PRUDENTIAL HEALTH LIMITED

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FINANCIAL STATEMENTS OF PRUDENTIAL HEALTH LIMITED
FOR THE YEAR ENDED 31 DECEMBER 2006

Incorporated and registered in England and Wales. Registered No. 5051253
Registered office: Laurence Pountney Hill, London EC4R 0HH

Directors report and financial statements for the year ended 31 December 2006

CONTENTS

Directors

A Gore (Chairman)
S Ellen
Sir AW Foster
R Harris (resigned 02 February 2007)
S Matisonn
DR Mezher
B Swartzberg
G Shaughnessy

Secretary

Prudential Group Secretarial Services Limited

Auditors

KPMG Audit Plc

DIRECTORS REPORT
For the year ended 31 December 2006

1. Principal Activities

The principal activity of the Prudential Health Limited (PruHealth) is to provide private medical insurance in the United Kingdom.

The strategic vision for PruHealth is "to build a substantial business that has a significant impact on the market by engaging consumers in their wellbeing and making them healthier".

The strategy is to leverage the strong brand and financial strength that comes with Prudential and blend this with product development and administration expertise of Discovery. Product leadership through strong innovation and a multi-channel distribution strategy is planned to deliver a significant market presence with a substantial market share by 2013.

The fast growth delivered in 2005 through to 2007 is generating significant added value in the form of future profit streams but the high new business strain generates a negative cash flow and losses in early years. Our aim is to achieve breakeven in 2008 and be profitable thereafter.

PruHealth offers three main product types:

Individual product
This is offered to the retail market either direct or via a broker. The product features include:

- Private Medical Insurance: Cover is offered for a range of private healthcare related claims. The cover is dependent on the plan type chosen and includes hospital and outpatient cover for selected conditions. It specifically excludes emergency cover, maternity cover and cover for chronic conditions;
- Starter discounts: Up to 30% based on answers to healthcare questions;
- Renewal discounts: Discounts are offered at renewal depending on claims and Vitality status; and
- Vitality rewards: Full Vitality package including gym offering and healthcare related rewards.

SME product
This is an age-rated product offered to small groups (2 – 100) via the broker market. The product features include:

- Private Medical Insurance: Cover is offered for a range of private healthcare related claims. The cover is dependent on the plan type chosen and includes hospital and outpatient cover for selected conditions. It specifically excludes emergency cover, maternity cover and cover for chronic conditions;
- Renewal discounts for employers: Discounts are offered at renewal depending on loss ratio;
- Cashback: Employees are eligible for cash bonuses depending on the amount claimed during the period and their Vitality status; and
- Vitality rewards: A full Vitality package is offered including gym offering and healthcare related rewards.

DIRECTORS REPORT cont.

Corporate product

This is a product with fixed premiums by age that is fully experience rated each year. It is offered by brokers and employee benefit consultants. The product features include:

- Private Medical Insurance: Cover is offered for a range of private healthcare related claims. The cover is dependent on the plan type chosen and includes hospital and outpatient cover for selected conditions. It specifically excludes emergency cover, maternity cover and cover for chronic conditions.
- Cashback: Companies can select their desired level of cashback. If selected, employees are eligible for cash bonuses depending on the amount claimed during the period and their Vitality status.
- Vitality rewards: A full Vitality package is offered including gym offering and healthcare related rewards.

2. Current Initiatives

PruHealth was voted Individual Private Medical Insurance "Provider of the Year" by health and protection intermediaries at a recent industry dinner held by Cover magazine. Intermediaries voting in the "Provider of the Year" category took into account the combination of product value, price, customer service and service to the intermediary. PruHealth was chosen, among other stakeholders, to champion the Department of Health's "Small change, big difference" campaign. PruHealth was the only private medical insurer to be selected at launch. This initiative is aimed at adults with the message that even small changes in diet and physical activity can make a difference.

PruHealth is in the process of launching a number of distribution and product initiatives that will fuel the continued growth mentioned above:

- In January, PruHealth commenced a significant brand awareness campaign with TV advertising used for the first time under the 'It Pays to be Healthy' strapline.
- Also in January, an enhanced Corporate scheme offering was launched, with the option of PMI and Vitality through Trusts and Cost-Plus schemes. We will be creating a PruHealth Services company to provide Trust services alongside the existing PMI offering through PruHealth.
- In February we entered into a strategic alliance with Boots to co-brand PMI as part of their Health club initiative, launching in 1400 stores in April with an 8 week half price Healthcare offer.
- Relationships with the IFA market are being strengthened with enhanced propositions being launched in Q2

3. Financial Results and Performance

PruHealth continues to grow strongly with full-year Gross Written Premiums up 300 per cent at £36 million (£9 million in 2005). On the 2nd February 2007, it achieved the milestone of 100,000 lives and the figure is expected to double during 2007. GWP from new lives (which is equivalent to APE) was £28m and the present value of new business premium over the expected duration of these contracts comes to £265m. Contributing to this growth is the number of companies adopting PruHealth for their employee healthcare schemes, including British Airways voluntary scheme, Smith and Nephew and Norton Rose.

DIRECTORS REPORT cont.

PruHealth's philosophy, and the thing that makes it stand out from the competition, is to reward people who make efforts to lead a healthy lifestyle with lower PMI premiums. By creating mutual benefit from motivating customers to maintain a healthy lifestyle and the resultant reductions in claims costs is illustrated by over 400,000 vitality events (including 280,000 gym visits) that our customers make to achieve this.

The successes of PruHealth's consumer engaged care model are not only delivered financially, but further through the uniquely positive relationship that we are building with our customers through Vitality.

A key part of the PruHealth philosophy is to align customer objectives with the company's. This is seen through the mutual benefit of a healthy lifestyle reducing claims and thus benefiting both the customer and the company financially through lower premiums and good returns respectively. We see excellence in customer servicing as a key plank of that philosophy. Despite the high premium growth, we are seeing above target levels of customer satisfaction and low levels of complaints.

4. Results and dividends

The state of affairs of PruHealth at 31 December 2006 is shown in the Balance Sheet on page 12. The Income Statement appears on page 13. No dividend is proposed for the current year.

Changes in the Company's share capital during 2006 are shown on page 14 and note 8.

5. Post Balance Sheet Events

Due to expansion of the business the company entered into an operating lease for further premises after year end. Future operating commitments are reflected in note 20.

In January 2007, the Company increased the authorised share capital to £1,200,002 by the creation of 200,000 additional A ordinary shares of £1 each and 200,000 additional B ordinary shares of £1 each and the following shares were issued:

- 95,000 A ordinary shares to The Prudential Assurance Company; and
- 95,000 B ordinary share to Discovery Offshore Holdings Limited.

The shares were allotted for cash at par value, with a premium of £99 per share.

In February 2007, the Company finalised a Reinsurance Treaty with London Life and Casualty (Barbados) Corporation for a 50% quota share on Individual and SME business.

6. Political and charitable donations

In 2006, the company spent £135 on charitable donations. No political donations were made.

DIRECTORS REPORT cont.

7. Directors

The present directors of the company are stated on page 3. Dates of appointment are detailed below. Mr Gary Shaughnessy, Mr Barry Swartzberg and Ms Susan Ellen were appointed as directors on 15 June 2006, 19 July 2006 and 25 July 2006 respectively. Mr Roger Ramsden and Mr Mark Adams resigned as directors with effect from 1 June 2006 and 25 July 2006 respectively. There were no other changes during the year.

9. Insurance and financial risks

Refer to page 20 for a full explanation of how the company deals with insurance and financial risk.

8. Directors interest

None of the directors in office:

- had any interest in shares of the Company during the financial year.
- was granted or exercised any right to subscribe for shares in or debentures of, the company.

Disclosure of Qualifying Third Party Indemnity Provision Pursuant to Section 309C Company Act 1985

There were qualifying third party indemnity provisions (as defined under section 309B of the Companies Act 1985) in force for the benefit of one or more directors of the company at the time this directors' report was approved under section 234A of the Companies Act 1985 and during 2005.

Auditors

The directors who held office at the date of approval of this directors' report confirm that, so far as they are each aware, there is no relevant audit information of which the Company's auditors is unaware; and each director has taken all the steps that they ought have taken as a director to make them aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

In accordance with Section 384 of the Companies Act 2985, a resolution proposing the re-appointment of KPMG Audit Plc as auditors of the company will be put to the members of the Company at the next Annual General Meeting.

On behalf of the directors

Date: 28 MARCH 2007

On behalf of:
Prudential Group Secretarial Services Limited
Secretary

Date: 28 March 2007

STATEMENT OF DIRECTORS' RESPONSIBILITIES IN RESPECT OF THE DIRECTORS REPORT AND THE ANNUAL FINANCIAL STATEMENTS

The directors are responsible for preparing the Directors' Report and the financial statements in accordance with the applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year that give a true and fair view of the state of affairs of the company and of the profit and loss of the company for the period.

In the current year the directors have elected to prepare the financial statements based on International Financial Reporting Standards as adopted by the EU. This has been adopted by the company for the first time in the current year. All comparative figures have been adjusted where necessary to conform to disclosure requirements.

In preparing the financial statements the directors are required to:

- select appropriate accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable International Financial Reporting Standards have been followed, subject to any material departures being disclosed and fully explained in the financial statements;
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 1985. They have general responsibility for the safeguarding of company's assets and to prevent and detect fraud and other irregularities.

Under applicable law the directors are also responsible for preparing a Directors' Report that complies with the law.

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Director

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF PRUDENTIAL HEALTH LIMITED

We have audited the financial statements of Prudential Health Limited for the year ended 31 December 2006 which comprise the Income statement, the Balance Sheet, the Cash Flow Statement and the Statement of changes in equity and the related notes. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU are set out in the Statement of Directors' Responsibilities on page 9.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the financial statements.

In addition we report to you if, in our opinion, the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read the Directors' Report and consider the implications for our report if we become aware of any apparent misstatements within it.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion:

- the financial statements give a true and fair view, in accordance with IFRSs as adopted by the EU, of the state of the company's affairs as at 31 December 2006 and of its loss for the year then ended;

- the financial statements have been properly prepared in accordance with the Companies Act 1985; and

- the information given in the Directors' Report is consistent with the financial statements.

KPMG Audit Plc

KPMG Audit Plc

Chartered Accountants

Registered Auditor

London

29 March 2007

BALANCE SHEET
As at 31 December 2006

ASSETS

	Notes	2006	2005
		£	£
Non current assets		250,536	4,863,743
Property, plant and equipment	3	250,536	372,545
Advance payment	4	-	4,491,198
Current assets		49,548,709	22,602,624
Trade and other receivables	5	30,465,967	7,195,847
Advance payment	4	4,964,245	2,574,132
Deferred acquisition costs	6	4,868,496	2,419,484
Cash and Cash Equivalents	7	9,250,001	10,413,161
Total assets		49,799,245	27,466,367

EQUITY AND LIABILITIES

	Notes	2006	2005
		£	£
Equity and reserves		18,946,650	15,507,401
Share capital	8	667,002	467,002
Share premium	9	66,033,000	46,233,000
Retained loss		(47,753,352)	(31,192,601)
Total liabilities		30,852,595	11,958,966
Current liabilities			
		30,852,595	11,958,966
Trade and other payables	10	7,320,314	4,726,935
Deferred tax liability	11	9,022	-
Insurance contract liabilities	12	22,769,703	6,886,803
Other taxation payable		753,556	345,228
Total equity and liabilities		49,799,245	27,466,367

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Income statement
For the year ended 31 December 2006

	Notes	2006	2005
Revenues			
Gross premiums written		35,558,588	9,315,584
Change in gross provision for unearned premiums		(11,721,145)	(5,237,256)
Gross insurance premiums		23,837,443	4,078,328
Payments to reinsurers		(410,025)	-
		23,427,418	4,078,328
Insurance claims			
Gross insurance claims paid		(18,756,431)	(1,986,511)
Change in gross provision for claims		(2,612,243)	(662,047)
		(21,368,674)	(2,648,558)
Recoveries from reinsurers on claims paid		153,320	-
Insurance claims incurred		(21,215,354)	(2,648,558)
Net revenue after insurance claims		2,212,064	1,429,770
Other income		1,189,221	261,730
Investment income	13	1,090,200	1,231,112
Operating expenses	14	(36,041,388)	(23,315,624)
Loss on ordinary activities before taxation		(31,549,903)	(20,393,012)
Taxation on loss on ordinary activities	16	14,989,152	3,072,234
Net loss for the year		(16,560,751)	(17,320,778)

STATEMENT OF CHANGES IN EQUITY
As at 31 December 2006

	Share Capital	Share Premium	Retained loss	TOTAL
Balance at 31 December 2004	300,002	29,700,000	(13,871,823)	16,128,179
Shares issued during the year	167,000	16,533,000	-	16,700,000
Loss for the year	-	-	(17,320,778)	(17,320,778)
Balance at 31 December 2005	467,002	46,233,000	(31,192,601)	15,507,401
Shares issued during the year	200,000	19,800,000	-	20,000,000
Loss for the year			(16,560,751)	(16,560,751)
Balance at 31 December 2006	667,002	66,033,000	(47,753,352)	(18,946,650)

Cash flow statement
For the year ended 31 December 2006

	Notes	2006	2005
		£	£
Cash flows from operating activities		(22,248,026)	(25,197,334)
Cash generated by operations	17	(25,351,134)	(29,175,524)
Taxation receivable		3,103,108	3,978,190
Cash flows from investing activities		1,084,866	1,132,659
Purchase of property, plant and equipment		(5,334)	(98,453)
Interest received		1,090,200	1,231,112
Cash flow from financing activities		20,000,000	16,700,000
Issue of ordinary share capital		20,000,000	16,700,000
Net (decrease) in cash and cash equivalents		(1,163,160)	(7,364,675)
Cash and cash equivalents at beginning of year		10,413,161	17,777,836
Cash and cash equivalents at end of period		9,250,001	10,413,161

1. ACCOUNTING POLICIES

Prudential Health Limited (PruHealth) is a company registered in England and Wales. The financial statements were authorised for issue in accordance with a resolution of the board of directors on the 8 March 2007.

Adoption of International Financial Reporting Standards (IFRS)

In the current year, the company has adopted all of the new and revised standards as applicable in the International Financial Reporting Standards (IFRS) as adopted by the EU. Previously the financial statements were prepared in accordance with the provisions of Sections 255 of, and schedule 9A to, the Companies Act 1985. These are the company's first financial statements under IFRS, and IFRS 1 has been applied.

The company's transition to IFRS is 1 January 2005. The company's opening balance sheet on transition and comparative information for 2005 have been restated to comply with all IFRS pronouncements effective as at 31 December 2005. The impact of the transition to IFRS on the company's net loss for 2005 and balance sheet is presented below. There is no impact on the cash flow statement.

Income statement

	2005 £
Net loss for the year before taxation	(14,195,262)
Adjusted for IFRS transition:	
Valuation allowance against deferred tax asset	(3,125,516)
Net loss for the year attributable to shareholders as reported under IFRS	(17,320,778)

Reconciliation of equity

	1 January 2005	31 December 2005
As reported under UK GAAP	18,487,949	32,987,331
Valuation allowance against deferred tax asset	(2,359,770)	(5,485,286)
As reported under IFRS	16,128,179	27,466,367

Basis of presentation

The financial statements have been prepared under the historical cost basis, modified where necessary to include the revaluation of investments and other assets as required. The financial statements are presented on a going concern basis.

Insurance premiums

Insurance premiums written relate to renewals and new contracts taken out during the year. These amounts are gross of commission after deducting taxes and duties.

Premiums written are recognised on policy inception and earned on a pro rata basis over the term of the insurance contracts to which they relate. Amounts relating to future periods are carried forward at the balance sheet date as unearned premiums. The change in provision for unearned premiums is taken to the income statement in order that revenue is recognised over the period of risk. Estimates of premiums written but not yet processed at the balance sheet date are assessed based on past experience and included in premiums earned.

Insurance claims

Insurance claims comprise claims and related expenses paid during the year as well as changes to the provisions for claims incurred but not reported. The gross provision arises as a result of claims that have not been reported at balance sheet date and represent an estimate based on current information.

Adjustments needed to the provision for prior years will be adjusted through the income statement once information has become available.

Insurance contract liabilities and related reinsurance recoveries

Provision is made at year end for estimated costs of claims incurred but not yet settled at balance sheet date whether currently reported to the company or not. The estimated cost of claims includes all expenses to be incurred in settling claims. The company takes all reasonable steps to ensure that it has appropriate information regarding claims exposure. However, given the uncertainty in establishing claims, it is likely that the final outcome will prove to be different from the original liability established.

The estimation of claims incurred but not reported ("IBNR") is generally subject to a greater degree of uncertainty than an estimation of costs of settling claims submitted to the company. In calculating the estimated costs of unpaid claims, the company uses statistical analyses of historical experience, which assumes that the development pattern of the current claims will be consistent with the past experience. However allowances are made for changes and uncertainties which may create distortions in the underlying statistics or which cause the cost of unsettled claims to increase or reduce when compared to previously unsettled claims.

ACCOUNTING POLICIES cont.

Changes in company processes which might accelerate or slow down the development and / or recording of paid or incurred claims compared with the statistics from previous periods include:

Changes in the legal environment;
Changes in the mix of business; and
Movements in industry benchmarks.

An impairment review is performed on all reinsurance assets when an indication of impairment occurs. Reinsurance assets are impaired only if there is objective evidence that the company may not receive all amounts due to it under the terms of the contract.

Liability adequacy test

For private medical insurance policies where future claims may exceed future earned premiums, an estimate of the deficiency is recorded as an unexpired risk provision. In instances where there is large variability in the size of the eventual deficiency, prudent assumptions are made so that the provision would be sufficient in reasonably foreseeable adverse circumstances.

At each balance sheet date, a liability adequacy test is performed to ensure the adequacy of unearned premiums less related deferred acquisition cost assets. In performing the test, current best estimates of future contractual cashflows, claims handling and policy administration expenses are used. Any inadequacy is immediately charged to the income statement by establishing an unexpired risk provision.

Provision for other liabilities and charges

A provision is recognised when the company has a present legal or constructive obligation which it is probable will result in an outflow of resources and when a reliable estimate of the amount of the obligation can be made. If the effect is material the provisions are determined by discounting the expected future cash flows at a the pre tax rate that reflects a current market assessment of the time value of money, and where appropriate, the risks specific to the liability.

The company recognises a provision for onerous contracts when the expected benefit to be derived from the contracts are less than the unavoidable costs of meeting the obligations under the contracts.

Acquisition costs

Acquisition costs represent commissions payable and other related expenses of acquiring insurance policies written during the year. Acquisition costs which relate to a subsequent period are deferred and charged to accounting periods in which the related premiums are earned.

ACCOUNTING POLICIES cont.

Non-operating income

Included in non-operating income is interest received.

Interest received is recognised on a time proportion basis that takes into account the effective yield on the asset. Such interest is recognised in the income statement.

Deferred Tax

Deferred taxation is provided on the comprehensive basis computed as the difference between the tax base and carrying amounts of assets and liabilities. Deferred tax liabilities are recognised for all taxable temporary differences. Deferred tax assets are recognised for all deductible temporary differences to the extent that it is probable that taxable profits will be available against which the deductible temporary difference can be utilised.

Operating Leases

PruHealth classifies leases of assets, where the lessor effectively retains the risks and benefits of ownership, as operating leases. Operating lease payments are charged to the income statement on a straight-line basis over the period of the lease. Minimum rentals due after year-end are reflected under commitments

Property, plant and equipment

Property, plant and equipment (owned and leased) are recognised initially at their cost. After initial recognition, the following accounting policies apply:

Historical cost model

Assets are carried at their cost less any accumulated depreciation. Depreciation is computed by allocating the depreciable amount of an asset on a systematic basis over its useful life and is applied separately to each identifiable component.

The following rates of depreciation are applicable to asset classes:

Computer equipment	33.33% straight line basis
Furniture and fittings	20% straight line basis
Leasehold improvements	20% straight line basis

Non current and current disclosure

For each asset and liability caption, amounts expected to be recovered or settled within twelve months of the balance sheet date will be classified as current and the remaining balance as non current.

2. INSURANCE AND FINANCIAL RISKS

PruHealth takes a proactive approach to managing its risk and each business unit responsible for the five risk groupings identified below have initiated a series of risk management processes to ensure that they are adequately controlled.

Insurance risk

The key areas of risk are premium pricing, claims volatility and failing to meet target levels of business. Monthly meetings are held to review actual experience against original pricing assumptions. The standard terms and conditions applicable to the company's products mitigate the risk of late reporting of claims. Current claims experience is monitored against expected to ensure that PruHealth's current pricing assumptions are reasonable. Information is fed into the pricing reviews conducted by the Actuarial and Underwriting department. On a quarterly basis, the financial forecast is reviewed against emerging experience. The financial model uses the product pricing assumptions and profitability output to produce a model office with financial statements that provide an overview of future company profitability and capital requirements of the business.

PruHealth uses Milliman, an external actuarial consultancy, for external peer review and formal product sign off. Milliman will continue to perform ongoing reviews of the results of emerging experience against our pricing assumptions. Their review will focus on underwriting, claims experience, reserving, demographics and new product pricing. A recent project has been completed to evaluate reinsurance options to PruHealth in the market and an excess of loss reinsurance treaty has been concluded with a joint syndicate consisting of Wellington (a Lloyd's syndicate) and Sirius, an international reinsurer. This mitigates the risk of undue concentrations of insurance risk. Due to the short tail nature of the company's risks all claims are expected to be settled within 12 months of reporting and, accordingly, the company has not presented a comparison of actual claims compared with previous estimates.

Liquidity risk

The key areas of risk here are asset mismatching, the inability to sell financial assets quickly enough and unexpected cash flows. At present the first two risks are minimised as all financial assets are held as cash and hence our liquidity position is strong. To manage unexpected cash flows monthly financials are compared to budget and quarterly budget re-forecasting is conducted to ensure that any additional financing required from PruHealth's shareholders is identified at least three to six months ahead.

Credit risk

Key counter-parties identified that may result in a credit risk to PruHealth are premium debtors and brokers. Premium debtors are managed by strong collection processes to ensure the identification of any unpaid debt and this is reported on a monthly basis. Most commission claw-backs are off set against future payments and hence the risk of outstanding commission is minimal. Whilst PruHealth's entry into a reinsurance arrangement will have an impact on credit risk it is not significant at present.

INSURANCE AND FINANCIAL RISKS cont.

Market risk

The key areas of risk are the movement on interest rates and exchange rate movements resulting in reduced income. PruHealth invests its cash assets on the overnight money market, seeking the best interest rate it can achieve in accordance with its investment policy. At present budgeted interest rate is being achieved. Should there be a change in the market, PruHealth's budgets would be adjusted accordingly to reflect the reduced investment income achievable. Exchange rate movements have been largely managed through the creation of an annual expense contract with Discovery at a fixed exchange rate.

Operational risk

A detailed risk management framework has been implemented across PruHealth through the implementation of individual business unit risk registers, a complaints management process and regular business continuity reviews.

USE OF ESTIMATES, ASSUMPTIONS AND JUDGEMENTS

PruHealth makes estimates, assumptions and judgements that affect the reported amounts of assets and liabilities. Estimates, assumptions and judgements are continually evaluated based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

The most significant use of estimates, assumptions and judgements relates to the estimates of insurance contract liabilities. The IBNR calculation is performed using the chain ladder approach. This allows for the historic patterns of claims payment in determining the likely future emergence of claims. The IBNR is further modified to reflect current operational conditions or known events.

3. Property, Plant and Equipment

	Computer equipment		Furniture and fittings		Leasehold improvements		Total	
	2006	2005	2006	2005	2006	2005	2006	2005
Net carrying amount at beginning of year	126,104	-	82,050	388,473	164,391	-	372,545	388,473
Gross carrying amount	175,274	-	108,371	392,321	207,129	-	490,774	392,321
Accumulated depreciation	(49,170)	-	(26,321)	(3,848)	(42,738)	-	(118,229)	(3,848)
Additions at cost	-	72,240	-	26,213	5,334	-	5,334	98,453
Reclassification of asset classes at carrying amount	-	103,034	-	(310,163)	-	207,129	-	-
Depreciation	(63,028)	(49,170)	(21,823)	(22,473)	(42,492)	(42,738)	(127,343)	(114,381)
Net carrying amount at end of year	63,076	126,104	60,227	82,050	127,233	164,391	250,536	372,545
Gross carrying amount	175,274	175,274	108,371	108,371	212,463	207,129	496,108	490,774
Accumulated depreciation	(112,198)	(49,170)	(48,144)	(26,321)	(85,230)	(42,738)	(245,572)	(118,229)

No assets were considered to be impaired at 31 December 2006.

NOTES TO FINANCIAL STATEMENTS
For the year ended 31 December 2006

4. Advance payment

	2006	2005
As at beginning of the year	7,065,330	-
Amount received during the year	-	6,687,472
Amount utilised during the year	(2,574,132)	-
Interest earned during the year	473,047	377,858
	4,964,245	7,065,330
Comprising of the following:		
Non current portion	-	4,491,198
Current portion	4,964,245	2,574,132

Discovery Health (Proprietary) Limited were prepaid for services to be rendered on behalf of PruHealth. Interest is chargeable at 6.8% per annum.

During the current year the prepaid service costs were utilised at a rate of £429,022 per month beginning in July 2006.

5. Trade and other receivables

	2006	2005
Debtors arising out of direct insurance premiums	16,559,805	5,544,451
Related party amounts receivable	13,343,992	1,448,928
Other debtors	562,170	202,468
	30,465,967	7,195,847

The directors consider the carrying amount of trade and other receivables to approximate their fair values. Refer to note 18 relating to related party amounts receivable.

6. Deferred acquisition costs

	2006	2005
Deferred acquisition costs	4,868,496	2,419,484

As part of the company's insurance business, direct costs in relation to the acquisition of insurance revenues are deferred. The movement in these deferred costs are set out below:

At beginning of the year	2,419,484	120,952
Acquisition costs released to the income statement	(2,419,484)	(120,952)
Acquisition costs incurred during the year	4,868,496	2,419,484
At end of year	4,868,496	2,419,484

7. Cash and cash equivalents

	2006	2005
Cash at bank	9,250,001	10,413,161
	9,250,001	10,413,161

According to company policy the amounts are held with multiple reputable financial institutions earning a market related interest rate.

8. Share capital

Authorised	2006	2005
400,001 A ordinary shares of £1 each	400,001	400,001
400,001 B ordinary shares of £1 each	400,001	400,001

Issued

	2006	2005
333,501 A ordinary shares of £1 each	333,501	233,501
333,501 B ordinary shares of £1 each	333,501	233,501
	667,002	467,002

9. Share premium

	2006	2005
333,500 A ordinary shares of £99 each	33,016,500	23,116,500
333,500 B ordinary shares of £99 each	33,016,500	23,116,500
	66,033,000	46,233,000

10. Trade and other payables

Trade and other payables consist of the following:

	2006	2005
Trade creditors and accruals	3,877,960	2,883,006
Other creditors	1,373,689	189,833
Related party amounts outstanding	2,068,665	1,654,096
Total	7,320,314	4,726,935

The directors consider the carrying amount of trade and other payables to approximate their fair values.

Outstanding related party amounts relate to services rendered on behalf of PruHealth. Refer to note 18.

11. Deferred tax

	2006	2005
Deferred tax asset at beginning of year	5,485,286	-
Movement in deferred tax asset during the year	(5,494,308)	3,125,516
Valuation allowance against deferred tax asset	-	(3,125,516)
Deductible temporary differences	(9,022)	-

	2006	2005
Deferred tax assets and liabilities are analysed as follows:		
Accelerated capital allowances	(9,022)	(9,022)
Other timing differences	-	3,134,538
Valuation allowance against deferred tax asset	-	(3,125,516)
Deferred tax liability at end of year	(9,022)	-

12. Insurance Contract Liabilities

	Provision for unearned premiums		Provision for unexpired risks		Provision for IBNR		Total	
	2006	2005	2006	2005	2006	2005	2006	2005
Opening carrying amount	5,624,516	387,260	619,639	-	545,152	12,538	6,886,803	399,798
Additional provisions	17,345,661	5,722,012	2,266,647	619,639	3,157,395	545,152	22,769,703	6,886,803
Amounts utilised	(5,624,516)	(387,260)	(619,639)	-	(545,152)	(12,538)	(6,886,803)	(399,798)
Closing carrying amount	17,345,661	5,722,012	2,266,647	619,639	3,157,395	545,152	22,769,703	6,886,803

NOTES TO FINANCIAL STATEMENTS cont.
for the year ended 31 December 2006

13. Investment income

	2006	2005
Interest from deposits with credit institutions	617,154	853,254
Other interest	473,046	377,858
	1,090,200	1,231,112

14. Operating expenses

	2006	2005
Operating expenses include the following items:		
Acquisition costs:		
Acquisition costs	28,000,977	18,995,833
Increase in deferred acquisition costs	(2,449,012)	(2,298,532)
Increase in provision for unexpired risks	1,647,008	619,639
	27,198,973	17,316,940
Administrative expenses	4,788,787	3,643,241
Development costs expensed	4,053,628	2,355,443
	36,041,388	23,315,624
The above operating expenses include:		
Commissions payable	4,603,924	1,013,480
Depreciation	127,343	114,381
Computer equipment	63,028	49,170
Furniture and fittings	21,823	22,473
Lease hold improvement	42,492	42,738
Staff costs	5,587,846	3,940,385
Wages and salaries	5,065,892	3,575,463
Social security costs	421,439	285,826
Pension costs	100,515	79,096
Auditors remuneration in their capacity as auditors	109,000	82,000

NOTES TO FINANCIAL STATEMENTS cont.
for the year ended 31 December 2006

15. Directors emoluments

The directors are employed by PruHealth and by Companies in both The Prudential Assurance Company Limited and Discovery Offshore Holdings Limited groups. Other than as disclosed below, no director has received any emoluments or other benefits from the Company.

	2006	2005
Remuneration before defined contribution scheme	486,770	598,419
Defined contribution scheme	13,700	17,757
	500,470	616,176

Directors interest in contracts

Directors did not have any interest in contracts relating to the company during the year, whether direct or with transacting parties.

Loans to directors and connected persons

No loans or quasi-loans were made to directors or connected persons during the year

16. Taxation on loss on ordinary activities

	2006	2005
UK normal taxation consists of:		
Current taxation	14,998,174	3,072,234
Current year tax loss	9,464,971	3,077,891
Under (over) provision for prior year	5,533,203	(5,657)
Deferred taxation	(9,022)	-
Current year	(9,022)	-
Total taxation credit due to losses	14,989,152	3,072,234

	2006	2005
Tax rate reconciliation:		
Loss on ordinary activities before taxation	(31,549,903)	(20,393,012)
Taxation credit on loss on ordinary activities at 30%	9,464,971	6,117,904
Reconciling items:		
Permanent differences	-	16,607
Adjustments in respect of prior periods	(5,533,203)	3,029,063
Current tax credit for the year	14,998,174	3,072,234
	9,464,971	6,117,904

17. Reconciliation of net loss before taxation with cash generated by operations

	2006	2005
Loss before tax	(31,549,903)	(20,393,012)
Adjustments		
Non cash expenses included in loss before tax	127,343	114,381
Depreciation	127,343	114,381
Items disclosed separately on cash flow statement	(1,090,200)	(1,231,112)
Interest received	(1,090,200)	(1,231,112)
Operating profit before working capital changes	(32,512,760)	(21,509,743)
Changes in working capital	7,161,626	(7,665,781)
(Increase) in debtors	(359,702)	(152,350)
(Increase) in debtors arising from direct insurance premiums	(11,015,354)	(5,178,445)
Decrease (Increase) in advance payments	2,101,085	(7,065,330)
(Increase) in deferred acquisition costs	(2,449,012)	(2,298,532)
Increase (Decrease) in other creditors	1,598,425	(1,219,469)
Increase in provisions	15,882,900	6,616,149
Increase in tax payable	408,328	262,712
Increase in trade creditors and accruals	994,956	1,369,484
Cash generated by operations	(25,351,134)	(29,175,524)

18. Related Party Transactions

Prudential Health Limited is a joint venture between The Prudential Assurance Company Limited and Discovery Health (Proprietary) Limited, each party holding 50% interest. During the current year both parties provided services to Prudential Health Limited.

Related party	Nature of Related Party Transactions	Transaction Amount		Balances outstanding at year end	
		2006	2005	2006	2005
The Prudential Assurance Company Limited	Services Rendered	2,313,005	2,241,329		
	Amounts due to			(738,637)	(574,094)
	Amounts due from			13,343,992	1,448,928
Discovery Health (Proprietary) Limited	Services Rendered	9,252,680	6,536,755		
	Interest earned	(473,046)	(377,858)		
	Amounts due to			(1,330,028)	(1,080,002)
	Advance payment			4,964,245	7,065,330
Total related party:	Services Rendered	11,565,685	8,778,084		
	Interest earned	(473,046)	(377,858)		
	Amounts due to			(2,068,665)	(1,654,096)
	Amounts due from			13,343,992	1,448,928
	Advance payment			4,964,245	7,065,330

Amounts due to and from Prudential and Discovery relating to services do not attract interest as these transactions are considered to be at an arms length.

On the 28 February 2005, PruHealth made an advance payment of £6,687,472 relating to administration services. This advance payment attracts interest at 6,8% on the outstanding balance. Refer to note 4.

Discovery Offshore Holdings Limited has provided the Prudential Assurance Company Limited with a bank guarantee through HSBC Bank plc. At the year end 31 December 2006 the bank guarantee stood at £1.65m (2005: £11.65 m).

NOTES TO FINANCIAL STATEMENTS cont.
for the year ended 31 December 2006

19. Commitments

Operating lease commitments

PruHealth has various operating lease agreements for computer equipment and offices.

The future minimum commitments in terms of leases are as follows:

	2006	2005
Due within 1 year	311,334	234,637
Due within 2 to 5 years	938,548	938,548
Due after 5 years	645,252	879,889
Net commitment	1,895,134	2,053,074

20. Post Balance Sheet Events

In January 2007 PruHealth negotiated a new operating lease for additional office space. The future minimum commitments in terms of leases are as follows:

	2006
Due within 1 year	210,505
Due within 2 to 5 years	842,020
Due after 5 years	410,010
Net commitment	1,462,535

In January 2007, the Company increased the authorised share capital to £1,200,002 by the creation of 200,000 additional A ordinary shares of £1 each and 200,000 additional B ordinary shares of £1 each and the following shares were issued:

- 95,000 A ordinary shares to The Prudential Assurance Company; and
- 95,000 B ordinary share to Discovery Offshore Holdings Limited.

The shares were allotted for cash at par value, with a premium of £99 per share.

In February 2007, the Company finalised a Reinsurance Treaty with London Life and Casualty (Barbados) Corporation for a 50% quota share on Individual and SME business.

21. Immediate and Ultimate Parent Company

The company is a joint venture between the Prudential Assurance Company Limited and Discovery Off shore Holdings Limited, with each shareholder owning 50% of the share capital, and consequently has no parent company.