# Financial results
# Full year ended 30 June 2005

Michael Hawker, Chief Executive Officer

George Venardos, Chief Financial Officer

19 August 2005

Insurance Australia Group Limited
ABN 60 090 739 923

Good morning. Welcome to the Insurance Australia Group 2005 full year results results briefing.

Copies of all the materials we are using here this morning are already on our website and an archive of this presentation will be published later today.

As usual, we'd like to complete the presentation before taking questions from those of you here with us in person this morning and from those on the phone lines.

# Agenda

| | |
|---|---|
| Results and operating conditions | Michael Hawker |
| Capital position | |
| Dividends | |
| Segmental analysis | George Venardos |
| Investment strategy/activities | |
| Capital | |
| IFRS | |
| Outlook | Michael Hawker |
| Conclusion & questions | |



Now I'd like to hand you over to our CEO, Mike Hawker.

# Michael Hawker

Insurance Australia Group Limited
ABN 60 090 739 923

# Record performance

- Net profit to all shareholders increased 14.3% to $760m
  - Increase of 25% excluding 2004 profit on sale of ClearView
- Continued strong margin performance by all divisions combined with high returns from equity markets
- Insurance margin of 16.3% up from 13.5% for FY04
  - Full year integration benefits from CGU/NZI
  - Benefits of improved claims outcomes in Commercial
  - Improvements in, and adherence to, underwriting controls and risk-selection
  - Increased storm activity and competition
- Record earnings on shareholders' funds of $479m (pre-tax)
  - Gross yield of 19.8% on portfolio (excluding RES income)
- Earnings per share of 45.9 cents (FY04: 37.9 cents)



The Group produced the strongest result in its history with a net profit after tax to all shareholders of $760m for the 2005 financial year (FY05), up 14.3% from the $665m for FY04. Excluding the non-recurring post-tax profit of $57m on the sale of ClearView in January 2004, the result increased by 25%.

It is particularly pleasing to be able to report an improved trading result in the current market conditions.

The Group's ability to leverage its underwriting and claims capabilities to effectively price risk and manage claims has been key to sustaining continued improvement in margins. This is a quality result driven by discipline and diversification.

Some of the key factors in no particular order were:

- A full year of integration benefits from the CGU and NZI acquisitions;
- Reduced liability reserving in recognition of benefits from tort reform which more than offset increased provisioning relating to asbestosis in 1H05; and
- Ongoing benefits from continued application of our underwriting and risk selection.

The positive factors outweighed the strain on the insurance margin from:

- Gross incurred claims from storm activity of $340m for FY05 relative to $250m on an equivalent basis for FY04. Most of the claims were incurred in 2H05; and
- Increased advertising and margin contraction in parts of the business in response to a more aggressively competitive environment.

Investment market performance and value added by the Group's asset managers generated record investment returns:

- Technical reserves returned $516m, which includes capital gains of $93m, the benefits of active return on fixed interest management and the use of equity overlays; and
- Investment income on shareholders' funds was $479m representing a yield of 19.8%, before expenses

Earnings per share grew by 21% from 37.9cps to 45.9cps.

# Financial results overview

| Financial Results/Ratios | Full-year ended Jun 03 | Full-year ended Jun 04 | Full-year ended Jun 05 |
|---|---|---|---|
| **GWP (A$m)** | **$5,150** | **$6,427** | **$6,673** |
| Profit attributable to all shareholders (A$m) | $153 | $665 | $760 |
| Reported ROE % (Average Equity) to ordinary shareholders pa | 5.1% | 21.1% | 23.1% |
| Normalised ROE % (Average Equity) to ordinary shareholders pa | 12.9% | 15.1% | 17.3% |
| Net cash flow from operations (A$m) | $825 | $1,169 | $897 |
| Basic EPS (cents) | 8.65 | 37.87 | 45.89 |
| Diluted EPS (cents) | 8.61 | 37.74 | 45.83 |
| DPS | 11.50 | 22.00 | 26.50 |
| **Group insurance ratios** | | | |
| Loss ratio | 72.5% | 65.1% | 66.2% |
| Expense ratio | 23.2% | 25.6% | 25.9% |
| Administration expense ratio | 17.5% | 17.9% | 17.7% |
| Commission ratio | 5.7% | 7.7% | 8.2% |
| Combined ratio | 95.7% | 90.7% | 92.1% |
| Insurance margin (before tax) | 12.3% | 13.5% | 16.3% |
| Minimum probability of adequacy of general insurance claims reserves / actual for FY05 | 90.0% | 90.0% | 92.5% |
| MCR multiple - Australian licensed entities | 2.03x | 2.29x | 2.29x |
| MCR multiple - Group | 1.62x | 1.75x | 2.00x |



Net cash flow from operations of $897m for FY05 is less than $1,169m in FY04. This is mainly due to paying almost $200m more in tax this year. There is also a smaller portion due to no longer having the net cash flows from the ClearView operations following the sale of that business in January 2004.

As I noted earlier, the earnings per share has increased by 21% this year and five-fold on 2003.

The Group's capital position, stated as a multiple of MCR (minimum capital requirement) has increased again to reach 2.00 times, well ahead of our benchmark level of 1.55 times. This has been achieved while still maintaining our standard of a minimum probability of adequacy on outstanding claims of 90%. In preparation for the extended disclosure requirements under A-IFRS, we have provided the actual figure this year and it is 92.5%.

# Industry premium growth only 1.7% (Australia)

| Australian Premiums | Y/e Mar-04 $'m | Y/e Mar-05 $'m | Growth |
|---|---|---|---|
| **Industry gross premium revenue** | **22,153** | **22,529** | **1.7%** |
| **IAG gross written premium** | **5,516** | **5,647** | **2.4%** |
| **IAG share of the market** | **24.9%** | **25.1%** | **0.2%** |

***Industry data per APRA Insights, excluding inwards reinsurance***

- Premium income growth is slowing across the industry
- IAG's growth has exceeded the market growth
- Market share has, consequently, increased marginally
- IAG NZ grew in line with the market



This slide shows the extent of the deceleration in premiums across the Australian industry and should be viewed in the context of a 3.8% increase in domestic demand (spending) for Australia in the same period.

This data highlights the conditions we have been speaking about for the past year to 18 months with premium rate reductions outweighing system growth. These reductions have been driven by the factors I alluded to earlier.

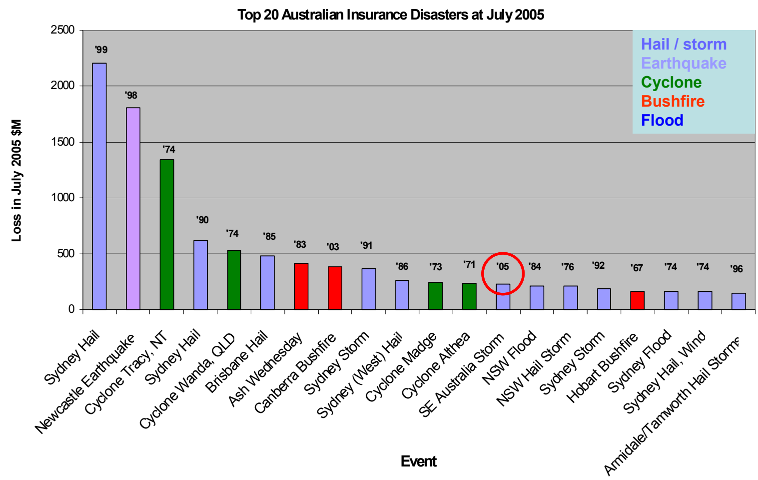
That the insurance industry has continued to generate profits while premium income is rising by less than economic growth and wage inflation is a testament to the improved efficiency of operations in the industry in recent years.

IAG's ability to deliver growth that outpaces the industry is reflective of its defensive mix of business and, I believe, the quality of the service we offer.

# Increased storm activity - Australia

*The storm which crossed SE Australia in early February ranks 13th largest in terms of insured losses in Australia*

IAG Insurance Australia Group




Note the year the event occurred is seen above each bar.

*Source: Insurance Disaster Response Organisation*

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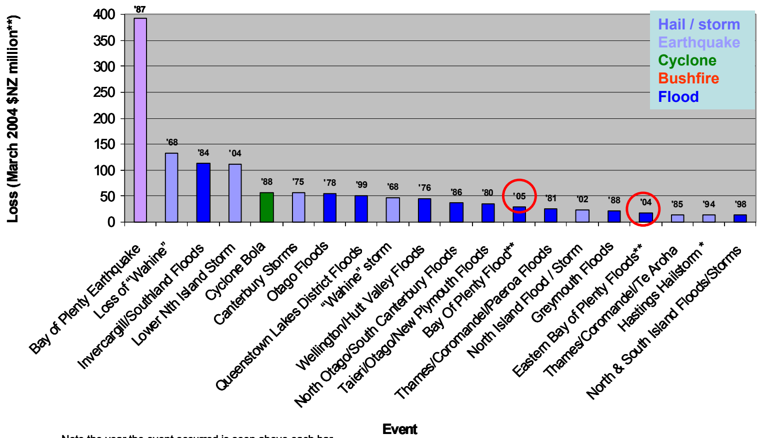
We had a number of large storms during the year and they included the 13th largest insured event in Australia's history, being the storm cell that crossed South East Australia in February.

# Increased storm activity - NZ

*New Zealand also experience its 13th largest event in terms of insured losses in May 2005*

Top 20 NZ Insurance Disasters at July 2005




Note the year the event occurred is seen above each bar.

*The Hastings Hailstorm - crops $9.4 million

** Figures are 2005 values

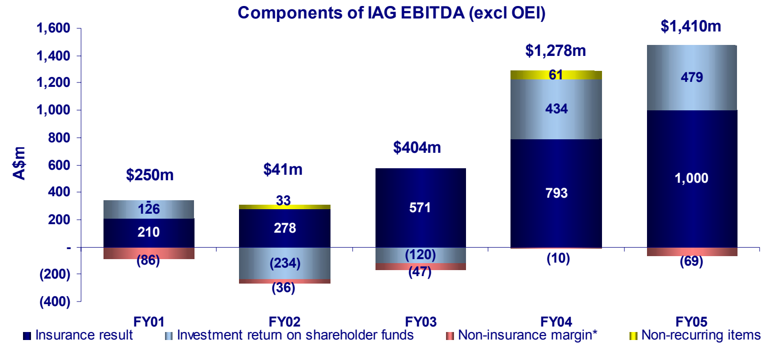
*Source: Insurance Council of New Zealand*



New Zealand also experienced a tough year in terms of weather-related events with with two major events during the year, both in the Bay of Plenty.

While these events were smaller in aggregate than the February 2004 storm, neither reached the catastrophe deductible in our New Zealand business leaving the full cost with the business and this actually exceeded the net incurred cost of the February 2004 storm.

# Continued growth in contribution from operations




*Non-insurance margin includes net corporate expenses, NSW Insurance protection tax, Financial services result (discontinued 4/1/04), fee based businesses.*

- The Group continues to produce improved earnings on the back of repeated strong performance by the insurance operations and investment returns



Turning now to the sources of the Group's profit before interest, tax, depreciation and amortisation.

The dark blue bar is the profit from our core operations – the insurance profit. It includes the underwriting profit and the investment return on the funds we invest to back our insurance liabilities. The insurance margin has continued to grow over the years. Over the past five years, the insurance profit has grown five-fold whilst at the same time the business has doubled in size.

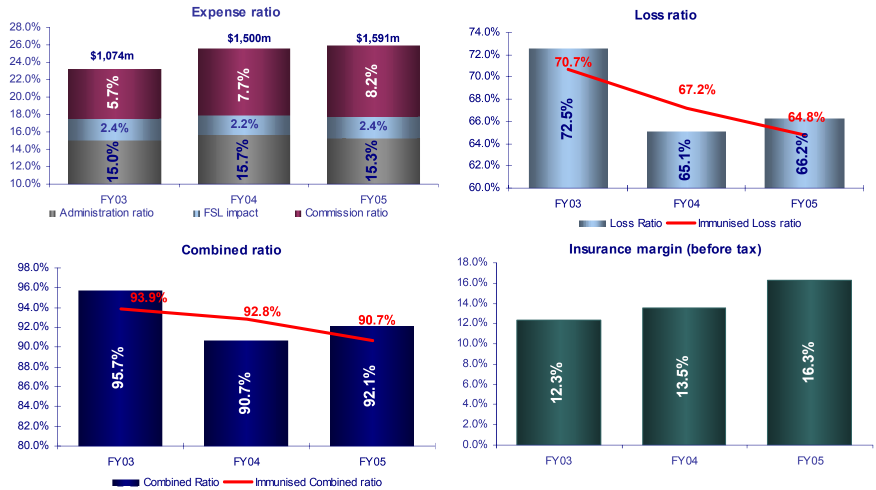
The light blue bar is the return from shareholders' funds. This is the most volatile element of the results and the reason we focus on normalised earnings when assessing the longer term performance and dividends.

The yellow bar is for non-recurring items. In FY04, this represented the profit from the sale of our ClearView operations.

The pink bar consists of other operating items such as fee based businesses and corporate expenses. The aggregate of these items has in the past resulted in a marginal net expense position, but has increased in FY05 due to:

- Increased corporate expenses due to costs associated with the Group's international growth strategy;
- A net loss in the fee-based business of $17m due to significant adjustments made to the prior year fees accrued for New South Wales workers' compensation business. Actions have been taken to prevent the recurrence of the issues which caused this. The loss also includes $5m from increased expenditure to grow the Group's China-based road service operation.

# Key insurance ratios improved




- Continued improvement in annual performance



- This slide shows the trend in the insurance margin and its components.
- The administration ratio, excluding fire service levies, improved by 0.4% to 15.3% from 15.7% for FY04. Achieving reductions while wage inflation and CPI continue to rise and premium rates are falling is very pleasing, although increasingly challenging.
- This has been achieved in spite of a number of additional expenses, which drove an increase in the ratio by 1% point between 1H05 and 2H05. The increase of $22m in administration costs included:
  - Increased advertising spend;
  - Restructuring costs relating to Australian personal lines distribution model;
  - Cessation of the Group's superannuation contribution holiday earlier than anticipated. Going forward, the full year expense is anticipated to be around $85m compared with $8m in FY05 and no expense in prior comparative periods.
  - Increased IT spend to enhance underwriting and claims models to support new products and improved claims processes during the period; and
  - Increase in accruals relating to staff incentive schemes due to the strong group result.
- We've updated these graphs this year to highlight the immunised loss and combined ratios by excluding the impact of changes in interest rates on claims reserves - which is essentially offset by changes in technical reserve assets. The red lines show the underlying improvement in our underwriting operations. The immunised combined ratios are 90.7% in FY05 compared to 92.8% FY04 and 93.9% in FY03.
- The strong improving margin performance for the past three years shows the ability of the Group to achieve repeated quality margins and includes the benefits of active return on the investments backing the technical reserves.

| | 1H04 | 2H04 | 1H05 | 2H05 | FY03 | FY04 | FY05 |
|---|---|---|---|---|---|---|---|
| Reported COR | 90.5% | 90.8% | 91.8% | 92.5% | 95.7% | 90.7% | 92.1% |
| Discount rate effect | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] |

# A 44% increase in investment income

| Portfolio income (pre-tax) and incl. derivatives | FY04 | | 1H05 | | 2H05 | | FY05 | |
|---|---|---|---|---|---|---|---|---|
| | A$m | Return (%) | A$m | Return (%)[1] | A$m | Return (%)[1] | A$m | Return (%) |
| Technical reserves | 244 | 3.8% | 263 | 8.1% | 253 | 6.8% | 516 | 7.6% |
| Shareholders' funds | 434 | 19.1% | 287 | 23.4% | 178 | 14.6% | 465 | 19.8% |
| **Total investment income** | **678** | **8.1%** | **550** | **12.4%** | **431** | **9.0%** | **981** | **11.0%** |

*[1] Returns for the half years are annualised.*

*[2] The yields are stated before expenses, the dollar returns are stated net of expenses*

- The FY05 technical reserves return of 7.6% includes active return of 80 basis points
- The FY05 return on shareholders' funds of 19.8% includes active return of 168 basis points
  - Return reflects mix of Australian equities (+29.9%), international equities (+2.0%), fixed interest (+6.2%) and cash (+5.6%)
- The overall gross return of 11.0% includes active return of 103 basis points or approximately $100m (pre-tax)
- Active returns delivered each year since listing in 2000

The returns shown here exclude the $14m earned on the portfolio backing the RES.



The combination of continued strong performance in the equity market and active return from our asset managers contributed to the increase in investment income in FY05.

Our asset managers continue to deliver returns in excess of benchmarks in both the technical reserves and shareholders funds. The active return of approximately $100m was equally shared between both funds. This compares to active return of $86m in FY04.

Following another exceptional year in the equity market, we produced a new record return on shareholders' funds of $465m with a nearly 20% return over FY05. Whilst we achieved a positive return on the international equities portfolio it was muted due to appreciation in Australian dollar against the US dollar.

Overall the portfolio returned 11%, which includes 103 basis points of active return generated by our fund managers.

This is the 5th consecutive year of improving active returns.

It is particularly pleasing that the strategy to reduce volatility has increased our diversification. George will give you more about the details later.

| IAG Group investment return (excluding derivatives) | FY01 | FY02 | FY03 | FY04 | FY05 |
|---|---|---|---|---|---|
| ACTUAL | 6.5% | (1.1%) | 3.9% | 8.5% | 11.0% |
| BENCHMARK | 5.9% | (1.4%) | 3.6% | 7.5% | 10.0% |
| Active Return | 0.6% | 0.3% | 0.3% | 1.0% | 1.0% |

# A range of drivers for premium

- Volume grew by 152,000 risks in force (1.1%)
  - Continued high retention rates
  - Growth in targeted segments – eg Landlords, Home@50 and particular SME segments
- Gross written premium growth was 3.8% in FY05
- Net earned premium growth was 4.8% in FY05
- Prices in CTP (NSW and Queensland) continued to reduce as these schemes remain stable
- Motor vehicle prices (new & second-hand) fell reducing sums insured
- Home premium rates rose due to inflation and increased storm activity
- Liability premium rates reduced by at least 10% over the year in recognition of tort reform
- Commercial property premium rates falling on a combination of improved claims experience and market competition



Growth in gross written premium (GWP) over the last year has been 3.8%.

Revenue (NEP) grew by 4.8% compared with a year ago.

GWP growth being lower than NEP growth includes the effect of reducing average premiums as a result of better risks in the portfolio, the benefits of which have been passed on to customers in the form of lower premiums. This is demonstrated in two of the Group's largest products - NSW motor and CTP (in NSW and Queensland).

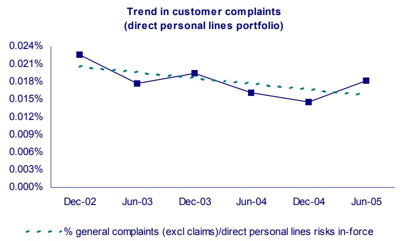
Home premium rates rose due to inflation in building costs and increased storm activity

Liability premium rates reduced by at least 10% over the year in recognition of tort reform

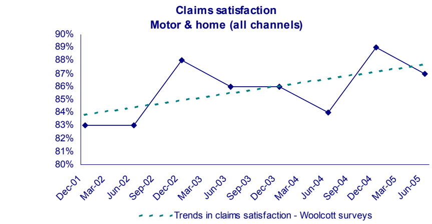
Commercial property premium rates falling on a combination of improved claims experience and market competition.

# Improving customer experience

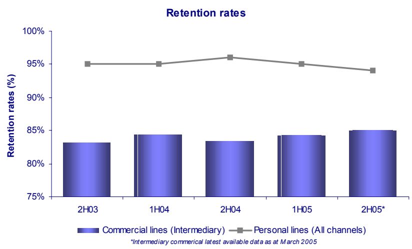
**Declining customer complaints below 0.02% in largest portfolio**



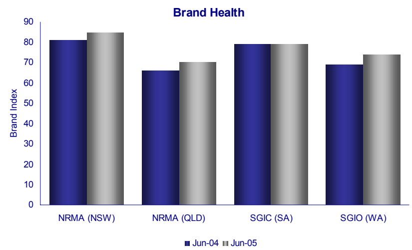

**Delivering on claims and service**




**Sustaining high customer retention levels**




**Improving Brand awareness**

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The ability of the Group to meet/exceed customer needs is central to its capacity to continually deliver sustainable returns.

The trends in the key customer measures show continued improvement over the past few years. A focus on underwriting and claims processes to improve the speed and quality of service has not only manifested in our margins but also in our levels of customer satisfaction.

The above graphs show the trend in key customer measures over time:

First graph – complaint levels to risks in-force continue to trend downward;

Second graph – shows for our largest portfolio the claims satisfaction has improved over the last four years. This is largely due to the Group's supply management models that have delivered faster turnaround times with higher quality of service from end-to-end ownership of the claims process.

Third graph – Customer satisfaction levels continue to support the retention of customers. In the personal lines portfolio, retention rates have trended above 90% and in the commercial lines portfolio has trended in the mid 80%.

Fourth graph – Our brand awareness for our key-retail brands continues to improve in all States.

# Improving shareholder returns and capital strength

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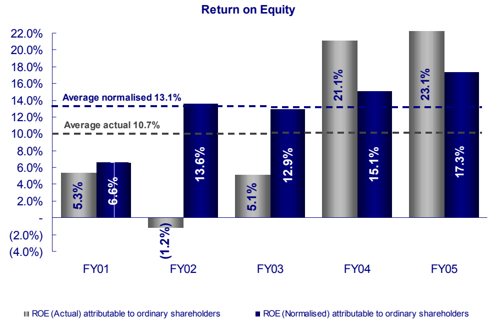
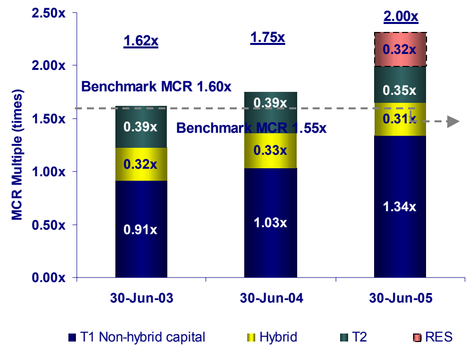



- Since listing:
  - Average normalised ROE of 13.1%
  - Average actual ROE of 10.7%

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The FY05 return on equity (ROE) to ordinary shareholders of 23.1% was driven by a combination of strong margins delivered in the insurance business and record-high performance in the Australian equity market.

The normalised ROE was 17.3%. Normalised ROE is determined by replacing the actual earnings on shareholders funds with the earnings that would have been generated using the 10 year bond rate plus 4%. The tax expense is adjusted accordingly. This normalised profit is also used in applying the Group's dividend policy.

The Group's target return on equity to ordinary shareholders over the cycle is a minimum of 1.5 times WACC. The FY05 ROE, both actual and normalised, is above this target. However, it needs to be considered in terms of cycles and the general insurance industry has experienced very favourable cyclical conditions recently. Over the period since listing early in FY01, the Group's average reported ROE is 10.7% (normalised 13.1%). This remains below 1.5 x WACC.

However, the sustained improvement in ROE since listing is indicative of the consistent improvement in the underlying business, which is supporting the increasing return to shareholders necessary to cushion the impact of the volatility that occurs over investment, economic and insurance cycles.

This result has been achieved while maintaining a very prudent level of reserving, maintaining "AA" (stable) insurer financial strength ratings for key wholly-owned insurance entities and having Group MCR of 2.00x at 30 June 2005.

The line across this slide shows the Group's benchmark MCR level, which is 1.55 times following the issue of the RES (reset exchangeable securities) in January 2005. The pink section at the top of MCR represents the increase in MCR if the RES were exchanged into preference shares as at balance date.

I will now hand over to George to take you through some more detail on the segment results and our capital position.

# Double digit dividend growth – 20%

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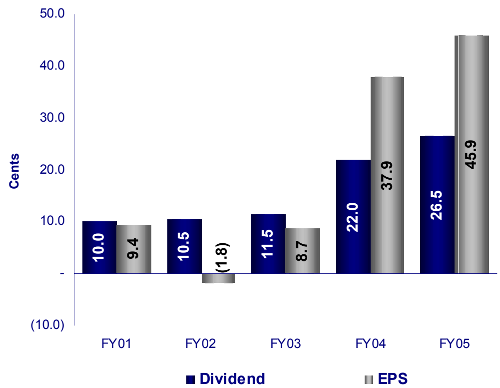


- Dividends for FY05 represent:
  - 55% of reported earnings for the year
  - 65% of normalised earnings for the year
- Since listing, cumulative dividend payout is 63% of cash earnings

*All earnings pre-goodwill amortisation and post RPS dividends*

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Close to one million investors continue to share in the improved performance of the our business over the years with an increase in dividend per share each year.

As can be seen from this chart, the first three years' dividends were supported by the accumulated wealth of the business with dividends exceeding earnings per share ('EPS'). In the last two years, the situation has reversed and earnings have been rebuilt through internally generated capital.

On the back of a record result, the Group has declared a final dividend of 14.5cps, bringing the full year dividend per share to 26.5cps. This represents a 20.5% growth on FY04 and is in line with Group's target of achieving double digit growth.

The full year FY05 dividends of 26.5cps represents a payout ratio of 55% of reported earnings before goodwill amortisation and after dividends on reset preference shares. Normalising these earnings for the very high equity market returns, the payout ratio was [65%], which is at the higher end of the Group's policy range of paying 50 – 70% of normalised earnings.

Over the five years since listing, the Group has achieved a cumulative dividend growth rate of 29.5% per annum. The total dividends declared represent 63% of cash earnings for those five years.

# George Venardos

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Thanks Mike.  Good morning.

# Australian personal lines

| Australian Personal Lines | Half-year ended Jun 04 | Half-year ended Dec 04 | Half-year ended Jun 05 | Full-year ended Jun 04 | Full-year ended Jun 05 |
|---|---|---|---|---|---|
| | A$m | A$m | A$m | | |
| **Gross written premium** | **1,980** | **2,002** | **1,976** | **3,900** | **3,978** |
| **Gross earned premium** | **1,921** | **1,986** | **1,950** | **3,794** | **3,936** |
| Reinsurance expense | (102) | (106) | (109) | (192) | (215) |
| **Net premium revenue** | **1,819** | **1,880** | **1,841** | **3,602** | **3,721** |
| Net claims expense | (1,152) | (1,262) | (1,279) | (2,325) | (2,541) |
| Commission expense | (108) | (114) | (116) | (213) | (230) |
| Underwriting expense | (339) | (322) | (337) | (632) | (659) |
| **Underwriting profit** | **220** | **182** | **109** | **432** | **291** |
| Investment income on technical reserves | 109 | 158 | 145 | 162 | 303 |
| **Insurance profit** | **329** | **340** | **254** | **594** | **594** |
| **Insurance ratios** | | | | | |
| Loss ratio | 63.4% | 67.1% | 69.5% | 64.5% | 68.3% |
| Expense ratio | 24.5% | 23.2% | 24.6% | 23.4% | 23.9% |
| *Commission ratio* | *5.9%* | *6.1%* | *6.3%* | *5.9%* | *6.2%* |
| *Administration ratio* | *18.6%* | *17.1%* | *18.3%* | *17.5%* | *17.7%* |
| Combined ratio | 87.9% | 90.3% | 94.1% | 87.9% | 92.2% |
| Insurance margin (before tax) | 18.1% | 18.1% | 13.8% | 16.5% | 16.0% |



- The Group's largest portfolio, Australian personal lines, produced a strong insurance margin of 13.8% in 2H05. This compared to 18.1% in 1H05, which benefited from relatively benign weather conditions.
- We experienced underlying improvement in the short-tail portfolio, particularly the indirect business, which was offset by a return to more sustainable margins in the long-tail personal lines portfolio, particularly in New South Wales (NSW) CTP.
- GWP in this business grew by 2.0% for the full year, weighted to 1H05, driven by higher retention rates and an increase in the sums insured in the home portfolio offset by lower average premiums in motor and CTP. Volume growth over the year was 0.8%.
- The slowing premium growth in the portfolio reflects a combination of increased competition, passing on savings in claims costs, reducing motor vehicle values and sums insured and a reduction in economic growth, particularly in NSW. The risk-mix in the portfolio continues to improve and is reflective of our philosophy where we are prepared to cede some marginal growth to ensure sustainable levels of profit. This trade-off is based on detailed analysis of incremental value. Recent examples of this include:
  - Re-pricing of some of the third-party branded personal lines business to ensure the return for the Group more appropriately reflects the risks being underwritten. This business, acquired from CGU, has been migrated gradually to revised terms and resulted in non-renewal of some risks but increased profitability to the Group.
  - Accepting some loss of market share in NSW CTP in recent months following price based advertising by competitors. This has led to an improved mix of risk in this portfolio where there is an element of community pricing. For example, comparing the business written in May 2004 and May 2005, the overall volume increased while the number of risks assumed that relate to the following higher risk customer profiles fell. Maximum malus -5%; Third-party property-damage insurance only -3.9%; No vehicle insurance -12.0%; Recent at fault claim -12.8%.
- This business continues to deliver quality results against a background of:
  - reduced net reserve releases from CTP; and
  - increased expenditure on advertising.

# Australian commercial lines

| Australian Commercial Lines | Half-year ended Jun 04 | Half-year ended Dec 04 | Half-year ended Jun 05 | Full-year ended Jun 04 | Full-year ended Jun 05 |
|---|---|---|---|---|---|
| | A$m | A$m | | | |
| **Gross written premium** | **845** | **827** | **867** | **1,613** | **1,694** |
| **Gross earned premium** | **779** | **831** | **803** | **1,572** | **1,635** |
| Reinsurance expense | (113) | (100) | (100) | (217) | (200) |
| **Net premium revenue** | **666** | **731** | **703** | **1,355** | **1,435** |
| Net claims expense | (437) | (518) | (401) | (858) | (919) |
| Commission expense | (79) | (90) | (88) | (160) | (178) |
| Underwriting expense | (144) | (132) | (138) | (268) | (270) |
| **Underwriting profit** | **6** | **(9)** | **76** | **69** | **68** |
| Investment income on technical reserves | 58 | 93 | 87 | 61 | 179 |
| **Insurance profit** | **64** | **84** | **163** | **130** | **247** |
| Profit from fee based business | 1 | 11 | (25) | 21 | (14) |
| **Total commercial line result** | **65** | **95** | **138** | **151** | **233** |
| **Insurance ratios** | | | | | |
| Loss ratio | 65.6% | 70.8% | 57.1% | 63.4% | 64.1% |
| Expense ratio | 33.6% | 30.4% | 32.1% | 31.6% | 31.2% |
| *Commission ratio* | *11.9%* | *12.3%* | *12.5%* | *11.8%* | *12.4%* |
| *Administration ratio* | *21.7%* | *18.1%* | *19.6%* | *19.8%* | *18.8%* |
| Combined ratio | 99.2% | 101.2% | 89.1% | 95.0% | 95.3% |
| Insurance margin (before tax) | 9.6% | 11.5% | 23.2% | 9.6% | 17.2% |



- The improved margins in the commercial business during FY05 are reflective of the continued adherence to technical pricing and customer retention in the softening rate environment. Margins also benefited from reduced liability reserving in long-tail classes, which included recognition of better claims outcomes flowing from tort reform. These releases more than offset increased provisioning relating to asbestosis in 1H05.
- Despite softening rate conditions, the GWP for this business grew by 5% driven primarily by risks in force growth of 7%. NEP grew by 5.9% year on year.
- The growth in volume is reflective of the focus on relationship management and development of improved e-business tools to increase the ease of transacting for our distributors, which has resulted in strong retention rates and encouraged additional business.
- The Group is insulated to a certain extent from the softening market by virtue of the heavy emphasis of its commercial lines portfolio in the SME and regional / rural markets, with a relatively small portfolio of corporate risks – the segment of the market currently experiencing the most acute pressure on rates.
- The insurance margin of 23.2% for 2H05 was significantly higher than prior periods and whilst this is due, in part, to reserve releases, it was underpinned by the strong performance of the core business. Adjusted for releases, the underlying insurance margin remains strong at 15.1% for 2H05 and 15.8% for FY05 reflecting the fact that, despite rate reductions, policy terms and conditions remain strong and our premium rates remain at a profitable level.
- The net loss of $14m from the combined operations of premium funding and the Group's management of Government underwritten workers' compensation schemes arose from significant provisions required in the NSW business due to the inadvertent overstatement of fee income relating to prior periods, offsetting continued profitable performance in the other areas of fee-based business.
- The misstatement in NSW was traced back over a number of years and appears to have been exacerbated by different systems and processes acquired with acquisitions in recent years not being properly integrated and complex formulae and measures required by the regulator not being correctly or consistently applied.
- As a result, the business has been restructured under new management and a detailed plan is being implemented to ensure processes are aligned across the business.
- These initiatives should improve both operational outcomes for the customers and the business and ensure mechanisms are operating to highlight, and react to, potential issues on a timely basis and expect profitability to revert to $15m-$20m next year.

# International businesses

| International operations | Half-year ended Jun 04 | Half-year ended Dec 04 | Half-year ended Jun 05 | Full-year ended Jun 04 | Full-year ended Jun 05 |
|---|---|---|---|---|---|
| | A$m | A$m | | | |
| **Gross written premium** | **460** | **499** | **502** | **914** | **1,001** |
| **Gross earned premium** | **449** | **494** | **496** | **899** | **990** |
| Reinsurance expense | 17 | 4 | (6) | 7 | (2) |
| **Net premium revenue** | **466** | **498** | **490** | **906** | **988** |
| Net claims expense | (317) | (287) | (323) | (632) | (610) |
| Commission expense | (39) | (49) | (44) | (81) | (93) |
| Underwriting expense | (65) | (80) | (81) | (146) | (161) |
| **Underwriting profit** | **45** | **82** | **43** | **47** | **125** |
| Investment income on technical reserves | 10 | 12 | 21 | 21 | 34 |
| **Insurance profit** | **55** | **94** | **64** | **68** | **159** |
| China Automobile Association | - | (2) | (2) | - | (5) |
| **Total international result** | **55** | **92** | **63** | **68** | **154** |
| **Insurance ratios** | | | | | |
| Loss ratio | 68.0% | 57.6% | 65.9% | 69.7% | 61.7% |
| Expense ratio | 22.4% | 25.9% | 25.4% | 25.1% | 25.6% |
| *Commission ratio* | *8.4%* | 9.8% | *8.8%* | *8.9%* | *9.3%* |
| *Administration ratio* | 14.0% | 16.1% | *16.6%* | 16.2% | *16.4%* |
| Combined ratio | 90.4% | 83.5% | 91.3% | 94.8% | 87.4% |
| Insurance margin (before tax) | 11.8% | 18.9% | 13.2% | 7.5% | 16.1% |



The international segment consists of the New Zealand business and the Group's Captive reinsurer, IAG Re which is currently based in Ireland.

**Captive**

The captive is the key reinsurer for the Group's businesses.

Risks ceded by the business units are aggregated by the captive and either retained in the captive or ceded to the open market.

The captive only writes premium with the IAG Group of companies.

The main area of IAG Re's exposure is catastrophe risks involving property and motor losses. These risks are aggregated and ceded to the external reinsurance market via the main catastrophe programme overlaid with a multi form aggregate style protection.

FY05 was an exceptional year for the captive generating a margin of 64.1%.

The increase in weather related events in 2H05 generated $55m of retained storm losses which were offset by recoveries of $70m from external reinsurers.

# NZ performance improved

| New Zealand Operations | Half-year ended Jun 04 | Half-year ended Dec 04 | Half-year ended Jun 05 | Full-year ended Jun 04 | Full-year ended Jun 05 |
|---|---|---|---|---|---|
| | A$m | A$m | A$m | A$m | A$m |
| **Gross written premium** | **460** | **499** | **502** | **914** | **1,001** |
| **Gross earned premium** | **449** | **494** | **496** | **899** | **990** |
| Reinsurance expense | (45) | (62) | (60) | (104) | (122) |
| **Net premium revenue** | **404** | **432** | **436** | **794** | **868** |
| Net claims expense | (272) | (271) | (298) | (535) | (569) |
| Commission expense | (39) | (49) | (44) | (81) | (93) |
| Underwriting expense | (58) | (70) | (71) | (131) | (141) |
| **Underwriting profit** | **35** | **42** | **24** | **47** | **65** |
| Investment income on technical reserves | 9 | 12 | 14 | 20 | 27 |
| **Insurance profit** | **45** | **54** | **38** | **68** | **92** |
| **Insurance ratios** | | | | | |
| Loss ratio | 67.3% | 62.7% | 68.3% | 67.4% | 65.5% |
| Expense ratio | 23.9% | 27.7% | 26.2% | 26.6% | 27.0% |
| *Commission ratio* | *9.6%* | 11.4% | 10.0% | 10.2% | 10.7% |
| *Administration ratio* | 14.3% | 16.3% | 16.3% | 16.5% | 16.3% |
| Combined ratio | 91.2% | 90.4% | 94.6% | 94.0% | 92.5% |
| Insurance margin (before tax) | 11.1% | 12.5% | 8.7% | 8.5% | 10.6% |



The main driver of our international result was the NZ business.

The increase in NZ gross written premium of 9.5% was boosted by the impact of appreciation in the New Zealand dollar of 5.4%. The underlying growth for the full year was 4.1% reflecting the challenging market conditions of rate softening in the commercial market and intense competitive pressures in the personal lines market.

Consistent with the Australian businesses' approach to maintaining growth and market position in an increasingly competitive market, the IAG NZ business continued to focus its efforts on improving the underlying mix. This involved improvements in risk-based pricing – including repricing the home portfolio and turning away commercial business that did not meet the technical pricing criteria. Despite this, the business continued to achieve strong retention rates across its portfolios.

The New Zealand business achieved improved margins, despite incurring a higher incidence of claims from weather related events of $23m concentrated in 2H05. This was absorbed through the combination of:

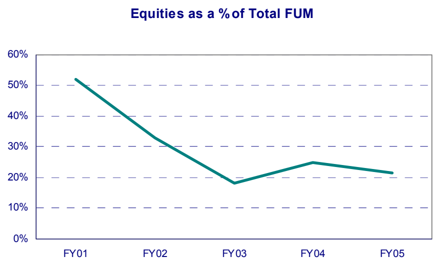
- Better claims management and processes in the motor portfolio; and
- The better outcomes from improved pricing in the home and commercial portfolios.

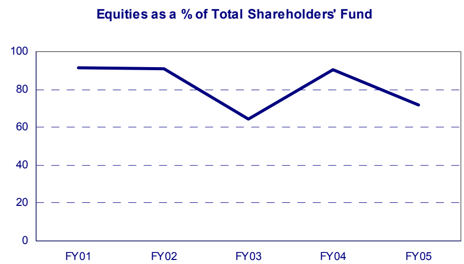
Along with improved results, the IAG NZ business continues to achieve high levels of customer satisfaction sustained at around 85%.

Consistent with our business in Australia, the NZ business is focussed on risk-based pricing, improving claims management and processes to deliver continued high levels of customer service.

Key challenges for the future will be maintaining premium levels in the commercial book and dealing with the poor performance of the home owner's book which has borne major storm losses in each of the past two years.

# Reducing investment volatility




- Relative equity exposure has continued to reduce
- Demonstrated capacity to take additional action when poor market conditions aligned with a challenging period for capital adequacy



Before reviewing the year's investment performance I would like to clarify the levels of our exposure to open equity market risk in the insurance business.

As you can see from the chart on your left, the Group's investment approach has progressively reduced exposure to open equity market risk since 2001. Following demutualisation and listing, we removed equities exposure from our technical reserves and executed three buy backs to return surplus capital to shareholders which has reduced our allocation to equities over time.

The allocation has reduced from 50% to 22% in the period from 2001 to 2003. Since the acquisition of CGU, the Group has maintained an allocation of around 20% of total insurance FUM.

The chart on the right shows the allocation percentage within shareholder funds which reduced considerably in 2003 to protect our balance sheet during the capital raising for the CGU acquisition. At 30 June 2005 we were running around 70% of shareholder funds in equities with the balance in cash and fixed interest.

As the surplus capital fund expands from operational performance, our proportional exposure to equities will continue to reduce. At 30 June 2005 we had $493m in the surplus capital fund, which represented 16.7% of shareholder funds at that date.

# Continued improvement in balance of risk and expected returns

- Equity overlay in technical reserves added $23m pre-tax (plus franking credits)
  - Net exposure of technical reserve investments remains in the nature of fixed income, primarily invested in high quality fixed income securities
  - Duration of the portfolio remains closely matched to the expected duration of the liabilities
- Enhanced cash mandate for capital held above 1.6x MCR
  - Reflects the intent to use the funds in the short-term
- Additional asset class
  - Global macro hedge funds
- Changes in equity mandates
  - Three external managers appointed in Australia
  - Allocation to internal "research fund" – top performer



The Group has continued with its strategy of investing the funds supporting its technical reserves in a conservative asset mix of cash and high credit quality fixed interest securities, and synthetic fixed income investments, and investing its shareholder funds across a diversified range of higher growth assets including equities and hedge funds. Within the broad parameters of this investment strategy, the Group has continually focused on reducing the volatility of the investment portfolio by increasing the diversification across both asset classes and the managers responsible for managing the funds.

The Group's portfolios outperformed the return on benchmark by 1.03% for 2005.

In total, the active return has contributed an additional $100m pre-tax to the Group's FYO5 result.

As part of actively managing the portfolios, 14 months ago the Group re-introduced an overlay position in the technical reserves. Physical equities are held and then swapped back to fixed interest market risk through the use of derivatives. The aim of this strategy is to capture active return on equities, including related franking credits, while still maintaining the market exposure to fixed interest. During 2005, this strategy added $23m in additional value when benchmarked to a traditional fixed interest mandate.

As part of the diversification strategy, an initial allocation to a range of diversified global macro hedge funds managers was seeded during the year. At 30 June 2005 the total investment in the Group's Global Macro Hedge Funds Programme was $121m.

To further diversify the alpha and reduce risk, the Group has introduced three external managers for its Australian equities portfolios. In aggregate, they manage about 16.5% of the Group's Australian equity holdings. We also allocated a portion of the internally managed Australian equities to what we've called our "research fund". This fund is based on our portfolio managers' preferred stocks and has a higher permitted tracking error. Mercers ranked it as the top performing fund amongst its peers for 2005.

The Group continues to investigate other opportunities to diversify the alpha but will only introduce these when the Board and management are satisfied about the potential improvement in return for risk and the controls and resources are in place to manage the

# Capital strength – surplus capital

| Coverage of regulatory capital requirements<br>Insurance Australia Group | | | |
|---|---|---|---|
| A$m | 30-Jun-03 | 30-Jun-04 | 30-Jun-05 |
| **Tier 1 capital** | | | |
| Paid-up ordinary shares | 3,434 | 3,263 | 3,263 |
| Hybrid equity | 539 | 539 | 539 |
| Reserves | (2) | (5) | (6) |
| Retained earnings[1] | (396) | (259) | 59 |
| Excess technical provisions (net of tax) | 353 | 375 | 499 |
| Less: deductions | (1,838) | (1,663) | (1,478) |
| | **2,090** | **2,250** | **2,876** |
| **Tier 2 capital** | | | |
| Term subordinated notes | 657 | 644 | 616 |
| **Capital base** | **2,747** | **2,894** | **3,492** |
| **Minimum capital requirements (MCR):** | | | |
| Australian general insurance businesses | 1,392 | 1,475 | 1,511 |
| International insurance businesses MCR [1] | 136 | 179 | 235 |
| Other business [2] | 165 | | |
| | **1,693** | **1,654** | **1,746** |
| **MCR multiple** | **1.62x** | **1.75x** | **2.00x** |

1. *The MCR and capital base for the international insurance business is calculated on a similar basis to the Australian regulatory requirements and includes the captive reinsurance business and the operations in New Zealand.*
2. *This includes capital held for ClearView sold in January 2004 and Health business sold in July 2003.*



Information made available in the market place over the past 12 months has confirmed the Group's opinion that the factors it applied in deriving its risk margins were considerably higher than market equivalents.

As a result of this review, the Group's approach to setting central estimates has not changed. However, less risk margin is required to generate the 75% level of probability of adequacy for all insurance liabilities.

On the current basis, the Group has a probability of adequacy in its claims reserves of 92.5% and 90.2% on total insurance liabilities, i.e. claims and premiums.

At 30 June 2005, the Group's risk margins represent 25.6% of the Group's net claims liability.

The Group's MCR multiple has grown to 2.0x the minimum, not counting the contingent capital issued in January of 2005.

If you include the contingent capital of $550m, Tier 1 capital increases by $415m and Tier 2 capital increases by $135m.

The contingent capital increases the MCR multiple to 2.32x the minimum.

# IFRS – Minimal impact on reported profits

| Reconciliation of net profit (Aust GAAP to A-IFRS) | $m |
|---|---|
| **Net profit before tax as reported under Australian GAAP** | **1,258** |
| Write-back of goodwill amortisation | 92 |
| Movement in defined benefit plans | (79) |
| Share based payment expense | 3 |
| Capitalisation of software development costs | 24 |
| Valuation of property | (9) |
| **Net profit before tax under A-IFRS** | **1,289** |

- No change to basis of insurance operating result, subject to any issues from the pending liability adequacy test
- Goodwill subject to annual review rather than recurring amortisation
- Reduction, at least initially, in expense for share based payments
- Obligated to capitalise more software development



Note 40 to our accounts sets out a comprehensive description of the differences that impact on the Group's financial reporting.

As you can see from this reconciliation of net profit which has been lifted direct from our accounts, the net difference of $31m is not large.

In effect, we have more aggressive policies which:

- eliminate the amortisation of goodwill;
- reduce the cost of share-based payments; and
- capitalise software costs, which were previously expensed as incurred.

Offsetting these adjustments we also have to recognise super contributions for the year and adopt the purpose test for owner occupied property which will be depreciated going forward.

# Outlook

# Outlook for FY06

- Strategy remains unchanged – focus on optimising our franchise in Australia and New Zealand and seeking investment opportunities to supplement future earnings
  - A number of opportunities continue to be explored
- In terms of our existing business
  - GWP growth will be challenging
    - Expect market to be flat
    - Goal of >2%
    - Premium will not be written unless it can service an adequate return on capital
  - Insurance margin to moderate but remain above the 13.5% margin generated in FY04
- Expect dividend growth of 10%
- Surplus capital will be utilised in acquisitions or returned



Our strategy remains unchanged. We will continue down the dual track of optimising our franchise in Australia and New Zealand and seeking overseas investment opportunities to supplement the future earnings profile of the business. A number of opportunities continue to be explored.

Within our existing business in Australia and New Zealand, it will be challenging to deliver premium growth in current market conditions. We expect the overall market growth to be flat. Evidence of this can be seen in the APRA statistics I referred to earlier.

According to APRA, the industry's direct premium revenue for the March 2005 quarter was 5.5% below the December 2004 quarter. While some of this is likely to be the seasonal peak in the December quarter, the March 2005 quarter only grew by 0.9% relative to the March 2004 quarter.

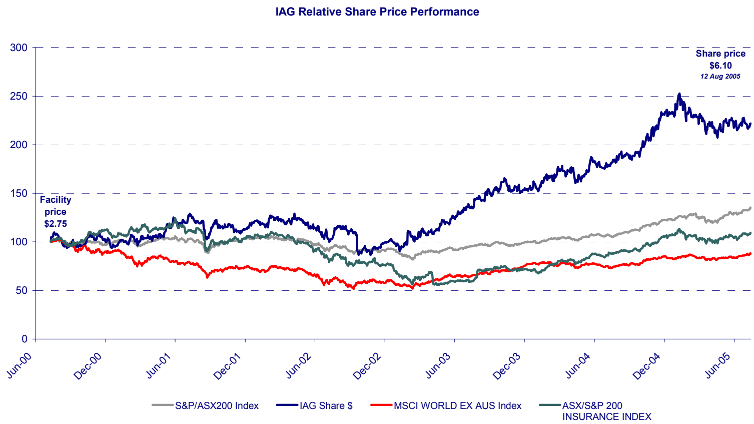
We have set ourselves a goal of growing GWP by at least 2%. Most of this would be from volume growth but delivering this will be put under more pressure if price-based competition in the market place drives premium rates below the levels needed to service an adequate return on capital as, in these circumstances, we will not write the business because it won't fit with our commitment to managing the business for the long term.

The FY06 insurance margin will, the Group expects, moderate but remain above the 13.5% margin reported for FY04, subject, of course, to not incurring claims costs significantly in excess of the allowances we make in our plans.

From the returns generated by our existing operations, we expect dividend growth to meet our 10% goal.

We clearly have surplus capital at present and, with reasonable investment market returns, we will generate more during FY06. This will be either used to fund acquisitions or returned to shareholders.

# Share price performance since listing




- TSR from listing to 30 June 2005 was at 82nd percentile relative to the entities in the ASX100



This slide shows our share price performance against key indices.

From listing to 30 June, this capital growth, combined with reinvestment of the dividends paid since listing, generated a TSR of 156.76% which ranks IAG at the 82nd percentile relative to the entities in the ASX100.

# Questions