for an insurance assessor's signoff.

Slide 8 – Managing impacts of inflation and crime

Tower's advantage is our ability to identify and quickly address emerging trends, thanks to our investments in digital and data technology and the decisive actions we've taken to deliver improvements.

As we respond to the challenges presented by climate change, Tower has also been actively managing the impacts of both inflation and increasing claims costs, particularly motor crime.

Since we started seeing the effects of inflation two years ago Tower has responded dynamically with decisive monthly rating actions. As you can see on this chart we have consistently kept pace with inflation across our motor and house premiums. The sharp rise in premiums earlier this year reflects the rating actions we've taken to mitigate the increasing costs of reinsurance and weather events.

We are continuing to ensure the accuracy of customers' sum insured amounts (and therefore their pricing) by updating these automatically at renewal either by the consumer price index or the Cordell calculator.

As we noted at our annual shareholder meeting in February, motor theft is a continuing challenge in New Zealand and it now accounts for more than 10% of total motor claims costs, around double historical averages. As you can see in this chart, New Zealand Police data clearly reflects this growing and concerning trend.

This type of crime not only affects the victims' property and well-being it affects their insurance too. While we are of course supporting customers with information to help mitigate the thefts, it should come as no surprise that we are also responding with actions to protect the impact on both our business and other policyholders. These include increasing premiums and excesses for vehicle models that are being stolen more regularly.

Slide 9 – Outlook for second half

Due to our disciplined performance, we remain a resilient business. We are mitigating risks from large event costs, motor crime and inflation, we are managing our expenses and we are growing well.

Importantly we are focused on supporting customers while working efficiently to settle the claims from the recent large events.

Through digitisation and our agile approach to pricing and underwriting we are continuing to address the challenges presented by inflation.

Through targeted organic growth as well as strong rating actions, we are expecting GWP growth of 15% to 20% over the year.

And we expect to continue our positive trend of delivering operational efficiencies.

We have successfully completed the reinstatement of our reinsurance arrangements and have protection for two additional catastrophe events of up to $889m per event for the remainder of the financial year.

We expect the storm in Auckland on 9 May to be a large event in the range of $4m to $6m.

Tower's 2023 full year underlying NPAT guidance is between $8m and $13m, assuming the $50m large events allowance is used. We have between $10m and $12m of our large events allowance remaining for any further large events in the financial year.

Slide 10 – Continued customer and premium growth

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

We have grown customer numbers to 320,000, up 5% on the 2022 half year. New Zealand risks in force also grew by 5% to 592,000.

Our 15% growth in premium reflects an appropriate mix of rating and organic growth with 60% of our New Zealand premium growth driven by decisive rating actions.

As you can see in this 12 month rolling view we are growing steadily in our core home, contents and motor product offerings with GWP reaching $486m year on year.

Our digitisation strategy continues to drive deeper customer engagement and growth, with our retention rate for Tower Direct up to 79% versus 78% in HY22.

We are continuing to sell more to existing customers who stay with us longer as we grow. Half of our New Zealand customers have two or more products with Tower, and these customers stay with us for an average of eight years.

Slide 11 – Channel and efficiency improvements

All three of our business channels are growing and delivering efficiency improvements.

Tower Direct

Our flagship Tower Direct business grew GWP by 19% to $183m as we continued to build rewarding and engaging relationships with customers.

Contributing to this was our strong, 88% retention of the customers we transitioned to Tower Direct via our legacy book acquisitions.

Our leading digital platform continues to perform strongly and increase customer engagement. In HY23 My Tower registrations grew to 237,000, up 44% on HY22.

Partnerships

Our Partnerships channel is continuing to deliver positive growth with GWP from active partners increasing by 23% to $37m for the half year.

The number of advisors referring customers to Tower has also expanded, increasing by 57% over the year to 2,200 active advisors.

Thanks to the successful completion of our strategy of acquiring legacy insurance books and migrating them to Tower Direct last year, our commission payments continue to reduce and our net commission expense is now equivalent to just 2.1% of gross earned premium compared to 2.3% in HY22.

Pacific

We are continuing to digitise and simplify our Pacific offering, aligning our New Zealand and Pacific activities more closely to deliver growth and efficiencies.

With this simplification in mind, we completed the sale of our Papua New Guinea subsidiary in October.

The full My Tower experience is now available across all markets where we operate contributing to Pacific GWP growing by 9% year on year to $24m in the half.

We are continuing to tighten our risk appetite in the Pacific to focus on our core personal lines offering. Following Cyclones Judy and Kevin we have paused sales of house policies in Vanuatu as we reassess the risk environment.

Slide 12 – Improving efficiency through leading data and digital

The customer and efficiency benefits from our leading digital and data technology platform are continuing to be realised.

Our digital platform is driving down the costs to acquire new business and serve customers as customers increasingly adopt our online sales and service channels. This is evidenced by 76% of New Zealand Direct sales now occurring online, up from 63% in the prior year, and 54% of New Zealand service and claims tasks now being completed online, up from 49% in HY22.

Our investments in digital technology are increasingly enabling us to move workflows to our Suva hub which is continuing to lower telephony and service costs.

These efficiency improvements are flowing through to improved customer satisfaction with our New Zealand online net promoter score improving to a pleasing 58% in HY23.

On top of winning Canstar's top Car Insurer of the Year Award, and Outstanding Value Award for the second year running last year, we were proud to win a Canstar Outstanding Value award for our home and contents insurance product.

The agility of our core platform continues to deliver efficiency improvements including rapid deployment of technology releases which now only take us 25 minutes a day, down from two hours previously.

Slide 13 – Reducing MER as simplification and digitisation realised

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 35.1% this half.

With our core platform live across all countries we have simplified our organisational alignment around our three customers journeys: new business, service and claims – rather than across geographical locations. This set up is aimed at delivering consistent and repeatable processes across our business – continuing to reduce complexity, duplication and risk.

In addition to these operational efficiencies, a key driver of MER improvements is our increasing scale being achieved through digitisation.

Slide 14 – 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 half.

Slide 15 – Group underlying financial performance

Thank you, Blair.

Looking at the consolidated results, we can see that growth in GWP has continued, increasing by $28.9m, or 15%, on HY22.

As Michael and Blair have highlighted increased motor frequency, driven by crime has contributed to our BAU loss ratio increasing 3% to 51.6%.

The reinsurance reinstatement costs contributed a $3.4m impact in the half year.

Pleasingly, management expenses improved to 35.1% as we continue to deliver expense efficiencies and increasing scale through the benefits of digitisation.

Underlying NPAT before large events increased 30% to $23.6m, demonstrating strong business performance. Including large events costs we have reported an underlying net loss after tax of $3.3m.

Reported loss of $5.1m was impacted by non-underlying transactions which include strengthening of the residual Canterbury earthquake provision and multi-policy discount remediation provision. These were partially offset by the sale of Tower's Papua New Guinea subsidiary and our building in Suva.

Slide 16 – Underlying NPAT impacted by large events

As this chart demonstrates the large events impact had a substantial $26.9m impact on our financial performance leading to the $3.3m underlying loss this half. HY23 large events costs were $14m higher than large events costs in HY22 after tax.

Premium growth provided a $5.8m benefit to the result which was partially offset by rising motor claims.

HY23 saw commissions further reduce by $400,000 and investment income increase by $5.2m.

The HY22 release of the Liability Adequacy Test provision contributed $1.8m to the movement between HY22 and HY23 underlying NPAT.

A $4.3m increase in after tax expenses includes amortisation of the legacy back book purchases and an increase in staffing costs due to wage inflation and an increased investment in growth.

As we have previously noted, reported loss was impacted by strengthening of the residual Canterbury earthquake provision and customer remediation provision which includes compensation payments as a result of discounts for taking out multiple policies being incorrectly applied.

Slide 17 – BAU claims challenged by motor frequency and inflation

The positive rating actions we have taken in the past two years to address the rapidly increasing inflationary pressures have seen improvements.

However, BAU claims costs continue to be challenged by the increasing frequency of motor claims as well as inflation which is impacting the severity, or cost of claims. These are tracking above historical norms in New Zealand at 12.7% following a more subdued period due to Covid lockdowns.

As motor crimes tend to result in the total loss of a vehicle, this trend of increasing motor theft is contributing to both higher frequency and severity with average New Zealand motor claims costs now up to $2,981.

While New Zealand house claims frequency is down to 6.9%, average severity is up to $3,499.

These factors have led to our BAU loss ratio increasing by 3% on HY22 to 51.6%. The large events experienced this half have contributed an additional 16.9% to a total claims ratio of 68.5%.

As Blair outlined, 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 to moderate the impact on customers as much as possible.

Slide 18 - Continued improvement in management expenses

We are pleased to see our management expense ratio continue to reduce with an improvement over the half year of 0.7% to 35.1%.

Business growth has enabled efficiencies and a 4.8 percentage point reduction in MER with a further 0.2 point decrease in net commission expenses due to the legacy back book portfolio purchases.

Other MER impacts include a 1.2 point increase in marketing and technology investments which help drive growth and efficiencies, as well as a 1.5 point increase in staff costs associated with inflation and increased investment in growth.

Slide 19 – Higher investment returns as yields increase

Net investment income in HY23 increased to $6.3m before tax, this was $7.2m higher than in HY22.

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 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 5.45% at 31 March 2023.

Slide 20 – 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 has been realised in the first half as we expect our reinsurance arrangements to protect us from up to an estimate of $276m of catastrophe event costs.

In line with our conservative approach to reinsurance, we have successfully reinstated $187m of our reinsurance arrangements which gives us cover for a potential third and fourth catastrophe event each up to $889m in the balance of the financial year.

This week we completed the purchase of additional catastrophe reinsurance to cover the increased estimate for the ultimate cost of February's Auckland and Upper North Island Weather event.

The costs for these reinstatements are included in our revised full year guidance and the expensed portion of reinstatement premium is included in our half year result.

We have mitigated potential increases to future reinsurance premiums and excesses by negotiating three year rolling contracts with our reinsurers who we continue to have positive relationships with.

Slide 21 – Canterbury earthquake claims reducing

We are continuing to make steady progress in settling Canterbury claims with 15 closed over the half. In line with expectations, we received an additional 10 new overcaps and reopened claims, bringing the total number of open claims at the half year to 31. This was a net decrease of 5 from a total of 36 as at the end of September 2022.

HY23 has seen an adverse Canterbury earthquake P&L charge of $1m after tax in non-underlying Items, reflecting increases in expected claims costs.

Some of our open CEQ claims are complex and long-term. The increase in expected cost was driven by both inflation and more costly rectification approaches. However, the remaining gross outstanding claims provision reduced down to $22.1m over the half from $24.5m at September 2022.

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

Slide 22 - Capital and solvency position

As a result of increased risk from any further catastrophe events and outstanding claims related to the catastrophe events experienced in the half, Tower is required to hold additional capital until claims are settled and reinsurance recoveries are received.

With a solvency ratio of 125%, we are holding $25m above the minimum capital required for solvency. This is below our historical operating range.

We are resolutely focused on settling these claims for customers and collecting the recoveries from reinsurers which will reduce our minimum solvency capital and improve our solvency position by the year end.

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

Slide 23 – Full year guidance

As we communicated to the market on the 8th of May, Tower anticipates FY23 underlying NPAT of between $8m and $13m.

This range is based on further growth of between 15% and 20% as well as a large events allowance of $50m.

A final decision on any FY23 dividend will be made when the full year results are finalised.

Slide 24 – Looking forward

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

Blair Turnbull

Thank you, Paul.

Slide 25 – Investing in future resilience and sustainability

As we manage the short and medium term challenges of inflation, motor crime and the changing climate we are focused on investing in our future resilience and sustainability.

We are scaling our parametric insurance offering by partnering with the United Nations to expand our pilot beyond Fiji to Tonga and Samoa.

We are focused on reducing our operational emissions as we recognise that every effort to reduce emissions helps to mitigate global warming. This half, we have reduced emissions by 59% compared to HY22 which has largely been achieved through a substantial reduction in Pacific fuel use due to changing driving and commuting patterns. We are currently on track to meet our five-year scope 1 and 2 emissions reduction target of 21% by 2025.

Importantly we are continually developing our hazard modelling and as I've previously outlined, this year we will add landslip as well as coastal erosion and inundation risks to our customer facing risk ratings tool, educating homeowners transparently about the risks that may impact their properties.

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 I'm pleased to share that 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.

We are currently making positive progress on our climate change strategy as we move towards the Climate-related Disclosures regime. We look forward to sharing more with you as we work towards our first disclosure.

Slide 26 – Positioned to deliver long-term earnings

In summary, our focus remains on continuing our solid underlying operating performance through robust risk management and continued rating actions to mitigate inflation, motor crime and weather events.

We continue to focus on targeted customer and premium growth while enhancing our margins through efficiency and organisational improvements.

Tower remains committed to mitigating the volatility of large events impacts through risk-based pricing and our robust reinsurance arrangements. And while we manage the effects of the changing climate now, we will continue to invest in future business resilience and sustainability.

Ultimately this leads to attractive earnings and dividends for shareholders in the long term.

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