IAG announces 1H20 results

12 February 2020

Financial indicators

	1H19	1H20	Change
GWP ($m)	5,881	5,962	1.4% ▲
Insurance profit ($m)[1]	496	501	1.0% ▲
Underlying insurance margin (%)	16.2	16.9	70bps ▲
Reported insurance margin (%)	13.7	13.5	20bps ▼
Shareholders' funds income ($m)	(7)	50	nm ▲
Net profit after tax ($m)	500	283	43.4% ▼
Diluted cash EPS (cps)	13.4	16.0	19.3% ▲
Dividend (cps)	12.0	10.0	16.7% ▼
Cash ROE (%)	9.8	12.1	230bps ▲
CET1 multiple	1.18	1.15	3bps ▼

Impact of recent weather events and guidance update

"Since the start of the financial year, we have seen multiple extreme weather events which have impacted our customers, their communities and our business. The devastating loss of life and property across the country has been heartbreaking.

Responding to the needs of our customers is particularly critical during natural disasters. We've increased the number of our people on the phones across our business, and in our claims and repair management teams, to help our customers lodge claims and get back on their feet as quickly as possible.

We're also on the ground in affected communities assessing claims and providing general support to customers through our NRMA Insurance agencies and by supporting our partners, including the Australian Red Cross and NSW SES.

While our focus now is on providing immediate and practical support for our customers in need, we are also looking at what we can do over the longer term to help communities recover.

These catastrophic weather events are also having a financial impact on our business performance. On 24 January 2020, we revised our reported margin guidance to 14.5 – 16.5% after the devastating bushfires and the hail event in Melbourne, Canberra and Sydney.

With the recent heavy rain event in south-east Australia in early February, we have further lowered guidance for the full year to 12.5-14.5%, a reduction of 200 basis points, in what is proving to be an exceptionally harsh perils season. We expect the cost of this event will be capped at $135 million, in line with our second maximum event retention under our calendar 2020 reinsurance program.

As a result, we have increased our assumption for FY20 net natural peril claim costs to $850 million, up from the $715 million advised on 24 January.

Financial performance

Our underlying business had a strong performance over the half, with our Australian business generating solid underlying profitability while meeting the challenge of a series of devastating bushfires. New Zealand continues to perform well, delivering strong margins and solid gross written premium (GWP) growth.

In Australia, while we achieved sound growth in our short tail personal lines, overall GWP growth was flat. This reflected business exits and continued remediation in our commercial business, and lower CTP premiums in the wake of scheme changes.

Our overall GWP growth was 1.4% and incorporated strong GWP growth of 6.3% in New Zealand, reflecting volume and rate growth, as well as a favourable foreign exchange effect. Local currency GWP growth in New Zealand was 4.2%.

Our underlying insurance margin of 16.9% was an improvement on 1H19 (16.2%) and similar to 2H19 as we continued to realise benefits from our optimisation program. This was offset to an extent by increased regulatory and compliance costs as previously flagged as well as lower interest rates impacting investment income.

A lower reported margin of 13.5% (1H19: 13.7%) included net natural peril claim costs nearly $100 million in excess of our allowance, reflecting relatively heavy natural peril activity, including the bushfires in Australia, as well as lower than anticipated prior period reserve releases for the half.

Net profit after tax of $283 million was considerably lower than 1H19, owing to the absence of the prior period's profit on the sale of the Thailand operations of over $200 million, and the inclusion of a post-tax provision of $82 million to address a specific customer pricing issue."

Peter Harmer
IAG Managing Director and Chief Executive Officer

1 The 1H20 reported insurance profit in this document is presented on a management reported (non-IFRS) basis which is not directly comparable to the equivalent statutory (IFRS) figure in IAG's 1H20 Financial Report (Appendix 4D). A reconciliation between the two is provided on page 10 of the 1H20 Investor Report and on page two of the Financial Report to comply with the Australian Securities and Investments Commission's Regulatory Guide 230. IAG's 1H20 net profit after tax is the same in the 1H20 Investor Report and in the Financial Report.

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GWP growth

Largely rate–driven

Reported GWP growth of 1.4%

- In line with full year guidance of 'low single digit' growth
- Net drag from combination of:
  - Divested/ceased business ($54m)
  - Lower CTP rates – scheme change
  - Favourable FX translation effect

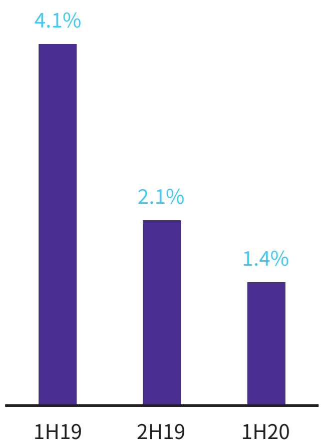
Like-for-like GWP growth of ~2.5%

- Short tail personal line rate increases broadly matching claims inflation
- Ongoing commercial rate increases
- Broadly flat overall volumes
- Modest growth in personal line volumes, skewed to New Zealand
- Lower commercial line volumes, driven by Australia

FY20 guidance of 'low single digit' GWP growth reaffirmed

- 2H20 growth expected to be similar to 1H20, from amalgam of:
  - Rate increases across short tail personal lines
  - Modest personal line volume gain
  - Further commercial rate rises
  - Lower commercial volumes, including business exit effects
  - Lower CTP GWP from cumulative scheme change-induced pricing

GWP growth



Insurance margin

Underlying improvement vs. 1H19

Higher underlying margin[1] of 16.9%

- Further realisation of net benefits from optimisation program
  - ~$80m achieved out of indicated $160m expectation for FY20
  - Large portion recognised in claims handling expenses in 1H20
- Partial offset of $20m from increased regulatory and compliance costs
- Investment yield headwind of ~70bps from lower interest rates
- Higher Australian commercial line profitability – cumulative rate increases and remediation
- Small drag from reversion to more normal working claim frequency in New Zealand

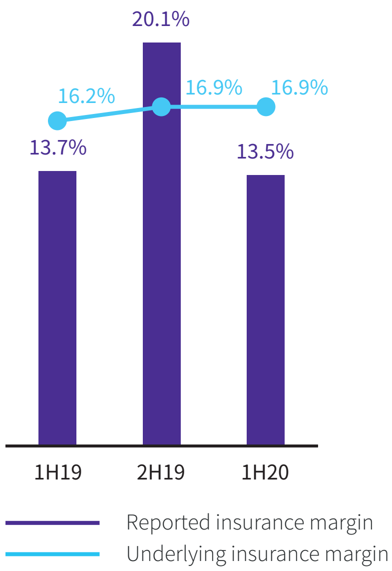
Lower reported margin of 13.5%

- Reconciliation to underlying margin:
  - High perils incidence, in excess of allowance by 2.7% of net earned premium (NEP)
  - Lower than anticipated prior period reserve releases (0.1% of NEP vs. 1.0% underlying assumption)
  - Minor positive credit spread impact

FY20 reported margin guidance lowered to 12.5-14.5%

- 150bps reduction, as advised on 24 January 2020, sourced from:
  - Lower reserve release assumption of 0.5% of NEP (vs. 1.0%)
  - Increased net natural peril claim cost assumption of $715m (vs. $641m)
- 200bps reduction to reflect heavy rain event in February – perils assumption raised to $850m

Margin trends 1H19-1H20



1. IAG's underlying insurance margin is its reported insurance margin adjusted for:
   - Net natural peril claim costs less related allowance for the period;
   - Reserve releases in excess of, or below, 1% of NEP; and
   - Credit spread movements.

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Operational performance

Australia

Improved underlying performance vs. 1H19

Like-for-like GWP growth of around 2%

- Flat reported growth
- Rate-driven growth of 3-4% in short tail personal lines
  - Volume gain in Victoria
- 8.8% reduction in CTP GWP
  - Scheme change impacts on pricing
- Commercial GWP 4.5% lower (like-for-like –0.7%)
  - ~5.5% rate increases
  - Like-for-like volumes ~6% lower
  - $54m effect from business exits (underwriting agency divestments, fleet leasing)

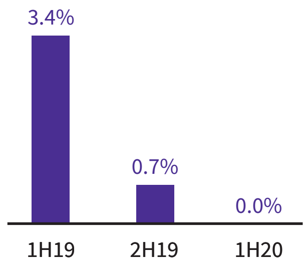
Higher underlying margin of 16.1% compared to 1H19

- Further optimisation benefits, partially offset by higher regulatory costs
- Earn through of commercial rate increases, in excess of claims inflation
- Increased average claims cost in home
- Impact of lower interest rates on investment income
- Reported margin of 12.1%
  - Natural perils over $80m above allowance owing to bushfire events
  - Modest net reserve strengthening

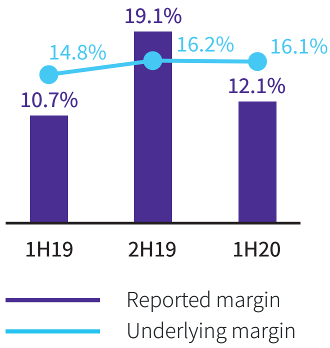
Solid performance expected in 2H20

- GWP trends similar to 1H20
  - Continued rate increases across commercial and short tail personal lines
  - Drag from lower CTP rates and impact of divested businesses
- Underlying profitability broadly maintained at 1H20 level

Australia GWP growth



Australia margins



New Zealand

Strong performance maintained

NZ$ GWP growth of 4.2%

- Predominantly rate-driven
- Volume growth in private and commercial motor classes
- Business GWP growth >8%
  - Rate increases >5%
  - Improved retention
  - Strong new business volumes – commercial motor and liability
- Consumer GWP growth of over 1%, led by AMI brand
  - Absorbed ~100bps adverse effect from Earthquake Commission changes
- >200bps favourable FX translation effect – reported GWP growth of 6.3%

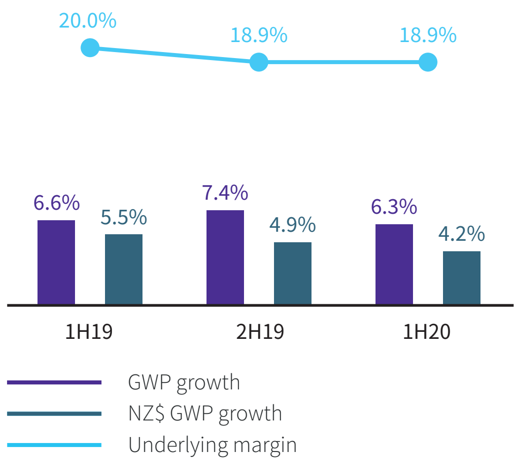
Lower 1H20 underlying margin compared to 1H19

- Largely reflected higher working and large claim experience
  - Abnormally benign conditions in 1H19
- Lower reported margin of 18.9% (1H19: 24.9%)
  - Large Canterbury hailstorm event
  - Partial offset from increased reserve releases

Strong performance expected in 2H20

- Solid GWP growth from a mixture of rate and volume
- Broad maintenance of underlying margin

New Zealand – GWP growth/underlying margin



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Operational scorecard

Range of activities linked to three strategic priorities

	1H20 activities	2H20 priorities
Customer	• **Marketing campaigns** launched to positive response: NRMA Insurance, *Every home is worth protecting*, and CGU small business, *Ambition* • Launch of **Safer Journeys crash detection and emergency response service** trial, to 100,000 NRMA Insurance customers • Support of Rural Fire Service bushfire efforts, via the fire retardant gel-equipped **NRMA Insurance helicopter**	• Supporting customers and communities in their rapid **recovery from recent bushfire and hailstorm events** • **Integration of** the recently-acquired **MotorServe** business, within the motor repair model, providing a one-stop-shop for repairs and servicing • Expansion of **Carbar**, the digital car-trading and subscription platform, to respond to customer appetite for alternative forms of vehicle ownership
Simplification	• Enhanced **short tail claims processes**, following claims system consolidation • Continued planning of **policy and pricing systems consolidation** • **Developed Repairhub** motor repair joint venture to improve efficiency of repairs	• Progress **policy and pricing systems consolidation** with first major release expected in 1H21 • Complete the design work for the **upgrade of digital finance system** (SAP) across Australia and New Zealand • Further **geographic expansion of Repairhub** motor repair joint venture
Agility	• Ongoing **'Listen Learn Act' program**, empowering frontline employees to identify and address customer pain points and process improvements • Introduced new **risk target operating model** to uplift risk management capability and capacity • Phase 1 rollout of Employee Central, to **simplify people systems into a single platform**	• Launch of **new culture program** to underpin next era of IAG's purpose-led strategy • Continue delivery of **enhanced risk management maturity** across IAG • Continue **harmonisation of people systems and processes**, for a consistent cross-Tasman people experience

Strategy update

"Over the past four years, our strategy has been to simplify and optimise our core insurance business while creating growth options for the future. We've done this with a focus on three strategic priorities: customer, simplification and agility.

We've made tremendous progress. We've built new capabilities and improved the experiences we provide to our customers. We've enhanced our digital expertise, expanded our customer offerings and invested in new businesses, such as the vehicle subscription platform Carbar, which will create a more connected experience for our customers.

We are now well-positioned to transition to the next era, shifting our focus more towards customer-led growth. We will provide more detail around our future plans at our Investor Day in Sydney on 14 May.

In line with the shift of our strategic focus towards customer growth, we have changed our operating model to achieve greater alignment between strategy and innovation as we consider the new and different services we can provide to customers.

Our newly created Strategy & Innovation division brings together our existing Customer Labs and Group Strategy & Corporate Development divisions and will be led by Julie Batch.

The division will be responsible for aligning the organisation around a common strategy with a greater emphasis on growth within our core insurance business as well as adjacent business opportunities.

In addition, IAG Group Executive Technology Neil Morgan will lead an expanded Technology & Digital division which brings together the digital teams from Australia and New Zealand, including those previously part of Customer Labs, and the existing Group Technology team.

We have an exciting opportunity ahead of us, as we look to grow our insurance business and create new experiences for our customers."

Peter Harmer
IAG Managing Director and
Chief Executive Officer

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Natural perils

FY20 perils assumption increased to $850m

1H20 perils ~$100m above allowance

- Severely impacted by bushfire events (over $180m)
- Significant reinsurance recoveries, including ~$280m under calendar 2019 aggregate cover

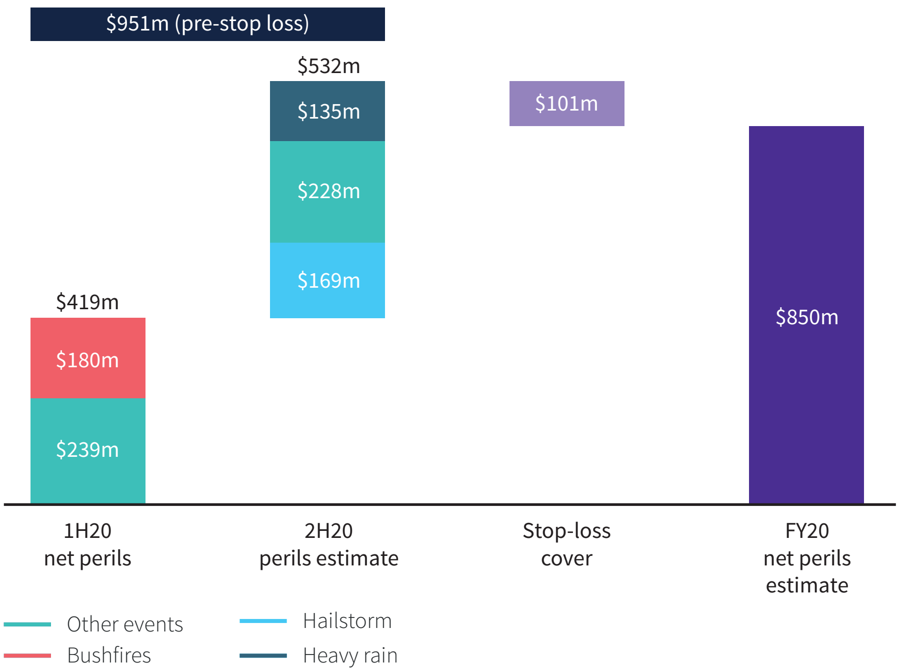
Increased FY20 net perils expectation of $850m, comprising:

- Year-to-date net cost of $645m until end of January 2020, including mid-January hailstorm event
- Net claim cost of $135m for February 2020 heavy rain event
- Estimate for five months to 30 June 2020 (excluding heavy rain event) based on 5-year average for gross (pre-quota share) events <$100m
- FY20 stop-loss cover providing post-quota share protection of $101m in excess of $675m
- No allowance for further gross events >$100m

Current maximum event retention of ~$50m

- Aggregate cover deductible eroded

FY20 net natural perils estimate



“This season has triggered broader debate and greater community concern than ever before over climate change and its impact.

IAG has a long history of action on climate – we’ve made important contributions to climate change discussions and have supported action for more than 15 years.

While I’m proud of IAG’s role on climate, we believe everybody needs to take responsibility for climate change – so it’s critical that all levels of government work with our communities and businesses to minimise the immediate and long-term impacts of climate change.

From our own business perspective, estimating the impact of weather is not a perfect science, as there is a lot of variability from year to year.

We consider a number of factors when determining our natural perils allowance and this includes the number of customers and the types of policies they have, as well as external factors around past weather patterns and future trends.

We have a team of meteorologists, scientists, climate studies experts and engineers dedicated to helping us understand climate risk and the extreme weather events that impact our customers.

This enables us to better estimate our natural perils allowance, but we will always have exceptional seasons such as in this financial year so far, following the unprecedented bushfires, a major hailstorm event across Melbourne, Canberra and Sydney, and the heavy rain event which impacted south-east Australia.”

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IAG Managing Director and Chief Executive Officer

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Return to shareholders

Dividend and capital position

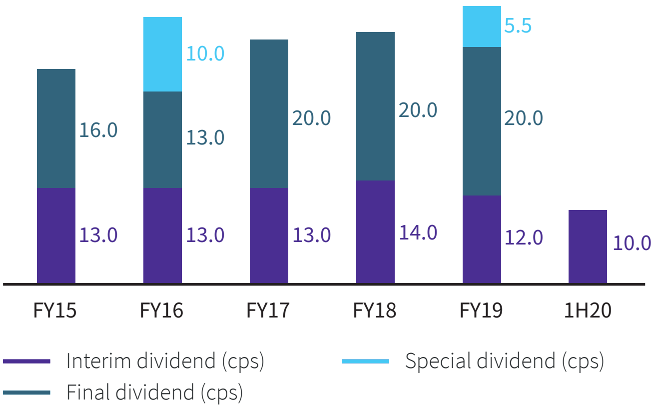
The Board has determined to pay an interim dividend of 10.0 cents per ordinary share, franked to 70% (1H19: 12.0cps, 100% franked). This equates to a cash payout ratio of nearly 61%. IAG's dividend policy remains one of distributing 60-80% of cash earnings, on a full year basis.

IAG's capital position remains strong. At 31 December 2019, IAG's Common Equity Tier 1 (CET1) ratio was 1.15, and 1.06 after allowance for payment of the interim dividend, against a target benchmark of 0.9-1.1.

In October 2019, IAG agreed to the sale of its interest in SBI General in India, indicating a profit after tax of at least $300 million and a regulatory capital benefit of more than $400 million. IAG expects this divestment to complete in 2H20.

The sale of its SBI General interest is expected to enhance IAG's capital position by at least 16bps in 2H20, once completed.

Dividend history – FY15-1H20



FY20 outlook

GWP guidance reaffirmed, reported margin guidance lowered for peril and reserve release effects

FY20 guidance

GWP growth
Low single digit

Reported insurance margin
12.5-14.5%

Underlying assumptions

1 **Net losses from natural perils of $850m**

2 **Reserve releases of around 0.5% of NEP**

3 **No material movement in foreign exchange rates or investment markets in 2H20**

GWP growth guidance of 'low single digit'

2H20 expected to feature:

- Short tail personal line rate increases to counter claims inflation pressures
- Modest personal lines volume growth
- Further average rate increases in commercial classes
- Lower Australian commercial volumes, including business exit effects
- Reduced CTP GWP from cumulative price response to scheme change

Reported insurance margin guidance of 12.5-14.5%

2H20 expected to feature:

- Strong underlying performance, including realisation of balance of targeted optimisation benefits
- Some further offset from higher regulatory and compliance costs
- Higher net natural peril claim costs

Fee-based business

- Increased pre-tax loss from accelerated investment in data, artificial intelligence and innovation technologies, and associated new businesses – up to $50m for FY20

Outlook

"We have lowered our reported margin guidance range for FY20, from 16-18% to 12.5-14.5%. This takes into account a reduction in expected contribution from prior period reserve releases, following the lower than anticipated reserve releases in the first half, and an increased net natural peril claim cost assumption following the significant January hailstorm across parts of Melbourne, Canberra and Sydney and the heavy rain event which affected south-east Australia in February. GWP guidance, of low single digit growth, has been reaffirmed, and the underlying performance of IAG is expected to remain strong in 2H20."

Peter Harmer
IAG Managing Director and
Chief Executive Officer

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IAG financial performance

Group results	1H19 A$m	2H19 A$m	1H20 A$m	1H20 vs 1H19 Mvt
Gross written premium	**5,881**	**6,124**	**5,962**	**+1.4%**
Gross earned premium	5,984	5,958	6,105	
Reinsurance expense	(2,373)	(2,331)	(2,396)	
Net earned premium	**3,611**	**3,627**	**3,709**	
Net claims expense	(2,358)	(2,261)	(2,433)	
Commission expense	(324)	(351)	(337)	
Underwriting expense	(535)	(506)	(519)	
Underwriting profit	**394**	**509**	**420**	
Investment income on technical reserves	102	219	81	
Insurance profit	**496**	**728**	**501**	**+1.0%**
Net corporate expense	5	(9)	(152)	
Interest	(48)	(46)	(54)	
Profit/(loss) from fee-based business	5	(14)	(2)	
Share of profit from associates	19	26	29	
Investment income on shareholders' funds	(7)	234	50	
Profit before income tax and amortisation	**470**	**919**	**372**	**–20.9%**
Income tax expense	(123)	(240)	(90)	
Profit after income tax (before amortisation)	**347**	**679**	**282**	
Non-controlling interests	(25)	(73)	20	
Profit after income tax and non-controlling interests (before amortisation)	**322**	**606**	**302**	
Amortisation and impairment	(29)	(28)	(15)	
Profit attributable to IAG shareholders from continuing operations	**293**	**578**	**287**	**–2.0%**
Net profit/(loss) after tax from discontinued operations	207	(2)	(4)	
Profit/(loss) attributable to IAG shareholders	**500**	**576**	**283**	**–43.4%**

Insurance margin	1H19 A$m	%	1H20 A$m	%
Management reported insurance margin	496	13.7%	501	13.5%
Net natural peril claim costs less allowance	110	3.1%	99	2.7%
Reserve releases in excess of, or below, 1% of NEP	(47)	(1.3%)	32	0.9%
Credit spread movements	24	0.7%	(7)	(0.2%)
Underlying insurance margin	**583**	**16.2%**	**625**	**16.9%**

Contacts

Media
Amanda Wallace
Mobile. +61 (0)422 379 964
Email. amanda.wallace@iag.com.au

Investor Relations
Simon Phibbs
Telephone. +61 (0)2 9292 8796 Mobile. +61 (0)411 011 899
Email. simon.phibbs@iag.com.au