



**Tidjane Thiam**  
Group Chief Executive

*Tidjane Thiam*

# GROUP CHIEF EXECUTIVE'S REPORT

**I am pleased to report that Prudential continued to perform strongly in the first half of 2010, achieving high levels of sales growth and new business profits.**

Our determination to consistently allocate capital to the geographies and products that deliver the highest returns for our shareholders is continuing to deliver positive results. Our rates of return in Asia remain high, we are driving profitable growth in the US, our focused strategy in the UK continues to deliver amongst the highest margins in the sector, as well as being cash generative, and our asset management businesses continue to perform very well.

The results we are reporting today show considerable growth on the first half of 2009, a period of marked economic dislocation. To better assess the long-term progress of the business, it is also useful to compare our performance during the first half of 2010 with our results in the first half of 2008, a period of relatively favourable economic and market conditions. Since the first half of 2008, new business profits have grown by 59 per cent<sup>1</sup>, EEV operating profit before tax by 24 per cent and IFRS operating profit before tax by 37 per cent, excluding US hedging gains in both periods.

The first half of this year has also seen us maintain our robust capital position of £3.4 billion (31 December 2009: £3.4 billion) despite the payment of the 2009 final dividend and the AIA transaction costs.

## **AIA transaction**

Alongside the strong performance of the business, the first half of 2010 was dominated by our proposed acquisition of AIA, the Asian arm of AIG. The Board unanimously believed that this acquisition represented a unique opportunity to significantly amplify and accelerate our successful strategy in Asia. It was an opportunity which was available to us only because of the quality and standing of the Group.

On 1 March 2010 we announced we had reached agreement with AIG to acquire AIA. We subsequently re-negotiated a lower price with the AIG management in May. This revised bid was supported by AIG's executive management. However, the Board of AIG decided not to sell AIA to us and as a result the agreement was terminated on 3 June 2010. We very much regret that this transaction did not proceed and that costs were incurred.

## **Note**

<sup>1</sup> Excludes Japan which ceased writing new business in 2010.

## THERE'S MORE TO PRUDENTIAL

**Our strategy of consistently allocating capital to the geographies and products that deliver the highest returns is continuing to deliver positive results.**

**Our rates of return in Asia remain high, we are driving profitable growth in the US, our focused strategy in the UK continues to deliver amongst the highest margins in the sector, as well as being cash generative, and our asset management businesses continue to perform very well.**

# ACCELERATING

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The total cost to the Group from terminating the agreement, including the associated US dollar hedging programme, was £377 million pre-tax, and £284 million post expected tax relief. These costs comprised: the break fee of £153 million paid to AIG; foreign exchange hedge cost of £100 million; underwriting fees of £58 million; and adviser fees of £66 million, less expected tax relief of £93 million. Our prudent initial estimate that the pre-tax costs would be £450 million was reduced as we closed the foreign exchange hedging positions and worked with our suppliers and advisers to minimise costs. The costs associated with the transaction will not impact the Group's dividend policy.

While the proposed AIA transaction was high profile and attracted a great deal of interest, the Group continued to perform strongly. I would like to take this opportunity to thank our employees across the Group for their hard work and continued commitment to our customers throughout this challenging period.

### Group performance

We continue to manage the Group with a balance across the three metrics of Embedded Value, International Financial Reporting Standards (IFRS) and cash, as we believe this is the best way to generate value for our shareholders over the long-term.

On the European Embedded Value (EEV) basis, Group operating profit before tax increased by 35 per cent over 2009, to £1,677 million (2009: £1,246 million). New business profit for the period was £892 million, an increase of 27 per cent (2009: £700 million), and the average margin across the Group was maintained at 54 per cent (2009: 54 per cent), excluding Japan where we stopped writing new business this year.

In achieving this growth in new business profit, our absolute investment in new business remained broadly flat compared to the first half of 2009 at £337 million (2009: £319 million). This demonstrates a marked increase in our capital efficiency as our sales grew significantly during the same period. We continued to focus on the opportunities with the highest returns, lowest capital requirements and shortest payback periods.

Our IFRS operating profit before tax from continuing operations increased by 41 per cent in the first half of 2010 to £968 million (2009: £688 million). These results include £123 million of variable equity hedge gains in our US operations (2009: equity hedge losses of £23 million). Excluding these variable hedge gains, there was an increase of 19 per cent in the first half of 2010 to £845 million (2009: £711 million), which is a better reflection of our underlying performance over the previous year and constitutes excellent progress.

Asset management net inflows were £4.4 billion (2009: £10.1 billion). Although this is down against the same period last year, which saw exceptional inflows into M&G's bond funds as a result of the financial crisis, this remains a leading performance driven by continuing strong inflows into M&G's retail funds.

As a key indicator of our ability to generate cash and capital, the free surplus in the life and asset management operations increased to £3.2 billion, up from £2.5 billion at the end of 2009 and £0.9 billion at the end of 2008. Embedded value shareholders' funds increased nine per cent to £16.7 billion (2009: £15.3 billion) and IFRS shareholders' funds rose 14 per cent to £7.2 billion (2009: £6.3 billion).

### Capital and risk management

As a consequence of our actions and ongoing operational performance, the capital position of the Group remains robust. Using the regulatory measure of the Insurance Groups Directive (IGD), the Group's capital surplus was estimated at £3.4 billion at 30 June 2010 (before any allowance for the 2010 interim dividend). The Group's required capital is covered 2.7 times by available capital. This positions us as one of the best capitalised insurers.

### Interim dividend

Given the sound financial position of the Group, and our continuing strong financial performance, the Board has agreed an increase of five per cent in the interim dividend to 6.61 pence per share (2009: 6.29 pence). The Board remains committed to a growing 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.



### Hong Kong and Singapore listings

On 25 May 2010, we announced the listing of our ordinary shares on the main board of the Stock Exchange of Hong Kong Limited as a dual primary listing alongside our primary listing of ordinary shares in London. In addition, we also listed our ordinary shares on the Singapore Exchange Securities Trading Limited.

The listings were by way of introduction, with no new shares being issued or sold to the public or investors, and over the longer-term will offer a wider range of investors the opportunity to invest in Prudential. These listings further underline the Group's long-term commitment to Asia, deepening our presence in the region's dynamic business environment and raising our profile with governments, local business communities and our customers and staff.

### Our strategy

We have managed the Group to a clear and consistent strategy, applying rigorous operating principles. We have continued to (i) prioritise our highly profitable growth in Asia, (ii) put an emphasis on growth and cash generation in the US, (iii) focus on sustainable cash generation in the UK ahead of growth and (iv), in our asset management businesses, focus on generating strong investment performance, which is the foundation of our ability to attract flows and increase assets under management.

By maintaining our discipline in the implementation of this strategy, allocating capital to the most attractive markets and products, and managing proactively risk and capital, we believe we can continue to generate sustainable and differentiated value for our shareholders. Over the past two years our strategy has proven its worth under the most testing conditions, and it has continued to deliver a very good performance amid the improving global conditions experienced in the first half of 2010.

Many of the highest return opportunities are in Asia. We find the emerging markets of South-East Asia – such as Indonesia, Vietnam, Singapore and Malaysia, together with Hong Kong – particularly attractive. These remain the priority destination for our marginal capital investment. Even within Asia, we remain committed to focusing our capital on the areas with the highest returns. This disciplined and pragmatic approach led us to decide to stop writing new business in Japan at the start of 2010. In a sector where distribution is key, we have been growing and diversifying our distribution, including increasing our agency workforce and completing a long-term strategic bancassurance partnership with United Overseas Bank Limited (UOB).

In the US, the world's largest retirement market, we continue to see opportunities for high returns. During the first half of 2010, the US financial services industry remained under pressure. This created opportunities for us, with our strong financial ratings and product set. We have established a reputation as a high-quality and reliable business partner. We remain focused on increasing volumes profitably in variable annuities, whilst managing fixed annuity sales in line with our strategy of capital efficiency.

The UK is a mature market with lower growth and lower returns than are available to us elsewhere in the Group's portfolio. By maintaining a balance between writing profitable new business and generating surplus cash, the Group is able to invest the surplus cash we generate in the UK into markets with higher returns. Our financial performance in the UK provides strong support to our credit rating at a Group level and continues to be a significant contributor to our overall performance.

Our asset management businesses provide high quality profits and cash, have limited capital requirements and are central to the successful delivery of our strategy, as investment returns are at the core of our value proposition to our customers.

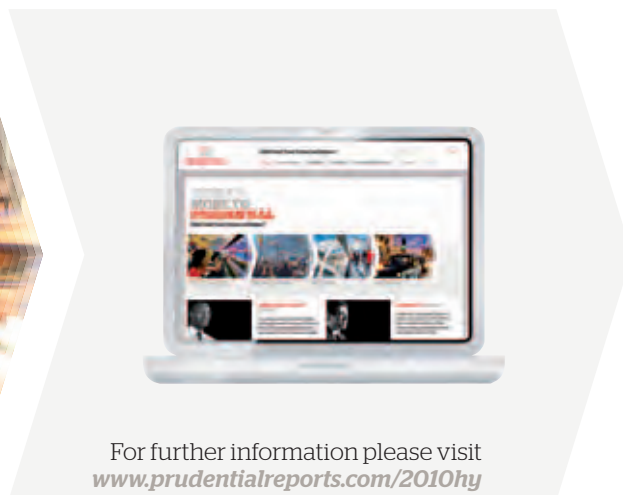
### Our operating performance

Our operating model enables each of our businesses to stay close to their customers, by identifying and developing the specific product and distribution mix most suited to their particular market and customer base. Our aim in all our markets is to have a suite of savings, income and protection products that deliver good value and meet customers' needs in a profitable and capital efficient manner.

Looking at the operating performance of each of our business units, I am pleased to report a strong performance in the first half of 2010.

### Prudential Corporation Asia

The Asia life insurance sector has done well during the first half as the region recovered from the economic downturn. Our approach remains to expand our distribution reach via our proprietary agency distribution and through partnerships, together with a continued focus on improving our productivity. Agency remains the main distribution channel and agent numbers continue to grow. Bank distribution has performed well and is growing, with our new partnership with UOB already generating significant sales. This is important for the future, as the banking distribution channel will grow, as the region becomes wealthier and banking penetration increases.



In line with the Group's strategy, we continue to manage proactively and rigorously our investment in new business, focusing on value creation, particularly with high margin regular premium business. New business written in the period has an average internal rate of return (IRR) in excess of 20 per cent and an average payback period of three years.

#### **Jackson National Life**

We continue to benefit from the market observed in the US in 2008 and 2009. Our focus remains on increasing volumes profitably in variable annuities whilst managing proactively the level of our fixed annuity sales and maintaining pricing discipline. In light of the continued volatility in US equity markets and low interest rates, customers continue to seek to mitigate equity risk while receiving an acceptable return through the purchase of variable and fixed annuities with guaranteed benefits. We have continued to expand the number of advisers appointed to sell our products, building on the 35 per cent increase in adviser numbers in 2009. We have also continued to invest in the bancassurance channel, which has been expanded recently through agreements with new distribution partners including Merrill Lynch.

As expected, new business margins reduced to 64 per cent from the exceptional level of 74 per cent in the same period in 2009. This was anticipated as the corporate bond market recovered, the abnormally high spreads in 2009 normalised and our competitors progressively recovered from the 2008/2009 market dislocation. Nevertheless, business conditions remain favourable and we continue to write new business at an IRR in excess of 20 per cent with an average payback of two years.

#### **Prudential UK and Europe**

Our UK business is a valuable part of the Group and a market leader in both individual annuities and with-profits. In the first half we maintained a focus on balancing writing new business, with cash and capital generation, successfully delivering attractive returns on capital employed. Our business in the UK is disciplined, generating very attractive returns relative to the market.

During the first half of 2010, we continued to actively manage sales volumes to control capital consumption, with new business concentrated in the retail markets. We have maintained a strict focus on value in the bulk annuity and back-book markets and wrote no new business in this area during the period. The weighted average post-tax IRR on the shareholder capital allocated to new business growth was in excess of 15 per cent and the average free surplus undiscounted payback period was five years.

#### **Asset Management**

Our asset management businesses have continued to capitalise on their leading market positions and strong track records in investment performance. In the UK, M&G has been the leading net seller of retail funds for six consecutive quarters, driven by excellent investment performance. Over the three years ending 30 June 2010, 34 per cent of M&G's retail funds ranked in the top quartile and 66 per cent in the top half. M&G continues to add value to the Group by generating attractive returns on internal funds as well as growing profits from the management of third-party assets.

In Asia, the first half performance of our asset management business has been very strong, with a significant increase in profitability. Given the increasing wealth in the region, we see asset management as a very attractive opportunity.

#### **Outlook**

We have significant opportunities for profitable growth and the financial strength to take advantage of those opportunities. We are cautious about the outlook for the western economies. However, our Asian business gives us a material and powerful presence in the most attractive markets in our industry, and one that will continue to underpin our growth.

So we view the future with confidence. We expect the momentum that we have seen in our businesses during the first half to be sustained during the rest of the year. As we look further ahead, beyond the second half, we are well positioned to continue to deliver strong growth and generate strong returns for our shareholders, thanks to our operational focus and strong market positions.