

medibank



2019 Half Year Results Investor Presentation

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Friday 15 February 2019



Highlights

Craig Drummond – Chief Executive Officer

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1H19 results summary

Solid performance delivering better outcomes for customers alongside sound returns for shareholders

Group operating profit

\$293.0m

↑ 2.4%

Group NPAT

\$207.7m

↓ 15.4%

Interim dividend

5.70cps

↑ 3.6%

- \$2.7 billion in benefits paid to customers
- Strong improvement in customer advocacy. Medibank Service NPS¹ of 24 (+8) compared to the prior period and ahm Service NPS was 35 (+5) over the same period
- Good momentum in policyholder growth with 6,400 new resident policyholders since 30 June 2018. This reflects our successful dual brand strategy, the strong recovery of the Medibank brand and improved customer retention
- Health Insurance result (\$281.5m, +1.5%) reflects:
 - Premium revenue \$3,240.3m, up 2.1%
 - Management expense ratio 8.5%, down from 8.6% in 1H18
 - Operating margin 8.7%, unchanged from 1H18
- Medibank Health operating profit up 14.7% to \$28.9m or up 38.5% to \$12.6m on a continuing basis
- Net investment income \$4.1m, down from \$59.7m in 1H18 and in-line with relevant indices

Milestone scorecard – 1H19 update

Good progress with all milestones on track and a new Medibank Health milestone set beyond FY19

Objectives

1. Customer advocacy

Drive Service and Customer NPS for Medibank and ahm to be best in class¹

2. Health interactions

By 2020 every Medibank customer³ has at least one health interaction⁴ through the year with our company

3. Market share

To grow market share in FY19

4. Medibank at Home

More than double the number of customers receiving Medibank at Home⁵ services in FY19

5. Medibank Health

More than double Medibank Health's segment share of operating profit from FY16 to FY19

6. Productivity

3 year target of \$60m

1H19 update

Customer NPS (Gap to peers)

Continued improvement

	Avg Service NPS	
	1H18	1H19
Medibank	+15.6	+23.6
ahm	+30.4	+35.5

PHIO complaints

1H19: 21.0% share

Customer cover check-ins²

1H19: c. 230,000

FY17	FY18	1H19	FY20
<100k	c. 500k	c. 670k	target c.1.5 million

Policyholder growth

30 Jun 18 / 31 Dec 18

+0.4% / +6.4k

Market share

1H18	2H18	1H19
down 13bps	up 5bps	up 2bps

FY18	1H19	FY19
936 customers	1,004 customers	target 2,000 customers

FY16	FY17	FY18	1H19
4.6%	6.7%	8.1%	9.3%

Revised milestone:

To organically replace the reported FY18 operating profit of Garrison by FY22

FY18	FY19 - FY20 ⁶
\$20m productivity delivered	On track to deliver \$20m in productivity in FY19 and FY20

1 Against major private health insurance peers (Bupa, HCF, nib) by the end of CY19
 2 Inbound or outbound conversations with customers about the appropriateness of their cover
 3 Based on number of policyholders that consent to contact for marketing purposes, some exclusions may apply. Excludes new joins and customer lapses over the period

4 Includes CareComplete, Medibank at Home, Health Concierge, Health Advice Line, and personalised health communications
 5 Excludes Home Support Services (HSS) which was acquired by Medibank on 29 August 2018
 6 We expect to provide an update on additional productivity initiatives at the FY19 result

Strategy and FY19 priorities

Medibank's strategy remains unchanged, focused on growing PHI by leveraging our dual brands, building competitive advantage in our customer offering and transforming into a broader health services company

Better Health for Better Lives			
Strategic pillar	Deliver differentiated products and services for customers	Continue to improve healthcare value for customers	Expand the offering for customers and grow the business
FY19 priorities	<ul style="list-style-type: none"> Personalise and integrate health into our customers' experience Simplify and enhance our cover options Enhance loyalty offering to recognise and reward membership 	<ul style="list-style-type: none"> Focus on reducing low value care and improving customer health outcomes by providing greater choice and transparency Lead health system reform Expand the scope of our payment integrity program 	<ul style="list-style-type: none"> Strengthen and broaden our partnerships Grow corporate, non-resident and diversified portfolios Health services expansion – build scale and grow capability Investment in core enablers (below)
Enablers	People Data Simplicity		

Private Health Insurance

We have a clear strategy to deliver an exceptional customer experience through differentiated products and services



Differentiation	Value	Growth
<p>Personalising the customer experience</p> <ul style="list-style-type: none">Strengthening of digital member services for both brandsAutomate platform to drive proactive, personalised contact and support <p>Recognition and reward through health and wellbeing program</p> <ul style="list-style-type: none">Rolled out Medibank's Priority program, recognising our most loyal customersLive Better rewards to be launched mid year – rewarding members for healthy choices <p>Health support and services</p> <ul style="list-style-type: none">Expanded Health Concierge and Hospital Assist tools to include additional services and channelsHealth promotions expanded to include new campaignsRoll-out of in-home care for Medibank customers	<p>Product value</p> <ul style="list-style-type: none">Lowest average premium increase in 18 yearsReinforcing product differentiators through reform changesSegment focused Right Cover program continues <p>Better value networks</p> <ul style="list-style-type: none">Launched new Members Choice Advantage dental network in January 2019 <p>Contracting with healthcare providers</p> <ul style="list-style-type: none">Continuing to progress value based purchasing to deliver the best customer outcomesWorking with government and private providers to drive structural health system changes	<p>Resident policyholder growth</p> <ul style="list-style-type: none">Maintaining momentum in turnaround within the Medibank brandDual brand retention program continues <p>Non-resident customers</p> <ul style="list-style-type: none">Strategy to differentiate through service, product (health and wellbeing) and partnerships <p>Partnerships</p> <ul style="list-style-type: none">Continued investment in partnerships to broaden and strengthen relationships <p>Acquisitions</p> <ul style="list-style-type: none">We will consider acquiring a PHI business in a stressed operating environment

2019 reform

Upcoming reform is a real opportunity to improve the transparency, simplicity and affordability of PHI

Mandatory reform	Optional reforms		
gold / silver / bronze / basic product standardisation ¹	Young adult discounts	Higher excess	Rural and regional travel allowances
Outcomes			
<ul style="list-style-type: none">• Customers will have more informed choices and be more easily able to compare products across funds	<ul style="list-style-type: none">• Improves affordability among younger customers• c. 150,000 customers will be given a discount of up to 10% from 1 April 2019• Discount is expected to be largely offset by overall policyholder growth and customer retention	<ul style="list-style-type: none">• Provides a lower price point improving affordability for customers• Lower premiums will be partially offset by policyholder growth and improved customer retention	<ul style="list-style-type: none">• Provides an additional benefit for customers with hospital cover who have to travel more than 200km for treatment

- No material ongoing financial impact of gold / silver / bronze / basic with an implementation approach designed to minimise disruption to customers
- We expect to communicate these important changes to all of our customers by April 2020
- One-off reform implementation cost of \$10m expected in FY19 (included in Health Insurance management expenses)
- We have re-prioritised our FY19 investment slate to offset the majority of this additional cost

¹ Mandatory reforms also include the removal of some natural therapies with 100% of this benefit to be passed onto customers

Medibank Health

Our strategy and our ability to execute is unchanged. We will continue to build scale and capability in healthcare delivery

In-home care

- Delivered by MHS, HealthStrong and Home Support Services (HSS)
- Trials continue in dialysis, chemotherapy, reconditioning rehab, palliative care and infusions
- Planned expansion of rehabilitation program
- Home Care Packages, Commonwealth Home Support Program, State Government programs, allied health programs, and private services
- Services provided to multiple payers, both public and private
- HSS delivered over 1,300 episodes of care to Medibank customers in the first half. Combined with Medibank at Home, this equates to almost 3,000 episodes of care and more than 28,000 days of service
- HSS acquisition brought 297 additional employees with a large network of 1,500 contractors

Telehealth

- Stable operating performance with broad spread of contracts
- Increasingly leveraging Telehealth capabilities into Medibank PHI

CareComplete

- Spectrum of prevention programs targeted at patients with a chronic condition, to reduce unnecessary hospital utilisation
- Services provided to multiple payers, both public and private
- Increasingly leveraged by Medibank PHI

Provider network and claims management

- Leverage existing capabilities that are currently deployed for Medibank PHI into other payers

Growth

- Organic growth of HSS and HealthStrong into new states and regions. This will create additional synergies with our PHI business
- We continue to consider M&A opportunities to build out our health services capability

Diversified Insurance

- Increase product breadth and value
- Broaden our customer relationships through integrated promotions

Financial results

Mark Rogers – Chief Financial Officer

Group financial summary

Six months ended 31 Dec (\$m)	1H19	1H18	Change
Health Insurance premium revenue	3,240.3	3,175.1	2.1%
Medibank Health revenue ¹	320.6	291.9	9.8%
Revenue	3,560.9	3,467.0	2.7%
Health Insurance operating profit	281.5	277.3	1.5%
Medibank Health operating profit	28.9	25.2	14.7%
Segment operating profit	310.4	302.5	2.6%
Corporate overheads	(17.4)	(16.4)	6.1%
Group operating profit	293.0	286.1	2.4%
Net investment income	4.1	59.7	n.m.
Amortisation of intangibles	(3.8)	(3.5)	8.6%
Other income/(expenses)	(2.9)	3.8	n.m.
Profit before tax	290.4	346.1	(16.1%)
Income tax expense	(82.7)	(100.5)	(17.7%)
NPAT	207.7	245.6	(15.4%)
Effective tax rate	28.5%	29.0%	(50 bps)
EPS (cents)	7.5	8.9	(15.4%)
Underlying² NPAT	232.8	234.4	(0.7%)
Underlying ² EPS (cents)	8.5	8.5	(0.7%)
Dividend per share (cents)	5.70	5.50	3.6%
Dividend payout ratio	67%	65%	3.1%

¹ Net of intercompany eliminations

² Dividend payout ratio based on underlying NPAT, refer to appendix slide 28

Health insurance result

Continued improvement in operating performance

Six months ended 31 Dec (\$m)	1H19	1H18	Change
Premium revenue	3,240.3	3,175.1	2.1%
Claims expense	(2,699.7)	(2,655.0)	1.7%
Risk equalisation	15.2	30.4	(50.0%)
Net claims expenses	(2,684.5)	(2,624.6)	2.3%
Gross profit	555.8	550.5	1.0%
Management expenses	(274.3)	(273.2)	0.4%
Operating profit	281.5	277.3	1.5%
Gross margin ¹	17.2%	17.3%	(10bps)
MER ¹	8.5%	8.6%	(10bps)
Operating margin ^{1,2}	8.7%	8.7%	-

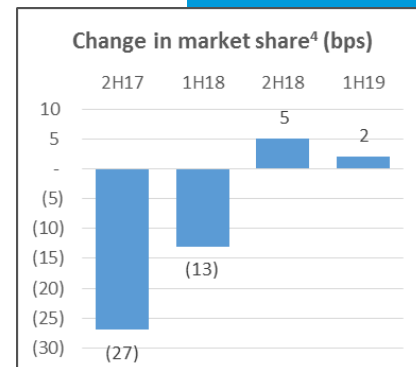
1 Includes Australian residents, OSHC and OVHC. The gross margin for Australian residents only was 16.8% in 1H18 and 16.5% in 1H19, the MER for Australian residents only was 8.4% in 1H18 and 8.1% in 1H19, and the operating margin for Australian residents only was 8.4% in 1H18 and 8.4% in 1H19

2 The reported result includes the benefit of a \$10.3 million provision release relating to the FY18 provision. By way of comparison, in 1H18, the benefit relating to the FY17 release was \$33.8 million

Health insurance – policyholders

Encouraging resident policyholder growth of 0.9% over the last 12 months

Six months ended 31 Dec	1H19	1H18	Change
Policyholders¹ (thousand):			
Opening balance	1,780.9	1,776.1	0.3%
Acquisitions	94.9	88.3	7.5%
Lapses	(88.5)	(92.5)	(4.3%)
Closing balance	1,787.3	1,771.9	0.9%
- Medibank	1,410.8	1,431.9	(1.5%)
- ahm	376.5	340.0	10.7%
Acquisition rate²	5.3%	5.0%	30bps
- Medibank	4.1%	3.6%	50bps
- ahm	11.0%	12.0%	(100bps)
Lapse rate²	5.0%	5.2%	(20bps)
- Medibank	4.8%	5.0%	(20bps)
- ahm	6.9%	7.5%	(60bps)
Policyholder growth	0.4%	(0.2%)	60bps
Total Policy Units^{1,3} (thousand)			
Closing balance	4,678.4	4,662.9	0.3%
Average balance	4,680.0	4,671.8	0.2%
Annualised average revenue per policy unit^{1,3} (\$)	1,384.8	1,359.3	1.9%



1 Consistent with reported industry data, policyholder numbers only include resident business whereas total policy units include both resident and non-resident policyholders (i.e. OSHC and OVHC)

2 Consolidated lapse and acquisition rates exclude transfers of policyholders between ahm and Medibank at a combined brand level. Figures at brand level include these transfers. Lapse and acquisition rates are based on the average of the opening and closing balances for the period

3 Refer to glossary for definition of policy units

4 APRA market share data – Medibank Group

Health insurance – claims

Underlying average net claims expense per policy unit up 2.1%

- Hospital Claims – up 2.2%, reflecting:
 - Subdued utilisation growth rate of 1.1%
 - Slowing hospital claims growth due to changing case mix, savings from Medibank at Home program and improved hospital contracting outcomes
 - Reducing reliance on risk equalisation receipts reflecting ahm growth
- Extras Claims – up 2.5%
 - Growth moderated compared to 4.1% in 1H18, which reflected:
 - Investment in additional product benefits
 - Live limits which enabled customers to better utilise and understand services available

Six months ended 31 Dec (\$m)	1H19	1H18	Change	Change Per PSEU adjusted for provision release
Claims expense	(2,699.7)	(2,655.0)	1.7%	
Risk equalisation	15.2	30.4	(50.0%)	
Net claims expense (includes risk equalisation)	(2,684.5)	(2,624.6)	2.3%	
- Hospital	(2,037.6)	(1,993.3)	2.2%	1.8%
- Extras	(646.9)	(631.3)	2.5%	3.2%
Annualised average net claims expense per policy unit¹ (\$)	(1,147.2)	(1,123.6)	2.1%	2.1%
Resident hospital utilisation growth ²	1.1%	0.8%	30 bps	

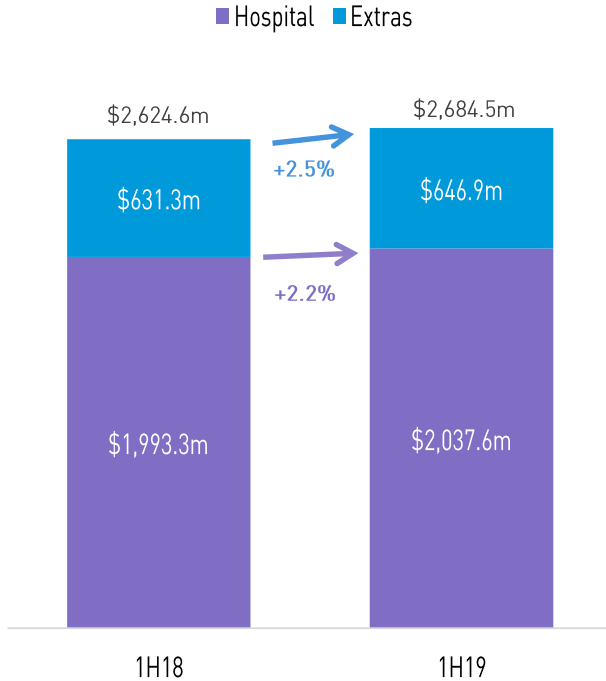
¹ Refer to glossary for definition of policy units. Policy units include both resident and non-resident business (i.e. OSHC and OVHC). Based on average of the month-end balances over the reporting period.

² Estimated hospital utilisation is defined as the number of hospital admissions per hospital policy unit and includes a provision for IBNR. Actual utilisation growth for 1H18 was 0.8% compared to the reported estimate of 2.6% as at 31 December 2017. Actual utilisation growth of 0.9% for FY18 compares to the previous estimate of 1.1% as at 30 June 2018. Estimated utilisation differs from actual utilisation largely as a result of the claims provision releases

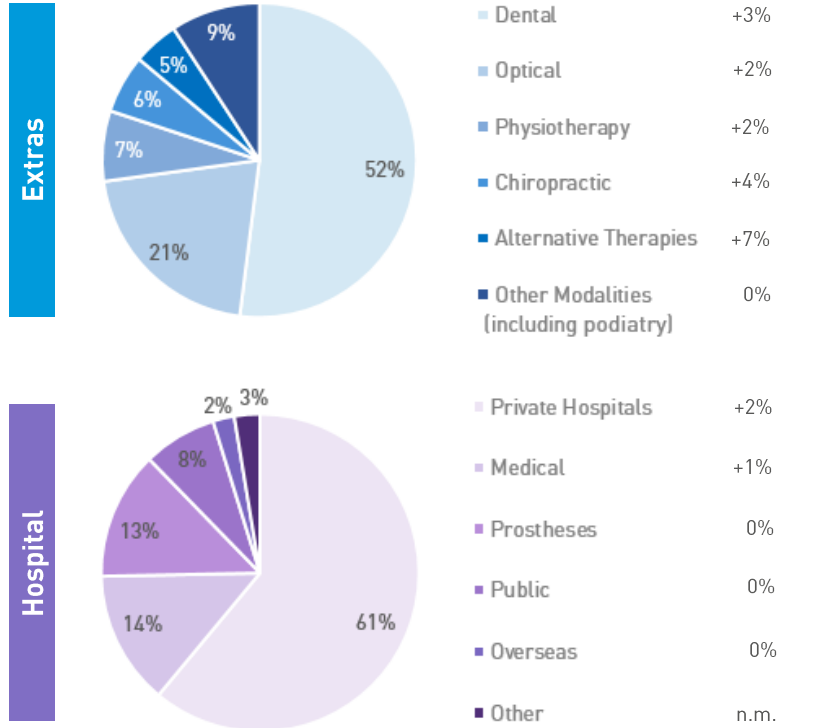
Health insurance – claims

Private hospital outlays up 2% - reflecting benign utilisation growth

Net claims expense
(including risk equalisation)



Indicative composition and movement in dollar value vs. 1H18



Health insurance – management expenses

Overall decrease in MER includes a 1.3% reduction in operating expenses

- Flat overall management expenses, including a 1.3% reduction in operating expenses due to sound cost management and ongoing benefit from our productivity program
- DAC amortisation stabilised, reflecting the progressive shift in ahm customer acquisition towards direct channels
- D&A was higher than 1H18 but broadly in-line with 2H18, reflecting the successful commissioning of our ERP system in November 2017
- We remain on track to deliver our targeted \$20 million of productivity savings during FY19 and are building the required capability to deliver additional productivity in the future

Six months ended 31 Dec (\$m)	1H19	1H18	Change
Premium revenue	3,240.3	3,175.1	2.1%
Management expenses	(274.3)	(273.2)	0.4%
- Depreciation and amortisation	(25.0)	(21.1)	18.5%
- DAC amortisation	(19.9)	(19.7)	1.0%
- Operating expenses ¹	(229.4)	(232.4)	(1.3%)
MER	8.5%	8.6%	(10bps)

¹ 1H18 operating expenses includes \$5.0m relating to customer remediation initiatives

Medibank Health

Strong result reflects contributions from HSS and HealthStrong

Continuing businesses

- Four-month revenue and operating profit contribution from Home Support Services (HSS) of approximately \$13 million and \$2 million, respectively
- Increase in operating profit due to strong growth in diversified insurance¹ and the contribution from HSS
- Gross margin decline of 420 basis points to 44.5%, reflects lower margin contribution from HSS
- MER improved by 510 basis points with \$8 million expense savings expected post Garrison exit

Garrison financial impacts

- c. \$5 million in exit costs relating to Garrison contract expected in 2H19 and release of c. \$30 million in working capital shortly after 30 June 2019

Six months ended 31 Dec (\$m)	Medibank Health total		Discontinuing business		Continuing businesses ²		
	1H19	1H18	1H19	1H18	1H19	1H18	Change
Revenue	339.0	305.0	230.1	219.0	108.9	86.0	26.6%
Gross profit	75.4	67.9	26.9	26.0	48.5	41.9	15.8%
Management expenses	(46.5)	(42.7)	(10.6)	(9.9)	(35.9)	(32.8)	9.5%
Operating profit	28.9	25.2	16.3	16.1	12.6	9.1	38.5%
Gross margin	22.2%	22.3%	11.7%	11.9%	44.5%	48.7%	(420bps)
MER	13.7%	14.0%	4.6%	4.5%	33.0%	38.1%	(510bps)
Operating margin ³	8.5%	8.3%	7.1%	7.4%	11.6%	10.6%	100bps

- First half continues to include a seasonal benefit relating to Telehealth and Garrison revenue

¹ Diversified Insurance includes non private health insurance products such as travel, life and pet insurance

² Includes Telehealth, in-home care, CareComplete, Health Concierge and Diversified Insurance

³ 1H18 operating margin restated based on gross revenue

Investment portfolio and investment income

Reduction in investment income driven by lower equity and credit market returns

- Investment performance was in-line with negative returns in equities and a widening of credit spreads that resulted in the \$55.6m decline in investment income. Normalisation adjustment to investment income of \$35.8m (pre-tax)
- Underlying portfolio return of 1.59% is a 0.84% premium above the RBA cash rate – within our target range of 1.5% – 2.0% above the benchmark (annualised)
- Domestic and International equities have now transitioned to low carbon investments

Six months ended 31 Dec (\$m)	1H19	1H18	Change
Closing balance:			
Growth	460.0	502.1	(8.4%)
Defensive ¹	1,888.9	1,901.0	(0.6%)
Total balance¹	2,348.9	2,403.1	(2.3%)
Average monthly balance:			
Growth	497.0	497.8	(0.2%)
Defensive ¹	2,019.0	2,035.7	(0.8%)
Total average monthly balance¹	2,516.0	2,533.5	(0.7%)
Net investment income:			
Growth	(15.1)	31.8	n.m.
Defensive	21.4	30.0	(28.7%)
Investment expenses	(2.2)	(2.1)	4.8%
Total net investment income^{2,3}	4.1	59.7	n.m.
Total net return – underlying ⁴			
RBA cash rate (average) ⁵			
Underlying premium over RBA cash rate			

Investment Returns		
1H19	1H18	Change
(3.03%)	6.40%	(943bps)
1.06%	1.47%	(41bps)
-	-	-
0.16%	2.36%	(220bps)
1.59%	1.73%	(14bps)
0.75%	0.75%	-
0.84%	0.98%	(14bps)

1 1H18 restated to include non health fund investments

2 Net investment income includes interest income from non health fund investments and operational cash – this was \$1.6m in 1H19 and \$0.9m in 1H18

3 Reported and underlying returns are calculated using total average monthly balances

4 Adjusted to normalise equity returns and credit spread movements – refer to appendix slide 28 for details

5 RBA cash rate pro-rata for 6 months

Cash flow

Reflects increase in working capital and the purchase of HSS

Six months ended 31 Dec (\$m)	1H19	1H18	Change
Profit before net investment income and income tax	286.3	286.4	(0.1)
Changes in working capital	(78.5)	7.0	(85.5)
Customer acquisition costs	6.0	4.1	1.9
Changes in other operating assets and liabilities	(177.9)	(196.6)	18.7
Depreciation and amortisation	31.4	26.0	5.4
Net cash flows from operations	67.3	126.9	(59.6)
Income tax	(119.4)	(148.0)	28.6
Capital expenditure	(25.2)	(23.3)	(1.9)
(Purchase) / sale of business	(70.4)	(37.5)	(32.9)
Net cash flows before investment related items and dividends	(147.7)	(81.9)	(65.8)
Net realised investment income	20.2	17.2	3.0
(Purchase) / sale of investments	268.5	270.3	(1.8)
Purchase of shares to settle share-based payment	(3.5)	(4.3)	0.8
Net cash flows before dividends	137.5	201.3	(63.8)
Dividends paid	(198.3)	(185.9)	(12.4)
Net increase / (decrease) in cash and cash equivalents	(60.8)	15.4	(76.2)
Cash and cash equivalents at beginning of the period	470.1	594.6	(124.5)
Cash and cash equivalents at end of the period	409.3	610.0	(200.7)

- Working capital increase due to timing of claims payments and contract receipts in Medibank Health
- The reduction in other assets and liabilities reflects lower unearned premium and claims liabilities
- Income tax paid reflects the timing of tax instalments
- Capital investment continues to be lower than D&A
- Deferred acquisition cost balance reduced
- HSS acquired on 29 August 2018

Capital

Our capital position remains strong and balance sheet debt free

- Health Insurance capital continues to be at the top of the 12-14% target range, with unallocated capital of \$111.9 million
- The acquisition of HSS resulted in a decrease in unallocated capital and an increase in intangible and illiquid assets
- APRA's intention is to harmonise with the life and general insurance industry framework
 - We are well placed to implement new PHI capital framework
 - We already adjust for 100% of deferred acquisition costs, capitalised software and all other intangible assets
 - Industry consultation period commencing in March 2019
- We expect to provide an update on our capital management settings at the FY19 results

(\$m)	31 Dec 2018	30 Jun 2018	31 Dec 2017
Total equity	1,838.8	1,829.2	1,778.9
Less: Intangible and illiquid assets	(501.4)	(448.0)	(475.7)
Total tangible and liquid assets	1,337.4	1,381.2	1,303.2
Less: Allowance for declared but unpaid dividends	(157.0)	(198.3)	(151.5)
Less: Allowance for cost of product bonus additions ¹	(31.5)	(14.8)	(34.0)
Total tangible adjusted capital	1,148.9	1,168.1	1,117.7
Required capital			
- Health Insurance	905.6	895.3	895.3
- Other	131.4	129.5	124.0
Unallocated capital	111.9	143.3	98.4
Health Insurance (%)²	14.0%	14.0%	14.0%

¹ Policies that include a product bonus receive an entitlement every 1 January to spend on otherwise uncovered expenses. The allowance is booked on 1 January each year

² Calculated as required Health Insurance related capital post dividends divided by the last 12 months' Health Insurance premium revenue inflated by the growth rate in Health Insurance premium revenue over the same 12 month period

Dividend

Increased interim dividend

- Interim dividend up 0.20 cents to 5.70 cents (fully franked)
- Payment date of 28 March 2019 (ex-dividend date: 5 March 2019)
- Interim¹ dividend represents a payout ratio of 67% of Underlying NPAT (1H18: 65%), normalising for investment market returns
- For FY19 we expect to pay towards the top end of the 70-80% range

Interim dividend	1H19 payout ratio
5.70cps	67%

¹ Refer to appendix slide 28 for further detail on Underlying NPAT

Navigating a lower premium environment

Broad response across four levers

1. Claims

Hospital contracting:

- Re-contract in-line with premium rate rise environment
- Leverage capability

Expand / invest in payment integrity program

Accelerate and enhance services to improve outcomes and experience for consumers in lower cost settings

Agitate for further regulatory reform

2. Customer growth

Policyholder growth:

- Stabilisation of Medibank volumes
- Continuation of dual brand retention strategy
- Consideration of future PHI M&A in a stressed operating environment

Enhanced portfolio management

Potential favourable impact of lower rate rises on level of downgrading

3. Management expenses

Productivity program:

- Deliver \$60 million in savings between FY18 and FY20
- We expect to provide an update on additional productivity initiatives at the FY19 result

Improve cost per acquisition:

- Optimising channel mix

Manage DAC and D&A headwinds

4. Growth outside of resident PHI

Continue to grow non-resident PHI business

Medibank Health organic growth:

- HSS, HealthStrong and Medibank at Home synergies
- Broaden diversified insurance proposition
- \$8 million expense savings target post Garrison exit

Consider M&A opportunities to build out our health services capability

Summary and outlook

Craig Drummond – Chief Executive Officer

Private Healthcare Reform

Creating a stronger and more sustainable health system requires meaningful reform

- The sustainability and strength of Australia's health system is reliant on both a strong public and private health system
- Over 13 and a half million Australians participate in the private health system each year
- Affordability is still a big issue - over the past decade the cost of healthcare in Australia has risen by 4.5% p.a. above inflation
- We want a system that is more affordable, easier to use and creates greater value for customers

To achieve this we need to continue to:

- Improve transparency within our system, especially around out-of-pocket costs
- Meet the challenges of chronic disease and an ageing population - the ageing population means greater demand on our health system and simultaneously fewer taxpayers to help fund it
- Be smarter around healthcare spending. The Productivity Commission estimates that 10% of healthcare spending either has no effect, causes harm or is not worth its cost

None of these issues can be solved by a private health insurer alone

- Expect flat overall PHI market volumes to persist
- On the current policyholder trajectory we expect to see Medibank brand volumes stabilise by the end of FY20
- Hospital and extras utilisation growth is expected to remain subdued for the remainder of FY19
- Management expenses for FY19 are targeted to be modestly above those recorded in FY18. We expect to provide an update on additional productivity initiatives at the FY19 result
- Expect our dividend payout ratio to remain at the top end of our stated target range of 70-80%
- We will look to provide an update on our capital management settings at the FY19 result, subject to APRA's industry consultation process
- In the short to medium term we see the potential to make 1-2 more small acquisitions to build our health services capability
- We will consider acquiring a PHI business in a stressed operating environment
- While the operating environment in FY20 is likely to be challenging, we are confident with our plans leading into the likely lower rate rise environment and see future reform as critical to promoting industry sustainability. Our intention is to aspire for stronger growth in volumes at a reasonable margin, while retaining ongoing tight control of our MER

Appendix

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2019 Reform

Summary

Reform	What it means for our customers	Medibank's approach	Customer outcomes
Optional reforms – to be implemented for Medibank and ahm customers from 1 April 2019			
Higher excess	<ul style="list-style-type: none"> - Customers will be able to choose hospital cover with excess of \$750 for singles and \$1,500 for couples / families 	<ul style="list-style-type: none"> - Higher excess will be available on many Medibank and ahm products from 1 April 2019 including front and back book policies 	<ul style="list-style-type: none"> - Provides a lower price point in exchange for higher excess, improving affordability for customers - Simple process for customers to opt in
Young adult discounts	<ul style="list-style-type: none"> - Customers between the ages of 18 and 29 will be eligible for a discount of up to 10% on their hospital cover which will apply until the customer turns 41 	<ul style="list-style-type: none"> - Medibank and ahm will apply young adult discounts to the majority of front and back book products from 1 April 2019 	<ul style="list-style-type: none"> - Discount to be applied to all eligible customers hospital cover on 1 April 2019 - Improves affordability among younger customers
Rural and regional travel allowances	<ul style="list-style-type: none"> - Customers may receive benefits towards travel and accommodation as part of hospital cover when they travel more than 200km for treatment 	<ul style="list-style-type: none"> - To be included in the majority of Medibank hospital covers 	<ul style="list-style-type: none"> - Lower out-of-pocket costs for regional and rural customers
Mandatory reform – to be implemented across Medibank and ahm in 2019, available to new and existing customers from 1 April 2019			
Product categorisation and standardisation: Gold / Silver / Bronze / Basic	<ul style="list-style-type: none"> - Hospital policies will transition to a standard product category which have a set of criteria and inclusions that must be met to meet the product category 	<ul style="list-style-type: none"> - Few Medibank and ahm policies currently include restrictions - Seamless transition and well considered communications planned for customers to support the amount of change 	<ul style="list-style-type: none"> - Customers will be able to make more informed choices about their cover and will be able to easily compare products across funds - Customers receive additional products and services differentiating the Medibank and ahm customer experience (for example LiveBetter, Medibank at Home, Health Concierge)

Normalisation adjustment to investment income

Asset Class ¹	Expected Benchmark Return p.a.	Actual Benchmark Return 1H19	Underlying Adjustment (Pre-tax) 1H19 (\$m)	Actual Benchmark Return 1H18	Underlying Adjustment (Pre-tax) 1H18 (\$m)	Change (\$m)
Domestic Equities		(7.0%)	13.0	8.6%	(5.3)	18.3
International Equities (Unhedged)		(4.6%)	5.5	8.5%	(3.3)	8.8
International Equities (Hedged)		(8.8%)	8.5	10.1%	(4.3)	12.8
Infrastructure		(1.4%)	2.5	3.8%	-	2.5
Total	8.0%	(3.1%)	29.5	7.7%	(12.9)	42.4

Six months ended 31 Dec (\$m)	1H19	1H18	Change
Group NPAT	207.7	245.6	(15.4%)
Normalisation of equity returns	29.5	(12.9)	n.m.
Normalisation for credit spread movement	6.3	(3.1)	n.m.
Tax	(10.7)	4.8	n.m.
Underlying NPAT	232.8	234.4	(0.7%)
Dividend payout ratio	67%	65%	3.1%

¹ Asset class benchmarks are S&P/ASX Total Return 300 Index (Domestic Equities), MSCI World ex. Australia Total Return in AUD Index (International Equities – Unhedged), MSCI World ex. Australia Total Return Hedged to AUD Index (International Equities – Hedged), FTSE Global Core Infrastructure 50/50 Hedged to AUD Index (Infrastructure)

Balance sheet

(\$m)	31 Dec 2018	30 Jun 2018	31 Dec 2017	Change vs. 31 Dec 2017
Cash and cash equivalents	409.3	470.1	610.0	(32.9%)
Financial assets at fair value through profit or loss	1,992.0	2,276.5	1,843.9	8.0%
Trade and other receivables	290.5	292.2	281.2	3.3%
Deferred acquisition costs	34.7	36.2	35.6	(2.5%)
Other	18.0	16.0	11.8	52.5%
Current assets	2,744.5	3,091.0	2,782.5	(1.4%)
Property, plant and equipment	52.0	53.6	55.4	(6.1%)
Intangible assets	409.9	350.1	353.8	15.9%
Deferred acquisition costs	44.2	48.7	47.8	(7.5%)
Other	1.1	1.5	1.7	(35.3%)
Non-current assets	507.2	453.9	458.7	10.6%
Total assets	3,251.7	3,544.9	3,241.2	0.3%
Trade and other payables	268.6	350.6	299.6	(10.3%)
Claims liability	370.9	365.6	388.2	(4.5%)
Unearned premium liability	515.0	689.5	503.5	2.3%
Other	87.3	128.3	90.6	(3.6%)
Current liabilities	1,241.8	1,534.0	1,281.9	(3.1%)
Trade and other payables	37.9	41.0	30.3	25.1%
Claims liability	12.7	14.2	10.7	18.7%
Unearned premium liability	85.1	83.4	76.1	11.8%
Other	35.4	43.1	63.3	(44.1%)
Non-current liabilities	171.1	181.7	180.4	(5.2%)
Total liabilities	1,412.9	1,715.7	1,462.3	(3.4%)
Net assets	1,838.8	1,829.2	1,778.9	3.4%

Group financial summary – half by half

(\$m)	1H19	2H18	1H18	Change 1H19 vs. 1H18	Change 1H19 vs. 2H18
Health Insurance premium revenue	3,240.3	3,144.4	3,175.1	2.1%	3.0%
Medibank Health revenue	320.6	295.0	291.9	9.8%	8.7%
Revenue	3,560.9	3,439.4	3,467.0	2.7%	3.5%
Health Insurance operating profit	281.5	258.3	277.3	1.5%	9.0%
Medibank Health operating profit	28.9	22.1	25.2	14.7%	30.8%
Segment operating profit	310.4	280.4	302.5	2.6%	10.7%
Corporate overheads	(17.4)	(17.7)	(16.4)	6.1%	(1.7%)
Group operating profit	293.0	262.7	286.1	2.4%	11.5%
Net investment income	4.1	35.9	59.7	n.m.	n.m.
Amortisation of intangibles	(3.8)	(4.1)	(3.5)	8.6%	(7.3%)
Other income/(expenses)	(2.9)	(12.3)	3.8	n.m.	n.m.
Profit before tax	290.4	282.2	346.1	(16.1%)	2.9%
Income tax expense	(82.7)	(82.7)	(100.5)	(17.7%)	-
NPAT	207.7	199.5	245.6	(15.4%)	4.1%
EPS (cents)	7.5	7.2	8.9	(15.4%)	4.1%
Underlying NPAT	232.8	202.0	234.4	(0.7%)	15.2%
Underlying EPS (cents)	8.5	7.3	8.5	(0.7%)	15.2%
Dividend per share (cents)	5.70	7.20	5.50	3.6%	(20.8%)
Dividend payout ratio	67%	98%	65%	3.1%	(31.6%)

Health insurance policyholders – half by half

	1H19	2H18	1H18	Change 1H19 vs. 1H18	Change 1H19 vs. 2H18
Premium revenue (\$m)	3,240.3	3,144.4	3,175.1	2.1%	3.0%
Policyholders¹ (thousand):					
Opening balance	1,780.9	1,771.9	1,776.1	0.3%	0.5%
Acquisitions	94.9	116.5	88.3	7.5%	(18.5%)
Lapses	(88.5)	(107.5)	(92.5)	(4.3%)	(17.7%)
Closing balance	1,787.3	1,780.9	1,771.9	0.9%	0.4%
- Medibank	1,410.8	1,419.6	1,431.9	(1.5%)	(0.6%)
- ahm	376.5	361.3	340.0	10.7%	4.2%
Acquisition rate²	5.3%	6.6%	5.0%	30bps	(130bps)
- Medibank	4.1%	4.9%	3.6%	50bps	(80bps)
- ahm	11.0%	15.0%	12.0%	(100bps)	(400bps)
Lapse rate²	5.0%	6.1%	5.2%	(20bps)	(110bps)
- Medibank	4.8%	5.8%	5.0%	(20bps)	(100bps)
- ahm	6.9%	8.9%	7.5%	(60bps)	(200bps)
Policyholder growth	0.4%	0.5%	(0.2%)	60bps	(10bps)
Total policy units^{3,4} (thousand):					
Closing balance	4,678.4	4,668.0	4,662.9	0.3%	0.2%
Average balance	4,680.0	4,665.7	4,671.8	0.2%	0.3%
Annualised average revenue per policy unit^{1,3} (\$)	1,384.8	1,347.9	1,359.3	1.9%	2.7%

1 Consistent with reported industry data, policyholder numbers only include resident business whereas total policy units include both resident and non-resident business (i.e. OSHC and OVHC)

2 Consolidated lapse and acquisition rates exclude transfers of policyholders between ahm and Medibank at a combined brand level. Figures at brand level include these transfers. Lapse and acquisition rates are based on the average of the opening and closing balances for the period

3 Policy units or Policy Single Equivalent Units (PSEUs) – refer to glossary for definition

4 Average of the month-end balances over the reporting period

Investment portfolio

As at 31 Dec 2018	Balance (\$m)	Portfolio composition	Target asset allocation
Australian Equities	110.2	4.8%	5.0%
International Equities	141.7	6.2%	6.0%
Property	160.4	7.0%	7.0%
Infrastructure	47.7	2.1%	2.0%
Growth	460.0	20.1%	20.0%
Fixed income ¹	1,217.2	53.2%	52.0%
Cash ²	609.7	26.7%	28.0%
Defensive	1,826.9	79.9%	80.0%
Total Fund	2,286.9	100.0%	100.0%
Non health fund investments ³	62.0		
Total Investment Portfolio	2,348.9		

- 1 Target asset allocation comprises floating rate notes and asset-backed investments (32.0%) and other fixed income (20.0%). Average credit duration is approximately 2.5 years and the average credit rating is 'A'
- 2 For investment portfolio purposes, cash comprises cash and cash equivalents (\$409.3m), cash with maturities between 3-12 months (\$314.8m) less non health fund investments (\$62.0m) less operational cash (\$52.4m)
- 3 The fund's strategic asset allocation does not apply to the non health fund investments

Glossary

Term	Definition
1H	Six months ended/ending 31 December of the relevant financial year
2H	Six months ended/ending 30 June of the relevant financial year
APRA	Australian Prudential Regulation Authority
Brand NPS	A measure of the likelihood of an existing customer to recommend the brand
bps	Basis points (1.0% = 100 bps)
DAC	Deferred acquisition costs
Central estimate	Estimate of the level of claims liability
cps	Cents per share
EPS	Earnings per share
FY	Financial year ended/ending 30 June
IBNR	Incurred but not reported
MER	Management expense ratio
MPL	Medibank Private Limited
n.m.	Not meaningful
NPAT	Net profit after tax
NPS	Net promoter score
OSHC	Overseas students hospital cover
OVHC	Overseas visitor hospital cover
PHI	Private Health Insurance

Term	Definition
PHIO	Private Health Insurance Ombudsman
Policyholder	The primary person who is insured under a private health insurance policy (other than in relation to overseas students or visitors), who is not a dependent child, and who is responsible for paying the premium
PSEUs or policy units	Policy Single Equivalent Units are used by Medibank as a standard measure of income units. They take into account the number of adults on a policy, and whether they have Hospital Cover or Extras Cover or both. For example, a household with two parents and three children, all of which had both Hospital and Extras Cover, would represent four policy units (2 adults x 2 types of Cover = 4; no premium payable in relation to children). This measure includes residents and non-resident policies.
Service NPS	A measure of the likelihood of an existing customer to recommend the brand immediately following a service interaction
Underlying NPAT	Underlying NPAT is calculated based on statutory NPAT adjusted for short-term outcomes that are expected to normalise over the medium to longer term, most notably in relation to the level of gains or losses from equity investments and movements in credit spreads, and for one-off items, especially those that are non-cash, such as asset impairments
Working capital	Working capital comprises trade and other receivables, other assets, trade and other payables other than balances relating to customer acquisition costs and operating assets and liabilities