IAG announces FY18 results

15 August 2018

Financial indicators

	FY17	FY18	Change	
GWP ($m)	11,439	11,647	1.8%	↑
Insurance profit ($m)	1,270	1,407	10.8%	↑
Underlying margin (%)	12.4	14.1	170bps	↑
Reported margin (%)	15.5	18.3	280bps	↑
Shareholders' funds income ($m)	246	165	–32.9%	↓
Net profit after tax ($m)	929	923	–0.6%	↔
Cash earnings ($m)	990	1,034	4.5%	↑
Dividend (CPS)	33.0	34.0	3.0%	↑
Cash ROE (%)	15.2	15.6	40bps	↑
CET1 multiple	1.09	1.26	17bps	↑

"In an era of unprecedented focus on community expectations, we are pleased to present a set of financial results that are testament to our continuing work to better understand our customers and meet their needs; and speak to the strength of our brands, and the passion and commitment of our people.

"This is a solid result for IAG with an encouraging improved underlying performance, in line with our expectations.

"We've met the guidance we provided last year, slightly exceeding the reported margin component thanks to favourable natural perils and higher reserve releases than anticipated.

"Australia Consumer had a strong performance, as rate increases addressed claims inflation challenges; there was a modest improvement from Australia Business and a continued strong performance from New Zealand.

"GWP growth of 1.8% met our forecast of low single digit growth, with like-for-like growth exceeding 4% after allowance for discontinued activities, NSW CTP reform impacts and foreign exchange translation effects.

"Our optimisation program is progressing to plan and we expect to see a benefit of approximately $100m pre-tax in FY19.

"We also announced the sale of our operations in Thailand, Indonesia and Vietnam, which are expected to complete in FY19 and deliver a net profit after tax in excess of $200m.

"Overall, we are making sound progress in our efforts to transform IAG into a company able to anticipate, respond to, and satisfy the needs of all those who rely on us – our customers, our people, the communities we help, and the shareholders who support us. Success allows us to continue to invest in the services, products and experiences our customers and the community want and need.

"At the heart of the company we are creating is our purpose to make your world a safer place. We focus our energy around three priorities: Customer, Simplification and Agility, building on organisational capabilities that will enable us to succeed now, and thrive in an unpredictable future.

"We have developed a Safer Communities framework that supports the creation of safer, stronger, and more confident communities.

"We are using our purpose to create meaning for IAG's people and support organisational performance, and we are acting responsibly to build and maintain trust, including addressing social and environmental issues important to our stakeholders.

"We are developing and adapting products and services that deliver commercial, customer and community advantage. And we are working with partners to tackle systemic issues that affect community resilience and our business. This includes risk exposure, community preparedness, insurance access and affordability."

Peter Harmer
IAG Managing Director and
Chief Executive Officer

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Insurance margin

Year-on-year improvement

Higher underlying margin[1] of 14.1% (FY17:12.4%)

- Reduced pressure on motor profitability as rates at least match claims inflation
- Some earn-through of higher commercial rates
- Improved NSW CTP profitability derived from initial reform measures
- Degree of respite from large losses in Australian commercial property, but still at elevated levels
- Initial 12.5% quota share impact of approximately 125bps

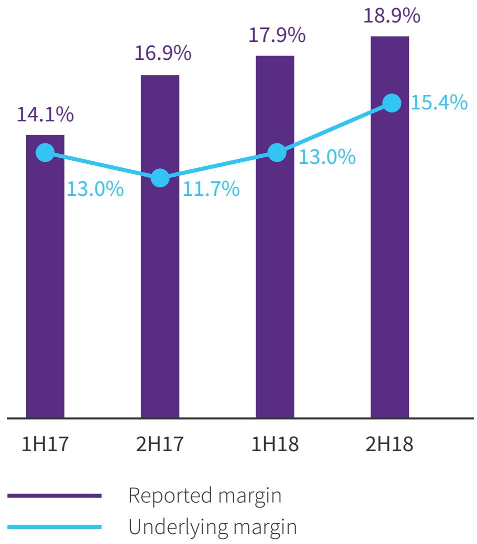
2H18 Underlying margin consistent with 1H18

- After allowing for:
  - ~250bps quota share impact in 2H18
  - Absorption of ~$10m of Royal Commission-related costs in 2H18

FY18 Reported margin of 18.3% (FY17: 15.5%)

- Slightly above updated guidance of 16-18% driven by:
  - Higher than expected reserve releases at 4% of net earned premium (NEP) compared to 3% guidance
  - Favourable net natural peril claim cost outcome of $541m - $84m below allowance

Margin trends – 1H17-2H18



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 of around 1% of NEP; and
   - Credit spread movements.

GWP growth

Like-for-like > 4%, largely rate driven

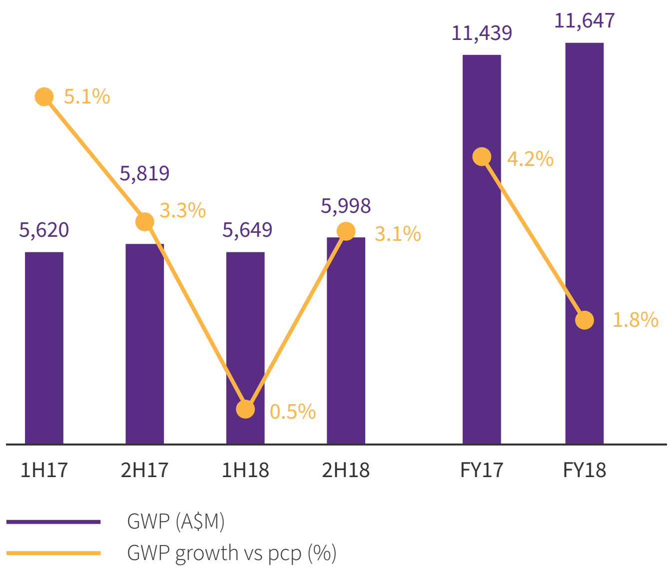
Sound underlying growth

- Rate increases addressing claims inflation in motor and home
- Higher commercial rates, notably in New Zealand
- Relatively flat overall volumes:
  - Advances in motor (New Zealand) and CTP
  - Commercial lower reflecting new business, retention and remediation of property and fleet portfolios

Reported growth of 1.8% in line with low single digit guidance

- After absorption of several one-off influences:
  - NSW CTP reform-related pricing and refunds ($190m)
  - Swann discontinued motor dealer and motorcycle business (>$40m)
  - Adverse foreign exchange movement re New Zealand (>$60m)

GWP growth



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Return to shareholders

Dividend and capital position

The Board has determined to pay a final fully franked dividend of 20.0 cents per share (cps) (2H17:20.0 cps) on 27 September 2018. This brings the full year dividend to 34.0 cents, representing an increase of 3% over FY17 and a cash payout ratio of 77.9%.

IAG's capital position remains strong with a Common Equity Tier 1 (CET1) ratio of 1.26 against a target benchmark of 0.9-1.1.

Capital management initiative

IAG has announced a $592m capital management initiative to distribute surplus capital to shareholders. The initiative, which is subject to shareholder approval at the AGM is expected to occur on or around 26 November 2018 and amounts to 25 cents per ordinary share, and is expected to comprise:

- A capital return of 19.5 cents
- A fully franked special dividend of 5.5 cents

The 19.5 cents per share capital return will be accompanied by a related share consolidation which is expected to reduce the number of shares on issue by approximately 2.4%.

After the consolidation, each shareholder's proportionate interest in IAG will be unchanged.

On a pro forma 30 June 2018 basis, IAG expects its key capital multiple to be close to the mid-point of its benchmark range. This is after allowance for payment of the final dividend and the capital management initiative, as well as receipt of the proceeds from the sale of the Thailand business which is expected to occur by 31 August 2018.

Future franking capacity

IAG's franking credit balance has reduced in recent years, owing to past capital management measures and the move to a higher dividend payout policy.

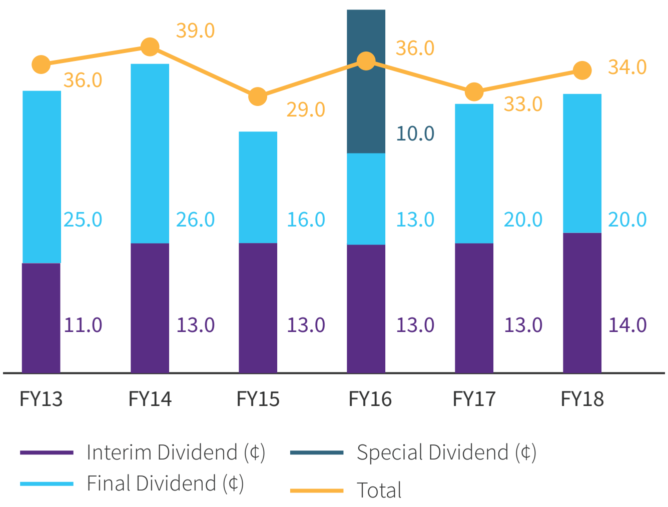
Following the special dividend component of the initiative planned to occur in November 2018, it is anticipated that IAG's franking balance will further reduce.

As a result, IAG may not be in a position to fully frank distributions on its securities from the second half of calendar 2019 onwards, with franking from that date expected to be in the range of 70% to 100%.

"We have long maintained the best place for surplus capital is with our shareholders in the absence of significant operational demands for capital. We are pleased that as a result of the quota share arrangements releasing capital as well as the sale of the Asia businesses, we are now in a position to deliver this surplus to our shareholders."

Peter Harmer
IAG Managing Director and Chief Executive Officer

Dividend history – FY13-FY18



Capital initiative

Timetable	Share Consolidation	Future Franking

26 October: Approval sought at AGM
30 October: Ex-capital return/special dividend date
1 November: Record date
2 November: DRP record date
26 November: Payment of capital return/special dividend
	• Approximately 2.4% reduction in shares on issue
	• Based on five-day VWAP to 10 August
	• Preserves consistency of EPS calculation
		• Reduction in franking capacity following
		  • Past capital management
		  • Higher payout ratio
		• Full franking of distributions may not be possible after 30 June 2019
		  • Franking range of 70%-100% expected from that date

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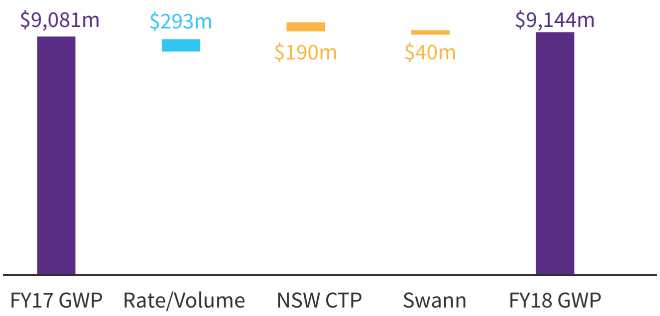
Operational performance

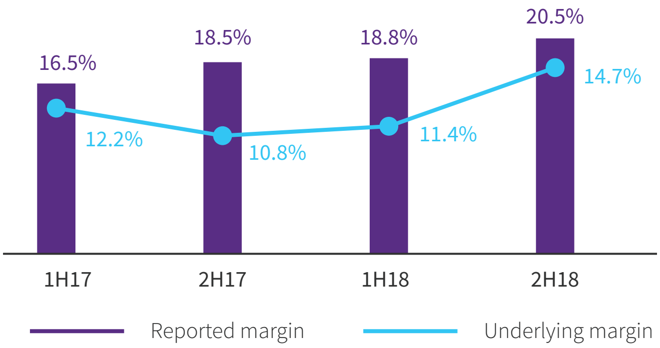
Australia

Strong Consumer results, modest Business margin recovery

Australia GWP growth



Australia margins



Underlying GWP growth of over 3%

- Rate-driven growth of 4-5% in short tail personal lines
- Average positive rate momentum of ~5% maintained in commercial lines
- 14% reduction in CTP GWP – NSW reform influences
- Relatively flat overall volumes – growth in CTP, lower home and commercial

Improvement in FY18 underlying margin to 12.9% (FY17: 11.5%)

- Positive trend from 2H17 low point maintained, ex-quota share effects
- Stronger Consumer performance – higher rates addressing claims inflation in motor, improved NSW CTP current year profitability
- Modest improvement in Business – some rate earn-through and lower large losses
- Higher reported margin of 19.6% – higher than expected reserve releases, perils below allowance

Further improvement expected in FY19

- Sound GWP growth – despite impact of lower NSW CTP rates
- Higher underlying margin from a mix of full 12.5% quota share effect, optimisation benefits, improved Business margin, and lower NSW CTP profitability under new scheme

New Zealand

Strong performance maintained

Healthy NZ$ GWP growth of 8.9% in FY18

- Consumer Division growth of 8% – led by higher motor rates and volumes
- Business Division growth of over 10% – higher commercial rates, some offset from lower new business volumes
- Adverse FX effect trimmed reported GWP growth to 6.3%

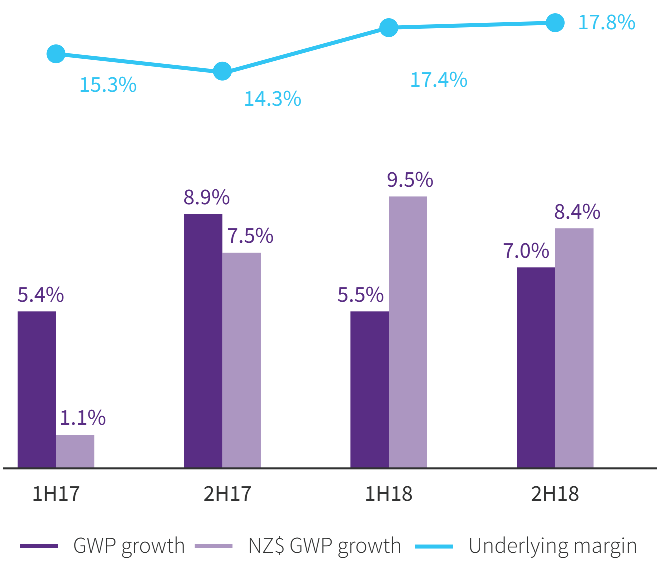
Strong FY18 underlying margin of 17.6%

- Earn-through of rate increases and disciplined expense management
- Quota share benefit in 2H18
- Improved reported margin of 13.8%
- Perils above allowance after 2H18 storm activity, but lower than earthquake-affected FY17

Strong performance expected in FY19

- Further GWP growth – from rate and volume
- Maintained strong underlying profitability

New Zealand – GWP growth / underlying margin



Asia

Strategic review update

IAG has progressed its strategic review to assess options for its Asian businesses, with the company announcing in June sale agreements for its operations in Thailand, Indonesia and Vietnam.

An after-tax profit of at least $200m is expected to be identified in IAG's FY19 results from the combined transactions, after allowance for related costs and foreign currency translation reserve effects.

The businesses in Thailand, Indonesia and Vietnam are identified, for accounting purposes, as discontinued operations in the FY18 results, and comparative figures for FY17 and 1H18 have been restated to reflect this.

The minority interests in joint ventures in Malaysia and India continue to be held.

Strategy

Operational scorecard

Range of activities linked to three strategic priorities

	2018 activities	2019 priorities
Customer	• Applied the customer segmentation model to inform brand strategy, marketing and customer journey design • Digitised key customer journeys including redesigning the motor claims process • Consolidated IAG's data asset using open source technologies and received the Red Hat 2018 Innovation Award • Deployed world-class pricing capability using machine learning and real-time pricing models, across core personal lines portfolios	• Apply customer behavioural analysis to prioritise investment decisions that drive customer advocacy • Transition the data platform onto a scalable, flexible and cost-efficient cloud capability that powers decision-making • Embed cognitive capabilities such as chat bots and computer visioning across the organisation • Continue digital transformation through the development of application programming interfaces (APIs), scaling of digital infrastructure and use of cloud
Simplification	• Embedded single Australia Division operating structure • Completed Australian personal motor and home lines claims component of systems consolidation • Continued transition of targeted activities to operational partners • Embedded operational partnering excellence framework	• Continue consolidation of core technology platforms and decommissioning of redundant systems • Complete transition of targeted activities to operational partners • Progress review and delivery of optimised repair model
Agility	• Deployed Leading@IAG program, linking purpose and strategy to individual accountability and performance • Increased employee advocacy score by 18 points • Launched Future ME program to empower employees to build their knowledge and preparedness to participate in the workforce of the future • Continued investments through Firemark Labs and partnerships to launch products and solutions that deliver on IAG's purpose	• Strengthen ways of working, leadership and people frameworks to create clarity, improve productivity and evolve skills to be successful in the future • Continue to develop partnerships, products and shared value programs that drive safer communities and deliver on IAG's purpose: we make your world a safer place

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FY19 outlook

Further underlying improvement

FY19 guidance

GWP growth
2-4%

Reported insurance margin
Range of 16.0-18.0%

Underlying assumptions

1. Net losses from natural perils of $608m, in line with allowance
2. Reserve releases of around 2% of NEP
3. No material movement in foreign exchange rates or investment markets

GWP growth guidance of 2-4%	Reported insurance margin guidance of 16.0-18.0%
Further rate increases anticipated across short tail personal and commercial classes	Improved underlying performance, including pre-tax benefit of ~$100m from optimisation program activities
Modest expected volume effect - personal lines growth (notably motor) offset by slight decline in commercial (further remediation activity)	Full 12.5% quota share impact of ~250bps (vs ~125bps in FY18)
Residual NSW CTP reform effects (~$80m reduction)	Lower reserve release expectation of 'around 2%' assumes continuation of benign inflationary environment

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IAG financial performance

Group results	1H17 A$m	2H17 A$m	1H18 A$m	2H18 A$m	FY17 A$m	FY18 A$m	FY18 vs FY17 Mvt
Gross written premium	**5,620**	**5,819**	**5,649**	**5,998**	**11,439**	**11,647**	**+1.8%**
Gross earned premium	5,682	5,639	5,780	5,742	11,321	11,522	
Reinsurance expense	(1,571)	(1,551)	(1,613)	(2,238)	(3,122)	(3,851)	
Net earned premium	**4,111**	**4,088**	**4,167**	**3,504**	**8,199**	**7,671**	
Net claims expense	(2,536)	(2,546)	(2,505)	(2,112)	(5,082)	(4,617)	
Commission expense	(383)	(391)	(387)	(320)	(774)	(707)	
Underwriting expense	(646)	(659)	(653)	(517)	(1,305)	(1,170)	
Underwriting profit	**546**	**492**	**622**	**555**	**1,038**	**1,177**	
Investment income on technical reserves	32	200	123	107	232	230	
Insurance profit	**578**	**692**	**745**	**662**	**1,270**	**1,407**	**+10.8%**
Net corporate expense	(4)	(4)	-	(9)	(8)	(9)	
Interest	(51)	(42)	(39)	(43)	(93)	(82)	
Profit/(loss) from fee based business	(1)	(33)	-	(12)	(34)	(12)	
Share of profit from associates	9	12	19	15	21	34	
Investment income on shareholders' funds	103	143	129	36	246	165	
Profit before income tax and amortisation	**634**	**768**	**854**	**649**	**1,402**	**1,503**	**+7.2%**
Income tax expense	(108)	(220)	(211)	(173)	(328)	(384)	
Profit after income tax (before amortisation)	**526**	**548**	**643**	**476**	**1,074**	**1,119**	
Non-controlling interests	(45)	(32)	(19)	(60)	(77)	(79)	
Profit after income tax and non-controlling interests (before amortisation)	**481**	**516**	**624**	**416**	**997**	**1,040**	
Amortisation and impairment	(29)	(30)	(65)	(28)	(59)	(93)	
Profit attributable to IAG shareholders from continuing operations	**452**	**486**	**559**	**388**	**938**	**947**	**+1.0%**
Net (loss) after tax from discontinued operations	(6)	(3)	(8)	(16)	(9)	(24)	
Profit attributable to IAG shareholders	**446**	**483**	**551**	**372**	**929**	**923**	**-0.6%**

	FY17		FY18	
Insurance margin	A$m	%	A$m	%
Reported insurance margin	**1,270**	**15.5%**	**1,407**	**18.3%**
Net natural peril claim costs less allowance	138	1.7%	(84)	(1.0%)
Reserve releases in excess of 1% of NEP	(374)	(4.6%)	(228)	(3.0%)
Credit spread movements	(20)	(0.2%)	(14)	(0.2%)
Underlying insurance margin	**1,014**	**12.4%**	**1,081**	**14.1%**