Equities

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Insurance Strategy and Previews

Plenty of value but little in the way of momentum

- Best Ideas
- Industry Overview

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- **Insurance order of preference** — Our order of preference going into reporting season is AMP, SUN, NHF, QBE, IAG and TWR. We have Buy calls on AMP and SUN, and Hold calls on the other stocks. With AXA AP now delisted, reporting season for Australian insurers starts relatively late with AMP on 18 August.

- **Nasty conditions for both life …** — Falling equity markets, subdued retail flows, a high incidence of income protection claims and ongoing uncertainty about regulation and capital requirements are major issues for AMP and other wealth managers.

- **… and general insurers** — On the GI side of the sector, we already know that the level of 1H catastrophes will see QBE significantly exceed its large loss allowance for the half. IAG and Suncorp also fail to escape the pain with FY11 including the worst claims in Australia for forty years and three NZ earthquakes. The domestic insurers also now face the prospect of substantially increased reinsurance costs, having to take on more risk on their own balance sheets and a need to significantly reprice not only to cover the increased costs of reinsurance but also to ensure their best years are more profitable to offset the likelihood of greater volatility in their results.

- **AMP offers value** — AMP is a scale provider in a growing wealth management market supported by compulsion and its current valuation is attractive. There are short-term issues and regulation looks likely to squeeze margins, but these and other fears seem to be overplayed in the stock price. It is hard to see AMP's 1H11 result per se as a catalyst for the stock and we expect to see another weak quarter for cashflows. However, we should receive a substantial update on AXA merger synergies including full detail on the sources of its targeted A$120m savings. We continue to view this target as conservative, although we would be surprised if it is upgraded just yet. Likely catalysts include equity market recovery and clarity on proposed regulatory changes.

- **So does SUN —** Suncorp looks attractive value to us. It is trading at just 8.7x our FY12E EPS albeit this includes allowance for a share buyback which could be converted into a special dividend. Although some uncertainties remain, most notably Basel III and LAGIC, we are hopeful that Suncorp's divisional capital targets will be announced alongside its results. Bad debts remain a risk but the method we successfully used to predict the 3Q11 impairment level is still not throwing up any warning signs for 4Q11 (refer to our analysis inside) though we admit it isn't foolproof. We retain our Buy, Medium risk call and A$9.75 target price.

- **Things to watch out for —** Slightly unusually our NPAT numbers for the June half do not differ too much from consensus though our Suncorp EPS is materially higher. Aside from Suncorp's capital targets and details of AMP synergies we refer to above, we will be most interested in insurance margin guidance for FY12E for IAG, given uncertain reinsurance costs, and FY11E for QBE, given risk of exceeding large loss allowances.

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Contents

Overall sector analysis and order of preference

Overview of sector issues

Heading into reporting season, sentiment towards the insurance sector is the weakest it has been for some time. On the general insurance side of the sector, natural catastrophes and hefty reinsurance reinstatement costs have reduced insurers' financial performance. On the life insurance side continuing adverse experience in income protection and lacklustre fund flows do little to excite investors. Overlay on top of these weak sector trends ongoing regulatory reform, which continues to drag on, and it becomes easy to see why investors have focused elsewhere. Perhaps therein lies the opportunity. In our view, valuations are the most attractive they have been for some time.

Reinsurance programmes mostly passed natural disaster stress tests

The past half has been costly for insurers. The frequency and severity of natural catastrophes and severe weather has exceeded natural peril allowances, tested insurers' catastrophe covers, exhausted aggregate covers and made reinsurers reconsider the price of risk in Australia and New Zealand. While insurers' financial performance has been impacted, the listed Australian and New Zealand insurers have not suffered significant balance sheet destruction. This, at least, sets them aside from some unlisted New Zealand mutual insurers which are now in financial difficulty, and some overseas listed insurers, which have seen the events over 1H11 destroy a material proportion of shareholders' capital. Much of the credit for this stronger performance lies in Australian and New Zealand insurers' diversification, their conservative risk management/profile, and at least up until their next reinsurance renewal, strong reinsurance programs.

However changes mean GI profitability targets likely need to rise

However, the are several lingering issues, especially for domestically focused insurers such as Suncorp and IAG. Not least of these is the prospect of materially higher reinsurance costs, despite taking on considerably more risk on their own balance sheets. We discussed this issue in some depth in our recent industry report dated 6 July 2011, Reinsurance in Australia and NZ - Risk profile changes for IAG and SUN; QBE's timing impeccable. However, we also now highlight the implication that not only do insurers need to reprice their products to cover increased costs of reinsurance, but also increased loss allowances (as a result of taking on more risk). In short, they need to aim to make larger profits in the benign claims years, because the bad claims years are likely to produce considerably worse results. Witness, for example, the analysis we performed in our recent report showing materially increased claims costs for Suncorp in FY11 if its FY12 reinsurance programme had been in place then. We set out below a few of the reasons why domestic insurers will need to increase their targeted underwriting margins:

- higher reinsurance rates encouraging higher reinsurance retentions;
- higher reinsurance retentions and less comprehensive aggregate covers increasing the volatility of results;
- increased volatility driving up the cost of capital, such that good years need to be more profitable to offset the bad years which will be even less profitable; and
- LAGIC proposals appearing to result in an increase in regulatory capital for current levels of risk, implying reduced returns on equity at current levels of profitability.

QBE is also not completely immune from these factors and it will be subject to the new LAGIC requirements, although it at least has the luxury of having negotiated its reinsurance contract with 80% at a fixed price for three years. This appears to be a masterstroke of timing although there are some significant exclusions, including Balboa, crop insurance, marine, lenders' mortgage insurance, energy and retrocession and it is also unclear whether the new programme has increased its losses this year. Furthermore pricing conditions remain difficult in a number of areas in which it operates and short dated interest rates in Australia and the US appear to be heading in the wrong direction for it at the moment, although there has been a rise in the Eurozone.

Spring session legislation should reduce uncertainty in wealth management

The life insurance side of the sector is facing greater regulatory change with the government's Future of Financial Advice ("FoFA") and Stronger Super legislative reforms set to be tabled in parliament during the spring session (sometime between August and November), although there appears to be risk of delay. The draft legislation should provide the industry with greater clarity as to some of the government's proposals (such as how it plans to implement "best interests duty" and precisely define what constitutes "MySuper").

Depressed valuations

On multiple valuation metrics, the insurance sector appears the cheapest it has been for some time. IAG has derated to be at the lowest p/e multiple since it listed, while AMP and QBE are likely to be trading around p/e multiple cyclical lows. Additionally, AMP and SUN have recently been trading around 52 week lows and are now trading at a significant discount to our spot valuations for each stock.

Insurance reporting calendar

Figure 1. Insurance reporting calendar

Date	Company	Result	Forecast NPAT	Forecast Core Earnings	Forecast Core EPS	EPS Growth	Forecast Next Dividend
			A$m	A$m	cps	%	cps
18 Aug 2011	AMP	1H11	357.5	433.5	17.7	-2.8%	14.0
19 Aug 2011	QBE	1H11	672.4	706.4	64.1	-19.2%	62.0
22 Aug 2011	NHF	FY11	60.0	60.0	12.4	0.3%	4.0
25 Aug 2010	SUN	FY11	424.1	614.1	48.0	-24.3%	15.0
25 Aug 2011	IAG	FY11	245.6	419.6	20.2	145.1%	6.0

QBE NPAT and core earnings are in US$m; core EPS is in USc, dividends are in Acps
Source: dataCentral, CIRA

Insurance order of preference

Figure 2. Insurance order of preference

Rank	Reuters Ticker	Rating	Risk	Price 22 Jul 2011	Market Capitalisation (m)	Spot Valuation	12 Month Target	Expected Dividends	Expected Total Return
1	AMP.AX	Buy	Medium	4.80	13,243	6.30	5.80	0.30	27.1%
2	SUN.AX	Buy	Medium	7.73	9,778	9.60	9.75	0.40	31.3%
3	NHF.AX	Buy	High	1.32	609	1.80	1.60	0.08	27.8%
4	QBE.AX	Hold	Medium	17.33	18,673	19.32	18.25	1.28	12.7%
5	IAG.AX	Hold	Medium	3.42	7,027	3.70	3.70	0.26	15.8%
6	TWR.NZ	Hold	High	1.53	406	2.46	1.90	0.10	30.7%

Source: dataCentral, CIRA

Our top picks and why

With our strategists still forecasting a modest equity market recovery in 2HCY11, our top picks remain AMP and Suncorp, both of them "risk-on" stocks. We set out our reasons for this below. However, given the level of macro uncertainty, we also set out some of the factors causing leverage and defensive characteristics for each of the listed insurance sector names.

AMP

Value remains the main attraction

AMP's share price is well below our combined AMP/AXA spot valuation, even after allowing for what we continue to consider is a conservative estimate of integration synergies and despite us recently adopting a little more caution on new business multipliers for CWM and CWP. In our view, valuation remains the main attraction of an investment in AMP currently, with our combined AMP/AXA valuation of A$6.30 (was A$6.40). At its current price, investors are able enter the stock around 1 standard deviation below its average 12 month forward p/e multiple. We would also not completely rule out the prospect of a modest capital return in time, although if this occurs we see it as most likely to occur some time in FY12E.

Regulatory risk remains but likely priced in

While regulatory risk continues to be an issue for the stock, we believe this is likely priced in and mostly allowed for in our earnings forecasts. Indeed, if noises we hear from the stronger super negotiations are correct, there is the prospect of a long adjustment period for back book default FuM to transition to MySuper, whereas we are effectively assuming all AMP's back book FuM transitions to MySuper margins on 1 July 2013. This suggests the potential for earnings upgrades to reflect the slower margin squeeze if this proves to be the case.

While some investors appear concerned about the outcome of the FoFA regulations, as we highlight in our recent note dated 29 April 2011 "*Wealth Management/Risk Insights - FoFA May Make Risk Sales Harder To Generate*", we saw most of the changes being as expected, with some a positive for AMP at least in a relative sense compared to IFAs. Although the ban on commissions on individual risk product sold within super has the potential to depress AMP/AXA's risk sales, this would only be the case if industry sales reduced, something that seems to be inconsistent with the Government's concerns about under insurance. We note too that this would take a while to have a significant impact on profit although value of new business and annual premium income measures would be more quickly hit.

Unlikely to be a quick recovery in retail flows

Certainly, retail flows look likely to be subdued for a while and we have not changed the view we most recently espoused in our recent report "*Trends in Wealth Management - Six FoFA contentious issues to be addressed*" dated 18 April 2011, that with reasonably attractive deposit rates and continued deleveraging, it could be a while before industry (and AMP's) discretionary flows improve. Indeed, if anything, we now believe it will likely take even longer for flows to recover.

FY11E EPS growth difficult but double digit possible thereafter

Furthermore, EPS growth in FY11E looks to be increasingly difficult and we are now estimating a small decline, although we expect this to expand to double-digit percentage growth in FY12E as synergies begin to contribute, assuming normal equity markets (i.e. 6% capital growth per annum). There is also some chance that CWM revenue margins hold up a little better than expected with the $ per week element of fees providing some resilience to the market downturn.

Rising equity markets would likely help the valuation gap close

We also see more likelihood of the gap between the share price and our target price closing if the equity market is rising rather than falling as it has been over recent times.

Shorter-term headwinds but value keeps us positive

So there are some shorter-term issues for the AMP stock but with valuation attractions still very significant in our view, we retain our Buy/Medium Risk (1M) rating and A$5.80 target price. AMP remains our top Australian based wealth management pick and one of our two favoured insurance stocks.

Suncorp

For FY11, we are slightly more bullish than consensus on Suncorp's bank impairment charges (see our review of public disclosures inside), although slightly below consensus for insurance margin. We also expect a further increase in past due loans in the core bank after the catastrophes in 3Q11. We are forecasting the weakest half for GI since 1H03 (we forecast a profit of just A$77m), although it is possible that higher than long term levels of reserve releases (given IAG's announcement suggesting higher releases than pcp for it) will help the headline result. Furthermore, we still expect underlying performance improvement in FY12E via its building blocks programme.

Even so, FY11 has not been an easy year for Suncorp with record high claims in Australia, with its home State Queensland particularly hard hit, and three earthquakes in NZ. However, despite this, we continue to believe the two main strands of our investment thesis remain intact, namely:

- The potential for significant profit improvement in its general insurance operation – all evidence still points to the building blocks programme being firmly on track, with claims and pricing engine improvements implemented on time and to budget despite the potential distraction of significant natural catastrophes. Despite higher reinsurance costs, Suncorp has reiterated its above 12% underlying insurance margin guidance for FY12E, reflecting apparent confidence that the price rises on its own products will be sufficient to cover both an increase in reinsurance costs and a higher large loss allowance.

- The potential for capital returns – Suncorp should provide more detail of its capital targets with its result and while there are uncertainties over the application of Basel III and LAGIC reforms, we remain optimistic these will reveal solid prospects for a capital return in FY12E. Suncorp plans to return any surplus capital to shareholders. We continue to forecast a share buyback in FY12E, although we think a special dividend is a very possible alternative.

  While our bank team recently lowered their earnings forecasts for the major banks given the impact of Basel III, we highlight that for Suncorp:

  - capital ratios are currently high in the bank;
  - market risk is low relative to the majors at only ~A$330m;
  - the bank is unlikely to be a domestically significant financial institution (although the general insurer is);
  - covered bonds look as if they will be a positive for funding, although not as much as for the major banks; and

- from a liquidity perspective, Suncorp's core bank is better placed than all of the majors, and by the time the liquidity rules come into effect in 2015 the run off of the non-core bank should largely be completed.

However, working the new provision method, requiring the adoption a good/bad split may require Suncorp to hold higher levels of provisions against whatever bad debts it has left at this point – and its preference shares will not meet the new requirements going forward (along with all of the hybrids from the major banks). Even so, this does not at face value seem enough to stop our forecast returns although it is a source of uncertainty.

These factors, together with an attractive valuation, leave us continue to recommend buying Suncorp. As such, we retain our Buy / Medium Risk recommendation and A$9.75 target price.

Leverage and defensive characteristics

Given our strategists remain optimistic about the prospects for a second half rally, we currently continue to assume rises in markets between now and calendar year end, at our normal rate of around 6% capital growth per annum. However, with the uncertain outlook, many investors concerned about the impact on financial markets from austerity measures from multiple overseas governments driven by concerns over accumulated budget deficit, we consider some of the economic and market leverage characteristics and defensive characteristics of the large listed insurers in Figure 3 below.

Figure 3. Qualitative analysis of insurers' leverage factors and defensive characteristics

	Economic and market leverage characteristics	Defensive characteristics
AMP	AuM in CWM, KiwiSaver, AMPCI	Premium based business in CWP, NZ
	Flows influenced by investor sentiment, which is in turn influenced by markets	Exposure to mandated superannuation flows
	Guarantees offered by Mature (although these are largely matched)	Introduction of $pw charging component of fees
		Shareholder capital predominantly invested in cash
SUN	Suncorp Bank lending exposures	Queensland conditions normalising after catastrophes
	Suncorp Life guarantees	Property insurance in Australia and NZ
IAG	Equities 40% of shareholder funds	Property insurance in Australia and NZ
	UK motor personal injury exposures	
QBE	Exposure to US and Europe	Lenders placed homeowners insurance
	Credit and liability insurance exposures	Other property insurance businesses
	Pricing power influenced by affordability	Only 2% of total investments in equities

Source: Citi Investment Research and Analysis

Analysing Citi vs. consensus

Where we differ to consensus and see risks

Our FY11E estimates are above consensus for Suncorp's EPS primarily we believe due to our treatment of preference shares – we believe that both classes of Suncorp's preference shares will again be anti-dilutionary in 2H11E, leading us to use the weighted average basic shares on issue for our diluted EPS calculation. Our estimate of Suncorp's FY11E NPAT on the other hand is close to consensus with reserve releases a source of upside risk to the headline number given IAG is guiding to well above long term average reserve releases this period.

Using Bloomberg we estimate that our forecasts are around consensus for QBE, while our AMP numbers are also similar to consensus. We also do not appear to differ too much from consensus on IAG, although we may be slightly above.

According to Bloomberg our estimates are at the bottom of the market for nib's earnings, despite being towards the top end of nib's guidance range. We believe that this is due to us factoring in higher seasonality into 2H11 and higher risk equalisation transfer fund costs, and potentially higher average shares on issue, given the low number of shares repurchased in 2H11.

Anticipated positives and negatives

Reporting season positives

We expect reporting season positives to include:

- further improvement in Suncorp's underlying margins (normalising for reinsurance reinstatements, weather events, natural catastrophes and reserve releases);
- further evidence of runoff of Suncorp's non-core book, with potentially only few new large exposures becoming impaired (refer to our work on this later in this report);
- reiteration of Suncorp's insurance margin target of more than 12% for FY12E;
- details of Suncorp's divisional capital targets which will hopefully provide some evidence of its ability to make capital returns, despite uncertainty surrounding Basel III and LAGIC;
- continued evidence of progress in the turnaround of IAG's Australian intermediated business, with IAG referring to top and bottom line growth in the business at its recent strategy day;
- a reduction in the size of losses from IAG UK;
- strong top line premium growth for QBE coming from its recent acquisitions;
- a statement that AMP's integration plan for AXA is on track and much greater detail about how it will achieve the targeted synergies, although we would be surprised if it were to upgrade its A$120m after tax target just yet, despite us continuing to believe it is likely conservative;
- details of AMP's capital position post merger which is likely to be very strong relative to existing regulatory requirements and, depending on the outcome of APRA's proposed LAGIC reforms and taking into account management's desire to be conservative, could nonetheless leave scope for a modest capital return in time, perhaps during FY12E;
- an increase in nib's group margin guidance, assisted through the growth in its overseas students and overseas workers businesses; and
- more detail on nib's plans to expand its overseas workers and overseas students businesses to 20% of its premiums in FY14E.

Reporting season negatives

We expect reporting season negatives to include:

- continued cautious commentary on insurance margins and its ability to reprice for higher reinsurance from IAG given uncertainty surrounding its FY12E reinsurance costs. We also highlight the possibility of downside risk to our FY12E insurance margin estimate;
- potential narrowing, and lowering, of QBE's insurance margin guidance for FY11E;
- a rise in past due loans within Suncorp's core bank following further flow through of the natural disasters in the March quarter;
- continuing poor experience in income protection across the life insurance industry, impacting both Suncorp and AMP/AXA, although Suncorp suggests it has been working on addressing a cohort of lapses which compounded its poor income protection experience in 1H11;
- the continuation of subdued industry-wide retail flows;
- AMP's aforementioned cost against AMP/AXA merged profits from New Zealand from the Christchurch earthquake, coupled with a stronger Australian dollar, of around $10m;
- a further sizeable increase in payments into the Risk Equalisation Transfer Fund for nib.

Investment theses and key issues for insurance stocks

Large cap insurers

AMP – continues to have significant value attractions

Following the acquisition of AXA, we continue to see AMP as offering significant value attractions. The AXA acquisition has been made at a time in the cycle when organic growth is lacking. AMP has cemented its industry leadership position in Australian life insurance and wealth management and we believe that it is reasonably well positioned to deal with coming regulatory changes, and in our view could be a relative beneficiary of the changes when compared to smaller independent players who are not vertically integrated.

AMP has Australia's largest financial planner force by a wide margin

Following completion of the AXA acquisition, AMP now has by a large margin Australia's largest financial planner force, with AMP and AXA having over 3,000 aligned and owned planners in Australia, a number further boosted by Hillross's recent acquisition of Iris. Additionally 6,500 IFAs (within other) offer AXA products, and AMP will likely aim to continue this relationship as it integrates the two company's product ranges. Following its unsuccessful attempt to acquire AXA, NAB has been attempting to poach AXA planners and staff. However, to date NAB/MLC appears to have had minimal success in doing this although we will be interested to observe precisely how many planners AMP retained as at 30 June 2011. While the government's "Future of Financial Advice" reforms are likely negative in an absolute sense (we await the draft legislation to confirm this), we expect AMP's planner force will be a relative beneficiary compared to others (such as IFAs) in the industry.

AMP has been investing heavily to improve planner productivity including:

- Horizons academy,
- adoption of COIN software, and
- scoped advice packages.

However there is little evidence of productivity improvement to date due to the continuing difficult environment and higher levels of professional development with launch of new AMP products and its move to fee for service.

Our margin squeeze assumptions could be conservative

We continue to believe that margin squeeze is manageable for AMP. While the "Stronger Super" reforms, including "MySuper" and "SuperStream" will likely accelerate margin squeeze the timetable for the reforms may be pushed out, so the squeeze may be less as some key details of the reforms are still to be determined. We currently assume ~6%pa revenue margin squeeze for the next 3 years, double AMP's guidance. With AXA, AMP has the largest market shares in superannuation, retirement income and individual risk – once integrated it will have the biggest economies of scale, and hence should be one of the best placed in the market to manage margin squeeze.

Cyclically (and perhaps partly structurally) weak flows, regulatory concerns, and recent market falls are resulting in the stock trading at a sizeable discount to our cross-cycle valuation. To us, the most obvious near term catalysts are rising equity markets, improved clarity over proposed regulation and more comfort about targeted merger synergies once AMP releases full detail thereof.

Figure 4. CIRA valuation of AMP

Business Division	Approach	Note	A$m	Per Share A$
AMP Financial Services				
Contemporary Wealth Management	Appraisal value	1	5,491	1.97
AXA Australia Wealth Management	as per AXA valuation	2	1,486	0.53
Contemporary Wealth Protection	Appraisal value	3	3,079	1.10
AXA Australia Financial Protection	as per AXA valuation	4	1,518	0.54
Mature	Appraisal value	5	1,664	0.60
AXA Australia Mature	as per AXA valuation	6	705	0.25
New Zealand	Appraisal value	7	653	0.23
AXA New Zealand	as per AXA valuation	8	431	0.15
Total AMP Life		**9**	**15,028**	**5.39**
AMP Banking	PE valuation	10	477	0.17
Total AMP Financial Services			**15,505**	**5.56**
AMP Limited tax loss recognition	DCF	11	78	0.03
AMP Capital Investors	PE valuation	12	1,591	0.57
Corporate capital	Adjusted amount	13	625	0.22
AXA Group net worth	One third of group net worth	14	404	0.14
Holding company costs	PE valuation	15	-360	-0.13
Additional AXA A/NZ holding company costs	as per AMP merger proposal	16	-234	-0.08
Synergies	12x PE valuation	17	1,440	0.52
Group Debt	Amount outstanding	18	-886	-0.32
Subdebt from AXA purchase	Amount issued to AXA SA	19	-600	-0.22
Total AMP Valuation			**17,563**	**6.30**

Note 1. AMP Financial Services Contemporary Wealth Management is valued at our estimated appraisal value, including embedded value using an RDR of 9.6% and a new business multiplier of 15x new business. This is equivalent to 6.7% growth for the first 15 years, and then 3.0% growth thereafter using a new business RDR of 12.5% (a 30% premium to the embedded value RDR to reflect regulatory risks etc).

Note 2. AXA Australia Wealth Management is valued at our estimated appraisal value. Our inforce RDR is 10.0%. In calculating the appraisal value we have used a multiple of 10x the value of one year's new business.

Note 3. AMP Financial Services Contemporary Wealth Protection is valued at our estimated appraisal value, including embedded value using an RDR of 9.6% and a new business multiplier of 14.5x. This is equivalent to 6.3% growth in new business for the next 15 years, then 3% growth thereafter using a new business RDR of 12.5%.

Note 4. AXA Australia Financial Protection is valued at our estimated appraisal value. Our inforce RDR is 11.0%. In calculating the appraisal value we have used a multiple of 9.0x the value of one year's new business.

Note 5. AMP Financial Services Mature is valued at our estimated appraisal value, including embedded value using an RDR of 9.6% and a new business multiplier of 8.5x. This is equivalent to -0.2% new business for 15 years and then flat in perpetuity using a new business RDR of 11.5%.

Note 6. AXA Australia Mature is valued at our estimated appraisal value. Our inforce RDR is 10.0%. In calculating the appraisal value we have used a multiple of 8.5x the value of one year's new business.

Note 7. AMP Financial Services New Zealand is valued at our estimated appraisal value, including embedded value using an RDR of 10.0% and a new business multiplier of 12x. This is equivalent to 3.5% growth for the next 15 years, then 3% thereafter using a new business RDR of 12%.

Note 8. AXA New Zealand is valued at our estimated appraisal value. Our inforce RDR is 11.0%. In calculating the appraisal value we have used a multiple of 11.3x the value of one year's new business.

Note 9. AMP Life is the sum of the individual components but our valuation is equivalent to an appraisal value, including embedded value and a new business multiplier of 13.2x.

Note 10. AMP Banking has been valued at 11x FY10A earnings of A$42m.

Note 11. We have explicitly discounted the value of future tax losses out to 2015 from Cobalt/Gordian at 11.5% pa.

Note 12. AMP Capital Investors valuation is based on 14x average annual earnings for the next 24 months.

Note 13. Corporate capital is capital that has not been valued in any other part of the business and is reported as at 31 December 2010, adjusted for market movements to date less A$140m of internal cash used towards integration.

Note 14: One third of AXA's group net worth as at 31 December 2010, adjusted for market movements to date.

Note 15. Holding company costs exclude interest on debt. Valuation is based on 9x estimated recurring holding company expenses.

Note 16. Valuation is based on 9x estimated incremental holding company expenses associated with AXA.

Note 17. Synergies are valued at 12x the after tax target of A$120m

Note 18. Group debt represents the amount outstanding as at 31 December 2010.

Note 19. Subdebt represents the amount issued at the end of March 2011 associated with the AXA acquisition.

Source: Company Reports and CIRA Estimates

SUN – building blocks building margins

In our view, Suncorp has clearly and reasonably articulated the path to improving its general insurance margins and its new reinsurance arrangements do not seemingly cause it to need too much extra capital. It also has reasonable prospects of fulfilling its plans to generate organic growth in its core bank and life business, particularly once the Queensland economy recovers post disasters. Furthermore, in our view, it is trading at an attractive valuation and it has solid prospects for capital release from its non-core bank as it reduces risks therein and as the portfolio runs off. Once Suncorp sets its new capital targets, we expect the amount of excess capital to become more evident.

Building blocks programme on track

As its recent strategy day showed, the general insurance building blocks programme is on track, with its single pricing engine and single claims engine already largely implemented. These are the two actions which should deliver the bulk of the A$235m of benefits (or at least 300 bps margin uplift) from its building blocks programme.

Reinsurance renewal changes Suncorp's risk profile

Suncorp's reported general insurance result will be weak, as catastrophe losses in FY11 have been the worst in 40 years, although there is the possibility of upside risk to our estimate from further reserve releases. Looking forward, Suncorp's new reinsurance programme increases retention and volatility of earnings but it will need to reprice its own product to ensure improved profit in benign claims years. Rates are rising following catastrophes and reinsurance price rises should result in further home insurance rate rises.

Lumpy bad debt experience continues

Figure 5. Suncorp 2H11 bad debts in the news

Date	News	Details
29-Jun-11	Four parties shortlisted to acquire Cubbie Station (which has been controlled by NAB and SUN since the company went into voluntary administration in 2009)	The banks are owed at least A$320m
17-Jun-11	Parliamentary committee to investigate long-stalled development by Ironbridge Property (recently issued winding up notice by ATO) in WA	The development has two mortgages to SUN totaling A$15m; a valuer has said that the estate would fetch a "single-digit" price in Perth's weak property market
2-Jun-11	Control of Redcape Property Group's senior debt seized by a consortium of U.S. investors (Goldman Sachs, backed by York Capital), which now holds about 40% (A$260m in loans)	Suncorp's 47% stake (believed to be A$27m) is understood to have been written down to zero; Ernst & Young is the appointed receiver for the stake
13-May-11	Suncorp APS330 update	Core bank impaired assets fell by A$4m to A$175m;
		Non-core bank impaired assets fell A$8m to A$2.3bn
		Gross non-performing loans rose by A$120m over the quarter to A$2.96bn at the end of the March quarter
12-Apr-11	Barbera Farms forced into receivership by Suncorp	Now under control of Ernst & Young
4-Apr-11	Ironbridge Property pressured by Thompson McRobert Edgeloe Group to pay outstanding debt of A$30,000 or face a wind-up	Ironbridge has two mortgages to Suncorp, totaling A$15m
18-Mar-11	Allco property up for sale by receiver Ernst & Young; bids reported in the range A$35-40m	Suncorp has mortgage on the site of about A$80m
17-Mar-11	Bevillesta owes A$900m to creditors	Banking syndicate incl. Suncorp provided the company with a limited recourse loan facility of about A$700m to develop a shopping centre
9-Mar-11	Drop in value of apartments in Gold Coast due to over supply	Suncorp exposed to the market
25-Feb-11	Receivers appointed to Noosa development (around Sunshine Coast) by Leighton Properties and Macquarie Real Estate	A$43m line of credit from Suncorp
24-Feb-11	Becton Group negotiating on recapitalisation strategy	A$174.4m short-term debt owed to debt providers incl. Suncorp
24-Feb-11	Impact on 1H11 result from Queensland flooding	A$35m economic overlay provision to cover potential losses
24-Feb-11	1H11 results	Impaired assets at A$2.5bn; in non-core - A$200m of Factory outlet and A$200m of south-east Queensland residential apartment exposure

Source: Australian Financial Review

Actions taken by Suncorp to derisk Suncorp Bank continue to progress. Runoff of the non-core bank is ahead of schedule and bad debt experience has been improving, but is still likely to be lumpy. We have again reviewed articles in the "Australian Financial Review" regarding bad loans for Suncorp and found as we set out in Figure 5 the number of mentions decreased in 4Q11 relative to 3Q11. Our research in 3Q11 ahead of Suncorp's APS 330 release proved mostly accurate. However, there is the risk that not all bad debts will gain media coverage mentioning Suncorp as a lender.

Much of the media coverage relates to existing bad debts, suggesting few new sizeable impairments. However, what we may see occur at the FY11E result is Suncorp having to take additional provisions on existing bad debts, due to a slow down in the process of realising the value of mortgaged security, although we still expect the impairment charges for 2H11 to be down on 1H11. Core bank lending growth slowed earlier in the year due to the natural catastrophes in Queensland, including flooding and Cyclone Yasi, but is slowly picking up again, reflected in our forecasts.

Issues in Life still present but being addressed

Suncorp Life is poised for growth. Suncorp Life insurance growth plans target growth via direct distribution using the group's general insurance brands to access underinsured segments of the community. The lapse issues in Life, revealed at the 1H11 result, appear to be in the process of being addressed, with 3Q11 lapses appearing to be an improvement over 1H11. At its recent strategy day, Suncorp appeared hopeful that this improved experience would continue into 4Q11.

Capital position continues to be one of the stock's attractions

We believe Suncorp's capital position is attractive, despite the bank's impaired assets appearing, prima facie, to be lightly provisioned (this is due to relatively low specific provisioning which seems to reflect the security backing its loans, with the prime risk being falls in the valuation of that security). At the start of the calendar year, the group adopted a NOHC structure to simplify the group and improve transparency and flexibility. The general and life insurance businesses are no longer subsidiaries of the bank.

Excess capital should be returned by Suncorp, following further clarity over capital targets. We believe that at a group level Suncorp will continue to look to hold:

- 0.5x GI MCR;
- 0.5x CAR for the bank;
- 10% of the life target surplus.

Suncorp is committed to returning excess capital to shareholders.

One of our top insurance picks

Suncorp continues to suggest multiple attractions to us. It has good prospects for improving underlying profitability in general insurance and banking, and reasonable growth in general insurance, the core bank, and its life company. Additionally, the capital release from the run off of the non-core bank should lead to capital returns in time. While there may be some earnings volatility due to lumpy bad debt charges, and catastrophes, the underlying trends still seem positive. Given the attractive valuation the stock is on, both on a sum of the parts basis and trading at just 8.7x our FY12E EPS, we continue to see Suncorp as one of the most attractive stocks in the insurance space.

Figure 6. Suncorp alternative sum of the parts

Assumptions		**Core bank**	
Non-core bank multiple of NTA (x)	0.6	FY12E average interest earning assets (A$m)	46,513
Core bank PE multiple (x)	10.0	Forecast net interest margin	1.84%
IAG share price (A$)	3.42	Share of forecast non-interest income	87%
Current SUN share price (A$)	7.73	Cost to income ratio	50.2%
		FY12E bad debts as a percentage of average assets	0.12%
Non-core bank		Net interest income (A$m)	858
Non-core RWA (A$bn)	11.0	Non interest income (A$m)	102
Total bank RWA (A$bn)	31.4	Total income (A$m)	960
Proportion of RWA (%)	34.9%	Operating expenses (A$m)	-482
Total bank NTA (A$bn)	3.0	Underlying income (A$m)	478
Non-core bank NTA	1.6	Bad debts (A$m)	-49
Non-core bank multiple of NTA (x)	0.6	Contribution pre-tax (A$m)	429
Non core bank value (A$bn)	**1.0**	Post tax earnings (tax @ 30%) (A$m)	300
		Core bank PE multiple (x)	10.0
General Insurance		**Core bank PE value (A$bn)**	**3.0**
IAG FY12E EPS (cps)	32.2	Multiple of core bank NTA	2.2
IAG FY12E PE (x)	10.6	Core net assets	1.6
SUN GI FY12E (after tax A$m)	696	Multiple of net assets	1.9
SUN GI value assuming current IAG FY12E PE (A$bn)	**7.4**	Check total bank multiple to total NTA	1.3
GI net assets (A$bn)	8.4	Total bank net assets (A$bn)	3.1
GI NTA (A$bn)	2.8	Total bank multiple to net assets	1.3
Check multiple of GI NTA (IAG trading on 2.7x)	2.6		
		Group value estimate (A$bn)	**13.8**
Suncorp Life		Diluted* share count (m)	1,389.9
Life embedded value (A$bn)	**2.4**	**Value per share estimate (A$ps)**	**9.90**
Life net assets (A$bn)	2.5	Current SUN share price	7.73
Life NTA (A$bn)	1.8	Difference	28%

*in FY11 preference shares are anti-dilutive, but we expect them to be dilutive in future periods, so we are diluting for them in this valuation.

Source: Company Reports and CIRA Estimates

IAG – could be in for a difficult 1H12

IAG's UK operation may have seen the worst and the planned turnaround of its intermediated business appears to be moving forward, but the company nonetheless still seems set for a difficult next few months. Reinsurance costs in 1H12 are not completely known but will be high and the level of volatility due to large events to which IAG is exposed is likely to be significantly greater than usual.

Is Australia Direct over-earning?

IAG's Australia Direct business is its 'crown jewel', potentially over-earning on an underlying basis, and representing the largest part of IAG's GWP. Its result this half will be, however, impacted by large natural catastrophe costs. Australia Direct is targeting ongoing growth faster than system, but this is only likely to be 3-5%. Despite press reports to contrary, IAG remains adamant that it maintains a strong relationship with NRMA, a significant source of business for Australia Direct.

CGU now over half way through turnaround

Australia Intermediated, aka CGU is now 3 years into a 5 year turnaround. Margins in CGU, are improving, but at a very slow pace, although IAG at its recent strategy day suggested that CGU is now achieving both top and bottom line growth.

Underlying performance in NZ hard to determine due to lack of disclosure, but 2Q11 result will be poor on a headline basis

IAG suggests its NZ operation will demonstrate a reasonable underlying performance. Reported margin, however, will be adversely impacted by the Christchurch earthquakes. Home premiums are rising after the Christchurch quakes and this should improve margins in time. Initially, however, we believe that most of the rises will go towards higher reinsurance costs, rather than improving margins. IAG is looking to grow in NZ through greater penetration of its customer base to increase its market share. We discuss the NZ market in more depth in our recent report dated 5 May 2011 NZ Insurance: General and Health Insurance - Market appears to be turning, which should help profit in time.

A smaller loss in the UK as IAG shrinks to profitability

IAG UK may have seen the worst, but it is still not profitable. The turnaround is slow. Given other management distractions, it seems IAG missed the early warning indicators of the deterioration in bodily injury experience in the UK, with rectification being costly and taking some time. IAG UK (Equity Red Star) is shrinking to profit, but may not even make breakeven in FY12. Sizeable rate increases for a second year are now being passed through. IAG claims to be achieving rate increases of 20-30% in private motor and ~15% in fleet, however market sources suggest real increases may be less than this. While IAG is now pricing for bodily injury superimposed inflation at 15% pa, it is difficult to assess whether this is adequate. Prior to the recent run of unprofitability Equity Red Star did have a multi-decade run of profitability, and we remain hopeful that IAG is able to restore this profitably before considering the options for this business.

SBI likely to represent a large proportion of Asian growth target

Asia is small, and appears to be IAG's only significant source of stronger growth, in part due to the strong growth of Asian economies. We expect that much of the growth to achieve its target to achieve 10% of group GWP on a pro-rata basis from Asia by 2016 is likely to come from its joint venture with the State Bank of India ("SBI"). Even so, IAG is only forecasting breakeven profitability in FY15E from this joint venture, before achieving a small underwriting profit in FY16E, so a significant contribution to profit from Asia appears to be still some way down the track. However, its growth ambitions present some acquisition risk, with IAG likely looking to make small acquisitions to enter into China, Indonesia and Vietnam. As it enters these markets we expect IAG to face significant competition from large foreign players already present. While businesses in Thailand and Malaysia are currently meeting the group's hurdle requirements, these represent only a few percent of the group, and the profits from these businesses are likely to offset the costs of expanding into Asia and the losses from the SBI joint venture.

Quantum of reinsurance rate increases could depend on US hurricane season

Reinsurance costs are currently a "wild card" with IAG incurring significantly higher catastrophe reinsurance costs in 1H12 and unsure of what it may be paying next calendar year (CY12). Reinsurance costs will likely increase even further, as we discussed above, and in our report "*Reinsurance in Australia and NZ - Risk profile changes for IAG and SUN; QBE's timing impeccable*" dated 6 July 2011. Indeed IAG has already flagged higher reinsurance costs in FY12 than FY11.

IAG's reinsurance costs in CY11 will, however, already be relatively high. The cost of the purchase of further adverse development cover for its UK division for underwriting year 2010, and the costs of reinsurance reinstatements after summer catastrophes will be expensed in 2H11 and 1H12. IAG will also likely need to buy additional reinstatements should there be any large events in 1H12 which hit its catastrophe programme, while following July weather events in Australia, IAG may have already exhausted its aggregate cover (it only had A$25m remaining after the last Christchurch earthquake), leaving it with few low level covers for the remainder of the calendar year.

IAG is also likely to have to pay significantly more at its 1 January 2012 reinsurance renewal. How much more may depend whether the global market hardens in reaction to possible 2HCY11 events. Indeed recent comments by Mike Wilkins in the Australian Financial Review on 18 July 2011 suggest that IAG is expecting *"that over one to three years equilibrium with return [to ease] these pressures"*.

Could be in for a difficult 1H12

So overall, we see IAG as being in for a difficult six months, with its FY12E reinsurance cost still very uncertain. In addition, the group's risk profile is increasing, with higher retentions for natural disasters. Growth prospects exist in Asia, particularly in India where its JV partner has a large distribution network, but the Indian joint venture may not contribute to profit within 5 years. While IAG's UK operations may have seen the worst, they may not even be breakeven in FY12, given the existing cost base and lower premium. Potentially paying investors to wait for improved performance is the prospect of a small capital return in 1H12, in the form of a special dividend. However, in some ways we see even this as a case of robbing Peter to pay Paul, with a likely low 2H11 ordinary dividend, given the likely relatively poor bottom line result. As such, we retain our Hold / Medium risk call and A$3.70 target price.

QBE – awaiting catalysts for a share price recovery

In our view, QBE is now trading at a reasonably attractive valuation relative to its historic p/e multiple (although price to book is still high relatively to its global peers) and offers an attractive (if slightly artificial) dividend yield with leverage to the potential for rising insurance premium rates, interest rates and a falling A$. The question though is when will these occur and none seem certain to be imminent. We still believe it is too early to buy into the prospect of recovery.

Global premium rates could be the first catalyst …

We are now of the view that increasing global premium rates could be the first catalyst for QBE although we see this as by no means certain to occur. While scope for optimism on reinsurance premium rates exists, it is not yet clear that the reinsurance cycle is at an inflection point. However, a near term turn in reinsurance rates would likely follow a severe run of 2HCY11 catastrophes for the global insurance and reinsurance industry, potentially including an active hurricane season. In time higher reinsurance rates should then trickle down into higher primary rates, probably with a lag.

However, given QBE's global exposures, such a severe run of catastrophes could lead to its claims being in excess of its large claims and catastrophe allowances, hurting margins. This would likely occur before QBE benefits from the higher premium rates, which would lag due to the delay in raising rates across its book and then those higher rates being earned. We therefore believe there is a strong chance of more disappointing results with a reasonably high chance of QBE exceeding its FY11E large loss allowance and reporting an insurance margin lower than the bottom end of its 15% to 18% guidance. At the moment we forecast a FY11E margin of 15% but this presumes QBE does not exceed its large loss allowance.

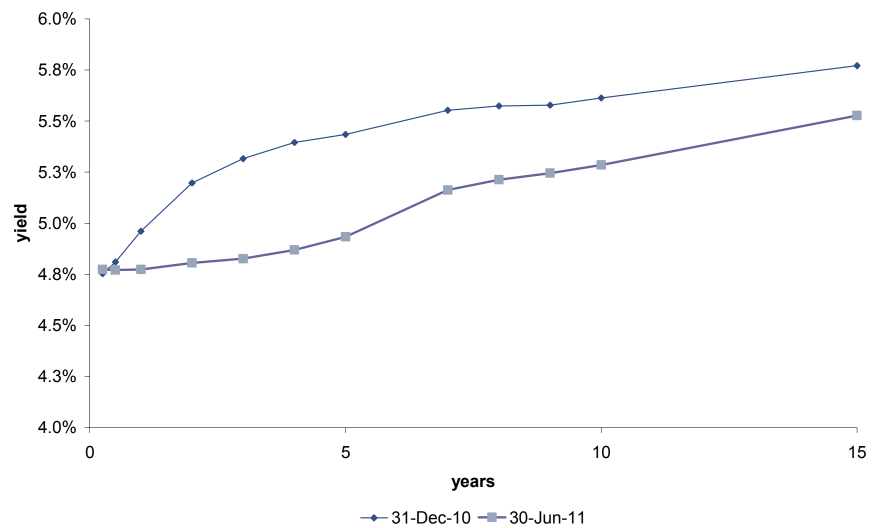
… however acquisitions have reduced leverage to global rate cycle

QBE continues to evolve, with acquisitions changing its business mix. Its leverage to the global insurance cycle has decreased with its acquisitions of crop insurance, LMI, and forced homeowners insurance, with both its Balboa acquisition and crop insurance to provide a greater NEP contribution to 2H11E than 1H11E. At the moment, we estimate these specialty lines account for around 25% of QBE’s premium and around 35% of profit. This will likely vary over time. At the same time, the proportion of NEP sourced from reinsurance and traditionally cyclical primary classes is now lower.

FX gains boost result, but yield moves could hurt profits

Despite its relatively recent market guidance, we see some risk that market volatility could still impact QBE's 1H11 results. QBE has already announced that FX gains have again provided a favourable boost to QBE’s investment earnings. However, akin to last year, movements in interest rates since it last provided guidance could still have an effect. Expanding credit spreads and the fall in government yields in Australia and the US relative to 31 December 2010 could still result in an adverse impact on earnings relative to recent guidance, although rising interest rates in the Euro zone could be favourable for the PoA contribution from Secura which had such a favourable impact on the PoA at 31 December 2010.

Figure 7. Movement down in the Australian government yield curve



Source: Bloomberg

The uncertain timing of favourable movements in macro factors denies QBE's stock several clear short term catalysts. It is however, trading at a reasonably attractive valuation (at least on a p/e and insurance value added (“IVA”) basis) and the attractive (if slightly artificial) dividend yield it offers likely provides investors some incentive to wait (at the risk of further share price weakness driven by declining insurance margins) for the catalysts of rising insurance premium rates, interest rates and a falling A$. Even so, we still think it too early to buy, especially given the risk to full year earnings. As such, we retain our Hold / Medium risk recommendation and A$18.25 target price.

Small cap insurers

NHF – an organic growth story

nib has a demonstrated organic growth story, and at its strategy day recently outlined some ambitious targets of expanding its offering of health insurance to migrant students and workers to accelerate its growth. This expansion also assists in improving margins for the group.

Organic growth investment thesis remains

nib is pursuing an organic growth strategy which is increasing its market share in demographically attractive markets and upselling to existing customers, leading to ~10% p.a. premium growth. The company is focused on maintaining its underwriting profit target at 5%-6% of premiums on its core health insurance business. We believe that this level of margins is sustainable, with several of the larger health insurers producing margins in this range. Hampering nib's performance is the large contribution it makes into the government's risk equalisation transfer fund, given its relatively youthful policyholder base, which we expect to further grow in 2H11E.

Cost base facilitating growth

nib has optimised its cost base, adopting a paperless back office and automating many of its back office processes, allowing it to adopt straight through processing. This has reduced its administration costs, which has allowed it to increase its marketing spend, while still keeping a competitive expense ratio overall. Its advertising spending compares favorably to other health insurers, although other insurers' spending is now starting to catch up to nib.

Expecting a further increase in market share in 2H11

nib's market share should allow for sustained growth for many years. nib is the fifth largest provider of private health insurance in Australia, with a market share ~7.5% and growing by ~25bps p.a., by targeting people without health insurance. Its policyholders are currently predominantly in NSW, expanding in Qld, Vic, and WA. We are currently allowing for nib's projected loss of policyholders in FY12E if the government is successful in passing legislation to means test the private health insurance rebate. Given the current structure of the lower house, we currently prescribe a 50% probability to this occurring.

Migrant businesses to enhance growth and margins

Additional premium growth and margin expansion is coming from nib's move into offering health insurance to immigrants, in particular overseas workers and overseas students. It has ambitious stretch targets to grow its overseas workers and overseas students businesses (targeting migrants into Australia) to 20% of its premiums in FY14E. If it continues to grow its core business at a similar pace to recent years, overall premiums could increase by 50% to over A$1.5bn in 3 years time.

Extension of the share buyback likely

Lending support to the share price is nib's ongoing share buyback. nib originally targeted to buy back 10% of its share count at demutualisation, but the pace of this buyback has been slow. We expect nib to announce an extension to its buyback at its FY11 result, and believe nib may need to continue its buyback for a few years before achieving its 10% repurchase target.

So with a top line growing strongly, relatively stable margins (compared to the large general insurers) kept stable though the government regulation around rate rises we see nib as a strong fundamental story, with share buyback enhancing EPS growth. This makes it our top pick among the small insurers. We rate NHF Buy / High risk with a A$1.60 target price.

TWR – trading at a justifiably low multiple given issues

In our view, Tower's general insurance business is at risk of becoming structurally challenged given rising reinsurance rates for New Zealand insurers, eroding profitability in the short, and potentially medium term. Its new IT system continues to suffer delays and cost blowouts, and changes to taxation and regulation for life insurance will put margins under pressure.

FY11 result unlikely to be pretty

While Tower is not reporting during the current reporting season, its FY11 result, likely to be released around the end of November, is unlikely to be pretty. Economic growth in New Zealand has been slow post the Christchurch earthquakes, hurting demand for life and health insurance and investment products. The Tower Insurance result will be very weak following the earthquake losses and large reinsurance reinstatement costs. Tower's new IT system has been delayed several times now due to problems with its accounts receivable and payable functionality.

Structural challenges

Tower's businesses face structural challenges. In short, there is no easy solution to its sub-scale problem. The rise in reinsurance rates for New Zealand insurance is likely to be especially pronounced for such insurers as Tower who do not have the offset of an Australian based programme. Changes to life insurance taxation are decreasing affordability of life insurance while healthcare cost inflation and soft economic conditions are issues in health insurance. Advisor reforms and move to fee for service could see large numbers of advisors choose to leave the industry. KiwiSaver has been the only source of growth in its Investments business, and this is driving down average margins. We discuss these changes in more detail in our reports "NZ Insurance: General and Health Insurance" dated 5 May 2011 and "NZ Insurance: Life Insurance and Wealth Management (including KiwiSaver)" dated 6 May 2011.

Risk elevated through growth ambitions

In an attempt to address its sub-scale position, Tower is looking to grow organically and via acquisition. To date it has been unsuccessful in executing an acquisition, although did attempt to acquire Fidelity Life. Tower has flagged potential interest in acquiring AMI, a property insurer which has run into financial difficulty following the Christchurch earthquakes. However it faces competition for this asset from the larger Australian insurers and may require around a NZ$200m capital raising for which there is no guarantee its major shareholder, Guinness Peat Group ("GPG") which owns 35% of Tower would support, given GPG has flagged its intention to divest its holding of Tower.

A lack of catalysts to close valuation gap

Tower's valuation appears undemanding but, in our view justifiably so, given the structural issues that face the company, the risk of a significant increase in reinsurance deductible and cost and the potential stock overhang from both its major shareholder flagging its planned exit and the potential need to raise capital to fund an acquisition the size of AMI. With a lack of catalysts to close value gap, we retain our Hold / High risk call and NZ$1.90 target price.

Key issues in more depth

GI underwriting margins need to rise

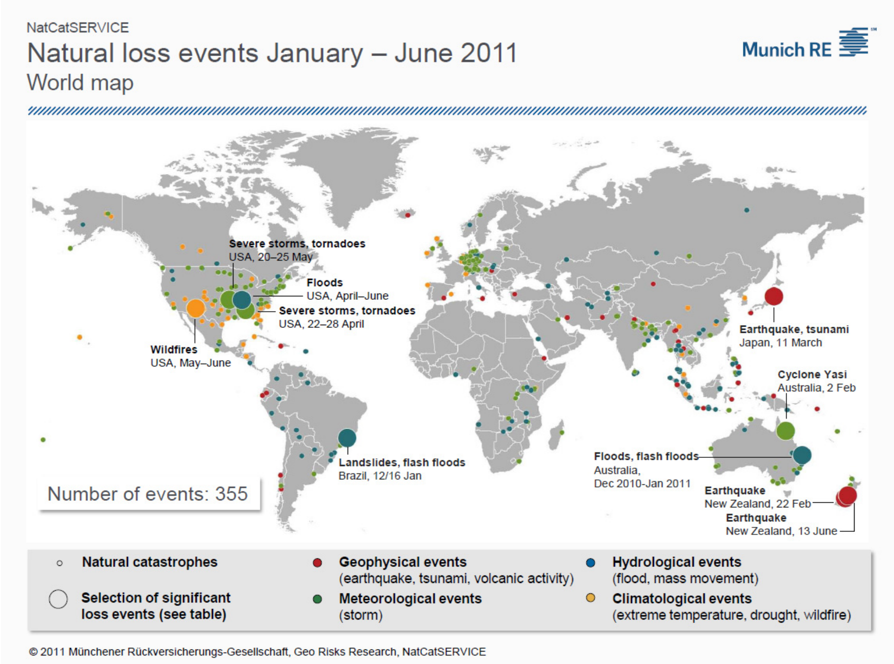
There are several key issues currently impacting the general insurance sector which, in our view, should lead to the conclusion that insurers need to further improve targeted underwriting margins. These include:

- Higher reinsurance rates encouraging higher reinsurance retentions;
- Higher reinsurance retentions and less comprehensive aggregate covers increasing the volatility of results;
- Increased volatility driving up the cost of capital, such that good years need to be more profitable to offset the bad years which will be even less profitable;
- LAGIC proposals appearing to result in an increase in regulatory capital for current levels of risk, implying reduced returns on equity at current levels of profitability.

We consider each of these issues in turn.

Recent natural catastrophes in Australia and NZ have been severe

Figure 8. Natural disasters



Source: Company Reports

Australia and NZ have incurred four major natural loss events in the first half of calendar 2011 – the same number of major natural loss events as the US, which has a much larger premium pool.

Reinsurance costs for Australian and NZ insurers are rising

Figure 9. Willis Re reported rate movements for renewals at 1 July 2011

Business class	Property	Property	Property	Property	Property	Casualty	Casualty	Casualty
Reinsurance type		risk	risk	catastrophe	catastrophe		Excess of loss	Excess of loss
Category	Pro rata commission	loss free	loss hit	loss free	loss hit	Pro rata commission	No loss emergence	With loss emergence
		% change	% change	% change	% change		% change	% change
Australia	0% to -2%	+10%	+30%	+5%	+30%	N/A	0%	0%
New Zealand	0% to -2%	+10%	+30%	+50%	+150%	N/A	N/A	N/A

Source: Company Reports

As we discussed in our report "*Reinsurance in Australia and NZ - Risk profile changes for IAG and SUN; QBE's timing impeccable*" dated 6 July 2011, there is the prospect of a significant rise in reinsurance rates for Australian and NZ insurers, given these loss events.

The result is Australian and NZ rates are set to rise further

Prices for primary insurance, particularly home and contents, in Australia and New Zealand are likely to rise further, driven by rises in the cost of reinsurance and larger natural peril allowances. Longer term, this should be a positive for insurers, as the industry structure should enable these price increases to be sustained, potentially leading to a larger premium and profit pool.

General insurers are becoming more risky, with more volatile earnings

In the shorter term though, insurers will wear the costs of increased reinsurance, and be subject to the potential for increased profit volatility, as they retain more risk on their books. By retaining more risk, insurers will need to ensure that they price their products to ensure that the good years become better (although there is an upper limit as to how good they can become), as it is likely that, going forward, losses in a bad claims year will be much worse than before.

LAGIC aims to reduce risk, but insurers may opt for more capital

In our view, APRA's LAGIC changes are an attempt to remove shortcomings identified in the regulatory framework over the past few years. However capital requirements look set to rise slightly for current levels of risk (as APRA is expecting behavioural changes to reduce risk to keep capital levels roughly constant), which might put pressure on returns until insurers are able to reprice.

Regulatory issues continue to cause investors concern

Federal parliamentary inquiry into the insurance response to natural disasters

Following the natural catastrophes in 1Q11, in particular flooding, there has been significant public outcry as to the lack of riverine flood cover offered by insurers to many affected customers, given that coverage for storm damage is well understood. This has spurred the government to established the "National Disaster Insurance Review" to review the current insurance arrangements for flood, propose a way forward, and to also provide a universal definition of flood.

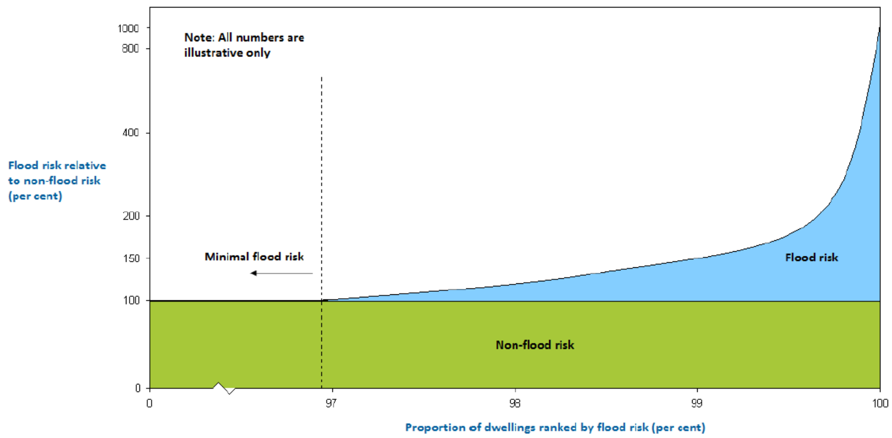
Three types of flood create consumer confusion

The three types of flood typically discussed by Australian insurers are riverine flood, flash flood and coastal flood. Some insurers will cover one type of flood, such as flash flooding, while not covering the other types of flood. This has created confusion among policyholders, leading the government to seek to provide a standard definition of flood.

Why flood coverage is a problem

One of the reasons suggested that some insurers do not offer flood cover is due to the high insurance premiums it would create. For a small proportion of properties, flood risk is multiples of all other risks combined.

Figure 10. The flood insurance problem



Source: National Disaster Insurance Review

Should see review recommendations before the end of the year

Submissions for the review closed on Thursday 14 July, and the review is scheduled to be completed, with a report delivered to the Assistant Treasurer, by the end of September. Given that the government often takes a month (or more) before releasing such reports, we may see the public release of the review panel's report by the end of the year. If insurers end up providing provide flood cover on a risk rated basis it is likely to be good for industry NEP growth, while if flood risk is pooled it would likely result in lower NEP.

Life and General Insurance Capital ("LAGIC")

QIS2 underway

Insurers are currently in the process of preparing their second quantitative impact study ("QIS2") responses, and need to have submitted these responses by the end of the month. Similar to the first round last reporting season, some insurers may make some vague comments about their responses when they report in response to questions on the topic, but in our view insurers are likely to avoid talking about the responses in detail as APRA is still yet to finalise its LAGIC proposals.

On the life insurance side of the sector, the results for QIS2 should be materially different to QIS1, due to the greater changes APRA has made to its LAGIC proposals. In our view the proposals may impact those insurers with large books of business containing investment risks (such as traditional long term business or annuities) differently to those insurers who have predominantly modern books containing just mortality and morbidity risk. The move to using the government yield curve (consistent with general insurers) rather than the swap curve also appears likely to increase capital requirements for life insurers, which APRA may be seeking to offset elsewhere.

As long as QIS2 results in more reasonable results for life insurers (with general insurers having relatively smaller changes to capital regulation) we believe APRA may seek to finalise its proposals in order to meet its original timetable for implementing the capital standards. APRA intends to comment on QIS2 towards the end of calendar year 2011, releasing finalised standards next year with the aim of introducing the new capital requirement framework on 1 January 2013.

LAGIC may delay capital management for general insurers

Both IAG and Suncorp have cited the ongoing LAGIC process as a reason for uncertainty about capital management. Investors have been worried about potential increases in capital requirements. This could come from higher investment capital charges, higher insurance charges and higher insurance concentration risk charges. Even so, we note it was APRA's stated intention not to materially increase the capital requirements for the industry and we would be surprised if most of the listed insurers come away with anything other than a relatively minor additional capital impost. The papers are, however, fairly technical and it is very hard from an external point of view to fully assess their impact. Consequently, uncertainty will likely continue to exist until the final details are known.

FoFA and Stronger Super

The Government's stated intention is that legislation for the reforms to financial advice and superannuation should be tabled in parliament during the spring session of 2011, meaning sometime between August and November 2011. While the proposed changes for the Future of Financial Advice are now reasonably clear, we understand there is still a good deal of lobbying taking place. Furthermore, the Government will likely have a fight on its hands about some of the aspect of the legislation with the Independents that hold the balance of power. Consequently there is still considerable uncertainty as to the look of the final legislation and the possibility of further delays.

The future of financial advice

We understand that the Future of Financial Advice reforms may be the Government's main priority, with commission bans, best interests duty and opt-in seen as the three key aspects. Legislating these changes will involve tabling the proposed amendments to the Corporations Act to clarify what it considers to be "best interests duty" and defining the requirements for carrying this out. The legislative amendments will also reveal the government's decisions on compensation for poor advice and any changes to the definition of retail investors.

Stronger Super

Similarly, for the Stronger Super reforms, the amendments to the Superannuation Industry (Supervision) Act should reveal precisely what defines "MySuper". At the moment, there appears to be significant disagreement within the industry about this, given the multiple reports that have apparently been provided to the Assistant Treasurer from the peak consultative group, with the Chairman, Paul Costello, reportedly submitting a dissenting report. Again the draft legislation should reveal the government's decision on these matters, and the compromises which have been made. We are of the view that the ultimate "MySuper" product may not be as pure as that originally proposed in Cooper's scheme review due to the practicalities involved in implementing it. It will be interesting to see whether the view that "MySuper" should be a product for individual workers, rather than for companies to provide their workers, receives the nod. If it does, this could, in time, see the end of favorable outsourced employer offerings via large corporate master trusts. However, there is no certainty this will make it through to the final legislation.

The draft legislation should also provide the detail around any transitional arrangements the government will allow, and whether the implementation timetable has been further delayed.

Best Ideas Update

Summary — We extend our relative call on SUN.AX as a Most Preferred stock and QBE.AX as a Least Preferred stock relative to our fundamental analyst coverage for the next 3 Months. Our original call was made on 15 May 2011.

Furthermore, we extend our relative call on AMP.AX as a Most Preferred stock and TWR.NZ as a Least Preferred stock relative to our fundamental analyst coverage for the next 3 Months. Our original call was made on 15 May 2011.

AMP Ltd

(AMP.AX; A$4.69; 1M)
Catalyst and Thesis — AMP's share price is well below our combined AMP/AXA spot valuation, even after allowing for what we continue to consider is a conservative estimate of integration synergies and despite us recently adopting a little more caution on new business multipliers for CWM and CWP.

QBE Insurance Group Ltd

(QBE.AX; A$16.98; 2M)
Catalyst and Thesis — The uncertain timing of favourable movements in macro factors such as global premium rate rises, interest rate rises and a weaker A$ denies QBE's stock several clear short term catalysts. We still think it too early to buy, especially given the risk to full year earnings.

Suncorp Group Ltd

(SUN.AX; A$7.55; 1M)
Catalyst and Thesis — We continue to believe the two main strands of our investment thesis remain intact, namely, the potential for significant profit improvement in its general insurance operation and the potential for capital returns. Combined with an attractive valuation, this makes Suncorp one of our best ideas.

Tower Ltd

(TWR.NZ; NZ$1.54; 2H)
Catalyst and Thesis — Tower's result should contain a sizeable fall in profit following the second Christchurch earthquake. While this is largely already reflected in the stock price, the result will rehash the bad news and likely lead to near term share price weakness.

Result previews and detailed financial summaries

AMP Ltd (AMP.AX)

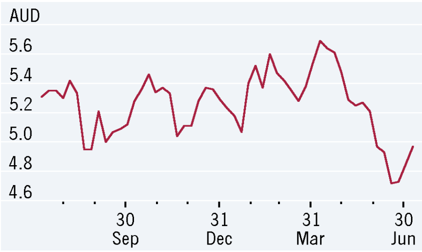
Figure 11. Forecast snapshot

Company	AMP
Result	1H11
Date	18 Aug 2011
Forecast NPAT (A$m)	357.5
Forecast Core Earnings (A$m)	433.5
Forecast Core EPS (cps)	17.7
EPS Growth on pcp(%)	-6.1%
Forecast Next Dividend (cps)	14.0

Source: Company Reports and CIRA Estimates

Buy/Medium Risk	1M
Price (22 Jul 11)	A$4.80
Target price	A$5.80
Expected share price return	20.8%
Expected dividend yield	6.3%
Expected total return	**27.1%**
Market Cap	A$13,496M
	US$14,638M

Price Performance
(RIC: AMP.AX, BB: AMP AU)



Synergy and planner detail likely to be of most interest

- **AXA to drive most of headline profit growth** — Soft conditions and weak markets in 1H11 are likely to have stunted organic growth. As such, most of the growth in headline profit will likely come from its acquisition of AXA. Even so, with higher share count, we are forecasting a 6% decline in EPS 1H11 vs. 1H10.
- **One quarter of AXA** — With AMP acquiring AXA at the end of March, AXA Australia and NZ will contribute to AMP's 2Q11 result. AMP will disclose AXA's operating results separately, together with some modest accounting adjustments.
- **Planning for integration should now be largely complete** — We eagerly await AMP's detailed commentary on its integration timetable and likely pattern of synergy realisation, but think that it is unlikely that it will upgrade its likely conservative A$120m after tax synergy target just yet.
- **Unlikely to see much of usual seasonal pick up in flows** — While 2Q flows have traditionally been stronger due to additional voluntary superannuation contributions, we expect poor sentiment and superannuation contribution caps are likely to result in relatively subdued 2Q11 cash flows.
- **Continuing difficult conditions for SMEs likely means continuing adverse CWP experience** — While we will be looking for some improvement in CWP experience, there is a risk that this may not occur due to SMEs continuing to experience difficult economic conditions.
- **NZ impacted by quake costs and soft economic conditions** — The bulk of AMP's NZ business is financial protection and, as guided to at its AGM, this will be impacted by both the Christchurch quake and soft economic conditions.
- **AMPCI cost to income ratio likely to remain elevated** — Weak markets will also be a hindrance for AMPCI's revenue, and given the spend it has been making on its new operating platform, we anticipate that its cost to income ratio will remain above AMPCI's medium term target of 55% to 60%.
- **Splitting out the transaction costs** — AMP has guided to A$30m in transaction costs associated with the AXA acquisition, in addition to its anticipated integration costs. We treat these as a one off item.
- **Franking to fall** — As flagged by AMP at its FY10 result, following completion of the AXA acquisition, we are forecasting AMP's franking to fall to 50% (due to 3 months contribution from AXA) at its 1H11 result, and 40% in later half years. AMP could however drop to 40% franking at 1H11 and maintain this level.

AMP.AU (Y/E Dec)	2010A	2011E	2012E	2013E
Reported Profit (A$m)	775.4	778.5	929.4	1,142.8
Core Net Profit (A$m)	770.4	960.7	1,140.5	1,257.0
Core EPS (A¢)	37.0	36.4	40.2	44.3
Core EPS Growth (%)	-2.0	-1.6	10.4	10.2
PE Ratio (x)	12.7	12.9	11.7	10.6
DPS (A¢)	30.0	30.0	35.0	38.0
Dividend Yield (%)	6.4	6.4	7.5	8.1
Franking Rate (%)	60.0	44.7	40.0	40.0
P/NTA (x)	4.8	4.0	4.0	4.0
ROE (%)	28.0	19.5	16.6	18.5

Source: Company Reports and dataCentral, CIRA.

AMP detailed financial summary

Financial Summary - AMP

Nigel Pittaway (612) 8225 4860
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Year ended 31 December									
Segmental earnings (A$m)	**FY09A**	**1H10A**	**2H10A**	**FY10A**	**1H11E**	**2H11E**	**FY11E**	**FY12E**	**FY13E**
Business unit operating margins									
AMP Financial Services									
Contemporary wealth management	278	150	153	303	160	158	318	325	338
Contemporary wealth protection	164	73	65	138	73	80	153	177	191
Australian contemporary	**442**	**223**	**218**	**441**	**233**	**238**	**471**	**502**	**530**
Australian mature	151	68	72	140	66	63	129	123	118
New Zealand	54	32	26	58	25	26	51	54	57
AMP Financial Services - total	**647**	**323**	**316**	**639**	**324**	**328**	**651**	**679**	**705**
AXA Australia and NZ									
Wealth management					11	23	34	48	51
Wealth protection					19	42	61	89	92
Mature					13	25	38	50	50
New Zealand					9	18	27	36	37
AXA Australia and NZ - total					**52**	**108**	**160**	**222**	**230**
AMP Capital Investors	91	44	43	87	46	49	94	112	130
Total business unit op margins	**738**	**367**	**359**	**726**	**421**	**484**	**906**	**1,014**	**1,065**
Corp. & other expenses	(37)	(20)	(20)	(40)	(27)	(33)	(60)	(66)	(66)
AXA synergies	0			0	3	15	18	66	120
Total operating margins	**701**	**347**	**339**	**686**	**398**	**466**	**864**	**1,014**	**1,119**
Interest expense on debt	(71)	(36)	(36)	(72)	(36)	(39)	(75)	(78)	(78)
Tax loss recognition	16	8	8	16	9	9	18	20	22
Total operating profit	**646**	**319**	**311**	**630**	**371**	**437**	**807**	**956**	**1,063**
Underlying investment earnings	126	64	66	130	75	95	170	194	203
Underlying profit	**772**	**383**	**377**	**760**	**446**	**531**	**977**	**1,149**	**1,266**
Market adjs (inv income, annuities, risk)	(7)	7	3	10	(13)	(4)	(17)	(9)	(9)
Core earnings	**765**	**390**	**380**	**770**	**433**	**527**	**961**	**1,140**	**1,257**
Other items									
Employee defined benefit schemes	0	0	0	0	0	0	0	0	0
Fair value of debt and derivatives	(5)	8	(7)	1	0	0	0	0	0
Other including M&A transaction costs	10	(3)	(15)	(18)	(30)	0	(30)	0	0
Merger costs					(29)	(71)	(100)	(141)	(44)
Amortisation of intangibles					(18)	(35)	(53)	(70)	(70)
Seed fund writedown	(30)	0	0	0	0	0	0	0	0
	(25)	**5**	**(22)**	**(17)**	**(76)**	**(106)**	**(182)**	**(211)**	**(114)**
Reported net profit pre mismatch items	**740**	**395**	**358**	**753**	**357**	**421**	**778**	**929**	**1,143**
Mismatch items	(1)	30	(8)	22	0	0			
Reported profit	**739**	**425**	**350**	**775**	**357**	**421**	**778**	**929**	**1,143**
Normalised reported profit pre mismatch	**747**	**388**	**355**	**743**	**370**	**425**	**795**	**938**	**1,152**
Normalised core profit	**772**	**383**	**377**	**760**	**446**	**531**	**977**	**1,149**	**1,266**
Growth in normalised core profit	*-4.7%*			*-1.5%*			*28.5%*	*17.6%*	*10.1%*

B/sheet (A$m) (AIFRS basis)	**FY09A**	**1H10A**	**2H10A**	**FY10A**	**1H11E**	**2H11E**	**FY11E**	**FY12E**	**FY13E**
Investment assets	84,171	81,867	82,943	82,943	99,014	100,596	100,596	103,355	106,134
Intangibles	216	216	217	217	1,475	1,425	1,425	1,325	1,225
Goodwill	730	730	702	702	2,181	2,181	2,181	2,181	2,181
Receivables & other assets	4,713	5,546	5,399	5,399	6,711	6,670	6,670	6,592	6,613
Total assets	**89,830**	**88,359**	**89,261**	**89,261**	**109,381**	**110,872**	**110,872**	**113,453**	**116,153**
Borrowings	12,350	12,214	11,136	11,136	12,186	12,186	12,186	12,186	12,186
Policyholder liabilities	71,740	70,313	72,233	72,233	86,081	87,373	87,373	90,013	92,734
Other liabilities & provisions	3,106	2,983	2,894	2,894	4,255	4,315	4,315	4,372	4,415
Total liabilities	**87,196**	**85,510**	**86,263**	**86,263**	**102,522**	**103,873**	**103,873**	**106,571**	**109,334**
Net assets	**2,634**	**2,849**	**2,998**	**2,998**	**6,859**	**6,999**	**6,999**	**6,882**	**6,819**
Share capital	4,814	4,955	5,051	5,051	8,839	8,986	8,986	8,986	8,986
Reserves	(2,563)	(2,555)	(2,565)	(2,565)	(2,565)	(2,565)	(2,565)	(2,565)	(2,565)
Retained earnings	320	398	452	452	526	517	517	401	337
OEI	63	51	60	60	60	60	60	60	60
Total shareholders' funds	**2,634**	**2,849**	**2,998**	**2,998**	**6,859**	**6,999**	**6,999**	**6,882**	**6,819**
Net tangible assets	**1,625**	**1,852**	**2,019**	**2,019**	**3,143**	**3,333**	**3,333**	**3,316**	**3,353**
AMPCI AuM (A$bn)	**FY09A**	**1H10A**	**2H10A**	**FY10A**	**1H11E**	**2H11E**	**FY11E**	**FY12E**	**FY13E**
By asset class									
Equities	43.7	38.8	41.7	41.7	41.1	41.8	41.8	43.1	44.5
Fixed income	31.3	33.3	32.3	32.3	35.2	35.8	35.8	37.0	38.2
Property	15.7	15.9	16.2	16.2	16.6	16.9	16.9	17.5	18.0
Private capital	6.3	7.2	7.8	7.8	4.9	5.0	5.0	5.1	5.3
Total	**96.9**	**95.2**	**98.0**	**98.0**	**97.9**	**99.5**	**99.5**	**102.7**	**106.1**
By line of business									
Internal funds	62.1	62.1	60.3	60.3	58.5	56.8	56.8	53.5	50.4
Institutional	34.8	34.8	37.8	37.8	39.4	42.7	42.7	49.2	55.6
Total	**96.9**	**96.9**	**98.0**	**98.0**	**97.9**	**99.5**	**99.5**	**102.7**	**106.1**

Current valuation summary (A$m)	**Embedded value**	**A$ per share**	**Other/New business**	**Total value**	**A$ per share**
Australian Financial Services	10,597	3.80	4,908	15,505	5.56
AMP Limited tax loss recognition	78	0.03	0	78	0.03
AMP Capital Investors	1,591	0.57	0	1,591	0.57
Corporate capital	1,029	0.37	0	1,029	0.37
Holding company costs	(594)	(0.21)	0	(594)	(0.21)
AXA synergies	1,440	0.52	0	1,440	0.52
Group debt	(1,486)	(0.53)	0	(1,486)	(0.53)
Total valuation	**12,655**	**4.54**	**4,908**	**17,563**	**6.30**

Overall performance measures	**FY09A**	**1H10A**	**2H10A**	**FY10A**	**1H11E**	**2H11E**	**FY11E**	**FY12E**	**FY13E**
RoE - operating margins	28.0%	26.5%	23.2%	22.9%	25.8%	17.9%	16.3%	13.9%	15.7%
RoE - investment earnings	5.2%	5.6%	5.0%	5.1%	2.6%	3.7%	3.1%	2.7%	2.9%
RoE core - total	**33.2%**	**32.1%**	**28.2%**	**28.0%**	**28.5%**	**21.6%**	**19.5%**	**16.6%**	**18.5%**
RoA - operating margins	0.8%	0.8%	0.8%	0.8%	0.8%	0.8%	0.9%	0.9%	1.0%
RoA - investment earnings	0.1%	0.2%	0.2%	0.2%	0.1%	0.2%	0.2%	0.2%	0.2%
RoA - total	**0.9%**	**0.9%**	**0.9%**	**0.9%**	**0.9%**	**1.0%**	**1.0%**	**1.1%**	**1.1%**

Financial Summary - AMP : continued

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Stock information			
Recommendation			Buy / Medium risk
Diluted market cap. (A$m)			10,053
Diluted market cap. (US$m)	USD:AUD	1.085	10,904
Current price (A$ per share)			4.80
Average daily volume (m shares)			12.0
Valuation data			
Citi spot valuation per share			6.30
Price: FY10A NTA at valuation			6.5

Valuation parameters	FY09A	1H10A	2H10A	FY10A	1H11E	2H11E	FY11E	FY12E	FY13E
Based on reported profit after tax									
Basic EPS (¢)	36.7	19.2	17.2	36.4	14.7	15.0	29.8	33.1	40.7
PER (x)	17.2	32.8	36.5	17.3	42.7	41.8	21.1	19.0	15.5
Based on core earnings after tax									
Basic EPS (¢)	38.0	18.9	18.3	37.2	17.9	18.8	36.8	40.6	44.7
PER (x)	12.6	25.4	26.2	12.9	26.9	25.5	13.1	11.8	10.7
Fully diluted EPS (¢)	**37.8**	**18.8**	**18.2**	**37.0**	**17.7**	**18.7**	**36.4**	**40.2**	**44.3**
PER (x)	12.7	25.5	26.4	13.0	27.2	25.7	13.2	11.9	10.8
PE Rel (All Ords.) (x)	0.9	1.8	1.8	0.9	1.9	1.8	0.9	0.8	0.7
EPS growth (%)	65.6%	20.2%	-17.7%	-2.0%	-6.1%	2.7%	-1.6%	10.4%	10.2%
Dividend data									
DPS (¢)	30.0	15.0	15.0	30.0	14.0	16.0	30.0	35.0	38.0
DPS growth (%)	-25.0%	7.1%	-6.3%	0.0%	-6.7%	6.7%	0.0%	16.7%	8.6%
Yield (%)	6.3%	3.3%	3.1%	6.3%	3.1%	2.9%	6.3%	7.3%	7.9%
Payout ratio (%)	79.4%	79.7%	82.5%	81.1%	79.2%	85.7%	82.4%	87.0%	85.7%
Underlying payout ratio (%)	79.6%	81.1%	83.2%	82.6%	88.3%	85.4%	87.0%	86.4%	85.1%
Franking (%)	50.0%	60.0%	60.0%	60.0%	50.0%	40.0%	44.7%	40.0%	40.0%
Capital return paid May/June (¢ps)									
Book value/NTA					-6.1%				
Book value per share (A$)	1.25	1.35	1.40	1.40	2.42	2.45	2.45	2.41	2.38
NTA per share (A$)	0.79	0.89	0.96	0.96	1.12	1.18	1.18	1.17	1.18
Price to book/NTA									
Price to book (x)	3.8	3.6	3.4	3.4	2.0	2.0	2.0	2.0	2.0
Price to NTA (x)	6.1	5.4	5.0	5.0	4.3	4.1	4.1	4.1	4.1
Price to diluted NTA (x)	6.1	5.4	5.0	5.0	4.3	4.1	4.1	4.1	4.1

Index weightings		
All Ordinaries		1.0%
S&P/ASX 200		1.1%
Insurance		24.2%
Shareholder information as at 20 May 2010		
Capital Group Companies	6.8%	
Commonwealth Bank Group	5.7%	

Source: Company reports and Citi estimates

Capital structure	FY09A	1H10A	2H10A	FY10A	1H11E	2H11E	FY11E	FY12E	FY13E
No. shares on issue (m)									
B/f no. of shares	**1992.9**	**2048.7**	**2072.0**	**2048.7**	**2094.5**	**2811.5**	**2094.5**	**2836.1**	**2836.1**
- issues under DRP	55.8	23.3	22.5	45.8	22.1	24.6	46.7	54.3	54.5
- other	0.0	0.0	0.0	0.0	695.0	0.0	695.0	-54.3	-54.5
C/f no. of shares	**2048.7**	**2072.0**	**2094.5**	**2094.5**	**2811.5**	**2836.1**	**2836.1**	**2836.1**	**2836.1**
Options	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Diluted shares on issue	**2048.7**	**2072.0**	**2094.5**	**2094.5**	**2811.5**	**2836.1**	**2836.1**	**2836.1**	**2836.1**
Weighted ave. basic	2,016	2,060	2,080	2,070	2,427	2,797	2,612	2,810	2,810
Weighted ave. diluted	2,025	2,072	2,092	2,082	2,453	2,824	2,638	2,836	2,836

Net inflows	FY09A	1H10A	2H10A	FY10A
Australia				
Retail (A$m)	1483	555	390	945
Growth in retail (%)	23%	-26%	-30%	-36%
Corporate Super (A$m)	1144	530	378	908
Growth in corporate (%)	1%	0%	-29%	-21%
Mature	-1201	-588	-677	-1265
Growth in mature (%)	16%	-6%	15%	5%
New Zealand				
New Zealand net (A$m)	235	87	114	201
Growth in net NZ	87%	-41%	31%	-14%
Value of new business				
AMPFS VNB (A$m) - 4%dm	292	123	121	244
Growth in AMPFS NBV (%)	-8%	-27%	-2%	-16%

Persistency	FY09A	1H10A	2H10A	FY10A
AMP Financial Services	90.1%	90.7%	89.9%	90.4%

Investments	FY09A	1H10A	2H10A	FY10A	1H11E	2H11E	FY11E	FY12E	FY13E
Allocation of investments backing tangible shareholder capital									
Australia & NZ									
- income	71.5%	75.3%	72.9%	72.9%	72.9%	72.9%	72.9%	72.9%	72.9%
- growth	17.1%	11.0%	12.1%	12.1%	12.1%	12.1%	12.1%	12.1%	12.1%
- other	11.4%	13.7%	15.1%	15.1%	15.1%	15.1%	15.1%	15.1%	15.1%
TOTAL	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**

Corporate Gearing (ex op debt)	FY09A	1H10A	2H10A	FY10A	1H11E	2H11E	FY11E	FY12E	FY13E
Debt/ equity	46%	49%	30%	30%	20%	19%	19%	20%	20%
Debt/(debt+equity)	32%	33%	23%	23%	16%	16%	16%	16%	17%

Source: Company Reports and Citi Investment Research and Analysis.

QBE Insurance Group Ltd (QBE.AX)

Figure 12. Forecast snapshot

Company	**QBE**
Result	1H11
Date	19 Aug 2011
Forecast NPAT (US$m)	672.4
Forecast Core Earnings (US$m)	706.4
Forecast Core EPS (US cps)	64.1
EPS Growth on pcp (%)	43.6%
Forecast Next Dividend (A cps)	62.0

Source: Company Reports and CIRA Estimates

Hold/Medium Risk	**2M**
Price (22 Jul 11)	A$17.33
Target price	A$18.25
Expected share price return	5.3%
Expected dividend yield	7.4%
Expected total return	**12.7%**
Market Cap	A$18,936M
	US$20,538M

Price Performance
(RIC: QBE.AX, BB: QBE AU)

When will the margin stop falling?

- **1H margin looks likely to be close to 13%** — QBE's 1H11 insurance margin looks likely to be close to 13%, well down on the 15.7% in pcp and 14.4% in 2H11, despite FX gains contributing around 1.8% to the margin (it would have been closer to 11% without them). Large losses around 4 percentage points higher than guidance are the key contributory reason. This sees a further decline in half yearly insurance margin, a trend that has continued largely unabated since the December 2006 half.

- **So FY11E margin guidance could be narrowed, and potentially lowered** — With the weak 1H11 result dampening QBE's FY11 margin, we would not be surprised to see QBE narrow its FY11 guidance range from the 15-18% it originally guided to at its FY10 result. Presenting downside risk to its guidance range is the risk of blowing through the top of its large loss allowances.

- **Macro factors will again influence results** — The fall in Australian yields in 1H has likely been a negative for profit. However, a rise in yields in the Euro zone could be a stronger impact on the PoA than falling US yields.

- **Recent market volatility will be a wildcard** — On 14 June, QBE indicated that its investment yield (ex FX gains) was above its guidance range. The expansion of credit spreads in the second half of the month could, however, pose some threat to this higher yield. We will be looking to ascertain more precisely what the causes were.

- **High levels of catastrophes could increase average tax rate** — With the high level of catastrophes in 1H11, earnings from Equator Re may be depressed, potentially negating some of the tax benefits, lifting the group's effective tax rate.

- **Recent acquisitions will only modestly contribute to 1H NEP growth** — We would not be surprised to see QBE raise its NEP growth estimates for the full year given the ongoing strength of the A$. With Balboa transferred at the start of April, CUNA Mutual completing at the end of 1Q11, and Ren Re US completing at the start of March, acquisitions will also contribute for a full 6 months in 2H11E. Crop insurance NEP is also skewed towards the second half.

- **Dividend likely to tighten capital position** — Given QBE has committed to hold its 1H dividend of A$0.62ps flat for 1H11E, this suggests a payout ratio of ~100%. QBE has suggested it will not underwrite its 1H11 dividend, which will likely tighten its capital position. We expect that at 30 June its capital position was 1.5x-1.6x MCR rising to around 1.65x by 31 December 2011.

QBE.AU (Y/E Dec)	2010A	2011E	2012E	2013E
Reported Profit (US$m)	1,278.0	1,680.7	2,006.3	2,051.9
Core Net Profit (US$m)	1,337.0	1,751.2	2,079.3	2,124.9
Core EPS (US¢)	125.0	156.4	179.8	179.2
Core EPS Growth (%)	-19.2	25.2	15.0	-0.3
PE Ratio (x)	14.7	11.8	10.2	10.3
DPS (US¢)	119.5	131.8	124.5	119.5
Dividend Yield (%)	6.5	7.2	6.8	6.5
Franking Rate (%)	12.4	20.0	20.0	22.6
P/NTA (x)	3.9	3.3	2.8	3.6
ROE (%)	13.7	16.1	17.2	17.8

Source: Company Reports and dataCentral, CIRA.

QBE detailed financial summary

Financial Summary - QBE Insurance Group (QBE)

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Year ended 31 December

Profit and loss statement (US$m)	FY09A	1H10A	2H10A	FY10A	1H11E	2H11E	FY11E	FY12E	FY13E
Gross written premium	11,239	6,861	6,768	13,629	8,709	8,966	17,675	18,663	19,078
Unearned premium movement	(296)	(751)	554	(197)	(876)	294	(582)	(578)	(511)
Gross earned premium	**10,943**	**6,110**	**7,322**	**13,432**	**7,833**	**9,260**	**17,093**	**18,086**	**18,567**
Reinsurance expense	(1,497)	(870)	(1,200)	(2,070)	(987)	(1,130)	(2,117)	(2,188)	(2,228)
Net earned premium	**9,446**	**5,240**	**6,122**	**11,362**	**6,846**	**8,130**	**14,976**	**15,897**	**16,339**
Gross claims incurred	(6,343)	(3,756)	(4,119)	(7,875)	(5,095)	(5,030)	(10,125)	(10,381)	(10,695)
Reinsurance recoveries	645	620	448	1,068	800	339	1,139	1,178	1,218
Net claims incurred	**-5,698**	**-3,136**	**-3,671**	**-6,807**	**(4,295)**	**(4,691)**	**(8,986)**	**(9,203)**	**(9,476)**
Underwriting expenses	(2,767)	(1,562)	(1,825)	(3,387)	(2,109)	(2,472)	(4,580)	(4,761)	(4,803)
Underwriting result	**981**	**542**	**626**	**1,168**	**442**	**967**	**1,410**	**1,933**	**2,059**
Income on technical reserves	628	280	255	535	464	376	841	775	731
Insurance profit	**1,609**	**822**	**881**	**1,703**	**907**	**1,344**	**2,250**	**2,709**	**2,790**
Income on s'holders funds	529	(171)	295	124	113	182	295	397	393
Borrowing costs	(191)	(98)	(124)	(222)	(137)	(184)	(321)	(369)	(369)
Share of net profits of associates	(6)	0	5	5	2	4	6	7	8
Earnings before tax and minorities	**1,941**	**553**	**1,057**	**1,610**	**884**	**1,345**	**2,230**	**2,744**	**2,822**
Tax	(348)	(82)	(175)	(257)	(168)	(291)	(459)	(645)	(677)
Minorities after tax	(11)	(6)	(10)	(16)	(10)	(10)	(20)	(20)	(20)
Citi core earnings	**1,582**	**465**	**872**	**1,337**	**706**	**1,045**	**1,751**	**2,079**	**2,125**
Amortisation and impairment of intangibles	(50)	(25)	(34)	(59)	(34)	(37)	(71)	(73)	(73)
Reported net profit	**1,532**	**440**	**838**	**1,278**	**672**	**1,008**	**1,681**	**2,006**	**2,052**

AIFRS balance sheet (US$m)	FY09A	1H10A	2H10A	FY10A	1H11E	2H11E	FY11E	FY12E	FY13E
Investments	22,563	22,464	25,269	25,269	31,730	38,739	38,739	38,499	37,500
Deferred acquisition costs	1,753	2,237	2,003	2,003	2,289	2,852	2,852	2,672	2,712
Intangibles	4,495	4,373	5,387	5,387	5,413	5,377	5,377	5,304	5,231
Receivables	3,855	4,355	5,506	5,506	4,666	3,801	3,801	3,562	3,615
Reinsurance recoveries	3,302	3,067	3,219	3,219	5,874	5,268	5,268	4,937	5,010
Other assets	755	632	804	804	804	804	804	804	804
Total assets	**36,723**	**37,128**	**42,188**	**42,188**	**50,777**	**56,840**	**56,840**	**55,779**	**54,870**
Outstanding claims	16,166	15,738	18,236	18,236	22,230	28,041	28,041	25,183	25,170
Unearned premium	6,127	6,557	6,788	6,788	8,564	8,270	8,270	8,848	9,358
Subordinated debt	295	500	820	820	2,320	2,320	2,320	2,320	2,320
Borrowings	2,368	2,968	2,423	2,423	3,123	3,123	3,123	3,123	3,123
Other liabilities & provisions	2,535	2,371	3,528	3,528	3,528	3,528	3,528	3,528	3,528
Total liabilities	**27,491**	**28,134**	**31,795**	**31,795**	**39,765**	**45,282**	**45,282**	**43,002**	**43,499**
Net assets	**9,232**	**8,994**	**10,393**	**10,393**	**11,012**	**11,558**	**11,558**	**12,778**	**11,370**
Net tangible assets (excl OEI)	**4,555**	**4,502**	**4,878**	**4,878**	**5,466**	**6,043**	**6,043**	**7,324**	**5,917**
Share capital	6,604	6,351	7,972	7,972	8,695	8,980	8,980	9,586	10,137
Reserves*	-2,027	-892	-1,396	-1,396	-1,481	-1,481	-1,481	-1,481	-4,119
Retained earnings	4,587	3,462	3,735	3,735	3,710	3,967	3,967	4,569	5,237
Outside equity interests	68	73	82	82	88	93	93	104	115
Total shareholders' funds	**9,232**	**8,994**	**10,393**	**10,393**	**11,012**	**11,558**	**11,558**	**12,778**	**11,370**

*: Includes equity component of hybrid securities

Performance ratios	FY09A	1H10A	2H10A	FY10A	1H11E	2H11E	FY11E	FY12E	FY13E
Premium									
GWP growth	2.0%	24.0%	-1.4%	21.3%	28.7%	3.0%	29.7%	5.6%	2.2%
GEP/GWP	97%	89%	108%	99%	90%	103%	97%	97%	97%
GEP growth	1.6%	3.5%	19.8%	22.7%	7.0%	18.2%	27.3%	5.8%	2.7%
NEP growth	1.6%	3.4%	16.8%	20.3%	11.8%	18.8%	31.8%	6.2%	2.8%
Reinsurance and claims									
Reinsurance ratio (earned)	13.7%	14.2%	16.4%	15.4%	12.6%	12.2%	12.4%	12.1%	12.0%
Gross claims as % of GEP	58.0%	61.5%	56.3%	58.6%	65.0%	54.3%	59.2%	57.4%	57.6%
Reinsurance cost to recoveries ratio	232.2%	140.3%	267.9%	193.8%	123.4%	333.2%	185.8%	185.8%	182.9%
Recoveries to gross claims	10.2%	16.5%	10.9%	13.6%	15.7%	6.7%	11.2%	11.3%	11.4%
Key expense ratios									
Net claims ratio	60.3%	59.8%	60.0%	59.9%	62.7%	57.7%	60.0%	57.9%	58.0%
Expense ratio	29.3%	29.8%	29.8%	29.8%	30.8%	30.4%	30.6%	29.9%	29.4%
Combined operating ratio	**89.6%**	**89.7%**	**89.8%**	**89.7%**	**93.5%**	**88.1%**	**90.6%**	**87.8%**	**87.4%**
Insurance margins									
Insurance earnings as a % of NEP	17.0%	15.7%	14.4%	15.0%	13.2%	16.5%	15.0%	17.0%	17.1%
Growth in insurance profit	-12.1%	-2.7%	7.2%	5.8%	2.9%	48.2%	32.1%	20.4%	3.0%
Effective tax rate	17.9%	14.8%	16.6%	16.0%	19.0%	21.6%	20.6%	23.5%	24.0%
Investments									
Investment asset allocation									
- equities	6%	6%	6%	6%	2%	2%	2%	2%	2%
- fixed interest	41%	41%	41%	41%	45%	45%	45%	45%	45%
- property	0%	0%	0%	0%	0%	0%	0%	0%	0%
- cash & short term deposits	52%	52%	52%	52%	52%	52%	52%	52%	52%
	100%	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**
Investment returns (excluding non-recurring items)									
Income on technical reserves	628	280	255	535	464	376	841	775	731
Income on s'holders funds (net of interest)	529	-171	295	124	113	182	295	397	393
Total investment income	**1,157**	**109**	**550**	**659**	**577**	**558**	**1,135**	**1,172**	**1,124**

Mix of business	FY09A	1H10A	2H10A	FY10A	1H11E	2H11E	FY11E	FY12E	FY13E
NEP (US$m)									
Australia	2,138	1,510	1,523	3,033					
Asia Pacific	372	198	222	420					
Americas	2,527	1,299	1,710	3,009					
Europe	2,534	1,227	1,366	2,593					
Equator	1,875	1,006	1,301	2,307					
Total	**9,446**	**5,240**	**6,122**	**11,362**					
COR (%)									
Australia	89.0	89.8	91.4	89.2					
Asia Pacific	88.2	91.4	82.5	86.7					
Americas	89.7	91.0	88.7	89.7					
Europe	91.4	88.4	92.4	90.5					
Equator Re	88.2	88.9	91.1	90.1					
Group	**89.6**	**89.7**	**89.8**	**89.7**					

Financial Summary - QBE Insurance Group (QBE) : continued

Stock information			
Recommendation		**Hold / Medium risk**	
AUD USD	1.0812	A$	US$
Market cap.		18,226	19,705
Current price (per share)		17.33	18.74
Current no. shares on issue (mill.)			1,052
Average daily volume (m shares)			5.3
Valuation data			
Citi spot valuation per share		18.86	20.39
Price : FY10A NTA at valuation			4.3
Price: FY10A after tax insurance earnings at valuation			14.7

Valuation parameters	FY09A	1H10A	2H10A	FY10A	1H11E	2H11E	FY11E	FY12E	FY13E
Based on reported net profit after tax									
Basic EPS (¢)	152.7	42.8	81.1	123.7	62.7	91.7	154.8	179.0	178.4
PER (x)	12.3	21.9	11.5	15.1	14.9	10.2	12.1	10.5	10.5
Fully diluted EPS (¢)	149.9	42.2	76.2	119.5	61.0	88.8	150.2	173.6	173.1
Growth (%)	**-13%**	**-41%**	**81%**	**-20%**	**45%**	**46%**	**26%**	**16%**	**0%**
PER (x)	12.5	22.2	12.3	15.7	15.4	10.5	12.5	10.8	10.8
PE Rel (All Ords.) (x)	0.7	1.3	0.8	0.9	1.1	0.8	0.9	0.9	1.0
Based on core earnings									
Fully diluted EPS (US¢)	**154.7**	**44.6**	**79.3**	**125.0**	**64.1**	**92.0**	**156.4**	**179.8**	**179.2**
Growth (%)	-11.7%	-39.9%	77.8%	-19.2%	43.6%	43.6%	25.2%	15.0%	0%
PER (x)	12.1	21.0	11.8	15.0	14.6	10.2	12.0	10.4	10.5
Based on insurance profit after tax									
Insurance profit	1,609	822	881	1,703	907	1,344	2,250	2,709	2,790
Tax rate	30%	30%	30%	30%	30%	30%	30%	30%	30%
Insurance profit after tax and adj.	1,228	619	673	1,291	691	1019	1,711	2,055	1,976
After tax insurance profit per share	118.5	59.1	60.3	119.5	61.7	88.8	150.8	175.7	164.9
Growth (%)	-16%	4%	2%	1%	4%	44%	26%	17%	-6%
PER (x)	11.9	12.1	11.6	11.7	11.0	7.4	8.7	6.9	8.2
Price to book/NTA									
Price to book (x)	2.1	2.2	1.9	1.9	1.9	1.8	1.8	1.7	1.9
Price to NTA (x)	4.1	4.2	3.9	3.9	3.7	3.4	3.4	2.8	3.6
Price to diluted NTA (x)	4.2	4.4	4.1	4.1	3.8	3.5	3.5	3.0	3.7
Dividend data									
DPS (A¢)	128.0	62.0	66.0	128.0	62.0	66.0	128.0	130.0	134.0
DPS growth (%)	2%	0%	6%	0%	0%	6%	0%	2%	3%
Yield (%)	7.4	3.6	3.8	7.4	3.6	3.8	7.4	7.5	7.7
Payout ratio (%)	81%	120%	85%	102%	104%	75%	89%	70%	67%
Franking (%)	20%	15%	10%	12%	20%	20%	20%	20%	23%

Shareholder information		Other	
Major Shareholders at 10 March 2010			
Credit Suisse (including Aberdeen Asset Management)	13.2%	**DRP (discount):**	Yes (2.5%)
National Australia Bank	6.1%	**Index weightings**	
Commonwealth Bank of Australia	5.1%	All Ords	1.3%
		S&P ASX 200	1.5%
		Insurance	33.3%

Source: Company reports and Citi Investment Research and Analysis estimates

Capital adequacy (US$m)	FY09A	1H10A	2H10A	FY10A	1H11E	2H11E	FY11E	FY12E	FY13E
Tier 1									
Share capital	6,604	6,351	7,972	7,972	8,695	8,980	8,980	9,586	10,137
Reserves and retained earnings	2,560	2,570	2,339	2,339	2,229	2,485	2,485	3,087	1,118
Excess risk margins (net of tax)	977	898	1,129	1,129	1,263	1,299	1,299	1,305	1,324
Dividend (net of DRP and BSP) and FX	-402	-90	60	60	23	-471	-471	-450	-443
Intangibles	-4,428	-4,335	-5,394	-5,394	-5,578	-5,542	-5,542	-5,469	-5,396
Perpetual debt	178	177	179	179	179	179	179	179	179
Total tier 1	**5,489**	**5,571**	**6,285**	**6,285**	**6,810**	**6,931**	**6,931**	**8,239**	**6,920**
Tier 2: Sub debt & hybrids	514	768	720	720	2,420	2,420	2,420	2,420	2,420
Total capital base	**6,003**	**6,339**	**7,005**	**7,005**	**9,230**	**9,351**	**9,351**	**10,659**	**9,340**
Group MCR	3,754	3,869	4,332	4,332	5,698	5,698	5,698	5,771	5,778
MCR multiple	**1.6**	**1.6**	**1.6**	**1.6**	**1.6**	**1.6**	**1.6**	**1.8**	**1.6**
Technical reserves (US$m)	**FY09A**	**1H10A**	**2H10A**	**FY10A**	**1H11E**	**2H11E**	**FY11E**	**FY12E**	**FY13E**
Claims reserves	16,166	15,738	18,236	18,236	22,230	28,041	28,041	25,183	25,170
Unearned premium reserve	6,127	6,557	6,788	6,788	8,564	8,270	8,270	8,848	9,358
DAC	-1,753	-2,237	-2,003	-2,003	-2,289	-2,852	-2,852	-2,672	-2,712
Reinsurance receivables & recoverables	-3,302	-3,067	-3,219	-3,219	-5,874	-5,268	-5,268	-4,937	-5,010
Other	-2,145	-2,760	-2,670	-2,670	-3,051	-3,801	-3,801	-3,562	-3,615
Total technical reserves	**15,093**	**14,231**	**17,132**	**17,132**	**19,580**	**24,390**	**24,390**	**22,858**	**23,193**
Growth in technical reserves	11.8%	-5.7%	20.4%	13.5%	14.3%	24.6%	42.4%	-6.3%	1.5%
Yield on average insurance funds	4.4%	1.9%	1.6%	3.3%	2.5%	1.7%	4.0%	3.3%	3.4%
Solvency and gearing ratios	**FY09A**	**1H10A**	**2H10A**	**FY10A**	**1H11E**	**2H11E**	**FY11E**	**FY12E**	**FY13E**
Solvency ratios									
Average NAV (excl. OEI)/NEP	90.0%	86.3%	85.7%	85.7%	77.5%	72.7%	72.7%	75.9%	73.2%
Closing NTA (incl. OEI)/NEP	48.9%	43.7%	40.5%	43.7%	40.6%	37.7%	41.0%	46.7%	36.9%
Closing NTA (excl. OEI)/NEP	48.2%	43.0%	39.8%	42.9%	39.9%	37.2%	40.4%	46.1%	36.2%
Claims solvency (excl. OEI)	28.9%	28.9%	27.0%	27.0%	24.8%	21.7%	21.7%	29.3%	23.9%
Technical reserves									
Technical reserves/NTA	3.3	3.2	3.5	3.5	3.6	4.0	4.0	3.1	3.9
Technical reserves/investments	0.7	0.6	0.7	0.7	0.6	0.6	0.6	0.6	0.6
Gearing									
Gross debt/equity	29.1%	38.9%	31.5%	31.5%	49.8%	47.5%	47.5%	42.9%	48.4%
Debt:(Market cap + debt)	12.7%	16.0%	15.1%	15.1%	23.0%	23.0%	23.0%	23.0%	23.0%

Capital structure	FY09A	1H10A	2H10A	FY10A	1H11E	2H11E	FY11E	FY12E	FY13E
No. shares on issue (m)									
B/f no. of shares	981.8	1,024.7	1,035.1	1,024.7	1,051.7	1,092.7	1,051.7	1,106.2	1,135.0
- issues under dividend plans	22.1	8.0	16.5	24.5	37.5	13.5	51.1	28.7	30.2
- issues under ESOP	0.6	2.4	0.1	2.5	3.5	0.0	3.5	0.0	0.0
- issues to hybrid holders	9.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
- other	10.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
C/f no. of shares net of plan shares s.t. loa	**1,024.7**	**1,035.1**	**1,051.7**	**1,051.7**	**1,092.7**	**1,106.2**	**1,106.2**	**1,135.0**	**1,165.1**
Dilution for convertible prefs & options	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2
Dilution for LYONS/SCSs	21.0	50.0	43.0	43.0	43.0	43.0	43.0	43.0	43.0
Diluted shares on issue	**1,049.8**	**1,089.2**	**1,098.8**	**1,098.8**	**1,139.8**	**1,153.4**	**1,153.4**	**1,182.1**	**1,212.3**
Weighted avg. basic	1,003.0	1,027.0	1,033.0	1,033.0	1,072.2	1,099.4	1,085.8	1,120.7	1,150.1
Weighted avg. diluted	1,036.0	1,047.0	1,114.9	1,081.0	1,120.6	1,147.9	1,134.3	1,169.1	1,198.5
Overall performance measures and NTA/NAV									
Pre tax return on average investments	5.8%	1.1%	5.1%	2.9%	4.3%	3.3%	3.7%	3.2%	3.1%
Core return on average assets	4.5%	2.5%	4.4%	3.4%	3.0%	3.9%	3.5%	3.7%	3.8%
Core return on average equity	18.6%	10.3%	18.1%	13.7%	13.3%	18.7%	16.1%	17.2%	17.8%
Reported return on average equity	18.0%	9.7%	17.4%	13.1%	12.7%	18.0%	15.4%	16.6%	17.1%
NAV per share	8.94	8.62	9.80	9.80	10.00	10.36	10.36	11.17	9.73
NTA per share	4.62	4.46	4.76	4.76	5.12	5.59	5.59	6.59	5.27
Diluted NTA per share	4.51	4.24	4.56	4.56	4.91	5.36	5.36	6.32	5.06

NIB Holdings Ltd (NHF.AX)

Figure 13. Forecast snapshot

Company	**NHF**
Result	FY11
Date	22 Aug 2011
Forecast NPAT (A$m)	60.0
Forecast Core Earnings (A$m)	60.0
Forecast Core EPS (cps)	12.4
EPS Growth (%)	0.3%
Forecast Next Dividend (cps)	4.0

Source: Company Reports and CIRA Estimates

Buy/High Risk	**1H**
Price (22 Jul 11)	A$1.32
Target price	A$1.60
Expected share price return	21.2%
Expected dividend yield	6.1%
Expected total return	**27.3%**
Market Cap	A$616M
	US$668M

Price Performance
(RIC: NHF.AX, BB: NHF AU)

Result should again highlight organic growth

- **Likely to deliver the top end of its guidance range** — We are forecasting nib to deliver an underwriting result of A$57.1m, towards the top end of its guidance range of A$55m to A$58m.

- **Looking for A$1bn of premiums** — We are looking for annual premium growth of 11.8%, lifting the group's premiums to ~A$1bn. Within this, we expect policyholder growth of 5.7%.

- **Growing risk equalisation drag an underlying concern** — We expect nib's risk equalisation transfer fund contributions as a percentage of premiums to have doubled over the past 5 years to 12.8%, and to be 100bps higher in 2H11E than in 1H11, exceeding 13% for the half. This growing drag has the potential to prevent nib from being able to offer market leading prices for its basic products.

- **Underwriting margin** — We are looking for a FY11E underwriting margin of 5.7%, the top end of nib's guidance range of 5.4% to 5.7%, which suggests a much weaker 2H11E margin of 3.2% compared to the 8.3% achieved in 1H11.

- **Migrant businesses still likely to be a sideshow** — While nib has ambitious growth aspirations for its overseas students and overseas workers these are still small and likely to be below the quantitative thresholds of AASB 8.

- **Watch out for elevated expense levels** — As flagged by nib, other expenses are likely to be considerably higher than pcp due to multiple factors, including the EGM for the capital return and its approach to GMHBA.

- **Expecting a flat dividend, but with downside risk** — nib's stated payout ratio target is between 50% and 60% of earnings, with special dividends to distribute surplus capital subject to the availability of franking credits. A 4cps final dividend is flat on 1H11, but down 1c on pcp and would push nib to just beyond this stated payout ratio for the full year. Hence we believe that there is some downside risk to our dividend forecast due to nib's low franking credit balance.

- **Should recommit to buyback** — To date, nib has repurchased around 24.1m shares since it listed, just under half the 51.8m originally anticipated to repurchase. As such, we expect that at its FY11 result it will recommit to its buyback for another year.

- **Likely to achieve 15% return on equity, despite carrying excess capital** — We are forecasting nib to achieve a 15% return on equity for FY11, despite the group carrying excess capital. Following its capital return in early July, we anticipate nib will begin to highlight its improving RoE profile.

NHF.AU (Y/E Jun)	2010A	2011E	2012E	2013E
Reported Profit (A$m)	61.5	60.0	61.7	69.4
Core Net Profit (A$m)	61.5	60.0	61.7	69.4
Core EPS (A¢)	12.4	12.4	13.2	14.8
Core EPS Growth (%)	164.3	0.3	5.9	12.5
PE Ratio (x)	10.6	10.5	9.9	8.8
DPS (A¢)	7.0	8.0	8.0	9.0
Dividend Yield (%)	5.3	6.1	6.1	6.9
Franking Rate (%)	100.0	100.0	100.0	100.0
P/NTA (x)	1.7	1.7	1.9	1.8
ROE (%)	16.3	15.0	16.2	18.9

Source: Company Reports and dataCentral, CIRA.

NHF detailed financial summary

Figure 14. Detailed financial summary

Date	Jun-08	Jun-09	Dec-09	Jun-10	Jun-10	Dec-10	Jun-11	Jun-11	Jun-12	Jun-13
Year ending 30 June	**FY08A**	**FY09A**	**1H10A**	**2H10A**	**FY10A**	**1H11A**	**2H11E**	**FY11E**	**FY12E**	**FY13E**
Income statement year ended 30 June (IRFS A$m)										
Premium revenue	**758.2**	**829.5**	**446.1**	**455.3**	**901.4**	**495.0**	**512.4**	**1007.4**	**1131.7**	**1269.9**
Claims expense	-553.9	-599.3	-310.7	-325.2	-635.9	-339.6	-361.8	-701.4	-773.3	-856.3
HBRTF/RETF Levy	-73.1	-87.0	-53.3	-56.6	-109.9	-60.9	-68.2	-129.1	-159.2	-191.3
State levies	-19.9	-21.2	-10.9	-11.1	-22.0	-11.4	-11.7	-23.1	-25.7	-28.6
Claims handing expenses	-17.7	-18.4	-7.0	-7.4	-14.4	-7.5	-10.3	-17.9	-18.4	-18.8
Net claims incurred	**-664.6**	**-725.8**	**-381.8**	**-400.4**	**-782.3**	**-419.5**	**-452.1**	**-871.5**	**-976.5**	**-1095.0**
Acquisition costs	-25.6	-26.6	-14.0	-18.5	-32.5	-15.2	-21.8	-37.0	-42.3	-47.5
Other underwriting expenses	-34.9	-36.8	-19.7	-19.8	-39.5	-19.4	-22.3	-41.7	-45.0	-50.3
Underwriting expenses	**-60.5**	**-63.5**	**-33.8**	**-38.3**	**-72.0**	**-34.6**	**-44.1**	**-78.7**	**-87.3**	**-97.8**
Underwriting result	**33.1**	**40.2**	**30.5**	**16.6**	**47.1**	**40.9**	**16.3**	**57.1**	**67.8**	**77.0**
Investment income	8.8	-1.2	34.2	11.6	45.8	19.4	13.6	33.0	24.5	25.8
Investment expenses	-1.3	-0.7	-0.6	-0.8	-1.3	-0.8	-0.7	-1.5	-1.4	-1.5
Net investment income	**7.5**	**-1.8**	**33.6**	**10.8**	**44.5**	**18.6**	**12.9**	**31.5**	**23.1**	**24.3**
Other revenue	1.5	1.2	0.6	0.7	1.3	1.0	4.5	5.4	1.9	1.9
Other expenses	-3.5	-7.9	-3.3	-2.6	-5.8	-4.0	-4.0	-8.0	-5.3	-4.7
Net other business	**-2.1**	**-6.7**	**-2.6**	**-1.9**	**-4.5**	**-3.1**	**0.5**	**-2.6**	**-3.4**	**-2.8**
Profit before income tax	**38.4**	**31.6**	**61.5**	**25.5**	**87.0**	**56.4**	**29.6**	**86.0**	**87.5**	**98.5**
Income tax on continuing businesses	-10.9	-7.8	-18.4	-7.1	-25.4	-17.4	-8.7	-26.1	-25.9	-29.2
Continuing core profit	**27.5**	**23.8**	**43.1**	**18.4**	**61.5**	**39.0**	**20.9**	**60.0**	**61.7**	**69.4**
Discontinued operations	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Core profit	**27.6**	**23.8**	**43.1**	**18.4**	**61.5**	**39.0**	**20.9**	**60.0**	**61.7**	**69.4**
One off items										
Costs associated with demutualisation	-27.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Amortisation of acquired intangibles	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total one off items	**-27.2**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Net profit after tax	**0.4**	**23.8**	**43.1**	**18.4**	**61.5**	**39.0**	**20.9**	**60.0**	**61.7**	**69.4**
Dividend data										
DPS (¢)	2.1	7.4	2.0	5.0	7.0	4.0	4.0	8.0	8.0	9.0
DPS growth (%)	n.a.	252.4%	-33.3%	13.6%	-5.4%	100.0%	-20.0%	14.3%	0.0%	12.5%
Yield (%)	1.6%	5.6%	3.0%	7.6%	5.3%	6.1%	6.1%	6.1%	6.1%	6.8%
Payout ratio (%)	39.4%	154.8%	23.0%	134.5%	56.4%	47.8%	89.3%	62.3%	60.5%	60.5%
Franking (%)	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Capital return (¢)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	16.1	0.0
Valuation parameters										
Based on reported profit after tax										
Basic EPS (¢)	0.1	4.7	8.7	3.7	12.4	8.0	4.5	12.5	13.2	14.9
PER (x)	1370.4	28.1	7.6	17.8	10.6	8.2	14.7	10.6	10.0	8.9
Fully diluted EPS (¢)	0.1	4.7	8.7	3.7	12.4	8.0	4.5	12.4	13.2	14.8
PER (x)	1370.4	28.1	7.6	17.8	10.6	8.2	14.8	10.6	10.0	8.9
Based on core earnings after tax										
Basic EPS (¢)	6.6	4.7	8.7	3.7	12.4	8.0	4.5	12.5	13.2	14.9
PER (x)	20.1	28.1	7.6	17.8	10.6	8.2	14.7	10.6	10.0	8.9
Fully diluted EPS (¢)	**6.6**	**4.7**	**8.7**	**3.7**	**12.4**	**8.0**	**4.5**	**12.4**	**13.2**	**14.8**
Growth (%)	n.a.	-28.6%	2033.1%	-13.6%	164.3%	-7.6%	20.3%	0.3%	5.9%	12.5%
PER (x)	20.1	28.1	7.6	17.8	10.6	8.2	14.8	10.6	10.0	8.9
PER Rel (ASX 300) (x)	1.7	1.6	0.3	0.8	0.5	0.5	1.0	0.7	0.8	0.7

Recommendation		Buy High Risk	**Valuation data**	
Market cap. (A$m)		654.0	Citi spot valuation per share (A$)	1.60
Market cap. (US$m)	1.0827	708.1	WACC	11.5%
Current price (A$ per share)		1.32	Terminal growth assumption	4.0%
Current no. diluted shares on issue (mill.)		467.8	Price/FY11E NTA at valuation	2.0
Average daily volume ('000 shares)		317		

Source: Company Reports and CIRA Estimates

Figure 15. Detailed financial summary

Date	Jun-08	Jun-09	Dec-09	Jun-10	Jun-10	Dec-10	Jun-11	Jun-11	Jun-12	Jun-13
Year ending 30 June	**FY08A**	**FY09A**	**1H10A**	**2H10A**	**FY10A**	**1H11A**	**2H11E**	**FY11E**	**FY12E**	**FY13E**
Capital structure										
No. shares on issue (m)										
B/f no. of shares - fully paid	517.9	517.9	496.1	495.9	496.1	495.4	466.8	495.4	466.7	466.5
Demutualisation / buyback	0.0	-21.8	-0.2	-0.5	-0.7	-28.7	0.0	-28.7	-0.2	-0.2
C/f no. of shares - fully paid	**517.9**	**496.1**	**495.9**	**495.4**	**495.4**	**466.8**	**466.7**	**466.7**	**466.5**	**466.3**
Dilutive items	0.0	0.0	0.0	0.0	0.0	1.1	1.1	1.1	1.3	1.5
Diluted shares on issue	**517.9**	**496.1**	**495.9**	**495.4**	**495.4**	**467.9**	**467.8**	**467.8**	**467.8**	**467.8**
Weighted ave. basic	419.4	506.7	495.4	495.7	495.8	485.1	466.8	481.1	466.1	466.4
Weighted ave. diluted	419.4	506.7	495.4	495.7	495.8	485.7	467.9	481.6	467.8	467.8
Balance sheet (A$m)										
Assets										
Cash and cash equivalents	179.2	167.1	161.6	197.4	197.4	171.5	171.9	171.9	122.4	168.2
Receivables	36.5	32.9	35.6	32.1	32.1	68.6	58.9	58.9	48.9	38.9
Financial assets	242.8	230.3	259.2	264.4	264.4	274.1	299.5	299.5	331.0	351.2
Investment property	30.0	30.0	30.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Property, plant and equipment	39.0	43.8	42.2	41.0	41.0	42.6	42.6	42.6	42.6	42.6
Intangibles	9.9	10.9	11.8	12.4	12.4	39.2	39.2	39.2	39.2	39.2
Other	8.6	0.4	0.0	30.0	30.0	0.0	0.0	0.0	0.0	0.0
Total assets	**565.8**	**536.5**	**553.1**	**588.0**	**588.0**	**601.8**	**617.8**	**617.8**	**590.1**	**646.2**
Liabilities										
Creditors	55.1	58.8	56.7	68.5	68.5	71.1	76.7	76.7	83.9	94.4
Borrowings	2.1	0.4	1.4	3.6	3.6	2.7	2.7	2.7	2.7	2.7
Outstanding claims liability	62.3	56.2	56.5	62.1	62.1	60.2	64.9	64.9	71.0	80.0
Unearned premium provision	47.0	49.9	46.4	54.4	54.4	53.7	55.6	55.6	62.3	70.0
Provision for employee entitlements	4.1	3.4	3.5	3.6	3.6	3.6	3.7	3.7	3.7	3.8
Total liabilities	**180.9**	**174.6**	**169.8**	**196.6**	**196.6**	**198.4**	**212.2**	**212.2**	**236.0**	**264.7**
Shareholders equity										
Share capital	44.6	42.5	42.5	42.4	42.4	41.9	41.9	41.9	32.5	32.5
Retained earnings	329.6	317.9	339.4	347.4	347.4	359.9	362.1	362.1	320.0	347.4
Reserves	10.7	1.5	1.4	1.6	1.6	1.6	1.6	1.6	1.6	1.6
Minority interest	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total equity	**384.8**	**361.9**	**383.3**	**391.4**	**391.4**	**403.4**	**405.6**	**405.6**	**354.1**	**381.5**
Price to book/NTA										
Basic book value per share	0.74	0.73	0.77	0.79	0.79	0.86	0.87	0.87	0.76	0.82
Basic NTA per share	0.72	0.71	0.75	0.76	0.76	0.78	0.78	0.78	0.67	0.73
Price to book (x)	1.8	1.8	1.7	1.7	1.7	1.5	1.5	1.5	1.7	1.6
Price to NTA (x)	1.8	1.9	1.8	1.7	1.7	1.7	1.7	1.7	2.0	1.8
Overall performance measures										
ROE - core earnings	**7.7%**	**6.4%**	**23.1%**	**9.5%**	**16.3%**	**19.7%**	**10.3%**	**15.0%**	**18.0%**	**18.9%**
ROE - one off items	-7.5%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
ROE - total	**0.1%**	**6.4%**	**23.1%**	**9.5%**	**16.3%**	**19.7%**	**10.3%**	**15.0%**	**18.0%**	**18.9%**
ROA - core earnings	**5.2%**	**4.3%**	**15.8%**	**6.5%**	**10.9%**	**13.1%**	**6.9%**	**9.9%**	**10.2%**	**11.2%**
ROA - one off items	-5.1%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
ROA - total	**0.1%**	**4.3%**	**15.8%**	**6.5%**	**10.9%**	**13.1%**	**6.9%**	**9.9%**	**10.2%**	**11.2%**
Gearing										
Gross debt/equity	0.5%	0.1%	0.4%	0.9%	0.9%	0.7%	0.7%	0.7%	0.8%	0.7%
Debt/(Debt + BV equity)	0.5%	0.1%	0.4%	0.9%	0.9%	0.7%	0.7%	0.7%	0.8%	0.7%
Debt/(Debt + market cap)	0.3%	0.1%	0.2%	0.5%	0.5%	0.4%	0.4%	0.4%	0.4%	0.4%

Source: Company Reports and CIRA Estimates

Suncorp Group Ltd (SUN.AX)

Figure 16. Forecast snapshot

Company	SUN
Result	FY11
Date	24 Aug 2011
Forecast NPAT (A$m)	424.1
Forecast Core Earnings (A$m)	614.1
Forecast Core EPS (cps)	48.0
EPS Growth (%)	-24.3%
Forecast Next Dividend (cps)	15.0

Source: Company Reports and CIRA Estimates

Buy/Medium Risk	1M
Price (22 Jul 11)	A$7.73
Target price	A$9.75
Expected share price return	26.1%
Expected dividend yield	5.2%
Expected total return	**31.3%**
Market Cap	A$9,945M
	US$10,787M

Price Performance
(RIC: SUN.AX, BB: SUN AU)

Capital targets of key interest

- **EPS could beat consensus due to preference shares being anti-dilutive** — Preference shares are again likely to be anti-dilutionary in 2H11 / FY11; which suggests that consensus EPS is too low despite our NPAT being largely in line.
- **Expecting a lower dividend 2H11 vs. 2H10** — Despite its strong capital position, we expect weak earnings in General Insurance to result in Suncorp lowering its final dividend to 15cps, given its payout ratio "*target range of 50% to 60% of cash earnings*".
- **Margin guidance maintained through anticipatory repricing** — As we elaborate in our recent report "*Reinsurance in Australia and NZ - Risk profile changes for IAG and SUN; QBE's timing impeccable*" dated 6 July 2011. Suncorp moved early to reprice risks following recent events in expectation of a rise in reinsurance premiums. As a result, it has been able to reiterate its margin guidance of "at least 12%" for FY12E, despite what we can only presume is a significant rise in its overall reinsurance costs.
- **Large loss allowance set to increase** — With Suncorp increasing its Maximum Event Retention (MER) to A$250m, reducing its aggregate excess of loss reinsurance cover, and having exceeded its FY11 A$465m allowance, we expect it to announce an increased natural hazards allowance for FY12E. In our view the FY12E allowance could be at least A$500m given premium growth and the reinsurance coverage changes. The capital impact of this higher retention is likely to lower Suncorp's MCR multiple by around 0.04x.
- **Growth in core bank likely below targets in 2H11** — APRA's monthly banking statistics reveal that in the 5 months to May, Suncorp bank grew below industry, likely due to the weak economic growth in Queensland following the natural catastrophes in 1Q11.
- **Runoff of non-core bank** — Runoff in the non-core bank appears to be progressing relatively smoothly, with few new impaired loans in 4Q11 gaining media attention. However, Suncorp may need to raise its impairment provisions for existing impaired loans due to it taking longer to realise security.
- **Past dues set to lift again** — There is a risk of a further significant increase in past dues following the catastrophes in 1Q11, although we doubt whether this will lead to any significant losses given LMI and levels of security.
- **Capital targets potentially released** — With reinsurance arrangements finalised, and QIS2 completed, Suncorp should be able to announce its capital targets, despite Basel III and LAGIC reform uncertainties remaining.

SUN.AU (Y/E Jun)	2010A	2011E	2012E	2013E
Reported Profit (A$m)	780.0	424.1	1,048.2	1,205.2
Core Net Profit (A$m)	826.0	614.1	1,157.4	1,314.4
Core EPS (A¢)	63.5	48.0	88.9	104.0
Core EPS Growth (%)	51.2	-24.3	85.1	16.9
PE Ratio (x)	11.9	15.7	8.5	7.3
DPS (A¢)	35.0	30.0	53.0	61.0
Dividend Yield (%)	4.6	4.0	7.0	8.1
Franking Rate (%)	100.0	100.0	100.0	100.0
P/NTA (x)	1.3	1.3	1.2	1.1
ROE (%)	6.1	4.4	8.3	9.3

Source: Company Reports and dataCentral, CIRA.

SUN detailed financial summary

Financial Summary - Suncorp Group (SUN)

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	FY09A	1H10A	2H10A	FY10A	1H11A	2H11E	FY11E	FY12E	FY13E
General Insurance (A$m)									
Gross written premium	6,815	3,490	3,537	7,027	3,563	3,702	7,265	7,680	8,121
Unearned premium movement	-273	-53	-85	-138	-16	-101	-117	-176	-179
Gross earned premium	**6,542**	**3,437**	**3,452**	**6,889**	**3,547**	**3,602**	**7,149**	**7,504**	**7,942**
Reinsurance expense	-561	-293	-286	-579	-281	-512	-793	-715	-758
Net earned premium	**5,981**	**3,144**	**3,166**	**6,310**	**3,266**	**3,090**	**6,356**	**6,788**	**7,184**
Net incurred claims	-4,610	-2,191	-2,446	-4,637	-2,284	-2,537	-4,821	-4,737	-4,984
Acq'n and other costs	-1,642	-812	-858	-1,670	-795	-766	-1,561	-1,631	-1,705
Underwriting result	**-271**	**141**	**-138**	**3**	**187**	**-213**	**-26**	**421**	**496**
Investment income - insurance funds	733	260	342	602	169	255	424	441	472
Insurance profit	**462**	**401**	**204**	**605**	**356**	**42**	**398**	**862**	**967**
Managed schemes net income	19	8	-4	4	3	7	10	16	16
Joint venture income	1	23	30	53	12	0	12	0	0
Investment income - shareholder funds	130	100	94	194	87	102	189	198	210
Profit before tax and capital funding	**612**	**532**	**324**	**856**	**458**	**151**	**609**	**1,076**	**1,193**
Capital funding	-115	-41	-41	-82	-43	-41	-84	-82	-82
Profit before tax	**497**	**491**	**283**	**774**	**415**	**111**	**526**	**994**	**1,112**
Income tax	-157	-144	-73	-217	-123	-33	-156	-298	-334
General insurance profit after tax	**340**	**347**	**210**	**557**	**292**	**77**	**369**	**696**	**778**
Profit & loss (banking operations A$m)									
Net interest income	1,117	466	462	928	438	446	884	905	929
Non interest income	202	98	77	175	70	66	136	127	124
Total income	**1,319**	**564**	**539**	**1,103**	**508**	**512**	**1,020**	**1,032**	**1,053**
Operating expenses	-538	-277	-269	-546	-279	-272	-551	-537	-534
Underlying profit	**781**	**287**	**270**	**557**	**229**	**240**	**469**	**495**	**519**
Impairment losses on loans and advances	-710	-274	-205	-479	-213	-119	-332	-119	-73
Banking profit before tax	**71**	**13**	**65**	**78**	**16**	**121**	**137**	**376**	**446**
Income tax	-48	-9	-25	-34	-13	-28	-41	-113	-134
Banking profit after tax	**23**	**4**	**40**	**44**	**3**	**93**	**96**	**263**	**312**
Life									
Underlying profit after tax	180	86	106	192	71	87	158	210	236
Market adjustments after tax	-63	19	11	30	-10	4	-6	0	0
Life profit after tax	**117**	**105**	**117**	**222**	**61**	**91**	**152**	**210**	**236**
Profit after tax from business lines	**480**	**456**	**367**	**823**	**356**	**261**	**617**	**1,169**	**1,326**
LJ Hooker	8	4	0	4	0	0	0	0	0
Consolidation adjustments	3	-1	10	9	5	2	7	0	0
Other core profit before tax	**11**	**3**	**10**	**13**	**5**	**2**	**7**	**0**	**0**
Income tax	-3	-1	0	-1	0	0	0	0	0
Other core profit after tax	**8**	**2**	**10**	**12**	**5**	**2**	**7**	**0**	**0**
Outside equity interests	-5	-3	-6	-9	-4	-6	-10	-12	-12
Citi core earnings	**483**	**455**	**371**	**826**	**357**	**257**	**614**	**1,157**	**1,314**
Other non-core items before tax									
Amortisation of identifiable intangible assets	-245	-112	-98	-210	-76	-80	-156	-156	-156
One off gains / (costs) before tax									
Integration and restructuring costs	-147	-59	0	-59	0	0	0	0	0
Gain from Visa IPO / Hooker Corp sale / JV sale	4	50	165	215	0	0	0	0	0
Gain from subordinated debt buy-back	129								
Loss on sale of Tyndall/Guardian Trust					-106	0	-106		
DAC adjustment									
Bank software write-off	-11								
Total one offs before tax	**-25**	**-9**	**165**	**156**	**-106**	**0**	**-106**	**0**	**0**
Tax on one offs and non-core other items	135	30	-22	8	48	24	72	47	47
One offs and noncore other items after tax	**-135**	**-91**	**45**	**-46**	**-134**	**-56**	**-190**	**-109**	**-109**
NPAT	**348**	**364**	**416**	**780**	**223**	**201**	**424**	**1,048**	**1,205**

	FY09A	1H10A	2H10A	FY10A	1H11A	2H11E	FY11E	FY12E	FY13E
Valuation parameters									
Based on reported profit after tax									
Basic EPS (¢)	31.6	29.0	32.8	61.8	17.5	15.7	33.2	84.3	100.5
PER (x)	24.4	26.7	23.6	12.5	44.1	49.3	23.3	9.2	7.7
Fully diluted EPS (¢)	31.1	28.3	31.9	60.1	17.5	15.7	33.2	80.9	95.7
Growth on pcp (%)	-42%	15%	260%	93%	-38%	-51%	-45%	144%	18%
PER (x)	24.9	13.7	12.1	12.9	22.1	24.7	23.3	9.6	8.1
Based on core earnings after tax									
Basic EPS (¢)	43.9	36.2	29.3	65.4	28.1	20.0	48.0	93.0	109.6
PER (x)	17.6	10.7	13.2	11.8	13.8	19.3	16.1	8.3	7.1
Fully diluted EPS (¢)	**42.0**	**35.0**	**28.6**	**63.5**	**28.1**	**20.0**	**48.0**	**88.9**	**104.0**
Growth on pcp (%)	-46.8%	-3.0%	205.5%	51.2%	-19.9%	-30.0%	-24.3%	85.1%	16.9%
PER (x)	18.4	11.0	13.5	12.2	13.8	19.3	16.1	8.7	7.4
PE Rel (All Ords.) (x)	1.2	0.7	0.9	0.8	1.1	1.5	1.3	0.7	0.6
Price to NTA (x)	1.5	1.4	1.3	1.3	1.3	1.3	1.3	1.2	1.1
Price to diluted NTA (x)	1.7	1.5	1.5	1.5	1.3	1.3	1.3	1.4	1.2
Dividend data									
DPS (¢)	38.9	15.0	20.0	35.0	15.0	15.0	30.0	53.0	61.0
DPS growth on pcp (%)	-61.5%	-20.5%	0.0%	-9.9%	0.0%	-25.0%	-14.3%	76.7%	15.1%
Yield (%)	5.0%	1.9%	2.6%	4.5%	1.9%	1.9%	3.9%	6.9%	7.9%
Franking (%)	100%	100%	100%	100%	100%	100%	100%	100%	100%
Payout ratio on cash earnings excl div'ments (%)	115%	47%	70%	58%	53%	75%	62%	60%	59%
Payout ratio on reported profit (%)	125%	53%	63%	58%	86%	96%	90%	66%	64%
Capital structure									
Dilution factor	**1.00**	**1.00**	**1.00**	**1.00**	**1.00**	**1.00**	**1.00**	**1.00**	**1.00**
No. shares on issue (m)									
B/f no. of shares	955.5	1,257.4	1,270.9	1,257.4	1,281.4	1,281.4	1,281.4	1,286.6	1,229.9
Options & DRP	46.4	13.5	10.5	24.0	0.0	5.2	5.2	0.0	0.0
Shares issued for Promina	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Rights issue	145.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other/buyback	109.8	0.0	0.0	0.0	0.0	0.0	0.0	-56.7	-41.1
Pref share conversion	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total shares on issue	**1,257.4**	**1,270.9**	**1,281.4**	**1,281.4**	**1,281.4**	**1,286.6**	**1,286.6**	**1,229.9**	**1,188.8**
Dilution for convertible prefs & options	138.3	103.4	108.5	108.5	0.0	0.0	0.0	108.9	108.9
Diluted shares on issue	**1,395.7**	**1,374.3**	**1,389.9**	**1,389.9**	**1,281.4**	**1,286.6**	**1,286.6**	**1,338.8**	**1,297.7**
Weighted avg. basic	1,100.5	1,256.4	1,267.8	1,262.1	1,272.7	1,284.0	1,278.4	1,244.1	1,199.1
Weight ave diluted	1,238.8	1,359.8	1,376.4	1,370.7	1,272.7	1,284.0	1,278.4	1,353.0	1,308.0
General insurance operating ratios	**FY09A**	**1H10A**	**2H10A**	**FY10A**	**1H11A**	**2H11E**	**FY11E**	**FY12E**	**FY13E**
Growth in GWP on pcp	6.0%	4.4%	1.9%	3.1%	2.1%	4.7%	3.4%	5.7%	5.7%
Growth in NEP on pcp	2.0%	5.2%	5.8%	5.5%	3.9%	-2.4%	0.7%	6.8%	5.8%
Claims ratio	77.1%	69.7%	77.3%	73.5%	69.9%	82.1%	75.9%	69.8%	69.4%
Expense ratio	27.5%	25.8%	27.1%	26.5%	24.3%	24.8%	24.6%	24.0%	23.7%
Combined ratio	**104.5%**	**95.5%**	**104.4%**	**100.0%**	**94.3%**	**106.9%**	**100.4%**	**93.8%**	**93.1%**
Insurance margin (%)	7.7%	12.8%	6.4%	9.6%	10.9%	1.4%	6.3%	12.7%	13.5%
General insurance solvency capital (A$m)									
Total Tier 1	2,446	2,800	3,004	3,004	2,650	2,456	2,456	2,596	2,801
Total Tier 2	784	767	778	778	763	655	655	655	655
Minimum capital requirement	**1,932**	**1,898**	**1,996**	**1,996**	**1,881**	**1,902**	**1,902**	**2,026**	**2,132**
MCR multiple	**1.67**	**1.88**	**1.89**	**1.89**	**1.81**	**1.64**	**1.64**	**1.60**	**1.62**

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Financial Summary - Suncorp (SUN) : continued

Stock information

Recommendation			**Buy / Medium risk**
Market cap. (A$m)			9,824
Market cap. (US$m)	USD:AUD	1.083	10,636
Current price (A$ per share)			7.73
Current no. shares on issue (mill.)			1,270.9
Average daily volume (m shares)			4.3

Valuation data

Citi spot valuation per share	9.60
Price: FY10E diluted NTA at valuation	1.9

Banking	**FY09A**	**1H10A**	**2H10A**	**FY10A**	**1H11A**	**2H11E**	**FY11E**	**FY12E**	**FY13E**
Core bank profit before tax		224	167	391	169	196	365	428	468
Tax on core bank profit		-70	-53	-123	-59	-51	-110	-128	-140
Core bank profit after tax		**154**	**114**	**268**	**110**	**146**	**256**	**299**	**327**
Non-core bank profit/(loss) before tax		-211	-102	-313	-153	-75	-228	-52	-22
Tax on non-core bank profit/(loss)		61	28	89	46	23	69	16	7
Non-core bank profit/(loss) after tax		**-150**	**-74**	**-224**	**-107**	**-53**	**-160**	**-36**	**-15**
Banking profit after tax		**4**	**40**	**44**	**3**	**93**	**96**	**263**	**312**
Banking - Solvency capital (A$m)									
Shareholders funds	13,443	13,542	13,630	13,630	3,122	3,168	3,168	3,300	3,456
Preference shares	879	879	879	879	2,362	2,362	2,362	2,362	2,362
Total shareholder funds and preference shares	14,322	14,421	14,509	14,509	5,484	5,530	5,530	5,662	5,818
Less: goodwill	-7,818	-7,837	-7,809	-7,809	0	0	0	0	0
Total Tier 1	4,709	4,789	4,925	4,925	4,983	5,024	5,024	5,156	5,312
Total Tier 2	2,031	2,107	1,981	1,974	1,672	1,706	1,706	1,706	1,706
Deduct investments in non banking subs	-1,424	-1,413	-1,428	-1,428	-1,504	-1,504	-1,504	-1,504	-1,504
Capital base	5,316	5,483	5,478	5,478	5,151	5,226	5,226	5,358	5,514
Total assessed risk	41,626	40,026	37,234	37,234	37,710	34,139	34,139	30,660	29,505
Tier 1 capital ratio	**11.31%**	**12.0%**	**13.2%**	**13.2%**	**13.2%**	**14.7%**	**14.7%**	**16.8%**	**18.0%**
Risk weighted capital ratios	**12.77%**	**13.7%**	**14.7%**	**14.7%**	**13.7%**	**15.3%**	**15.3%**	**17.5%**	**18.7%**
Adjusted fundamental tier 1	**5.8%**	**6.2%**	**7.0%**	**7.0%**	**6.9%**	**7.7%**	**7.7%**	**9.0%**	**9.9%**
Total - Solvency capital (A$m)									
Total Tier 1	7,256	7,575	8,318	8,318	8,405				
Total Tier 2	2,814	2,874	2,759	2,759	2,435				
Total capital base	10,070	10,449	11,077	11,077	10,840				
Target capital base	9,405	9,526	9,777	9,777	9,494				
Excess	**665**	**923**	**1,300**	**1,300**	**1,346**				

Shareholder information

Major Shareholders at 26 August 2010

(none)

Other

DRP (discount):	Yes (2.5%)
Index weightings	
All Ords	0.7%
S&P ASX 200	0.8%
Insurance Index	18.1%

Asset allocation

General insurance funds (technical reserves)	**FY09A**	**1H10A**	**2H10A**	**FY10A**	**1H11E**	**2H11E**	**FY11E**	**FY12E**	**FY13E**
Cash and short term deposits	7%	4%	2%	2%	1%	1%	1%	1%	1%
Interest bearing securities	93%	96%	98%	98%	99%	99%	99%	99%	99%
Australian equities	0%	0%	0%	0%	0%	0%	0%	0%	0%
Overseas equities	0%	0%	0%	0%	0%	0%	0%	0%	0%
Property	0%	0%	0%	0%	0%	0%	0%	0%	0%
Total	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**
Shareholders' funds asset allocation									
Cash and short term deposits	8%	5%	8%	8%	2%	2%	2%	2%	2%
Interest bearing securities	84%	91%	84%	84%	86%	86%	86%	86%	86%
Australian equities	0%	0%	0%	0%	0%	0%	0%	0%	0%
Overseas equities	2%	0%	2%	2%	2%	2%	2%	2%	2%
Property	7%	4%	6%	6%	10%	10%	10%	10%	10%
Total	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**

	FY09A	**1H10A**	**2H10A**	**FY10A**	**1H11A**	**2H11E**	**FY11E**	**FY12E**	**FY13E**
Banking - operating ratios									
Unadjusted spread	1.38%	1.11%	1.06%	1.09%	0.95%	1.10%	1.02%	1.17%	1.26%
Unadjusted margin	1.68%	1.40%	1.43%	1.42%	1.35%	1.44%	1.40%	1.54%	1.62%
Capital adequacy ratio									
Tier one ratio	11.3%	12.0%	13.2%	13.2%	13.2%	14.7%	14.7%	16.8%	18.0%
Capital adequacy ratio	12.8%	13.7%	14.7%	14.7%	13.7%	15.3%	15.3%	17.5%	18.7%
Assets									
Retail loans	28,912	28,990	29,048	29,048	31,021	32,262	32,262	34,894	37,742
Business loans	25,451	23,232	19,050	19,050	17,145	15,431	15,431	11,271	9,643
Other	1,015	1,959	8,358	8,358	7,683	7,318	7,318	8,110	7,989
Total loans	**55,378**	**54,181**	**56,456**	**56,456**	**55,849**	**55,011**	**55,011**	**54,275**	**55,374**
Growth in loans	-1%	-2%	4%	2%	-1%	-2%	-3%	-1%	2%
Impairment losses to average loans (bps)	128	102	80	92	87	47	65	24	15
Banking balance sheet (A$bn)									
Total assets	97,463	95,540	95,339	95,339	93,856	96,313	96,313	97,445	98,673
RWA	41,626	40,026	32,149	32,149	31,442	30,203	30,203	28,094	27,405
Ave interest earning assets	66,670	66,040	64,489	65,265	64,370	62,076	63,223	58,735	57,417
Loans	54,619	53,361	51,818	51,818	51,011	49,973	49,973	48,837	49,536
Non accrual loans	1,474	2,219	2,122	2,122	2,516	2,423	2,423	1,836	1,277
Average equity (A$m)	13,246	13,394	13,586	13,630	8,376	3,145	3,168	3,300	3,456
Ratios									
Reported return on weighted average assets	0.4%	0.8%	0.9%	0.8%	0.5%	0.4%	0.5%	1.1%	1.2%
Reported return on weighted average equity	2.8%	5.4%	6.0%	5.7%	3.2%	2.9%	3.0%	7.6%	8.5%
Cost to income - banking	40.8%	49.1%	49.9%	49.5%	54.9%	53.1%	54.0%	52.0%	50.7%
Cost to assets - banking	0.7%	0.7%	0.7%	0.7%	0.8%	0.8%	0.8%	0.8%	0.8%

Source: Company reports and Citi Investment Research and Analysis

Insurance Australia Group Ltd (IAG.AX)

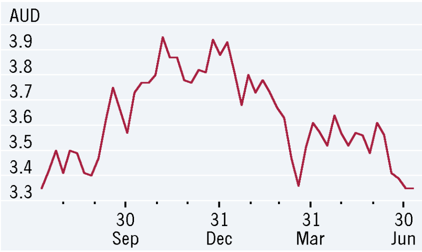
Figure 17. Forecast snapshot

Company	**IAG**
Result	FY11
Date	25 Aug 2011
Forecast NPAT (A$m)	245.6
Forecast Core Earnings (A$m)	419.6
Forecast Core EPS (cps)	20.2
EPS Growth (%)	145.1%
Forecast Next Dividend (cps)	6.0

Source: Company Reports and CIRA Estimates

Hold/Medium Risk	**2M**
Price (22 Jul 11)	A$3.42
Target price	A$3.70
Expected share price return	8.2%
Expected dividend yield	7.6%
Expected total return	**15.8%**
Market Cap	A$7,110M
	US$7,712M

Price Performance
(RIC: IAG.AX, BB: IAG AU)



Not gone according to IAG’s plan

- **High reserve releases but how sustainable?** — While natural catastrophes have battered IAG's results, it has been able to maintain its most recent FY11E insurance margin guidance range of 8-10% due to anticipated reserve releases above last year's levels. We will be keen to gain as much information as possible as to the source and likely sustainability of these extra reserve releases. Improvement in IAG's 2H11 underlying margins should come from CGU and modest improvement in the UK.

- **Will we see underlying deterioration in Australia Direct?** — The Direct result will be significantly hit by catastrophes but it will be interesting to see whether there has been any underlying margin deterioration from its lofty level of 19% in 1H11. IAG claims to have gained market share in this division so we will be looking to see whether this required any margin surrender, given on an underlying basis it is likely currently over-earning in Direct.

- **Proof of Australia intermediated top and bottom line improvement** — At its recent strategy day IAG suggested that CGU was achieving both top and bottom line expansion. We therefore expect to see further improvement in the underlying intermediated result, and a return to growth for CGU.

- **New Zealand** — IAG’s allocation of its reinsurance cost between divisions will be key for the profitability of IAG NZ. NZ is likely to make a reported loss in 2H11, although IAG suggests respectable underlying profitability. This claim would be helped if IAG were to separately disclose reserve releases and natural peril costs as it does for its Australian divisions.

- **UK turnaround progress update** — Comments on rate growth and GWP contraction should clarify how much business IAG UK has surrendered. We expect a further fall in premiums in 2H11 but of a smaller magnitude to 1H11.

- **Asia newsflow** — IAG may be keen to talk up the initial growth experienced in its SBI JV (with FY11 being the first year of business for this JV). However this may begin to depress associate earnings in 2H11E.

- **Capital position should remain robust** — We expect IAG's capital position to be robust enough to justify a small capital return later this year.

- **Expecting a higher final dividend, but weaker than 1H11** — With IAG’s payout policy of 50% to 70% cash earnings on a full year basis, our forecast 2H11E dividend estimate is 6.0cps, a 33% improvement on the 4.5cps in pcp, but down 33% on the 9.0cps paid in 1H11.

IAG.AU (Y/E Jun)	2010A	2011E	2012E	2013E
Reported Profit (A$m)	91.0	245.6	646.0	756.9
Core Net Profit (A$m)	171.0	419.6	670.0	780.9
Core EPS (A¢)	8.2	20.2	32.2	37.6
Core EPS Growth (%)	-37.6	145.1	59.7	16.6
PE Ratio (x)	40.7	16.6	10.4	8.9
DPS (A¢)	13.0	15.0	32.0	24.0
Dividend Yield (%)	3.9	4.5	9.6	7.2
Franking Rate (%)	100.0	100.0	100.0	100.0
P/NTA (x)	2.9	2.7	2.4	2.2
ROE (%)	3.7	9.4	14.7	16.1

Source: Company Reports and dataCentral, CIRA.

IAG detailed financial summary

Financial Summary - Insurance Australia Group (IAG)

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Year ended 30 June	FY09A	1H10A	2H10A	FY10A	1H11A	2H11E	FY11E	FY12E	FY13E
Profit and loss statement (A$m)									
Gross written premium	7,842	3,863	3,919	7,782	3,936	4,051	7,987	8,335	8,767
Unearned premium movement	-124	9	-170	-161	2	-91	-89	-198	-224
Gross earned premium	**7,718**	**3,872**	**3,749**	**7,621**	**3,938**	**3,961**	**7,899**	**8,137**	**8,544**
Reinsurance expense	-485	-229	-327	-556	-228	-404	-632	-667	-648
Net earned premium	**7,233**	**3,643**	**3,422**	**7,065**	**3,710**	**3,556**	**7,266**	**7,470**	**7,895**
Gross claims incurred	-6,066	-2,577	-3,321	-5,898	-3,514	-3,050	-6,564	-5,706	-5,891
Reinsurance & other recoveries	696	242	584	826	1,155	320	1,475	599	619
Net claims incurred	**-5,370**	**-2,335**	**-2,737**	**-5,072**	**-2,359**	**-2,730**	**-5,089**	**-5,107**	**-5,273**
Underwriting expenses	-2,128	-1,030	-1,024	-2,054	-1,030	-959	-1,989	-1,988	-2,135
Underwriting result	**-265**	**278**	**-339**	**-61**	**321**	**-133**	**188**	**375**	**487**
Income on technical reserves	780	210	344	554	149	296	445	493	522
Insurance profit	**515**	**488**	**5**	**493**	**470**	**163**	**633**	**868**	**1,009**
Fee based business	4	9	-1	8	17	9	26	17	19
Investment in associates	6	2	0	2	0	-2	-2	0	4
Interest expense	-87	-43	-45	-88	-44	-41	-85	-82	-82
Income on shareholders' funds	-66	187	5	192	147	87	234	287	315
Profit before tax	**372**	**643**	**-36**	**607**	**590**	**216**	**806**	**1,090**	**1,265**
Tax	-47	-158	-179	-337	-223	-81	-304	-305	-354
Outside equity interests	-66	-58	-41	-99	-44	-39	-83	-115	-130
Core earnings	**259**	**427**	**-256**	**171**	**323**	**97**	**420**	**670**	**781**
Other items:									
Non-goodwill amortisation	-65	-12	-14	-26	-12	-12	-24	-24	-24
Profit on sale of Malaysian business	38								
Sub-debt repurchase profit / Financing restructu	66		119	119					
'The Buzz' establishment and lease provisions	-22								
Restructuring provision / charges	-30								
Impairment charges / loss on UK exit	-92	10	-87	-77	-150		-150		
Revaluation of RES embedded option	27	-96		-96					
Total other items (after tax)	**-77**	**-98**	**18**	**-80**	**-162**	**-12**	**-174**	**-24**	**-24**
Reported profit	**181**	**329**	**-238**	**91**	**161**	**85**	**246**	**646**	**757**
IAG definition of cash earnings	279	405	-379	382	359	97	456	670	781
Normalised reported profit	143	288	-207	81	149	125	274	646	757
Normalised core profit	221	386	-225	161	311	137	448	670	781
Growth in normalised core profit	-32%	9%	-158%	-27%	-238%	-56%	178%	50%	17%

Balance sheet (A$m)	**FY09A**	**1H10A**	**2H10A**	**FY10A**	**1H11A**	**2H11E**	**FY11E**	**FY12E**	**FY13E**
Cash and call deposits	344	387	416	416	413	413	413	413	413
Investment assets	10,563	11,540	11,734	11,734	11,810	11,666	11,666	12,568	13,391
Deferred acquisition costs	733	688	688	688	634	629	629	668	703
Intangibles (goodwill & other)	2,278	2,195	2,083	2,083	1,853	1,841	1,841	1,817	1,793
Receivables	2,126	1,896	2,046	2,046	1,876	1,861	1,861	1,976	2,080
Reinsurance recoveries	1,047	909	1,071	1,071	1,869	1,854	1,854	1,969	2,072
Other assets	2,224	2,142	2,408	2,408	2,327	2,327	2,327	2,327	2,327
Total assets	**19,315**	**19,757**	**20,446**	**20,446**	**20,782**	**20,592**	**20,592**	**21,738**	**22,778**
Outstanding claims	7,816	7,576	8,253	8,253	8,847	8,655	8,655	9,250	9,743
Unearned premium	4,072	4,033	4,207	4,207	4,117	4,208	4,208	4,405	4,629
Corporate debt	1,053	1,586	1,450	1,450	1,380	1,380	1,380	1,380	1,380
Other liabilities & provisions	1,538	1,522	1,880	1,880	1,780	1,780	1,780	1,780	1,780
Total liabilities	**14,479**	**14,717**	**15,790**	**15,790**	**16,124**	**16,023**	**16,023**	**16,815**	**17,532**
Net assets	**4,836**	**5,040**	**4,656**	**4,656**	**4,658**	**4,569**	**4,569**	**4,922**	**5,247**
Share capital net of treasury shares	5,271	5,298	5,295	5,295	5,295	5,295	5,295	5,295	5,295
Reserves	-11	-37	-34	-34	-92	-92	-92	-92	-92
Retained earnings	-589	-362	-775	-775	-692	-795	-795	-481	-203
Outside equity interests	165	154	170	170	147	160	160	201	246
Total shareholders' funds	**4,836**	**5,053**	**4,656**	**4,656**	**4,658**	**4,569**	**4,569**	**4,922**	**5,247**
NTA (excl. OEI)	**2,393**	**2,691**	**2,403**	**2,403**	**2,658**	**2,567**	**2,567**	**2,905**	**3,207**

	FY09A	1H10A	2H10A	FY10A	1H11A	2H11E	FY11E	FY12E	FY13E
Operating ratios									
Premium - group									
GWP growth on pcp	0.6%	-1.5%	0.0%	-0.8%	1.9%	3.4%	2.6%	4.4%	5.2%
GEP/GWP	98.4%	100.2%	95.7%	97.9%	100.1%	97.8%	98.9%	97.6%	97.5%
GEP growth on pcp	-0.6%	-1.5%	-1.0%	-1.3%	1.7%	5.6%	3.6%	3.0%	5.0%
NEP growth	-0.8%	-1.1%	-3.6%	-2.3%	1.8%	3.9%	2.8%	2.8%	5.7%
Key group expense ratios									
Net claims ratio	74.2%	64.1%	80.0%	71.8%	63.6%	76.8%	70.0%	68.4%	66.8%
Expense ratio	29.4%	28.3%	29.9%	29.1%	27.8%	27.0%	27.4%	26.6%	27.0%
Combined operating ratio	**103.7%**	**92.4%**	**109.9%**	**100.9%**	**91.3%**	**103.7%**	**97.4%**	**95.0%**	**93.8%**
Reinsurance ratio	6.3%	5.9%	8.7%	7.3%	5.8%	10.2%	8.0%	8.2%	7.6%
Group insurance margins									
Insurance margin	7.1%	13.4%	0.1%	7.0%	12.7%	4.6%	8.7%	11.6%	12.8%
Growth in insurance profit	31.4%	115.0%	-98.3%	-4.3%	-3.7%	large	28.4%	37.0%	16.3%
Effective tax rate	12.7%	24.6%	-497.2%	55.5%	37.8%	37.5%	37.7%	28.0%	28.0%
Divisional splits									
International division									
NEP growth	-10.3%	-13.2%	-21.9%	-17.2%	-6.5%	-1.5%	-4.3%	-3.4%	2.4%
Net claims ratio	68.2%	58.7%	100.7%	77.1%	68.5%	70.2%	69.2%	59.8%	57.9%
Expense ratio	31.4%	32.1%	45.9%	38.1%	36.5%	33.7%	35.2%	32.9%	32.9%
Combined operating ratio	**99.6%**	**90.7%**	**146.6%**	**115.3%**	**105.0%**	**103.8%**	**104.4%**	**92.7%**	**90.8%**
International insurance margin	4.9%	10.7%	-44.6%	-13.6%	-4.1%	-2.0%	-3.2%	8.7%	10.5%
Intermediated business									
NEP growth	0.2%	-2.7%	-6.3%	-4.5%	-2.0%	4.1%	0.9%	3.5%	4.6%
Net claims ratio	72.9%	59.8%	74.1%	66.7%	54.9%	75.5%	65.2%	64.0%	62.8%
Expense ratio	38.5%	34.9%	34.6%	37.0%	33.8%	34.6%	35.7%	35.7%	35.6%
Combined operating ratio	**111.3%**	**99.0%**	**97.1%**	**103.7%**	**96.2%**	**97.0%**	**100.9%**	**99.7%**	**98.4%**
Intermediated insurance margin	2.2%	10.2%	2.5%	6.5%	14.3%	-0.6%	6.9%	8.8%	10.1%
Direct business:									
NEP growth	5.1%	8.1%	8.6%	8.4%	8.9%	6.0%	7.4%	5.0%	7.6%
Net claims ratio	78.9%	69.8%	75.1%	72.5%	66.5%	80.0%	73.3%	74.2%	72.3%
Expense ratio	21.7%	20.4%	19.3%	19.8%	19.0%	19.3%	19.2%	18.9%	20.0%
Combined operating ratio	**100.7%**	**90.2%**	**94.4%**	**92.3%**	**85.5%**	**99.3%**	**92.4%**	**93.1%**	**92.3%**
Direct insurance margin	12.0%	16.9%	16.9%	16.9%	19.4%	10.1%	14.8%	14.4%	15.1%
Overall performance measures									
Return on average investments	7.0%	7.2%	6.0%	6.7%	5.0%	6.6%	5.8%	6.5%	6.5%
Return on average assets	0.9%	3.4%	-2.4%	0.5%	1.6%	0.8%	1.2%	3.1%	3.4%
Core return on average equity	**5.8%**	**17.8%**	**-10.9%**	**3.7%**	**14.4%**	**4.3%**	**9.4%**	**14.7%**	**16.1%**
Reported RoE	4.1%	13.8%	-10.1%	2.0%	7.2%	3.8%	5.5%	14.2%	15.6%
NTA/NAV									
NAV per share	2.27	2.36	2.17	2.17	2.18	2.13	2.13	2.28	2.41
NTA per share	1.16	1.30	1.16	1.16	1.29	1.24	1.24	1.40	1.54
Diluted NTA per share	1.16	1.29	1.16	1.16	1.28	1.23	1.23	1.40	1.53
Capital adequacy/MCR (A$m)									
Paid up ordinary shares	5,484	5,473	5,492	5,492	5,465	5,455	5,455	5,496	5,541
Hybrid equity	350	496	475	475	496	496	496	496	496
Reserves	-11	-37	-34	-34	-91	-92	-92	-92	-92
Retained earnings	-589	-362	-775	-775	-692	-795	-795	-481	-203
Excess technical provisions (net of tax)	438	482	522	522	454	435	435	462	486
Less: deductions	-2,689	-2,789	-2,513	-2,513	-2,326	-2,147	-2,147	-2,123	-2,099
Tier 1 capital	**2,983**	**3,263**	**3,167**	**3,167**	**3,306**	**3,353**	**3,353**	**3,757**	**4,130**
Tier 2	590	945	973	973	878	878	878	878	878
Total capital base	**3,573**	**4,208**	**4,140**	**4,140**	**4,184**	**4,231**	**4,231**	**4,635**	**5,008**
Minimum capital requirement	1,997	2,070	2,154	2,154	2,315	2,319	2,319	2,462	2,591
MCR multiple (amended target 1.5x)	**1.79**	**2.03**	**1.92**	**1.92**	**1.81**	**1.82**	**1.82**	**1.88**	**1.93**
Excess over target	577	1,103	909	909	712	753	753	943	1,121

Financial Summary - Insurance Australia Group (IAG)

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Stock information	
Recommendation	Hold / Medium Risk
Market cap. (A$m)	7,630
Market cap. (US$m) A$1 = US$1.0827	8,261
Current price (A$ per share)	3.42
Average daily volume (m shares)	7.25
Valuation data	
Citi spot valuation per share	3.70
Price: FY10A NTA at valuation	3.2

	FY09A	1H10A	2H10A	FY10A	1H11A	2H11E	FY11E	FY12E	FY13E
Valuation parameters									
Based on core earnings after tax									
Basic EPS (¢)	13.3	20.7	-12.4	8.3	15.6	4.7	20.3	32.4	37.7
PER (x)	25.7	8.3	-13.8	41.3	10.9	36.6	16.9	10.6	9.1
Fully diluted EPS (¢)	**13.2**	**20.6**	**-12.3**	**8.2**	**15.5**	**4.6**	**20.2**	**32.2**	**37.6**
Growth (%)	92.3%	142.8%	-159.8%	-37.6%	-226.2%	-70.1%	145.1%	59.7%	16.6%
PER (x)	25.9	8.3	-13.9	41.5	11.0	36.8	16.9	10.6	9.1
PE Rel (All Ords.) (x)	2.1	0.7	-1.2	3.6	0.9	3.3	1.5	1.0	0.9
Based on reported profit									
Fully diluted EPS (¢)	9.3	15.9	-11.4	4.4	7.75	4.1	11.8	31.1	36.4
Growth (%)	large	82.2%	-172.2%	-52.6%	-167.7%	-47.5%	169.6%	163.0%	17.2%
PER (x)	37.0	10.8	-14.9	78.1	22.1	42.0	29.0	11.0	9.4
Based on business profit									
Business profit	525	499	4	503	487	170	657	884	1,031
Normalised tax	-152	-150	-1	-151	-146	-51	-197	-265	-309
Business profit after tax	373	349	3	352	341	119	460	619	722
After tax business profit per share	19.0	16.8	0.1	17.0	16.4	5.7	22.1	29.8	34.7
Growth (%)	21.1%	67.2%	-99.2%	-10.6%	large	-65.2%	30.3%	34.6%	16.7%
PER (x)	11.9	6.3	838.1	13.3	6.5	19.1	9.9	6.8	5.4
Price to book/NTA									
Price to book (x) - exclude OEI and hybrid	1.5	1.4	1.6	1.6	1.6	1.6	1.6	1.5	1.4
Price to NTA (less goodwill)	2.9	2.6	2.9	2.9	2.7	2.8	2.8	2.4	2.2
Price to diluted NTA (x) (less goodwill & prefs)	3.0	2.6	3.0	3.0	2.7	2.8	2.8	2.4	2.2
Dividend data									
DPS (¢)	10.0	8.5	4.5	13.0	9.0	6.0	15.0	22.0	24.0
DPS growth (%)	-55.6%	112.5%	-25.0%	30.0%	-170.6%	33.3%	15.4%	46.7%	9.1%
Yield (%)	2.9%	5.0%	2.6%	3.8%	5.3%	3.5%	4.4%	6.4%	7.0%
Franking (%)	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Payout ratio on reported profit (%)	110.2%	53.7%	-39.3%	297.0%	116.2%	147.5%	127.0%	70.8%	65.9%
Payout ratio on core profit (%)	77.2%	41.4%	-36.5%	158.1%	57.9%	129.2%	74.3%	68.3%	63.9%
Payout ratio on cash earnings (%)	71.5%	43.6%	-24.7%	70.8%	52.1%	129.2%	68.5%	68.3%	63.9%
Special DPS								10.0	

Shareholder information
Substantial shareholders at 3 March 2011

Blackrock	5.1%
NAB	5.0%

Other

DRP (discount):	Yes (No)
Index weightings	
All Ords	0.5%
S&P ASX 200	0.6%
Insurance	13.0%

	FY09A	1H10A	2H10A	FY10A	1H11A	2H11E	FY11E	FY12E	FY13E
Technical reserves (A$m)									
Claims reserves	7,816	7,576	8,253	8,253	8,847	8,655	8,655	9,250	9,743
Unearned premium reserve	4,072	4,033	4,207	4,207	4,117	4,208	4,208	4,405	4,629
DAC	-733	-688	-688	-688	-634	-629	-629	-668	-703
Reinsurance recoverables	-1,047	-909	-1,071	-1,071	-1,869	-1,854	-1,854	-1,969	-2,072
Insurance receivables	-2,108	-2,112	-2,301	-2,301	-2,361	-2,343	-2,343	-2,487	-2,617
Total technical reserves	**8,000**	**7,900**	**8,400**	**8,400**	**8,100**	**8,037**	**8,037**	**8,532**	**8,979**
Growth in technical reserves	5.3%	-1.3%	6.3%	5.0%	-3.6%	-0.8%	-4.3%	6.2%	5.2%
Solvency and gearing ratios									
Solvency ratios									
NTA (incl. OEI)/NEP	33.1%	36.9%	35.1%	34.0%	35.8%	36.1%	35.3%	38.9%	40.6%
NTA (excl. OEI)/NEP	30.8%	34.8%	32.6%	31.6%	33.8%	33.8%	33.1%	36.2%	37.5%
Claims solvency (incl. OEI)	61.9%	66.7%	56.4%	56.4%	52.7%	52.8%	52.8%	53.2%	53.9%
Claims solvency (excl. OEI)	59.8%	64.7%	54.4%	54.4%	51.0%	50.9%	50.9%	51.0%	51.3%
Technical reserves									
Technical reserves/NTA	334.3%	293.6%	349.6%	349.6%	304.7%	313.0%	313.0%	293.7%	280.0%
Technical reserves/investments	75.7%	68.5%	71.6%	71.6%	68.6%	68.9%	68.9%	67.9%	67.1%
Gearing									
Gross debt/equity (ex OEI, incl. pref)	22.5%	32.4%	32.3%	32.3%	30.6%	31.3%	31.3%	29.2%	27.6%
Debt:(Market cap + debt)	12.1%	17.2%	16.0%	16.0%	15.3%	15.3%	15.3%	15.3%	15.3%
Debt/total tangible capitalisation	29.2%	35.7%	36.0%	36.0%	33.0%	33.6%	33.6%	30.8%	28.6%
Capital structure									
No. shares on issue (m)									
B/f no. of shares	1,878.3	2,071.4	2,079.0	2,071.4	2,079.0	2,079.0	2,079.0	2,079.0	2,079.0
- placement/SPP etc	178.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
- DRP	15.0	7.6	0.0	7.6	5.7	11.4	17.1	20.3	29.2
- share buyback	0.0	0.0	0.0	0.0	-5.7	-11.4	-17.1	-20.3	-29.2
C/f no. of shares*	**2,071.4**	**2,079.0**	**2,079.0**	**2,079.0**	**2,079.0**	**2,079.0**	**2,079.0**	**2,079.0**	**2,079.0**
Dilution for options etc	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	13.9
Diluted shares on issue*	**2,071.4**	**2,079.0**	**2,079.0**	**2,079.0**	**2,079.0**	**2,079.0**	**2,079.0**	**2,079.0**	**2,092.9**
Weighted ave. basic*	1,948.0	2,062.7	2,067.0	2,065.0	2,068.0	2,068.0	2,068.0	2,068.0	2,073.5
Weighted ave. diluted*	1,961.0	2,075.2	2,079.0	2,077.0	2,078.7	2,079.0	2,079.0	2,079.0	2,079.0
Investments									
Investment asset allocation - technical reserves									
- Fixed interest	99.8%	99.8%	99.8%	99.8%	99.8%	99.8%	99.8%	99.8%	99.8%
- Cash	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
- Other	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%
Total	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**
Investment asset allocation - shareholders' funds									
- Australian equities	15.4%	14.4%	19.4%	19.4%	19.8%	20.0%	20.0%	20.0%	20.0%
- Listed property trusts	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
- International equities	6.2%	9.5%	17.7%	17.7%	20.4%	5.0%	5.0%	5.0%	5.0%
- Fixed Interest	78.4%	76.1%	62.9%	62.9%	59.8%	50.0%	50.0%	50.0%	50.0%
- Hedge Funds	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
- Cash	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Total	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**100.0%**	**75.0%**	**75.0%**	**75.0%**	**75.0%**

Source: Company reports and Citi Investment Research and Analysis estimates

Latest company and industry research

Figure 18. Insurance research published between 2 February 2011 and 25 July 2011

Date	Pages	Headline
22-Jul-2011	12	AMP Ltd (AMP.AX): Markets to dent 1H11 EPS but synergies should help from FY12
22-Jul-2011	12	Suncorp Group Ltd (SUN.AX): NPAT in line but EPS significantly higher than consensus
6-Jul-2011	44	Reinsurance in Australia and NZ: Risk profile changes for IAG and SUN; QBE's timing impeccable
1-Jul-2011	7	Alert: Suncorp Group Ltd (SUN.AX) - New reinsurance programme should alleviate some fears
30-Jun-2011	7	Alert: Insurance Australia Group Ltd (IAG.AX) - NZ cost clarified, MER now A$165m
28-Jun-2011	20	NIB Holdings Ltd (NHF.AX): Deliberately disruptive
15-Jun-2011	40	NIB Holdings Ltd (NHF.AX): Value in Health Insurance
15-Jun-2011	13	Plan for Life FuM and Fund Flows: Challenger flows make up the difference
15-Jun-2011	28	Insurance Australia Group Ltd (IAG.AX): Higher reinsurance costs already here plus 2H dividend risk
15-Jun-2011	20	QBE Insurance Group Ltd (QBE.AX): Large Losses Take Margins To A New Low Despite High FX Gains
30-May-2011	24	Suncorp Group Ltd (SUN.AX): More claims dent 2H11; but hope of progress thereafter remains
30-May-2011	24	Tower Ltd (TWR.NZ): Travelling sideways
12-May-2011	28	Suncorp Group Ltd (SUN.AX): Cause for Encouragement Especially Given the Backdrop
12-May-2011	7	Alert: Suncorp Group Ltd (SUN.AX) - Impaired assets and charges both fall
10-May-2011	16	Tower Ltd (TWR.NZ): Pain now, some optimism for later
6-May-2011	24	Suncorp Group Ltd (SUN.AX): Cleaning up Our Forecasts Ahead of APS 330
6-May-2011	28	NZ Insurance: Life Insurance and Wealth Management (including KiwiSaver): Life new business profitability under near term pressure
5-May-2011	25	AMP Ltd (AMP.AX): Value vs. near term EPS, regulation, retail sentiment and markets
5-May-2011	36	NZ Insurance: General and Health Insurance: Market appears to be turning, which should help profit in time
5-May-2011	7	Alert: AMP Ltd (AMP.AX) - Poor retail sentiment and SME sector weakness hurt flows
29-Apr-2011	16	Wealth Management/Risk Insights: FoFA May Make Risk Sales Harder To Generate
28-Apr-2011	5	Alert: Wealth Management/Risk Insights - FoFA risk decision will surprise some
19-Apr-2011	11	AMP Ltd (AMP.AX): FoFA Reforms May Favour AMP Relative to IFAs etc
19-Apr-2011	48	Trends in Wealth Management: Six FoFA contentious issues to be addressed
8-Apr-2011	16	AMP Ltd (AMP.AX): Accelerated timing and/or increased quantity should help EPS
5-Apr-2011	19	QBE Insurance Group Ltd (QBE.AX): Upgrade brings relief but not much to capitalise beyond FY11E
5-Apr-2011	7	Alert: QBE Insurance Group Ltd (QBE.AX) - Upgrades NEP guidance with higher crop prices and FX
16-Mar-2011	11	Plan for Life FuM and Fund Flows: Retirement income products beat super for 2010 FuM growth
14-Mar-2011	11	Tower Ltd (TWR.NZ): Earthquake impact more severe than Tower's initial estimates
10-Mar-2011	6	AXA Asia Pacific Holdings Ltd (AXA.AX): Discontinuing Coverage
2-Mar-2011	4	Insurance and Diversified Financials Strategy: Making clear our stock preferences and the reasons why
1-Mar-2011	34	QBE Insurance Group Ltd (QBE.AX): Margin questions not all answered and mix harder to fathom
28-Feb-2011	7	Alert: QBE Insurance Group Ltd (QBE.AX) - Europe drops markedly 2H vs. 1H and low ETR helps again
25-Feb-2011	32	Insurance Australia Group Ltd (IAG.AX): Not much evidence of underlying margin expansion
24-Feb-2011	7	Alert: Insurance Australia Group Ltd (IAG.AX) - Underlying margin still looks a little shy on 2H10
24-Feb-2011	36	Suncorp Group Ltd (SUN.AX): Turnaround still firmly on track despite the difficult backdrop
23-Feb-2011	7	Alert: Suncorp Group Ltd (SUN.AX) - Ahead on bottom line and respectable overall
23-Feb-2011	6	Alert: Insurance Australia Group Ltd (IAG.AX) - Another downgrade to guidance
18-Feb-2011	35	AMP Ltd (AMP.AX): Value attractions should shine through after a solid enough result
17-Feb-2011	7	Alert: AMP Ltd (AMP.AX) - Mostly in line: solid but subdued by market conditions
14-Feb-2011	18	Insurance Australia Group Ltd (IAG.AX): Further UK issues likely to inhibit near term advance
14-Feb-2011	7	Alert: Insurance Australia Group Ltd (IAG.AX) - UK causes further problems
5-Feb-2011	24	QBE Insurance Group Ltd (QBE.AX): Accretive Balboa acquisition takes attention off rocky 2H margin
4-Feb-2011	8	Insurance Australia Group Ltd (IAG.AX): Adverse 2H Perils Variance Looking Likely
2-Feb-2011	52	Insurance/Diversified Financials Strategy and Previews: CATs shouldn't turn insurers into longer-term dogs

Source: Citi Investment Research and Analysis

Notes

Notes

Appendix A-1

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The research analyst(s) primarily responsible for the preparation and content of this research report are named in bold text in the author block at the front of the product except for those sections where an analyst's name appears in bold alongside content which is attributable to that analyst. Each of these analyst(s) certify, with respect to the section(s) of the report for which they are responsible, that the views expressed therein accurately reflect their personal views about each issuer and security referenced and were prepared in an independent manner, including with respect to Citigroup Global Markets Inc and its affiliates. No part of the research analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst in this report.

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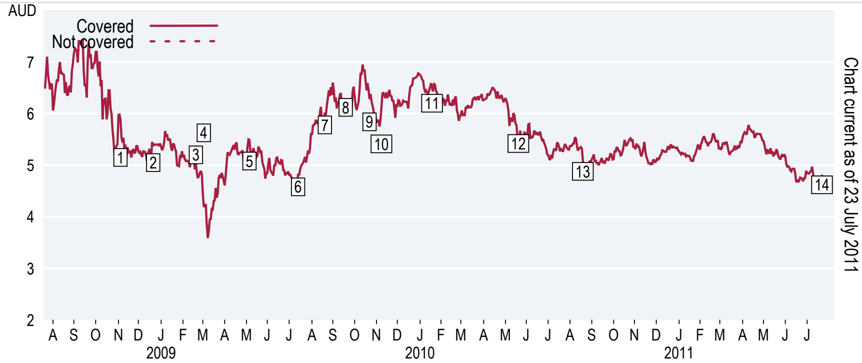
Ratings and Target Price History
Fundamental Research

Analyst: Nigel Pittaway



	Date	Rating	Target Price	Closing Price
1	5-Nov-08	*2M	6.00	5.89
2	22-Dec-08	2M	*5.50	5.37
3	19-Feb-09	2M	*5.30	5.05
4	3-Mar-09	2M	*4.40	4.19
5	6-May-09	*3M	*4.90	5.49
6	14-Jul-09	*2M	*4.80	4.83
7	20-Aug-09	2M	*6.20	6.02
8	18-Sep-09	2M	*6.60	6.25
9	22-Oct-09	2M	*6.75	6.28
10	9-Nov-09	*1M	6.75	6.12
11	19-Jan-10	*2M	*7.00	6.50
12	20-May-10	*1M	*6.50	5.46
13	19-Aug-10	1M	*6.10	5.09
14	22-Jul-11	1M	*5.80	4.80

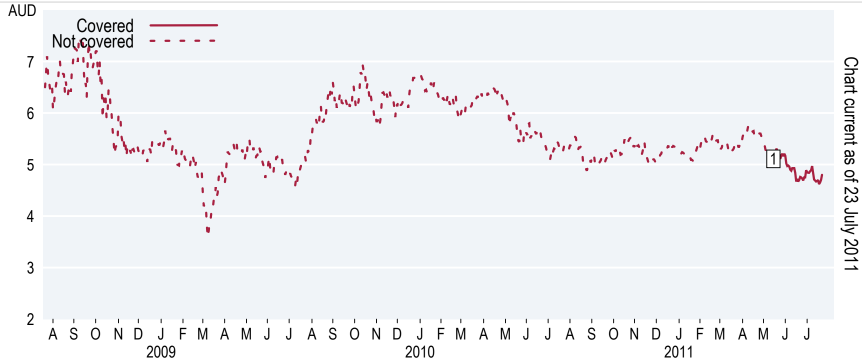
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

AMP Ltd (AMP.AX)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Nigel Pittaway



	Date	Rating	Target Price	Closing Price
1	15-May-11	*ADD MP	-	5.25

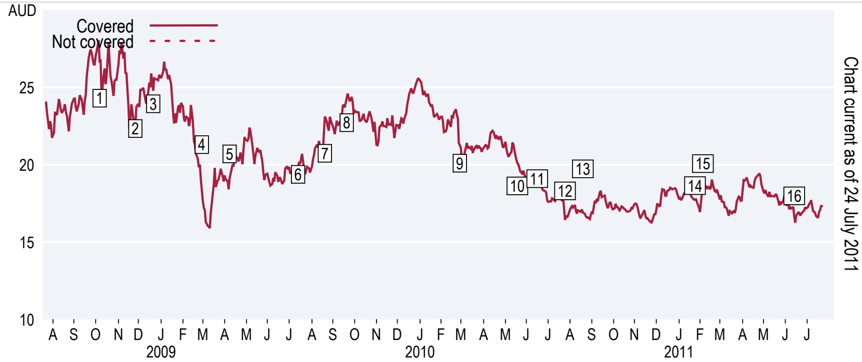
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

QBE Insurance Group Ltd (QBE.AX)

Ratings and Target Price History
Fundamental Research

Analyst: Nigel Pittaway



Date	Rating	Target Price	Closing Price
1 7-Oct-08	2M	*28.50	26.69
2 26-Nov-08	2M	*25.00	22.50
3 22-Dec-08	2M	*25.50	24.79
4 27-Feb-09	2M	*18.50	19.06
5 8-Apr-09	2M	*19.00	19.12
6 14-Jul-09	2M	*20.00	19.80
7 20-Aug-09	2M	*22.00	23.12
8 21-Sep-09	*1M	*26.50	24.31
9 26-Feb-10	1M	*24.50	21.40
10 19-May-10	1M	*23.00	20.11
11 16-Jun-10	1M	*21.50	18.68
12 26-Jul-10	1M	*19.50	16.43
13 19-Aug-10	*2M	*18.00	16.91
14 25-Jan-11	2M	*18.20	17.74
15 4-Feb-11	2M	*19.60	18.20
16 14-Jun-11	2M	*18.25	16.65

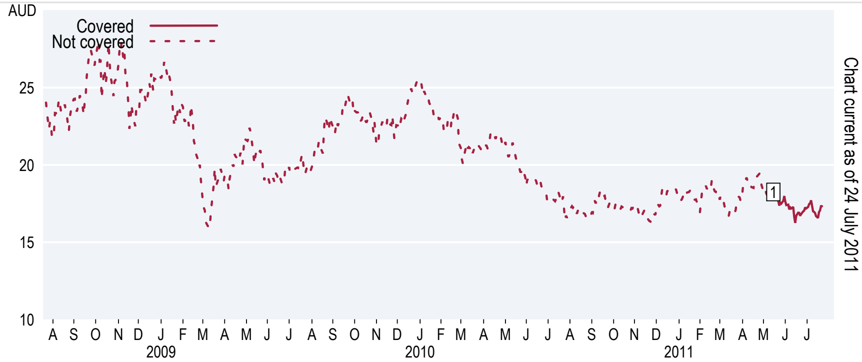
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

QBE Insurance Group Ltd (QBE.AX)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Nigel Pittaway



Date	Rating	Target Price	Closing Price
1 15-May-11	*ADD LP	-	17.99

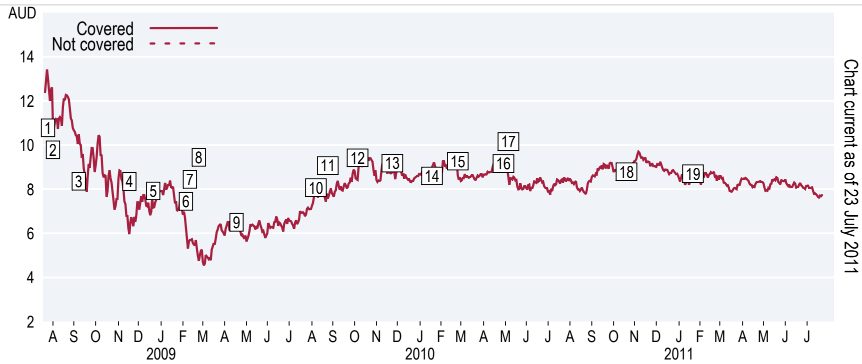
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Suncorp Group Ltd (SUN.AX)

Ratings and Target Price History
Fundamental Research

Analyst: Nigel Pittaway



Date	Rating	Target Price	Closing Price
1 24-Jul-08	1M	*14.38	13.42
2 1-Aug-08	*2M	*11.32	10.88
3 8-Sep-08	2M	*9.90	10.49
4 18-Nov-08	*1H	*7.07	5.96
5 22-Dec-08	1H	*8.49	7.17
6 5-Feb-09	1H	*5.66	6.73
7 11-Feb-09	1H	*6.00	5.70
8 24-Feb-09	1H	*5.50	4.75
9 17-Apr-09	*2H	*6.60	6.50
10 7-Aug-09	*3H	*7.40	7.90
11 25-Aug-09	*2H	*7.50	7.58
12 6-Oct-09	2H	*9.00	8.42
13 24-Nov-09	2H	*9.25	8.78
14 19-Jan-10	*1M	*10.00	8.99
15 24-Feb-10	*2M	*9.00	8.62
16 29-Apr-10	2M	*9.50	8.90
17 6-May-10	*1M	9.50	8.53
18 20-Oct-10	1M	*10.00	8.91
19 21-Jan-11	1M	*9.75	8.42

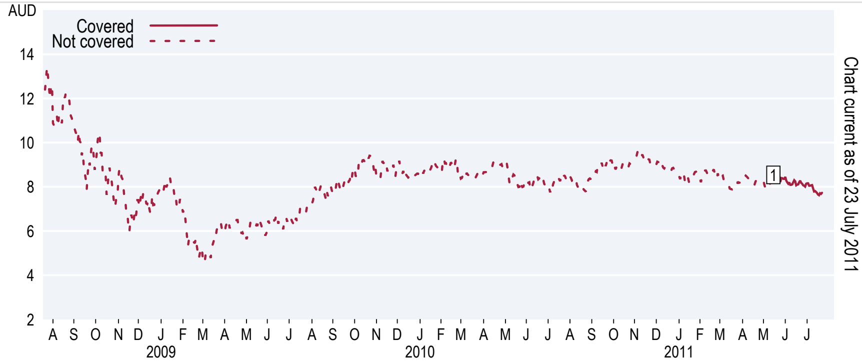
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Suncorp Group Ltd (SUN.AX)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Nigel Pittaway



	Date	Rating	Target Price	Closing Price
1	15-May-11	*ADD MP	-	8.45

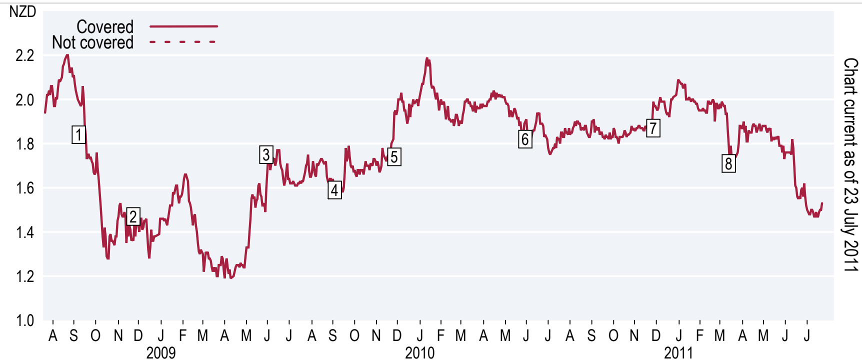
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Tower Ltd (TWR.NZ)

Ratings and Target Price History
Fundamental Research

Analyst: Mark Tomlins
Covered since July 7 2011



	Date	Rating	Target Price	Closing Price
1	8-Sep-08	2H	*2.00	1.99
2	23-Nov-08	2H	*1.52	1.37
3	29-May-09	*1H	*1.90	1.60
4	3-Sep-09	1H	*2.00	1.60
5	26-Nov-09	1H	*2.25	1.94
6	30-May-10	*2H	*2.10	1.89
7	26-Nov-10	2H	*2.20	1.99
8	14-Mar-11	2H	*1.90	1.79

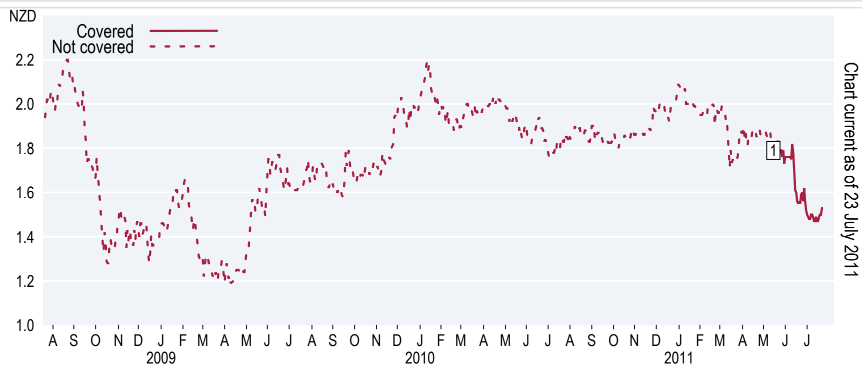
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

Tower Ltd (TWR.NZ)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Mark Tomlins
Covered since July 7 2011



	Date	Rating	Target Price	Closing Price
1	15-May-11	*ADD LP	-	1.83

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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