**News release**
19 August 2016

# IAG posts sound financial results for FY16

IAG today reported a FY16 insurance profit[1] of $1.18 billion, a 6.8% increase on FY15 ($1.10 billion) equating to a reported insurance margin of 14.3% (FY15: 10.7%). This is a sound result in light of relatively flat gross written premium (GWP), which reflects challenging operating conditions in the Australian and New Zealand commercial markets.

The company also announced a $300 million off-market share buyback, reflecting IAG's strong capital position. The buy-back will be open to eligible shareholders registered at 25 August 2016 and is expected to be completed in mid-October 2016.

Key financial indicators included:

- Insurance profit $1.18 billion, up 6.8% on FY15 ($1.10 billion)
- Reported insurance margin 14.3%, a 360 basis points (bps) increase on FY15 (10.7%)
- Underlying insurance margin[2] 14.0% (FY15: 13.1%)
- Gross written premium of $11.37 billion, a 0.6% fall from FY15 ($11.44 billion)
- Net profit after tax $625 million, down 14.1% on FY15 ($728 million)
- Cash return on equity 13.0%
- Final fully franked dividend 13 cents per share. Full year payout 26 cents per share (FY15: 29 cps)
- Full year dividend payout ratio 72.9% of cash earnings (FY15: 70.2%)

The relatively flat GWP outcome reflects sound rate and volume growth in IAG's short tail personal lines in Australia and New Zealand, offset by softer commercial market conditions in both countries.

IAG's profitability remained strong with an underlying margin of 14.0% (FY15: 13.1%) which included a positive benefit from the Berkshire Hathaway quota share arrangement of 250bps.

IAG Managing Director and Chief Executive Officer Peter Harmer said he was pleased with the solid performance of the Group and felt confident about the business as it enters FY17.

"We've seen solid growth and strong profitability in our personal insurance lines in Australia and New Zealand, primarily driven by GWP growth for home and motor.

[1] The FY16 reported insurance profit and margin are presented on a management reported (non-IFRS) basis which is not directly comparable to the equivalent statutory (IFRS) figure in IAG's FY16 Annual Report. A reconciliation between the two is provided on page 7 of the Annual Report to comply with the Australian Securities and Investments Commission's Regulatory Guide 230. IAG's FY16 net profit after tax is the same in this announcement and in IAG's 2016 Annual Report.

[2] IAG defines its underlying insurance margin as the reported insurance margin adjusted for:
– Net natural peril claim costs less related allowance for the period;
– Reserve releases in excess of 1% of NEP; and
– Credit spread movements.

“Our commercial businesses in Australia and New Zealand have withstood continuing price pressure and maintained their strict underwriting discipline which has resulted in lower business volumes as we exited unprofitable business – but we are encouraged by growing signs of rate improvement,” Mr Harmer said.

“Asia represents an important source of long term growth for IAG. IAG’s proportional GWP (excluding China) has grown 7.5% to $757 million, with India in particular performing well.

“The Berkshire Hathaway quota share arrangement continues to perform well for us, reducing earnings volatility and releasing capital,” Mr Harmer added.

IAG’s reported margin of 14.3% for FY16 (FY15: 10.7%) was in line with the updated guidance announced in February 2016 and included:

- Net natural peril claim costs of $659 million (FY15: $1.05 billion). This exceeded allowance by $59 million following a higher than originally anticipated loss from the east coast low in June 2016
- An adverse credit spread impact of $37 million, compared to a favourable effect of $33 million in FY15
- Higher than expected prior period reserve releases of $207 million – equivalent to 2.5% of net earned premium (NEP) – up from $167 million (1.6% of NEP) in FY15. This reflects mainly compulsory third party (CTP) releases and an offsetting NZ$150 million increase to risk margin relating to the February 2011 Canterbury earthquake, recognised in 1H16

Net profit after tax of $625 million was 14.1% lower than FY15 ($728 million). This included a significantly lower contribution from investment income on shareholders’ funds, which reflected relatively flat equity markets in the period, a higher effective tax rate due to a significantly lower favourable effect from earthquake related reinsurance recoveries, and a $139 million post-tax charge in respect of capitalised software assets.

IAG’s quota share arrangement with Berkshire Hathaway came into effect 1 July 2015 and has:

- Reduced IAG’s earnings volatility as the company has exchanged a portion of its insurance risk for a fee paid by Berkshire Hathaway to access IAG’s strong core franchise
- Enhanced IAG’s underlying margin by approximately 250bps
- Lowered IAG’s regulatory capital requirement by approximately $400 million with an estimated further $300 million reduction over the next two to three years

IAG entered into the 20% whole-of-account quota share arrangement with Berkshire Hathaway for a minimum term of 10 years. This underpins the strategic relationship agreement with Berkshire Hathaway which IAG announced in June 2015.

**Capital management**

The Board has determined to pay a final fully franked dividend of 13 cents per ordinary share (2H15: 16 cps), bringing the full year dividend to 26 cents per share (FY15: 29 cps). The final dividend is payable on 5 October 2016 to shareholders registered as at 5pm on 7 September 2016.

This represents a full year cash payout ratio of 72.9%, in line with IAG’s revised dividend payout ratio of 60-80% of cash earnings on a full year basis, which took effect from FY16. It was previously 50-70% of cash earnings.

IAG also paid a special fully franked dividend of 10 cents per ordinary share at the end of March 2016.

IAG's capital position remained strong, at 1.72 times the Prescribed Capital Amount (PCA) at 30 June 2016, above the Group's 1.4-1.6 targeted range. The Common Equity Tier 1 (CET1) ratio was 1.06 times, against a target benchmark of 0.9-1.1.

If allowance is made for payment of the final dividend in October 2016, the PCA multiple at 30 June 2016 would remain above IAG's benchmark range, while the CET1 multiple would remain within the equivalent target range.

In recognition of its strong capital position, and with a focus on maximising shareholder returns, IAG will conduct a $300 million off-market share buy-back which is expected to be completed in mid-October 2016. The buy-back will be open to eligible shareholders in Australia and New Zealand registered at 7pm on 25 August 2016.

**Strategy progress**

IAG will hold an investor briefing in December this year to provide an update on its company strategy.

IAG has now bedded down the company structure it announced in December 2015, designed around enhancing the customer experience and leveraging new technologies, and is well advanced in creating a leaner, more responsive company.

"Everything we do at IAG is structured to present our customers with products and services that make their lives better and safer. We want to lead the change that is happening in their lives – and our industry – rather than just reacting to it.

"This is the rationale behind our organisational design, including the establishment of IAG Labs and IAG Garage, where we experiment with emerging technology such as drones, the connected home and collision avoidance technology.

"By doing this successfully we can continue to deliver world class customer experiences, based on a deep understanding of our customer, while ensuring IAG is as financially healthy and efficient as possible. This in turn will allow us to reinvest in continuing our leadership," Mr Harmer said.

The company also outlined activities being undertaken to drive greater operational efficiencies that will reduce its cost base in ways that actively improve the customer experience.

This includes a technology simplification program which will reduce 32 policy and claims platforms down to two, the consolidation of its insurance licences from nine to two, and operational partnering with offshore-based global service suppliers to access their specific expertise and economies of scale.

## DIVISIONAL RESULTS

The **Australian Consumer Division** (51.0% of Group GWP) produced a strong underlying margin of 16.0% (FY15: 13.9%). Short tail home and motor lines performed well, generating GWP growth of around 4.0%. Within this, Coles Insurance posted strong double digit growth, off a small base. Long tail CTP contributed flat GWP to the Division, while its profitability continued to suffer from claims frequency issues in the NSW market. The Division's reported margin of 19.8% (FY15: 15.9%) benefited from reserve releases well above long term expectations, at over 6.0% of NEP, and a much reduced adverse natural perils outcome compared to FY15.

The **Australian Business Division** (26.0% of Group GWP) saw a 6.7% contraction in GWP in tough commercial market conditions. Strict adherence to underwriting disciplines contributed to lower volumes, while the impact of lower average rates diminished from the end of 1H16 as modest rate rises were progressively implemented. Reported margin rose to 10.0% (FY15: 3.0%), following a significantly lower net natural peril claim cost and higher reserve releases.

**New Zealand** (19.0% of Group GWP) continued to perform well, registering a strong underlying margin of 16.9% (FY15: 15.9%), despite increased pressure on the commercial side of its business. A lower reported margin of 8.6% (FY15: 10.8%) included the increased risk margin in respect of the February 2011 earthquake event, recognised in 1H16. Modest premium growth in direct personal lines was more than offset by the tougher market conditions in the commercial segment, resulting in a 3.7% decline in reported GWP.

**Asia** saw consolidated GWP growth of more than 9.0%, with sound gains in Thailand amplified by a favourable foreign exchange rate effect. This year also saw the first full contribution from the small business acquired in Indonesia. Asia's overall earnings contribution increased to $26 million (FY15: $21 million).

**Capitalised software accelerated amortisation and impairment**

As at 30 June 2016, IAG recognised a non-cash, pre-tax charge of $198 million ($139 million post-tax) for accelerated amortisation and impairment of capitalised software. This has been included in the net corporate expense line for reporting purposes.

The capitalised software charge has been excluded from cash earnings for determination of the dividend, but included in the cash return on equity calculation for determination of FY16 executive long term incentive entitlements.

The charge follows a detailed review of capitalised software assets and accounting treatment. This is in light of the present environment of unprecedented digital disruption and its likely material impact on the complexion of future information technology infrastructure investment, and due to IAG's program to significantly simplify its information technology systems in future years.

## FY17 OUTLOOK

For FY17, IAG expects reported GWP will be relatively flat. It expects modest growth in short tail personal lines in Australia and New Zealand as well as CTP volume growth from IAG's entry into the South Australian market from 1 July 2016.

These are expected to be offset by continued tough conditions in commercial markets and an approximately $130 million reduction in GWP from the sale of Swann Insurance's motor vehicle dealership business in August 2016.

IAG's reported margin guidance for FY17 is 12.5-14.5% and the underlying assumptions are:

- Net losses from natural perils in line with allowance of $680 million (FY16: $600 million)
- Prior period reserve releases of at least 1% of NEP
- No material movement in foreign exchange rates or investment markets

A range of cost-out initiatives will gather momentum in FY17, including the operational partnering with offshore-based global service suppliers and organisation-wide systems simplification.

IAG's margin guidance includes a small net negative effect from these activities, as modest initial benefits are more than offset by related implementation costs, which will be included within the insurance profit.

The FY17 margin guidance also reflects anticipated ongoing pressure on NSW CTP profitability ahead of scheme reform and the further earned-through effect of lower commercial volumes and rates.

The impact of the Berkshire Hathaway quota share is expected to be similar to FY16.

## IAG FINANCIAL PERFORMANCE

| GROUP RESULTS | 1H15 A$m | 2H15 A$m | 1H16 A$m | 2H16 A$m | FY15 A$m | FY16 A$m | FY16 vs FY15 Mvt |
|---|---|---|---|---|---|---|---|
| **Gross written premium** | **5,603** | **5,837** | **5,543** | **5,824** | **11,440** | **11,367** | **-0.6%** |
| Gross earned premium | 5,805 | 5,720 | 5,734 | 5,677 | 11,525 | 11,411 | |
| Reinsurance expense | (651) | (545) | (1,632) | (1,551) | (1,196) | (3,183) | |
| **Net earned premium** | **5,154** | **5,175** | **4,102** | **4,126** | **10,329** | **8,228** | |
| Net claims expense | (3,481) | (3,460) | (2,589) | (2,808) | (6,941) | (5,397) | |
| Commission expense | (518) | (516) | (423) | (386) | (1,034) | (809) | |
| Underwriting expense | (889) | (924) | (654) | (653) | (1,813) | (1,307) | |
| **Underwriting profit** | **266** | **275** | **436** | **279** | **541** | **715** | |
| Investment income on technical reserves | 427 | 135 | 174 | 289 | 562 | 463 | |
| **Insurance profit** | **693** | **410** | **610** | **568** | **1,103** | **1,178** | **+6.8%** |
| Net corporate expense | (44) | (111) | (14) | (207) | (155) | (221) | |
| Interest | (52) | (55) | (51) | (48) | (107) | (99) | |
| Profit/(loss) from fee based business | 10 | 9 | 10 | (8) | 19 | 2 | |
| Share of profit from associates | 9 | 7 | 8 | 12 | 16 | 20 | |
| Investment income on shareholders' funds | 137 | 86 | 38 | 59 | 223 | 97 | |
| **Profit before income tax and amortisation** | **753** | **346** | **601** | **376** | **1,099** | **977** | **-11.1%** |
| Income tax expense | (68) | (51) | (67) | (151) | (119) | (218) | |
| **Profit after income tax (before amortisation)** | **685** | **295** | **534** | **225** | **980** | **759** | |
| Non-controlling interests | (63) | (39) | (40) | (37) | (102) | (77) | |
| **Profit after income tax and non-controlling interests (before amortisation)** | **622** | **256** | **494** | **188** | **878** | **682** | |
| Amortisation and impairment | (43) | (107) | (28) | (29) | (150) | (57) | |
| **Profit attributable to IAG shareholders** | **579** | **149** | **466** | **159** | **728** | **625** | **-14.1%** |

| INSURANCE MARGIN | FY15 A$m | FY15 % | FY16 A$m | FY16 % |
|---|---|---|---|---|
| Management reported insurance margin | 1,103 | 10.7 | 1,178 | 14.3 |
| Net natural peril claim costs less allowance | 348 | 3.3 | 59 | 0.7 |
| Reserve releases in excess of 1% of NEP | (64) | (0.6) | (125) | (1.5) |
| Credit spread movements | (33) | (0.3) | 37 | 0.5 |
| Underlying insurance margin | 1,354 | 13.1 | 1,149 | 14.0 |

**About IAG**

IAG is the parent company of a general insurance group with controlled operations in Australia, New Zealand, Thailand, Vietnam and Indonesia, employing more than 15,000 people. Its businesses underwrite over $11 billion of premium per annum, selling insurance under many leading brands, including: NRMA Insurance, CGU, SGIO, SGIC, Swann Insurance and WFI (Australia); NZI, State, AMI and Lumley Insurance (New Zealand); Safety and NZI (Thailand); AAA Assurance (Vietnam); and Asuransi Parolamas (Indonesia). IAG also has interests in general insurance joint ventures in Malaysia and India. For further information please visit www.iag.com.au.

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