IAG REPORTS STRONG FY14 OPERATING PERFORMANCE AND INCREASED DIVIDEND

Insurance Australia Group Limited (IAG) has announced a strong operating performance for the financial year ended 30 June 2014 (FY14), with an insurance profit of $1,579 million for the year, up 10.6% from $1,428 million for FY13.

This equates to a reported insurance margin of 18.3% compared with 17.2% for FY13. The underlying margin[1] improved to 14.2%, compared with 12.5% in FY13.

Gross written premium (GWP) increased by 3% to $9,779 million, while net earned premium (NEP) rose by 3.9% to $8,644 million.

Net profit after tax increased 59% to $1,233 million (FY13: $776 million). This was boosted by increased investment income on shareholders' funds, which grew by 14% to $396 million, and the absence of the prior year's loss of $287 million in respect of the discontinued UK business, which was sold in April 2013.

The Board has determined to pay a final fully franked dividend of 26 cents per share, bringing the full year dividend to 39 cents. The full year dividend is an 8.3% increase on FY13 and represents a cash payout ratio of nearly 70%. This is at the upper end of the Group's policy to pay out 50–70% of cash earnings to shareholders each financial year.

IAG Managing Director and Chief Executive Officer, Mr Mike Wilkins, said: "This has been a significant year for IAG. We have delivered a strong financial result, maintained the strength of our capital position and completed the acquisition of the Wesfarmers insurance underwriting business.

"The improvement in our underlying performance has continued and demonstrates the value of pursuing a disciplined and consistent strategy over a number of years."

IAG's reported insurance margin of 18.3% benefited from lower than expected claim costs from natural perils, favourable credit spreads on fixed interest investments and higher than originally expected reserve releases.

The net natural peril claim expense of $553 million (FY13: $464 million), compared to an allowance of $640 million, reflected relatively benign weather in Australia in the second half of the financial year, partially offset by significant storm activity in New Zealand. A narrowing of credit spreads had a positive impact of $100 million. Favourable experience in long-tail classes, in a low inflation environment, led to prior period reserve releases of $248 million (FY13: $212 million), equivalent to 2.9% of NEP.

The GWP growth rate in FY14 was lower than FY13 reflecting the substantially reduced need for premium rate increases in Australia and New Zealand, in an environment of modest input cost pressures. In addition, GWP growth was influenced by removal of the Victorian Fire Services Levy (FSL), which accounted for over $100 million of GWP in FY13 (without this change GWP growth would have been 4.1%), and the favourable effect of foreign exchange movements, notably an increase in the value of the New Zealand dollar.

[1] 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.

DIVISIONAL RESULTS

IAG's largest business, Australia Direct, reported relatively flat GWP at $4,545 million. The business had a stronger underlying insurance margin of 16.4% due to lower underlying claim costs which reflected supply chain and operational efficiencies, as well as a lower than expected claim frequency. Motor GWP reduced slightly by 0.6%, although volume growth of 1% was roughly in line with system as renewal levels remained high and at a similar level to FY13. Home GWP was flat, after Victorian FSL effects, while renewal levels remained high and exceeded those of FY13.

CGU, the Group's intermediated business, reported GWP of $3,058 million, up 1%. Low single digit rate increases were recorded across most products as CGU broadly maintained its market position. Its underlying insurance margin increased to 11.4%, maintaining the improved performance evident in FY13. Further improvement in underlying claims performance was realised, building on the progress of prior years.

New Zealand's performance remained strong. Local currency GWP grew 3.7%, reflecting improved volumes from customer and sales initiatives, as well as rate increases on home insurance to recover higher reinsurance costs. Reported margin rose to 11.5% (FY13: 8.9%) despite the impact of a number of heavy rain and storm events which led to natural peril claim costs being well above the related allowance. The underlying margin improved to 14.8%.

The development of IAG's Asia operations is progressing to plan, with Asia accounting for 7.1% of Group GWP on a proportional basis (FY13: 6.3%). GWP growth in India and China was particularly strong, while there was a small contraction in Thailand in line with weaker vehicle sales. The division contributed a profit of $14 million (FY13: $20 million) based on strong underlying performances from the established businesses in Thailand and Malaysia, and a slightly higher combined operating loss from the developing businesses in India, China and Vietnam.

CAPITAL POSITION

IAG's capital position remains strong at 1.72 times the Prescribed Capital Amount (PCA), at 30 June 2014, compared to the Group's long term benchmark of 1.4-1.6. The Common Equity Tier 1 (CET1) capital ratio was 1.14 at 30 June 2014, against a target range of 0.9-1.1.

If allowance is made for the final dividend of 26 cents per share, which will be paid on 8 October 2014, both the PCA and CET1 multiples would be within the Group's benchmark ranges.

Debt to total tangible capitalisation stood at 35%, placing the Group in the middle of its target gearing range of 30-40%.

OUTLOOK

Mr Wilkins said IAG was well-placed to deliver attractive returns over the longer term.

"Our new operating model will create an organisation that is more customer-focused and efficient, allowing the Group to better leverage its scale and insurance expertise. The acquisition of the Wesfarmers business further strengthens our ability to meet the needs of our customers and partners by providing additional expertise and more choice of products and services," said Mr Wilkins.

"We are also helping to make our customers and their communities safer by promoting a deeper understanding of risk, and through our advocacy on natural disaster resilience, which includes our work with the Australian Business Roundtable for Disaster Resilience & Safer Communities."

The acquisition of the Wesfarmers insurance underwriting business was completed on 30 June 2014. It comprises the businesses trading under the WFI and Lumley Insurance brands, as well as a 10-year distribution agreement with Coles. It delivers market leadership in commercial insurance in Australia and consolidates IAG's market leadership in New Zealand.

The integration of the Wesfarmers insurance underwriting business and the move to a new operating model in Australia, which was announced in May 2014, is expected to result in a combined annualised pre-tax synergy and benefit run rate of $230 million by the end of FY16. One-off pre-tax costs of approximately $220 million are expected to be recognised over the course of a roughly two-year period, including $50 million which has been identified in FY14.

FY15 GUIDANCE

IAG's guidance for FY15 comprises higher GWP growth of 17-20%, largely as a result of consolidating the Wesfarmers business in Australia and New Zealand. This also reflects the expected limited need for rate increases, owing to current minimal input cost pressures.

The Group anticipates a reported insurance margin in the range of 13.5-15.5%. Underlying assumptions behind the insurance margin guidance are:

- Net losses from natural perils in line with allowance of $700 million;
- Lower prior period reserve releases of around 2% of NEP; and
- No material movement in exchange rates or investment markets.

About Insurance Australia Group

Insurance Australia Group Limited (IAG) is the parent company of a general insurance group with controlled operations in Australia, New Zealand, Thailand and Vietnam, 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, WFI and Lumley Insurance (Australia); NZI, State, AMI and Lumley Insurance (New Zealand); Safety and NZI (Thailand); and AAA Assurance (Vietnam). IAG also has interests in general insurance joint ventures in Malaysia, India and China. For further information please visit www.iag.com.au.

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