

Group Chief Executive's review



Mark Tucker
Group Chief Executive

'We continued to perform strongly in the first half of 2008 with double-digit growth in new business sales and profits, maintaining the momentum of the last three years. Our retirement-led strategy continues to drive the Group's growth, with a clear focus on profitable revenue streams across the diverse geographic spread of our businesses.'

In the first half of 2008, the Group continued the momentum achieved over the past three years and once again delivered strong performance.

Our retirement-led strategy continues to drive the Group's growth, with a clear focus on profitable revenue streams across the diverse geographic spread of our businesses. This growth has been achieved against a background of deteriorating macro economic conditions and significant capital market volatility.

The retirement market offers significant long-term and sustainable growth, in particular in Asia, where economic growth and an increased emphasis on retirement savings continue to fuel demand, and in the US, which is experiencing the biggest demographic wave of people in history moving into retirement. The Prudential Group has a very powerful franchise in the sector, based on our financial strength, our investment and risk management skills, our brands and our product and distribution expertise.

The specific opportunity differs from market to market but our operating structure, product and distribution expertise give us the flexibility to capture growth and create value across the pre- and post-retirement market. Our approach is one that ensures that solutions matched to local customer needs can be offered in each market, but with significant product, operational and financial synergies still provided by the wider Group.

Group performance

Group operating profit before tax, on the European Embedded Value (EEV) basis, was up seven per cent to £1,430 million and on the statutory International Financial Reporting Standards (IFRS) basis operating profit before tax increased by 13 per cent to £674 million.

New business across the Group's insurance operations increased by 12 per cent to £1,513 million on an Annual Premium Equivalent (APE) basis. Profit on new business increased by 11 per cent to £602 million with almost 80 per cent being generated overseas.

The Group's asset management operations continue to demonstrate the value of their track record for excellent long-term investment performance, achieving net inflows of £4.1 billion and an operating profit of £181 million in line with the first half of 2007 in what have been very testing market conditions.

The cash flow position of the Group has continued to improve. Operating cash flow at Group level at the half year was positive at £86 million, supported by a higher than average uptake of the scrip dividend, and is in line with our projection of being operating cash flow positive at the Group level for the full year 2008.

The balance sheet and capital position remain robust, though the significant falls in markets have offset the gains we have made at the operating level. Shareholders' funds on an EEV basis were £14.0 billion (2007 year end: £14.6 billion).

As a result of the focus we have given to our credit management processes and capabilities we have not experienced any defaults and there have only been a limited number of downgrades. In addition, through proactive management and more defensive positioning of the portfolio we have reduced interest rate risk.

We have taken a rigorous approach in relation to the accounting treatment of Other Than Temporarily Impaired (OTTI) bonds and asset backed securities in the US and a charge of £108 million for net credit losses has been taken in the period.

The Group's regulatory capital position is assessed under the European Insurance Group's Directive (IGD). As at 30 June 2008 the IGD surplus was estimated to be £1.4 billion (2007 year end: £1.6 billion) with cover of 1.7 times of required capital.

The Board has agreed that an interim dividend of 5.99 pence per share be paid, an increase of five per cent. The Board remains committed to a progressive dividend policy, with the level of dividend determined after taking into account the Group's financial requirements, including opportunities to invest in the business at attractive returns. As previously stated, the Board believes that in the medium term a dividend cover of around two-times is appropriate.

Insurance operations

Asia

The underlying fundamentals in Asia of economic growth, increasing mass affluence and the significant shift in demographics will continue to be powerful drivers of growth in the retirement savings and health markets.

The Group's unique balance of operations across the Asian region, including top-three positions in seven out of 12 markets, and the strength of our product and distribution capabilities put us in an ideal position to continue to access these high return growth opportunities.

Across the region the Group has over 420,000 tied agents and has distribution relationships with over 80 financial institutions. We continue to build our distribution capability in the region through enlarging and broadening our agency, direct and partnership channels.

We were very pleased to announce that we have renewed and extended our main agreement with Standard Chartered through to 2016. This long-standing and successful agreement covers Hong Kong, Singapore and Malaysia and has been extended to include Japan and Thailand. In addition, we have separate agreements covering Taiwan, China and Korea. As part of the renewed agreement, we will now become a provider of health products through Standard Chartered in all these countries.

New business APE increased by 14 per cent in the first half of the year building on the exceptional 48 per cent growth achieved in the first half of 2007 and new business profit increased by 15 per cent to £336 million.

The 2007 comparative period benefited from the significant success of the launch of our 'What's your number?' retirement campaign in Taiwan supported by the introduction of a new variable annuity product. As a consequence we saw a decline in sales in Taiwan of 36 per cent to £97 million APE, however we continued to gain profitable market share.

Excluding Taiwan, aggregate new business in Asia grew by 29 per cent and new business profit increased by 26 per cent.

Within the region, we achieved very strong new business growth in a number of markets: Indonesia 96 per cent; over 50 per cent in China, on a comparable basis taking into account the change in consolidation basis effected for the fourth quarter of 2007, and in Hong Kong; India 45 per cent and 39 per cent in Vietnam.

We remain confident of doubling Asia's 2005 new business profit by the end of 2008 – a year ahead of our previously stated target of 2009.

IFRS operating profit before tax from the Asian life businesses increased by 28 per cent to £102 million and net cash remittances to the Group were £11 million.

United States

The US life insurance sector has been adversely affected by current economic uncertainties, which have resulted in more conservative customer behaviour and short-term pricing pressures in the market. Despite this, the strength of Jackson's position across the annuity product range in particular is demonstrated by the resilient flow of new business and overall Jackson has reported record first half new business volumes.

Poorly performing equity markets, economic uncertainty and an upward sloping yield curve have led to an increase in demand for fixed annuity products and reduced demand for variable annuities. We have rapidly responded to capture the revenue stream resulting from this more conservative trend, while recognising that variable annuities remain the cornerstone of longer-term retirement income provision. The current market conditions have given rise to some competitive pricing behaviour, specifically in the variable annuity market. We consider this unsustainable, and our position remains that we will only write profitable business.

Total new business was £356 million, up one per cent on an APE basis; with retail new business of £274 million down four per cent. Variable annuity volumes, which accounted for two-thirds of retail new business, stabilised in the second quarter but were down 20 per cent for the half year. Fixed annuities new business increased by 121 per cent. The change in product mix resulted in new business profit down five per cent to £137 million.

Net flows across the annuity product range continued to be very strong with net flows in the second quarter being the highest for five years.

We are continuing to monitor the market for bolt-on acquisition targets that meet our target returns, in particular life back books that would suit our scaleable platforms. In current conditions there are an increased number of sellers and, with the prices of assets now at more realistic levels, we see more potential here than we have for a number of years.

United Kingdom

Conditions in the UK retail savings market in general have also been difficult in the first half of the year. However, as a result of our targeted approach to the market, our UK operations were able to achieve an 11 per cent increase in retail new business APE. Overall new business including wholesale operations increased by 18 per cent and new business profit was £129 million, up 19 per cent. The internal rate of return on new business was 15 per cent.

These figures demonstrate that the disciplined delivery of our UK strategy is producing the anticipated positive financial results, with strongly based growth across both our retail and wholesale operations. Our focus in the UK is to capitalise on our strengths in the retirement income market. We have re-shaped our approach to retirement savings to improve returns by exiting unprofitable segments of the market and to take full advantage of our with-profits capabilities and we have in place the actions to reduce the cost base.

Individual annuity volumes, supported by strong vestings from internally maturing pension policies, held up well over the period. The attractiveness of cautiously managed with-profits products has supported sales across the annuity and pensions product range and with-profits bond sales tripled. With-profits accounted for 46 per cent of overall retail sales in the period.

We are also continuing to see steady growth in the strategically important Lifetime Mortgage market with new advances up 75 per cent against the first half of last year. We estimate that we are now the market leader in this segment.

In the wholesale annuity market, activity levels have increased and we have seen a narrowing of pricing differentials. We completed a bulk annuity reinsurance contract with Goldman Sachs for the reinsurance of £30 million in APE terms, of Rothesay Life's non-profit annuity liabilities. This is an interesting development for us in terms of bringing alternative risk management solutions to the defined benefit bulk market.

We have continued to make good progress against our cost reduction goals in the UK. By the end of 2007 we had already achieved £115 million of the targeted annual total cost savings of £195 million. Work is proceeding in line with plan and we are on track to deliver the targeted reduction in our cost base by 2010. In April, we began to migrate many of the back office processes for our mature books of business to Capita, as part of our already announced outsourcing contract, and this will deliver the bulk of the remaining savings.

In June, we announced that we would not proceed with a reattribution of the inherited estate held in the with-profits sub-fund of The Prudential Assurance Company Limited. After extensive assessment, it was concluded that maintaining the current operating model was in the best long-term interests of both current and future policyholders and shareholders.

Asset management

Our asset management businesses performed strongly in the first half, despite extremely difficult market conditions, with net inflows of £4.1 billion.

M&G had a strong first half year with operating profit of £146 million (2007: £140 million) and net inflows for the period in both its retail and institutional business totalling £2.4 billion. As a result, M&G's external funds under management increased to £51.7 billion (2007 year end: £51.2 billion).

This result has been built on sustained and excellent fund performance. In the retail business, 45 per cent of M&G branded funds by number and 78 per cent by fund value were in the top quartile over three years and over 20 per cent by number and over 50 per cent by fund value were in the top decile over the same period, including a number of our flagship funds: Global Basics, Recovery, American and Optimal Income. In the institutional business, 69 per cent of mandates with a three-year performance track record either met or exceeded their benchmark over three years.

Operating profit for our Asian asset management business was £29 million (2007: £33 million). Net inflows were £1.6 billion as we continued to extend our fund range with major fund launches in Taiwan, Korea, Japan and a third fund in China.

External funds under management in Asia at the end of the period were £15.7 billion compared with £17.4 billion at end 2007, reflecting the significant equity market falls across the region.

In Vietnam we again broke new ground with the launch of the country's first institutional property fund. In Japan, where we have the second largest foreign asset manager, we established a new distribution relationship with Nomura and our recently established Middle East operations have already secured 14 distribution agreements.

Outlook

The macro economic climate will doubtless continue to be difficult for some while.

We expect Asian economic growth to remain strong but beneath the peak levels of recent years. The fundamentals underpinning our Asian growth are highly positive.

Jackson will continue to show resilient performance in the short-term and we remain confident will out-perform over the cycle.

In the UK, we are delivering on our strategy and in asset management we are very well placed to capitalise on the strength of our positions.

We expect to continue to outperform our competitors. We have a clear agenda, our retirement-led strategy and our business model, with its geographic mix and diversification, are robust, while our balance sheet and capital position have been very resilient.

The prospects for the Group remain positive.