

“Our strategy is rather simple: continue our profitable growth in the UK and take what we know and do well and do it elsewhere.”

Henry Engelhardt, CBE



Chief Executive's statement

At the end of 2008 the market capitalisation of Admiral Group was almost twice that of General Motors. Funny year 2008!

Normally at this point in my commentary I like to get right to the highlights so that shareholders can see straight away what we accomplished in the year. This year, however, I think there are few key messages that I need to get across and, for those of you who never read beyond the third paragraph of these reports, I'd better put them next to make sure you get them. The highlights, and there were plenty of them, will follow, further down the page.

Key messages:

- 1 Resistant, not proof
- 2 Freight train gaining speed
- 3 Headlines don't mirror reality
- 4 Fierce competition
- 5 It's not just add water and stir
- 6 Stick to the strategy

So, for those of you who only do three paras, thanks for your time. For those who want to know more, please read on.

Resistant, not proof

Car insurance is probably as good an industry as there is in a recession. The very simple fact that it's compulsory purchase means consumers aren't deciding whether or not to buy it this year, they're just asking 'who from?' I don't think any industry is airtight, recession-proof, but this one is recession-resistant – it's a compulsory purchase product! I don't see people giving up their cars en masse and so they'll have to buy the insurance. I do see consumers shopping around even more to ensure they get the best deal. In the UK, I think this additional shopping, especially when it's done

on price comparison sites, plays very nicely in Admiral's hands, because it becomes more and more a survival of the fittest. And we're one of, if not the, fittest. And in those markets where we have fledgling businesses, additional shopping around will only make our job easier.



Freight Train Gaining Speed

The aforementioned freight train is our UK direct business. We continue to grow the number of customers we serve, premium income, ancillary revenues and, not surprisingly, our profits. The number of vehicles we insure in the UK grew by 15% in 2008. 15%! The profits increased from £142m to £180m. Other signs of our excellent performance here are:

- Premium income increased by 12%, from £617m to £690m;
- Combined ratio fell from 83% to 81%;
- Ancillary income per vehicle rose from £69 to £71;

All of this was achieved in an environment where distribution patterns were changing rapidly and price hikes were hard to come by.

In particular, we're really quite proud of our ability to increase the ancillary contribution per vehicle, albeit modestly (£69.00 to £70.70). Growing or even keeping the ancillary contribution per vehicle stable is challenging in the current economic climate. However, our track record on this is good and we feel comfortable that ancillary income per vehicle in 2009 will be close to, if not above, the 2008 figure.

You might now wonder what the 'gaining speed' part of the freight train is all about. Well, we've made changes to our reinsurance arrangements that will mean we get a greater share of any underwriting profits in the future. This means that even if we stand still, we'll be more profitable.

A couple of years ago we revised the existing agreement with Munich Re in favour of an agreement that goes until at least 2014. The new agreement gives us better profit share terms in 2007-8-9 and then further improvements in 2010 and beyond. The benefits of these profit share improvements are only just starting to hit the bottom line with releases from the 2007 underwriting year. In addition, in order to give us greater control over our book, Munich Re is in the middle of a multi-year process of stepping back from underwriting 65% (2006) to 40% (2011). For 2008 they took 55% and for 2009 they will take 50%. We have been fortunate to replace this capacity for 2009, 2010 and 2011 with other reinsurers, with arrangements that are shorter in duration and smaller in size, such that we retain a greater proportion of the profits than the Munich Re deal.

In addition to getting a greater share of the profits through improved reinsurance arrangements we fully expect the UK business to grow further in 2009. The combination of all these factors means that the low-risk, capital-lite, high-dividend model moves forward in 2009.

Headlines don't mirror reality

The UK car insurance market remains a very competitive place. The market performed pretty much as we forecast with rates grudgingly (sloth-like?), inching upwards in 2008. Based on our data, headlines of 5%-10% rate increases during the year are misleading. I don't know the exact methodology of either the AA or

Deloitte's price trackers but I'd be surprised if they pick up on special offers (like Direct Line's early 2009 offer of 12 months cover for 10 months cost implying a 16.6% price reduction) or any special rates on price comparison sites. A recent review of prices done solely on price comparison sites indicated, for instance, that the best rate offered for a variety of risks actually declined by 1% in January 2009.

Rate increases are being muted by the dominance of price comparison sites, where consumers naturally drift to the lowest price offered. One measure we use to gauge price changes by the market is the percentage times one of our brands comes up first on price comparison sites. This percentage stayed roughly the same throughout 2008. Meanwhile, during the year we moved our rates up, on average, 4%. This leads me to think that the market moved its rates up about 4% as well.

However, I don't think this modest price move means the results for the market will be poor. In my opinion, subdued claims inflation, led by reduced accident frequency, will result in this year being no worse for the market than 2007. I think 2008 will again be marked by large reserve releases by the market as a whole.

It's not yet clear how rates will trend in 2009. There are competing factors that influence the potential of rate increases and rate decreases. On the 'rates moving up' side, there is the decline in interest rates and therefore investment income. With firms earning less investment income there is added pressure to produce a better underwriting result. In addition, lower petrol prices might spur more driving, which would result in more accidents, which in turn should lead to price increases. Already the winter has been more severe than many recent winters, with a corresponding rise in frequency. All of these factors weigh in favour of rate increases.

On the 'rates stable or moving down' side there is lack of intense pain in the industry. It does not appear that the industry as a whole is suffering a lot; combined ratios plus profits from ancillary products, after releases for 2007 (latest data available) indicate the market makes a reasonable return on capital. Economic pain is always the greatest catalyst for price increases and if that pain does not exist then insurers generally do not increase rates. In addition, the further growth of price comparison sites means more and more consumers will get the industry's lowest rate, pinning the industry to rate increases only as dictated by the slowest mover for any individual risk. Lastly, the recession might result in people driving less and, despite the difficult winter, this would have a beneficial effect on frequency, which might lead to insurers deciding to hold the line on, or even decrease, rates.

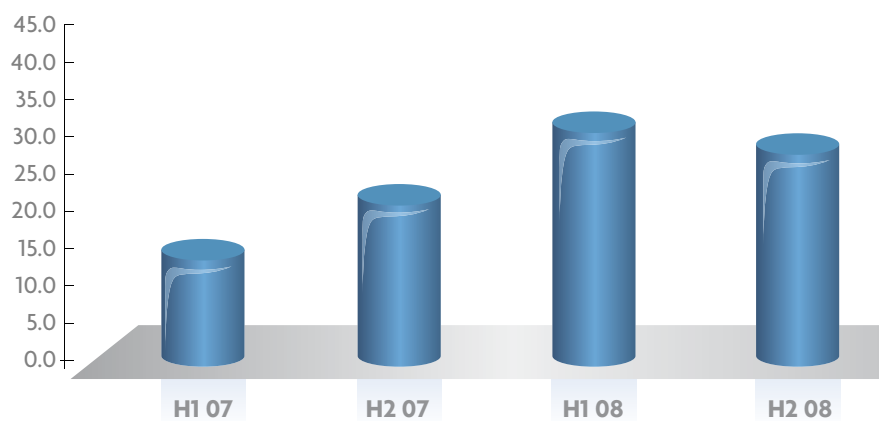
All in all, I think it means a bit of a sleepy year on rates, with the above cocktail of factors working to produce rate increases similar to 2008. For those needing animal imagery I'd suggest the koala bear. There are a number of idiosyncrasies about the koala bear that resonate with similarity to the UK car insurance market. Here are three, I leave it to you to pick and choose which ones best represent the UK car insurance market: koalas sleep some 16 hours a day, they can be nasty if provoked and they are known to smell quite bad.

Fierce competition

Confused had a pretty good year. However, as predicted, competition was fierce and as a result profits reduced from £37m in 2007 to £26m in 2008. The spend on TV and press by price comparison sites has gone from approximately £5.5m in 2006 to £51m in 2007 to £76m in 2008. Confused's portion of this spend has gone from virtually 100% in 06, to a third of the spend in 07 to around a fifth of the



The UK car insurance market?



Price comparison market media spend £m

spend in 08. Simply put, competition has taken a lot of profit out of this market through increased marketing costs, despite continued growth in the number of people using price comparison sites. The dominance of price comparison sites as the method of choice for buying car insurance in the UK is reflected by:

- The fact that in 2008 73% of Admiral's new business originated through price comparison sites, up from 50% in 2007, up from 30% in 2006.
- TV and press advertising by price comparison sites as a percentage of all car insurance TV and press advertising rose from 35% in 2007 to 52% in 2008.
- The fact that only one brand has yet to have a presence on any price comparison site and that's Direct Line. Even all the other RBS insurance brands have joined price comparison panels.

But enough whinging about what a tough world it is, let me tell you what Confused is doing to respond. First, we took the better part of 2008 to rebuild the quote engine. It's now faster and easier for the customer. It also looks better. Second, we've launched a new TV campaign which, given the number of times people have seen the old campaign over the last few years, will certainly be welcomed by the British public. Third, we are improving Confused's offerings of other products. In particular we're seeing growth in household insurance and energy comparisons.

It is very hard to predict Confused's result for 2009, the sector remains under intense competitive pressures. However, the market is still growing and this, coupled with the changes Confused made at the end of 2008, has resulted in Confused producing the biggest number of car insurance quotes ever in January 2009. But, I'm sorry to say, it was not a record month for profits. The missing data point to the future is how much money each of the competitors in this sector is willing to spend in 2009 to try and reach, or grow, profitability. If January is anything to go by then Britain will be seeing a lot of price comparison advertising during the year!

It's not just add water and stir

We are in the process of sowing the seeds of our future growth and success with the development of our businesses outside the UK. In 10 years time I expect these seeds to be a forest of profit growth for the Group. However, the non-UK operations should not be expected to make any noticeable return for a few years. Building profitable, growing, sustainable direct operations takes time. Balumba, in Spain, has only just completed its second full year of trading, AdmiralDirekt in Germany is less than two years old and ConTe in Italy only launched at the very end of May 2008. The development of these businesses outside the UK will take not only time, but also money. Not a lot of money, but money nonetheless.



The new Confused.com website.

We don't do things on a grand scale until we are quite confident of the result and we work hard to learn as we go, but as we grow these businesses on top of each other the capital requirement increases. This should not put off investors, as our business model generates cash and we have no debt to repay.

Balumba was challenged to improve its loss ratio in 2008 and it did so. The loss ratio for 2007 at the end of 2007 was 137%. The loss ratio for 2008 at the end of 2008 was 102%. We are looking for continued improvement in 2009. Improving the loss ratio was our primary focus during the year and while we were making adjustments to pricing and claims management we pulled back a bit on our advertising spend, resulting in the number of customers Balumba services growing by 8,500, from 46,900 to 55,400 (18%). Balumba's earned combined ratio was 165% for the year, compared to 232% in 2007. Overall however, Balumba posted a loss of only £1.2m (€1.5m). This sum appears modest largely due to the sale of ancillary products and services to its customers. This is very nice income to have but the key to long-term success for Balumba is to become a good insurer.

The German market is an odd beast (certainly bigger and arguably even less friendly than a koala). There is a season for car insurance in Germany that runs about 10 weeks, from early October to early December. There is very limited activity during the rest of the year. This comes about because almost the entire market renews on a single date, January 1, and consumers have to give their insurers a month's notice to leave them, which means they have to give notice by the end of November. After that the only substantial group of people shopping are those who are changing vehicle. Besides the difficult logistics of trying to gear up for a short sales window, you

lose the ability to test, re-calibrate, re-test, re-re-calibrate, etc. that we employ everywhere else. You can test but then you have to wait 42 weeks to re-calibrate!

There's good news and bad news from AdmiralDirekt.de. On the 1st of January 2009 (from the '2008 season') we had around 30,000 policyholders. This was at the high end of our expectations. That's the good news. The bad news is that the 8,000 policyholders that went on risk on January 1, 2008 did not perform well. The loss ratio for the 2008 year at the end of 2008 was 142%. Part of this is the volatility inherent in a small book of business where one or two large claims make a big difference. But part of this too is down to an inexperience in claims handling and the typically poorer loss ratios that accompany first year business.

Our reaction to these problems was to spend a lot of energy improving the claims systems and re-calibrating our pricing. Our renewal rate for this season was low enough to lead us to believe our pricing re-calibration had an effect. Now we wait to see how this year's customers perform.

In Italy we were successful in launching ConTe on schedule and within budget at the end of May. However, as we'd seen Balumba and, to some extent, AdmiralDirekt.de, grow their respective volumes quickly to the detriment of their loss ratios, in Italy we put rates up from the outset to protect the loss ratio. The result was our writing just 3,660 policies in the year with annualised premium income of €1.4m. However, the 2008 loss ratio at the end of 2008 was 87%! But the loss ratio on such a small premium income is subject to dramatic change with even a single claim. As the year ended we were re-calibrating rates to stimulate sales.

In sum, I am pleased with the progress we've made in Spain, Germany and

Italy despite the challenges noted above. They all hold great potential for the future.

Stick to the strategy

Our strategy has been and continues to be, rather simple: continue our profitable growth in the UK and take what we know and do well and do it elsewhere. This means expanding our direct businesses geographically to take advantage of changing distribution patterns in countries with large, mature car insurance markets. I believe that this is the way to ensure a prosperous future. For 2009 this means that, besides continuing to invest in our Spanish, German and Italian operations, we are working on a launch in the United States, the world's largest car insurance market.

The business in the US will start small, one or two states to begin with and, if successful, expand to other interesting states. The company, which has yet to be named, will be based in Richmond, Va. and should launch either in the final quarter of 2009 or first quarter of 2010. Our strategic plan has always shown five markets to expand into. With the US coming on-stream that would leave only the French market left on the list and we are beginning to investigate this market.

We are also looking to expand the international presence of our Confused business. The first launch outside the UK will again be Spain, with an operation called Rastreator (a made up word, but close to 'rastreador', which means tracker). The growth of internet distribution for car insurance makes this market interesting for price comparison. This business should go live sometime in the first half of 2009.

Highlights

Okay, if anyone's gotten through all that, it's time for some highlights of 2008. I'm proud to say that it was another excellent year for the Admiral Group:

- 1 Profit before tax up 11% to £202.5m
- 2 Number of customers up 17% to 1.75m
- 3 Turnover up 13% to £910m
- 4 Combined ratio still well below 90% at 86%
- 5 Top 10 in the FT Best Companies To Work For; 37th in the Sunday Times Best Companies To Work For in the UK
- 6 Launched ConTe in Italy
- 7 Still debt- free
- 8 Record dividend of 52.5p per share for the year
- 9 Robust return on capital of 57% (56% 2007)
- 10 Robust return on income of 56% (57% 2007)
- 11 Number of people employed in the Group rose to 3,110 from 2,500 (+24%), we opened a new office in Newport (Wales, not Rhode Island) and we're hiring in every operation!

It is a hugely exciting time within Admiral Group and I'm glad to be a part of it. I am fortunate to work with intelligent, highly motivated, nice people. I'd like to say a specific thanks to all the senior managers who are so dedicated to Admiral Group and to all the staff in all our offices who work hard every day to provide a great service to our customers. I'm looking forward to another excellent year in 2009.



Henry Engelhardt
Chief Executive Officer



37th best Company to Work For in the UK 2009



Opening of the new Newport office