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Calliden Group Limited
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Calliden Group Limited today reported net profit of \$9.1 million for the year ended December 2008 up from \$1.3 million in the previous year. Gross written premium (GWP) was \$200.0 million, up from \$124.4 million. The growth partly reflected your acquisition of the AU general insurance businesses at the end of July 2007. In the second half, GWP was \$102.4 million, up 7 percent from the previous corresponding period. Given slowing economic growth, is this level of GWP growth sustainable going forward?

CEO Nick Kirk

Our focus has been very much on growing our bottom line profit. As a result, in the latter part of 2007 and early 2008 we exited a number of unprofitable insurance portfolios, which amounted to around \$19 million in GWP. We also discontinued underwriting crop insurance which accounted for approximately \$7 million worth of premium. If you take that into account, and annualise the contribution from the AU general insurance businesses in the previous year, underlying GWP growth in 2008 was more like 15 percent.

Looking forward, the economic climate introduces a level of uncertainty but premium rates are increasing, and we've worked very hard to create a differentiated offering. We now have a specialised small and medium enterprise and personal lines insurer with a range of focused offerings from farms to sports clubs to high value cars and homes. In 2009 and beyond, we believe we can organically and profitably grow GWP at over 10 percent a year.

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Second half net profit was \$5.5 million, up from \$1.9 million, with a fall in net underwriting profit to \$7.5 million from \$8.8 million offset by a rise in investment income to \$9.7 million from \$5.0 million. Can you comment on the year on year fall in underwriting earnings in the second half and the outlook for the underwriting result in the current year ending December 2009?

CEO Nick Kirk

The change reflected the reduction in interest rates, which lowered the discount rate applied to our claims reserves, increasing the value of those reserves. In the second half of 2008, this added up to a \$3 million increase in our claims reserves net of reinsurance. As we duration-match our investment portfolio to our claims reserves, the increase in our claims from falling interest rates was balanced by a gain in our investment portfolio. As a result, there was a reduction in the relative contribution of underwriting even though we had an underlying improvement in the loss ratio.

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Calliden's original business case envisaged the achievement of ROE of 12.5 to 20 percent when the company reached a GWP level of \$200 million. Last year's ROE was 9.2 percent. What are the main reasons returns have been lower than expected and when do you expect to achieve returns in line with the business case?

CEO Nick Kirk

The original business plan was for five years. We've met the premium target two years earlier than we predicted, and I believe the 9.2 percent return in 2008 was a solid step towards our target return band, which we said we'd achieve in 2010.

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You've indicated that the insurance pricing environment has improved and that Calliden's price increases in 2008 were in line with the industry. What level of price increase did you achieve across your portfolio and to what extent did price rises contribute to earnings?

CEO Nick Kirk

We measure trends in our premium rates in a number of different ways, but looking at the movement in average premiums from December 2007 to December 2008 our commercial short-tail lines increased by 4.4 percent, our home insurance by 9.6 percent, our motor business by 6.5 percent and our commercial long-tail portfolio by 7.6 percent. In the long-tail business, the rise was primarily due to larger increases in builders' warranty rates reflecting economic conditions. You should also bear in mind that in some classes premium rates were still falling in the first quarter of 2008, so the total price rise from the bottom of the cycle has been slightly higher than the numbers I've quoted.

The contribution to earnings from rate increases in 2008 was relatively minor since they started in earnest at the beginning of the second quarter and take a full 12 months to earn through. The improvement in our loss ratio in 2008 was the result of lower catastrophe costs and our discontinuing of a number of loss-making portfolios rather than price increases.

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What scope is there for further price rises in the current year ending December 2009 and what's the potential upside for earnings?

CEO Nick Kirk

We've already put through further increases in our home and motor portfolios and we're increasing rates further in our commercial and rural books from March. We're targeting high single digit increases for this round of premium increases. The flow-through of the 2008 increases and part of the 2009 increases will have a positive effect on earnings in 2009, but this will be balanced by further potential falls in interest rates, and overall lower investment returns. We need the premium increases!

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Calliden's underwriting profit for 2008 was \$19.7 million, up from \$8.7 million. Excluding statutory charges, the gross claims ratio improved to 60 percent, down from 70 percent, and the net expense ratio improved to 39 percent, down from 43 percent. To what extent can these improvements be sustained going forward and what's the outlook for the claims and expense ratios in 2009?

CEO Nick Kirk

It's worth noting the reason we've restated the ratios to exclude statutory charges is that due to our quota share reinsurance arrangement, the statutory charges distort our 2008 ratios quite markedly – they reduce the loss ratio by 9 percent and inflate the expense ratio by 15 percent.

In 2009 the loss ratio will be impacted by the Victorian bush fires, but over time we'd expect to continue bringing the net claims ratio down through the impact of premium increases and portfolio improvement, balanced by further reductions in interest rates which will impact our long-tail reserves. The expense ratio should gradually reduce as we work toward our growth targets and see the benefits of the work we're doing to simplify the business, such as the recent push-across to one insurer and our ongoing implementation of a single software platform.

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Investment income was \$13.1 million in 2008, up from \$8.2 million in the previous year. With most of your investment funds now in fixed interest instruments and in light of recent interest rate cuts, will you seek to change your investment strategy in the short term? What's the outlook for investment income in the current year?

CEO Nick Kirk

We've no current plans to change our investment style, although we regularly review the strategy in the light of the prevailing environment. Also, returns aren't our only criterion, we look at the risk that's inherent with each asset class and seek to protect the capital of the company as much as possible from the volatility inherent in investment choices.

Investment income is likely to be lower in 2009 due to the fall in interest rates, but this should also drive further premium increases in the market, particularly in longer-tail lines.

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Calliden booked cash outflow from operations of \$6.0 million in 2008 compared with inflow of \$14.1 million in the previous year. This largely reflected a rise in reinsurance premium paid to \$92.0 million, up from \$20.0 million, which was only partly offset by an increase in reinsurance recoveries to \$53.5 million from \$22.5 million. Can you comment on how your reinsurance flows might impact cash flow going forward?

CEO Nick Kirk

As we've applied a unified reinsurance program across the portfolio, there's been a net cash outflow because the premiums are paid upfront. We expected this to correct by year end as reinsurance recoveries, particularly on the quota share treaties, are bought to account. In 2008, the lower level of gross claims meant the correction is taking longer. Reinsurance flows should even out in 2009 as recoveries start to balance with premiums paid.

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Calliden had a capital base of \$48.4 million as at the end of December 2008, and a capital surplus to regulatory requirements of \$19.8 million. What level of surplus do you feel is necessary for Calliden and would you consider a distribution of some of the surplus to shareholders as the business matures?

CEO Nick Kirk

The business will need more capital as it continues to grow and at the current level, it makes sense to retain capital for future growth. Our preference is to provide dividends based on a growing and profitable business such that shareholders can benefit from both our franking credits and tax losses.

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Calliden also announced a maiden, fully franked dividend of 1.25 cents for the year. The payout ratio was about 32 percent. Given the capital surplus, why wasn't there a higher payout? How indicative is the 2008 payout of the expected payout level going forward?

CEO Nick Kirk

We believe the dividend reflects a prudent and conservative level of payment for our current profitability and our retained earnings available for distribution. The 2008 payout shouldn't be seen as a precedent for future dividends. Our policy is to pay dividends to shareholders while retaining sufficient funds within the group to maintain a strong capital base and be able to invest in future growth, so our payout ratio will depend on future profitability and capital needs.

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Calliden has achieved many of its objectives in relation to exiting poorly performing insurance portfolios, strengthening its reinsurance arrangements and simplifying its structure, and your focus this year will be on maximising value. Where do you see the greatest potential to maximise value within the business?

CEO Nick Kirk

We've been very focused on putting the business together, getting the right business mix and simplifying our business structure. The greatest potential to maximise value now is to grow the business profitably. We have an expense base that could support a larger business, and profitable organic growth will maximise the value of what we have, as well as allowing us to unlock the value of our tax losses and franking credits through distributions to shareholders. We believe the business we've put together now makes us a genuine alternative to the major insurers.

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Thank you Nick.

For more information about Calliden Group, please visit www.calliden.com.au or call General Counsel & Company Secretary Charles Whattam, on +61 (2) 9551 1143.

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