

calliden
group

**ANNUAL
REPORT &
SHAREHOLDER
REVIEW 2012**

“
**CALLIDEN
REPORTED A
MUCH IMPROVED
OPERATING
PERFORMANCE IN
2012, RETURNING
A MODEST PROFIT
OF \$1.1M FOR THE
12 MONTHS ENDED
31 DECEMBER 2012.**
”

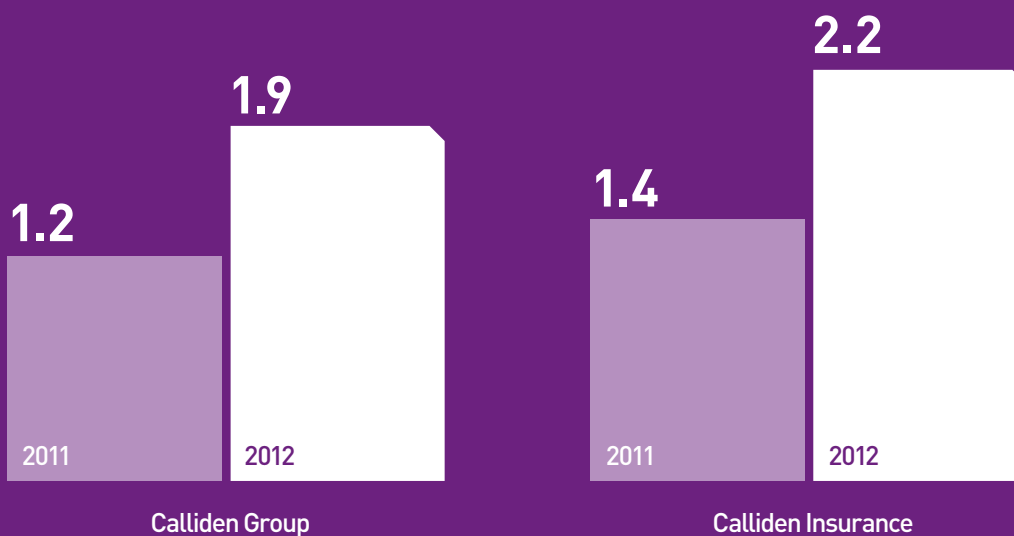
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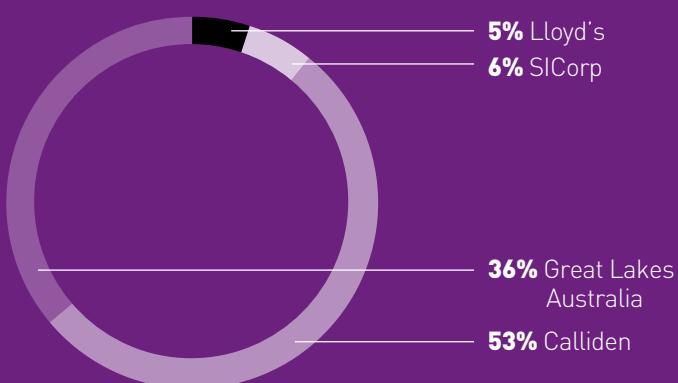
Chairman's Report

“On behalf of the Board and Management, it is gratifying to be able to report a strong turnaround in the Group's performance in 2012, from a loss of \$10.2m the previous year, to a modest profit of \$1.1m.”

Capital Strength Multiples



2013 Forecast Gross Written Premium by Insurer



This result was also achieved during a period of significant change for the Company as it set about implementing the new strategic direction approved by the board in 2011. At the close of 2012, Calliden's plan to become Australia's leading Managing General Agent ("MGA") was well advanced and we are now firmly focused on delivering the financial benefits associated with this new operating model in 2013.

Strategic Progress

The decision in 2011 to pursue the MGA model was driven by the twin goals of reducing both the volatility in Group results and the capital intensity of the insurer. Under the MGA model, Calliden is able to use the capital of both its own insurer and that of other insurers to back its products whilst continuing to provide the same level of service to its brokers and clients.

In May 2012 Calliden implemented an agreement with Great Lakes Australia ("GLA") to underwrite its Business Pack portfolio. This was followed by a second agreement with GLA to underwrite Calliden's Farm portfolio from 1 January 2013. During 2013 we also plan to release a Middle Market offering targeting medium-sized commercial risks.

As a result of these agreements with GLA, together with the continuation of our contracts with Lloyd's and the NSW Government's SICorp, Calliden has achieved its objective of having approximately half of its business placed with insurers other than Calliden Insurance Limited ("CIL") by the commencement of the 2013 year.

Strengthening of Capital

Following the unprecedented level of weather catastrophes in 2011, CIL embarked on a major programme of reinsurance in 2012, increasing its quota share reinsurance to 60% on new risks written during the year and increasing the quota share ceded on unexpired risks as at 31 December 2011 to 65%.

This programme of reinsurance delivered the desired result of allowing Calliden to rebuild its capital buffers above the regulatory minimum for CIL from 1.4 times at the beginning of the year to 2.2 times at 31 December 2012. It also ensured that both Calliden Group and CIL could comfortably meet the new regulatory capital standard for insurance companies which applied from 1 January 2013.

One direct benefit of implementing the MGA model and strengthening its capital base is that Calliden is able to reduce the amount of proportional reinsurance purchased by its insurer to 25%. This, together with a range of comprehensive portfolio management actions taken during 2012, should enable CIL to produce an improved return in 2013 and beyond.

Outlook

I look forward to the future of Calliden as we move into the second and final phase of executing on the new strategic direction for the business. Calliden is now operating as an MGA, comprising a smaller, better performing insurance company and an agency division that offers a range of opportunities for growth.

This new operating model is designed to deliver a more stable, less capital-intensive business, capable of generating more consistent profits that will in turn deliver shareholders a regular flow of fully-franked dividends into the future.

The past year has been a busy one and I would like to thank my fellow Directors for their important contributions, and our business partners for their support. On behalf of the Directors, I would like to acknowledge the efforts of Nick Kirk and his team for the hard work in meeting the goals set out in the 2012 business plan. Finally, I would like to thank our shareholders for their ongoing support.



Richard Hill
Chairman

Chief Executive Officer's Report

Calliden reported a much improved operating performance in 2012, returning a modest profit of \$1.1m for the 12 months ended 31 December 2012. This was achieved during a year of major change for the Group as it reoriented its business model to operate along the lines of a Managing General Agent ("MGA").

Calliden's profit result for the year was underpinned by an improved underwriting performance and reduced operating expenses. It was also aided by the benign catastrophe experience for the year, in strong contrast to 2011.

Our decision to take additional reinsurance protection delivered the desired benefit of increasing the amount of capital above minimum regulatory requirements in both the holding company, and in Calliden Insurance Limited ("CIL"). This was important in a year when the general insurance industry was preparing for the introduction of a new capital regime by the prudential regulator in 2013.

Improved Insurance Result

CIL's insurance metrics are shown below and show considerable improvement over 2011 and compare favourably with earlier years.

While our gross claims ratio was much improved, our net claims ratio was affected by the year's reinsurance programme. Although the level of reinsurance coverage came at a cost to the Company in terms of overall profitability, it was the most effective method at the time of increasing capital strength, enabling Calliden to rationalise its portfolio and restructure its overall business. CIL is now much better positioned to take advantage of the increased profitability of its underwritten portfolios.

Calliden Agency Services

Calliden's commitment to implementing a new strategy for the business, centred on its role as a Managing General Agent, resulted in the establishment of Calliden Agency Services as a new division within the Group.

"Although the level of reinsurance coverage came at a cost to the Company in terms of overall profitability, it was the most effective method at the time of increasing capital strength, enabling Calliden to rationalise its portfolio and restructure its overall business."

The agency business reported a modest profit of \$1.1m, in a year of transition with Calliden's Business Pack transferring to an agency basis. This was accompanied by a number of one-off costs directly associated with the restructure.

In 2013, our wholly-owned subsidiary, Mansions of Australia Limited, will be renamed Calliden Agency Services Limited. The Group's agency activities will be consolidated within this corporate entity and its operations. This is important as it will ensure that the agency is able to grow without any limitations placed on it by CIL's regulatory capital obligations. Upon completion of the corporate restructure, Calliden Agency Services will be one of Australia's largest insurance agencies.

Key Insurance Ratios

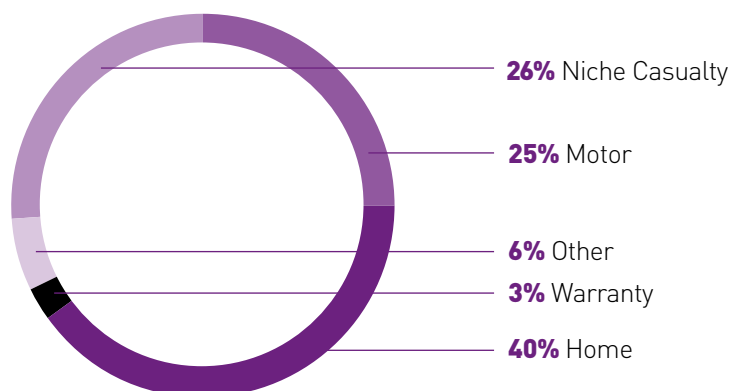
| | 2012 % | 2011 % | 2010 % | 2009 % |
|--------------------------|-----------|-----------|-----------|-----------|
| Gross Claims Ratio | 62 | 94 | 71 | 93 |
| Net Claims Ratio | 66 | 81 | 60 | 66 |
| Net Acquisition Ratio | 33 | 38 | 33 | 39 |
| Combined Operating Ratio | 99 | 119 | 93 | 105 |
| Insurance Margin | 9 | (15) | 14 | (1) |

Ratios exclude statutory levies & duties

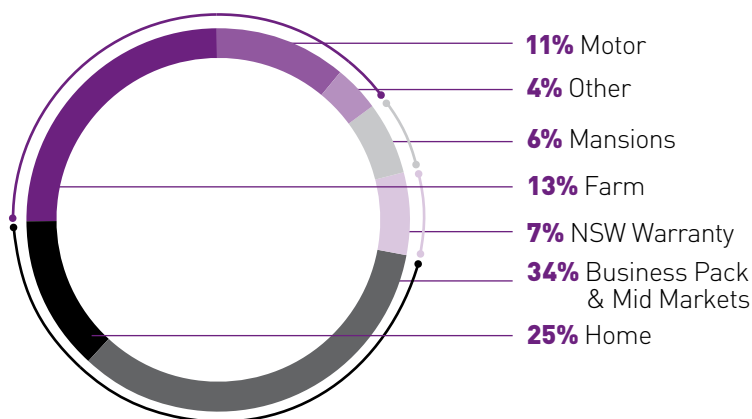
“Calliden’s profit result for the year was underpinned by an improved underwriting performance and reduced operating expenses. It was also aided by the benign catastrophe experience for the year, in strong contrast to 2011.”

Growing the Agency

2012 GWP* c.110m



2013 Projected GWP* c.170m



Calliden Insurance Limited

Great Lakes Australia

Lloyd's

SICorp

* Excluding levies

Delivering on the Strategy in 2013

While much of the work associated with developing Calliden's MGA model was completed during 2012, the focus in 2013 will be on consolidating the new operating structure. This will be the first full year as an MGA and demonstrating the financial benefits of this strategy by delivering a strong return to shareholders is a priority shared by both Board and Management.

In 2013 the size and composition of Calliden Insurance's portfolio will begin to look quite different. As a smaller more focused insurer, its Gross Written Premium will reduce from \$156.6m to around \$110m. The reduced range of product it continues to underwrite is more tailored to suit its risk appetite. This will allow CIL to grow its net revenue by reducing the amount of proportional reinsurance and providing a more efficient use of capital.

Calliden Agency Services will become a sizable operation in 2013 with a projected GWP of around \$170m and an attractive, diverse range of products for its intermediary network.

Revenue growth from the Group's agency operations will be generated by further diversification of its product range as well as via writing larger risks based on the greater risk appetite of the underwriting (external) insurers.

Finally, I believe it is important to recognise that the change that has been created within Calliden's underlying business over the past year would not have been possible without the support of the Board and the dedication of its staff. I would also like to thank Calliden's business partners and customers, as well as the continued support from the Group's shareholders.

Nick Kirk

Chief Executive Officer

Group Operating Model

Calliden Group commenced as a general insurer in 2005. Since then the Group has evolved into a Managing General Agent ("MGA") with two distinct businesses: Calliden Insurance and Calliden Agency Services.

Calliden Agency Services Limited ("CAS") underwrites and distributes, via professional intermediaries, a range of insurance products from electronically delivered business packages and home insurance to specialised niche offerings for high value homes and exotic cars.

CAS operates as an agent on behalf of a variety of insurers including Great Lakes Australia, Lloyd's, the NSW Government's SICorp as well as the Group's own insurer Calliden Insurance Limited.

Calliden Insurance Limited ("CIL") is an insurer that manufactures and distributes products through a number of underwriting agencies. Its focus is on achieving a return on its capital in excess of its weighted average cost of capital over the course of the insurance cycle.

At the end of 2012 approximately 50% of the Group's future premium is insured by Calliden Insurance Limited with the remainder backed by third party insurers.

From 2013 more than 50% of the Group's future profit will be derived from less volatile commission and fee based income.

Figure 1 shows which business unit each product resides within and the insurer for each.

Organisational Structure

A new organisational structure has been implemented to better align with our Group MGA operating model, which is shown in Figure 1.

The new structure allows our people to focus on the discrete goals of the two business units supported by cost effective central services and the Group's Finance and Governance teams.

It is our vision to be the number one MGA group in Australia in terms of volume and profit.

To achieve this we are committed to continually improving and consistently delivering good quality underwriting, customer service and claims management. This is supported by modern and flexible IT systems, an engaged workforce and strong relationships with our business partners including but not limited to: capital providers, underwriting agencies, broker groups, professional intermediaries and their customers.

What is a Managing General Agent?

A Managing General Agent may perform one or more of the many tasks performed by an insurer.

In Calliden's case this includes, but is not limited to: underwriting, marketing, relationship management, handling claims and issuing policies on behalf of insurers, including its own licensed insurer.

In acting as an agent for insurers, Calliden Agency Services is paid a commission which is determined by the scope of services provided, while Calliden Insurance carries risk in return for premiums.

Our vision is to be the number one MGA in terms of volume and profit.

By delivering insurance in a better way we create enduring relationships that matter.

MANAGING GENERAL AGENT CALLIDEN GROUP LIMITED

Services

CLAIMS, IT, PEOPLE & CULTURE, PROJECTS & PRODUCT DEVELOPMENT, ACCOUNTS, FINANCE, RISK & REINSURANCE, INVESTMENTS (QUS, ARENA)

CALLIDEN INSURANCE LIMITED

Insurance Business

ACTUARIAL, AGENCY MANAGEMENT, UNDERWRITING CONTROL & OPERATIONS

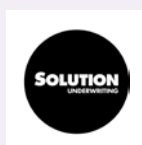
CALLIDEN AGENCY SERVICES LIMITED

Agency Services

PORTFOLIO MANAGEMENT, SERVICE CENTRES, SALES & MARKETING

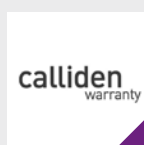
CAPITAL PROVIDED BY EXTERNAL INSURERS

COMMERCIAL



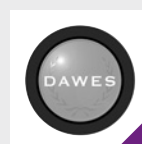
Great Lakes Australia

BUILDERS WARRANTY

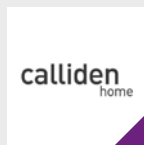


SiCorp

PERSONAL LINES MOTOR



PERSONAL LINES HOME



Lloyd's

Figure 1

KEY

INSURED BY CALLIDEN INSURANCE LIMITED

INSURED BY EXTERNAL INSURERS

Consolidated Financial Report

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Five Year Financial Summary

| | 2012 \$'000 | 2011 \$'000 | 2010 \$'000 | 2009 \$'000 | 2008 \$'000 |
|---|----------------|-----------------|----------------|----------------|----------------|
| Gross written premium | 172,000 | 245,653 | 211,641 | 217,843 | 200,026 |
| Net premium revenue | 79,308 | 126,076 | 116,809 | 100,962 | 105,814 |
| Net claims expense | (39,961) | (85,731) | (58,387) | (55,569) | (57,869) |
| Net acquisition costs | (10,550) | (30,344) | (23,796) | (20,451) | (25,631) |
| Underwriting expenses | (28,579) | (31,777) | (26,264) | (28,453) | (24,701) |
| Underwriting profit / (loss) | 218 | (21,776) | 8,362 | (3,511) | (2,387) |
| Investment income on assets backing insurance liabilities | 5,247 | 6,278 | 4,998 | 4,010 | 8,890 |
| Insurance profit / (loss) | 5,465 | (15,498) | 13,360 | 499 | 6,503 |
| Commission and fee revenue | 18,708 | 8,820 | 6,489 | 4,178 | 3,610 |
| Acquisition costs | (10,881) | (3,990) | (3,193) | (2,068) | (1,828) |
| Operating expenses | (6,698) | (3,289) | (1,811) | (1,178) | (1,701) |
| Agency profit / (loss) | 1,129 | 1,541 | 1,485 | 932 | 81 |
| Investment income on shareholders' funds | 425 | 393 | 1,905 | 2,041 | 3,597 |
| Share of net profit of joint ventures | 253 | 1,274 | 1,266 | 1,589 | 1,558 |
| Gains on sale of joint ventures | 58 | 8,169 | 1,100 | - | - |
| Other (expense) / revenue | (100) | 159 | 237 | 2,206 | 1,782 |
| Administration and other expenses | (6,141) | (5,943) | (9,500) | (6,447) | (4,258) |
| Borrowing costs | - | (343) | (1,367) | (1,285) | (2,222) |
| Profit / (loss) before income tax | 1,089 | (10,248) | 8,486 | (467) | 7,041 |
| Income tax benefit | - | - | 1,638 | 71 | 2,106 |
| Net profit / (loss) after income tax | 1,089 | (10,248) | 10,124 | (396) | 9,147 |
| Shareholders' equity | 95,851 | 94,451 | 107,046 | 100,083 | 103,396 |
| Total assets | 360,834 | 425,961 | 380,251 | 431,684 | 394,490 |
| Premium growth | | | | | |
| Gross written premium ⁽¹⁾ | (15%) | 17% | 1% | 10% | 48% |
| Insurer ratios ⁽²⁾ | | | | | |
| Gross claims ratio | 62% | 94% | 71% | 93% | 60% |
| Net claims ratio | 66% | 81% | 60% | 66% | 62% |
| Net acquisition ratio | 33% | 38% | 33% | 39% | 42% |
| Combined operating ratio | 99% | 119% | 93% | 105% | 104% |
| Insurance margin | 9% | (15%) | 14% | (1%) | 7% |
| Share information | | | | | |
| Dividends per share - fully franked (cents) | - | 1.00 | 1.00 | 1.25 | - |
| Basic earnings per share (cents) | 0.48 | (4.52) | 4.45 | (0.17) | 3.96 |
| Share price at 31 Dec (\$) (ASX: CIX) | 0.16 | 0.19 | 0.28 | 0.31 | 0.40 |
| Net assets per share (\$) | 0.42 | 0.42 | 0.47 | 0.43 | 0.45 |
| Net tangible assets per share (\$) | 0.20 | 0.18 | 0.23 | 0.21 | 0.25 |

(1) The Premium Growth Ratio excludes the Fire Services Levy and includes premiums underwritten by Calliden as well as on behalf of external insurers.

(2) Insurer ratios are presented excluding statutory charges as this is considered a more appropriate reflection of underlying business performance and these ratios are not audited.

Some amounts have been reclassified in prior years to be consistent with the current year presentation. This has had no effect on net profit.

Directors' Report

The Directors present their report together with the financial report of Calliden Group Limited and the consolidated financial report of Calliden Group Limited and its subsidiaries for the year ended 31 December 2012 and the auditor's report thereon.

The following terminology is used throughout the financial report:

- › Calliden, Parent or Company - Calliden Group Limited; and
- › Group or Consolidated - the Consolidated entity consists of Calliden Group Limited and its subsidiaries.

1.0 DIRECTORS OF CALLIDEN GROUP LIMITED

The names and details of the Company's Directors in office at any time during or since the end of the year are as follows:

| DIRECTOR | DATE OF APPOINTMENT | SPECIAL RESPONSIBILITIES |
|---------------|---------------------|--|
| RJ Hill | 19 April 2000 | Chairman Member of Risk Management Committee Member of Remuneration and Nominations Committee |
| MW Loomes | 24 October 2000 | Chairman of Audit Committee Member of Investment and Capital Committee Member of Risk Management Committee |
| JT Lowenstein | 19 April 2000 | Chairman of Investment and Capital Committee Member of Risk Management Committee Member of Audit Committee |
| NG Kirk | 1 January 2005 | Managing Director and Chief Executive Officer Member of Risk Management Committee Member of Investment and Capital Committee |
| JI Messenger | 24 May 2007 | Chairman of Risk Management Committee Member of Audit Committee Member of Remuneration and Nominations Committee |
| AV Connon | 21 September 2007 | Member of Risk Management Committee Member of Audit Committee Member of Investment and Capital Committee |
| GGM Smith | 23 October 2008 | Chairman of Remuneration and Nominations Committee Member of Risk Management Committee Member of Audit Committee |

All Directors were in office for the entire period.

1.1. Experience and Qualifications of Directors

Richard James Hill B.A, LL.B, LL.M

Age 66. Chairman. Independent Non-Executive Director

Richard Hill has extensive investment banking and management experience. He was a founding partner of Hill Young & Associates and formerly held a number of senior executive positions in Hong Kong and New York with Wardley Holdings Limited, a wholly owned subsidiary of Hong Kong & Shanghai Banking Corporation. He was admitted as an attorney in New York State, USA and registered by the US Securities and Exchange Commission and the Ontario Securities Commission. He is the Chairman of Sirtex Medical Limited* (since August 2006) and a Chairman of Blackwall Property Group Ltd* (since July 2006) and Biota Holdings Limited (since November 2008).

Maurice William Loomes B.Comm (Econ Hons), F Fin

Age 65. Independent Non-Executive Director

Maurice Loomes has an extensive background in investment analysis and strategy, and for a number of years was a Senior Executive with Guinness Peat Group Plc* (from 1996 to May 2000). He is Chairman of Canberra Investment Corporation Limited* (Director since September 1994). He is also a Director of Ariadne Australia Limited* (since May 2004). He is a former Director of Tower Limited (from September 2003 to March 2005).

Jack Theseus Lowenstein M.A (Oxon)

Age 56. Independent Non-Executive Director

Jack Lowenstein is Managing Director and Joint Chief Investment Officer of Morpheic Asset Management Pty Ltd, a global equity fund manager based in Sydney. He was a Director of Hunter Hall International Limited* (from March 2004 to November 2011) and was a Director of Hunter Hall Global Value Limited* (from December 2003 to November 2011). He is also the non-Executive Chairman of Kontiki Capital Limited, a Fiji-based regional investment bank.

Nicholas George Kirk Associate, Chartered Insurance Institute and Chartered Insurer (UK)

Age 51. Executive Director

Nick Kirk has more than 30 years insurance experience in Australia, continental Europe and the UK. He was previously with Vero where he held a number of General Management roles most latterly responsible for their Specialty Businesses in Australia. Prior to Vero he held a number of Senior Underwriting Management roles internationally with the Royal & Sun Alliance Group.

John Ian Messenger ANZIIIF (Snr Assoc), CIP

Age 67. Independent Non-Executive Director

John Messenger has extensive insurance, property and risk management experience. He was previously the Managing Director of MLC Insurance Limited, Chief Executive Officer of Corporate Risk Management for the Lend Lease Group*, a Director of Investa Properties Group Limited and a Deputy Chairman of Territory Insurance Office.

Anthony Vincent Connon BA (Oxon), FCA, FAICD

Age 62. Non-Executive Director

Tony Connon is a Chartered Accountant with over 40 years' experience in various industries, having held senior finance and administration positions with Price Waterhouse, Grindlays Australia Limited, Elders Finance Group and The Australian Wheat Board. Since 1995, he has been the Chief Financial Officer of Australian Unity Limited and is an Executive Director of a majority of its operating subsidiaries. He is the Honorary Treasurer of Friendly Societies Australia Inc. and a member of the Board of the Lord Mayor's Charitable Foundation.

Gordon Geoffrey Marsden Smith

Age 60. Independent Non-Executive Director

Gordon Smith has an extensive background in the financial services industry in New Zealand and Australia, with involvement in banking, insurance and the rural sector. He operates a business consultancy company in New Zealand and is currently a Director of the New Zealand Earthquake Commission (since October 2011), Chairman of CodeBlue Hawkes Bay Limited (since March 2011) and a Director of Cole Murray Group Limited (since March 2011), all New Zealand based companies. He was formerly Chief Executive Officer of Farmers Mutual Group in New Zealand and a Director of eight related Group companies including Farmers Mutual Insurance Limited in Australia (from 2001 to 2007) and the Insurance Council of New Zealand (from 2006 to 2008).

* The companies denoted with * are listed on the Australian Securities Exchange

1.2. Attendance at Board and Board Committee Meetings

The number of meetings each Director attended during the financial year is summarised as follows:

| | BOARD | RISK MANAGEMENT | AUDIT ⁽¹⁾ | INVESTMENT & CAPITAL ⁽²⁾ | REMUNERATION & NOMINATIONS ⁽³⁾ |
|---|-----------|--------------------|----------------------|--|--|
| Meetings held for the year ended 31 December 2012 (written resolutions circulated) | 12 | 5 | 7 | 7 | 3 |
| Director attendances | | | | | |
| RJ Hill | 11 | 5 | n/a | n/a | 3 |
| MW Loomes | 12 | 5 | 7 | 7 | n/a |
| JT Lowenstein | 12 | 5 | 7 | 7 | n/a |
| NG Kirk | 12 | 5 | n/a | 7 | n/a |
| JI Messenger | 11 | 5 | 7 | n/a | 3 |
| AV Connon | 12 | 5 | 7 | 7 | n/a |
| GGM Smith | 11 | 5 | 6 | n/a | 3 |

(1) RJ Hill and NG Kirk are not members of the Audit Committee.

(2) RJ Hill, JI Messenger and GGM Smith are not members of the Investment and Capital Committee.

(3) MW Loomes, JT Lowenstein, NG Kirk and AV Connon are not members of the Remuneration and Nominations Committee.

1.3. Directors' Benefits

No Director of the Company has, since the end of the preceding financial year, received or become entitled to receive a benefit other than a benefit included in the total amount of remuneration received, or due and receivable, by Directors and disclosed in the Remuneration report, or by reason of a contract made by the Company or its controlled entities with the Director, or with a firm of which the Director is a member, or with an entity in which the Director has a substantial financial interest.

1.4. Term and Rotation

The Company's constitution states that each year one-third of Directors, being the Directors with the longest term served since election must stand for re-election or retire. In addition, any other Director except the Managing Director, who has been in office for three years or more since last re-election, must stand for re-election or retire.

2.0 COMPANY SECRETARY

Nicholas John Victor Geddes FCA, FCIS was appointed Company Secretary in March 2011. Mr Geddes is the Principal of Australian Company Secretaries, a company secretarial practice that he formed in 1993. He is a past President and Director of Chartered Secretaries Australia and a former Chairman of the NSW Council of that Institute. His previous experience, as a Chartered Accountant and Company Secretary, includes investment banking and development, and venture capital in Europe, Africa, the Middle East and Asia. He is a Chartered Accountant (Fellow of the Institute of Chartered Accountants in England & Wales) and Fellow of the Institute of Chartered Secretaries (Chartered Secretaries Australia).

3.0 PRINCIPAL ACTIVITIES AND REVIEW OF OPERATIONS

3.1. Principal Activities

The Group's principal activity during the year was that of a Managing General Agent ("MGA"), and included:

- ▶ The underwriting of general insurance through its authorised insurance subsidiary Calliden Insurance Limited ("CIL");
- ▶ Acting as an agent on behalf of Lloyd's of London ("Lloyd's"), Great Lakes Australia ("GLA") and the NSW Government;
- ▶ The investment management of shareholders' and policyholders' funds; and
- ▶ Ownership interests in several underwriting agencies.

3.2. Review of Operations

In 2012, Calliden substantially completed the implementation of its new strategy following a comprehensive review of the business in 2011. At that time the Directors announced that the Group would expand on its existing MGA business and that 2012 would represent a transitional year as the Company increased its MGA operations. The primary benefits from this strategic shift are to provide a more reliable profit base as well as a less capital intensive business model.

The Group's operating and financial results for 2012 reflect the impact of the transition from that of a general insurer to an MGA, and the decision to strengthen the capital base through additional reinsurance.

The Group's insurance operations undertook a number of portfolio management actions, including:

- ▶ Limits on aggregate exposures, particularly in northern Queensland residential strata;
- ▶ Improved capability in geographic risk rating allowing a reduced exposure to unacceptably high flood and bushfire risks;
- ▶ Reducing commission expense on certain portfolios;
- ▶ The exiting of unprofitable lines; and
- ▶ Increasing premiums to bring loss ratios to acceptable levels.

As a consequence, CIL's insurance book is structurally more profitable. Following the rebuilding of the capital base in 2012, CIL has been able to reduce its reinsurance coverage through a lower quota share cession in 2013, which will allow the Group to take advantage of this improved profitability.

The key operating highlights for Calliden's agency business have been:

- ▶ Transitioning key insurance portfolios to operate on an agency basis on behalf of third party insurers including the Business Pack portfolio from May 2012 and preparation for the transition of the Farm portfolio from January 2013;
- ▶ Systems development work to enable the introduction of agency fees; and
- ▶ The implementation of the commercial on-line rating engine which will allow for a better pricing of the Business Pack portfolio.

The Group also undertook a restructuring of the business to align the operations with the MGA model. This restructuring will continue in 2013, as Calliden sees the consolidation of its agency business in the wholly-owned subsidiary, Mansions of Australia Limited ("Mansions"), and its renaming to Calliden Agency Services Limited ("CAS").

3.3. Operating Result for the Financial Year

The Group returned to profit in the 2012 financial year following an extremely difficult year in 2011 not only for the Group but the general insurance sector. The Group's net profit after tax was \$1.1m, compared with a \$10.2m loss in the prior year.

The result is attributable to better than expected net attritional and catastrophe claims experience of \$1.7m offset by the following factors:

- ▶ Increased catastrophe reinsurance premiums of \$2.3m;
- ▶ Additional reinsurance protection covering the unexpired risk at 31 December 2011 of \$2.7m;
- ▶ Additional proportional reinsurance of \$2.5m;
- ▶ Adverse discount rate impact on reserves of \$0.7m; and
- ▶ Non-recurring restructuring costs of \$1.0m.

3.3.1. GENERAL INSURANCE

The insurance profit for the year was \$5.5m, compared with a prior year loss of \$15.5m. The insurance performance of the Group for this year is much improved principally due to improved claims experience, which was partly offset by the increased reinsurance costs.

The Group reported an underwriting profit of \$0.2m compared with a loss of \$21.8m in the same period last year.

CIL underwrote GWP of \$172.0m, which was 30% lower than 2011. The reduction in underwritten GWP was a result of the transfer of our Business Pack portfolio to an agency basis with effect from the middle of May in line with the MGA strategy. Additionally, we undertook portfolio management actions to improve underlying profitability and reduce CIL's exposure to high natural catastrophe risk.

CIL's gross earned premium fell 2% to \$218.9m for the year and net earned premium fell 37% to \$79.3m in 2012, driven chiefly by the increase in reinsurance protection through an increase in quota share and unearned premium quota share agreements. CIL, in common with the industry, also experienced a large increase in the cost of catastrophe reinsurance premiums following the unprecedented number of catastrophes experienced in 2011.

As a result of the portfolio management actions and more benign catastrophe activity during 2012, Calliden's exposure to claims was reduced, resulting in a reduction in net incurred claims from \$85.7m in 2011 to \$40.0m. Our net incurred claims include the adverse impact of a reduction in the discount rate from 3.4% at December 2011 to 2.8% at December 2012; this was \$0.7m for the year.

3.3.2. AGENCY

Calliden's agency produced a profit of \$1.1m in contrast with the prior year profit of \$1.5m. The result was affected by transitional costs incurred in transferring the Business Pack and Farm portfolios to GLA and projects to implement agency fees.

In line with the transition to an MGA, Calliden now writes policies on behalf of three external insurers: GLA - part of the Munich Re Group, Lloyd's and the NSW Self-Insurance Corporation ("SICorp"). The Group increased its GWP underwritten by third party insurers by 132% from \$22.7m in 2011 to \$52.7m in 2012 and in 2013 almost half of Calliden's GWP is forecast to be underwritten by third party insurers.

3.4. Review of Financial Condition

3.4.1. FINANCIAL POSITION

The Group's financial position was strengthened over 2012, with Shareholders' Equity increasing to \$95.9m and Net Tangible Assets increasing from 17.9 cents per share to 20.0 cents per share.

The total assets of the Group as at 31 December 2012 were \$360.8m compared with \$426.0m at 31 December 2011. The movement is mainly attributable to:

- ▶ A reduction in cash and investments of \$27.6m to pay for higher reinsurance costs and cessions;
- ▶ A reduction in premium receivables of \$8.2m and a reduction in deferred acquisition costs of \$10.2m flowing from lower written premium as a result of the transition of the Business Pack portfolio to GLA and exiting unprofitable lines;
- ▶ A reduction in reinsurance receivables of \$11.9m following the settlement of 2011 catastrophe claims; and
- ▶ A reduction in intangible assets of \$3.7m largely as a result of amortisation exceeding our additional IT development spend.

The total liabilities of the Group as at 31 December 2012 were \$265.0m compared to \$331.5m at 31 December 2011. The movement is mainly attributable to:

- ▶ A reduction in unearned premium liability of \$46.8m as a result of the GLA transfer and other portfolio management measures;
- ▶ A reduction in outstanding claims of \$27.1m following the settlement of a large proportion of the catastrophe claims incurred in late 2011; and
- ▶ A reduction in reinsurance premiums payable of \$6.1m.

The increase in the Group's equity from \$94.5m at 31 December 2011 to \$95.9m at 31 December 2012 reflects the results of operations for the year.

3.4.2. CASH FROM OPERATIONS

The Group's net cash outflow from operating activities for 2012 was \$27.7m compared to a net inflow of \$6.7m in 2011. The majority of this outflow was attributable to a reduction in the size of the underwritten business and increased reinsurance premiums arising chiefly from increased reinsurance cessions.

3.4.3. CAPITAL MANAGEMENT

Calliden undertook a strategy to rebuild its capital strength through additional reinsurance and the transfer of some of its portfolio to an agency basis. Consequently, the Group's and CIL's capital positions have improved, as reflected in the Capital Adequacy Multiple ("CAM").

The Group's CAM was 1.9 as at 31 December 2012 compared with 1.2 as at 31 December 2011. CIL's CAM improved considerably to 2.2 as at 31 December 2012 compared with 1.4 at 31 December 2011.

3.5. Impact of Legislation and other External Requirements

The Australian Prudential Regulation Authority ("APRA") adopted new Life and General Insurance Capital ("LAGIC") standards with effect from 1 January 2013. These standards generally increased the level of capital required by insurers and required the establishment of an Internal Capital Adequacy Assessment Process ("ICAAP"). Calliden worked with APRA and its advisors to ensure that its ICAAP was in place and that its capital position was adequate to meet the new standards at the start of 2013.

3.6. Investment Activities

The Group continued its investment strategy from 2011 by investing in fixed term deposits and cash at call with Australian banks. This ensured Calliden was protected against a fall in the market value of its investment assets and reduced its investment management costs. In anticipation of falling interest rates, the Group sought to lock in term deposits, which has largely protected its investment returns in 2012 and for 2013. As a result, there was no offset to the impact of discount rates on claims reserves which amounted to an adverse movement in net claims reserves of \$0.7m in 2012.

The investment portfolio was made up of \$70.0m in term deposits and \$24.5m in cash at call as at year end compared with \$80.0m in term deposits and \$42.1m in cash at call the previous year end.

Total investment income earned during the year was \$5.7m (2011: \$6.7m) which equates to an average yield of 5.9% (2011: 6.4%).

The Group also holds a number of joint venture investments. The Group's share of net profits from joint ventures was \$0.3m (2011: \$1.3m). The reduction was due to the sale of Calliden's share in Claims Services Australia Pty Ltd in late 2011.

3.7. Outlook

In 2013, Calliden will continue to pursue its MGA strategy. From 1 January 2013 the Farm portfolio is being underwritten by GLA. This, together with our new middle market offering, is forecast to result in Calliden generating around 50% of its business in 2013 from policies underwritten by third party insurers.

CIL will continue to focus on improving the underlying profitability of our underwritten portfolio and importantly, optimising our reinsurance programme to take advantage of the improved loss ratios arising from our portfolio management actions in 2012. The Group will also continue to pursue new agency opportunities to complement our existing product suite.

3.8. Likely Developments

In 2013, Calliden's wholly-owned subsidiary, Mansions, intends to expand its activities to act as an agent on behalf of insurers in addition to Lloyd's and to take over the agency agreements from CIL with GLA and the NSW Self-Insurance Corporation. Mansions will also act as an agent for CIL. Mansions intends to change its name to CAS.

Further information about likely developments in the Group's operations and commentary on the expected results of those operations in future financial years have not been included in this report because disclosure would be likely to result in unreasonable prejudice for the Group.

3.9. Events Subsequent to Reporting Date

On 28 February 2013, the Directors declared a fully franked dividend of 0.4 cents per share (2012: nil).

In January 2013, Calliden was exposed to the flooding and storm damage which occurred in Queensland and northern New South Wales arising from ex-tropical cyclone Oswald. The total cost of this damage has not been determined, however the majority of the policies are reinsured under a 60% quota share cession and the final net cost is expected to be within budgeted catastrophe allowances for the year.

As at the date of this report, there were no other material or unusual events or transactions occurring after the reporting date that the Directors are aware of that would significantly affect the Group's operations or the state of affairs of the Group in future years.

4.0 DIVIDENDS

On 28 February 2013, the Directors declared a fully franked dividend of 0.4 cents per share. This dividend has not been provided for and will be recognised in subsequent financial reports.

5.0 LEAD AUDITOR'S INDEPENDENCE DECLARATION UNDER SECTION 307C OF THE CORPORATIONS ACT 2001

The Lead Auditor's Independence Declaration is set out on page 23 and forms part of the Directors' Report for the year ended 31 December 2012.

6.0 NON-AUDIT SERVICES

During the year, KPMG performed the external peer review of the actuarial valuation conducted by the Appointed Actuary as well as a review of the NSW Home Warranty Insurance Fund controls in addition to their audit services. KPMG performed no other non-audit services to Calliden.

7.0 INDEMNIFICATION AND INSURANCE OF DIRECTORS AND OFFICERS

7.1. Indemnification

The Company's constitution contains an indemnity in favour of every officer and past officer (including the Directors, Secretaries and other officers). To the fullest extent permitted by law, the indemnity extends to any liability incurred in the relevant capacity and to legal costs and expenses incurred in defending an action for such liability.

In addition, the Company has entered into a deed of indemnity with each current Director and certain former Directors indemnifying them on a continuing basis, to the maximum extent permitted by law and the Company's constitution, against all liabilities and payments (including legal expenses) incurred or paid in connection with their position as Director or employee of the Company or a controlled entity.

As at the date of this report, no Director or officer of the Company has received the benefit of an indemnity from the Company during or since the end of the year.

7.2. Insurance

Under the Company's constitution and the deeds of indemnity, the Company is required to pay to the fullest extent permitted by the law the premium on a contract insuring the indemnified persons against liability incurred in respect of the relevant office. The insurance must be maintained for a minimum of seven years after the date the person ceases to hold office. The Company has paid insurance premiums in respect of insurance contracts for Directors' and Officers' liability and legal expenses for all current and former Directors and officers of the Company and its controlled entities. Disclosure of the details of the liability covered or the amount of the insurance premium is prohibited by the relevant insurance contract.

8.0 ENVIRONMENTAL REGULATION

The Group's operations are subject to environmental regulations under either Commonwealth or State legislation. These regulations do not have a significant impact on the Group's operations. The Board of Directors believes that the Group has adequate systems in place for the management of its environmental requirements and is not aware of any breach of those environmental requirements as they apply to the Group.

9.0 REMUNERATION REPORT - AUDITED

9.1. Principles of Compensation

Remuneration is referred to as compensation throughout this report.

Key Management Personnel ("KMP") have authority and responsibility for planning, directing and controlling the activities of the Group. KMP comprise the Directors of the Company and Senior Executives for the Group.

Compensation levels for KMP of the Group are competitively set to attract and retain appropriately qualified and experienced KMP. The Remuneration and Nominations Committee obtains independent advice on the appropriateness of compensation packages of the KMP given trends in comparative companies, and the objectives of the Group's compensation strategy.

In respect of at-risk remuneration, the Group's policy is to provide meaningful entitlements when the performance of the business delivers significant and sustained benefits to shareholders. A significant proportion of the KMP (excluding non-Executive Directors) overall remuneration is directly linked to shareholder returns, with no incentives being provided unless minimum thresholds defined by the Board are exceeded.

The compensation structures explained below are designed to attract suitably qualified candidates, reward the achievement of strategic objectives, and achieve the broader outcome of creation of value for shareholders. The compensation structure takes into account:

- › The capability and experience of the KMP;
- › The KMP's ability to control the relevant segment/s performance;
- › The Group's performance including:
 - › The Group's earnings;
 - › The growth in share price and delivering constant returns on shareholder wealth; and
 - › The amount of incentives within each key management person's compensation.

Compensation packages include a mix of fixed and variable compensation, and short and long-term performance-based incentives.

9.1.1. FIXED COMPENSATION

Fixed compensation consists of base compensation (which is calculated on a total cost basis and includes any Fringe Benefits Tax charges) related to employee benefits, as well as employer contributions to superannuation funds.

Compensation levels are reviewed annually by the Remuneration and Nominations Committee through a process that considers individual, segment and overall performance of the Group. In addition, external consultants provide analysis and advice to ensure the Directors' and senior KMP compensation is competitive in the market place.

9.1.2. PERFORMANCE LINKED COMPENSATION

Performance linked compensation is provided to executive KMP including both short-term and long-term incentives, and is designed to reward them for meeting or exceeding financial and personal objectives. No short-term and long-term incentives are provided to Directors.

The short-term incentive ("STI") is an 'at risk' bonus provided in the form of cash, while the long-term incentive ("LTI") is provided as rights over ordinary shares of the Company under the rules of the Calliden LTI Plan (the "Plan").

9.1.3. SHORT-TERM INCENTIVE BONUS

The STI is a performance-based cash bonus calculated as a percentage of the total of cash salary (Managing Director) or fixed remuneration (KMP). The STI commenced in 2005.

The aims of the STI are to:

- › Align the interests of KMPs and the shareholders of the Group;
- › Provide an attractive variable remuneration component to KMP contingent on achievement of objectives and performance hurdles;
- › Ensure that KMP are rewarded and recognised for their contribution to the Group; and
- › Attract, motivate and retain talent.

The primary performance measure for the KMP incentives has been set around the Group's net profit after tax ("NPAT"). The Board each year determines 'threshold', 'target' and 'stretch' levels of NPAT. No level of STI is guaranteed to be paid at any level of profitability and the established practice is that no level of STI will begin to be earned until the predetermined 'threshold' NPAT is achieved. The NPAT for 2012 was not achieved.

The Board reserves the right to exercise discretion in the determination of STI. An example of this may be where a KMP entitlement during the year is reduced due to a performance threshold being marginally not achieved or in the event of incapacity, death, or other exceptional circumstances.

9.1.4. LONG-TERM INCENTIVE

9.1.4.1. ELIGIBILITY AND PURPOSE

Eligible employees are invited to participate in the Plan. The Plan is intended to engage KMP in the success of the business by linking rewards with the performance of the Group. This is achieved by employing objective performance measures directly linked to the creation of shareholder wealth, such as growth in earnings per share and total shareholder returns, as well as encouraging their retention. The Plan commenced in 2005.

Eligibility is considered by the Board based on KMP ability to influence the overall and long-term performance of the business.

9.1.4.2. PERFORMANCE RIGHTS

Under the Plan, participating KMP may receive annual grants of performance rights. Subject to the rules of the Plan, each performance right entitles the KMP holding that right to receive, for no consideration, one fully-paid ordinary share in the Company at the end of the performance period if criteria specified by the Board are satisfied over the performance period. Currently, no new shares have been issued for the Plan and those required to satisfy vesting requirements are purchased on the Australian Securities Exchange ("ASX").

9.1.4.3. NUMBER OF PERFORMANCE RIGHTS

There was no grant made in the 2010 year. There were grants made for each of the 2011 and 2012 years for three years in duration for each grant.

The number of performance rights is determined by dividing the value of the LTI component of each KMP's remuneration by the value of the rights in the grant. For the 2011 and 2012 grants, the LTI component of each KMP remuneration ranges from 60% to 120% of salary plus superannuation. The value of each right is calculated based on the volume-weighted average price ("VWAP") of Calliden's shares in the 5 days prior to the performance period (that is, up to and including 31 December 2011 for the 2012 grant), less the projected dividends over the performance period (1 January 2012 to 31 December 2014 for the 2012 grant). Where rights are subject only to service conditions ("Retention Rights") then the resulting value is used. Rights subject to performance conditions ("Performance Rights") have an Adjusted Right Value determined where the value is discounted recognising the attaching performance vesting conditions – for grants in respect of 2011 and 2012 the discount is 50%.

The proportion of Retention Rights in the 2011 and 2012 grants vary from 33% up to 100%. A decision was made by the Board that, in consideration of APRA's Prudential Standard GPS 510, Retention Rights would be 100% of all rights granted to risk and financial control personnel so as to ensure that this performance-based component of remuneration does not in any way compromise the independence of these personnel in carrying out their functions.

9.1.5. CONSEQUENCES OF PERFORMANCE ON SHAREHOLDER WEALTH

In considering the Group's performance and benefits for shareholder wealth, the Remuneration and Nominations Committee have regard to the following measures in respect of the current financial year and the previous four financial years.

| | 2012 | 2011 | 2010 | 2009 | 2008 |
|---|--------|--------|--------|--------|--------|
| Net profit / (loss) after tax (\$m) | 1.1 | (10.2) | 10.1 | (0.4) | 9.1 |
| Opening share price for the year (\$) | 0.19 | 0.28 | 0.31 | 0.40 | 0.58 |
| Closing share price for the year (\$) | 0.16 | 0.19 | 0.28 | 0.31 | 0.40 |
| Change in share price for the year (\$) | (0.03) | (0.09) | (0.03) | (0.09) | (0.18) |
| Highest share price for the year (\$) | 0.19 | 0.28 | 0.32 | 0.40 | 0.58 |
| Lowest share price for the year (\$) | 0.10 | 0.17 | 0.21 | 0.29 | 0.26 |
| Dividends paid (\$m) | - | 2.3 | 2.3 | 2.9 | - |
| Return of capital (\$m) ⁽¹⁾ | - | 0.1 | 1.0 | - | - |

(1) This related to a share buy-back and cancellation of shares.

Net profit after tax ("NPAT") is considered as one of the most important performance targets in setting the STI.

9.1.6. SERVICE AGREEMENTS

The major provisions of the service agreements for the KMPs of the Company and the Group are as follows:

| | APPOINTMENT DATE | TERM OF AGREEMENT | RENEWAL OF AGREEMENT | NOTICE TO BE GIVEN BY KMP | TERMINATION PAYMENTS |
|------------------------------|------------------|-----------------------------|----------------------|---------------------------|---|
| Current KMP | | | | | |
| NG Kirk | 29 March 2004 | Renewable 12 month contract | Every 12 months | 12 months | 12 months fixed remuneration (or payment in lieu) |
| AR Diggelmann ⁽¹⁾ | 15 August 2005 | Indefinite | n/a | 3 months | 6 months fixed remuneration (or payment in lieu) |
| S Dossetor | 1 November 2010 | Indefinite | n/a | 3 months | 6 months fixed remuneration (or payment in lieu) |
| SJ Fay | 10 May 2004 | Indefinite | n/a | 3 months | 6 months fixed remuneration (or payment in lieu) |
| MJ Hooton | 5 October 2004 | Indefinite | n/a | 3 months | 12 months fixed remuneration (or payment in lieu) |
| T Thomas | 26 April 2012 | To 30 April 2013 | By agreement | 3 months | 3 months fixed remuneration (or payment in lieu) |
| Former KMP | | | | | |
| I Mabbutt ⁽²⁾ | 17-Mar-2010 | Indefinite | n/a | 3 months | 3 months fixed remuneration (or payment in lieu) |

(1) AR Diggelmann left the Company on 30 April 2012.

(2) I Mabbutt ceased being KMP on 6 December 2011 but continues as an employee.

Termination payments with respect to KMP consist of statutory entitlements and, at the discretion of the Board, bonuses to which the employee has not yet become entitled. To date, no circumstances have arisen in which such discretion has been deemed necessary to be exercised.

9.1.7. SERVICES FROM REMUNERATION CONSULTANTS

The Remuneration and Nominations Committee engaged Godfrey Remuneration Group Pty Limited ("Godfrey") as a remuneration consultant to the Board to review the amount and elements of the KMP remuneration and provide recommendations in relation thereto.

Godfrey was paid \$16.5k for the remuneration recommendations in respect of reviewing the amount and elements of the KMP remuneration.

The engagement of Godfrey by the Remuneration and Nominations Committee was based on a documented set of protocols that would be followed by Godfrey, members of the Remuneration and Nominations Committee and members of the KMP for the way in which remuneration recommendations would be developed by Godfrey and provided to the Board.

The protocols included the prohibition of Godfrey providing advice or recommendations to KMP before the advice or recommendations was given to members of the Remuneration and Nominations Committee and not unless Godfrey had approval to do so from the Board.

These arrangements were implemented to ensure that Godfrey would be able to carry out its work, including information capture and the formation of its recommendations, free from undue influence by members of the KMP about whom the recommendations may relate.

Directors' Report Continued

The Board undertook its own enquiries and review of the processes and procedures followed by Godfrey during the course of its assignment and is satisfied that its remuneration recommendations were made free from undue influence.

These inquiries included arrangements under which Godfrey was required to provide to the Board with a summary of the way in which it carried out its work, details of its interaction with KMP in relation to the assignment and other services, and respond to questioning by members of the Board after the completion of the assignment.

9.1.8. NON-EXECUTIVE DIRECTORS

Total compensation for all non-Executive Directors, which is determined by the Board following recommendations by the Remuneration and Nominations Committee, is not to exceed \$750,000 per annum, and is set based on advice from external advisers with reference to fees paid to other non-Executive Directors of comparable companies.

The Chairperson receives up to twice the base fee of the other non-Executive Directors. Non-Executive Directors do not receive performance-related compensation. Directors' fees cover all main board activities and membership of committees.

The Company does not pay non-Executive Director retirement benefits other than statutorily prescribed superannuation contributions.

9.1.9. AT-RISK INCENTIVES

The following table summarises the details and terms associated with LTI grants to KMP as well as the overall outcomes:

| LTI GRANT | 2012 | 2011 ¹ |
|--|--|--|
| Grant date | 8 October 2012 | 1 February 2012 |
| Performance period ² | 3 years: 1 January 2012 to 31 December 2014 | 3 years: 1 January 2011 to 31 December 2013 |
| Performance test/s ³ | Service + Absolute Total Shareholder Return (ATSR) + Compound Average Growth Rate in Earnings Per Share (CAGR EPS) | Service + Absolute Total Shareholder Return (ATSR) + Compound Average Growth Rate in Earnings Per Share (CAGR EPS) |
| Vesting date ⁴ | 1 January 2015 | 1 January 2014 |
| Rights granted ⁵ | 5,252,001 | 3,436,400 |
| Lapsed or forfeited rights ⁶ | nil | nil |
| Vested rights | nil | nil |
| % Vested as a proportion of maximum available | nil | nil |
| Valuation of rights with market vesting conditions | Nil | nil |
| Valuation of rights with non-market vesting conditions | nil | nil |

1. The Board resolved to make a grant in 2011. Offers were extended in December 2011 and grants made in 2012.

2. The performance period over which entitlements are determined is generally three calendar years commencing from 1 January in the year to which the offer relates. Three years is selected based on the assessment that it is a sufficiently long duration over which to measure performance and foster consistent long-term improvements in business performance.

3. The number of performance rights for which KMPs actually receive shares (i.e. that "vest") are determined according to the Group's performance over the performance period, as measured by the performance tests set for the relevant grant. These tests are subject to determination by the Board for each grant and are amended as necessary with each Offer to drive the best possible outcomes for the business and shareholders. The 2011 and 2012 performance tests providing objective measures of sustainable profitable growth were chosen: Absolute Total Shareholder Return ("ATSR"); and, Compound Annual Growth Rate in Earnings per Share ("CAGR EPS").

4. For the 2011 and 2012 grants, vesting occurs automatically after the Performance Period when the Board determines the extent to which the performance tests have been satisfied. In the case of Retention Rights, this is subject to the KMP remaining in service. For Performance Rights, the proportion of the maximum available rights which vest as shares depends on the extent to which performance is achieved, subject to a minimum threshold level, below which no rights vest, and a target level at which 50% of maximum Performance Rights vest.

5. The numbers of rights granted reflect the maximum number of rights which may vest as shares at the end of the performance period.

6. Predetermined formulae for each performance test are used to calculate what proportion, if any, of performance rights should vest. Any performance rights for which the tests are not satisfied over the performance period lapse.

Performance rights also lapse and an KMP will forfeit any performance rights or shares held under the Plan if the KMP:

- ▶ is dismissed for cause; or
- ▶ in the Board's reasonable opinion, acts fraudulently or dishonestly, is in serious breach of duty to the Company or commits an act of harassment or discrimination; or
- ▶ in the Board's reasonable opinion, has brought the Company into serious disrepute.

Performance rights lapse if an KMP ceases employment with the Company except in the case of death, total and permanent disability or redundancy that occurs after the first 12 months of the performance period relevant to the performance rights. If any of these latter circumstances apply, the Board may, at its discretion, allocate shares for a proportion of the performance rights held by an KMP at the time. To date, the Board has never exercised such discretion.

At the discretion of the Board, performance rights may vest on a pro rata basis on a change of control of the Company [generally an entity acquiring more than 50% of the issued shares of the Company]. The Board has not, to date, exercised discretion in regard to any grants or rights.

KMPs are precluded from hedging any element of unvested, vested, or restricted Rights or Shares.

While the Board has absolute discretion to vary the terms of the LTI Plan there have been no circumstances or situations to date in which this has been exercised.

9.1.10. PERFORMANCE RIGHTS GRANTED AND VESTED

A summary of the number of performance rights that have been granted to KMP in accordance with the LTI and the numbers which have ultimately vested (where known), the minimum possible value is nil:

| LTI Grant | | 2012 | 2011 |
|-------------------------|---------|-----------|-----------|
| NG Kirk | Granted | 3,098,000 | 1,886,050 |
| | Vested | nil | nil |
| S Dossetor | Granted | 372,001 | 344,520 |
| | Vested | nil | nil |
| SJ Fay | Granted | 762,000 | 519,000 |
| | Vested | nil | nil |
| MJ Hooton | Granted | 1,020,000 | 686,830 |
| | Vested | nil | nil |
| T Thomas ⁽¹⁾ | Granted | nil | nil |
| | Vested | nil | nil |
| Total | Granted | 5,252,001 | 3,436,400 |
| | Vested | nil | nil |

(1) T Thomas commenced with the Company and as a KMP on 26 April 2012.

9.2. Directors' and Executive Officers' Remuneration - Audited

Details of the nature and amount of each major element of each Director of the Company, and other KMP of the consolidated entity are:

| | | SHORT-TERM | | | POST-EMPLOYMENT | SHARE-BASED PAYMENT | | | |
|---|------|---------------|-------------------------------|---------|-----------------|---------------------------|---------|------------------------------------|--|
| | | SALARY & FEES | STI CASH BONUS ⁽¹⁾ | TOTAL | | LTI RIGHTS ⁽²⁾ | TOTAL | PERFORMANCE RELATED ⁽³⁾ | |
| Directors | | \$ | \$ | \$ | \$ | \$ | \$ | % | |
| Non-Executive Directors | | | | | | | | | |
| RJ Hill | 2012 | 140,000 | - | 140,000 | - | - | 140,000 | - | |
| | 2011 | 140,000 | - | 140,000 | - | - | 140,000 | - | |
| MW Loomes | 2012 | 72,000 | - | 72,000 | 6,480 | - | 78,480 | - | |
| | 2011 | 72,000 | - | 72,000 | 6,480 | - | 78,480 | - | |
| JT Lowenstein | 2012 | 72,000 | - | 72,000 | - | - | 72,000 | - | |
| | 2011 | 72,000 | - | 72,000 | - | - | 72,000 | - | |
| JI Messenger | 2012 | 72,000 | - | 72,000 | 6,480 | - | 78,480 | - | |
| | 2011 | 72,000 | - | 72,000 | 6,480 | - | 78,480 | - | |
| AV Connon | 2012 | 72,000 | - | 72,000 | - | - | 72,000 | - | |
| | 2011 | 72,000 | - | 72,000 | - | - | 72,000 | - | |
| GGM Smith | 2012 | 72,000 | - | 72,000 | - | - | 72,000 | - | |
| | 2011 | 72,000 | - | 72,000 | - | - | 72,000 | - | |
| Sub-total non-Executive Directors' remuneration | 2012 | 500,000 | - | 500,000 | 12,960 | - | 512,960 | - | |
| | 2011 | 500,000 | - | 500,000 | 12,960 | - | 512,960 | - | |
| Executive Director | | | | | | | | | |
| NG Kirk | 2012 | 461,497 | - | 461,497 | 41,284 | - | 502,781 | - | |
| | 2011 | 424,449 | 25,000 | 449,449 | 40,051 | - | 489,500 | 5 | |
| Sub-total Executive Directors' remuneration | 2012 | 461,497 | - | 461,497 | 41,284 | - | 502,781 | - | |
| | 2011 | 424,449 | 25,000 | 449,449 | 40,051 | - | 489,500 | 5 | |

Directors' Report Continued

| | | SHORT-TERM | | | POST-EMPLOYMENT | SHARE-BASED PAYMENT | | |
|---|------|------------------|----------------------------------|-----------|-----------------|------------------------------|-----------|---------------------------------------|
| | | SALARY & FEES | STI CASH BONUS ⁽¹⁾ | TOTAL | SUPER | LTI RIGHTS ⁽²⁾ | TOTAL | PERFORMANCE RELATED ⁽³⁾ |
| Executives | | \$ | \$ | \$ | \$ | \$ | \$ | % |
| S Dossetor | 2012 | 175,168 | - | 175,168 | 15,765 | - | 190,933 | - |
| | 2011 | 152,376 | 9,174 | 161,550 | 14,450 | - | 176,000 | 5 |
| SJ Fay | 2012 | 230,903 | - | 230,903 | 20,781 | - | 251,684 | - |
| | 2011 | 221,596 | 9,174 | 230,770 | 20,679 | - | 251,449 | 4 |
| MJ Hooton | 2012 | 307,434 | - | 307,434 | 27,669 | - | 335,103 | - |
| | 2011 | 294,577 | 10,000 | 304,577 | 26,422 | - | 330,999 | 3 |
| T Thomas ⁽⁵⁾ | 2012 | 169,551 | - | 169,551 | 15,260 | - | 184,811 | - |
| | 2011 | - | - | - | - | - | - | - |
| Former | | | | | | | | |
| AR Diggelmann ^{(4) (5)} | 2012 | 89,582 | - | 89,582 | 7,293 | - | 96,875 | - |
| | 2011 | 230,953 | 11,467 | 242,420 | 21,727 | - | 264,147 | 4 |
| GT Hickey ⁽⁵⁾ | 2012 | - | - | - | - | - | - | - |
| | 2011 | 388,749 | 13,761 | 402,510 | 21,897 | - | 424,407 | 3 |
| I Mabbut ⁽⁵⁾ | 2012 | - | - | - | - | - | - | - |
| | 2011 | 173,965 | 13,761 | 187,726 | 16,805 | - | 204,531 | 7 |
| RF Walliser ⁽⁵⁾ | 2012 | - | - | - | - | - | - | - |
| | 2011 | 399,465 | 9,174 | 408,639 | 21,262 | - | 429,901 | 2 |
| Total Executives' remuneration | 2012 | 972,638 | - | 972,638 | 86,768 | - | 1,059,406 | - |
| | 2011 | 1,861,681 | 76,511 | 1,938,192 | 143,242 | - | 2,081,434 | 4 |
| Total Directors' and Executive Officers' remuneration | 2012 | 1,934,135 | - | 1,934,135 | 141,012 | - | 2,075,147 | - |
| | 2011 | 2,786,130 | 101,511 | 2,887,641 | 196,253 | - | 3,083,894 | 3 |

(1) The STI figures presented above include other bonus amounts as determined by the Board and the amounts are incurred in their respective years whether paid in that or the following year. KMP accrued no STI entitlements in 2010, 2011 or 2012. The 2011 amounts were ex-gratia bonuses paid on 18 March 2011 in recognition of contributions towards improving the business and in order to secure KMPs' continuing engagement in meeting the business challenges in that year.

(2) The LTI is explained in the Remuneration section of this Directors' Report. No other LTI or share-based payments were made to KMP. The amounts reported are calculated based on the number of Performance Rights offered for each year multiplied by an estimated vesting price prorated over the vesting period. The total represents the sum of the value of the performance rights outstanding on this basis. The estimate of the percentage of performance rights that vest and the estimated vesting price are, as required determined using an external valuation. The ultimate value of the LTI will be determined by the prevailing share price on the date that the shares vest. The LTI is an equity-settled share-based payment program accounted for in accordance with AASB 2 as discussed in Note 30.

(3) The Performance Related % shown above represents the proportion of Total emoluments in the year represented by STI and LTI as explained above. No remuneration was paid in the form of rights to Directors in 2012.

(4) Includes salary up to date of departure and termination payment in accordance with terms of service agreement.

(5) Refer to section 9.1.6 Service Agreements section of this Remuneration Report for date of appointment and/or cessation as KMP.

9.2.1. SIGN-ON PAYMENTS

No sign-on payments were made to KMP during 2012 (2011: nil).

9.2.2. OTHER PAYMENTS

No other payments were made to KMP during 2012 (2011: nil).

9.2.3. OTHER BENEFITS

No other benefits were received by KMP during 2012 (2011: nil).

9.2.4. TERMINATION PAYMENTS TO FORMER KMP

A termination payment was made to Mr Adrian Diggelmann of \$8,550.52 on 30 April 2012 in accordance with the terms of his service agreement. Total termination payments to other KMP in 2011 were \$329,600.

9.3. Options and Rights Granted to Directors and Senior KMP

Apart from the performance rights issued pursuant to participation in the LTI plan, no options or rights were granted to or exercised by KMP during or since the end of the year.

9.4. Directors' Interests in Share Capital

The relevant interest of each Director in the share capital of the companies within the Group, as notified by the Directors to the ASX at the date of this report:

| Directors | | BALANCE AT THE START OF THE YEAR | MOVEMENT DURING THE YEAR | | BALANCE AT THE END OF THE YEAR |
|--------------------------|------|--|--------------------------|-----------|--------------------------------------|
| | | | SALES | PURCHASES | |
| RJ Hill | 2012 | 1,000,000 | - | - | 1,000,000 |
| | 2011 | 600,000 | - | 400,000 | 1,000,000 |
| JT Lowenstein | 2012 | 450,000 | - | - | 450,000 |
| | 2011 | 450,000 | - | - | 450,000 |
| NG Kirk ⁽¹⁾ | 2012 | 1,567,264 | - | - | 1,567,264 |
| | 2011 | 1,567,264 | - | - | 1,567,264 |
| JI Messenger | 2012 | 50,000 | - | - | 50,000 |
| | 2011 | 50,000 | - | - | 50,000 |
| MW Loomes | 2012 | - | - | - | - |
| | 2011 | - | - | - | - |
| AV Connon ⁽²⁾ | 2012 | - | - | - | - |
| | 2011 | - | - | - | - |
| GGM Smith | 2012 | 100,000 | - | - | 100,000 |
| | 2011 | 50,000 | - | 50,000 | 100,000 |
| Total | 2012 | 3,167,264 | - | - | 3,167,264 |
| | 2011 | 2,717,264 | - | 450,000 | 3,167,264 |

(1) These figures include 1,438,765 shares held in trust in accordance with employee share schemes and LTI plans. Refer to section 9.1.4 for details of the LTI plan in which NG Kirk is a participant. There were no options or other rights over ordinary shares granted or exercised by Directors during or since the end of the year, or outstanding as at the date of this report.

(2) AV Connon is a Director nominated by Australian Unity Strategic Holdings Pty Ltd, a significant shareholder of the Group with 30,142,850 shares held at 31 December 2012.

All Directors' interests in the share capital of the Company are in the form of fully paid ordinary shares issued by Calliden Group Limited.

9.5. Executives' Interests in Share Capital

The relevant interest of each KMP in the share capital of the companies within the Group, as notified by the KMP to the ASX at the date of this report.

| Executives | | BALANCE AT THE START OF THE YEAR | MOVEMENT DURING THE YEAR | | BALANCE AT THE END OF THE YEAR |
|------------------------------|------|--|--------------------------|-----------|--------------------------------------|
| | | | SALES | PURCHASES | |
| AR Diggelmann ⁽¹⁾ | 2012 | 263,494 | - | - | 263,494 |
| | 2011 | 220,494 | - | 43,000 | 263,494 |
| S Dossetor | 2012 | 15,334 | - | - | 15,334 |
| | 2011 | 5,334 | - | 10,000 | 15,334 |
| SJ Fay | 2012 | 204,192 | - | - | 204,192 |
| | 2011 | 201,639 | - | 2,553 | 204,192 |
| MJ Hooton | 2012 | 480,117 | - | - | 480,117 |
| | 2011 | 475,769 | - | 4,348 | 480,117 |
| T Thomas ⁽²⁾ | 2012 | 35,000 | - | - | 35,000 |
| | 2011 | - | - | - | - |
| Total | 2012 | 998,137 | - | - | 998,137 |
| | 2011 | 903,236 | - | 59,901 | 963,137 |

(1) AR Diggelmann left the Company on 30 April 2012.

(2) T Thomas commenced as an Executive on 26 April 2012.

No LTI rights vested as shares in 2012 (2011: nil).

These amounts include shares purchased by the KMP and any vested shares held in trust in accordance with long-term incentive or employee share schemes.

The Calliden Share Trading policy, including risk measures, applies to all KMP interests in share capital.

9.6. Options or Rights over Ordinary Shares Granted to Non-Directors

There were no options or rights over ordinary shares granted or exercised during or since the end of the year, or outstanding as at the date of this report.

10.0 ROUNDING OFF

The Group is of a kind referred to in the Class Order 98/100 dated 10 July 1998 and in accordance with that Class Order, amounts in the consolidated financial report and Directors' Report have been rounded off to the nearest thousand dollars, unless otherwise stated.

This report is made with a resolution of the Directors.



RJ Hill

Chairman

Dated at Sydney this 28th day of February 2013.



Lead Auditor's Independence Declaration Under Section 307c of the Corporations Act 2001

To the Directors of Calliden Group Limited,

I declare that, to the best of my knowledge and belief, in relation to the audit for the financial year ended 31 December 2012 there have been:

- (i) no contraventions of the auditor independence requirements as set out in the *Corporations Act 2001* in relation to the audit; and
- (ii) no contraventions of any applicable code of professional conduct in relation to the audit.

KPMG

KPMG

A handwritten signature in black ink, appearing to read 'Madeleine Mattera', written in a cursive style.

Madeleine Mattera

Partner

Sydney

28 February 2013

Statements of Comprehensive Income

FOR THE YEAR ENDED 31 DECEMBER 2012

| | | CONSOLIDATED | | COMPANY | |
|---|------|----------------|-----------------|----------------|----------------|
| | NOTE | 2012 \$'000 | 2011 \$'000 | 2012 \$'000 | 2011 \$'000 |
| Gross written premium | 6 | 172,000 | 245,653 | - | - |
| Gross premium revenue | 6 | 218,847 | 223,992 | - | - |
| Reinsurance premium expense | 7 | (139,539) | (97,916) | - | - |
| Net premium revenue | | 79,308 | 126,076 | - | - |
| Gross claims expense | 7,8 | (123,375) | (192,923) | - | - |
| Reinsurance and other recoveries revenue | 6 | 83,414 | 107,192 | - | - |
| Net claims expense | | (39,961) | (85,731) | - | - |
| Acquisition costs | 6,7 | (54,591) | (61,078) | - | - |
| Reinsurance commission revenue | 6 | 44,041 | 30,734 | - | - |
| Net acquisition costs | | (10,550) | (30,344) | - | - |
| Other underwriting expenses | 7 | (9,658) | (12,051) | - | - |
| Levies and charges | 7 | (18,921) | (19,726) | - | - |
| Underwriting expenses | | (28,579) | (31,777) | - | - |
| Underwriting profit / (loss) | | 218 | (21,776) | - | - |
| Investment income on assets backing insurance liabilities | 6 | 5,247 | 6,278 | - | - |
| Insurance profit / (loss) | | 5,465 | (15,498) | - | - |
| Agency commission and fee revenue | 6 | 18,708 | 8,820 | - | - |
| Agency acquisition costs | 7 | (10,881) | (3,990) | - | - |
| Agency expenses | 7 | (6,698) | (3,289) | (35,514) | (39,848) |
| Investment income on shareholders' funds | 6 | 425 | 393 | 26 | 88 |
| Share of net profits of joint ventures | 6 | 253 | 1,274 | 30 | 1,050 |
| Management fee revenue | 6 | - | - | 38,765 | 42,645 |
| Gains on sale of joint ventures | 6 | 58 | 8,169 | 58 | 8,808 |
| Other (expense) / revenue | 6 | (100) | 159 | - | 103 |
| Administration and other expenses | 7 | (6,141) | (5,943) | (6,141) | (4,752) |
| Borrowing costs | 7 | - | (343) | - | (343) |
| Profit / (loss) before income tax | | 1,089 | (10,248) | (2,776) | 7,751 |
| Income tax expense | 9 | - | - | - | - |
| Total comprehensive income attributable to the members of Calliden Group Limited | | 1,089 | (10,248) | (2,776) | 7,751 |
| | | Cents | Cents | | |
| Basic earnings per ordinary share | 12 | 0.48 | (4.52) | | |
| Diluted earnings per ordinary share | 12 | 0.48 | (4.52) | | |

The notes on pages 29 to 69 are an integral part of this consolidated financial report.

Statements of Financial Position

AS AT 31 DECEMBER 2012

| | | CONSOLIDATED | | COMPANY | |
|---|------|----------------|----------------|----------------|----------------|
| | NOTE | 2012 \$'000 | 2011 \$'000 | 2012 \$'000 | 2011 \$'000 |
| Assets | | | | | |
| Cash and cash equivalents | 13 | 24,504 | 42,121 | 269 | 69 |
| Investments | 14 | 70,000 | 80,000 | - | - |
| Trade and other receivables | 15 | 64,752 | 68,500 | 6,891 | 8,465 |
| Reinsurance and other recoveries receivable | 16 | 72,902 | 84,826 | - | - |
| Prepayments | | 817 | 918 | 820 | 918 |
| Deferred levies and charges | | 7,455 | 11,493 | - | - |
| Deferred reinsurance expense | 17 | 46,561 | 50,276 | - | - |
| Deferred acquisition costs | 17 | 20,792 | 31,021 | - | - |
| Deferred tax assets | 18 | 3,750 | 3,750 | 3,750 | 3,750 |
| Plant and equipment | 19 | 2,180 | 2,477 | 2,180 | 2,477 |
| Investments in joint ventures | 20 | 603 | 381 | 160 | 160 |
| Other financial assets | 21 | - | - | 103,718 | 99,218 |
| Intangible assets | 22 | 46,518 | 50,198 | 7,289 | 9,502 |
| Total assets | | 360,834 | 425,961 | 125,077 | 124,559 |
| Liabilities | | | | | |
| Trade and other payables | 23 | 27,947 | 20,502 | 12,182 | 9,316 |
| Employee entitlements | 24 | 1,254 | 1,137 | 1,254 | 1,137 |
| Unearned premium liability | 26 | 81,331 | 128,178 | - | - |
| Unearned reinsurance commission | 25 | 16,141 | 17,536 | - | - |
| Unearned agency commission | 28 | 1,252 | - | - | - |
| Outstanding claims liability | 27 | 137,058 | 164,157 | - | - |
| Total liabilities | | 264,983 | 331,510 | 13,436 | 10,453 |
| Net assets | | | | | |
| | | 95,851 | 94,451 | 111,641 | 114,106 |
| Equity | | | | | |
| Issued capital | 29 | 99,539 | 99,539 | 99,539 | 99,539 |
| Treasury shares held in trust | 29 | (70) | (2) | (70) | (2) |
| Share-based payments reserve | 30 | 379 | - | 379 | - |
| (Accumulated losses) / retained earnings | | (3,997) | (5,086) | 11,793 | 14,569 |
| Total equity | | 95,851 | 94,451 | 111,641 | 114,106 |

The notes on pages 29 to 69 are an integral part of this consolidated financial report.

Statements of Changes in Equity

FOR THE YEAR ENDED 31 DECEMBER 2012

| | ISSUED CAPITAL | TREASURY SHARES HELD IN TRUST | SHARE-BASED PAYMENTS RESERVE | (ACCUMULATED LOSSES) / RETAINED EARNINGS | TOTAL |
|---|-------------------|-------------------------------------|------------------------------------|--|---------------|
| Consolidated | \$'000 | \$'000 | \$'000 | \$'000 | \$'000 |
| For the year ended 31 December 2012: | | | | | |
| Balance at the beginning of the year | 99,539 | (2) | - | (5,086) | 94,451 |
| Total comprehensive income | - | - | - | 1,089 | 1,089 |
| Transactions with owners in their capacity as owners | | | | | |
| Decrease in issued capital | - | - | - | - | - |
| Dividend paid | - | - | - | - | - |
| Lapsing of share-based remuneration | - | - | - | - | - |
| Acquisition of shares by the Calliden Employee Share Trust ⁽¹⁾ | - | (68) | - | - | (68) |
| Long-term incentive expense | - | - | 379 | - | 379 |
| Balance at the end of the year | 99,539 | (70) | 379 | (3,997) | 95,851 |
| For the year ended 31 December 2011: | | | | | |
| Balance at the beginning of the year | 99,615 | (2) | 160 | 7,273 | 107,046 |
| Total comprehensive income | - | - | - | (10,248) | (10,248) |
| Transactions with owners in their capacity as owners | | | | | |
| Decrease in issued capital | (76) | - | - | - | (76) |
| Dividend paid | - | - | - | (2,271) | (2,271) |
| Lapsing of share-based remuneration | - | - | (160) | 160 | - |
| Balance at the end of the year | 99,539 | (2) | - | (5,086) | 94,451 |

(1) Cash transferred to broker, however no trades were completed as at reporting date.

The notes on pages 29 to 69 are an integral part of this consolidated financial report.

| | ISSUED CAPITAL | TREASURY SHARES HELD IN TRUST | SHARE-BASED PAYMENTS RESERVE | (ACCUMULATED LOSSES) / RETAINED EARNINGS | TOTAL |
|---|-------------------|-------------------------------------|------------------------------------|--|----------------|
| Company | \$'000 | \$'000 | \$'000 | \$'000 | \$'000 |
| For the year ended 31 December 2012: | | | | | |
| Balance at the beginning of the year | 99,539 | (2) | - | 14,569 | 114,106 |
| Total comprehensive income | - | - | - | (2,776) | (2,776) |
| Transactions with owners in their capacity as owners | | | | | |
| Decrease in issued capital | - | - | - | - | - |
| Dividend paid | - | - | - | - | - |
| Lapsing of share-based remuneration | - | - | - | - | - |
| Acquisition of shares by the Calliden Employee Share Trust ⁽¹⁾ | - | (68) | - | - | (68) |
| Long-term incentive expense | - | - | 379 | - | 379 |
| Balance at the end of the year | 99,539 | (70) | 379 | 11,793 | 111,641 |
| For the year ended 31 December 2011: | | | | | |
| Balance at the beginning of the year | 99,615 | (2) | 160 | 8,929 | 108,702 |
| Total comprehensive income | - | - | - | 7,751 | 7,751 |
| Transactions with owners in their capacity as owners | | | | | |
| Decrease in issued capital | (76) | - | - | - | (76) |
| Dividend paid | - | - | - | (2,271) | (2,271) |
| Lapsing of share-based remuneration | - | - | (160) | 160 | - |
| Balance at the end of the year | 99,539 | (2) | - | 14,569 | 114,106 |

(1) Cash transferred to broker, however no trades were completed as at reporting date.

The notes on pages 29 to 69 are an integral part of this consolidated financial report.

Statements of Cash Flows

FOR THE YEAR ENDED 31 DECEMBER 2012

| | | CONSOLIDATED | | COMPANY | |
|---|------|-----------------|----------------|----------------|----------------|
| | Note | 2012 \$'000 | 2011 \$'000 | 2012 \$'000 | 2011 \$'000 |
| Cash flows from operating activities | | | | | |
| Premiums received ⁽¹⁾ | | 216,379 | 238,927 | - | - |
| Reinsurance and other recoveries received | | 94,099 | 92,854 | - | - |
| Acquisition costs paid | | (44,032) | (64,716) | - | - |
| Reinsurance premium paid | | (96,145) | (67,945) | - | - |
| Claims paid | | (150,590) | (162,554) | - | - |
| Underwriting expenses paid | | (39,631) | (35,609) | (37,575) | (41,163) |
| Management fees received | | - | - | 38,765 | 42,645 |
| Interest received | | 3,871 | 6,381 | 30 | 83 |
| Interest paid | | - | (411) | - | (411) |
| Dividends received from joint ventures | | 30 | 1,050 | 30 | 1,050 |
| Commission and fee income received | | 7,394 | 4,193 | - | 101 |
| Premiums paid to underwriters | | (19,102) | (5,744) | - | - |
| Other operating income / (expenses) | | - | 259 | (308) | 2 |
| Net cash flows from / (used in) operating activities | 13 | (27,727) | 6,685 | 942 | 2,307 |
| Cash flows from investing activities | | | | | |
| Net proceeds from sale of investments | | 10,000 | 25,394 | - | - |
| Proceeds from sale of plant and equipment | | 8 | 33 | 8 | 33 |
| Outlays for plant and equipment purchased | | - | (218) | - | (218) |
| Outlays for software development expenditure | | (718) | (3,303) | (718) | (3,303) |
| Proceeds from disposal of joint venture | | 500 | 10,000 | 500 | 10,000 |
| Net cash flows from / (used in) investing activities | | 9,790 | 31,906 | (210) | 6,512 |
| Cash flows from financing activities | | | | | |
| Dividend paid | | - | (2,271) | - | (2,271) |
| Capital injection to subsidiary | | - | - | (4,500) | - |
| Share redemption | | - | (76) | - | (76) |
| Repayment of loan provided to joint ventures | | 388 | 409 | - | 359 |
| Return of capital from joint ventures | | - | 163 | - | 163 |
| Proceeds of loan from subsidiaries | | - | - | 4,036 | (2,228) |
| Repayment of borrowings | | - | (5,000) | - | (5,000) |
| Outlays for purchase of treasury shares | | (68) | - | (68) | - |
| Net cash flows from / (used in) financing activities | | 320 | (6,775) | (532) | (9,053) |
| Net movement in cash and cash equivalents | | (17,617) | 31,816 | 200 | (234) |
| Cash and cash equivalents at the beginning of the year | | 42,121 | 10,305 | 69 | 303 |
| Cash and cash equivalents at the end of the year | 13 | 24,504 | 42,121 | 269 | 69 |

(1) Includes premiums received on behalf of GLA, Lloyd's and SiCorp.

The notes on pages 29 to 69 are an integral part of this consolidated financial report.

Notes to the Consolidated Financial Report

FOR THE YEAR ENDED 31 DECEMBER 2012

NOTE 1 REPORTING ENTITY

Calliden Group Limited is a company limited by shares, incorporated and domiciled in Australia whose shares are publicly traded on the Australian Securities Exchange ("ASX"). The address of the Group's registered office is Level 7, 100 Arthur Street, North Sydney, NSW 2060, Australia. The consolidated financial report of the Group as at and for the year ended 31 December 2012 comprises the Company and its subsidiaries (together referred to as the "Group" and individually as "Group entities") and the Group's interest in associates and jointly controlled entities. The Group is a for-profit entity and primarily is involved in the underwriting of general insurance and acting as an agent on behalf of external underwriters.

NOTE 2 BASIS OF PREPARATION

2.1. Statement of Compliance

This consolidated financial report is a general purpose financial report which has been prepared in accordance with Australian Accounting Standards ("AAS") adopted by the Australian Accounting Standards Board ("AASB") and the *Corporations Act 2001*. This financial report complies with International Financial Reporting Standards ("IFRS") adopted by the International Accounting Standards Board ("IASB").

This financial report was authorised for issue by the Board of Directors on 28 February 2013.

2.2. Basis of Measurement

This consolidated financial report has been prepared on an historical cost basis.

2.3. Functional and Presentation Currency

This consolidated financial report is presented in Australian dollars, which is the Company's functional currency.

The Company is of a kind referred to in ASIC Class Order 98/100 dated 10 July 1998 and in accordance with that Class Order, all financial information presented in Australian dollars has been rounded to the nearest thousand unless otherwise stated.

2.4. Uses of Estimates and Judgements

The preparation of this financial report in conformity with IFRS requires management to make judgements, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimates are revised and future periods affected.

Information about critical judgements in applying accounting policies that have the most significant effect on the amounts recognised in this consolidated financial report is included in the following notes:

(i) Insurance contracts related:

Note 27 - Outstanding claims liability;

Note 16 - Reinsurance and other recoveries on outstanding claims; and

Note 26.2 - Liability Adequacy Test ("LAT").

There are other amounts relating to insurance contracts that are based on allocation methodologies supported by assumptions (e.g. deferred acquisition costs). The estimates relate to past events, do not incorporate forward looking considerations, and generally do not change from year to year.

(ii) Other:

Note 22 - Intangible assets and goodwill;

Note 9 - Income tax and related assets and liabilities; and

Note 30 - Share-based payments.

2.5. Changes in Accounting Policies

There were a number of AAS and Interpretations applicable for the current reporting period. Adoption of these Standards and Interpretations has not had any material effect on the financial position or performance of the Group.

NOTE 3 SIGNIFICANT ACCOUNTING POLICIES

The accounting policies set out below have been applied consistently to all periods presented in this consolidated financial report, and have been applied consistently by Group entities.

3.1. Basis of Consolidation

3.1.1. BUSINESS COMBINATIONS

Business combinations are accounted for using the acquisition method as at the acquisition date, which is the date on which control is transferred to the Group. Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, the Group takes into consideration potential voting rights that are currently exercisable.

The Group measures goodwill at the acquisition date as:

- The fair value of the consideration transferred; less
- The net recognised amount (generally fair value) of the identifiable assets acquired and liabilities assumed.

When the difference is negative, a discount is recognised immediately in profit and loss.

Transaction costs, other than those associated with the issue of debt or equity securities, that the Group incurs in connection with a business combination are expensed as incurred.

3.1.2. SUBSIDIARIES

Subsidiaries are entities controlled by the Group. The financial reports of subsidiaries are included in the consolidated financial report from the date that control commences until the date that control ceases.

Upon the loss of control, the Group derecognises the assets and liabilities of the subsidiary, any non-controlling interests and the other components of equity related to the subsidiary. Any surplus arising on the loss of control is recognised in the Statements of Comprehensive Income.

If the Group retains any interest in the previous subsidiary, then such interest is measured at fair value at the date that control is lost. Subsequently it is accounted for as an equity-accounted investee or as an available-for-sale financial asset depending on the level of influence retained.

3.1.3. INVESTMENTS IN JOINTLY CONTROLLED ENTITIES (EQUITY-ACCOUNTED INVESTEES)

Investments in jointly controlled entities are accounted for using the equity method (equity-accounted investees) and initially recognised at cost. The cost of the investment includes transaction costs.

This consolidated financial report includes the Group's share of the profit or loss and other comprehensive income of equity-accounted investees, after adjustments, to align the accounting policies with those of the Group, from the date that significant influence of joint control commences until the date that significant influence or joint control ceases.

3.1.4. TRANSACTIONS ELIMINATED ON CONSOLIDATION

Intra-group balances and transactions, and any unrealised income and expenses arising from the intra-group transactions, are eliminated in preparing the consolidated financial report. Unrealised gains arising from transactions with equity-accounted investees are eliminated against the investment to the extent of the Group's interest in the investee. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

Significant Accounting Policies Related to General Insurance Contracts

All of the general insurance products on offer meet the definition of an insurance contract (a contract under which one party, the insurer, accepts significant insurance risk from another party, the policyholder, by agreeing to compensate the policyholder if a specified uncertain future event, the insured event, adversely affects the policyholder).

Financial risk is the risk of a possible future change in one or more of a specified interest rate, security price, commodity price, foreign exchange rate, index of prices or rates, a credit rating or credit index or other variable, provided that in the case of a non-financial variable the variable is not specific to a party to the contract. Insurance contracts may also transfer some financial risk.

3.2. Premium Revenue

Premium revenue comprises amounts charged to policyholders for insurance contracts. Premium includes amounts collected for levies and charges for which the amount to be paid by the insurer does not depend on the amounts collected, such as for fire services levies in Australia, but excludes stamp duties and taxes collected on behalf of third parties, including the Goods and Services Tax ("GST") in Australia. Premium is recognised as earned from the date of attachment of risk over the period of the related insurance contracts in accordance with the pattern of the incidence of risk expected under the contracts. The pattern of the risks underwritten is generally matched by the passing of time.

Premium for unclosed business (business written close to reporting date where attachment of risk is prior to reporting date and there is insufficient information to accurately identify the business) is brought to account based on previous experience with due allowance for any changes in the pattern of new business and based on previous experience with due allowance for any changes in the pattern of new business and renewals. The unearned portion of premium is recognised as an unearned premium liability in the Statements of Financial Position.

Premium receivable is recognised as the amount due and is normally settled between 30 days and 12 months. The recoverability of premium receivable is assessed and provision is made for impairment based on objective evidence and having regard to past default experience.

3.3. Outwards Reinsurance

Premium ceded to reinsurers is recognised as an expense in accordance with the pattern of reinsurance service received. Accordingly, a portion of reinsurance premium expense is treated as a prepayment and presented as deferred reinsurance expense in the Statements of Financial Position at the reporting date.

3.4. Claims

The outstanding claims liability is measured as the central estimate of the present value of expected future payments relating to claims incurred at the reporting date with an additional risk margin to allow for the inherent uncertainty in the central estimate. The liability is measured based on the advice of / valuations performed by, or under the direction of, the Appointed Actuary. The expected future payments include those in relation to claims reported but not yet paid or not yet paid in full, claims incurred but not enough reported ("IBNER"), claims incurred but not reported ("IBNR") and the anticipated direct and indirect claims handling costs. The liability is discounted to present value using a risk-free rate.

Claims expense represents claim payments adjusted for the movement in the outstanding claims liability.

The estimation of the outstanding claims liability involves a number of key assumptions and is the most critical accounting estimate. All reasonable steps are taken to ensure that the information used regarding claims exposures is appropriate. However, given the uncertainty in establishing the liability, it is likely that the final outcome will be different from the original liability established. Changes in claims estimates are recognised in the Statements of Comprehensive Income in the reporting period in which the estimates are changed.

3.5. Reinsurance and Other Recoveries

Reinsurance and other recoveries received or receivable on paid claims and on outstanding claims (notified and not yet notified) are recognised as revenue. Reinsurance and other recoveries receivable include the net GST receivable on outstanding claims and recoveries. Reinsurance recoveries on paid claims are presented as part of trade and other receivables net of any provision for impairment based on objective evidence for individual receivables. All recoveries receivable on outstanding claims are measured as the present value of the expected future receipts calculated on the same basis as the outstanding claims liability. Reinsurance does not relieve the originating insurer of its liabilities to policyholders and is presented separately in the Statements of Financial Position.

3.6. Acquisition Costs

Costs associated with obtaining and recording general insurance contracts are referred to as acquisition costs. These costs include advertising expenses, commissions or brokerage paid to agents or brokers, premium collection costs, risk assessment costs and other administrative costs. Such costs are capitalised where they relate to the acquisition of new business or the renewal of existing business, are presented as deferred acquisition costs and are amortised on the same basis as the earning pattern of the premium over the period of the related insurance contracts. The balance of the deferred acquisition costs at the reporting date represents the capitalised acquisition costs relating to unearned premium.

3.7. Liability Adequacy Test ("LAT")

The LAT is an assessment of the carrying amount of the unearned premium liability and is conducted at each reporting date. If current estimates of the present value of the expected future cash flows relating to settlement of future claims arising from occurrences after balance date from the rights and obligations under current general insurance contracts, plus an additional risk margin to reflect the inherent uncertainty in the central estimate, exceed the unearned premium liability (net of reinsurance) less related deferred acquisition costs, then the unearned premium liability is deemed to be deficient. The test is performed at the level of a portfolio of contracts that are subject to broadly similar risks and that are managed together as a single portfolio. Any deficiency arising from the test is recognised in the Statements of Comprehensive Income with the corresponding impact in the Statements of Financial Position recognised first through the write down of deferred acquisition costs for the relevant portfolio of contracts, with any remaining balance being recognised in the balance sheet as an unexpired risk liability.

3.8. Levies and Charges

Levies and charges, for which the amount paid does not depend on the amounts collected, as is the case with fire services levies in Australia, are expensed on the same basis as the recognition of premium revenue. The portion relating to unearned premium is treated as a prepayment and presented as deferred levies and charges in the Statements of Financial Position. A liability for levies and charges payable is recognised on business written to the reporting date. Other levies and charges that are simply collected on behalf of third parties are not recognised as income or expense in profit or loss.

Significant Accounting Policies Applicable to Other Activities

3.9. Agency Fees and Other Income

Agency fees and other income are recognised on an accruals basis and there is no deferral as there are no future obligations.

3.10. Agency Commission Revenue

Commission revenue is recognised in the Statements of Comprehensive Income on an accrual basis in accordance with each underwriting agency agreement. The commission is recognised to the extent that there is no future obligation. Where there is a future obligation a portion is deferred over the expected service period.

NOTE 3 SIGNIFICANT ACCOUNTING POLICIES Continued

3.11. Leases

The majority of leases entered into are operating leases, where the lessor retains substantially all the risks and benefits of ownership of the leased items. The majority of the lease arrangements are entered into as lessee for whom the lease payments are recognised as an expense on a straight line basis over the term of the lease. Certain sublease arrangements are entered into as the lessor for whom the lease payments are recognised as revenue on a straight line basis over the term of the lease. Lease incentives relating to the agreement of a new or renewed operating lease are recognised as an integral part of the net consideration agreed for the use of the leased asset. Operating lease incentives received are initially recognised as a liability, are presented as trade and other payables, and are subsequently reduced through recognition in profit or loss as an integral part of the total lease expense (lease payments are allocated between rental expense and reduction of the liability) on a straight line basis over the period of the lease.

3.12. Taxation

3.12.1. INCOME TAX

Income tax expense for a reporting period comprises current and deferred tax. Income tax expense is recognised in the Statements of Comprehensive Income except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Current tax expense is the expected tax payable on the taxable income for the year, using tax rates for each jurisdiction, and any adjustment to tax payable in respect of previous financial periods. Deferred tax expense is the change in deferred tax assets and liabilities between the reporting periods.

Deferred tax assets and liabilities are recognised using the balance sheet method for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes, except in the following circumstances when no deferred tax asset or liability is recognised:

- ▶ Temporary differences if they arose in a transaction, other than a business combination, that at the time of the transaction did not affect either accounting profit or taxable profit or loss;
- ▶ Temporary differences between the carrying amount and tax bases of investments in subsidiaries where it is probable that the differences will not reverse in the foreseeable future; and
- ▶ Temporary differences relating to the initial recognition of goodwill.

The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at reporting date. Deferred tax assets are recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised.

3.12.2. TAX CONSOLIDATION

Calliden and its Australian resident wholly owned subsidiaries adopted the tax consolidation legislation with effect from 1 January 2004 and are therefore taxed as a single entity from that date. Calliden Group Limited is the head entity within the tax-consolidated group.

Any current tax liabilities or assets and deferred tax assets arising from unused tax losses of the subsidiaries are assumed by the head entity in the tax consolidated group and are recognised as amounts receivable from / (payable to) other entities in the tax consolidated group in conjunction with any tax funding arrangement amounts. Any difference between these amounts is recognised by Calliden Group Limited as an equity contribution or distribution.

All entities in the tax consolidated group have entered into a tax sharing agreement which, in the opinion of the Directors, limits the joint and several liabilities of the wholly owned entities in the case of a default by the head entity.

The entities have also entered into a tax funding agreement under which the wholly owned entities fully compensate the Company for any current tax payable assumed.

In addition to its own current and deferred tax amounts, Calliden Group Limited also recognises the current tax liabilities or assets and the deferred tax assets arising from unused tax losses and unused tax credits assumed from subsidiaries in the tax consolidated group.

3.12.3. GOODS AND SERVICES TAX ("GST")

Revenue, expenses and assets are recognised net of the amount of GST, except where the amount of GST incurred is not recoverable. In these circumstances the GST is recognised as part of the cost of acquisition of the asset or as part of an item of expense. Receivables and payables are stated inclusive of GST. Cash flows are included in the Statements of Cash Flows on a gross basis.

3.13. Investments

Investments comprise assets held to back insurance liabilities (also referred to as technical reserves) and assets that represent policyholders' funds. All investments are managed and performance evaluated on a fair value basis for both external and internal reporting purposes.

All investments are designated as fair value through the Statements of Comprehensive Income upon initial recognition. They are initially recorded at fair value (being the cost of acquisition excluding transaction costs) and are subsequently remeasured to fair value at each reporting date. Changes in the fair value are recognised as realised or unrealised investment gains or losses in the Statements of Comprehensive Income. Purchases and sales of investments are recognised on a trade date basis, being the date on which a commitment is made to purchase or sell the asset.

Transaction costs for purchases of investments are expensed as incurred. Investments are derecognised when the rights to receive future cash flows from the assets have expired, or have been transferred, and substantially all the risks and rewards of ownership have transferred.

For securities traded in an active market, fair value is determined by reference to published bid price quotations. For securities traded in a market that is not active, valuation techniques are used based on market observable inputs. In a limited number of instances, valuation techniques are based on non-market observable inputs.

Investment revenue is brought to account on an accruals basis.

3.14. Investment in Subsidiaries

Investment in subsidiaries is initially recognised at cost being fair value of consideration provided and is subsequently carried at the lower of cost and recoverable amount by the Parent entity. Costs incurred in investigating and evaluating an acquisition up to the point of formal commitment to an acquisition are expensed as incurred. Where the carrying value exceeds the recoverable amount, an impairment charge is recognised in the Statements of Comprehensive Income which can subsequently be reversed in certain conditions. Where an additional interest is purchased in an existing subsidiary, the acquisition is treated as a transaction between owners and has no impact on the Statements of Comprehensive Income. Income from these investments, comprising dividends and trust distributions, is brought to account on an accruals basis.

Dividend revenue is accrued on the date the dividends are declared.

3.15. Trade and Other Receivables

Trade and other receivable are stated at the amounts to be received in the future, less any impairment losses. The amounts are discounted where the effect of the time value of money is material. The recoverability of debts is assessed on an on-going basis and provision for impairment is made based on objective evidence and having regard to past default experience. The impairment charge is recognised in the Statements of Comprehensive Income. Debts which are known to be uncollectible are written off.

3.16. Property and Equipment

3.16.1. RECOGNITION AND MEASUREMENT

Items of property and equipment are measured at cost less accumulated depreciation and accumulated impairment losses.

Costs include expenditure that is directly attributable to the acquisition of the asset.

Any gain or loss on disposal of an item of property and equipment (calculated as the difference between the net proceeds from disposal and the carrying amount of the item) is recognised in the Statements of Comprehensive Income.

3.16.2. SUBSEQUENT COSTS

Subsequent expenditure is capitalised only when it is probable that the future economic benefits associated with the expenditure will flow to the Group. Ongoing repairs and maintenance is expensed as incurred.

3.16.3. DEPRECIATION

Items of property and equipment are depreciated on a straight-line basis in the Statements of Comprehensive Income over the estimated useful lives of each component. Leased assets are depreciated over the shorter of the lease term and their useful lives unless it is reasonably certain that the Group will obtain ownership by the end of the lease term.

The estimated useful lives for the current and comparative years of significant terms of property and equipment are as follows:

| | |
|--|--------------|
| Leasehold improvements, furniture and fittings | 13 1/3 years |
| Office equipment | 5 - 10 years |
| Computing assets – software & hardware | 3 - 5 years |

Depreciation methods, useful lives and residual values are reviewed at each reporting date and adjusted if appropriate.

3.17. Intangible Assets

3.17.1. ACQUIRED INTANGIBLE ASSETS

Acquired intangible assets are initially recorded at their cost at the date of acquisition being the fair value of the consideration provided and, for assets acquired separately, incidental costs directly attributable to the acquisition. Intangible assets with finite useful lives are amortised on a straight line basis (unless the pattern of usage of the benefits is significantly different) over the estimated useful lives of the assets being the period in which the related benefits are expected to be realised (shorter of legal duration and expected economic life). Amortisation rates and residual values are reviewed annually and any changes are accounted for prospectively.

The carrying amount of intangible assets with finite useful lives is reviewed each reporting date by determining whether there is an indication that the carrying value may be impaired. If any such indication exists, the item is tested for impairment by comparing the recoverable amount of the asset or its Cash Generating Units ("CGUs") to the carrying value. Where the recoverable amount is determined by the value-in-use, the projected net cash flows are discounted using a pre-tax discount rate. For assets with indefinite useful lives, the recoverability of the carrying value of the assets is reviewed for impairment at each reporting date, or more frequently if events or changes in circumstances indicate that it might be impaired. An impairment charge is recognised when the carrying value exceeds the calculated recoverable amount. Impairment charges are recognised in the Statements of Comprehensive Income and may be reversed where there has been a change in the estimates used to determine the recoverable amount.

3.17.2. SYSTEMS DEVELOPMENT COSTS

Software or systems development expenditure that meets the criteria for recognition as an intangible asset is capitalised in the Statements of Financial Position and amortised over its expected useful life, subject to impairment testing. Costs incurred in researching and evaluating a project up to the point of formal commitment to a project are treated as research costs and are expensed as incurred. Smaller projects and other costs are treated as maintenance costs, being an ongoing part of maintaining effective computer systems, and are expensed as incurred.

NOTE 3 SIGNIFICANT ACCOUNTING POLICIES Continued

All such capitalised costs are deemed to have an expected useful life of five years unless it can be clearly demonstrated for a specific project that the majority of the net benefits are to be generated over a longer period. The capitalised costs are amortised on a straight line basis over the period following completion of a project or implementation of part of a project. The recoverability of the carrying amount of the asset is assessed in the same manner as for acquired intangible assets with finite useful lives.

3.18. Goodwill

Goodwill is initially measured as the excess of the purchase consideration over the fair value of the net identifiable assets and contingent liabilities acquired and subsequently presented net of any impairment charges. Goodwill arising on acquisitions prior to 1 July 2004 has been carried forward on the basis of its deemed cost being the net carrying amount as at that date.

For the purpose of impairment testing, goodwill is allocated to CGUs. CGUs are determined principally based on how goodwill is monitored by management. The carrying value of goodwill is tested for impairment at each reporting date.

Where the carrying value exceeds the recoverable amount, an impairment charge is recognised in the Statements of Comprehensive Income and cannot subsequently be reversed. The recoverable amount of goodwill is determined by the present value of the estimated future cash flows by using a pre-tax discount rate that reflects current market assessment of the risks specific to the CGUs.

3.19. Trade and Other Payables

Trade and other payables are carried at cost, which is the fair value of the consideration to be paid in the future for goods and services received. The amounts are discounted where the effect of the time value of money is material.

3.20. Employee Benefits

3.20.1. WAGES AND SALARIES, ANNUAL LEAVE AND SICK LEAVE

Liabilities for wages and salaries (including bonuses), annual leave and sick leave are recognised at the nominal amounts unpaid at the reporting date using remuneration rates that are expected to be paid when these liabilities are settled, including on-costs. A liability for sick leave is considered to exist only when it is probable that sick leave taken in the future will be greater than entitlements that will accrue in the future.

3.20.2. LONG SERVICE LEAVE

A liability for long service leave is recognised as the present value of estimated future cash outflows to be made in respect of services provided by employees up to the reporting date. The estimated future cash outflows are discounted using interest rates on national government guaranteed securities which have terms to maturity that match, as closely as possible, the estimated future cash outflows. Factors which affect the estimated future cash outflows such as expected future salary increases, experience of employee departures and period of service, are incorporated in the measurement.

3.20.3. SHARE-BASED INCENTIVE ARRANGEMENTS

Share-based remuneration is provided in different forms to eligible employees. The majority of the arrangements are equity settled share-based payments with a small portion being cash settled. The fair value at grant date (the date at which the employer and the employee have a shared understanding of the terms and conditions of the arrangement) is determined for each equity settled share-based payment using a valuation model which excludes the impact of any non-market vesting conditions. This fair value does not change over the life of the instrument. At each reporting date during the vesting period (the period during which related employment services are provided), and upon the final vesting or expiry of the equity instruments, the total accumulated expense is revised based on the fair value at grant date and the latest estimate of the number of equity instruments that are expected to vest based on non-market vesting conditions only, and taking into account the expired portion of the vesting period. Changes in the total accumulated expense from the previous reporting date are recognised in the Statements of Comprehensive Income with a corresponding movement in an equity reserve. Upon exercise of the relevant instruments, the balance of the share-based remuneration reserve relating to those instruments is transferred within equity.

The different treatment of market and non-market vesting conditions means that if an equity instrument does not vest because a participant ceases relevant employment then the accumulated expense charged in relation to that participant is reversed, but if an equity instrument does not vest only because a market condition is not met, the expense is not reversed.

3.20.4. SUPERANNUATION

For defined contribution superannuation plans, obligations for contributions are recognised in the Statements of Comprehensive Income as they become payable.

3.21. Provision for Dividends

Provision for dividends is made in respect of ordinary shares where the dividends are declared on or before the reporting date but have not yet been distributed at that date.

3.22. Earnings Per Share

3.22.1. BASIC EARNINGS PER SHARE

Basic earnings per share is determined by dividing the profit or loss attributable to shareholders of the Parent by the weighted average number of shares of the Parent on issue during the reporting period, net of treasury shares held in trust.

3.22.2. DILUTED EARNINGS PER SHARE

Diluted earnings per share is determined by dividing the profit or loss attributable to equity holders of the Parent used in the calculation of basic earnings per share, adjusted for relevant costs associated with dilutive potential ordinary shares, by the weighted average number of ordinary shares and dilutive potential ordinary shares.

3.23. Share Capital

Shares are classified as equity when there is no obligation to transfer cash or other assets to the holder. Transaction costs directly attributable to the issue of equity instruments are shown in equity as a deduction from the proceeds, net of tax.

3.24. Segment Reporting

Segment results that are reported to the Chief Operating Decision Maker ("CODM") include items directly attributable to a segment as well as those that can be allocated on a reasonable basis. Unallocated items comprise mainly corporate assets (primarily the Company's headquarters), certain head office expenses, share of joint ventures, investment income on shareholders' funds and income tax assets and liabilities.

3.25. Restatement of Comparatives

Certain comparative amounts have been reclassified to conform to current year presentation in this consolidated financial report. This relates to:

- ▶ a reclassification between other underwriting expenses and other administration expenses in Note 7 – Expenses and agency commission and fee revenue in Note 6 – Revenue. This has had nil impact in the Statements of Comprehensive Income; and
- ▶ a restatement of 2011 balances in Note 13, 15 and 23 to reflect the inclusion of the Mansions Trust accounts.

NOTE 4 STANDARDS AND INTERPRETATIONS NOT YET ADOPTED

A number of new standards, amendments to standards and interpretations are effective for annual periods beginning after 1 January 2013 and have not been applied in preparing this consolidated financial report. None of these is expected to have a significant effect on the consolidated financial report of the Group. Those which may be relevant to the Company are set below. The Company does not plan to adopt these standards early.

| TITLE | DESCRIPTION | OPERATIVE DATE | NOTE |
|--------------|--|----------------|------|
| AASB 9 | Financial instruments | 1 January 2013 | A |
| AASB 10 | Consolidated financial statements | 1 January 2013 | A |
| AASB 11 | Joint arrangements | 1 January 2013 | A |
| AASB 12 | Disclosure of interests in other entities | | |
| AASB 13 | Fair value measurement | 1 January 2013 | A |
| AASB 119 | Employee benefits | 1 January 2013 | A |
| AASB 128 | Investments in Associates and Joint Ventures | 1 January 2013 | A |
| AASB 2009-11 | Amendments to Australian Accounting Standards arising from AASB 9 | 1 January 2013 | C |
| AASB 2010-7 | Amendments to Australian Accounting Standards arising from AASB 9 (December 2010) | 1 January 2013 | C |
| AASB 2010-8 | Amendments to Australian Accounting Standards - Deferred Tax: Recovery of Underlying Assets | 1 January 2013 | A |
| AASB 2011-4 | Amendments to Australian Accounting Standards to Remove Individual Key Management Personnel Disclosures Requirements | 1 January 2013 | B |
| AASB 2011-7 | Amendments to Australian Accounting Standards arising from the Consolidation and Joint Arrangements Standards | 1 January 2013 | A |
| AASB 2011-8 | Amendments to Australian Accounting Standards arising from AASB 13 | 1 January 2013 | A |
| AASB 2011-9 | Amendments to Australian Accounting Standards - Presentation of Items of Other Comprehensive Income | 1 January 2013 | A |
| AASB 2011-10 | Amendments to Australian Accounting Standards arising from AASB 119 | 1 January 2013 | A |

A. These changes are not expected to have a significant, if any, financial impact.

B. These changes will only impact disclosures when preparing the annual financial report.

C. This standard gives effect to consequential changes arising from the issuance of AASB 9.
This standard is required to be adopted in the same reporting period when AASB 9 is adopted.

NOTE 5 GROUP RISK MANAGEMENT

Risk Management Framework (“RMF”)

The Group’s RMF is embedded at the Board level and in each of the functional areas. This structure recognises that effective risk management is critical in order for the Group to meet its strategic and operational goals.

The RMF, based on ISO 31000, provides reasonable assurance that the material risks in the business are being prudently and soundly managed. The Board understands that all business activity entails varying degrees of risk. The focus of the RMF is to provide a framework to assess the exposure and impact of the risk and then appropriately control or avoid it, in accordance with the Group’s defined risk appetite.

The RMF is underpinned by the Risk Management Strategy (“RMS”) and the Reinsurance Management Strategy (“REMS”), both of which are reviewed annually by the Board. Once approved by the Board, both documents are submitted to the Australian Prudential Regulation Authority (“APRA”).

The RMF details the layers of managerial responsibility, risk management related policies and the key processes used to identify, assess, monitor, report on and mitigate all material risks likely to impact on the operations of the Group. The Board has delegated its authority for the oversight of the RMF to the Risk Management Committee. In turn, the Risk Management Committee works closely with the dedicated risk management function to ensure that the RMF remains appropriate and effective. The Risk Management Committee is charged with overall accountability for the RMF and risk management capability.

Additionally, the Calliden Executive Team (“CET”) provides executive oversight and direction setting across the Group, taking risk considerations into account. A member of the risk management function attends business unit meetings on a regular basis, and the findings are used in the quarterly report to the Risk Management Committee.

The key risks addressed by the RMF are discussed below:

5.1. Insurance Risk

Insurance risk is the risk of financial loss and the inability to meet liabilities due to inadequate or inappropriate insurance product design, pricing, underwriting, concentration risk, reserving, claims management and/or reinsurance management.

5.1.1. UNDERWRITING RISK

For all policies, the Group retains ultimate responsibility for:

- › Acceptance criteria and process;
- › Pricing;
- › Product wordings;
- › Portfolio management; and
- › Monitoring of underwriting performance.

The Group uses Authorised Representatives and brokers acting under a binder as an important part of its distribution model. The Group does not permit these parties to apply acceptance criteria or make decision as to pricing. Group underwriting guidelines include authorities, limits, risk assessment and selection criteria.

Underwriting procedures are reviewed regularly, particularly when changes occur in the internal or external environment. Compliance with the procedures is subject to underwriting audits, peer reviews, and internal audit.

5.1.1.1. PERSONAL LINES

Personal Lines is characterised by homogeneous products. The Group is generally a price taker and therefore reactionary to industry price movements. In addition, these lines are subject to the risk of environmental and economic disasters which will have a negative effect on claims. These risks are managed via active portfolio and aggregate management.

5.1.1.2. COMMERCIAL LINES

Risks in this class concern ensuring the Group restrains its exposures within the gross acceptance limits of the relevant reinsurance treaties, and reducing exposure to higher hazards.

Builders warranty products are a statutory class of insurance in most jurisdictions, and this class is heavily influenced by the regulators in each state. The marketability of this product is directly tied with the market for new homes and renovations, and as such is greatly influenced by economic factors.

The Group Agency division undertakes underwriting services for a number of classes via electronic and manual mechanisms. These products tend to be homogeneous in nature, and therefore the Group’s risks in this space concern maximising customer service and convenience, whilst remaining cost competitive.

5.1.2. INSURANCE RISK MITIGATION

The principal risk associated with any insurance contract is the possibility of the insured event occurring, and the uncertainty of the amount of the resulting claim. To mitigate the impact of insurance risk the Group has the following key policies and procedures in place:

5.1.2.1. SELECTION AND PRICING OF RISK

Pricing risk relates to the risk of assigning an insurance premium at a price too low to cover all risks associated with the type of cover sought. The Group has in place the following controls to manage this risk:

- › Underwriting authority is delegated to experienced underwriters following a detailed analysis of each class of business being manufactured by the Group;
- › Implementation and annual review of underwriting guidelines and criteria covering the classes of product the Group is authorised to manufacture;
- › Maximum limits are set for the acceptance of risk on an individual contact basis, for classes of business and across the portfolio with particular attention paid to geographic exposure, industry segment and the Group risk appetite;
- › Management information systems are used to provide reliable and accurate data about the various risks being underwritten;
- › In-house pricing models are formulated and monitored by the actuarial team using historical pricing and statistical data, as well as claims analysis for each portfolio. Economic data and industry information is gathered to ensure underwriters are aware of current developments and prevailing conditions in the markets being underwritten, and the expected future trends facing those markets;
- › Pricing for new schemes is thoroughly reviewed during the inception year, then regularly thereafter; and
- › Portfolio reporting indicators such as loss ratio development highlight specific portfolios that require pricing review.

5.1.2.2. CLAIMS RISK

Full details of the Group's claims approach are contained within the Claims Manual. These procedures are periodically reviewed by Management. Compliance with the procedures is subject to regular internal audit.

Calliden seeks to ensure the adequacy of its reserving and effective claims management through the use of the following controls:

- › Experienced claims officers are used to assess claims and determine case strategies. Where necessary, they are assisted by external subject-matter experts. It is Group policy to respond to and resolve genuine claims as quickly as possible, in accordance with the provisions of the policy;
- › Claims reserves are established using actuarial valuations and are informed by local knowledge from actuaries, underwriters and specialist advisors. Actuaries provide an independent assessment of the provision, and this is reviewed by the Appointed Actuary at least semi-annually; and
- › The risk of the liability being inadequate is monitored by way of half-yearly actuarial valuation and mitigated by the inclusion of a risk margin to increase the probability of adequacy of the reserves to the greater of 75%, and the central estimate plus one half of a standard deviations above the mean, as required by APRA's GPS 320 Actuarial and Related Matters.

5.1.2.3. PRODUCT RISK

The Board has delegated product development to the Group Executive, Services and the CEO. A process has been put into place to ensure appropriate underwriting, legal and reinsurance reviews and approvals are undertaken prior to release of a product.

There has been a shift away from developing specific products for new schemes and therefore the quantity of new products is reducing. The terms and conditions of insurance contracts written are entered into using a standard form basis. There are no specific contract terms and conditions that are expected to have a material impact on this financial report. The Group develops contract terms that are specific to each product written.

5.1.2.4. CONCENTRATION RISK

Concentration exposure is monitored on a regular basis, ensuring the portfolio is sufficiently diversified such that there is no undue concentration by risk class or by industry. The Group also writes business across broad geographical regions within Australia. Regular reviews are undertaken to gauge the Group's geographic accumulation exposure. Catastrophe reinsurance is purchased to ensure that any accumulation of losses from one area is protected.

Concentration risk is particularly relevant on the occurrence of a catastrophic event. Typically these are weather related but can also be man-made such as industrial accidents and infrastructure collapse.

The nature and level of catastrophes in any one year cannot be accurately anticipated but Calliden uses predictive modelling in conjunction with its reinsurance broker to manage its exposure.

5.1.2.5. REINSURANCE RISK

Management is required to develop, implement and maintain an appropriate REMS to safeguard the on-going viability of the Group, including its capacity to meet obligations to policyholders. The REMS details the Maximum Event Retention ("MER") exposures by class and for the Group as a whole. These have been approved by the Board.

The total programme is designed to maintain the Group's ability to satisfy the capital adequacy requirements of Prudential Standard GPS 110. This approach is detailed in the REMS.

Reinsurance (including Quota Share and Excess of Loss) is used to limit the Group's exposure to individual claims and catastrophes. The Group risk appetite guides reinsurance purchases.

Some of the reinsurers used are domiciled outside of the jurisdictions in which the Group operates, and so there is the potential for additional risk such as country risk and transfer risk.

Notes to the Consolidated Financial Report Continued

NOTE 5 GROUP RISK MANAGEMENT Continued

5.1.2.6. REINSURANCE COUNTERPARTY RISK

The Group reinsurance programme is spread across major reinsurance markets and reinsurers to avoid over-dependency upon any one market and to generate competition.

The Group has clearly defined credit policies for the approval and management of credit risk in relation to reinsurers. The Group monitors the financial condition of its reinsurers on an on-going basis using rating information available in the public domain or from reinsurance brokers.

It is Group policy to only deal with reinsurers with credit ratings of at least A- as determined by Standard & Poor's ("S&P"), unless approved by the Board. Where the credit rating of a reinsurer falls below the required quality during the period of risk, a contractual right to replace the counterparty exists.

Reinsurance protection with strongly rated reinsurers benefits the Group in its regulatory capital requirements. Risk charges vary with the grade of reinsurers, such that higher credit quality reinsurance counterparties incur lower APRA regulatory capital charges.

In order to reduce concentrations of credit risk, Calliden seeks to limit exposure to any single reinsurer, or group of related reinsurers, when purchasing reinsurance protection. Calliden uses collateral arrangements or letters of credit to guarantee the recoverability of the assets from non-APRA-authorised reinsurers. The collateral is required when there is a recoverable outstanding at the second balance date of the treaty after the date the loss occurred.

The Group transacts with a large number of reinsurers in various regions without any individual counterparty having a material outstanding balance other than the trading balance with Munich Reinsurance Group – Australian Branch ("Munich Re") as a quota share reinsurer. Calliden's relationship with Munich Re results in an exposure for concentration within its reinsurance recoveries and protection. To manage this specific concentration risk, Calliden has a policy to limit Munich Re participation elsewhere on the treaty Excess of Loss program. Furthermore, the credit position of Munich Re is actively monitored, as are the claims settlements to ensure consistency with the provisions set out under the quota share treaty. The Board considers that the benefits generated from the strategic partnership with Munich Re, which includes significant and flexible capital support, reinsurance expertise and business support, warrants the consequent concentration risk.

The following table provides information regarding the credit risk exposure of the Group to the reinsurance recoveries receivable on outstanding claims balances, based on S&P's counterparty credit ratings.

These recoveries are not due until the original gross claim is paid by the Group to the insured however, the credit rating of the reinsurers is extremely important both from a balance sheet strength position and from an APRA capital charge perspective.

| REINSURANCE RECOVERIES | | | CONSOLIDATED | |
|----------------------------|---------------|------------|---------------|------------|
| | 2012 | | 2011 | |
| Counterparty credit rating | \$'000 | % | \$'000 | % |
| AAA | 100 | - | 1,873 | 2 |
| AA | 66,894 | 97 | 71,429 | 88 |
| A | 2,305 | 3 | 7,895 | 10 |
| Non-rated | 70 | - | 137 | - |
| Total | 69,369 | 100 | 81,334 | 100 |

No separate provision for impairment has been recognised for the reinsurance recoveries on outstanding claims balances.

5.2. Investment Risk

Details of the various investment risks relevant to the Group and risk mitigation measures are contained within the Investment Policy and Strategy, which governs Group investment decisions.

5.2.1. LIQUIDITY RISK

To ensure payments are made when they fall due, investment portfolio mandates provide sufficient cash deposits to meet day-to-day obligations; investment funds can be realised to meet significant claims payment obligations; and in the event of a catastrophe, immediate cash access is available under the terms of reinsurance arrangements.

A maturity analysis of the Group's investments by contractual maturity is provided in the following table along with maturity analysis of the estimated net discounted outstanding claims liability based on the remaining term to payment at the reporting date.

This maturity profile is a key tool used in the investment of assets backing insurance liabilities in accordance with the policy of matching the maturity profile of the assets with the estimated pattern of claims payments.

| | NET DISCOUNTED OUTSTANDING CLAIMS LIABILITY | | CONSOLIDATED INVESTMENTS ⁽¹⁾ | |
|------------------------------|--|----------------|--|----------------|
| | 2012 \$'000 | 2011 \$'000 | 2012 \$'000 | 2011 \$'000 |
| Maturity | | | | |
| Within 1 year or less | 20,273 | 38,412 | 10,000 | 60,000 |
| Within 1 to 2 years | 15,902 | 14,828 | 10,000 | 10,000 |
| Within 2 to 3 years | 10,259 | 9,566 | 15,000 | 5,000 |
| Within 3 to 4 years | 7,178 | 6,693 | 10,000 | - |
| Within 4 to 5 years | 4,491 | 4,188 | 25,000 | 5,000 |
| Over 5 years | 6,053 | 5,644 | - | - |
| Total | 64,156 | 79,331 | 70,000 | 80,000 |

(1) Additionally, the Group held \$24.5m in cash at call as at 31 December 2012 (2011: \$42.1m).

5.2.1.2. MARKET (PRICE) RISK

Market risk is the risk of loss arising from unfavourable movements in interest rates, equity prices or foreign exchange rates. The Group's interest rate exposure is limited to the on-going valuation of insurance liabilities which are discounted and the risk that new or renewed investments need to be made at different interest rates. The Group has no exposure to investment price or currency risks.

5.2.1.3. COUNTERPARTY RISK

The investment exposure to any individual entity is limited by entity-specific and Group exposure limits.

The following table provides information regarding the credit risk exposure of the Group to the investments based on S&P's counterparty credit ratings.

| INVESTMENTS ⁽¹⁾ | CONSOLIDATED | | | |
|----------------------------|---------------|------------|--------|-----|
| | 2012 | | 2011 | |
| Counterparty credit rating | \$'000 | % | \$'000 | % |
| AA | 30,000 | 43 | 50,000 | 63 |
| A | 35,000 | 50 | 30,000 | 37 |
| BBB | 5,000 | 7 | - | - |
| Total | 70,000 | 100 | 80,000 | 100 |

(1) Additionally, the Group held \$24.5m in cash at call which was rated AA as at 31 December 2012 (2011: \$42.1m).

5.2.1.4. DERIVATIVES

All derivative transactions must be approved in advance by the Board, or must comply with the guidelines stipulated in the Investment Policy and Strategy. The Group had no exposure to derivatives in 2012 (2011: nil).

5.2.2. ASSET QUALITY

The asset base is protected through compliance with the Investment Policy and Strategy, the tight control of credit and effective collection practices; and the use of insurance and risk management strategies for physical assets.

Notes to the Consolidated Financial Report Continued

NOTE 5 GROUP RISK MANAGEMENT Continued

5.2.3. CREDIT RISK

The Group's credit risk arises predominantly from investments, premium receivables and reinsurance recoveries.

Non or short-payment of premium results in the cancellation of the insurance contract with the policyholder, eliminating both the credit risk and insurance risk for the unpaid balance.

| | NOT YET DUE \$'000 | LESS THAN 1 YEAR \$'000 | GREATER THAN 1 YEAR \$'000 | PAST DUE AND IMPAIRED \$'000 | TOTAL \$'000 |
|---------------------------------|--------------------------|-------------------------------|----------------------------------|------------------------------------|-----------------|
| Consolidated | | | | | |
| 2012 | | | | | |
| Premium receivable | 20,647 | 16,154 | 10 | 100 | 36,911 |
| Provision for impairment | - | - | - | (100) | (100) |
| Net balance | 20,647 | 16,154 | 10 | - | 36,811 |
| 2011 | | | | | |
| Premium receivable | 50,961 | 6,490 | 297 | 269 | 58,017 |
| Provision for impairment | - | - | - | (269) | (269) |
| Net balance | 50,961 | 6,490 | 297 | - | 57,748 |

Investments are held in accordance with the credit framework set out in the Investment Policy and Strategy.

5.3. Operational Risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. In addition to financial loss, a failure in controls can result in reputational damage, regulatory supervision and personal injury.

Operational risks are identified and assessed on an on-going basis by Management and staff. The internal audit function also monitors processes and procedures surrounding operational risk. The following controls are used to manage operational loss:

- ▶ Key risks to the Group are identified, assessed and treated;
- ▶ Risks within Calliden are assessed against the Group risk appetite and active management of any excess risk is assigned to a responsible person, together with the development of a time bound action plan;
- ▶ Staff with industry expertise and/or specialist qualifications are employed and charged with the responsibility for implementing the RMF within their functional areas; and
- ▶ Delegated authorities are based on expertise and proven performance with compliance closely monitored.

5.3.1. OUTSOURCING RISK

Outsourcing is an important part of the Group business model and recognises that the reliance on outsourcing agreements to achieve business objectives gives rise to substantial risks. An Outsourcing Policy has been developed which complies with APRA CPS 231 Outsourcing.

All business units are required to comply with the Outsourcing Policy when outsourcing any material business activities to commercial service providers and insurance intermediaries. The policy specifies the minimum requirements for all outsourcing agreements. A requirement is that all material outsourced service providers also have in place an adequate risk management framework of their own.

The Board and Management recognise that material outsourced business activities remain the responsibility of the Board.

The Group's primary outsourced service provider is Innovation Group, a global provider of business process services and software solutions. Innovation Group plc predominantly manage personal lines claims on behalf of the Group.

5.3.2. BUSINESS CONTINUITY RISK

The Board acknowledges that critical events may occur that are beyond the control of the Group, but which may potentially have catastrophic effects on its ability to reach business objectives.

The Group manages these risks through a combination of strategies. Adequate insurance is undertaken to reduce financial loss and a system of crisis identification and management has been adopted.

Procedures are in place to determine the most appropriate course of action in response to a potential crisis event. The Business Continuity Plan describes how the Group aims to ensure the on-going operation of its critical business functions and the Disaster Recovery Plan describes how the Group will ensure the recovery of business operations following a crisis event. This is tested annually.

NOTE 6 REVENUE

| | CONSOLIDATED | | COMPANY | |
|--|----------------|----------------|----------------|----------------|
| | 2012 \$'000 | 2011 \$'000 | 2012 \$'000 | 2011 \$'000 |
| (i) General insurance revenue | | | | |
| Gross written premium | 172,000 | 245,653 | - | - |
| Movement in unearned premium liability | 46,847 | (21,661) | - | - |
| Gross premium revenue | 218,847 | 223,992 | - | - |
| Reinsurance and other recoveries revenue | 83,414 | 107,192 | - | - |
| Reinsurance commission revenue | 44,041 | 30,734 | - | - |
| Fee revenue | 1,357 | 1,104 | - | - |
| Total general insurance revenue | 347,659 | 363,022 | - | - |
| (ii) Agency commission and fee revenue | | | | |
| Agency commission revenue | 19,689 | 8,549 | - | - |
| Movement in unearned agency commission | (1,252) | - | - | - |
| Net agency commission revenue | 18,437 | 8,549 | - | - |
| Agency fee revenue | 271 | 271 | - | - |
| Total agency commission and fee revenue | 18,708 | 8,820 | - | - |
| (iii) Investment income | | | | |
| Interest revenue | 5,672 | 6,757 | 26 | 88 |
| Total investment revenue | 5,672 | 6,757 | 26 | 88 |
| Realised net losses on investments | - | (86) | - | - |
| Total investment income | 5,672 | 6,671 | 26 | 88 |
| (iv) Share of net profit of joint ventures | 253 | 1,274 | 30 | 1,050 |
| Total share of net profit of joint ventures | 253 | 1,274 | 30 | 1,050 |
| (v) Other (expense) / revenue | | | | |
| Management fee revenue | - | - | 38,765 | 42,645 |
| Gains on sale of joint ventures | 58 | 8,169 | 58 | 8,808 |
| Other (expense) / revenue | (100) | 159 | - | 103 |
| Total other (expense) / revenue | (42) | 8,328 | 38,823 | 51,556 |
| Total revenue | 372,250 | 388,115 | 38,879 | 52,694 |

NOTE 7 EXPENSES

| | CONSOLIDATED | | COMPANY | |
|--|---------------------|---------------|----------------|---------------|
| | 2012 | 2011 | 2012 | 2011 |
| | \$'000 | \$'000 | \$'000 | \$'000 |
| Profit / (loss) before income tax includes the following specific expenses: | | | | |
| Gross claims expense | 123,375 | 192,923 | - | - |
| Reinsurance premium expense | 139,539 | 97,916 | - | - |
| Acquisition costs - insurance | 55,948 | 62,182 | - | - |
| Acquisition costs - agency | 10,881 | 3,990 | - | - |
| Other underwriting expenses | 9,658 | 12,051 | - | - |
| Levies and charges | 18,921 | 19,726 | - | - |
| Borrowing costs | - | 343 | - | 343 |
| Administration and other expenses ⁽¹⁾: | | | | |
| Defined contribution superannuation expense | 1,519 | 1,582 | 1,519 | 1,582 |
| Depreciation expense | 277 | 407 | 277 | 407 |
| Amortisation expense - systems development costs | 2,879 | 2,619 | 2,879 | 2,619 |
| Amortisation expense - customer relationships | 1,466 | 1,336 | 1,466 | 144 |
| Other agency expenses | 6,698 | 3,289 | 35,514 | 39,848 |
| Total expenses | 371,161 | 398,364 | 41,655 | 44,943 |

(1) All administration expenses are initially incurred by the Company and recharged to other Group entities. Direct administration expenses and a share of corporate overheads are recharged at cost based on estimates of time incurred and an analysis of actual expenditure.

NOTE 8 NET CLAIMS EXPENSE

Current year claims relate to claim events that occurred in the current financial year. Prior year claims relate to a reassessment of the claim events that occurred in all previous financial periods.

| | 2012 | | | 2011 | | |
|---|---------------------|--------------------|-----------------|---------------------|--------------------|---------------|
| | CURRENT YEAR | PRIOR YEARS | TOTAL | CURRENT YEAR | PRIOR YEARS | TOTAL |
| | \$'000 | \$'000 | \$'000 | \$'000 | \$'000 | \$'000 |
| Consolidated | | | | | | |
| Gross claims incurred - undiscounted | 124,279 | (2,759) | 121,520 | 191,812 | (2,602) | 189,210 |
| Impact of discounting | (2,108) | 3,963 | 1,855 | (2,789) | 6,502 | 3,713 |
| Gross claims incurred - discounted | 122,171 | 1,204 | 123,375 | 189,023 | 3,900 | 192,923 |
| Reinsurance and other recoveries - undiscounted | (83,487) | 831 | (82,656) | (106,242) | 1,058 | (105,184) |
| Impact of discounting | 1,393 | (2,151) | (758) | 1,023 | (3,031) | (2,008) |
| Reinsurance and other recoveries - discounted | (82,094) | (1,320) | (83,414) | (105,219) | (1,973) | (107,192) |
| Net claims expense | 40,077 | (116) | 39,961 | 83,804 | 1,927 | 85,731 |

NOTE 9 INCOME TAX

9.1. Composition

| | CONSOLIDATED | | COMPANY | |
|---------------------------|----------------|----------------|----------------|----------------|
| | 2012 \$'000 | 2011 \$'000 | 2012 \$'000 | 2011 \$'000 |
| Current tax expense | - | - | - | - |
| Deferred tax expense | - | - | - | - |
| Income tax expense | - | - | - | - |

9.2. Income Tax Reconciliation

| | CONSOLIDATED | | COMPANY | |
|---|----------------|----------------|----------------|----------------|
| | 2012 \$'000 | 2011 \$'000 | 2012 \$'000 | 2011 \$'000 |
| The income tax for the year differs from the amount calculated on the profit / (loss) before income tax. The differences are reconciled as follows: | | | | |
| Profit / (loss) for the year before income tax | 1,089 | (10,248) | (2,776) | 7,751 |
| Income tax calculated at 30% (2011: 30%) | 327 | (3,074) | (833) | 2,325 |
| Amounts which are not deductible /(taxable) in calculating taxable income: | | | | |
| - Net non-deductible / assessable items | 596 | 1,502 | 191 | 80 |
| - Tax losses (recouped) / not recognised as a deferred tax asset | (923) | 1,572 | 642 | (2,405) |
| Income tax expense applicable to current year | - | - | - | - |

9.3. Deferred Tax Asset Recognised

A deferred tax asset of \$3.8m (2011: \$3.8m) (refer to Note 18) has been recognised as carried forward tax losses. This represents the balance that the Directors believe is probable of being recovered.

9.4. Tax Losses

| | CONSOLIDATED | | COMPANY | |
|---|----------------|----------------|----------------|----------------|
| | 2012 \$'000 | 2011 \$'000 | 2012 \$'000 | 2011 \$'000 |
| Unused tax losses for which no deferred tax asset has been recognised | 229,385 | 226,676 | 229,385 | 226,676 |
| Potential tax benefit @ 30% | 68,815 | 68,003 | 68,815 | 68,003 |

These potential future income tax benefits for tax losses and other temporary differences will only be obtained if:

- ▶ The Group derives future assessable income of a nature and of an amount sufficient to enable the benefit to be realised in accordance with Division 166 of the *Income Tax Assessment Act 1997*;
- ▶ The Group continues to comply with the conditions for deductibility imposed by the law; specifically the continuity of ownership and same business tests; and
- ▶ No changes in tax legislation adversely affect the Group in realising the benefit.

NOTE 10 SEGMENT REPORTING

Operating segments are identified by the Consolidated entity based on separate discrete internal financial information which is reported and reviewed on a monthly basis by the Chief Executive Officer and his immediate executive team, representing Calliden's Chief Operating Decision Maker ("CODM") in assessing performance and in determining the allocation of resources.

10.1. Operating Segments

The Consolidated entity operates in the Australian general insurance intermediated market which includes brokers and Authorised Representatives, small businesses and householders. The financial results are generated from three different segments - being Underwriting, Agency and Corporate.

The operating segments are identified by Management based on the activity undertaken, being:

- ▶ The underwriting of general insurance and the investment of policyholders' funds;
- ▶ Acting as an agent for external capital providers; and
- ▶ The investment of shareholders' funds and corporate activities including investing in insurance related joint ventures.

The reportable segments are based on aggregated operating segments as these are the source of the Consolidated entity's major risks and have the most effect on the rates of return.

The reportable segments comprise the following:

10.1.1. UNDERWRITING

This segment comprises underwriting general insurance products through our APRA authorised insurer Calliden Insurance Limited ("CIL") being sold through a network of brokers, agents, Authorised Representatives and distribution partners.

10.1.2. AGENCY

This segment comprises CIL and Mansions of Australia Limited acting as Managing General Agent ("MGA") for four portfolios of general insurance business. These include acting as an agent on behalf of Lloyd's of London ("Lloyd's"), Great Lakes Australia ("GLA") and the NSW Government in respect of the underwriting of high value homes, Business Package and Builders Warranty respectively.

10.1.3. CORPORATE AND OTHER

This segment comprises other activities, including corporate services, the investment in two joint ventures and investment of shareholders' funds.

While profit and loss information is reviewed by the CODM at both an operating segment and entity level, assets and liabilities information are reviewed by the CODM at business entity level.

Segment results presented are measured on a consistent basis to how they are reported to the CODM:

- ▶ Revenues and expenses occurring between segments are subject to contractual agreements between the legal entities comprising each segment.
- ▶ Inter-segment transactions which are eliminated on consolidation are reported on a gross basis except for operating expenses incurred by the Corporate segment on behalf of the other two segments. These are recharged on a cost-recovery basis and are presented on a net basis in the segments.
- ▶ Depreciation and amortisation expense relating to the Corporate segment's property, plant and equipment and non-business combinations acquired intangible assets are allocated to other segments based on their utilisation.
- ▶ Goodwill is allocated to each operating segment on a consistent basis to goodwill impairment testing (Note 22).

There are no differences between the recognition and measurement criteria used in the segment disclosures and those used in this financial report.

| | CONSOLIDATED | | | |
|---|------------------------|-------------------|---------------------|--------------------|
| | GENERAL INSURANCE | | | |
| Business area operating segments | UNDERWRITING \$'000 | AGENCY \$'000 | CORPORATE \$'000 | TOTAL \$'000 |
| 2012 | | | | |
| Gross written premium ⁽¹⁾ | 172,000 | 52,478 | - | 224,478 |
| Gross premium revenue | 218,847 | - | - | 218,847 |
| Reinsurance premium expense | (139,539) | - | - | (139,539) |
| Net premium revenue | 79,308 | - | - | 79,308 |
| Commission and fee income | - | 18,708 | - | 18,708 |
| Net claims expense | (39,961) | - | - | (39,961) |
| Net acquisition costs | (10,550) | (10,881) | - | (21,431) |
| Operating expenses | (28,579) | (6,698) | - | (35,277) |
| Profit / (loss) | 218 | 1,129 | - | 1,347 |
| Investment income on assets backing insurance liabilities | 5,247 | - | - | 5,247 |
| Depreciation and amortisation expense | - | - | (4,622) | (4,622) |
| Share of net profit of joint ventures | - | - | 253 | 253 |
| Investment income on shareholders' funds | 160 | 240 | 25 | 425 |
| Gains on sale of joint ventures | - | - | 58 | 58 |
| Other expenses | - | - | (100) | (100) |
| Administration and other expenses | - | - | (1,519) | (1,519) |
| Profit / (loss) before income tax | 5,625 | 1,369 | (5,905) | 1,089 |
| Income tax expense | - | - | - | - |
| Profit / (loss) after income tax | 5,625 | 1,369 | (5,905) | 1,089 |
| Reportable segment assets | 339,845 | 20,989 | - | 360,834 |
| Equity accounted investees | - | - | 603 | 603 |
| Reportable segment liabilities | (244,441) | (20,542) | - | (264,983) |

[1] Agency GWP is not earned by the Group and is exclusive of any Fire Services Levy.

Notes to the Consolidated Financial Report Continued

NOTE 10 SEGMENT REPORTING Continued

| Business area operating segments | GENERAL INSURANCE | | | CONSOLIDATED |
|---|------------------------|------------------|---------------------|-----------------|
| | UNDERWRITING \$'000 | AGENCY \$'000 | CORPORATE \$'000 | TOTAL \$'000 |
| 2011 | | | | |
| Gross written premium ⁽¹⁾ | 245,653 | 22,697 | - | 268,350 |
| Gross premium revenue | 223,992 | - | - | 223,992 |
| Reinsurance premium expense | (97,916) | - | - | (97,916) |
| Net premium revenue | 126,076 | - | - | 126,076 |
| Commission and fee income | - | 8,820 | - | 8,820 |
| Net claims expense | (85,731) | - | - | (85,731) |
| Net acquisition costs | (30,344) | (3,990) | - | (34,334) |
| Operating expenses | (31,777) | (3,289) | - | (35,066) |
| Profit / (loss) | (21,776) | 1,541 | - | (20,235) |
| Investment income on assets backing insurance liabilities | 6,278 | - | - | 6,278 |
| Depreciation and amortisation expense | - | - | (4,362) | (4,362) |
| Share of net profit of joint ventures | - | - | 1,274 | 1,274 |
| Investment income on shareholders' funds | 162 | - | 231 | 393 |
| Gains on sale of joint ventures | - | - | 8,169 | 8,169 |
| Other revenue / (expense) | - | - | 159 | 159 |
| Administration and other expenses | - | - | (1,581) | (1,581) |
| Borrowing costs | - | - | (343) | (343) |
| Profit / (loss) before income tax | (15,336) | 1,541 | 3,547 | (10,248) |
| Income tax expense | - | - | - | - |
| Profit / (loss) after income tax | (15,336) | 1,541 | 3,547 | (10,248) |
| Reportable segment assets | 421,227 | 4,734 | - | 425,961 |
| Equity accounted investees | - | - | 381 | 381 |
| Reportable segment liabilities | (336,329) | 4,819 | - | (331,510) |

(1) Agency GWP is not earned by the Group and is exclusive of any Fire Services Levy.

10.2. Geographical Segments

The Group operates in one geographical segment being Australia.

10.3. Major Customers

Revenues from one customer of the Group's underwriting segment represents approximately \$73.0m (2011: \$80.4m) of the Group's total revenues.

NOTE 11 DIVIDENDS

11.1. Ordinary Shares

| | CENTS PER SHARE | TOTAL AMOUNT \$'000 | PAYMENT DATE | TAX RATE FOR FRANKING CREDIT | PERCENTAGE FRANKED |
|---------------|--------------------|---------------------------|-----------------|------------------------------------|-----------------------|
| 2012 | | | | | |
| Dividend paid | - | - | - | - | - |
| | | - | | | |
| 2011 | | | | | |
| Dividend paid | 1.0 | 2,271 | 25 March 2011 | 30% | 100% |
| | | 2,271 | | | |

In accordance with the relevant accounting policy (refer to Note 3.21) a dividend is accrued when it is determined to be paid and so the dividends for a period are generally recognised and measured in that financial reporting period to which the dividend relates.

11.2. Dividends not Recognised at Reporting Date

Since year end the Directors have declared a dividend of 0.4 cents per fully paid ordinary share (2012: nil) fully franked based on tax paid at 30%. The aggregate amount of the proposed dividend expected to be paid on 28 March 2013 out of retained earnings at 31 December 2012, but not recognised as a liability at year end is \$0.9m (2012: nil).

11.3. Dividend Franking Account

Any franked portion of the final dividends recommended after 31 December 2012 will be franked out of existing franking credits.

| | 2012 \$'000 | 2011 \$'000 |
|--|----------------|----------------|
| Franking credits available for subsequent years based on a tax rate of 30% (2011: 30%) | 26,699 | 26,686 |

The balance of the franking account arises from:

- Income tax paid, after adjusting for any franking credits which will arise from the payment of income tax provided for in this financial report;
- Franking debits that will arise from the payment of dividends recognised as a liability at the reporting date; and
- Franking credits that will arise from the receipt of dividends recognised as receivables at the reporting date.

The impacts on the franking account of the dividend but not recognised as a liability at year end, will be a reduction in the franking account of \$0.4m (2012: nil).

NOTE 12 EARNINGS PER SHARE

| | CONSOLIDATED | |
|--|----------------|----------------|
| | 2012 Cents | 2011 Cents |
| 12.1 Reporting Period Values | | |
| Basic earnings per ordinary share | 0.48 | (4.52) |
| Diluted earnings per ordinary share | 0.48 | (4.52) |
| | 2012 \$'000 | 2011 \$'000 |
| 12.2 Reconciliation of Earnings used in Calculating Earnings Per Share | | |
| Profit / (loss) for the year | 1,089 | (10,248) |
| Profit / (loss) attributable to equity holders of the Parent which is used in calculating basic and diluted earnings per share | 1,089 | (10,248) |

NOTE 12 EARNINGS PER SHARE Continued

| | 2012 NUMBER | 2011 NUMBER |
|--|----------------|----------------|
| 12.3 Reconciliation Weighted Average Number of Ordinary Shares used in Calculating Earnings Per Share | | |
| Ordinary shares on issue | 226,683,914 | 226,683,914 |
| Treasury shares held in trust | (5,407) | (5,407) |
| Weighted average number of ordinary shares used in the calculation of basic earnings per share | 226,678,507 | 226,678,507 |
| Unvested share-based remuneration rights supported by treasury shares held in trust | 5,407 | 5,407 |
| Weighted average number of ordinary shares used as the denominator in calculating diluted earnings per share | 226,683,914 | 226,683,914 |

The Company acquires any shares required for the Long-Term Incentive Scheme ("LTI") on-market which does not increase the shares on issue. The presentation of the performance rights as an increase of shares on issue is mandated by the Accounting Standards.

NOTE 13 NOTES TO THE STATEMENTS OF CASH FLOWS

13.1. Composition

| | CONSOLIDATED | | COMPANY | |
|--|----------------|----------------|----------------|----------------|
| | 2012 \$'000 | 2011 \$'000 | 2012 \$'000 | 2011 \$'000 |
| Cash held for operational purposes | 19,131 | 40,140 | 269 | 69 |
| Trust accounts ⁽¹⁾ | 5,373 | 1,981 | - | - |
| Total cash and cash equivalents | 24,504 | 42,121 | 269 | 69 |

(1) Cash held on behalf of other insurers.

Cash and cash equivalents represent cash on hand and held with banks and deposits at call readily convertible to cash. There are no cash balances held that are not available for use in normal operations.

13.2. Significant Risks

The net carrying amount of cash and cash equivalents represents the maximum exposure to credit risk relevant to cash and cash equivalents at reporting date and is equivalent to the fair value of the assets because of the negligible credit risk.

13.3. Reconciliation of Profit / (Loss) for the Year to Net Cash Flows from Operating Activities

| | CONSOLIDATED | | COMPANY | |
|---|-----------------|-----------------|----------------|----------------|
| | 2012 \$'000 | 2011 \$'000 | 2012 \$'000 | 2011 \$'000 |
| Profit / (loss) for the year | 1,089 | (10,248) | (2,776) | 7,751 |
| i. Non-cash items | | | | |
| Depreciation of property, plant and equipment | 277 | 407 | 277 | 407 |
| Amortisation of intangible assets | 4,345 | 3,955 | 2,999 | 2,763 |
| Share of net profits of joint ventures | (222) | (223) | (58) | - |
| Gains on sale of joint ventures | (500) | (8,169) | (500) | (8,728) |
| Changes in fair value of investments | - | 86 | - | - |
| Share-based payments expense | 379 | - | 379 | - |
| Gain on sale of property, plant and equipment | 68 | 163 | 68 | 163 |
| ii. Movement in operating assets / liabilities | | | | |
| Decrease / (increase) in operating assets | | | | |
| Trade and other receivables | 2,266 | (13,707) | 339 | 539 |
| Reinsurance and other recoveries | 11,927 | (15,032) | - | - |
| Prepayments | 97 | (134) | 97 | (134) |
| Deferred levies and charges | 4,038 | (2,000) | - | - |
| Deferred reinsurance expense | 3,714 | (8,608) | - | - |
| Deferred acquisition costs | 10,229 | (2,820) | - | - |
| Increase / (decrease) in operating liabilities | | | | |
| Trade and other payables | 8,538 | 7,812 | (1) | (642) |
| Employee entitlements | 117 | 188 | 117 | 188 |
| Unearned premium liability | (46,847) | 21,661 | - | - |
| Unearned reinsurance commission | (1,395) | 2,996 | - | - |
| Unearned agency commission | 1,252 | - | - | - |
| Outstanding claims liability | (27,099) | 30,358 | - | - |
| Net cash flows from operating activities | (27,727) | 6,685 | 942 | 2,307 |

NOTE 14 INVESTMENTS**14.1. Composition**

| | CONSOLIDATED | | COMPANY | |
|----------------------------------|------------------------|----------------|------------------------|----------------|
| | 2012 \$'000 | 2011 \$'000 | 2012 \$'000 | 2011 \$'000 |
| Fixed term deposits | 70,000 | 80,000 | - | - |
| Total fixed term deposits | 70,000 | 80,000 | - | - |

The carrying value of interest bearing investments includes \$60.0m (2011: \$20.0m) which is expected to mature more than 12 months from reporting date.

Interest bearing term deposits with a carrying amount of \$70.0m at 31 December 2012 have yields ranging from 4.8 to 7.1 per cent p.a and mature between 2 months to 4.75 years.

The Group's exposure to credit and interest rate risks related to investments are disclosed in Note 5.

14.2. Determination of Fair Value

The total investments balance is based on a hierarchy that reflects the significance of the inputs used in the determination of fair value. The fair value hierarchy has the following levels:

(i) Level 1 quoted prices

Quoted prices (unadjusted) in active markets for identical assets and liabilities are used.

(ii) Level 2 other observable inputs

Inputs that are observable (other than Level 1 quoted prices) for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices) are used.

(iii) Level 3 observable inputs

Inputs for the asset or liability that are not based on observable market data (unobservable inputs) are used. The assets are effectively marked to model rather than marked to market. Reasonable changes in the judgement applied in conducting these valuations would not have a significant impact on the balance sheet.

Term deposits \$70.0m (2011: \$80.0m) have been categorised in the Level 1 fair value hierarchy.

NOTE 15 RECEIVABLES**15.1. Composition**

| | CONSOLIDATED | | COMPANY | |
|---|------------------------|----------------|------------------------|----------------|
| | 2012 \$'000 | 2011 \$'000 | 2012 \$'000 | 2011 \$'000 |
| I. Premium receivable | | | | |
| Premium receivable | 36,911 | 58,017 | - | - |
| Provision for impairment | (100) | (269) | - | - |
| Premium receivable - Group | 36,811 | 57,748 | - | - |
| Premium receivables - Trusts ⁽¹⁾ | 15,645 | 2,866 | - | - |
| Premium receivables - Total | 52,456 | 60,614 | - | - |
| II. Trade and other receivables | | | | |
| Receivables from controlled entities | - | - | 6,588 | 7,395 |
| Receivables from related parties | - | 879 | - | 448 |
| Reinsurance receivables | 1,543 | 2,691 | - | - |
| Investment income receivable | 3,246 | 1,445 | - | 4 |
| Other receivables | 7,507 | 2,871 | 303 | 618 |
| Trade and other receivables | 64,752 | 68,500 | 6,891 | 8,465 |

(1) Trust premium receivables held on behalf of other insurers.

The carrying value of trade and other receivables is expected to mature within 12 months from reporting date.

The Group's exposure to credit and market risks and impairment losses related to trade and other receivables are disclosed in Note 5.

NOTE 16 REINSURANCE AND OTHER RECOVERIES ON OUTSTANDING CLAIMS

16.1. Reinsurance and other Recoveries Receivable on Outstanding Claims

| | CONSOLIDATED | | COMPANY | |
|--|----------------|----------------|----------------|----------------|
| | 2012 \$'000 | 2011 \$'000 | 2012 \$'000 | 2011 \$'000 |
| Expected reinsurance and other recoveries receivable on outstanding claims - undiscounted | 76,187 | 88,870 | - | - |
| Discount to present value | (3,285) | (4,044) | - | - |
| Expected reinsurance and other recoveries receivable on outstanding claims - discounted | 72,902 | 84,826 | - | - |

The carrying value of reinsurance recoveries and other recoveries includes \$34.2m (2011: \$36.0m) which is expected to be settled more than 12 months from the reporting date.

16.2. Actuarial Assumptions

The measurement of reinsurance and other recoveries on outstanding claims is an inherently uncertain process involving estimates. The amounts are generally calculated using actuarial assumptions and methods similar to those used for the outstanding claims liability (refer Note 27).

Where possible, the valuation of reinsurance recoveries is linked directly to the valuation of the gross outstanding claims liability. Accordingly, the valuation of outstanding reinsurance recoveries is subject to similar risks and uncertainties as the valuation of the outstanding claims liability. Significant individual losses (for example those relating to catastrophe events) are analysed on a case by case basis for reinsurance purposes.

16.3. The Effect of Changes in Assumptions

The effect of changes in assumptions on the net outstanding claims liability, which incorporates the reinsurance recoveries on outstanding claims and other recoveries receivable, is disclosed in Note 27.

NOTE 17 DEFERRED INSURANCE ASSETS

| | CONSOLIDATED | | COMPANY | |
|---|----------------|----------------|----------------|----------------|
| | 2012 \$'000 | 2011 \$'000 | 2012 \$'000 | 2011 \$'000 |
| A. DEFERRED ACQUISITION COSTS | | | | |
| Reconciliation of movements | | | | |
| Balance at the beginning of the year | 31,021 | 28,201 | - | - |
| Acquisition costs deferred during the year | 45,719 | 69,564 | - | - |
| Acquisition costs expensed for the year | (55,948) | (62,182) | - | - |
| Write-down for liability adequacy test | - | (4,562) | - | - |
| Balance at the end of the year | 20,792 | 31,021 | - | - |
| B. DEFERRED REINSURANCE EXPENSE | | | | |
| Reconciliation of movements | | | | |
| Balance at the beginning of the year | 50,276 | 41,667 | - | - |
| Reinsurance expenses deferred during the year | 135,824 | 106,525 | - | - |
| Reinsurance expense expensed for the year | (139,539) | (97,916) | - | - |
| Balance at the end of the year | 46,561 | 50,276 | - | - |

The carrying value of deferred insurance assets is expected to be expensed within 12 months from the reporting date.

NOTE 18 DEFERRED TAX ASSETS

| | CONSOLIDATED AND COMPANY | |
|----------------------------|---------------------------------|---------------|
| | \$'000 | \$'000 |
| At 31 December 2011 | 3,750 | 3,750 |
| At 31 December 2012 | 3,750 | 3,750 |

NOTE 19 PROPERTY, PLANT AND EQUIPMENT

| | CONSOLIDATED AND COMPANY | | | | |
|---|-----------------------------------|-----------------------------|-----------------------------|---------------------------|---------------|
| | LEASEHOLD IMPROVEMENTS | COMPUTING ASSETS | OFFICE EQUIPMENT | MOTOR VEHICLES | TOTAL |
| | \$'000 | \$'000 | \$'000 | \$'000 | \$'000 |
| A. COMPOSITION | | | | | |
| 2012 | | | | | |
| At cost | 2,204 | 1,122 | 106 | - | 3,432 |
| Accumulated depreciation | (124) | (1,122) | (6) | - | (1,252) |
| Balance at the end of the year | 2,080 | - | 100 | - | 2,180 |
| B. RECONCILIATION OF MOVEMENTS | | | | | |
| Balance at the beginning of the year | 2,341 | 12 | 117 | 7 | 2,477 |
| Additions | - | - | - | - | - |
| Disposals | (7) | (5) | (4) | (5) | (21) |
| Depreciation | (254) | (7) | (13) | (2) | (276) |
| Balance at the end of the year | 2,080 | - | 100 | - | 2,180 |
| C. COMPOSITION OF COMPARATIVES | | | | | |
| 2011 | | | | | |
| Cost | 3,382 | 1,127 | 269 | 23 | 4,801 |
| Accumulated depreciation | (1,041) | (1,115) | (152) | (16) | (2,324) |
| Balance at the end of the year | 2,341 | 12 | 117 | 7 | 2,477 |

In 2012, 470 assets were consolidated into 18 assets as a result of a detailed review of the fixed assets register. The written down value of the assets became the new cost base.

There are no items of property, plant and equipment pledged as security for liabilities.

NOTE 20 INVESTMENTS ACCOUNTED FOR USING THE EQUITY METHOD

Equity accounted investments of the Group are detailed below:

20.1. Composition

| | CONSOLIDATED | | COMPANY | |
|--|----------------|----------------|----------------|----------------|
| | 2012 \$'000 | 2011 \$'000 | 2012 \$'000 | 2011 \$'000 |
| Investment in joint ventures | 603 | 381 | 160 | 160 |
| Total investments accounted for using the equity method | 603 | 381 | 160 | 160 |

Investments in joint ventures are accounted for in this consolidated financial report using the equity method of accounting and are carried at cost by the Company.

20.2. Investment in Joint Ventures

| | | | CONSOLIDATED | |
|-------------------------------------|--------------------------|--------------------|---|------------------------|
| | COUNTRY OF INCORPORATION | OWNERSHIP INTEREST | CARRYING AMOUNTS OF INVESTMENTS IN JOINT VENTURES | |
| | | | 2012 % | 2011 % |
| Joint ventures | | | 2012 \$'000 | 2011 \$'000 |
| Arena Underwriting Pty Ltd | Australia | 50 | 50 | 157 |
| QUS Pty Ltd | Australia | 50 | 50 | 446 |
| Investment in joint ventures | | | 603 | 381 |

| | | | COMPANY | |
|-------------------------------------|--------------------------|--------------------|---|------------------------|
| | COUNTRY OF INCORPORATION | OWNERSHIP INTEREST | CARRYING AMOUNTS OF INVESTMENTS IN JOINT VENTURES | |
| | | | 2012 % | 2011 % |
| Joint ventures | | | 2012 \$'000 | 2011 \$'000 |
| Arena Underwriting Pty Ltd | Australia | 50 | 50 | 60 |
| QUS Pty Ltd | Australia | 50 | 50 | 100 |
| Investment in joint ventures | | | 160 | 160 |

20.3. Share of Joint Ventures Assets and Liabilities

| | | CONSOLIDATED | |
|--------------------------|--|----------------|----------------|
| | | 2012 \$'000 | 2011 \$'000 |
| Current assets | | 796 | 618 |
| Non-current assets | | 110 | 172 |
| Total assets | | 906 | 790 |
| Current liabilities | | 303 | 215 |
| Non-current liabilities | | - | 194 |
| Total liabilities | | 303 | 409 |
| Net assets | | 603 | 381 |

NOTE 20 INVESTMENTS ACCOUNTED FOR USING THE EQUITY METHOD Continued**20.4 Share of Joint Ventures Income and Expenses**

| | CONSOLIDATED | |
|--|---------------------|---------------|
| | 2012 | 2011 |
| | \$'000 | \$'000 |
| Income | 2,753 | 12,480 |
| Expenses | (2,405) | (10,659) |
| Income tax | (95) | (547) |
| Share of joint ventures' profit after tax | 253 | 1,274 |

Dividends distributed from joint ventures were \$30k (2011: \$1.49m).

20.5. Share of Joint Ventures Capital Commitments

There are no capital commitments arising from the investment in joint ventures.

20.6. Share of Joint Ventures Contingent Liabilities

There are contingent liabilities arising from the joint ventures.

NOTE 21 OTHER FINANCIAL ASSETS

Investments held by the parent entity are detailed below:

21.1. Composition

| | COMPANY | |
|-------------------------------------|----------------|---------------|
| | 2012 | 2011 |
| | \$'000 | \$'000 |
| Investment in subsidiaries | 103,718 | 99,218 |
| Total other financial assets | 103,718 | 99,218 |

These financial assets are carried at cost and are reviewed annually for impairment.

21.2. Subsidiaries

| | | OWNERSHIP INTEREST | | BOOK VALUE OF COMPANY INVESTMENT | |
|--|-----------|---------------------------|----------|---|---------------|
| COUNTRY OF INCORPORATION | | 2012 | 2011 | 2012 | 2011 |
| | | % | % | \$'000 | \$'000 |
| Subsidiaries | | | | | |
| ARGIS Pty Limited ⁽¹⁾ | Australia | 100 | 100 | - | - |
| Calliden Insurance Limited | Australia | 100 | 100 | 80,245 | 75,745 |
| Dawes Underwriting Australia Pty Limited | Australia | 100 | 100 | 2,434 | 2,434 |
| IUA Pty Limited | Australia | 100 | 100 | 5,414 | 5,414 |
| Mansions of Australia Limited | Australia | 100 | 100 | 15,625 | 15,625 |
| Investment in subsidiaries | | | | 103,718 | 99,218 |

(1) Owned by Mansions of Australia Limited

The consolidated financial report incorporates the assets, liabilities and results of the above subsidiaries in accordance with the accounting policy described in Note 3.1.2. The proportion of ownership investment is equal to the proportion of voting power held. The class of shares of all the ownership investment is Ordinary.

NOTE 22 INTANGIBLE ASSETS

| | CONSOLIDATED | | | |
|---------------------------------------|---------------|---------------------------|--|---------------|
| | GOODWILL | CUSTOMER RELATIONSHIPS | SYSTEMS DEVELOPMENT EXPENDITURE ⁽¹⁾ | TOTAL |
| | \$'000 | \$'000 | \$'000 | \$'000 |
| 2012 | | | | |
| A. COMPOSITION | | | | |
| Cost | 34,371 | 11,987 | 17,562 | 63,920 |
| Accumulated amortisation | - | (7,129) | (10,273) | (17,402) |
| Balance at the end of the year | 34,371 | 4,858 | 7,289 | 46,518 |
| 2012 | | | | |
| B. RECONCILIATION OF MOVEMENTS | | | | |
| Balance at the beginning of the year | 34,371 | 6,325 | 9,502 | 50,198 |
| Additions acquired and developed | - | - | 722 | 722 |
| Disposals | - | - | (56) | (56) |
| Amortisation | - | (1,467) | (2,879) | (4,346) |
| Balance at the end of the year | 34,371 | 4,858 | 7,289 | 46,518 |
| 2011 | | | | |
| C. COMPOSITION OF COMPARATIVES | | | | |
| Cost | 34,371 | 11,987 | 16,896 | 63,254 |
| Accumulated amortisation | - | (5,662) | (7,394) | (13,056) |
| Balance at the end of the year | 34,371 | 6,325 | 9,502 | 50,198 |

(1) The Company's intangible assets are solely systems development expenditure.

22.1. Explanatory Notes for Intangible Assets

22.1.1. SOFTWARE DEVELOPMENT EXPENDITURE

The software development expenditure asset comprises both internally generated assets and acquired assets.

22.1.2. ACQUIRED INTANGIBLE ASSETS

All of the intangible assets, other than the capitalised software development expenditure intangible asset, have been acquired. Each of the acquired intangible assets has a finite useful life. The amortisation of the acquired intangible assets forms part of administration and other expenses in the Statements of Comprehensive Income.

22.1.3. CUSTOMER RELATIONSHIPS

This represents at least the present value of future profits expected to arise from existing customer relationships (developed prior to acquisition). The assumptions for the useful life and attrition rates for the existing customer base are determined based on historical information of the business.

Notes to the Consolidated Financial Report Continued

NOTE 22 INTANGIBLE ASSETS Continued

22.2. Impairment testing for goodwill

For each category, an impairment trigger review was conducted and where necessary the recoverable amount of particular assets determined.

A summary of the goodwill allocation to its Cash-Generating Unit ("CGU") is presented below:

| Cash-Generating Units | 2012 \$'000 | 2011 \$'000 |
|-----------------------|----------------|----------------|
| Underwriting | 29,493 | 29,493 |
| Agency | 4,878 | 4,878 |
| Total goodwill | 34,371 | 34,371 |

The recoverable amount of a CGU is determined based on value-in-use calculations. These calculations use cash flow projections based on financial budgets approved by the Board covering a five year period. Cash flows beyond the five year period are extrapolated using a terminal growth rate of 2.5%. The growth rate does not exceed the long-term average growth rate for the business in which the CGU operates.

22.3. Key Assumptions used for Value-In-Use Calculations

The following describes the key assumptions on which Management has based its cash flow projections to undertake impairment testing of goodwill:

- ▶ Cash flow forecast: forecast profits for the first five years are used to derive a medium-term cash flow proxy;
- ▶ Discount rate: a discount rate of 12.0% per annum ("p.a"), calculated based on weighted average cost of capital, was applied in 2012 (2011: 12.0%);
- ▶ Terminal growth rate at year 2018 of 2.5% (2011: 2.5%) and beyond is based on Management's expectation for future performance in both the Underwriting CGU and the Distribution CGU;
- ▶ Investment return from assets backing insurance liabilities is expected to be 5.0% p.a over the cycle; and
- ▶ The Group will increase the proportion of revenue derived from Agency operations with a corresponding decline in the proportion of revenue derived from Underwriting over the 2013 financial year.

These assumptions have been used for the analysis of each CGU as applicable within the business segment.

22.4. Impact of Possible Changes in Key Assumptions

The carrying value of identified intangible assets, as well as net tangible assets are deducted from the values generated from the cash flow projections to arrive at a recoverable value for goodwill which is then compared with the carrying value of goodwill.

The recoverable amount of the goodwill of the Underwriting CGU is estimated to be \$96.6m (2011: \$71.1m). This exceeds the carrying amount of the Underwriting CGU's goodwill at 31 December 2012 by \$67.1m (2011: \$41.6m).

If the discount rate applied to the cash flow projections of the Underwriting CGU was 19.0% p.a instead of 12.0% p.a, the recoverable amount of the Underwriting CGU's goodwill would equal its carrying amount.

The future valuation of the CGUs is dependent on the revenue assumptions. The revenue in both CGUs involves both GWP and Agency Fees which are driven by policy count.

If the policy count applied to the cash flow projections of the Underwriting CGU and was reduced by 45%, the recoverable amount of the Underwriting CGU's goodwill would equal its carrying amount.

If the policy count applied to the cash flow projections of the Distribution CGU and was reduced by 63%, the recoverable amount of the Underwriting CGU's goodwill would equal its carrying amount.

The recoverable amount of the goodwill of the Agency CGU is estimated to be \$29.6m (2011: \$17.8m). This exceeds the carrying amount of the CGU's goodwill at 31 December 2012 by \$24.7m (2011: \$12.9m).

If the discount rate applied to the cash flow projections of the Agency CGU was 25.0% p.a instead of 12.0% p.a, the recoverable amount of the Distribution CGU's goodwill would equal its carrying amount.

22.5. Impairment Charge

There is no impairment charge as no impairment was indicated.

NOTE 23 TRADE AND OTHER PAYABLES

| | CONSOLIDATED | | COMPANY | |
|---------------------------------------|----------------|----------------|----------------|----------------|
| | 2012 \$'000 | 2011 \$'000 | 2012 \$'000 | 2011 \$'000 |
| Trade creditors | 2,785 | 5,513 | 2,112 | 2,475 |
| Reinsurance premiums payable | 4,120 | 10,170 | - | - |
| Payables to controlled entities | - | - | 10,070 | 6,841 |
| Trust account payables ⁽¹⁾ | 21,042 | 4,819 | - | - |
| Total trade and other payables | 27,947 | 20,502 | 12,182 | 9,316 |

(1) Premiums payable to other insurers.

The carrying value of trade and other payables is expected to be settled within 12 months from reporting date.

Trade and other payables are unsecured, non-interest bearing and are normally settled within 30 days. Amounts have not been discounted because the effect of the time value of money is not material. The carrying amount of payables is a reasonable approximation of the fair value of the liabilities because of the nature of the liabilities.

NOTE 24 EMPLOYEE ENTITLEMENTS

| | CONSOLIDATED | | COMPANY | |
|-------------------------------------|----------------|----------------|----------------|----------------|
| | 2012 \$'000 | 2011 \$'000 | 2012 \$'000 | 2011 \$'000 |
| Employee entitlements | | | | |
| Provision for employee entitlements | | | | |
| Current | 560 | 548 | 560 | 548 |
| Non-current | 694 | 589 | 694 | 589 |
| Total employee entitlements | 1,254 | 1,137 | 1,254 | 1,137 |

24.1. Calliden Group Limited Employee Share Offer

No shares were offered under the Employee Share Offer during the year ended 31 December 2012 (2011: 573,514).

NOTE 25 UNEARNED REINSURANCE COMMISSION

25.1. Reconciliation of Movement in Unearned Reinsurance Commission

| | CONSOLIDATED | | COMPANY | |
|---|----------------|----------------|----------------|----------------|
| | 2012 \$'000 | 2011 \$'000 | 2012 \$'000 | 2011 \$'000 |
| Balance at the beginning of the year | 17,536 | 14,540 | - | - |
| Reinsurance commission deferred during the year | 42,646 | 33,730 | - | - |
| Reinsurance commission earned for the year | (44,041) | (30,734) | - | - |
| Balance at the end of the year | 16,141 | 17,536 | - | - |

The carrying value of unearned reinsurance commission is expected to be earned within 12 months from reporting date.

NOTE 26 UNEARNED PREMIUM LIABILITY

26.1. Reconciliation of Movement in Unearned Premium Liability

| | CONSOLIDATED | |
|--|----------------|----------------|
| | 2012 \$'000 | 2011 \$'000 |
| Balance at the beginning of the year | 128,178 | 106,517 |
| Written premium deferred during the year | 172,000 | 245,653 |
| Written premium earned for the year | (218,847) | (223,992) |
| Balance at the end of the year | 81,331 | 128,178 |

The carrying value of unearned premium liability includes \$54k (2011: \$64k) which is expected to be earned more than 12 months from reporting date.

26.2. Liability Adequacy Test ("LAT")

The LAT has been conducted using the central estimate of the premium liabilities calculated for reporting to APRA, adjusted as appropriate, together with an appropriate margin for uncertainty.

The Group uses an Expected Profitability Analysis ("EPA") model for setting its pricing which determines a required loss ratio and target margin to achieve the targeted return on capital. Management believes that the use of the EPA margin is a more relevant measure for the purposes of the LAT.

The EPA margin is not calculated using the statistical concept of Probability of Adequacy ("POA"), which is used for the determination of risk margins. The reason for the difference in approach is that the LAT is an impairment test used only to test the adequacy of premium liabilities whereas the POA is a measurement in accounting policy used in determining the carrying value of the outstanding claims liability in the Statements of Financial Position.

The margin included in the Group's expected future cash flows for future claims as a percentage of the central estimate is 9.7% (2011: 6.5%). While the concepts are not directly comparable, the margin is equivalent to a POA of approximately 73% (2011: 65%).

The application of the LAT has identified a surplus of \$0.3m as at 31 December 2012 (2011: \$4.6m deficiency).

| | CONSOLIDATED | |
|--|----------------|----------------|
| | 2012 \$'000 | 2011 \$'000 |
| LAT calculation | | |
| Unearned premium liability | 81,331 | 128,178 |
| Fire services levy | (7,455) | (11,493) |
| Deferred acquisition costs | (20,775) | (35,583) |
| Related reinsurance commission | 16,141 | 17,536 |
| Related reinsurance asset | (46,561) | (50,276) |
| Total provision available | 22,681 | 48,362 |
| Actuarial estimate of future liabilities | | |
| Central estimate of present value of expected future cash flows from future claims | 45,014 | 79,906 |
| Present value of expected future cash inflows arising from reinsurance recoveries on future claims | (24,335) | (29,866) |
| Risk margin | 1,743 | 2,884 |
| Total actuarial estimate of future liabilities | 22,422 | 52,924 |
| Net surplus / (deficiency) | 259 | (4,562) |
| Deficiency recognised in the Statements of Comprehensive Income: | | |
| Write-down of deferred acquisition costs | - | (4,562) |
| Risk margin percentage | 10% | 7% |

NOTE 27 OUTSTANDING CLAIMS LIABILITY

27.1. Composition of Gross Outstanding Claims Liability

| | CONSOLIDATED | |
|--|----------------|----------------|
| | 2012 \$'000 | 2011 \$'000 |
| Case estimates | 69,699 | 84,687 |
| IBNR | 63,018 | 75,024 |
| Gross central estimate - undiscounted | 132,717 | 159,711 |
| Claims handling expenses | 4,763 | 4,744 |
| Risk margin | 5,656 | 7,635 |
| | 143,136 | 172,090 |
| Discount to present value | (6,078) | (7,933) |
| Gross outstanding claims liability - discounted | 137,058 | 164,157 |

The outstanding claims liability includes \$68.6 m (2011: \$76.9m) which is expected to be settled after 12 months from reporting date.

The Group's exposure to liquidity risk related to trade and other payables is disclosed in Note 5.2.

27.2. Reconciliation of Movement in Outstanding Claims Liability

| | CONSOLIDATED | | | | | |
|--|-----------------|--|---------------|-----------------|--|---------------|
| | GROSS \$'000 | 2012 REINSURANCE AND OTHER RECOVERIES \$'000 | NET \$'000 | GROSS \$'000 | 2011 REINSURANCE AND OTHER RECOVERIES \$'000 | NET \$'000 |
| Balance at the beginning of the year | 164,157 | (84,826) | 79,331 | 133,799 | (69,796) | 64,003 |
| Current year claims incurred | 121,903 | (82,633) | 39,270 | 187,976 | (104,636) | 83,340 |
| Movement in discounting ⁽¹⁾ | 1,472 | (783) | 689 | 4,947 | (2,556) | 2,391 |
| Incurred claims recognised in the Statements of Comprehensive Income | 123,375 | (83,416) | 39,959 | 192,923 | (107,192) | 85,731 |
| Claim (payments) / recoveries during the year | (150,474) | 95,340 | (55,134) | (162,565) | 92,162 | (70,403) |
| Balance at the end of the year | 137,058 | (72,902) | 64,156 | 164,157 | (84,826) | 79,331 |

[1] Represents solely the impact from change in discount rate assumptions during the year.

Notes to the Consolidated Financial Report Continued

NOTE 27 OUTSTANDING CLAIMS LIABILITY Continued

27.3. Development Table

The following table shows the development of the net undiscounted outstanding claims for the five most recent accident years and also reconciliation to the net discounted outstanding claims liability.

| | ACCIDENT YEAR | | | | | |
|--|--------------------------|----------------|----------------|----------------|----------------|------------------|
| | 2008 and prior \$'000 | 2009 \$'000 | 2010 \$'000 | 2011 \$'000 | 2012 \$'000 | Total \$'000 |
| NET ULTIMATE CLAIMS PAYMENTS | | | | | | |
| Development | | | | | | |
| At end of accident year | 379,798 | 49,841 | 60,923 | 78,198 | 37,228 | |
| One year later | 382,920 | 47,477 | 60,396 | 75,577 | | |
| Two years later | 375,950 | 47,191 | 59,720 | | | |
| Three years later | 372,817 | 47,613 | | | | |
| Four years later | 372,029 | | | | | |
| Current estimate of net ultimate claims payments | 372,029 | 47,613 | 59,720 | 75,577 | 37,228 | 592,167 |
| Cumulative payments made to date | (363,376) | (42,065) | (50,741) | (60,782) | (19,064) | (536,028) |
| Net undiscounted outstanding claims payments | 8,653 | 5,548 | 8,979 | 14,795 | 18,164 | 56,139 |
| Discount to present value | (222) | (306) | (620) | (889) | (740) | (2,777) |
| Net discounted outstanding claims payments | 8,431 | 5,242 | 8,359 | 13,906 | 17,424 | 53,362 |
| Reconciliation | | | | | | |
| Run-off portfolios | | | | | | 373 |
| Claims handling expenses | | | | | | 4,763 |
| Risk margin | | | | | | 5,658 |
| Net outstanding claims liability | | | | | | 64,156 |
| Reinsurance and other recoveries on outstanding claims liability | | | | | | 72,902 |
| Total gross outstanding claims per the Statements of Financial Position | | | | | | 137,058 |

Conditions and trends that have affected the development of the liabilities in the past may or may not occur in the future, and accordingly conclusions about future results may not necessarily be derived from the information presented in the tables above.

The development table shown above relates to both short-tail and long-tail claims.

27.4. Central Estimate and Risk Margin

| | CONSOLIDATED | |
|---|--------------|-----------|
| | 2012 % | 2011 % |
| The percentage of risk margin applied to the net outstanding claims liability | 9.7 | 10.6 |
| The probability of adequacy of the risk margin | 75 | 75 |

27.5. Process

The outstanding claims liability is determined based on three building blocks being:

- › A central estimate of the future cash flows;
- › Discounting for the effect of the time value of money; and
- › A risk margin for uncertainty.

27.5.1. FUTURE CASH FLOWS

The estimation of the outstanding claims liability is based on a variety of actuarial techniques that analyse experience, trends and other relevant factors. The expected future payments include those in relation to claims reported but not yet paid or not yet paid in full, claims incurred but not enough reported ("IBNER"), claims incurred but not reported ("IBNR") and the anticipated direct and indirect claims handling costs.

The estimation process involves using the Consolidated entity's specific data, relevant industry data and more general economic data. Each class of business is usually examined separately and the process involves consideration of a large number of factors. These factors may include the risks to which the business is exposed at a point in time, claim frequencies and average claim sizes, historical trends in the incidence and development of claims reported and finalised, legal, social and economic factors that may impact upon each class of business, the key actuarial assumptions and the impact of reinsurance and other recoveries.

Different actuarial valuation models are used for different claims types and lines of business. The selection of the appropriate actuarial model takes into account the characteristics of a claim type and class of business and the extent of the development of each past accident period.

27.5.2. DISCOUNTING

Projected future claims payments, both gross and net of reinsurance and other recoveries, and associated claims handling costs are discounted to a present value using appropriate risk free discount rates.

27.5.3. RISK MARGIN

The central estimate of the outstanding claims liability is an estimate which is intended to contain no deliberate or conscious over or under estimation and is commonly described as providing the mean of the distribution of future cash flows. It is considered appropriate to add a risk margin to the central estimate in order for the claims liability to have an increased probability of adequacy. The risk margin refers to the amount by which the liability recognised in this financial report is greater than the actuarial central estimate of the liability.

Uncertainties surrounding the outstanding claims liability estimation process include those relating to the data, actuarial models and assumptions, the statistical uncertainty associated with a general insurance claims runoff process, and risks external to Calliden, for example the impact of future legislative reform. Uncertainty from these sources is examined for each class of business and expressed as a volatility measure relative to the net central estimate. The volatility measure for each class is derived after consideration of statistical modelling and benchmarking to industry analysis.

Certain product classes may be subject to the emergence of new types of latent claims and such uncertainties are considered when setting the volatility, and hence the risk margin appropriate for those classes.

The measure of the volatility is referred to as the coefficients of variation ("CoV"). The CoV is defined as the standard deviation of the distribution of future cash flows divided by the mean.

The long-tail classes of business generally have the highest volatilities for outstanding claims as the longer average time for claims to be reported and settled allows more time for sources of uncertainty to emerge. Short-tail classes generally have lower levels of volatility for outstanding claims.

The risk margin required to provide a given probability of adequacy for two or more classes of business or for two or more geographic locations combined is likely to be less than the sum of the risk margins for the individual classes. This reflects the benefit of diversification.

The measure of the parameter used to derive the diversification benefit is referred to as correlation. The higher the correlation between two classes of business, the more likely it is that a negative outcome in one class will correspond to a negative outcome in the other class. The correlations are adopted with regard to industry analysis, historical experience and the judgement of experienced and qualified actuaries.

The determination of the overall risk margin takes into account the volatility of each class of business and the correlations between the lines of business. The current risk margin, which has been determined after assessing the inherent uncertainty in the central estimate and the prevailing market environment, results in an overall probability of adequacy for the outstanding claims liability of 75% (2011: 75%).

27.6. Actuarial Assumptions

27.6.1. PROCESS USED TO DETERMINE ASSUMPTIONS

27.6.1.1. DISCOUNTED AVERAGE TERM TO SETTLEMENT

The discounted average term to settlement relates to the expected payment pattern for claims (inflated and discounted). It is calculated by class of business and is generally based on historic settlement patterns. The discounted average term to settlement, while not itself an assumption, provides a summary indication of the future cash flow pattern.

Notes to the Consolidated Financial Report Continued

NOTE 27 OUTSTANDING CLAIMS LIABILITY Continued

27.6.1.2. INFLATION RATE

Insurance costs are subject to inflationary pressures. Economic inflation assumptions are set by reference to current economic indicators.

27.6.1.3. SUPERIMPOSED INFLATION RATE

Superimposed inflation occurs due to non-economic effects such as the cost of court settlements increasing at a faster rate than the economic inflation rate utilised. An allowance for superimposed inflation is made for each underlying model, where appropriate, after considering the historical levels of superimposed inflation present in the portfolio projected future superimposed inflation and industry superimposed inflation trends.

27.6.1.4. DISCOUNT RATE

The discount rate is derived from market yields on Commonwealth Government Securities at the reporting date having similar duration to the liability cash flows. A single discount rate which is equivalent to the yield curve is adopted.

27.6.1.5. UNDISCOUNTED

A range of different actuarial methods is used depending on the nature of the class of business, and the extent and duration of Company experience available. Where possible the assumptions are based on the Company's own experience, but if necessary assumptions are guided by industry data or benchmarks relating to similar businesses.

For all classes of business the undiscounted outstanding claims liability is established by adding an amount in respect of incurred but not reported ("IBNR") and incurred but not enough reported ("IBNER") claims to the case estimates established. The IBNR/ER includes an allowance for any consistent under or over-estimation in the case estimates.

27.6.1.6. NON-REINSURANCE RECOVERIES

Salvage and subrogation recoveries are significant for motor business. For all motor classes, separate estimates have been made for recoveries, based on payment and case estimate data.

27.6.1.7. CLAIMS HANDLING EXPENSES

The liability includes allowance for claim handling expenses ("CHE") equal to:

- 4.0% (2011: 3.5%) of gross outstanding claims for portfolios where the claims are handled in house; and
- 2.0% (2011: 1.5%) of gross outstanding claims for portfolios where the claims are handled by third party administrators who are paid upfront to manage the claim until finalisation.

These assumptions have been derived following an analysis of the actual and budgeted expenses of the Group.

27.7. The Effect of Changes in Assumptions

27.7.1. GENERAL IMPACT OF CHANGES

27.7.1.1. DISCOUNTED AVERAGE TERM TO SETTLEMENT

A decrease in the discounted average term to settlement would reflect claims being paid sooner than anticipated and so increase the claims expense. Note that this sensitivity test only extends or shortens the term of the payments assumed in the valuation, without changing the total nominal amount of the payments.

27.7.1.2. INFLATION AND SUPERIMPOSED INFLATION RATES

Expected future payments are inflated to take account of inflationary increases. An increase or decrease in the assumed levels of either economic or superimposed inflation will have a corresponding decrease or increase on profit and loss.

27.7.1.3. DISCOUNT RATE

The outstanding claims liability is calculated by reference to expected future payments. These payments are discounted to adjust for the time value of money. An increase or decrease in the assumed discount rate will have a corresponding increase or decrease on profit and loss.

27.7.1.4. CLAIMS HANDLING COSTS RATIO

An increase in the ratio reflects an increase in the estimate for the internal costs of administering claims. An increase or decrease in the ratio assumption will have a corresponding decrease or increase on profit and loss.

27.8. Sensitivity Analysis of Changes

The impact on the Statements of Comprehensive Income before income tax to changes in key actuarial assumptions is summarised below. Each change has been calculated in isolation of the other changes and is net of reinsurance recoveries.

The movements are stated in absolute terms where the base assumption is a percentage, for example, if the loss ratio assumption was 50%, a 10% increase would mean assuming a 60% loss ratio.

| | MOVEMENT IN ASSUMPTION | CHANGE IN OUTSTANDING CLAIMS LIABILITY | | | PROFIT / (LOSS) IMPACT BEFORE TAX |
|------------------------------------|------------------------|--|------------|--------|-----------------------------------|
| Assumption | | GROSS \$'000 | NET \$'000 | NET % | \$'000 |
| 2012 | | | | | |
| Base | | 137,058 | 64,156 | | |
| Loss ratio | +10% | 7,369 | 3,450 | 5.4% | (3,450) |
| | -10% | (7,369) | (3,450) | (5.4%) | 3,450 |
| Incurred claims development factor | +50% | 3,685 | 1,725 | 2.7% | (1,725) |
| | -50% | (3,558) | (1,665) | (2.6%) | 1,665 |
| Discount rate | +1% | (2,315) | (1,083) | (1.7%) | 1,083 |
| | -1% | 2,419 | 1,133 | 1.8% | (1,133) |
| Claims handling expenses ratio | +1% | 1,369 | 1,369 | 2.1% | (1,369) |
| | -1% | (1,369) | (1,369) | (2.1%) | 1,369 |
| 2011 | | | | | |
| Base | | 164,157 | 79,331 | | |
| Loss ratio | +10% | 5,407 | 2,612 | 3.3% | (2,612) |
| | -10% | (5,407) | (2,612) | (3.3%) | 2,612 |
| Incurred claims development factor | +50% | 3,745 | 1,810 | 2.3% | (1,810) |
| | -50% | (4,161) | (2,011) | (2.5%) | 2,011 |
| Discount rate | +1% | (2,306) | (1,114) | (1.4%) | 1,114 |
| | -1% | 3,168 | 1,531 | 1.9% | (1,531) |
| Claims handling expenses ratio | +1% | 1,660 | 1,660 | 2.1% | (1,660) |
| | -1% | (1,660) | (1,660) | (2.1%) | 1,660 |

NOTE 28 UNEARNED AGENCY COMMISSION

28.1. Reconciliation of Movement in Unearned Agency Commission

| | CONSOLIDATED | | COMPANY | |
|--|--------------|-------------|-------------|-------------|
| | 2012 \$'000 | 2011 \$'000 | 2012 \$'000 | 2011 \$'000 |
| Balance at the beginning of the year | - | - | - | - |
| Agency commission deferred in the year | 1,252 | - | - | - |
| Balance at the end of the year | 1,252 | - | - | - |

The carrying value of unearned agency commission is expected to be earned within 12 months from reporting date.

NOTE 29 EQUITY**29.1. Share Capital**

| | CONSOLIDATED | | COMPANY | |
|--|------------------------|----------------|------------------------|----------------|
| | 2012 \$'000 | 2011 \$'000 | 2012 \$'000 | 2011 \$'000 |
| 226,683,914 (2011: 226,683,914) issued ordinary shares, fully paid | 99,539 | 99,539 | 99,539 | 99,539 |

Ordinary shares in the Company have no par value and entitle the holder to participate in dividends and the proceeds on winding up in proportion to the number of shares held after all other creditors. They are entitled to one vote per share at shareholders' meetings.

29.2. Movements in Ordinary Share Capital

| Date | DETAILS | NUMBER OF SHARES | BALANCE \$'000 |
|-------------------------|----------------|-----------------------------|---------------------------|
| 1 January 2011 | Balance | 227,065,914 | 99,615 |
| During 2011 | Share buy-back | (382,000) | (76) |
| 31 December 2011 | Balance | 226,683,914 | 99,539 |
| 31 December 2012 | Balance | 226,683,914 | 99,539 |

29.3. Treasury Shares Held in Trust

| | CONSOLIDATED AND COMPANY | |
|---------------------------------------|---------------------------------|----------------|
| Details | 2012 \$'000 | 2011 \$'000 |
| Balance at the beginning of the year | (2) | (2) |
| Acquisition of shares | (68) | - |
| Balance at the end of the year | (70) | (2) |

The reserve represents shares purchased to satisfy future Long-Term Incentive ("LTI") obligations.

NOTE 30 SHARE-BASED PAYMENT ARRANGEMENTS

| | CONSOLIDATED AND COMPANY | |
|--|---------------------------------|----------------|
| Details | 2012 \$'000 | 2011 \$'000 |
| Balance at the beginning of the year | - | 160 |
| Transfer from the reserve upon lapsing of rights | - | (160) |
| Charged to Statements of Comprehensive Income | 379 | - |
| Balance at the end of the year | 379 | - |

30.1. Eligibility and Purpose

Eligible Executives are invited to participate in the Calliden LTI plan (the "Plan"). The Plan is intended to engage Executives in the success of the business by linking rewards with the performance of the Group. This is achieved by employing objective performance measures directly linked to the creation of shareholder wealth, such as growth in earnings per share and total shareholder returns, as well as encouraging their retention. The Plan commenced in 2005.

Eligibility is considered by the Board based on Executives' ability to influence the overall and long-term performance of the business.

30.2. Performance Rights

Under the Plan, participating Executives may receive annual grants of performance rights. Subject to the rules of the Plan, each performance right entitles the Executive holding that right to receive, for no consideration, one fully-paid ordinary share in the Company at the end of the performance period if performance and service criteria specified by the Board are satisfied over the performance period. Currently, no new shares have been issued for the Plan and those required to satisfy vesting requirements are purchased on the Australian Securities Exchange ("ASX").

30.3. Number of Performance Rights

In 2012, two LTI grants were made to Executives and various employees. The 2011 Plan grant date was 1 February 2012. The 2012 Plan grant date was 8th October 2012.

The number of performance rights is determined by dividing the value of the LTI component of each Executive's remuneration by the value of the Rights in the grant. For any proposed grant, the LTI component of each Executive's remuneration ranges from 60% to 120% of salary plus superannuation and the value of each Right is calculated based on the volume-weighted average price ("VWAP") of Calliden's shares in the 5 days prior to the performance period (that is, up to and including 31 December at the relevant year), less the projected dividends over the performance period. For the 2011 LTI the performance period will be 1 January 2011 to 31 December 2013. For the 2012 LTI the performance period will be 1 January 2012 to 31 December 2014. Where Rights are subject only to service conditions ("Retention Rights") then the resulting value is used. Rights subject to performance conditions ("Performance Rights") have an Adjusted Right Value determined where the value is discounted recognising the attaching performance vesting conditions – for the grant in respect of 2011 and 2012 the discount is 50%.

It is noted that the proportion of value of Retention Rights of all Rights in the 2011 and 2012 grant varies from 100% to 33%. The decision was made by the Board that, in consideration of APRA's Prudential Standard GPS 510, only Retention Rights would be granted to risk and financial control personnel so as to ensure that this performance-based component of remuneration does not in any way compromise the independence of these personnel in carrying out their functions.

Details on rights over ordinary shares in the Company that were granted as compensation to each key management person during the reporting period and details on options that vested during the reporting period are as follows:

| Grant date | VESTING CONDITIONS | FAIR VALUE AT GRANT DATE | RIGHTS ON ISSUE AT 1 JAN | RIGHTS GRANTED DURING THE YEAR | RIGHTS LAPSED DURING THE YEAR | RIGHTS ON ISSUE AT 31 DEC |
|--------------------|-----------------------|--------------------------------|--------------------------------|---|--|---------------------------------|
| \$ | | | | | | |
| 2012 | | | | | | |
| 2012 rights | | | | | | |
| 8/10/2012 | Non-market | 0.116 | - | 5,289,334 | - | 5,289,334 |
| | Market | 0.090 | - | 3,297,667 | - | 3,297,667 |
| 2011 rights | | | | | | |
| 1/02/2012 | Non-market | 0.100 | - | 2,061,840 | - | 2,061,840 |
| | Market | 0.036 | - | 1,374,560 | - | 1,374,560 |
| 2011 | | | | | | |
| 2009 rights | | | | | | |
| 19/06/2009 | | 0.260 | 4,118,914 | - | (4,118,914) | - |

All options were granted during the reporting period. No rights have been granted since the end of the reporting period.

30.4. Fair Value Per Share

AASB 2 *Share-based Payment* requires a 'fair value' calculation of the rights granted at measurement date based on market prices and taking into account the terms and conditions upon which the instruments were granted (vesting conditions). The approach to the fair value calculation differs depending on the nature of the vesting conditions of the rights.

30.5. Valuation of Rights with Market Vesting Conditions

These reflect the fair value estimate of the rights at the grant date, and the value is not subsequently updated.

An adapted Black-Scholes methodology was employed to estimate the fair value of rights issued with market vesting conditions. Due to the complexity of the vesting conditions, a Monte Carlo simulation approach was adopted and this was used for all of the 2011 and 2012 rights.

The value of each 2011 right subject to market vesting conditions was \$0.036. The value of each 2012 right subject to market vesting conditions was \$0.090.

30.6. Valuation of Rights with Non-Market Vesting Conditions

These reflect the expected number of rights that will vest, with the best estimate of the number of rights that will vest being revised at each valuation date. This is used for the both the 2011 and 2012 rights that depend on earnings per share.

The value of each 2011 right subject to non-market vesting conditions was \$0.100. The value of each 2012 right subject to non-market vesting conditions was \$0.116.

NOTE 31 AUDITOR'S REMUNERATION

| | CONSOLIDATED | | COMPANY | |
|---|---------------------|-------------|----------------|-------------|
| | 2012 | 2011 | 2012 | 2011 |
| | \$ | \$ | \$ | \$ |
| (i) Audit services – KPMG Australia | | | | |
| Audit and review of financial reports | 276,795 | 327,070 | 110,355 | 110,355 |
| Other regulatory audit services: | | | | |
| – APRA review and audit | 47,250 | 47,250 | 15,750 | 15,750 |
| – Australian Financial Services Licences | 10,355 | 10,355 | - | - |
| – Fire services levy | 6,600 | 6,600 | - | - |
| (ii) Audit related services – KPMG Australia | | | | |
| Other services: | | | | |
| – Actuarial peer review services | 30,700 | 29,200 | - | - |
| – Home Warranty Insurance Fund controls review | 55,000 | - | - | - |
| Total auditor's remuneration | 426,700 | 420,475 | 126,105 | 126,105 |

NOTE 32 COMMITMENTS

Non-cancellable operating lease rentals are payable as follows:

| | CONSOLIDATED AND COMPANY | |
|-----------------------------------|---------------------------------|---------------|
| | 2012 | 2011 |
| | \$'000 | \$'000 |
| Less than one year | | |
| – Lease of premises | 661 | 1,017 |
| – Lease of computer equipment | 579 | 629 |
| | 1,240 | 1,646 |
| Between one and five years | | |
| – Lease of premises | 5,053 | 267 |
| – Lease of computer equipment | 395 | 487 |
| | 5,448 | 754 |
| More than five years | | |
| – Lease of premises | 337 | - |
| – Lease of computer equipment | - | - |
| | 337 | - |
| Total commitments | 7,025 | 2,400 |

The Group leases a number of office facilities under operating leases. The leases typically run for a period of 5 years. The Company entered into a new contract for the Sydney office premises in December 2012 for a period of 5 years and expires in February 2018. The Company entered into a new contract for the Melbourne office premises in August 2012 for a period of 4.7 years and expires in October 2017.

NOTE 33 RELATED PARTY DISCLOSURES

33.1. Parent Entity

The parent entity within the Group is Calliden Group Limited.

33.2. Subsidiaries

Investments in subsidiaries are set out in Note 21.

33.3. Inter-Company Transactions

Transactions between the Company and its controlled entities during the years ended 31 December 2012 and 31 December 2011 consisted of management fees being charged to the subsidiaries below for administration and support services provided during the year and these are usually settled on a monthly basis:

| | COMPANY | |
|---|-------------------|-------------------|
| | 2012 \$ | 2011 \$ |
| Aggregate amounts included in the determination of the operating result before income tax from these transactions: | | |
| Calliden Insurance Limited | 35,058,305 | 36,764,062 |
| Dawes Underwriting Australia Pty Limited | 928,056 | 2,772,206 |
| IUA Pty Limited | 587,329 | 1,403,581 |
| Mansions of Australia Limited | 1,108,927 | 1,705,106 |
| Total management fees | 37,682,617 | 42,644,955 |

Aggregate amounts receivable from / (payable to) entities in the wholly-owned Group at reporting date:

| | | |
|--------------------------------------|-------------|-------------|
| ARGIS Pty Limited | - | [2] |
| Calliden Insurance Limited | (9,908,275) | (6,766,998) |
| Dawes Underwriting Australia Pty Ltd | 1,980,674 | 2,336,429 |
| IUA Pty Ltd | (161,323) | (73,644) |
| Mansions of Australia Limited | 4,607,509 | 5,059,222 |

33.4. Key Management Personnel Remuneration

| | CONSOLIDATED AND COMPANY | |
|------------------------------|--------------------------|------------------|
| | 2012 \$ | 2011 \$ |
| Short-term employee benefits | 1,925,584 | 2,058,041 |
| Long-term employee benefits | - | 145,139 |
| Post-employment benefits | 141,012 | 182,293 |
| Share-based payment benefits | - | - |
| Termination benefits | 8,551 | 329,600 |
| | 2,075,147 | 2,715,073 |

The Group has applied the exemption under AASB 124 *Related Party Disclosures* which exempts listed companies from providing remuneration disclosure in relation to their key management personnel in the notes to this financial report where this information is disclosed in the Remuneration Report section of the Directors' Report. Information regarding Key Management Personnel's remuneration and some equity instruments disclosure is provided in the Remuneration Report section of the Directors' Report.

NOTE 34 CONTINGENT LIABILITIES

The Group is exposed to a range of contingencies. Some are specific to instruments or transactions, others relate more to risk faced in the normal course of business.

Contingent liabilities are not recognised in the balance sheet but are disclosed where the possibility of settlement is less than probable but more than remote. Provisions are not required with respect to these matters as it is not probable that a future sacrifice of economic benefits will be required or the amount is not reliably measurable. If settlement becomes probable, a provision is recognised. The best estimate of the settlement amount is used in measuring a contingent liability for disclosure. The measurement involves judgement.

In the normal course of business, transactions are entered into that may generate a range of contingent liabilities. These include:

- › Litigation arising out of insurance policies; and
- › Undertakings for maintenance of net worth and liquidity support to subsidiaries in the Consolidated entity. It is normal practice to provide wholly owned subsidiaries with support and assistance as may be appropriate with a view to enabling them to meet their obligations and to maintain their good standing. Such undertakings constitute a statement of present intent only and are not intended to give rise to any binding legal obligation. The Company has guaranteed to pay all of the debts of all of its subsidiaries as and when they fall due.

It is not believed that there are any other potential material exposures to the Consolidated entity and there are no known events that would require it to satisfy the guarantees or take action under a support agreement.

NOTE 35 CAPITAL MANAGEMENT

35.1. Capital Management Strategy

The capital management strategy plays a central role in managing risk to create shareholder value, whilst meeting the crucial and equally important objectives of providing an appropriate level of capital to protect policyholders' and lenders' interests, and satisfy regulators. The Group has a defined risk appetite regarding capital that is supported by strategies around the key levers of underwriting, reinsurance, asset allocation and risk management. The target level of capitalisation for the Group is identified by consideration of factors including:

- › The probability of ruin over the next one to three years;
- › The probability of falling below the APRA Minimum Capital Requirement ("MCR") over the next one to three years;
- › Other stakeholder perspectives on capitalisation, including rating agency capital models and associated ratings; and
- › Domestic and international levels of capitalisation.

The amount of capital required in light of these factors varies according to the business underwritten, the extent of reinsurance and asset allocation. Assessments of capital adequacy are aided by the use of dynamic financial analysis modelling.

For ease of communication both internally and externally, the Group has translated targets and actual capital levels into a multiple of MCR by applying the APRA prescribed methodology for a Level 2 Insurance Group. Internal policies are in place to ensure significant deviations from this benchmark will result in the Board considering how any shortfall should be made good or any surplus utilised.

In accordance with the provisions of the new Life and General Insurance Capital review ("LAGIC") regulatory environment in effect from 1 January 2013, the Group has implemented an Internal Capital Adequacy Assessment Process ("ICAAP"). The ICAAP framework further strengthens the Group's ability to continuously identify, measure, monitor and manage its risks to ensure capital levels are maintained that are consistent with the Group risk appetite and regulatory requirements.

35.2. Regulatory Capital

It is Group policy to ensure that each of the APRA authorised entities within the Group maintain an adequate capital position, and to hold regulatory capital levels in excess of the MCR. The Capital Adequacy Multiple ("CAM") as at 31 December 2012 for Calliden Group Limited is 1.9 (2011: 1.2); and for Calliden Insurance Limited is 2.2 (2011: 1.4).

Capital calculations for regulatory purposes are based on the premium liabilities model which is different to the deferral and matching model which underpins the measurement of assets and liabilities in this financial report. The premium liabilities model assesses future claims payments arising from future events insured under existing policies. This differs to the measurement of the outstanding claims liability on the balance sheet which considers claims relating to events that occur only up to and including the reporting date.

The Group has considered the implications of the new LAGIC regime, and has determined to maintain largely consistent capital levels as those under the regime in effect at 31 December 2012.

35.3. Capital Composition

The Group's capital comprises equity as shown in the Statements of Financial Position.

35.4. Regulatory Capital Compliance

The Company and the insurers within the Consolidated entity have at all times during the current and prior financial year complied with the externally imposed capital requirements to which they are subject. The Group is an APRA authorised general insurer, Calliden Insurance Limited, and one authorised non-operating holding Company ("NOHC"), Calliden Group Limited. The MCR calculation provided below is based on applying the APRA Level 2 Insurance Group requirements.

| | CALLIDEN GROUP LIMITED | CALLIDEN INSURANCE LIMITED |
|------------------------------------|-----------------------------------|---------------------------------------|
| | \$'000 | \$'000 |
| Statutory capital | 45,611 | 53,959 |
| Minimum capital requirement | 24,277 | 24,425 |
| Capital adequacy multiple | | |
| 2012 | 1.9 | 2.2 |
| 2011 | 1.2 | 1.4 |

NOTE 36 EVENTS SUBSEQUENT TO REPORTING DATE

On 28 February 2013, the Directors declared a fully franked dividend of 0.4 cents per share (2012: nil).

In January 2013, Calliden was exposed to the flooding and storm damage which occurred in Queensland and northern New South Wales arising from ex-tropical cyclone Oswald. The total cost of this damage has not been determined, however the majority of the policies are reinsured under a 60% quota share cession and the final net cost is expected to be within budgeted catastrophe allowances for the year.

As at the date of this report, there were no other material or unusual events or transactions occurring after the reporting date that the Directors are aware of that would significantly affect the Group's operations or the state of affairs of the Group in future years.

Directors' Declaration

In the opinion of the Directors of Calliden Group Limited:

- ▶ The financial report and Notes 1 to 36, including all the remuneration disclosures that are contained in the remuneration report of the Directors' report, are in accordance with the *Corporations Act 2001*, including:
 - Giving a true and fair view of the financial position of the Company and Consolidated entity as at 31 December 2012 and of their performance, as represented by the results of their operations and their cash flows, for the year ended on that date;
 - Complying with Australian Accounting Standards (including Australian Interpretations) and the *Corporations Regulations 2001*;
 - The financial report also complies with International Financial Reporting Standards as disclosed in Note 2;
- ▶ The Remuneration Report of the Directors' Report complies with Australian Accounting Standard AASB 124 Related Party Disclosures; and
- ▶ There are reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable.

The Directors have been given the declarations required by Section 295A of the *Corporations Act 2001* from the Chief Executive Officer and Chief Financial Officer for the financial year ended 31 December 2012.

- ▶ The Directors draw attention to Note 2 in this financial report, which includes a statement of compliance with International Financial Reporting Standards.

Signed at Sydney this 28th day of February 2013 in accordance with a resolution of the Directors.



RJ Hill

Chairman



Independent Auditor's Report to the Members of Calliden Group Limited

REPORT ON THE FINANCIAL REPORT

We have audited the accompanying financial report of Calliden Group Limited (the Company), which comprises the statements of financial position as at 31 December 2012, and statements of comprehensive income, statements of changes in equity and statements of cash flows for the year ended on that date, Notes 1 to 36 comprising a summary of significant accounting policies and other explanatory information and the directors' declaration of the company and the Group comprising the company and the entities it controlled at the year's end or from time to time during the financial year.

Directors' responsibility for the financial report

The directors of the company are responsible for the preparation of the financial report that gives a true and fair view in accordance with Australian Accounting Standards and the *Corporations Act 2001* and for such internal control as the directors determine is necessary to enable the preparation of the financial report that is free from material misstatement whether due to fraud or error. In Note 2, the directors also state, in accordance with Australian Accounting Standard AASB 101 *Presentation of Financial Statements*, that the financial statements of the Group comply with International Financial Reporting Standards.

Auditor's responsibility

Our responsibility is to express an opinion on the financial report based on our audit. We conducted our audit in accordance with Australian Auditing Standards. These Auditing Standards require that we comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance whether the financial report is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial report. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial report, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of the financial report that gives a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial report.

We performed the procedures to assess whether in all material respects the financial report presents fairly, in accordance with the *Corporations Act 2001* and Australian Accounting Standards, a true and fair view which is consistent with our understanding of the Company's and the Group's financial position and of their performance.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Independence

In conducting our audit, we have complied with the independence requirements of the *Corporations Act 2001*. We confirm that the independence declaration required by the *Corporations Act 2001*, which has been given to the directors of Calliden Group Limited on 28 December 2012, would be in the same terms if given to the directors as at the time of this auditor's report.

Auditor's opinion

In our opinion:

- (a) The financial report of Calliden Group Limited is in accordance with the *Corporations Act 2001*, including:
 - (i) Giving a true and fair view of the Company's and the Group's financial position as at 31 December 2012 and of their performance for the year ended on that date; and
 - (ii) Complying with Australian Accounting Standards and the *Corporations Regulations 2001*.
- (b) The financial report also complies with International Financial Reporting Standards as disclosed in Note 2.

REPORT ON THE REMUNERATION REPORT

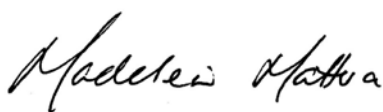
We have audited the Remuneration Report included in pages 15 to 22 of the Directors' report for the year ended 31 December 2012. The Directors of the Company are responsible for the preparation and presentation of the remuneration report in accordance with Section 300A of the *Corporations Act 2001*. Our responsibility is to express an opinion on the remuneration report, based on our audit conducted in accordance with auditing standards.

Auditor's opinion

In our opinion, the remuneration report of Calliden Group Limited for the year ended 31 December 2012, complies with Section 300A of the *Corporations Act 2001*.



KPMG



Madeleine Mattera

Partner

Sydney

28 February 2013

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Additional Information

A. SHAREHOLDERS INFORMATION AS AT 14 MARCH 2012

1.0 TWENTY LARGEST SHAREHOLDERS

| | NO. OF SHARES HELD | % ISSUED CAPITAL |
|--|--------------------|------------------|
| JP Morgan Nominees Australia | 70,772,536 | 31.22 |
| Australian Unity Strategic Holdings Pty Ltd | 30,142,850 | 13.30 |
| Citicorp Nominees Pty Limited (Colonial First State Inv A/C) | 10,430,326 | 4.60 |
| HSBC Custody Nominees (Australia) Limited | 9,964,970 | 4.40 |
| JP Morgan Nominees Australia Limited (Cash Income A/C) | 9,122,755 | 4.02 |
| Citicorp Nominees Pty Limited | 4,338,700 | 1.91 |
| National Nominees Limited | 3,331,955 | 1.47 |
| Chembank Pty Limited (Cabac Super Fund A/C) | 3,000,000 | 1.32 |
| CPU Share Plans Pty Limited (CIX-LTI Control Account) | 2,468,185 | 1.09 |
| Bell Potter Nominees Ltd (BB Nominees A/C) | 2,000,000 | 0.88 |
| Hillmorton Custodians Pty Ltd (The Lennox Unit A/C) | 1,324,000 | 0.58 |
| Mr Anthony Woolley (Woolley Kencian S/Fund A/C) | 1,307,749 | 0.58 |
| Chembank Pty Limited (Philandron Account) | 1,200,000 | 0.53 |
| Jagen Pty Ltd | 1,100,000 | 0.49 |
| Mr Bryan F Short (Short Family S/F A/C) | 1,020,000 | 0.45 |
| UBS Wealth Management Australian Nominees Pty Ltd | 1,017,000 | 0.45 |
| Tusa Pty Limited | 1,000,000 | 0.44 |
| Mr Geoffrey William Vines & Mrs Wendy Margaret Vines (Vines Family Super Fund A/C) | 1,000,000 | 0.44 |
| Ms Linh Ly Cossey | 859,213 | 0.38 |
| Dr David George Maxwell Welsh | 852,000 | 0.38 |
| Total | 156,252,239 | 68.93 |

2.0 DISTRIBUTION OF SHAREHOLDINGS

| NO. OF SHARES HELD | NO. OF HOLDERS | % ISSUED CAPITAL |
|--------------------|----------------|------------------|
| 1 – 1,000 | 349 | 0.08 |
| 1,001 – 5000 | 906 | 1.18 |
| 5001 – 10,000 | 420 | 1.51 |
| 10,001 – 100,000 | 775 | 12.54 |
| 100,001 and over | 156 | 84.69 |
| Total | 2,606 | 100 |

2.1 Unmarketable Parcel Information

| MINIMUM PARCEL SIZE* | HOLDERS | UNITS |
|----------------------|---------|-----------|
| 4,546 | 1,116 | 2,187,531 |

*Minimum \$500 parcel at \$0.11 per unit

3.0 SUBSTANTIAL SHAREHOLDERS AS AT DATE OF LAST NOTICE TO THE COMPANY

| | NO. OF SHARES HELD | % OF TOTAL ISSUED CAPITAL* | DATE OF LAST NOTICE |
|--|--------------------|-------------------------------|---------------------|
| Hunter Hall Investment Management Limited and related parties. | 46, 199,097 | 20.38 | 29/04/2010 |
| Australian Unity Strategic Holdings Pty Ltd | 30,142,850 | 13.30 | 29/07/2008 |
| Celeste Funds Management Limited | 18,464,216 | 8.15 | 27/01/2011 |
| Challenger Financial Services Group Limited (and related entities) | 17,577,459 | 7.75 | 29/01/2013 |
| Greencape Capital Pty Ltd | 13,875,584 | 6.12 | 14/12/2012 |

*The % of issued capital is based on the total issued capital as at 12 March 2013: 226,683,914 shares.

4.0 OPTIONS OVER ORDINARY SHARES

As at 12 March 2013 there were no options over unissued ordinary shares granted to Directors or to employees of the Company.

5.0 ON-MARKET SHARE BUY-BACK

The Company did not participate in any on-market share buy-back program during 2012.

B. Classes of Shares and Voting Rights

The Company has fully paid ordinary shares on issue. At a general meeting, every ordinary shareholder present in person or by proxy, attorney or representative has one vote on a show of hands and, on a poll, one vote for each fully paid share held.

C. Corporate Governance Statement

This Statement sets out details of the Company's compliance with the "Principles of Good Corporate Governance and Best Practice Recommendations" published by the ASX Corporate Governance Council and explains any departures from those recommendations, as required by ASX Listing Rule 4.10. Unless indicated otherwise, the documentation referred to in this Statement can be accessed from the Corporate Governance section of the Company's website, www.calliden.com.au.

The Company periodically reviews its policies and practices against the ASX principles and recommendations. The following table outlines the manner by which the Company complies with each of the recommendations.

| | | DOCUMENTATION |
|---------------------------|---|---------------|
| PRINCIPLE 1 | Lay solid foundations for management and oversight | |
| Recommendation 1.1 | Companies should establish the functions reserved to the board and those delegated to senior executives and disclose those functions. | |
| Response | <p>The Company has adopted a formal Board Charter that sets out the responsibilities of the Board. The Company provides formal letters of appointment for all Company Directors. A comprehensive check of their fitness and propriety is also undertaken prior to appointment.</p> <p>There is a clear delegation of authority to Senior Executives, and the Board has direct authority to amend and approve these.</p> | Board Charter |
| Recommendation 1.2 | Companies should disclose the process for evaluating the performance of senior executives. | |
| Response | The Company adopts an annual review process for all staff, including Senior Executives. This review process consists of establishing a number of objectives at the beginning of the year that are linked to the Business Plan and performance objectives of the Company. At the end of the year the Senior Executives are measured against the objectives. | |
| Recommendation 1.3 | Companies should provide the information indicated in the <i>Guide to Reporting on Principle 1</i> . | |
| | <ul style="list-style-type: none"> an explanation of any departure from Recommendations 1.1, 1.2 or 1.3. | |
| Response | There has been no material departure from recommendations 1.1, 1.2 or 1.3. | |
| | <ul style="list-style-type: none"> whether a performance evaluation for senior executives has taken place in the reporting period and whether it was in accordance with the process disclosed. | |
| Response | A review of the performance of Senior Executives has taken place in accordance with recommendation 1.2. | |

| PRINCIPLE 2 | | Structure the Board to add value |
|---------------------------|---|---|
| Recommendation 2.1 | A majority of the Board should be independent directors. | |
| Response | Five of the seven Company Directors are considered to be independent. Mr Kirk is not independent because he is an Executive Director. Mr Connon is not independent because of his connection with a substantial shareholder of the Company, Australian Unity Strategic Holdings Limited. Messrs Hill, Lowenstein, Smith, Messenger and Loomes are considered to be independent. | |
| Recommendation 2.2 | The Chairperson should be an independent director. | |
| Response | The Chairman, Mr Hill, is an independent Company Director. | |
| Recommendation 2.3 | The roles of Chairperson and Chief Executive Officer should not be exercised by the same individual. | |
| Response | The Chairman and the Managing Director is not the same individual. The Board's policy is that the Managing Director may not become the Chairman. | |
| Recommendation 2.4 | The Board should establish a Nomination Committee. | |
| Response | The Board has established a Remuneration and Nominations Committee that met three times during 2012. | Board Charter Remuneration and Nominations Committee Charter |
| Recommendation 2.5 | Companies should disclose the process for evaluating the performance of the Board, its committees and individual directors. | |
| Response | The Board undertakes an annual review of its performance. This review consists of each board member undertaking a self-assessment questionnaire which draws answers from each Company Director about the degree to which the Board has satisfied its obligations. The Board has conducted a review of its 2012 performance. | |
| Recommendation 2.6 | Provide the information set out in the <i>Guide to Reporting on Principle 2</i> . | |
| | <ul style="list-style-type: none"> the skills, experience and expertise relevant to the position of director held by each director in office at the date of the annual report | |
| Response | This information is provided on pages 10 to 11 of this Annual Report. | Annual Report |
| | <ul style="list-style-type: none"> the names of the directors considered by the Board to constitute independent directors and the Company's materiality thresholds | |
| Response | This information is provided on pages 10 to 11 of this Annual Report. The Company adopts the materiality thresholds prescribed in APRA Prudential Standard CPS510 Governance. | Annual Report |
| | <ul style="list-style-type: none"> the existence of any of the relationships listed in Box 2.1 and an explanation of why the board considers a director to be independent, notwithstanding the existence of those relationships | |
| Response | Mr Lowenstein was directly associated with Hunter Hall Limited, a significant shareholder of the Company until November 2011. | |
| | <ul style="list-style-type: none"> a statement as to whether there is a procedure agreed by the Board for directors to take independent professional advice at the expense of the Company. | |
| Response | Company Directors may seek independent professional advice at the expense of the Company in respect of matters relating to their role as a Company Director. This is codified in the Board Charter. | Board Charter |
| | <ul style="list-style-type: none"> a statement as to the mix of skills and diversity for which the board of directors is looking to achieve in membership of the board. | |
| Response | The Board undertakes regular reviews of its composition and structure to ensure an appropriate mix of skills and diversity. | Remuneration and Nominations Committee Charter |
| | <ul style="list-style-type: none"> the period of office held by each director in office at the date of the Annual Report | |
| Response | This information is provided on page 10 of this Annual Report. | Annual Report |

DOCUMENTATION

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| | <ul style="list-style-type: none"> the names of members of the nomination committee and their attendance at meetings of the committee, or where a company does not have a nomination committee, how the functions of a nomination committee are carried out. | |
| Response | Details of the members of the Remuneration and Nominations Committee and their attendance at the meetings are provided on page 11 of this Annual Report. | |
| | <ul style="list-style-type: none"> whether a performance evaluation for the board, its committees and directors has taken place in the reporting period and whether it was in accordance with the process disclosed. | |
| Response | The Board has conducted a review of its 2012 performance. | Board Charter |
| PRINCIPLE 3 | Promote ethical and responsible decision-making | |
| Recommendation 3.1 | <p>Establish a Code of Conduct to guide the directors, the Chief Executive Officer, the Chief Financial Officer and any other key executives as to:</p> <p>3.1.1 the practices necessary to maintain confidence in the Company's integrity</p> <p>3.1.2 the practices necessary to take into account their legal obligations and the reasonable expectations of their stakeholders</p> <p>3.1.3 the responsibility and accountability of individuals for reporting and investigating reports of unethical practices</p> | |
| Response | <p>The Company has established a Code of Conduct for Company Directors and employees.</p> <p>The Company has established a Compliance Policy which outlines the procedures and controls in place to maintain compliance with all legal obligations.</p> <p>A Whistleblower Policy is in force which details how employees may escalate instances of unethical practices.</p> | <p>Code of Conduct</p> <p>Compliance Policy (not publicly available)</p> |
| Recommendation 3.2 | Companies should establish a policy concerning diversity and disclose the policy or a summary of that policy. | |
| Response | <p>During 2012 the Company reviewed its published diversity policy.</p> <p>It is important for the sustainability and growth of the Company to attract and retain people with appropriate skills, knowledge and experience to meet the Company's current and future needs.</p> | Diversity Policy (not publicly available) |
| Recommendation 3.3 | Companies should disclose the measurable objectives for achieving gender diversity and progress towards achieving them. | |
| Response | <p>The Company has established the following diversity objectives to be achieved by 31 December 2015:</p> <ol style="list-style-type: none"> Appointment of a female Company Director (currently no female directors); 25% of Senior Executive positions to be filled by females (currently 20%); 50% of managers/team leaders to be female (currently 31%); and Maintain gender diversity in training and development (see response to recommendation 3.4). | |

| | | |
|---------------------------|--|--|
| Recommendation 3.4 | Companies should disclose the proportion of women employees in the organisation, senior executives and board members | |
| Response | <p>The composition of female employees within the Company is always fluctuating, although the Company is currently composed of 47% females and 53% males.</p> <p>There is currently one female Senior Executive, constituting 20% of the executive team.</p> <p>The leadership fundamentals program run by the Company consists of 42% females. The program covers core leadership competencies for all managers and team leaders below Senior Executive level. The program is open to all managers and team leaders, and potential successors to each role.</p> <p>Further, the Company runs a mentoring program for career development. The program consists of 35% female mentorees and 33% female mentors.</p> <p>Also, 45% of employees receiving education support are female.</p> | |
| Recommendation 3.5 | Provide the information indicated in the <i>Guide to Reporting on Principle 3</i> . | |
| Response | See responses to recommendations 3.1, 3.2, 3.3 and 3.4. | |
| PRINCIPLE 4 | Safeguard integrity in financial reporting | |
| Recommendation 4.1 | The Board should establish an Audit Committee. | |
| Response | The Board has established an Audit Committee. | Audit Committee Terms of Reference |
| Recommendation 4.2 | <p>The Audit Committee should be structured so that it:</p> <ul style="list-style-type: none"> › consists only of non-executive directors › consists of a majority of independent directors › is chaired by an independent chairperson who is not the chair of the Board › has at least three members | |
| Response | <p>The Audit Committee consists of non-Executive Directors, a majority being independent Company Directors. The committee members are: Messrs Loomes, Lowenstein, Messenger, Smith (all independent Company Directors); and Mr Connon. Mr Loomes, the Chairman of the Audit Committee, is not the Chairman of the Board.</p> <p>Details of the committee members' attendance at the meetings are provided on page 11 of this Annual Report.</p> | Audit Committee Terms of Reference |
| Recommendation 4.3 | The Audit Committee should have a formal charter. | |
| Response | The Audit Committee operates under formal Terms of Reference. | Audit Committee Terms of Reference |
| Recommendation 4.4 | <p>Provide the information indicated in the <i>Guide to Reporting on Principle 4</i>:</p> <ul style="list-style-type: none"> › the names and qualifications of those appointed to the Audit Committee and their attendance at meetings of the committee, or where a company does not have an audit committee, how the functions of an audit committee are carried out. › number of meetings of the Audit Committee | |
| Response | <p>Details of the members of the Audit Committee and their attendance at Audit Committee meetings are provided on page 11 of this Annual Report.</p> <p>The Audit Committee has responsibility for reviewing and making recommendations to the Board on the appointment, removal and independence of the external auditor. Rotation of the Appointed Auditor is undertaken in accordance with the requirements of the Corporations Act 2001.</p> <p>The current Appointed Auditor is KPMG.</p> | <p>Annual Report</p> <p>Audit Committee Terms of Reference</p> |

DOCUMENTATION

| PRINCIPLE 5 | | Make timely and balanced disclosure |
|---------------------------|---|--|
| Recommendation 5.1 | Companies should establish written policies designed to ensure compliance with ASX Listing Rule disclosure requirements and to ensure accountability at a senior executive level for that compliance and disclose of those policies or a summary of those policies. | |
| Response | <p>The Company has a documented Continuous Disclosure Protocol to ensure compliance with (in particular) ASX Listing Rule 3.1.</p> <p>The Company has in place a compliance management system to ensure that key dates are complied with and to obtain regular monitoring of continuous obligations.</p> | Continuous Disclosure Protocol |
| Recommendation 5.2 | Provide the information indicated in the <i>Guide to Reporting on Principle 5</i> . | |
| Response | See response to recommendation 5.1. | |
| PRINCIPLE 6 | | Respect the rights of shareholders |
| Recommendation 6.1 | Companies should design a communications policy for promoting effective communication with shareholders and encouraging their participation at general meetings and disclose their policy or a summary of that policy. | |
| Response | The Company aims to communicate clearly and transparently with existing and prospective shareholders. The Company's website is used as a core means of investor communication. All announcements made to the ASX are placed on the website, under the Investor tab, immediately after release to the market and past disclosures are archived on the website. The Company also offers an email service to alert interested parties of announcements made to the Company's website. The Company's policy is to provide periodic commentary on the Company's activities and financial results to enhance the clarity and balance of reporting and to provide information needed by an investor to make an informed assessment of the Company. The Company believes that its shareholders are afforded the opportunity for effective participation in general meetings of the Company. Prior to any investor briefing the Company announces any dial and/or webcasting details through the ASX and releases any relevant material. | <p>Announcements to ASX</p> <p>Company's website</p> <p>Continuous Disclosure Protocol</p> |
| Recommendation 6.2 | Companies should provide the information indicated in the <i>Guide to Reporting on Principle 6</i> . | |
| Response | See response to recommendation 6.1. | |
| PRINCIPLE 7 | | Recognise and manage risk |
| Recommendation 7.1 | Companies should establish policies for the oversight and management of material business risks and disclose a summary of those policies. | |
| Response | The Company has in place a Risk Management Strategy which outlines the policies and procedures in place to manage the risk framework within the Company. | <p>Board Charter</p> <p>Risk Management Committee Charter</p> <p>Risk Management Strategy (not publicly available)</p> |
| Recommendation 7.2 | The board should require management to design and implement the risk management and internal control system to manage the company's material business risks and report to it on whether those risks are being managed effectively. The board should disclose that management has reported to it as to the effectiveness of the company's management of its material business risks. | |
| Response | The Board Risk Management Committee receives a quarterly report on the development of risks and associated controls that are implemented to manage those risks. Management regularly hold meetings at the executive and operational level to monitor and review material business risks. | |

DOCUMENTATION

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| Recommendation 7.3 | The board should disclose whether it has received assurance from the chief executive officer (or equivalent) and the chief financial officer (or equivalent) that the declaration provided in accordance with s295A of the Corporations Act is founded on a sound system of risk management and internal control and that the system is operating effectively in all material respects in relation to financial reporting risks. | |
| Response | The CEO and CFO have provided such a statement to the Board. | Annual Report |
| Recommendation 7.4 | Provide the information indicated in the <i>Guide to Reporting on Principle 7</i> : <ul style="list-style-type: none"> Whether the board has received the report from management under Recommendation 7.2. | |
| Response | The quarterly reports to the Board Risk Management Committee have been received. | Risk Management Strategy (not publicly available) Internal Audit Policy (not publicly available) |
| | <ul style="list-style-type: none"> Whether the board has received assurance from the Chief Executive Officer (or equivalent) and the Chief Financial Officer (or equivalent) under Recommendation 7.3. | |
| Response | See response to recommendation 7.3 | |
| PRINCIPLE 8 | Remunerate fairly and responsibly | |
| Recommendation 8.1 | The Board should establish a Remuneration Committee. | |
| Response | The Board has established a Remuneration and Nominations Committee that met three times during 2012. | Board Charter Remuneration and Nominations Committee Charter |
| Recommendation 8.2 | The remuneration committee should be structured so that it: <ul style="list-style-type: none"> consists of a majority of independent directors is chaired by an independent chair has at least three members. | |
| Response | The Remuneration and Nominations Committee is comprised of three independent Company Directors. Mr Smith is the Chairman of the committee, and Mr Hill and Mr Messenger are committee members. Details of the committee members' attendance at the meetings are provided on page 11 of this Annual Report. | Remuneration and Nominations Committee Charter Annual Report |
| Recommendation 8.3 | Companies should clearly distinguish the structure of non-Executive Directors' remuneration from that of executive directors and senior executives. | |
| Response | Details of the Company Directors' remuneration are provided on page 19 of this Annual Report, and details of the remuneration of Executive Directors and Senior Executives are provided on pages 19 to 20 of this Annual Report. Details of incentive schemes are set out on pages 15 to 22 of this Annual Report. | Annual Report |
| Recommendation 8.4 | Provide the information indicated in the <i>Guide to Reporting on Principle 8</i> <ul style="list-style-type: none"> Names of the members of the Remuneration Committee and attendance at meetings of the committee, or where the company does not have a remuneration committee, how the functions of a remuneration committee are carried out. | |
| Response | See response to recommendation 8.2. | |
| | <ul style="list-style-type: none"> The existence and terms of any schemes for retirement benefits, other than statutory superannuation, for non-Executive Directors | |
| Response | As disclosed on page 18 of this Annual Report, non-Executive Directors do not receive retirement benefits other than statutory superannuation. | Annual Report |

DIRECTORY

Calliden Group Limited

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Fax: +61 2 9551 1155

Website: calliden.com.au

Registered Office

Level 7, 100 Arthur St

North Sydney NSW 2060

Controlled Entities

Calliden Insurance Limited

Dawes Underwriting Australia Pty Limited

Mansions of Australia Limited

ARGIS Pty Limited

IUA Pty Ltd

Share Registry

Computershare Investor Services PTY Limited

GPO Box 2975

Melbourne VIC 3001

AUSTRALIA

Telephone: (Australia) 1300 850 505

(Overseas) +61 (0)3 9415 4000

Appointed Auditor

Ms Madeleine Mattera, KPMG

10 Shelley Street

Sydney NSW 2000

Consulting Actuaries

Finity Consulting Pty Ltd

Level 7, 155 George Street

The Rocks NSW 2000

Calliden Group Limited is listed as CIX on the Australian Securities Exchange

The home exchange is Sydney.

