

IAG insurance margin on track for full year despite impact of weather events and investment markets

Insurance Australia Group Limited (IAG) today announced a net profit after tax of \$110 million for the half year ended December 2007 (December 2006: \$345 million), and an insurance margin of 5.9% (December 2006: 13.3%). For the full year, IAG expects to be at the low end of its insurance margin guidance, which is maintained at 9-11%.

Premium revenue was up 15.9% to \$3.9 billion on the back of the contributions from the UK businesses acquired last financial year and solid growth in the Australian Personal Lines and New Zealand portfolios. Other businesses curtailed their growth in light of soft market conditions.

IAG CEO, Mr Michael Hawker said the bottom-line result was disappointing but needed to be viewed in the context of a very challenging period for the local general insurance industry, with an unusually high number of weather events, volatile investment markets and a soft commercial cycle.

Factors that contributed to the profit decline included:

- significantly higher storm and natural event costs of \$326 million (before tax), well ahead of normal allowances of \$153 million and more than \$200 million higher than the \$125 million incurred in the previous corresponding period;
- a \$55 million (before tax) mark-to-market loss from the impact of widening credit spreads (expected to be recovered as the portfolio matures); and
- a \$90 million (before tax) decrease in investment returns due to the poorer relative performance of investment markets during the period and the Group's lower exposure to equities.

The Group improved its regulatory capital position with the Minimum Capital Requirement (MCR) multiple, a key indicator of balance sheet strength, rising to 1.87x. The interim dividend was maintained at 13.5 cents per share, fully franked.

"The past year has been a challenging one for the local general insurance industry. Dealing with weather events is part of our role as an insurer, but their extent in this period has been very unusual. On the claims side, we've had floods, hail and severe storms in Australia, the UK and New Zealand as well as an earthquake in New Zealand," Mr Hawker said.

"In addition to these large events, the change to a La Niña (or wetter) weather pattern has meant our Australian business is experiencing an increase in the number of home and motor claims, with average claims costs rising due to demand on the repair supply chain.

"In total these natural events have cost \$326 million, well ahead of our normal provisioning and more than two-and-a-half times the cost incurred in the same period last year. As a result, we've increased our reinsurance protections, and prices in some portfolios are increasing to cover ongoing higher claims costs.

"We are also looking beyond these factors, recognising that we must improve our underlying profitability and generate a better outcome for shareholders. To support this, we have initiated productivity improvements and strengthened our management team. In the UK, synergies are on track and Equity Insurance Group has performed in line with guidance. This has been partially offset by a poor, but improving, performance from Advantage, which continues to be a management focus."

Business Segments

In Australian Direct Personal Insurance, a refreshed advertising campaign and competitive price-led strategy contributed to a 4.6% increase in Gross Written Premium (GWP), adjusted for the impact of the Lifetime Care & Support Scheme (LTCS), on the same period last year. The largest portfolio, NSW motor, grew 5.8%, while market share in NSW CTP averaged around 38%¹ and Queensland CTP share increased to around 5%.

Business Partnerships continued its focus on improving profitability through risk-based pricing, active portfolio management and reducing expenses.

As expected, conditions in the Australian commercial insurance market remained soft, offset by the continued positive experience in long-tail classes, in particular liability and workers' compensation. As forecast in October, the Group increased prices in key areas and has shed some business volume, but customer retention remained high at 84%.

In New Zealand, GWP grew 3.5% in local currency terms, reflecting strong growth in commercial intermediated business and business partnerships, while personal lines remained steady. This result was overshadowed by severe weather events in July totalling around \$30 million and an earthquake in December, the cost of which was around \$9 million.

In Asia, the Thai market conditions remain challenging but GWP in the combined Thai businesses increased 6% in local currency terms. In Malaysia, further progress has been made with the planned increase of the Group's stake in AmAssurance's non-life insurance business to 49%, which should be completed by the end of the financial year.

The UK market continues to be challenging but recently instituted rate rises are holding. Equity is performing in line with earlier guidance, leveraging its niche specialised motor position. Advantage is showing early signs of improvement and remains a major management focus. The Equity broking operations continue to expand and the legacy issues within Hastings are being addressed.

Mr Hawker said: "Revenue in Australian Direct Personal Insurance was up 4.6% on the same period last year (adjusted for LTCS). A good result, but one we think we can better. Our New Zealand business grew revenue 3.5% and Asian GWP grew 6% (both in local currency terms).

"In the UK, Equity delivered an insurance margin of 12.9% and Advantage is showing early signs of improvement although it is still, as flagged in October, a poor result for the half year. The integration of our UK businesses remains on track with £25 million in annual after-tax synergies to be in place by June 2008."

Management Strengthening

Mr Hawker said he was pleased to have strengthened the Group's management team with several key appointments during the period.

"As we transition from an Australian-centric insurer to an international one, we've moved to a decentralised model, with end-to-end businesses managing different brands, products and customer bases.

¹ Rolling monthly average share of registrations for the 12 months to 31 December 2007

“In this context, I’m really pleased we’ve added to our management bench strength during the period. Our new Chief Operating Officer Mike Wilkins is now on board and the Group can expect to benefit from the depth of his experience in general insurance.”

Productivity Improvements

The Group continued its focus on productivity improvements during the period:

- the UK synergies programme has progressed as planned and remains on track to have £25 million per annum in after-tax benefits in place by 30 June 2008;
- the restructuring of the New Zealand business announced in October was completed and we expect to deliver the targeted 1-2% improvement in the insurance margin from the second half of FY08; and
- the Group’s Corporate Office was reorganised and the Australian cost base is now under review.

Investments

Investment returns on shareholders’ funds were \$90 million lower than in the previous corresponding period, at \$76 million, reflecting the lower returns from investment markets compared with the same period last year and the Group’s reduced exposure to equity investments.

The Group’s insurance profit was adversely impacted by a \$55 million (before tax) mark-to-market charge relating to the widening of credit spreads. The Group believes this loss will be recovered as the securities mature. The Group does not expect to incur any default-related losses from its bond and cash portfolios given their very high credit quality.

Reinsurance

Effective 1 January 2008, the Group has increased its reinsurance protections. Under the new programme, the maximum amount of catastrophe cover for Australia and New Zealand has increased from \$3.5 billion to \$4 billion and the Maximum Event Retentions for a first event until 30 June 2008 are as follows:

- \$93 million in Australia;
- \$81 million in New Zealand; and
- \$79 million in the UK.

These retentions are set to increase by approximately \$25 million from 1 July 2008 upon expiry of one reinsurance treaty.

The Group has also purchased additional reinsurance that is specifically designed to protect the Group’s financial performance from the adverse accumulated impact that a number of smaller events could generate.

Balance sheet, capital and dividends

Return on equity (ROE) for the period, normalised for investment returns and excluding amortisation of intangible assets, was 6.6%. Actual ROE was 4.7%.

The Group continues to maintain a very strong balance sheet with a strengthened regulatory capital position. The Group MCR multiple increased to 1.87x (June 2007: 1.67x).

The interim dividend has been maintained at 13.5 cents per share, fully franked. It will be paid on 14 April 2008 to shareholders registered as at 12 March 2008.

“While the dividend represents a high payout ratio of our current earnings, we made the decision to maintain the interim dividend in the context of our expectations of the future growth and earnings performance of our businesses and our conservatively positioned balance sheet,” Mr Hawker said.

“Recognising the more pessimistic economic and investment markets outlook, we have chosen to conserve capital by funding some of the dividend through the issue of shares to Dividend Reinvestment Plan participants, who will be given a 1.5% discount.

“The outlook for dividends depends on growth in underlying earnings, market conditions and the normal caveats we put on our financial forecasts.”

Outlook

Mr Hawker said for the full year the Group is maintaining its existing guidance of 7-9% GWP growth and an insurance margin of 9-11%, but expects to be at the low end of both ranges as a result of further catastrophic events, the ongoing soft market in commercial insurance and currency movements. The guidance is subject to no catastrophes or large losses outside the Group’s allowances nor any material movements in currency or investment markets in the second half.

“In Australia, we will continue to maintain our pricing disciplines. Some segments, such as personal lines, will experience price increases in line with rising claims costs following increased frequency and severity of weather events,” Mr Hawker said.

“Our key international portfolios of New Zealand and the UK are expected to deliver a stronger and more sustainable performance in the second half.

“We have also made changes to our reinsurance programme to help reduce volatility in reported earnings and protect the Group’s financial position over this period.

“We continue to pursue small, strategic acquisitions in our chosen markets of India, Malaysia, Thailand and China and are committed to completing our acquisition of the remaining 50% of NTI.

“While recent months have been challenging for the general insurance industry, we are confident the actions we are taking will improve the bottom-line performance of our business in the second half of the year,” Mr Hawker concluded.

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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 employs more than 16,000 people of which around 11,000 are in Australia. It sells insurance under many leading brands including NRMA Insurance, CGU, SGIO and SGIC (Australia); NZI and State (NZ); Equity Red Star and Hastings Direct (UK); and NZI and Safety (Thailand). For further information please visit www.iag.com.au

CORPORATE AFFAIRS

Carolyn McCann
T 02 9292 9557
M 0411 014 126
E carolyn.mccann@iag.com.au

INVESTOR RELATIONS

Michael Woods
T 02 9292 3156
M 0411 012 220
E michael.woods@iag.com.au

Insurance Australia
Group Limited
ABN 60 090 739 923

388 George Street
Sydney NSW 2000
Australia

T +61 (0)2 9292 9222
www.iag.com.au