iag

THE STORY SO FAR...

INSURANCE AUSTRALIA GROUP LIMITED
INTERIM REPORT 2017

ABN 60 090 739 923

IAG delivered a sound first-half operating performance, in an environment of increased claim costs.

Compared to the first half of the 2016 financial year, reported insurance profit fell 6% to $571 million, affected by an increase in net natural peril claim costs of over $140 million following the Kaikoura earthquake in New Zealand in November.

Peril costs were somewhat offset by higher-than-expected prior period reserve releases, primarily from Australian compulsory third party (CTP) insurance.

Gross written premium grew by 4.7% to $5,802 million, slightly higher than expected, reflecting:

- rate increases in response to claim cost pressures in Australian short tail lines;
- higher-than-anticipated business retention in Australian commercial lines; and
- an overall positive foreign exchange translation effect.

Other factors within our premium growth were:

- an initial $37 million contribution from IAG's entry into the South Australian CTP market from 1 July 2016;
- the absence of $61 million of premium following the sale of the Swann motor dealership business in early August 2016; and
- approximately $34 million from higher collection of the Emergency Services Levy in New South Wales. This effect will reverse in the second half of the year, ahead of the levy's abolition from 1 July 2017.

The business achieved an underlying margin of 12.6%, compared to 14.2% in the prior first half. The 2017 first half underlying margin included:

- an adverse impact of around 70 basis points from a $40 million increase in natural perils allowance to $340 million;
- the cumulative effect of rate reductions and volume loss in commercial lines;
- a slight drag from the Satellite business (within Consumer Division) which delivered strong growth but presently operates at a lower level of profitability;
- a lower result from the consolidated Asian operations (Thailand, Vietnam and Indonesia) which collectively moved into loss;
- the absorption of a small net cost from the optimisation program; and
- lower investment returns.

The impact of the Berkshire Hathaway quota share on underlying profitability was similar to the first half of the 2016 financial year.

The reported insurance margin of 13.5% included:

- net natural peril claim costs of $420 million, which exceeded allowance by $80 million, $117 million of which came from the New Zealand Kaikoura earthquake;
- a $5 million favourable credit spread impact; and
- higher-than-expected prior period reserve releases of $155 million, equivalent to 3.7% of net earned premium, from Australian long tail classes, principally CTP.

Net profit after tax of $446 million was approximately 4% lower than the $466 million reported for the first half of the 2016 financial year, and included a significantly higher contribution from investment income on shareholders' funds, after stronger equity market returns.

IAG's effective tax rate of 17% was lower than normal, owing to approval by Singapore tax authorities of a lower applicable tax rate for reinsurance recoveries relating to the February 2011 Canterbury earthquake. The effective tax rate is expected to return to a more normal level in the high 20s, in future.

Gross written premium grew by 4.7% to $5,802 million, slightly higher than expected.

THE NUMBERS CONTINUED.

BUSINESS PERFORMANCE

Compared to the first half of the 2016 financial year:

The Australian **Consumer Division** grew premium by 7.4% to $3,060 million, from a combination of: rate increases to counter claim inflation issues in motor; higher average sums insured in home; and higher collection of the Emergency Services Levy in New South Wales. The division also had a 12% increase in CTP premium, most of which came from IAG's entry into the South Australian CTP market.

The division produced a strong, but slightly lower, underlying margin of 14.1% while its reported margin of 21.5% benefited from reserve releases well in excess of expectations and a favourable perils outcome.

The Australian **Business Division**'s gross written premium was relatively flat, increasing 0.3% to $1,423 million, despite a $61 million reduction after the divestment of the Swann Insurance car dealership business. Removing this item, like-for-like premium growth of over 4% was higher than expected owing to better than anticipated retention levels. Increasingly, there is evidence that commercial pricing has passed the bottom of the cycle.

A lower underlying margin reflected the effect of past rate and volume declines, but represented a modest improvement over the previous half-year period. A lower reported margin housed an adverse natural peril claim cost experience and slightly lower reserve releases.

New Zealand premium rose by 5.4%, to $1,128 million, inflated by a favourable exchange rate movement. In local currency, premium grew by just over 1%, with sound growth in personal product rates and policies, largely offset by highly competitive conditions in commercial products.

The business continued to deliver a strong underlying margin, exceeding 15% despite increased claim cost pressures and a soft commercial market, where there are early signs of rate improvement emerging. The reported margin of 4.3% included a net claim cost of approximately $117 million from the Kaikoura earthquake event in November 2016.

Asia reported a 7.6% decline in consolidated premium to $182 million, affected by intensified price competition in Thailand and exaggerated by an adverse foreign exchange translation effect. Asia's overall earnings contribution decreased to $2 million. On a proportional basis, like-for-like gross written premium was flat, with continued strong growth in India offset by lower reported premium in Thailand and Malaysia.

KEY FIGURES.

$5,802m
GROSS WRITTEN PREMIUM ($M)

1H17	5,802
2H16	5,824
1H16	5,543

Increased by 4.7% from $5,543 million in the previous first half.

13.5%
INSURANCE MARGIN (%)

1H17	13.5%
2H16	13.8%
1H16	14.9%

The Group's reported insurance margin was 13.5%, after higher net natural peril claim costs, a favourable credit spread impact and higher-than-expected reserve releases.

$446m
NET PROFIT AFTER TAX ($M)

1H17	$446m
2H16	$159m
1H16	$466m

Net profit after tax of $446 million was approximately 4% lower than the first half of the 2016 financial year.

13.0cps
DIVIDEND (CPS)

1H17	13.0cps
2H16	13.0cps
1H16	13.0cps

Consistent with the last interim dividend of 13.0 cents per share (cps) and equal to a payout ratio of 64.3% of cash earnings. The Group's policy is to pay out 60-80% of cash earnings on a full year basis.

More detailed information about our half-year results, including financial statements for the half year ended 31 December 2016, our investor report and management presentation, are available in the Results and Reports area of our website (www.iag.com.au).

THE STORY.

We have delivered a sound result from our core businesses in Australia and New Zealand, reinforced by the strength and integrity of our brands, our sharpened customer focus, and the quality and passion of our people.

We are progressing well against our strategy, outlined in December, to drive customer and business benefits through our leading and fuelling themes.

Leading puts customers at the centre of what we do through the enhanced use of technology, offering innovative new products through our core businesses, and identifying new ways to meet ever-changing customer needs.

We are already seeing positive results, with customers measuring our performance across our different brands as being above industry average. Our 'listen, learn and act' model enables us to put customer feedback into action to implement improvements, from the front line through to senior management, to continuously drive better outcomes.

To fuel our leading position, we are simplifying the way we do business, optimising our resources, leveraging the benefits of our supply chain and continuing to build our partnerships.

Our optimisation program to simplify our operations and drive cost savings is well underway and we are taking a measured approach that focuses on the activities that will have the biggest positive impact on customer experiences.

We are on track with our plans to partner with global experts to simplify processes and reduce complexity, and to significantly reduce our core claim and policy administration systems.

All this work is being done in the context of rapidly changing and heightened customer and societal expectations, so it is more important than ever to focus on our core businesses while planning and implementing new ways of doing business.

DIVIDEND

The Board has determined to pay a fully franked interim dividend of 13 cents per ordinary share, equal to the 2016 interim dividend. The dividend will be paid on 30 March 2017 to shareholders registered at 5pm Australian Eastern Daylight Time on 1 March 2017.

CAPITAL

IAG's capital position remains strong. The Prescribed Capital Amount (PCA) multiple stood at 1.81, at 31 December 2016, compared to our targeted range of 1.4-1.6. The Common Equity Tier 1 (CET1) ratio was 1.09, against a target benchmark of 0.9-1.1.

OUTLOOK

IAG continues to expect to achieve a sound operating performance in the 2017 financial year. Following the half-year gross written premium growth of 4.7%, IAG has raised its full year gross written premium guidance to 'low single digit growth', compared to its previous 'relatively flat' prediction. The slightly improved top line outlook reflects:

- higher than originally anticipated rate increases across short tail classes in response to claims inflation pressures; and
- better than expected retention rates within Business Division in the first half of the financial year.

IAG has maintained its reported margin guidance for the 2017 financial year, of a range of 12.5-14.5%. This incorporates a slightly softer underlying profitability than originally anticipated, and increased prior period reserve release expectations.

ELIZABETH BRYAN AM
CHAIRMAN

PETER HARMER
MANAGING DIRECTOR AND CHIEF EXECUTIVE OFFICER

[1] Underlying assumptions behind the revised reported margin guidance are:
- net losses from natural perils in line with allowance of $680 million (unchanged);
- prior period reserve releases of at least 2% of net earned premium (previously at least 1%);
- no material movement in foreign exchange rates or investment markets in the second half of the financial year; and
- a small net negative from optimisation program initiatives, as early benefits are outweighed by related costs (unchanged).

THE NEWS CATCH-UP.

CAPITAL MANAGEMENT

In December, IAG completed a number of steps to improve the quality of its regulatory capital, including:

- issuing $404 million of Capital Notes, qualifying as Additional Tier 1 Capital;
- buying back $224 million of Convertible Preference Shares, as part of the Reinvestment Offer accompanying the Capital Notes issue;
- redeeming NZ$187 million of subordinated fixed rate bonds; and
- redeeming £100 million of subordinated fixed rate notes.

IAG also intends to buy back the $153 million balance of Convertible Preference Shares at their next call date in May 2017.

In recognition of its strong capital position, and with a focus on maximising shareholder returns, IAG conducted a $314 million off-market buy-back, completed in October 2016.

Small shareholding sale facility

IAG has announced a small shareholding sale facility for shareholders with holdings valued at $500 or less, enabling eligible shareholders to sell their shares without incurring any brokerage costs.

This is expected to be available in April 2017. Eligible shareholders will be sent further information on 23 February 2017.

BOARD APPOINTMENTS

In December 2016, IAG appointed Dr Helen Nugent AO and Mr Duncan Boyle to its Board as independent non-executive directors.

Dr Nugent is chairman of Australian Rail Track Corporation, a non-executive director of Origin Energy, and chairman of the National Portrait Gallery.

Mr Boyle is chairman of TAL Dai-ichi Life Australia and a former non-executive director of QBE Insurance Group, Stockland Property Group and Clayton Utz.

> “We are very pleased to have the benefits of the deep experience that Helen and Duncan bring to the Board.”
>
> ELIZABETH BRYAN, CHAIRMAN

IAG’s chairman Elizabeth Bryan said the appointments provide the IAG Board with additional strength in the areas of financial services and insurance, as well as more general strategic and corporate experience.

STRATEGY UPDATE

At an investor briefing in December, IAG provided an update on its 3-5 year strategy, which supports the delivery of its through-the-cycle targets of a cash return on equity equivalent to 1.5 times IAG’s weighted average cost of capital, and a top quartile total shareholder return. The updated strategy is expected to drive compound earnings per share growth of around 10%. It includes:

Enhanced measures to better understand customers’ requirements, including a new sophisticated data-driven segmentation model, to deliver growth in line with the industry of around 3-5%, in its core markets of Australia and New Zealand.

Higher growth from IAG’s focused strategy on chosen Asian markets.

Benefits from ongoing innovation in capital management.

An optimisation program that will reduce gross operating costs by an annual run rate of at least 10%, or $250 million pre-tax, by the end of the 2019 financial year.

IAG’s optimisation program will simplify its operating model and includes:

- partnering with global insurance and business process experts to simplify IAG processes;
- consolidation of core claims and policy administration systems to reduce them from 32 to two platforms; and
- a simpler procurement model.

A STUDY IN SAFETY.

A recent flood water research project conducted by the University of New South Wales' Engineering department helped bring to life our purpose: to make your world a safer place.

The research demonstrated just how easily cars can be washed away by even the smallest amount of flood water, reinforcing the message that crossing any flood water is a dangerous and potentially life-threatening decision. It's an important message given the heavy rainfall and flash flooding we have experienced this summer and one that our long-standing partner, the NSW SES, has been advocating for some time.

The tests were a world first because they used real cars, provided by IAG. Previous experiments to understand the strength of floodwater used vehicle miniatures.

The project used a specially-configured test tank in the University's labs to test how small and large cars behave when they encounter flash floods, replicating scenarios faced by many stranded motorists.

What was surprising was just how little water it took to make even a large vehicle unstable. Cars became vulnerable to moving floodwaters once the depth reached the floor of the vehicle.

A small car like a Toyota Yaris, weighing 1.05 tonnes, was moved by water only 15 cm deep; it completely floats away in 60 cm of water. Even a 2.5 tonne Nissan Patrol 4WD can be rendered unstable by floodwater 45cm high. Once the water reaches 95cm, the four-wheel drive can be moved easily – even by hand.

Robert McDonald, IAG's Road Safety Expert, said the research provides a timely reminder for people to be aware of the dangers of driving through flood water. "Common sense – and now research – says even a big 4WD can very quickly float like a boat," he said. "The message is very clear: it's never safe to enter flood water."

The experiments were funded by the University of New South Wales, the NSW SES and the NSW Office of Environment and Heritage, with IAG providing the cars.

AUSTRALIA

NRMA INSURANCE, SGIO, SGIC, swann insurance, RACV[1], CGU, WFI, Coles Insurance[2]

NEW ZEALAND

STATE, NZI, ami insurance, Lumley

ASIA

Safety Insurance[3], NZI[3], AmAssurance[4], Kurnia Insurans[4], SBI General Insurance[5], AAA Assurance[6], Asuransi Parolamas[7]

USEFUL INFORMATION

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ONLINE INFORMATION
To view other information about IAG and to manage your shareholding online, visit www.iag.com.au
You can also register to receive email news alerts when IAG makes important announcements.

100% OWNED UNLESS MARKED WITH A FOOTNOTE

1 IAG's short tail personal insurance products are distributed in Victoria under the RACV brand, via a distribution relationship and underwriting joint venture with RACV. These products are distributed by RACV and manufactured by Insurance Manufacturers of Australia Pty Limited (IMA), which is 70% owned by IAG and 30% by RACV.

2 IAG owns 100% of WFI Insurance Limited (WFI), the underwriter of general insurance products under the Coles Insurance brand. These products are distributed by Coles under an authorised representative agreement with WFI.

3 IAG holds a 98.61% beneficial interest in Safety Insurance, based in Thailand, which trades under the Safety and NZI brands.

4 IAG owns 49% of the general insurance arm of Malaysian-based AmBank Group, AmGeneral Holdings Berhad (AmGeneral), which trades under the AmAssurance and Kurnia brands.

5 IAG owns 26% of SBI General Insurance Company, a joint venture with State Bank of India.

6 IAG owns 63.17% of AAA Assurance Corporation, based in Vietnam.

7 IAG owns 80% of PT Asuransi Parolamas, based in Indonesia.

All ownership percentages are as at 31 December 2016.