

Group Chief Executive's report

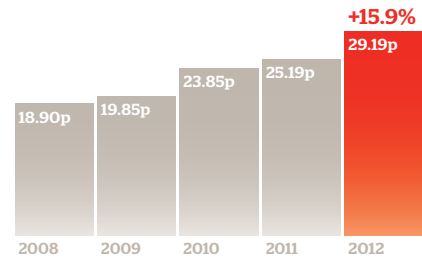
A strong performance based on consistent strategy



‘In 2012, we have delivered a strong performance. Our Group has achieved significant and profitable growth and produced increased levels of cash, which allowed us to provide our shareholders with a growing dividend.’

Tidjane Thiam
Group Chief Executive

Full-year dividend



IFRS operating profit based on longer-term investment returns¹



I am pleased to report a strong performance in 2012. Our focus on our customers in each of our geographies, combined with the strength of our distribution, franchise and brands, has allowed us to continue to provide distinctive value to our customers. Thanks to this, the Group has continued to deliver on the three key financial metrics we have focused on since 2009: IFRS operating profit, new business profit and net cash remittances. In 2012 in Asia, we have achieved two of the 2013 'Growth and Cash' objectives and have continued to make progress towards achieving the others, despite a global macroeconomic environment which remains challenging and historically low long-term interest rates.

Our strategy has remained consistent: to accelerate growth in Asia; to build on the strength of our US operations; to focus the UK business and to optimise asset management. We have remained focused on executing that strategy with discipline and on producing strong results across our geographies.

Asia has delivered excellent results in 2012. Our business, Prudential Corporation Asia, which is already one of the largest in the region, has nevertheless been able to more than double its IFRS operating profit in three years to almost £1 billion, delivering £988 million in 2012. That growth in IFRS operating profit was not achieved at the expense of cash generation or by slowing down sales growth. Asia reported record new business profit in 2012. It also delivered a net cash remittance of £341 million, exceeding its 2013 objective of £300 million. For the first time in our history, Asia was the largest contributor of cash to the Group, an exceptional performance when you consider that in 2009 Asia's net cash remittance was £40 million. This performance was largely driven by the clear progress we have made in some of our 'sweet-spot' markets, particularly Indonesia, Singapore, Malaysia, the Philippines and Thailand.

There was strong growth in the US, with total IFRS operating profit exceeding £1 billion for the first time, demonstrating the strength of Jackson's operations in a competitive marketplace. The UK remains focused on with-profits products and individual annuities, seeing strong sales of both in a difficult market. M&G has seen record net flows at £16.9 billion, IFRS operating profit and funds under management, all driven by its investment performance and customer proposition.

In a turbulent environment, we have continued to take proactive and decisive management action to deliver on our strategy. In our industry, distribution is absolutely key. Therefore we have continued to strengthen our ability to reach our chosen customers in our chosen markets. For instance, we have strengthened our distribution in Thailand by establishing an exclusive partnership with Thanachart Bank, a leading bank in this market, and through the acquisition of its life business,

Thanachart Life. In the US, we have continued to invest in our distribution as well, strengthening our relationship with our partners. We have, throughout the year, ensured that we put value ahead of volume, ensuring that we reached our return on capital and payback targets. To mention a few examples, in Malaysia we refocused the business on higher-value, lower-volume protection business. In Korea and in Taiwan, at times during the year, we refused to write poor-value business, sacrificing some sales growth in the process.

We have maintained our bias in favour of insurance income and fee income, which have grown as a proportion of our profits, ahead of spread income. True to that logic, in the US we acquired Reassure America Life Insurance Company (REALIC), which increased our insurance income. We also continue to drive our product mix to achieve the optimal balance between growth in sales, profit growth, cash generation and capital strength. Therefore, we have continued to emphasise and to grow protection products in Asia, which also provide excellent value to our customers. In the US, we have seen growing demand for Elite Access, a variable annuity without guarantees, launched in March 2012. Elite Access allows us to meet the needs of a key customer segment and to grow profitably while staying within our quantitative risk appetite in the year. We believe Elite Access has excellent prospects in the US market. More generally, we have continually and proactively re-priced our products and modified their features to ensure they continued to generate adequate returns in the new interest rate environment.

Having looked at the strength and sustainability of the results we have generated, the Board has decided to rebase our dividend upwards for the second time in three years. This decision reflects the Board's confidence in the Group's ability to continue to deliver strong, sustainable financial performance.

Group performance

The Group's strategy is supported by three key Group-wide operating principles.

First, we take a balanced approach to performance management across the key measures of IFRS, EEV and cash, with a particular focus on IFRS and cash. The Group has reported a strong performance across all business units on these measures. Our IFRS operating profit based on longer-term investment returns increased by 25 per cent in 2012 to £2,533 million (2011: £2,027 million¹) led by Asia and the US. IFRS shareholders' funds increased by 21 per cent to £10.4 billion, compared to £8.6 billion¹ as at 31 December 2011. EEV operating profit grew by 9 per cent to £4,321 million (2011: £3,978 million). Net cash remittances to the Group from our businesses increased by 9 per cent to £1,200 million (2011: £1,105 million), with Asia now the largest contributor.

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.

Group Chief Executive's report continued

Second, we focus on allocating capital to the highest return and shortest payback opportunities across the Group, taking strong action where necessary, such as deliberately reducing sales in geographies, products or channels where our return and payback criteria are not met. Our insurance businesses in Asia, the US, and the UK have delivered a 14 per cent increase in new business profit to £2,452 million (2011: £2,151 million) with a distinctive 18 per cent increase in Asia. APE sales for the Group have increased by 14 per cent to £4,195 million (2011: £3,681 million) in 2012 and included the Group's best-ever fourth quarter. M&G has attracted strong net inflows of £16.9 billion (2011: £4.4 billion), a record performance led by the return of investors' risk appetite in Continental Europe, where M&G has built a strong position over the last few years, and market-leading sales in the UK retail market.

Third, we are proactive in managing risk across the cycle. Our balance sheet continues to be defensively positioned and at the end of the period our IGD surplus was £5.1 billion¹ (31 December 2011: £4.0 billion). Our surplus increased due to strong net capital generation through operating earnings offset, as usual, by external dividend payments and other costs.

We continue to focus on promoting transparency by providing shareholders with relevant disclosures about our business and how we run it, to ensure that both our strategy and our operating principles are well understood. In addition to the disclosures that are provided with our quarterly financial results, since 2010 we have organised an annual seminar to provide investors and analysts with a further opportunity to discuss the business in detail with the Group's senior management.

We have organised three investor seminars in London (on 1 December 2010), Kuala Lumpur (on 15 November 2011) and New York (on 29 November 2012). These seminars consisted of presentations on different aspects of our business including: Group strategy; our operating principles; the 2013 'Growth and Cash' objectives; our Asian business, including country-by-country presentations; and Jackson, with further insights into its hedging strategy, capital position and sensitivity to market shocks. We intend to hold a fourth annual seminar in the last quarter of 2013 in London.

2013 'Growth and Cash' objectives

2012 has made a strong contribution to our progress towards delivering our challenging 2013 'Growth and Cash' objectives that I set out at our 2010 investor conference. Asia has achieved two of its three 2013 objectives in 2012 and the Group remains on track to meet the remaining objectives.

Turning first to our Asia objectives, I said in 2010 that we would aim to double our 2009 IFRS operating profit to £930 million by 2013 or, in other words, that we would double our IFRS operating profit in four years. In 2012, we have achieved IFRS operating profit of £988 million (2011: £784 million²). We have, therefore, more than doubled profits in three years, rather than four. Asia has also exceeded its 2013 cash objective, remitting a total of £341 million to the Group against a 2013 objective of £300 million. Looking at the remaining Asia objective, by the end of 2013 we aim to double 2009 new business profit to £1,426 million and we remain on target to reach this, with the business producing £1,266 million in 2012 (2011: £1,076 million). These results were achieved despite an unfavourable and volatile macroeconomic environment.

Beyond Asia, there has been continued progress towards our other cash objectives. The US remitted £249 million in 2012 (2011: £322 million including exceptional release of surplus), on track to meet its 2013 cash objective raised from £200 million to £260 million earlier this year. The UK made remittances to the Group of £313 million in 2012, on track to meet its 2013 objective of £350 million.

Looking at the cumulative cash target of £3.8 billion over the four-year period from 2010 to end-2013, we have so far achieved 85 per cent of the total objective with one year remaining.

	Actual	Objective
	2012 £m	2013 £m
Asia profitability		
Value of new business	1,266	1,426
IFRS operating profit ³	988	930
Business unit net remittance objectives		
Asia ^{note 4}	341	300
Jackson	249	260 ^{note 5}
UK	313	350
Cumulative net cash remittances from 2010 onwards	3,240	3,800

Notes

- From March 2013, the basis of calculating Jackson's contribution to the Group's IGD surplus will change. Further detail can be found in the 'Capital position, financing and liquidity' section of the Chief Financial Officer's overview.
- Comparatives adjusted for retrospective application of the accounting policy change for deferred acquisition costs as discussed in note A5 of the IFRS financial statements.
- 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 the Group's holding in China Life Insurance Company of Taiwan.
- Remittances from Asia in 2012 include a non-recurring 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.
- The net remittance objective for Jackson was increased from £200 million to £260 million to reflect the positive impact of the acquisition of REALIC.

Our operating performance by business unit Prudential Corporation Asia

Our strategy in Asia is focused on meeting the needs of the emerging middle class in the region for savings and protection. The region's positive demographics, strong economic growth, sound public finances and favourable public policy environment with a clear preference for private provision of protection, have all led to a rapidly expanding middle class, with a strong and growing demand for our savings and protection products.

Geographically, Asia is a vast and diverse region. Our primary area of focus is on what we call our 'sweet-spot' – Indonesia, Hong Kong, Singapore, Malaysia, the Philippines, Thailand and Vietnam. All these markets have attractive long-term characteristics. We are in a strong position to capture profitably the growing demand for our products and services in these selected markets. We continuously invest in these markets to grow our distribution and to ensure we are well positioned in terms of people, systems and capabilities. We will continue to innovate to meet the evolving needs of our customers and maintain our focus on regular premium savings and protection products.

Our primary growth metric is new business profit rather than sales. This focus on new business profit has ensured we have delivered healthy and sustainable quality growth. In 2012, new business profit was up 18 per cent in the region, led by Indonesia, Singapore and Malaysia, up 27 per cent collectively. While under-penetration of insurance in markets across the region offers significant long-term growth opportunities, we retain our focus on value not volume. New business profit grew more quickly than sales as we refocused our businesses in Taiwan, Korea and Malaysia, deliberately reducing sales of lower-margin products to ensure a consistent focus on higher-value lines. We are determined to continue taking management action across the region where and when required, to maintain our internal rates of return of more than 20 per cent across all businesses, with a payback period in Asia of three years, despite the low interest rate environment.

Our life business in Asia, with its focus on capital-efficient products and fast payback periods, continues to deliver profitable, cash-generative growth. IFRS long-term operating profit in Asia increased by 30 per cent in the period to £920 million (2011: £709 million¹) and net cash remittances increased by 66 per cent to £341 million (2011: £206 million).

Our multi-channel distribution model is at the heart of our success and we have continued to grow and strengthen our distribution further in 2012. In both the agency and the bank channels – bancassurance – the returns comfortably cover the cost of capital, so we have a strong appetite for growth in both. These channels grew their respective contribution to new business profit at similar rates in 2012. Agency is the largest channel and we continue to increase both the scale and,

importantly, the quality and productivity of our agency force. In the bank channel, where we are the regional leader, our partnerships with Standard Chartered Bank (SCB) and United Overseas Bank (UOB) have seen considerable sales growth, up 42 per cent and 65 per cent respectively. Regular premium products make up the bulk of our new business – in excess of 90 per cent of total APE sales – with higher-margin protection products making up almost one-third of new business APE.

Our four largest markets – Indonesia, Hong Kong, Singapore and Malaysia – have made the most material contribution to the region's growth in recent years. In addition to our well known strength in these four markets, we are building our presence and distribution in other markets that have the potential to become material drivers of growth over the medium and long term. Two such markets are Thailand and the Philippines, which in aggregate grew new business profit by 93 per cent in 2012. In Thailand, a market with considerable and attractive growth potential, where we were historically underweight, our recently announced exclusive long-term bancassurance partnership with Thanachart, and the acquisition of Thanachart Life, fulfils our long-standing ambition to significantly increase our footprint in that country. In the Philippines, where we are a market leader, our business is now making good progress, delivering strong and profitable growth. We believe this market has promising prospects due to its large population and the improved quality of its macroeconomic management, with its renewed emphasis on attracting foreign direct investment as well as the upgrading of the country's infrastructure. In January 2013, we started life insurance operations in Cambodia, our 13th market, and entered into a partnership with ACLEDA Bank PLC, the largest retail and commercial bank in the country. This is the first deal of its kind in Cambodia, where we believe there are significant opportunities for growth as the market develops.

Overall, our geographic footprint, combined with the exceptional quality of our distribution and of our products, has enabled us to deliver another year of very strong performance in Asia. Our 13 million insurance customers, whom we serve well and profitably, represent only a small proportion of the long-term potential of this part of the world for our company.

Jackson National Life Insurance Company (Jackson)

The US is the world's largest retirement savings market, with large cohorts of the 78 million baby-boomers² reaching retirement age each year, creating significant demand for retirement income products. Our strategy in the US is to take advantage of this profitable growth opportunity. We approach this with a long-term perspective, proactively managing sales through the economic cycle as our experience has shown us how important it is to put value ahead of volume in the variable annuity market. We take at all times a conservative approach to pricing, even when that means losing market share to other players, while hedging our financial risks and managing our balance sheet.

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 Source: US Census Bureau.

Group Chief Executive's report continued

In 2012, Jackson delivered IFRS long-term operating profit of £964 million, up 48 per cent on the prior year (2011: £651 million¹). This increase in profits is in part due to increased fee income from the significant net flows captured in the last few years, and in part due to the non-recurring in 2012 of an accelerated deferred acquisition cost amortisation charge of £190 million in 2011. In 2012, new business profit grew 7 per cent, with APE sales up 15 per cent as historically low interest rates continued to weigh on profits. The pricing actions taken during the year allowed Jackson to mitigate the negative impact of these interest rates.

There is always a degree of tactical management in the variable annuity market as sales are impacted by a number of factors, including but not limited to equity market levels, interest rates and the actions of Jackson's competitors. During the second half of 2012, as equity markets recovered, we saw stronger sales growth in variable annuities despite pricing actions taken earlier in the year to mitigate the impact of lower investment returns as bond yields remained low. Therefore, in November and December Jackson worked closely with distributors to proactively manage volumes and to ensure that the level of sales for 2012 would remain within the Group's quantitative risk appetite. We will continue to proactively balance value, volume, capital and balance sheet strength in this market.

In March 2012 we launched Elite Access, a variable annuity without guarantees, which offers access to alternative investments. It taps into an unmet demand from customers and has been particularly well received by distributors. The launch of Elite Access helps Jackson to continue growing within the Group's risk appetite for products with guarantees. The acquisition of REALIC, a traditional US life business, has helped to diversify Jackson's earnings and make the business more resilient.

In the context of industry debates about the advantages and disadvantages of various accounting methods, we believe that cash generation is ultimately a very tangible metric of the quality and value of a strategy. Therefore we set Jackson a net cash remittance objective for 2013 which, following the acquisition of REALIC, was increased from £200 million to £260 million. In 2012, Jackson delivered net cash remittances of £249 million in the year (2011: £322 million including an exceptional release of surplus) and is on track to meet this objective.

Prudential UK and Europe

In the UK, Prudential has adopted a focused strategy and competes selectively to help Britain's ageing population convert their accumulated wealth into retirement income. We have a clear focus on writing profitable new business while generating cash sustainably and preserving our capital. We concentrate on areas in which we have a clear competitive advantage, namely individual annuities and with-profits products, where we continue to be market leaders.

Over the last decade, Prudential has been widely recognised as the UK's leading with-profits manager. Our long-term approach to the management of the with-profits fund has continued to benefit customers during 2012 as it helps to provide protection from the full impact of volatile market conditions. The fund has consistently outperformed the FTSE All-Share Index. Over the last 15 years, the fund has delivered a cumulative investment return of 184.3 per cent on investments covering policyholder liabilities. This compares favourably with the FTSE All-Share Index total return of 106.5 per cent over the same period. Total bonus payments are expected to top £2 billion in 2013 and our policyholders will typically see year-on-year increases of between 3.5 per cent and 6.5 per cent in accumulating with-profits policy values. Since 2003 an estimated £22 billion has been added to policy values. Our UK business is also one of the largest providers of annuities in the UK and in 2012 paid out £2.9 billion in income to UK annuitants.

Our performance in 2012 has been strong in a difficult market, which has been impacted by significant UK and EU regulatory change. This includes the implementation of the Retail Distribution Review (RDR), auto-enrolment for company pension schemes and gender neutral pricing.

Our UK business has demonstrated resilience as it continues to benefit from its focus on its core products, with-profits and individual annuities, with sales of both increasing by more than 30 per cent. We achieve internal rates of return that are commensurate with other parts of the business. New business profit increased 20 per cent to £313 million (2011: £260 million) and IFRS long-term operating profit grew 3 per cent to £703 million (2011: £683 million). We completed two selective bulk annuity deals that contributed to this figure.

Where we see opportunities for future profitable growth we will seek to capitalise on them but only if they meet our payback criteria. In 2013 we have commenced sales operations in Poland, one of Europe's fastest-growing economies, which has an expanding middle class and high savings rates.

We continue to assess the impact of the RDR, which was implemented on 31 December 2012, and the resulting changes to distributors' business models. This is likely to lead to some short-term dislocation in the market as consumers and distributors adjust to the new sales environment. We expect this transition phase to dampen our sales of investment bonds in 2013, compared to the high sales in 2012. We are confident that the strength of our brand combined with our investment capabilities, financial strength and experience will ensure that we remain well placed to provide customers with dependable retirement income. We believe that with-profits products will continue to be popular with customers seeking competitive long-term real investment returns.

Net cash remittances were £313 million, up 5 per cent (2011: £297 million). Our inherited estate, which is estimated at £7.0 billion (31 December 2011: £6.1 billion), is a key source of capital strength.

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.

Asset management

Our asset management business, M&G, has continued to focus on delivering superior investment performance for our customers while maximising the strength of its distribution capabilities. It has pursued business diversification across both geographies and asset classes. Its retail funds are now registered for sale in 20 jurisdictions, with offices in 15 countries. During 2012, the business has seen record net sales, funds under management and IFRS operating profit. The growth in sales has been driven by M&G's business in Continental Europe as investor risk appetite returned.

M&G continued to attract significant new asset flows during the recent years of global market volatility, testament to the strength of its reputation and focus on investment performance. It has seen record total retail and institutional net inflows of £16.9 billion in 2012, significantly higher than 2011 and the previous high of £13.5 billion in 2009.

Total net sales in the UK were lower than 2011, reflecting the maturity of the UK business and management decisions to slow the inflow of new money into two market-leading UK corporate bond funds to safeguard investment performance. We expect these trends to persist in 2013. Despite the deliberate slowing of sales in the UK, M&G was the UK's top-selling investment management house in 2012 and has ranked number one for both net and gross fund sales for an unprecedented four consecutive calendar years. Net fund sales in Continental Europe have increased, generating a record £5.2 billion of net sales in 2012. Assets sourced from outside the UK account for 29 per cent of total retail funds under management, up from 25 per cent in 2011.

Underlying profits for the full year rose by 14 per cent to a new record level of £298 million. Following the addition of performance-related fees and profit from our associate investment in South Africa, total operating profit for 2012 was £320 million. M&G's funds under management also grew to a record £228 billion (2011: £201 billion).

Looking ahead, the diversification of our business by asset class and geography positions us well to manage the expected shifts in consumer asset allocation going forward.

Eastspring Investments, our rebranded Asia asset management business, increased funds under management to £58.1 billion, up 16 per cent (2011: £50.3 billion). IFRS operating profit was marginally lower, reflecting a change in product mix towards bond funds that attract lower fees. Also costs were higher as we continued to invest in people and infrastructure, as we build out our offshore capabilities following the launch of the new brand. This included opening a US distribution office, starting an operation in Indonesia and launching new funds in Taiwan, China and India.

Capital and risk management

We take a disciplined approach to capital management and continue to take action to ensure our capital works efficiently and effectively for the Group. Using the regulatory measure of the Insurance Groups Directive (IGD), our Group capital surplus position at 31 December 2012 was estimated at £5.1 billion (31 December 2011: £4.0 billion), before allowing for the final dividend. The Group's required capital cover was three times. The structure of the Group, and the approach we have taken to managing our risks, with a sizeable credit reserve in the UK annuity book, a strong inherited estate in UK with-profits and the relatively low-risk nature of our asset management and Asia operations, together with a high level of IGD surplus, means we have positioned ourselves well for future regulatory developments and stresses to our business.

There is broad agreement that ultimately it would be beneficial to replace the IGD regime with a regime that is more risk-based. Solvency II may provide such a framework but we now know that it will not be implemented before 31 December 2015. In common with other insurers we have been working with regulators to ensure that the current capital regime remains robust while we wait for the implementation of Solvency II.

In early March 2013, we agreed with the FSA to revise the calculation of the contribution Jackson makes to the Group's IGD surplus. We consider the revised basis to be an improvement as it is more closely aligned to the one we use to assess and report free surplus. 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 revised IGD surplus calculation has no impact on the way that the US business is managed or regulated locally. On this revised basis, the IGD surplus at 28 February 2013 is estimated at £4.4 billion¹, before allowing for the final dividend, equivalent to a capital cover of 2.5 times.

Uncertainty about the final Solvency II outcome remains. We will continue to evaluate our options, including consideration of the Group's domicile, in the event that the final outcome is negative and potentially impacts our ability to deliver value to our customers and shareholders. We welcome the decision by the UK Financial Services Authority to strengthen the existing Individual Capital Adequacy Standards (ICAS) regime in the absence of the implementation of Solvency II.

Note

¹ The estimated position at 28 February 2013 allows for economic conditions and surplus generation since 31 December 2012. It 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.

Group Chief Executive's report continued

Dividend

The Board has decided to rebase the full-year dividend upwards by 4 pence, reflecting the strong progress made in both the earnings and free surplus generation of the business and in the delivery of our financial objectives. In line with this, the directors recommend a final dividend of 20.79 pence per share (2011: 17.24 pence), which brings the total dividend for the year to 29.19 pence (2011: 25.19 pence), representing an increase of 15.9 per cent over 2011.

The Board will maintain its focus on delivering a growing dividend from this new higher base, which will continue to be determined after taking into account the Group's financial flexibility and our assessment of opportunities to generate attractive returns by investing in specific areas of the business. The Board believes that in the medium term a dividend cover of around two times is appropriate.

Outlook

In 2012, we have delivered a strong performance. In spite of tough macroeconomic conditions and the negative effect of persistently low long-term interest rates, our Group has achieved significant and profitable growth and produced increased levels of cash, which allowed us to provide our shareholders with a growing dividend.

Our strategy and operating principles remain clear and unchanged. Asia is the key driver of sustainable and profitable growth, building on the significant opportunity that the emergence of the growing and increasingly wealthy middle class in this region represents. Our best opportunities lie in South-east Asia, where the depth and breadth of Prudential's franchise is a source of strength. Our business units in the US and in the UK will continue to focus on delivering strong earnings and cash. We will achieve this by continuing to execute with discipline, by maintaining a robust balance sheet and with proactive risk management.

Our Group is set to continue to provide a distinctive combination of profitable growth and cash by meeting the needs of our customers across the world. Our confidence is reflected in the decision to rebase the dividend upwards, the second time in three years, as we remain focused on creating long-term, sustainable value for our shareholders.



Tidjane Thiam
Group Chief Executive

Strategy and operating principles

