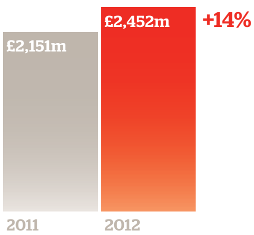
Chief Financial Officer's overview

Delivering profitable growth and enhanced capital flexibility

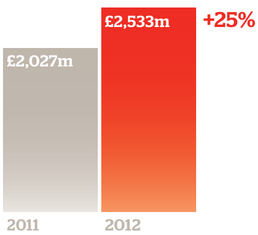
'Over the last few years, our success has been founded on attracting new customers and on retaining those who have chosen Prudential for their savings and protection needs. We operate in markets where consumer demand for the products that we provide is strong and we have achieved success by providing both value and service to our customers while generating attractive returns for shareholders.'

Nic Nicandrou
Chief Financial Officer

EEV new business profit



IFRS operating profit based on longer-term investment returns[1]



Our guiding operating principle is simple – drive the creation of sustainable shareholder value while operating within a conservative risk management framework. Over the last four years, through a combination of disciplined execution and prudent management of our balance sheet risks, Prudential has delivered profitable growth and enhanced its capital flexibility, despite the challenging market environment.

2012 has seen Prudential continue to build on the positive momentum of recent years, with a strong financial performance that included two of our 2013 'Growth and Cash' financial objectives being exceeded and continued progress towards the rest. This performance reflects good contributions across our key financial measures from each of our business operations, despite the challenge of low long-term interest rates and weak growth in the global economy. It is particularly pleasing to note that Asia became the largest contributor of cash to the Group in 2012, remitting over £300 million for the first time in its history and exceeding its 2013 cash objective. With IFRS operating profit, after development expenses, of £988 million in 2012, Asia has also exceeded its 2013 IFRS operating profit objective.

EEV new business profit ('new business profit'), our primary growth measure, increased by 14 per cent to £2,452 million (2011: £2,151 million), IFRS operating profit based on longer-term investment returns ('IFRS operating profit') increased by 25 per cent to £2,533 million (2011: £2,027 million)[1] and net cash remitted from the business units to the Group increased by 9 per cent to £1,200 million (2011: £1,105 million). As these results demonstrate, the quality of our businesses across Asia, the US and the UK, combined with the strength of our balance sheet and financial discipline, underpins the Group's ability to deliver both growth and cash in the face of continued macroeconomic headwinds.

Note
1 Comparatives adjusted for retrospective application of the accounting policy change for deferred acquisition costs as discussed in note A5 of the IFRS financial statements.

Profitability

Over the last few years, our success has been founded on attracting new customers and on retaining those who have chosen Prudential for their saving and protection needs. We operate in markets where consumer demand for the products that we provide is strong and we have achieved success by providing both value and service to our customers while generating attractive returns for shareholders. In 2012 this approach produced £10.5 billion of life business net inflows on shareholder-backed business, which together with investment-related and other movements, drove an increase in the overall size of our life insurance book of business by 22 per cent to £163 billion (2011: £133.5 billion). At the same time, our combined asset management operations attracted £18.3 billion of retail and institutional net flows, surpassing the previous highs in 2009 and 2010, driving an increase in the third party managed funds by 20 per cent to £133 billion (2011: £111 billion). By attracting, retaining and growing our customers' savings and our obligations towards them, we are able to generate higher revenues, which in 2012 have once again increased at a faster rate than our expenses, culminating in greater overall profits.

Group IFRS operating profit increased by 25 per cent in 2012 to £2,533 million (2011: £2,027 million)[1], driven by strong growth in total contributions[2] from Asia and the US, which were up 26 per cent and 49 per cent respectively. Group EEV operating profit based on longer-term investment returns ('EEV operating profit') increased by 9 per cent to £4,321 million (2011: £3,978 million), with growth in all regions. Non-UK operations now account for a larger proportion of both total IFRS and EEV operating profit than ever before, while the contribution to these metrics from each business operation and each earnings source remains well balanced, preserving both the quality and the resilience of the Group's earnings.

Our Asia long-term business has continued to build on the progress of recent years, with IFRS operating profit of £920 million (2011: £709 million)[1] up 30 per cent. This strong performance has been driven by the increase in the size of the in-force portfolio including the growth of our health and protection business. Our largest markets of Indonesia, Hong Kong, Singapore and Malaysia continue to generate good levels of growth, with IFRS operating profit up 22 per cent collectively. Asia's long-term EEV operating profit grew by 11 per cent in 2012 to £1,960 million (2011: £1,764 million), with progress on this measure impacted by lower expected returns as a result of the fall in interest rates during the year.

In the US, long-term business IFRS operating profit was up 48 per cent in 2012 to £964 million (2011: £651 million)[1], which includes a contribution of £67 million from REALIC, following its acquisition in September 2012. The remaining increase primarily reflects higher fee income generated by growth in the separate account assets, as well as the expected non-recurring impact of accelerated deferred acquisition cost (DAC) amortisation of £190 million in 2011. This has been partially offset by the adverse effect on spread income of lower bond yields. Fee income increased by 29 per cent to £875 million in 2012 (2011: £680 million), as a result of growth in separate account asset balances, which stood at £49 billion at 31 December 2012 (31 December 2011: £38 billion), together with higher average fee levels. Spread income (including the expected return on shareholders' assets) was £757 million in 2012 (2011: £813 million), with lower yields reducing the average spread margin that we earned on general account liabilities from 258 basis points in 2011 to 239 basis points in 2012 as expected. Jackson's long-term EEV operating profit increased by 13 per cent to £1,610 million (2011: £1,431 million) primarily due to improved new business profits and higher opening value of in-force business following recent growth in the portfolio. We are pleased with the acquisition of REALIC as it presents a financially attractive deal, generating seasoned insurance income, immediate earnings accretion and a gain on EEV shareholders' funds of £453 million.

UK long-term business IFRS operating profit was 3 per cent higher at £703 million (2011: £683 million) including £431 million from the shareholder-backed business. The strength of the with-profits fund, which currently has a surplus estate of £7.0 billion, offers strong policyholder protection and assists in generating positive returns for both policyholders and shareholders. EEV long-term operating earnings increased by 2 per cent in 2012 to £866 million (2011: £853 million), representing higher new business profits offset by the impact of lower interest rates on the recognition of in-force profits.

Our asset management businesses generated IFRS operating profit of £485 million in 2012 (2011: £461 million), with M&G's contribution higher at £371 million (including Prudential Capital). M&G continues to benefit from the delivery of strong inflows, with underlying profits (excluding performance-related payments and earnings from associates) up 14 per cent in 2012. This progress reflects higher revenues, up 10 per cent in 2012, as the scale and proportion of external funds continues to grow, and improvements in the cost-income ratio, to 59 per cent in 2012 (2011: 61 per cent). IFRS operating profit from Eastspring Investments of £75 million (2011: £80 million) was impacted by lower average margins on funds under management following a consumer-led shift in business mix away from equities to fixed income funds, as well as increased costs as the business continues to invest in growth opportunities. This included the opening of its first US office, in Chicago, in June 2012 and starting operations in Indonesia.

Notes

1 Comparatives adjusted for retrospective application of the accounting policy change for deferred acquisition costs as discussed in note A5 of the IFRS financial statements.

2 Operating profit from long-term and asset management business.

Chief Financial Officer's overview continued

Capital generation

We continue to promote disciplined use of our capital resources across the Group, and focus on allocating capital to the growth opportunities that offer the most attractive returns with the shortest payback periods. We have taken several important steps over the last few years to improve the efficiency and effectiveness of the capital allocation process, which has improved not only our returns on capital invested but also our overall financial flexibility. In 2012 we have continued to produce significant amounts of free capital, which we measure as free surplus generated.

In 2012, we generated £2,700 million of underlying free surplus (before reinvestment in new business) from our life in-force and asset management businesses. This is 6 per cent higher than the £2,536 million generated in 2011, reflecting increases from Asia and the US. We reinvested £618 million of the free surplus generated in the period into writing new business (2011: £553 million).

Asia continues to be our preferred destination for new capital and accounted for £292 million of this reinvestment (2011: £297 million), falling despite the growth in new business as we continue to focus on more capital-efficient products. We have not sought to invest in spread-based products in the region that carry more onerous capital charges and produce insufficient returns. In the US, new business investment has increased to £281 million from £202 million in 2011, which primarily reflects the higher level of new business written, changes in business mix, and the impact on regulatory reserving requirements for new business from the low interest rate environment. In the UK, our capital-efficient product focus on annuities and with-profits bonds means we invested just £45 million, yet delivered more new business profit. The IRRs on invested capital were more than 20 per cent in Asia, the US, and the UK; with payback periods of three years, two years and three years respectively.

Of the remaining free surplus generated after reinvestment in new business, £1,200 million was remitted from the business units to Group. This cash was used to meet central costs of £205 million, service net interest payments of £278 million and meet dividend payments of £655 million. The total free surplus balance deployed across our life and asset management operations at the end of the year was £3,689 million (2011: £3,421 million).

'Growth and Cash' financial objectives

The following discussion contains forward-looking statements that involve inherent risks and uncertainties. Prudential's actual future financial condition or performance or other indicated results may differ materially from those indicated in any such forward-looking statement due to a number of important factors (including those discussed under the heading 'Risk factors' in this document). See the discussion under the heading 'Forward-looking statements' at the front of this document.

At our 2010 investor conference, entitled 'Growth and Cash', we announced new financial objectives demonstrating our confidence in continued rapid growth in Asia, and increasing levels of cash remittances from all of our businesses. These objectives have been defined as follows:

(i) **Asia growth and profitability objectives[1]:**
To double the 2009 value of IFRS life and asset management pre-tax operating profit in 2013 (2009: £465 million); and

To double the 2009 value of new business profits in 2013 (2009: £713 million).

(ii) **Business unit cash remittance objectives[1]:**
Asia to deliver £300 million of net cash remittance to the Group in 2013 (2009: £40 million);

Jackson to deliver £260 million[2] of net cash remittance to the Group in 2013 (2009: £39 million); and

UK to deliver £350 million of net cash remittance to the Group in 2013 (2009: £284 million[3]).

(iii) **Cumulative net cash remittances[1]:**
All business units in aggregate to deliver cumulative net cash remittances of at least £3.8 billion over the period 2010 to end-2013. These net remittances are to be underpinned by a targeted level of cumulative underlying free surplus generation of £6.5 billion over the same period.

As mentioned in the Group Chief Executive's report, we remain focused on these objectives and have continued to make progress towards them. In 2012 we have exceeded our 2013 IFRS operating profit and net remittance objectives for Asia and we are on track to achieve the rest. We set out below in more detail our progress towards these objectives based on our results for 2012.

Notes

1 The objectives assume current exchange rates and a normalised economic environment consistent with the economic assumptions made by Prudential in calculating the EEV basis supplementary information for the half-year ended 30 June 2010. They have been prepared using current solvency rules and do not pre-judge the outcome of Solvency II, which remains uncertain.

2 The net remittance objective for Jackson was increased from £200 million to £260 million to reflect the positive impact of the acquisition of REALIC.

3 Representing the underlying remittances excluding the £150 million impact of proactive financing techniques used to bring forward cash emergence of the in-force book during the financial crisis.

Asia profitability objectives

	Actual (as originally reported)						Objective
	2009 £m	2010 £m	2011 £m	2012 £m	Change (over 2011) %	Change (since 2009) %	2013 £m
Value of new business	713	901	1,076	**1,266**	18	78	1,426
IFRS operating profit(note 1)	465	604	784	**988**	26	112	930

Business unit net cash remittance objectives

	Actual				Objective
	2009 £m	2010 £m	2011 £m	2012 £m	2013 £m
Asia(note 2)	40	233	206	**341**	300
Jackson(note 3)	39	80	322	**249**	260(note 6)
UK(note 4)	434	420	297	**313**	350
M&G(note 5)	175	202	280	**297**	
	688	935	1,105	**1,200**	

Objectives for cumulative period 1 January 2010 to 31 December 2013

	Actual	Objective	Percentage achieved
	1 Jan 2010 to 31 Dec 2012 £m	1 Jan 2010 to 31 Dec 2013 £m	At 31 Dec 2012 %
Cumulative net cash remittances from 2010 onwards	3,240	3,800	**85**
Cumulative underlying group free surplus generation (which is net of investment in new business)	5,779	6,500	**89**

Notes

1 Total Asia operating profit from long-term business and Eastspring Investments after development costs. 2012 operating profit includes a one-off gain of £51 million arising on sale of Group's interest in China Life Insurance Company of Taiwan. The comparatives represent results as reported in the respective periods and excludes adjustment for altered US GAAP requirements for deferred acquisition costs as described in note A5 to the IFRS financial statements.

2 Remittances from Asia in 2012 include net remittance of £27 million, representing cash from sale of Group's holding in China Life Insurance Company in Taiwan offset by repayment of funding contingent on future profits of the Hong Kong life insurance operations. 2010 remittances included a one-off remittance of £130 million, representing the accumulation of historic distributable reserves.

3 Net remittances from Jackson in 2011 include releases of excess surplus to Group.

4 In 2009, the net remittances from the UK included the £150 million arising from the proactive financing techniques used to bring forward cash emergence of the in-force book during the financial crisis. The 2010 net remittances included an amount of £120 million representing the releases of surplus and net financing payments.

5 Including Prudential Capital.

6 The net remittance objective for Jackson was increased from £200 million to £260 million to reflect the positive impact of the acquisition of REALIC.

Chief Financial Officer's overview continued

In 2012, cash remitted to the Group increased by 9 per cent to £1,200 million (2011: £1,105 million), with considerable amounts of cash remitted from all our business operations highlighting the improved balance of contributions from across the Group. Asia's remittances increased 66 per cent to £341 million (2011: £206 million), demonstrating its transition into a highly cash-generative business as a result of significant growth and its focus on health and protection products. Asia's 2012 cash remittance is ahead of its 2013 financial objective of £300 million. We remain confident of further positive progress underpinned by strong cash generation from the in-force portfolio and continued growth in capital-efficient new business. The quality of Jackson's post-financial crisis expansion in variable annuities is evidenced by its cash remittance of £249 million while continuing to grow the business, and financing the acquisition of REALIC through its internal resources. The positive impact of this financially attractive acquisition will enable Jackson to increase its net remittance objective for Group from £200 million to £260 million in 2013 and beyond. The UK life operations have continued to make sizeable remittances at £313 million (2011: £297 million), supported by shareholder transfers from the with-profits fund and cash-positive new annuity business. M&G (including Prudential Capital) delivered net remittances of £297 million (2011: £280 million), reflecting its relatively capital-light business model that facilitates a high dividend payout ratio from earnings.

Against the cumulative 2010 to 2013 net remittance objective of £3.8 billion, by 31 December 2012 over £3.2 billion has been remitted by business operations. We remain confident of achieving this target. Our confidence is underpinned by the strong underlying free surplus generation of our businesses which, by 31 December 2012, had generated a total of £5.8 billion against our 2010 to 2013 cumulative objective of £6.5 billion.

Capital position, financing and liquidity

Despite the challenging macroeconomic conditions, we continue to operate with a strong solvency position, while maintaining high levels of liquidity and capital generation. This is testament to our capital discipline, the effectiveness of our hedging activities, our low direct Eurozone exposure, the minimal level of credit impairments and our comparatively low interest rate sensitivity.

The Group has maintained a strong capital position. At 31 December 2012, our IGD surplus before final dividend is estimated at £5.1 billion (31 December 2011: £4.0 billion), generating very strong coverage of three times the requirement.

All of our subsidiaries continue to hold strong capital positions on a local regulatory basis. In particular, at 31 December 2012, the value of the estate of our UK with-profits funds is estimated at £7.0 billion (31 December 2011: £6.1 billion), while Jackson's risk-based capital (RBC)[1] ratio was 423 per cent at 31 December 2012, excluding the gains on interest rate swaps under permitted practice, which if included would increase the RBC ratio to 478 per cent.

Furthermore, on a statutory (Pillar 1) basis the total credit default reserve for the UK shareholder annuity funds also contributes to protecting our capital position in excess of the IGD surplus. Notwithstanding the absence of defaults in the period, at 31 December 2012 we have maintained our credit default reserves at £2.1 billion, representing 40 per cent of the portfolio spread over swaps, compared with 33 per cent at 31 December 2011.

The delays in finalising the implementation measures for Solvency II prolong the uncertainty of the effective date of the capital adequacy regime, a major overhaul for European insurers. We are supportive in principle of the development of a more risk-based approach to capital, but we have concerns as to the potential consequences of some aspects of the Solvency II regime under consideration. With the continued delays to policy development, the final outcome of Solvency II remains uncertain. Despite this uncertainty we remain focused on preparing for implementation of the new regime.

Note

1 The National Association of Insurance Commissioners designed the Risk-Based Capital (RBC) formula as an early warning tool for State regulators to identify potentially inadequately capitalised companies for purposes of initiating regulatory action. The RBC ratio, being the ratio of available capital to regulatory capital, is based on the highest level of capital requirement at which remedial action may be initiated, the Company Action Level.

In March 2013, we have agreed with the FSA to revise the calculation of the contribution Jackson makes to the Group's IGD surplus. Until now the contribution of Jackson to the reported IGD surplus was based on an intervention level set at 75 per cent of US Risk-Based Capital Company Action Level (CAL). Going forward the contribution of Jackson to IGD surplus will equal the surplus in excess of 250 per cent of CAL. This is more in line with the level at which we currently report free surplus, which we have set at 235 per cent of CAL. In the absence of an agreed Solvency II approach, we believe that this change makes the IGD surplus a more meaningful measure and one that is more closely aligned with economic reality. The change has no impact on the way that the US business is managed or regulated locally. For consistency we also intend to align our free surplus calibration to 250 per cent of CAL going forward.

On the new basis, the IGD surplus at 28 February 2013 is estimated at £4.4 billion[1] (equivalent to a capital cover of 2.5 times), which includes the proceeds of £0.4 billion of subordinated debt, raised in January 2013, and is after deducting £1.3 billion in respect of the Jackson change from 75 per cent to 250 per cent of CAL. The intended change to free surplus will have a negligible effect on EEV and is estimated to reduce total free surplus by around £100 million.

Our financing and liquidity position remained strong throughout the period. The issue of US$700 million (£0.4 billion) of subordinated debt (perpetual tier 1 notes) in January 2013 further supports the financial flexibility of the Group, while taking advantage of very favourable market conditions. Our central cash resources amounted to £1.4 billion at 31 December 2012, up from £1.2 billion at 31 December 2011, and we retain a further £2.1 billion of untapped committed liquidity facilities.

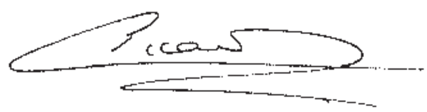
Shareholders' funds

During 2012, investment markets continued to experience considerable volatility, with positive movements in global equity market indices only towards the end of the year and further falls in long-term interest rates in the US, the UK and a number of Asian countries, most notably Hong Kong and Singapore. Despite these effects, the Group's EEV shareholders' funds increased by 14 per cent during 2012 to £22.4 billion (31 December 2011: £19.6 billion). On a per share basis EEV at the end of 31 December 2012 stood at 878 pence, up from 771 pence at 31 December 2011. IFRS shareholders' funds were 21 per cent higher at £10.4 billion (31 December 2011: £8.6 billion)[2].

The increases in shareholders' funds on both reporting bases are the result of the Group's strong operating performance, while our balance sheet continues to benefit from both the quality of the asset portfolio and the effectiveness of our proactive approach to risk management.

Summary

The financial progress we have reported in 2012 demonstrates the Group's resilience to the challenges faced by the global economy. By maintaining our bias in favour of less volatile types of income, such as insurance and fee, and by diversifying our products set and distribution platforms, we have continued to improve both the quality and the balance of our earnings. Our disciplined approach to value creation and focus on cash generation, combined with a robust capital position and a conservative risk management stance, provide us with a strong foundation for the future.



Nic Nicandrou
Chief Financial Officer

Notes

1 The estimated position at 28 February 2013 allows for economic conditions and surplus generation since 31 December 2012 and is stated before the final dividend and the effect of the Thanachart acquisition, and after allowing for a reduction in Jackson's contribution to IGD surplus of £1.3 billion.

2 Comparatives adjusted for retrospective application of the accounting policy change for deferred acquisition costs as discussed in note A5 of the IFRS financial statements.