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## CEO on Positive 2010 Outlook

Open Briefing interview with CEO Nick Kirk

**calliden**  
group

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### In this Open Briefing<sup>®</sup>, CEO Nick Kirk discusses

- 2009 result impacted by unusually large number of catastrophes, reduced investment income
- Growing scale contributes to continuing fall in expense ratio
- Outlook for 2010 positive given rising premiums, increasing investment income – subject to normal claims environment

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#### Record of interview:

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Calliden Group Limited booked a net loss of \$0.4 million for the year ending December 2009, compared with a profit of \$9.1 million in the previous year. Pre-tax, the loss was \$0.5 million compared with profit of \$7 million. The result reflected a deterioration in claims performance and a reduction in investment income to \$6.0 million from \$12.5 million. What is your level of confidence in achieving your original target of ROE of 12.5 to 20 percent within five years of launching the business, i.e. in 2010?

##### CEO Nick Kirk

While the 2009 result was disappointing, there were a number of underlying positives that give us confidence for 2010. We achieved top line growth of 9 percent for the year and this was stronger in the second half at 12 percent. About two thirds of that came from premium increases which were 8 percent in the second half, up from 5 percent in the first half. The majority of the bottom line benefit of this will flow into 2010.

It is a similar picture on investments where the investable funds increased due to strong cash flow in the second half of 2009 and the rate of return also increased from 4 percent per annum in the first half to 6 percent in the second. This trend should continue into 2010. So subject to a normal year for catastrophe claims, we should be in a position to hit our 2010 targets.

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Calliden's gross claims expense was \$178.1 million in 2009, up \$67.0 million from the previous year. This was offset by an increase in reinsurance recoveries to \$122.5 million, up \$69.3 million. However reinsurance expenses also increased, up \$14.1 million to \$107.8 million. To what extent will the claims experience of 2009 mean material increases in your reinsurance premiums going forward?

**CEO Nick Kirk**

In 2009 our conservative reinsurance strategy protected us really well in a tough environment. We've deliberately taken a conservative reinsurance position during our formation years to protect our capital against just the sort of horror year we had in 2009. Longer term, the cost of reinsurance will reflect our loss experience over time, but we've renewed our program for 2010 on a like-for-like basis with a pricing increase in the single digits.

The two main reasons for the increase in our reinsurance expenses in 2009 were first that we have a proportional contract: as our premiums grew by 9 percent, so to a large degree did our reinsurance spend. Second, the large number of catastrophes and big losses in 2009 meant that we had to pay about \$2.4 million in reinsurance reinstatement premiums.

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Net loss ratio, excluding statutory charges, was 66 percent in 2009, up from 62 percent in the previous year. The loss ratio deteriorated to 71 percent in the second half from 61 percent in the first half, which you've partly attributed to the cost of a large claim relating to a fire in Western Australia in November. How did Calliden come to have such a high exposure to this event and are there other potential exposures of this nature in your portfolio?

**CEO Nick Kirk**

The Western Australian loss related to business interruptions following a fire. We insured three interconnected companies for business interruption risk and each of them suffered a substantial loss. The total gross cost of the three claims was over \$20 million. We therefore incurred three retentions under our reinsurance treaty, and three reinstatement premiums before our aggregate protection was applied. The net impact of the claims was approximately \$2.7 million in total.

The vast majority of our policies are for relatively modest sums, and we keep this under constant review. As a result of the loss in Western Australia, we've put in place additional reinsurance protection to cover any unknown accumulations in the future.

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The Western Australian fire followed the Victorian bush fires in February, which had a negative impact on your first half result. To what extent can the high level of claims in 2009 be considered "one off"? How will your reinsurance strategy change in the nearer term?

**CEO Nick Kirk**

Last year was certainly a poor one from both a catastrophe and large loss perspective. However, our underlying or attritional loss ratio is the best we've had for more than three years, so a normalised catastrophe and large loss experience would mean a significant improvement in profitability.

We believe that the net impact of the higher catastrophes in 2009 was \$2.5 million to \$2.8 million over and above our normalised catastrophe allowance for the year. This also had a knock-on impact on our investment income: investable funds were reduced for a period as we paid out claims in advance of reinsurance recoveries. This, together with low market

interest rates, contributed to a reduction in investment income compared with a normalised year, which we estimate at \$2.5 million. In addition, the net cost of the large Western Australian business interruption losses was about \$2.7 million.

We're seeking to ensure our reinsurance strategy develops as the business develops. For example, we've reduced our proportional reinsurance in 2010 to 40 percent from 50 percent, in line with our comfort in our underlying performance. As a result, our overall reinsurance expense should be lower than 2009, assuming we don't have an abnormal number of reinstatement charges.

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Calliden booked gross written premium (GWP) of \$217.8 million in 2009, up from \$200.0 million in the previous year, and you've attributed two thirds of the growth to premium increases. Can you comment on the current pricing environment in your main risk classes? What do you see as the key drivers of GWP growth in the current year?

**CEO Nick Kirk**

In 2009 our price rises were less than the 10 percent we'd hoped for. There are mixed signals on prices at the moment, but we expect further price rises in our book in 2010. Our regional and rural business, for example, still needs further increases to achieve a decent return. Overall, we'd be pleased to see a further 8 percent increase in 2010 and would expect overall GWP growth of at least 10 percent for the year.

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In spite of the increase in GWP, net premium revenue dropped to \$101.0 million in 2009 from \$105.8 million in the previous year, reflecting the rise in reinsurance expenses. However, expenses also fell, to \$47.9 million, down from \$49.7 million, and the acquisition ratio fell to 37 percent from 39 percent. What is the outlook for the acquisition expense ratio given further increases in reinsurance costs?

**CEO Nick Kirk**

We'll continue to tightly manage our expenses in 2010, and given further GWP growth of at least 10 percent, we'd expect the net acquisition ratio to continue to trend downwards.

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In light of expectations that interest rates will continue to rise, what are your intentions regarding your investment portfolio – will you remain invested solely in fixed interest securities?

**CEO Nick Kirk**

We've shortened the duration of our portfolio somewhat and are watching the situation carefully. We're looking to see whether some exposure to equities would be better on a risk-adjusted basis than staying 100 percent in fixed interest. As with our reinsurance, we may gradually increase our investment risk appetite in the coming financial year.

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Calliden booked cash flow from operations of \$1.7 million in 2009 compared with outflow of \$6.0 million in the previous year. This largely reflected lower acquisition, and underwriting

and administration expenses, as increases in premiums received and reinsurance recoveries were offset by rises in reinsurance premiums and claims paid. Given the reduction in your proportional reinsurance in the current year, what is the outlook for reinsurance flows, and cash flow, going forward?

**CEO Nick Kirk**

The reduction of our reinsurance quota share to 40 percent from 50 percent means we'll retain 10 percent more of each premium booked in 2010. It should have the impact of increasing investable funds and further improving cash flow, depending on the underlying performance of the book. We'd expect a benefit from increased investable funds in 2010.

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As at the end of December, Calliden had total borrowings of \$25.0 million, all of which mature at the end of July. What are your intentions in relation to this debt and do you have any indication of the potential cost of any refinancing?

**CEO Nick Kirk**

We intend to start discussing this with our bankers shortly. Given the changes in the financial environment since the loan was taken out, it's likely that the interest rate would increase on renewal.

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Calliden Insurance Limited, your insurance entity, had a regulatory capital base of \$47.7 million as at 31 December 2009, down from \$48.4 million a year earlier. The capital adequacy ratio was 2.1 times, down from 2.4 times. What is your level of comfort with the current capital adequacy ratio and where do you see the ratio trending in a more normal claims environment?

**CEO Nick Kirk**

Calliden Group was capitalised at 1.9 times the Australian Prudential Regulation Authority (APRA) minimum as at the end of December. This is a new measure, introduced following changes last year to the prudential framework for general insurance groups. Both the Group and the insurance company are strongly capitalised.

We'd expect to remain strongly capitalised while balancing the need to maximise the efficiency of our use of capital. Over time of course, the reduction in our reinsurance quota share will further increase our capital efficiency.

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Calliden announced a fully franked dividend of 1.00 cent for 2009, down from 1.25 cents for the previous year. What was the rationale for maintaining a dividend in a year in which the company made a loss and what is the outlook for dividends in the coming year?

**CEO Nick Kirk**

We made a loss in 2009 but we believe the outlook for 2010 is positive. The Group has retained earnings, plus accumulated franking credits and given our strong capital adequacy, we believe it's appropriate to return some money to our shareholders. The dividend payment is also a signal of confidence in the future.

In respect to the dividend outlook for 2010, our policy remains to consider dividends on the basis of our level of profitability in the recent period and the capital needs of the company in the period ahead. The board will therefore consider the question of dividends when the 2010 full year result is finalised.

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Thank you Nick.

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

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