Group Chief Executive's review

In the first half of 2006 the Group has continued to build on the momentum established during a successful 2005, with Group operating profit on an European Embedded Value (EEV) basis up 17 per cent to £980 million before restructuring costs in the UK.

Insurance sales were £9.8 billion on a present value of new business premiums (PVNBP) basis, with strong growth in Asia and the US and a steady performance in the UK. Net sales in our asset management businesses more than doubled to £5.3 billion. Difficult trading conditions in the personal loans market resulted in a loss at Egg in the first half of the year but we expect Egg to report an operating profit for the second half.

In line with our forecast that Asia will be cash positive in 2006 there was a net remittance to the Group of £5 million in the first half of the year. Across our UK insurance business and Egg we have increased our cost saving target to £150 million per annum from the £40 million announced in December 2005.

Operational highlights

Insurance and banking

The Group's insurance businesses delivered an increase of 22 per cent in operating profit before tax on an EEV basis to £1,041 million and the operating profit on an International Financial Reporting Standards (IFRS) basis was £516 million, up eight per cent.

Insurance sales in Asia grew by 27 per cent on a PVNBP basis to £2.3 billion (up 35 per cent on an annual premium equivalent (APE) basis) in the half year building on strong growth in 2005 as a whole. There was continuing strong growth in India up 61 per cent, Korea up 56 per cent, China up 40 per cent, Singapore up 32 per cent and Taiwan up 19 per cent.

The average margin on new business in the region was 10 per cent on a PVNBP basis (2005: 9.4 per cent) and we expect margins for the full year to be maintained at around this level.

In line with our forecast that Asia will be cash positive in 2006 there was a net remittance to the Group of £5 million in the first half of the year. The Group has an unrivalled exposure to the high growth, high return markets in Asia and we continue to expect significant growth as we build on our powerful distribution capability; and to generate increasing levels of cash from the region.

Jackson National Life (JNL), our US business, benefits from a strong presence in all the annuity product areas. Market conditions continue to favour variable annuities and JNL increased its sales by over 50 per cent in the first half of the year well ahead of overall market growth and market share in the first quarter increased to 4.2 per cent. Overall sales in the US increased by 12 per cent on a PVNBP basis (up 12 per cent on an APE basis).

JNL has continued to develop its core Perspective II product with a number of enhancements that have been well received by customers and advisors. Overall margins on new business increased to 4.2 per cent on a PVNBP basis (2005: 3.5 per cent). We will maintain our focus on the variable annuity market and we expect to increase our market share as the 'baby boomer' generation looks to generate income from their retirement savings.

Further increases in US interest rates in the second half of the year could lead to a change in the sales mix across the annuity product range. The breadth of our offering in variable, fixed-indexed and fixed annuities means we are well positioned to respond.

The US business generated almost US$300 million of statutory capital in the period and is expected to remit US$180 million to the Group during 2006.

The UK insurance business continued to focus on value. Sales of £4.2 billion on a PVNBP basis were down 12 per cent (down nine per cent on an APE basis) on the first half of 2005 with retail sales remaining stable and retail margins improving. Two large bulk annuity transactions were completed in the first half of 2006 with sales of £1.25 billion on a PVNBP basis. In the first half of 2005 we completed one large transaction of £1.45 billion on a PVNBP basis. There has been some reduction in margins on the bulk annuity business.

The aggregate margin on new business was 3.3 per cent on a PVNBP basis (2005: 3.3 per cent). We will continue to target an internal rate of return on new business of 14 per cent. In the first half we achieved an internal rate of return of 13 per cent.

Egg's card book is performing well and 153,000 new cards were sold during a successful marketing campaign in the first quarter. Egg has grown its card book by three per cent at a time when the UK card market has contracted by two per cent.

Conditions in the personal loans market, which had begun to deteriorate in 2005, continued to be difficult in the first half of the year. In current market conditions we do not see attractive returns. We have taken action to lower our exposure to personal lending and we expect this to continue for some time. This action adversely affects short-term reported profits but we are confident that it will improve the long-term value of the loan book. Bad debt charges in the first half increased significantly across the unsecured lending industry as a whole and we have taken prudent action by increasing the charge in the first half by 42 per cent. As a result, Egg reported an operating loss before tax of £39 million (2005: profit £13 million). We expect Egg to report an operating profit for the second half.

We are restructuring our UK operations to focus on the opportunities for income in retirement, the wealth and health sectors and retail banking. We will also separate out our mature products and manage these as a specific business area. We are making good progress in integrating our UK insurance operations and Egg following the completion of the buy-back of the Egg minority announced in December 2005.

Following a further review of the combined cost base we are targeting total cost savings of £150 million per annum (inclusive of £40 million per annum savings announced in December 2005) by 2009. These savings are equivalent to 18 per cent of the cost base and one-off costs to be incurred up to 2008 are estimated at £110 million (inclusive of £50 million announced in December 2005). In addition, following the purchase of the minority interest in Egg, we have reorganised the Group's structure with an expected benefit of £120 million to the Group's Financial Conglomerates Directive capital position.

Asset management

Supported by continuing excellent investment performance, our asset management businesses in the UK and Asia are performing very strongly with net investment flows more than doubling to £5.3 billion. Operating profit before tax at M&G increased by 20 per cent to £100 million and in Asia first half profits were £22 million (2005: £2 million). External funds under management have increased to £51 billion (2005: £46 billion).

Outlook

Overall, the Group has significant capacity to grow and to build on the strength of our positions in the major retail financial services markets of Asia, the US and the UK.

Our clear focus continues to be to drive profitable growth across each of our businesses as well as leveraging opportunities within each region and across the Group. There remains tremendous scope to increase value for our shareholders and I am confident of the outlook for the Group.

Mark Tucker
Group Chief Executive
27 July 2006