

IAG delivers sound underlying improvement in first half

Insurance Australia Group Limited (IAG) today announced an insurance profit of \$227 million for the six months ended 31 December 2008 (1H08: \$190m), representing an improved insurance margin of 6.2% (1H08: 5.1%). The Group also provided an update on its previously announced capital management initiatives.

IAG Managing Director and CEO, Mr Michael Wilkins, confirmed that the Group had improved its underlying performance during the first half of the 2009 financial year, as indicated in a recent market update. The improvement was achieved despite the adverse impact of the following key factors:

- Widening credit spreads, which reduced the 1H09 insurance profit by \$86 million, or the insurance margin by 2.3% (1H08: -\$55m or -1.5%). The Group has not experienced any impairment on these assets and expects to recover this revaluation loss over the remaining duration of the securities;
- A net impairment of deferred acquisition costs (DAC) of \$42 million, which reduced the first half insurance margin by 1.1% (1H08: nil). This largely reflects an impairment within Australia Intermediated (CGU) as required by the liability adequacy test (LAT), which was significantly influenced by the steep decline in interest rates in the half year period; and
- Natural peril claim costs which modestly exceeded the Group's first half allowances by \$23 million during the period, largely due to a number of severe weather events, including the extensive New Zealand storms in July 2008 and storms in south east Queensland in November 2008.

When excluding the impact of these factors, the adjusted insurance margin for the first half would have been 10.3%.

Mr Wilkins said the improvement of the underlying business during the first half demonstrated that the Group is making solid progress towards the goals outlined in the refined corporate strategy announced in July 2008, despite operating in a challenging environment.

"In this year of rebuilding, the first half insurance margin benefited from increased average premiums across all businesses, improved underwriting discipline, a strong performance from our largest business, Australia Direct, and the initial benefits from our efficiency programme in Australia which is on track to deliver \$130 million in annual before tax run rate cost savings.

"Gross written premium (GWP) grew 1.8% compared with the previous corresponding period, driven by strong growth in the Australia Direct business. When excluding the divested businesses and the impact of foreign exchange movements, the Group's underlying GWP growth was almost 4% compared to the previous corresponding period.

"We are encouraged by the improvement in the Group's underlying performance for the first half. The operational and strategic changes we've made are delivering results and we remain confident of further improvements in the second half and beyond," Mr Wilkins said.

The Group reported a net profit after tax of \$4 million for the six months to 31 December 2008, which was significantly impacted by:

- An investment loss on shareholders' funds of \$72 million, compared to a profit of \$76 million in the previous corresponding period, reflecting weak equity investment markets; and
- A \$115 million loss on the sale of our non-core mass market operations in the UK, closure of the Lloyd's syndicate Alba and associated underwriter Diagonal, as well as the restructure of our business in the UK. This was partially offset by the \$38 million profit on the sale of IAG's interest in the life insurance portion of its Malaysian joint venture. These actions were in line with the Group's refined strategy.

Divisional results

Commenting on the individual business segments, Mr Wilkins said the Group's largest business, Australia Direct, delivered a particularly strong result.

"The direct insurance business in Australia, which includes the NRMA Insurance, SGIO and SGIC brands, as well as RACV via a joint venture distribution arrangement, grew GWP by around 9% and generated an improved insurance margin of 12.6%, up from 7.2% from the corresponding period.

"This improvement was driven by premium rate and volume increases across the portfolio, lower claims from natural perils and cost reduction initiatives. In addition, the 'Unworry' brand relaunch and new product initiatives showed encouraging early results. Lower reserve releases and the impact of wider credit spreads partially offset these benefits."

Mr Wilkins said the results of the intermediated insurance business in Australia, known as CGU, were broadly in line with expectations as the new leadership team implements its turnaround strategy.

"While CGU's underlying insurance margin is still at an unsatisfactory level, it has improved during the past six months after allowing for a significant reduction in reserve releases and the DAC impairment as required by the liability adequacy test (LAT). GWP marginally declined as the business continued to focus on improving underwriting discipline and repricing unprofitable portfolios.

"Our New Zealand operations recorded a disappointing insurance loss of \$17 million on the back of severe storms in late July 2008 and a higher than expected frequency of claims. We anticipate an improved second half, as rate increases flow through and we see the results of the business' focus on underwriting discipline and claims management.

"In the UK, Equity Red Star continued to perform well and delivered a pleasing underlying insurance margin of 13.4% after allowing for higher than expected reserve releases. The mass market businesses divested by the Group during the period reported a pre-tax operating loss of \$26 million and a negative insurance margin of 20%.

"In Asia, the underlying performance of our operations improved, reflecting continuing cost control and better claims experience. Asia remains important to our medium to long term strategy and we are pleased with the progress we've made with our joint venture partners in India and Malaysia," Mr Wilkins said.

Dividend

The Board has declared a fully franked interim dividend of 4.0 cents per ordinary share (1H08: 13.5 cps), payable on 8 April 2009 to shareholders registered on 11 March 2009. This is equivalent to approximately 70% of cash earnings, and is in line with the Group's revised dividend policy.

Capital management initiatives

As previously announced, the Group is undertaking a number of capital management initiatives and has successfully raised \$450 million through an institutional placement at \$3.00 per share. A share purchase plan to raise approximately \$100 million will be undertaken in March/April 2009.

The Group has also successfully repurchased £108 million of its sterling denominated subordinated debt at a 30% discount to face value. As a result, the Group will recognise a pre-tax profit of approximately \$70 million in 2H09.

Following completion of these capital management initiatives, the Group's minimum capital requirement (MCR) multiple will strengthen from 1.51x at 31 December 2008 to 1.69x on a proforma basis.

Mr Wilkins said, "I am pleased with the success of our capital management initiatives to date. Through these measures we have improved our capital mix and further strengthened our financial position, which we see as prudent in these current challenging market conditions."

IAG's key wholly owned insurers remain the highest rated of any Australian-based general insurer, with insurer financial strength ratings from Standard & Poor's of 'AA-' (Stable).

Outlook for FY09

Mr Wilkins said that the Group expects to continue to improve its performance over the balance of the 2009 financial year.

“During the second half of the year, we expect to fully realise the targeted \$130 million per annum of pre-tax cost savings in our Australian operations. We will also benefit from the earned effect of premium rises as well as the portfolio changes we’ve introduced, such as our exit from our poorly performing mass market operations in the UK,” Mr Wilkins said.

“Last week, we confirmed we are on track to deliver 0–2% reported GWP growth for the full year, and underlying GWP growth of 3–5%.

“We also revised our full year insurance margin guidance to 6%+ from 10%+. This takes into account the adverse impact of widening credit spreads and the net DAC impairment in the first half and natural perils beyond allowances. We have now increased our \$314 million natural perils allowance for the full year by \$150 million to include the cost from the recent devastating fires in Victoria which are anticipated to reach \$126 million (our maximum event retention under our reinsurance arrangements). The revised guidance is consistent with the previous guidance when allowing for these adverse influences.

“Moving forward, our priorities are to continue to improve the performance of our Australian and New Zealand businesses, progress our previously flagged growth opportunities in Asia, and drive operational performance, execution and accountability across the Group. We remain confident that the actions we are taking will improve IAG’s financial performance over the medium to longer term,” Mr Wilkins said.

The FY09 guidance is subject to no further material movements in foreign exchange rates; no catastrophes or large losses beyond \$150 million in excess of the Group’s full year allowances (\$314 million); no material changes in investment markets, including credit spreads; and no further LAT adjustments over the balance of the financial year.

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About Insurance Australia Group Limited

Insurance Australia Group Limited (IAG) is an international general insurance group, with operations in Australia, New Zealand, the United Kingdom and Asia. Its current businesses underwrite more than \$7.5 billion of premium per annum. It sells insurance under many leading brands including NRMA Insurance, CGU, SGIO, SGIC and Swann (Australia); NZI and State (NZ); Equity Red Star (UK); and NZI and Safety (Thailand). For further information please visit www.iag.com.au

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IAG results for the six months to 31 December 2008

Summary financial information	6 months to 31 Dec 2007 \$m	6 months to 30 June 2008 \$m	6 months to 31 Dec 2008 \$m
Gross written premium (GWP)	3,851	3,942	3,922
Insurance profit	190	202	227
Net profit after tax attributable to IAG shareholders	110	(371)	4
Group insurance margin	5.1%	5.6%	6.2%
Dividend per share (fully franked)	13.5c	9.0c	4.0c

Group highlights: 1H09 compared with 1H08

- **GWP grew 1.8% to \$3,922m**, driven predominantly by strong growth of 8.8% in Australia Direct. When excluding the Group's divested business and removing the impact of foreign exchange movements, **underlying GWP grew by almost 4%**.
- **Insurance profit increased to \$227m** representing an **improved insurance margin of 6.2%**. The insurance margin was significantly impacted by widening credit spreads, an impairment of deferred acquisition costs (DAC) largely influenced by the steep decline in interest rates, and natural peril claim costs which exceeded allowances. When excluding the impact of these factors the **insurance margin would have improved to 10.3%**.
- **Net profit after tax of \$4 million** was materially impacted by a \$148m reduction in investment returns on shareholders' funds and a \$115 million loss on the sale of our non-core mass market operations in the UK, the closure of the Lloyd's syndicate Alba and associated underwriter Diagonal, as well as the restructure of our business in the UK.
- The Group retained a **sound capital position**, with capital at a level of 1.51 times the regulatory minimum capital requirement. This capital position is being further strengthened through a series of capital management initiatives which were announced on 18 February 2009.
- The Group **delivered on a number of priorities** as part of the revised corporate strategy announced in July 2008, highlighted in the following table:

Priorities set in 1H09	Delivered in 1H09
- Implement simpler, devolved operating model	✓
- Deliver \$130m annual run rate savings pre tax in Australia	✓
- Appoint CEO of Direct Insurance in Australia	✓
- Pursue select growth opportunities in Asia	✓
- Exit Lloyd's syndicate 4455 ('Alba') and underwriting agency	✓
- Divest mass market operations in the UK	✓

Snapshot of divisional performance in 1H09

Australia Direct

- Improved performance supported by rate increases across the portfolio, volume gains, lower claims from natural perils and cost reduction initiatives, partially offset by lower reserve releases and the impact of wider credit spreads.
- The commencement of a brand relaunch, supplemented by new product initiatives, showed encouraging early results.

Aust Direct	1H08	1H09
GWP	\$1,516m	\$1,650m
Insurance result	\$106m	\$194m
Insurance margin	7.2%	12.6%

Australia Intermediated ("CGU")

- CGU's new leadership team's strategy for the business is beginning to yield positive results. While still below the desired level, the underlying insurance margin has improved, and further improvement is expected in 2H09.
- Continued focus on improving underwriting discipline, repricing unprofitable portfolios and controlling expenses in what remains a highly competitive environment. As a result, GWP has marginally declined, but some positive signs on rates are emerging.
- The 1H09 result includes a significantly reduced level of reserve releases and a \$50m impairment of DAC under the liability adequacy test requirements. This impairment was heavily influenced by the sharp drop in interest rates during the period.

Aust Intermediated	1H08	1H09
GWP	\$1,167m	\$1,159m
Insurance result	\$133m	\$(7)m
Insurance margin	11.8%	(0.6)%

New Zealand

- A disappointing result, exacerbated by severe storms in late July and a higher than expected frequency of claims.
- Local currency GWP growth of 4.7% has been driven by price increases across the majority of the business. Reported GWP is, however, flat due to an adverse foreign exchange movement.
- A focus on rate increases, underwriting discipline and tighter claims management is reducing the impact of higher claims frequency and will provide improved underlying profitability in future periods.

New Zealand	1H08	1H09
GWP	\$483m	\$482m
Insurance result	\$(2)m	\$(17)m
Insurance margin	(0.4)%	(3.9)%

United Kingdom

- Despite the ongoing challenging conditions in the private motor market, the UK businesses delivered an improved insurance margin during 1H09 reflecting the withdrawal of capacity from underperforming elements of the market, rate increases and reduced natural peril claim costs.
- The retained business, Equity Red Star, continued to perform well and delivered an underlying 1H09 insurance margin of 13.4% when excluding higher than expected one-off reserve releases.
- The divested mass market businesses reported a pre-tax operating loss of \$26m and a negative insurance margin of 20.0%. The sale of these businesses was completed in early February 2009.

UK	1H08	1H09
GWP	\$585m	\$532m
Insurance result	\$(34)m	\$54m
Insurance margin	(6.1)%	10.9%

Asia

- The underlying operating result improved owing to continuing cost control and lower claims ratios, and was achieved despite declining consumer confidence.
- The reported result was assisted by an \$8m one-off benefit from the introduction of DAC accounting in Thailand, bringing this business in line with the rest of the Group.
- Several important initiatives were executed in the half and are expected to materially increase the Asian business' regional footprint in India and Malaysia. This expanded presence is expected to provide significant growth potential over the longer term, and a steady improvement in profitability.

Asia	1H08	1H09
GWP	\$89m	\$92m
Insurance result	\$(6)m	\$9m
Insurance margin	(8.5)%	12.0%

Natural perils and associated claim costs (\$m)	1H09
WA and NSW storms – Australia (November 2008)	16
South East Queensland storms – Australia (November 2008)	69
Lismore hailstorm – Australia (October 2008)	15
NSW and Queensland storm – Australia (September 2008)	6
North Island storms – New Zealand (July 2008)	24
Other small events	46
Total	176
Natural peril claim cost allowance	153
Natural peril claim cost in excess of allowance	23

- Natural peril claim costs in 1H09 were \$150m less than 1H08.
- Full year natural peril claim costs expected to exceed allowance of \$314m by approximately \$150m, including \$126m capped cost for fires in Victoria.

Group outlook for FY09

- 2H09 operating performance is expected to further improve, driven by:
 - Full realisation of announced cost savings in Australia, at an annualised rate of \$130m (pre-tax);
 - Higher premiums including the earned effect of rate rises implemented in FY08 and 1H09; and
 - Favourable portfolio mix changes, including a reduced exposure to UK private motor.
- Priorities are to:
 - Continue to improve the performance of Australian and New Zealand businesses;
 - Progress previously flagged growth opportunities in Asia; and
 - Drive operational performance, execution and accountability across the Group.

Guidance for FY09	
Group GWP growth	0–2%
<ul style="list-style-type: none"> • Lower growth profile due to the Group's changed strategy in the UK. 	
Underlying GWP growth	3–5%
<ul style="list-style-type: none"> • Excludes the divested businesses and the impact of foreign exchange movements. 	
Insurance margin	6%+
<ul style="list-style-type: none"> • Revised from previously provided guidance of 10%+ to take account of widening credit spreads and DAC impairment charge in 1H09, and natural perils in excess of allowances for full year, including the cost of the Victorian fires. 	

- FY09 guidance is subject to no material movement in foreign exchange rates, no catastrophes or large losses beyond \$150m in excess of full year allowances (\$314m), no material changes in investment markets including credit spreads and no further LAT adjustments.

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