Group Chief Executive's review

Our results in 2006 demonstrate excellent and continued progress in the delivery of the Group's growth and value agenda

Mark Tucker
Group Chief Executive

Total EEV basis operating profit from continuing operations

+15%

2006 £1,976m
2005 £1,711m*

EEV basis shareholders' funds

+15%

2006 £11.9bn
2005 £10.3bn**

APE new business premiums

+16%

2006 £2,470m
2005 £2,134m*

*Comparison at constant exchange rates (CER).
**Comparison at reported exchange rates (RER).

The Group's strategy is centred on optimising our competitive advantages in life assurance, becoming a leading provider of financial services for the retirement market, and on the further development of our asset management businesses. In implementing this strategy our clear aim is to secure superior growth in value for our shareholders.

In 2006, we continued to focus on developing our position in our chosen markets of Asia, the US and the UK; markets that we believe offer the greatest opportunity for sustained profitable growth.

Total Group operating profit before tax was £1,976 million on a European Embedded Value (EEV) basis, an increase of 15 per cent, and the Group's return on embedded value was 13.5 per cent (2005: 15.5 per cent). Statutory International Financial Reporting Standards (IFRS) operating profit before tax was £893 million (2005: £957 million).

Across the Group's insurance operations, new business increased by 16 per cent to £2,470 million, on an APE basis. Profits on new business exceeded £1 billion for the first time, 20 per cent up on 2005. Average margins across the Group remained strong and were 42 per cent (41 per cent in 2005) and returns on new business have also improved. Operating profit from the insurance businesses was £2,209 million, on an EEV basis, increasing by 28 per cent on 2005, and IFRS operating profit increased by 15 per cent to £1,087 million.

In asset management we delivered record net flows at M&G and in our rapidly growing retail businesses in Asia. Net inflows of £8.6 billion were 66 per cent ahead of 2005 and external funds under management increased to £57 billion (2005: £46 billion). Operating profit from these businesses was £254 million, up 46 per cent on 2005.

Difficult trading conditions in the UK personal loans market led to losses at Egg, the Group's UK banking business, of £145 million (2005: profit £44 million). In January 2007 we received an offer for Egg from Citi and the business was sold for £575 million in cash, subject to completion adjustments. We expect this transaction to complete by the end of April 2007.

The Group's cash flow developed strongly in 2006 and its capital position remains robust. Taking into account our plans for sustained high levels of growth and a normalised level of scrip dividend uptake we expect our operating cash flow to be positive in 2008. In light of this the Board has reviewed its longer-term dividend policy.

The Board recommends a final dividend of 11.72 pence per share, bringing the full-year dividend to 17.14 pence per share, an increase of five per cent over the full year 2005 dividend of 16.32 pence.

The full year dividend is covered 1.5 times by post-tax IFRS operating profit from continuing operations.

The Board will focus on delivering a growing dividend, which will continue to be determined after taking into account the Group's financial flexibility and opportunities to invest in areas of the business offering attractive returns. The Board believes that in the medium term a dividend cover of around two-times is appropriate.

Insurance operations

The Group's position in Asia continues to develop rapidly with the region accounting for almost 50 per cent of the Group's 2006 new business profits. One of the key priorities in the region in 2006 was to continue to build our distribution capability. Agency remains the major channel in the region and during the year we added 115,000 agents, to total 285,000 agents by the end of the year. Building the agency force in a disciplined way in developing markets such as India, China and Indonesia is critical to success, whereas in some of the more developed markets in the region such as Hong Kong and Singapore where agency numbers are more stable, the main focus is on increasing productivity. Non-agency distribution is also developing strongly and accounted for 30 per cent of new business in 2006 (26 per cent in 2005) as we established a number of new and important relationships during the year. As well as experiencing rapid growth Asia became cash positive in 2006, in line with our previous forecast, with a net remittance of £28 million to the Group.

In 2007 and beyond, Asia offers significant potential for profitable growth and we are on track to deliver on our target to at least double 2005 new business profits by 2009. We are in all the region's major markets and see further opportunity to build distribution, improve productivity and efficiency and increase sales of our market leading unit-linked products. We also see scope to increase sales to our seven million existing customers; to use our regional and Group expertise to play a key role as the retirement market develops in a number of Asian countries; to extend our direct distribution capabilities and to increase selectively our presence in the Accident and Health product sector across a number of markets in the region.

Group Chief Executive's review continued

Our strategy in the US is to focus on the opportunities that exist in the growing retirement market as the US baby boomers retire, with a particular emphasis on variable annuities. We have market-leading product flexibility and high levels of product innovation, a focus on advice-based distribution and on maintaining high service levels at low cost. As a result our retail sales in 2006 grew at more than double the rate of the market overall. Variable annuity sales increased by 48 per cent over 2005, and we have achieved compound growth of 45 per cent over a five-year period.

In 2007, our aim is to capitalise on the market position that the Jackson team have built, growing distribution and further developing the product range to address both existing and new market areas. For example, in January 2007, we launched a new simplified retirement annuity aimed at mutual fund representatives, extending our distribution reach. We remain confident that we can continue to outperform the market and gain profitable market share.

In the UK, retail insurance new business increased by 14 per cent in 2006 and overall new business sales were up one per cent. We continued to focus on writing for value across the UK business with average margins increasing to 30 per cent (27 per cent in 2005). Returns on new business improved to 15 per cent and remain high compared with the rest of the UK market.

Notwithstanding this strong performance, we have continued to assess the positioning of our UK insurance operations, examining a broad range of potential options with a clear goal of maximising value for our shareholders. We are confident that there are profitable opportunities for the Group in the retirement income and savings market.

We have significant competitive advantages in the retirement income market, in particular our flow of internal vestings from our back book of personal pensions, and this market remains very attractive. We therefore see retail annuities and equity release and the nurturing of our existing policyholders as key parts of our strategy. In the wholesale annuity market we also have distinct competitive advantages but we will only write business that meets our required returns.

Much of our Wealth and Health business is low margin and our strategy will be to improve returns through a much narrower business, exiting segments that are unprofitable and concentrating our effort only where we have a material and sustainable competitive advantage and where we can achieve returns significantly in excess of the cost of capital. We have withdrawn from provision of front-end commission individual pensions and will also exit front-end commission unit-linked bonds, segments of the market where we do not see that adequate returns can be made.

We believe there is an opportunity in the retirement savings market for us to capitalise on our proven low risk multi-asset investment capabilities. We will bring a new range of products to the market based on these capabilities and with improved returns through a focus on trail, rather than front-end commission. We will concentrate our advice-based distribution activity on the significant number of investors approaching retirement who have substantial assets outside personal or corporate pension plans, or have investments in poorly performing funds, and require inflation protection.

We also see opportunity to develop further our already strong position in the corporate pensions market and we will improve returns by focusing on schemes with higher case sizes and holding costs as volumes grow.

We will participate in the health market through our existing joint venture with Discovery, which will be expanded to include our new Flexible Protection product. A combination of the strength of the Prudential brand in the UK, clearly differentiated products and the operational capabilities of Discovery, provide an excellent base to deliver profitable growth in these markets. The joint venture will be led by Discovery.

EEV basis operating profit from long-term business from continuing operations

+28%

2006 £2,209m
2005 £1,722m*

EEV basis new business profit

+20%

2006 £1,039m
2005 £869m*

Asset management business IFRS operating profit

+46%

2006 £254m
2005 £174m*

*Comparison at constant exchange rates (CER).

Actions are in place to realise 65 per cent of the previously announced cost savings target of £115 million* for the UK insurance business. We have increased our annualised target cost savings to £195 million by 2010 and our current estimate is that these savings will lead to a £60 million positive impact on embedded value. Total restructuring costs are estimated to be up to £165 million*.

We have initiated discussions with the regulator on the possible reattribution of the inherited estate of the Group's main with-profits fund in the UK, Prudential Assurance Company. An Independent Policyholder Advocate has been nominated to represent policyholders should a decision be taken to proceed. We will only proceed if there are clear benefits to both policyholders and shareholders. If a decision is taken to proceed a formal appointment of the Policyholder Advocate could be expected to take place later this year.

With a focused strategy in the UK based on our competitive advantages, we see opportunities for growth in the retail market at high margins and returns relative to the overall market. In the wholesale annuity market we will write business that meets our required returns and by definition the flows will be lumpy year on year. We are maintaining our 14 per cent IRR target for new business and we expect the UK's shareholder-backed business to become a net capital generator for the Group by 2010.

Asset management

Maintaining superior investment performance is the key factor in the continuing growth and success of the Group's asset management businesses. In 2006, the performance of M&G in the UK and Europe and our asset management businesses in Asia has again been very strong, adding value to our insurance businesses worldwide, supporting record net inflows and continuing the growth of the Group's external funds under management.

In 2007, we will continue to build on the strong growth over recent years in both M&G and in Asia. In addition, Jackson will enter the US retail mutual fund market for the first time, a significant market that continues to gain momentum, especially among the baby boomers.

Group

As a Group we are continuing to increase the level of co-operation and the exchange of ideas across our businesses.

The Group's asset management businesses are using their global presence, exchanging information to support their investment decisions and to enable the efficient management of over £6 billion of cross-border money.

In our insurance businesses, which remain predominantly market specific, collaboration is taking place where there is a commercial benefit. Product development teams are working across the Group to access existing skills and expertise. In distribution, the UK business has utilised the very successful techniques developed by Jackson in the US, to segment the independent financial adviser market, saving time and cost and improving returns.

Work is ongoing to consolidate our technology infrastructure in particular across the UK and the US. A single Customer Service Desktop is now under development and will be launched in 2007.

Central to the management of the Group is capital efficiency and capital allocation. During 2006, we have made significant progress in the assessment of, and management of, risk on a Group-wide basis. This understanding provides a solid foundation as we continue to embed decision making on a risk-adjusted basis.

Summary

The Group goes into 2007 with strong momentum. I continue to see tremendous scope for the Group to build sustainable profitable growth and secure superior growth in value for our shareholders.

(*Previously announced UK cost savings target of £150 million by 2009 included £35 million in relation to Egg, which was acquired by Citi in January 2007. Previously announced restructuring costs of £110 million included £25 million related to Egg.)