calliden group

Attention ASX Company Announcements Platform
Lodgement of FIRST Interview
Date: 1 July 2013

Level 7, 100 Arthur Street
North Sydney NSW 2060, Australia
www.calliden.com.au

Profit drivers in FY13 and beyond

FIRST Interview with CEO Nick Kirk

Topics of discussion

- *Understanding the drivers behind the FY13 profit target of $10m*
- *The outlook for FY14 – Calliden's earnings and dividend profile under the new operating model*
- *A recap on Calliden's tax losses – where do they come from and do they have a use by date?*
- *The Continuity of Ownership Test – what is it and how is it linked to future payment of franked dividends?*

The FY13 NPAT target of $10m – an overview of key drivers and assumptions

FIRST Interview
Investors have asked a number of questions about your $10M net profit target for 2013. *Is there more information you can provide investors on how this is made up?*

CEO Nick Kirk
Firstly it is important to stress that the $10M is genuinely our target net profit for 2013. There is no difference between our internal budget and this number, so there is no buffer or safety margin implied in the number. It is as I have said our target, no more or less.

I have been asked a number of times about the target and why I have provided it to the market, so I will try and explain. I first provided the number at our AGM in 2012. Our 2011 result had been a significant loss and I had announced a significant change to the Company's strategy, which would mean a pretty lean year in 2012. Our shareholders were understandably concerned about their Company, did not necessarily share my confidence in this new direction, and wanted to know what the new strategy would deliver and when. Based on that I said that we would target $10M in 2013 and we have based our plans around achieving that return ever since.

We have detailed plans in place to meet that target and we keep them under regular review. The target is split roughly 45% from our new agency business, Calliden Agency Services, 45% from our insurer, Calliden Insurance Limited, and the balance from our joint ventures. Each component then has a number of key drivers on which the target is based.

For **Calliden Agency Services** the principal factors are volume of premium and number of policies written in the year, which drive the commission and fee revenue, less the expenses of running the business and, to a limited extent, the non-catastrophe loss ratio of a couple of the lines of business that have sliding commissions. Our target is based on a modest growth in premium income in the coming period. The largest risk to our target would be lower than estimated premium and policy numbers in the remaining months of the year.

For **Calliden Insurance Limited** the biggest driver is the loss ratio followed by the expense ratio. Each half a point change in the net loss ratio is the approximate equivalent of a $300K change in bottom line profit. Our target is based on the current trend in the loss ratio and includes the balance of our annual net cost of catastrophe events allowance. The expense ratio target assumes modest growth in premium income in the coming months. The biggest risks to the target in Calliden Insurance Limited would be natural catastrophe experience over our allowance, an increase in our non-catastrophe claims costs, worse than expected current or prior year claims development, or reductions in the discount rate that increase the value of our claim liabilities.

For the **Joint ventures** the target assumes a continuation of current trends in the joint venture businesses.

FIRST Interview

You have said that we should expect a 20/80 split in first half/second half profit in 2013. *Can you explain the reasons for this?*

CEO Nick Kirk

As we transition portfolios across to an agency basis we need to build an allowance for future administration and claims handling. With business pack still transferring until the middle of May this year and farm transferring across from 1st January this year, we have built that allowance principally in the first half. In addition the introduction of fees was staggered, with home for example not being implemented until May this year.

In our insurance business we have changed the proportional reinsurance treaty from over 60% for policies written in 2012 to 25% for policies written in 2013. Therefore more is being ceded to reinsurers on the policies being earned from last year, resulting in a higher reinsurance cost in the first half. On top of that cash balances should build up gradually during the year meaning we get more investment income in the second half.

Calliden's earnings and dividend profile in FY14

FIRST Interview

Based on what you have outlined for the second half in 2013, would it be reasonable to expect that the 2014 profit will effectively be double the second half profit for 2013?

CEO Nick Kirk

No definitely not and it's important not to simply double the second half profit for a number of reasons. We know already that, in return for securing a longer term agreement, we will be paying significantly more commission for one of our portfolios in 2014 than we did this year and this will have a material impact. In addition the run-off premium from some of the transferred portfolios will not be a feature again in 2014. While these two factors will to an extent be balanced by planned growth in the new products we are introducing, I am taking a more conservative view of 2014 where I see a modest uplift in profit over the 2013 full year.

NPAT in 2014 is likely to be split in a more balanced way as opposed to the 20/80 split during 2013**.**

FIRST Interview

Would it be fair to say then that Calliden will become more of a predictable, annuity style investment with the underlying growth in its agency business delivering a steady increase in dividend over time?

CEO Nick Kirk

At the AGM in May this year, the board announced the company's new dividend policy which will apply to current and future years. The policy effectively increases the amount paid out in dividends to between 60% and 80% of net profit. It is important for investors to be aware that the Group still includes an insurer and we need to keep that insurer well-capitalised and that, while reduced, the potential for volatility remains.

A key driver of the strategy we have been implementing over the past year was to get to a point where we could pay fully franked dividends, given the bank of franking credits ($26m) that the company has available. The board has been very conscious of that and it was influential in developing the strategy that we are now following.

A large part of the reason we are looking to grow our agency operations in the future is to increase the proportion of non-volatile earnings that we report each year. This will enhance our ability to deliver steady growth in earnings which will in turn support our capacity to pay an increasing, fully franked dividend to our shareholders.

A recap on Calliden's tax losses

FIRST Interview

Calliden has $229.4m in unused tax losses which were incurred as Reinsurance Australia Corporation ("ReAC"), prior to its renaming as Calliden and launching as a new general insurer in 2005. In addition, there is $3.8m of deferred tax assets sitting on the balance sheet relating to 2011 losses. *How confident are you that the Company will be able to reap the benefit of these tax losses as it returns to profit in FY13?*

CEO Nick Kirk

Over the past year the ATO has undertaken an audit of older tax losses. These are the $229m in unused tax losses noted in our Annual Report. The ATO position, as recently as last month, was that it confirmed Calliden's ongoing ability to utilise $71.7m in these older tax losses. When combined with the losses that are on the balance sheet, we believe this effectively delivers tax free earnings to shareholders for at least the next 5 years. This is of course subject to the Company continuing to comply with the Continuity of Ownership Test ("COT") as per the tax legislation and, if we failed that, satisfying the Same Business Test ("SBT").

That gives Calliden five years to argue its case with the ATO, and Calliden reserves its objection rights with respect to the now disputed $160m in tax losses. Calliden's position remains that it should be entitled to most of the balance of the losses, although this is dependent on Calliden being able to prove certain historical facts.

Importantly, I believe that the tax losses are of most value to our investors when they are combined with franking credits. You could argue that franking credits or tax losses on their own have little worth to investors. Calliden's franking balance is $26m which is not subject to any test and remains until used up, which is also likely to be at least 5 years away.

On balance I believe that the audit has strengthened our position and provides plenty of time for us to prove the balance of the losses, while retaining tax free earnings that can be fully franked as dividends for some time to come.

Continuity of Ownership Test

FIRST Interview

Aside from its ongoing debate with the ATO, Calliden's ability to access these tax losses is also subject to some conditions, as you alluded to earlier. *Can you explain what these are and the likelihood that they might actually be triggered?*

CEO Nick Kirk

The conditions that need to be satisfied relate to the COT and, should Calliden fail the COT, continuing satisfaction of the SBT.

It is worth saying that while these are quite complex tests we have been satisfying them now for nearly ten years without difficulty. I will start with the SBT, as this is the easiest to deal with. This test only applies to us should we fail the COT, and importantly the starting point for the test is the business being carried on at the time of any COT failure. There are a number of factors that are taken into account, but it is a very strict test and my understanding is that it would be very difficult for most companies to satisfy this test for very long at all.

The key test then is the COT, which is designed to tie the future benefit of the losses to those shareholders who owned the Company at the time the losses were incurred or, in our case, from when the losses were "refreshed" as part of the tax consolidation.

Calliden consolidated for tax purposes in 2004, and so the test runs from 1st January 2004 for us. The test looks for at least 50% continuity of ownership judged in two tranches – shareholders with more than 10% of the equity and all other shareholders. To satisfy the test we need to have a total of at least 50% continuing shareholders when the continuity for each category is added together. The way the test calculates this relates to the percentage of shares in each tranche in 2004 and the percentage at the date of the test.

Currently we calculate that our continuity of ownership is 75%, providing a "buffer" of 25%. The reduction from 100% can be ascribed to a number of events; the exit of a shareholder with 15% in 2004, the additional equity issued to Australian Unity in 2007 as part of the purchase of their general insurance business and our various share buy backs since 2004. It is worth noting that today we have only one beneficial owner with more than 10% who held over 10% in 2004.

So what this means is that the risk of failing the COT is increased when shareholders holding less than 10% of the stock, or new investors, increase their shareholding to 10% or more. If this arises as a result of our existing 'over 10% holder' selling, then the risk of failure is magnified. However, if the existing holder was to sell to owners who each held less than 10%, and the purchase of these shares didn't take any of their holdings above 10%, then our continuity would in fact be strengthened.

So in summing up, the best outcome is for Calliden to have a range of shareholders each with holdings of less than 10% of the stock. Any shareholder who increases their stake to 10% or more may unwittingly reduce the value of future profits. Needless to say we want to make sure that such shareholders are fully aware of this position.

While I would hope and expect that we could retain the tax losses for some time to come, it is important that investors recognise that, over the course of time, our ability to satisfy the test is likely to get harder not easier. To my mind the tax losses are a bonus that I hope our shareholders can benefit from as we build the business, but we are not relying on them being there to deliver a sustainable business model that can deliver increasing shareholder returns over time.