As a business that deals in risk, it is vital for us to manage our business over long-term trends to ensure we continue to deliver sustainable, quality shareholder returns.

Five years ago, we determined the best way to achieve this was to set in place a strategy to build a general insurance business based on scale, with diversity across products, geography and distribution channels. The goal is to diversify and increase our revenue streams, reduce volatility and lower our cost of capital.

This means we aim to broaden our exposure to different regional insurance markets, which have varying economic and social influences, weather patterns and other factors, such as insurance cycles and levels of competition. We also aim to expand our portfolio of general insurance products, and the channels through which they are sold.

Adhering to this strategy has seen IAG transition from its beginnings as an Australian motor insurer selling policies direct to customers, to become a multi-line general insurance group with both direct and indirect distribution channels, operating across multiple international insurance markets.

During the past year, our most significant achievement against this strategy was the acquisition of general insurance businesses in the UK. These added to our growing international portfolio, which includes businesses in New Zealand and Asia, and now contributes about 26% to our Group’s insurance premium revenue.

Since we set the strategy five years ago, we have achieved the following financial results:

- we met our stretch goal of doubling our gross written premium over five years;
- our profit has grown on a normalised basis at a compound annual growth rate of 8.8%;
- our return on equity over that time has averaged 17.3%, which is above our target of 1.5 times our weighted average cost of capital; and
- we have increased shareholder dividends by a compound annual growth rate of 22.9%.

**PERFORMANCE IN 2007**

The Group recorded a net profit after tax of $552 million for the 12 months to 30 June 2007, compared with $759 million in the previous year, and an insurance margin of 11.4%, compared with 13.7%.

Our profit was significantly affected by the impact of the severe storms which struck Australia and the UK in June 2007, causing a $200 million pre-tax loss and reducing our insurance margin by 3%.

In addition, when compared to the previous year, the reported result includes a $47 million increase in amortisation costs on the newly acquired UK businesses and an expected $167 million after-tax decrease in investment returns following the Group’s decision to de-risk its portfolio by reducing its exposure to equities and investing in its core businesses.

The Group achieved strong premium revenue growth during the year. Gross written premium increased by 15% to a record $7.4 billion compared with the previous year, which was ahead of our target.
This was achieved on the back of growth in our domestic franchise, particularly in our largest business of Australian Personal Insurance, and the first contribution from the newly acquired UK businesses. These UK businesses constituted almost 16% of the Group’s gross written premium in the second half and delivered an $86 million pre-tax diversification benefit.

The Group’s key wholly owned licensed insurers retained their very strong capital position, with a ‘AA’ insurer financial strength rating from Standard & Poor’s and the Group had a multiple of 1.67 times APRA’s minimum capital requirement at 30 June 2007. This remains above our internal benchmarks.

**IMPROVED DOMESTIC PERFORMANCE**

Our largest business, Australian Personal Insurance, reported improved results during the year. Revenue from insurance products sold direct to customers, which makes up about 74% of Australian Personal Insurance, grew by around 5% in the second half of the year compared to the first half, after adjusting for the impact of the NSW Lifetime Care & Support Scheme. The business also improved its position in a number of domestic markets, including CTP, where NSW share hit our target of 38% and Queensland share grew to 3.7% during the same period.

A major contributor to the growth in our personal insurance portfolio has been a renewed focus during the year on improving our customers’ experience. Evidence of these efforts can be seen in our direct personal lines customer satisfaction score which has increased by 3% to 83%, while customer renewals remained over 90%.

Our commercial business, CGU, also performed strongly, growing both revenue and profit. However, a fourth consecutive year of falling premiums and significant competitive pressure mean the reported profitability of commercial insurance across the industry has relied on unsustainable levels of prior period reserve releases.

Our Australian Business Partnerships division experienced a turnaround in its underlying performance during the year, and our New Zealand business grew revenue in local currency terms.

Costs have been closely managed across the Australian and New Zealand businesses, and have been kept flat for four consecutive years. This means we made productivity gains in real terms.

**GROWING OUR INTERNATIONAL PLATFORM**

Our newly acquired general insurance businesses in the UK contributed around 10% or $725 million to the Group’s total gross written premium for the year.

Within the combined UK business, the niche insurance portfolio performed well while the private motor market remained challenging as rate increases in the market took longer to come through than originally anticipated.

We are integrating our UK businesses, and expect to deliver synergies of £25 million, which is about 1.4% ahead of our original target.

We welcomed Equity Insurance Group’s CEO Mr Neil Utley to the Executive team as IAG CEO, UK. He now has responsibility for building our business within that market.
We also made further progress in strengthening our Asian operations. Our Thai businesses grew, and we reached agreement with our Malaysian partners to increase our ownership in the general insurance business of AmAssurance from 30% to 49% in the coming year, while divesting our interest in the associated life insurance business.

We remain committed to pursuing long-term investment opportunities in general insurance markets in China and other countries in Asia, to meet our ambition to grow our portfolio of general insurance businesses in the region.

The Group also completed the acquisition of Alba, a Lloyd’s syndicate and its managing agency now known as Diagonal Underwriting Agency Limited, and established IAG Re Labuan (L) Berhad during the year. These businesses, which form our Asian Reinsurance operations, aim to benefit from retaining individual business unit exposures and gain efficiencies in managing all reinsurance covers centrally.

MANAGING RISK ACROSS OUR BUSINESS
Managing risk plays an important element in all areas of business, and often means adjustments are made to suit changing circumstances.

During the year, we took the decision to restructure the Group away from a reliance on volatile investment returns towards a greater focus on diversified insurance returns with lower volatility. As a result, the Group reduced its asset management investment exposure to Australian and international equities.

The Group’s investment return on shareholders’ funds contributed $301 million of pre-tax income on the back of another year of strong underlying equity market returns. This result compares with $539 million achieved in the previous year, a higher return due in part to the previously greater equities exposure. Investment return from reserves for insurance liabilities also contributed $360 million to the Group’s pre-tax profit.
One of the largest exposures inherent in our business is to extreme weather events. This was particularly evident this year, having managed the impact of one of the most severe storms on record in Australia.

We cater for these events in two ways. We have extensive, high quality reinsurance covers in place to mitigate the effect on our financial results. We also have operational procedures in place to ensure we respond quickly to assist our affected customers get on with their lives as quickly as possible.

The frequency and severity of such weather-related events is expected to increase as a result of climate change. That is why we believe it is good management to address climate change.

To that end, we have announced our intention to become carbon neutral by 2012, and we have made progress toward this goal. The initiatives we are taking are not only benefiting the community, but they also make sense from a cost reduction perspective.

Further information on how we manage risk across our business – in terms of economic, social, workplace and environmental aspects – to ensure the longevity of our business, can be found in our 2007 Sustainability Report, to be released in November and available at www.iag.com.au.

As part of ensuring we are well-placed to successfully manage our increasingly diverse portfolio, we have continued to invest in our risk management systems. The quality of our processes was recognised earlier this year when Standard & Poor’s advised us that IAG was one of only seven insurers globally whose Enterprise Risk Management System had been assessed as ‘Excellent’ – the highest assessment available under its methodology.
OUR PEOPLE
The sustainability of our business relies on the ongoing participation and commitment of our employees. I am pleased to report that the overall engagement of our employees increased during the year. This is the fourth consecutive year of improvement since we started measuring employee engagement, and many business units now score within the ‘best employer’ zone.

As we become an international organisation we must continue to build a sustainable culture with common values, and continue to improve engagement. That is why we are investing in identifying and addressing emerging labour force trends, such as providing a more flexible working environment which helps us attract both working parents and mature age workers. Initiatives in this area include extending paid parental leave from six to 12 weeks, and trialling working from home solutions for our claims management employees.

I would like to thank all those people who have contributed to the success of our Group. I am proud of what we have all achieved.

Finally, I would like to thank my Executive team for their dedication to the performance of the Group.

In particular, I would like to pay tribute to Ms Sam Mostyn, Group Executive, Culture & Reputation, who will leave her full-time role on the Executive team in October 2007. Sam has made a significant contribution over the past six years in shaping the company culture and I look forward to her ongoing contribution in a more flexible advisory role. Sam’s portfolio will transition to Ms Christine McLoughlin, currently Group Executive, Strategy.

LOOKING FORWARD
Our long-term strategy remains to build a general insurance business based on scale, with diversity across products, geography and distribution channels.

Ultimately, our aim is to deliver top quartile total shareholder return over the long term, with our return to ordinary shareholders exceeding 1.5 times our weighted average cost of capital, and to maintain our ‘AA’ rating from Standard & Poor’s for our key wholly owned licensed insurers.

The Group remains committed to its ambition of doubling the size of the business over the next five years. We have made significant progress this year in building our international operations, and we are currently actively pursuing opportunities in China, India and Europe.

We will also continue to improve the momentum and strength of our domestic businesses. As a result, for the 2008 financial year, we are targeting gross written premium or revenue growth of 10–12%.

While we expect operating conditions to remain challenging, we’re executing plans to respond to various parts of the cycle. To ensure a more sustainable outcome in terms of a fair price for risk, we have started increasing rates in short-tail commercial in Australia and New Zealand and have already put rate rises through in private motor in the UK, which now appear to be holding across the market.

By managing our business over these long-term trends, we will continue to deliver sustainable, quality earnings for our shareholders.