Group overview

Performance measures

To create sustainable economic value for our shareholders we focus on delivering growth and cash while maintaining appropriate capital.

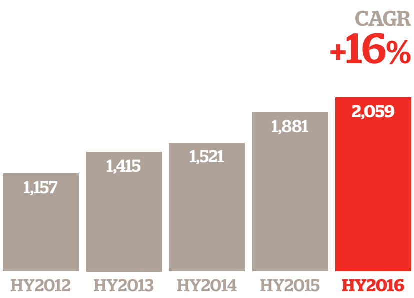
Profit, cash and capital

Prudential takes a balanced approach to performance management across IFRS, EEV and cash. We aim to demonstrate how we generate profits under different accounting bases, reflecting the returns we generate on capital invested, and highlight the cash generation of our business.

What we measure and why

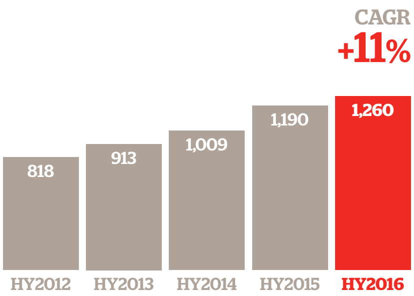
Performance[1]

IFRS operating profit[2] £m
IFRS operating profit is our primary measure of profitability. This measure of profitability provides an underlying operating result based on longer-term investment returns and excludes non-operating items.



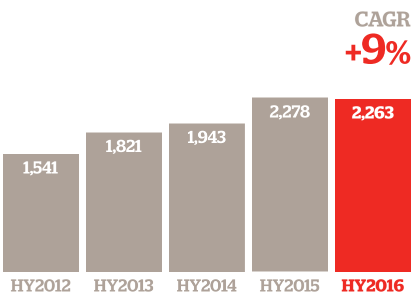
— Group IFRS operating profit in half year 2016 increased by 6 per cent on a constant exchange rate basis (9 per cent on an actual exchange rate basis), equivalent to an annualised 24 per cent return on opening IFRS equity. This result was driven by continued double-digit growth in our Asia life operations.

EEV new business profit[3,4,5] £m
Life insurance products are, by their nature, long term and generate profit over a significant number of years. Embedded value reporting provides investors with a measure of the future profit streams of the Group. EEV new business profit reflects the value of future profit streams which are not fully captured in the period of sale under IFRS reporting.



— EEV new business profit in half year 2016 increased by 8 per cent on a constant exchange rate basis (13 per cent on an actual exchange rate basis) compared to half year 2015, driven by a combination of higher volumes and pricing and product actions to increase profitability.

EEV operating profit[3,4] £m
EEV operating profit is provided as an additional measure of profitability. This measure includes EEV new business profit, the change in the value of the Group's long-term in-force business, and profit from our asset management and other businesses. As with IFRS, EEV operating profit reflects the underlying results based on longer-term investment returns.



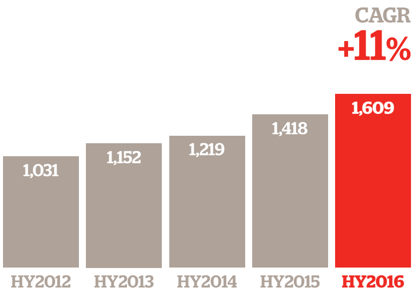
— Group EEV operating profit in half year 2016 was lower by 4 per cent on a constant exchange rate basis (1 per cent on an actual exchange rate basis) compared to half year 2015, reflecting higher new business profits and adverse impact of lower interest rates on the expected return from the in-force business.

What we measure and why

Performance[1]

Group free surplus generation[4,6] £m

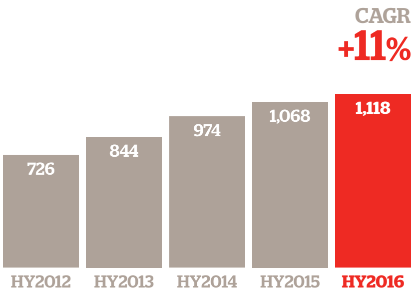
Free surplus generation is used to measure the internal cash generation of our business units. For insurance operations it represents amounts maturing from the in-force business during the period less investment in new business and excludes other non-operating items. For asset management it equates to post-tax IFRS operating profit for the period.



— Underlying free surplus in half year 2016 increased by 10 per cent on a constant exchange rate basis (13 per cent on an actual exchange rate basis) compared to half year 2015, driven by higher contribution from the in-force portfolio, and continued discipline in the allocation of free surplus to new business opportunities.

Business unit remittance[7] £m

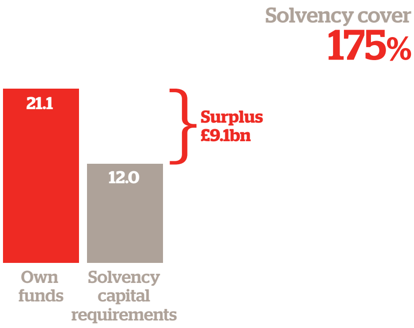
Remittances measure the cash transferred from the business units to the Group. Cash flows across the Group reflect our aim of achieving a balance between ensuring sufficient net remittances from business units to cover the dividend (after corporate costs) and the use of cash for reinvestment in profitable opportunities available to the Group.



— Net business unit remittances increased by 5 per cent in half year 2016, with sizeable contributions from Asia, the US and M&G.

Group Solvency II capital surplus[8,9] £bn

Replacing the IGD capital regime, from 1 January 2016 Prudential is subject to the risk-sensitive solvency framework required under European Solvency II Directives (Solvency II) as implemented by the Prudential Regulation Authority in the UK. The Solvency II surplus represents the aggregated capital (own funds) held by the Group less solvency capital requirements.



— The high quality and recurring nature of our operating capital generation and our disciplined approach to managing balance sheet risks have enabled us to enter the new Solvency II regime with a strong Group shareholders' capital surplus of £9.1 billion.

Chief Financial Officer's report on the 2016 first half financial performance page 08

Notes

1 The comparative results shown above have been prepared using Actual Exchange Rates (AER) basis except where otherwise stated. Comparative results on a Constant Exchange Rate (CER) basis are also shown in financial tables in the Chief Financial Officer's report on the 2016 first half financial performance. CAGR is Compound Annual Growth Rate.
2 IFRS operating profit is management's primary measure of profitability and provides an underlying operating result based on longer-term investment returns and excludes non-operating items. Further information on its definition and reconciliation to profit for the period is set out in note B1 of the IFRS financial statements.
3 Embedded value reporting provides investors with a measure of the future profit streams of the Group. The EEV basis results have been prepared in accordance with the EEV principles as discussed in note 1 of the EEV basis results. A reconciliation between IFRS and EEV shareholder funds is attached in note II (f) of the additional financial information.
4 The half year 2016 results for UK insurance operations have been prepared on a basis that reflects the Solvency II regime, effective from 1 January 2016. The results for UK insurance operations prior to 31 December 2015 reflect the Solvency I basis.
5 Excluding UK bulk annuities as Prudential has withdrawn from this market.
6 Free surplus generation represents 'underlying free surplus' based on operating movements, including the general insurance commission earned during the period and excludes market movement, foreign exchange, capital movements, shareholders' other income and expenditure and centrally arising restructuring and Solvency II implementation costs. Further information is set out in note 9 of the EEV basis results.
7 Business unit net remittances to the Group form part of the net cash flows of the holding company. A full holding company cash flow is set out in note II (a) of the additional financial information. This differs from the IFRS Consolidated Statement of Cash Flows which includes all cash flows relating to both policyholders and shareholders' fund. The holding company cash flow is therefore a more meaningful indicator of the Group's central liquidity.
8 Estimated before allowing for first interim dividends.
9 Excludes surplus in ring-fenced policyholder funds. The methodology and assumptions used in calculating the Group Solvency II capital results are set out in note II (c) of the additional financial information.

Delivering good progress for customers and shareholders

'The quality of our earnings, geographic diversity and strong balance sheet position us well to grow over the long term.'

Mike Wells
Group Chief Executive

The Group has delivered good progress on its key operating metrics – IFRS operating profit, underlying free surplus generation and new business profit – in a period of heightened macro-economic, geo-political and investment market uncertainty and volatility.

The Group's performance is led by double-digit growth in Asia and successful cycle management in the US and the UK. The quality of our earnings, geographic diversity and strong balance sheet position us well to grow over the long term.

The attractiveness and value to consumers of de-risking their financial lives, whether it is through protecting health or wealth, are accentuated in periods such as the one we have experienced in the first half of this year. The secular, global trend of increasing self-reliance of the middle class to provide for savings and retirement, be it by a fast-growing, wealthier but younger population in our Asian markets or by a growing number of retirees in the US and the UK, remains intact despite the macro-economic uncertainty. In a world of low investment returns, high volatility and improving life expectancy, Prudential is well placed to serve these needs through our leading position in three of the most attractive insurance regions globally.

Our business remains firmly anchored by these strong structural trends which give it the resilience to weather cyclical events. As a management team, we remain focused on delivering on our promises to our customers and our shareholders, and will be proactive in taking actions to protect our franchises from such headwinds.

The first half of this year has provided many such challenges, including a further decline in interest rates to historic low levels, higher investment market volatility, the announcement of the Department of Labor reforms in the US, a decline in annuity sales in the UK and the continuation of net outflows at M&G. In Asia, our scale allows us to evaluate the trade-off between long-term value creation and short-term volume growth without disrupting our overall delivery, while in the US we believe we are well positioned to navigate a period of significant change. In the UK, we continue to face an extraordinary amount of change in the marketplace alongside the introduction of new capital rules. This has led us to take actions such as prioritising our new post-pension reforms offering while withdrawing from the bulk annuity market to preserve shareholder value. At M&G, where we are coming off an extended period of earnings growth, we are focused on careful management of costs and improving performance. Overall, we have the scale, diversity and capabilities to outperform our markets over the long term.

The first-half performance demonstrates the quality of our franchises, the effectiveness of our strategy and our ability to leverage our broad capabilities to deliver on the significant growth opportunities in our chosen markets. We remain well placed to capitalise on the positive structural trends and remain distinctive in our ability to deliver both growth and cash.

£14.6bn
IFRS shareholders' funds

13%↑
increase on full year 2015

2016 half year financial performance

We are pleased that we have been able to grow our IFRS operating profit, underlying free surplus generation and new business profits in the first half of 2016, against an unfavourable macro-economic and market backdrop.

Our philosophy is simple: we continue to focus on both attracting new customers to our franchise and maintaining the loyalty of our existing customers. Through following this approach we are able to weather the effects of market cycles and consistently deliver value to both our customers and shareholders over the long term. Too often, the pursuit of growth which is narrowly defined as new customer acquisition can undermine the delivery of long-term value.

In the first half of 2016, our total premiums in Asia grew 12 per cent[1], and separate account assets under management in the US grew 4 per cent[2]; PruFund assets in the UK were up 22 per cent[3] while external funds under management in our asset management businesses were up 4 per cent compared to 31 December 2015.

This progress has allowed us to build on the strong progress of prior years, with IFRS operating profit of £2,059 million, up 6 per cent (9 per cent on an actual exchange rate basis), free surplus generation of £1,609 million, up 10 per cent (13 per cent on an actual exchange rate basis) and new business profit of £1,260 million, up 8 per cent[4] (13 per cent on an actual exchange rate basis) despite the known challenges in some of our businesses at the start of the period. IFRS shareholders' funds increased to £14.6 billion over the period after taking into account profit after tax and other movements. EEV shareholders' funds increased to £35.0 billion over the period, equivalent to 1,356 pence per share.

Given the long-term nature of our businesses, we believe it is useful to consider our growth metrics over a longer time scale. Over the last five years, we have grown our key operating metrics of IFRS operating profit, free surplus generation and new business profit by 101 per cent, 47 per cent and 67 per cent respectively on an actual exchange rate basis. Our broad diversification, by geography, product and channel remains a primary source of strength and resilience for both earnings and cash.

Chief Financial Officer's report on the 2016 first half financial performance page 08

Asia

Our ongoing success in Asia is enabled by the scale and diversification of our business, which is a substantial and sustainable competitive advantage. We continue to retain our leadership position across the region with a top three position in eight of our 13 markets, distribution capabilities and a product range that supports our customers' changing needs throughout their lives.

Operating across such a broad range of markets it is inevitable that, individually, each will exhibit different rates of growth. We remain agnostic about short-term country level sales progression since we have considerable strategic flexibility to adapt to local conditions without compromising regional growth.

The consistency of this approach is evident during the first half of the year, as we have continued to flex our businesses according to market conditions, prioritising value over volume and also investing in building out our platform. In **Hong Kong**, we are building out our distribution footprint to capture strong demand for our products at attractive margins, both from local customers and mainland China, while retaining our focus on sales quality and process controls that are at the forefront of the industry. In **Singapore** and **Indonesia**, we are proactively managing volumes through product mix and agency actions respectively, to protect our overall economics and reinforce our longer-term positioning. The long-term growth potential for these markets remains compelling and over time they will further enhance our performance. In **Malaysia**, we are already benefiting from initiatives we undertook previously to pull back from business with lower margins and to drive growth through investment in the faster-growing Bumi sector of the market. In **China**, we continue to make rapid progress as we build out our agency sales force with a focus on driving protection regular premium sales. We are continuing to invest for the long term with new start-ups in **Cambodia** and most recently in **Laos** that leverage our expertise in developing markets.

12.93p
first interim dividend

5%↑
increase on half year 2015

Across the region, we have taken proactive actions to lower the interest rate sensitivity of our business by withdrawing spread products. In this context, the quality of our delivery is reflected in the continuing growth in regular premium new business sales, which were up 21 per cent, reflecting the durable nature of demand for our products. Our now sizeable and growing in-force book of recurring premium business in the region has been the main contributor to a 17 per cent increase in life IFRS operating profit in the first half of the year to £682 million. Profits from health and protection alone contributed around two-thirds of this total.

Eastspring Investments, our asset management business, faced outflows as a result of the market volatility experienced during the half year, though we saw net inflows into our bond funds. Overall profits were in line with last year at £61 million.

Overall, at a regional level, despite the short-term adverse impact of our actions in some markets to underpin long-term value creation, we have delivered double-digit growth in our key operating metrics, with IFRS operating profit growing by 15 per cent to £743 million, free surplus generation growing by 15 per cent to £419 million and new business profit growing by 20 per cent to £824 million. We remain on track to achieve our 2017 objectives.

Our regional delivery and wide footprint are important drivers of our ability to acquire new customers at pace, adding to a large and highly valuable existing base. The headroom for growth across the region remains significant, with sizeable uninsured and underinsured populations across our markets.

US

Jackson has developed a high-quality business with significant competitive advantages across multiple dimensions. It makes more effective use of technology and is consistently recognised as having the best service[5] standards, with the largest distribution capabilities. It has a track record of innovation and bringing products to market faster and more effectively than peers and its product proposition remains central to our ability to deliver value for our customers, offering a wide fund choice and a strong track record of account value outperformance. All this is delivered on a cost base that is the most efficient[6] in the industry.

These are the hallmarks of success in any environment and are likely to be fully tested by the industry reforms announced by the Department of Labor in April. The market will take time to adjust to these reforms, which are scheduled to come into effect fully in 2018. There is likely to be market disruption in the shorter term, which has already resulted in lower variable annuity sales for the industry and for Jackson.

In the first half of 2016, traditional variable annuity sales excluding Elite Access were 22 per cent lower than the first half of 2015 in an environment of elevated market volatility and significant uncertainty on the Department of Labor reforms. The quality of our franchise is reflected in the continuing delivery of net inflows, which have driven a positive 4 per cent[2] increase in separate account assets to US$138.9 billion, contributing to a 9 per cent increase in fee business IFRS operating profit to £642 million. The total life IFRS operating profit is in line with last year at £888 million, and cash remittance for the half year was £339 million.

In volatile markets, our in-force book has remained profitable and our hedging performance economically effective.

We remain closely engaged with all our stakeholders, in particular leveraging our exceptional relationships with broker-dealers to assess their needs, and we have already filed products that complete a range of options for distributors under the new Department of Labor regime. We believe Jackson's platform is second to none and we are convinced that it will extend its competitive position through this period.

UK

In the UK, we have already adapted to significant industry change in recent years, demonstrating our ability to innovate and distribute the right products, backed by a trusted brand. The new business focus on with-profits products continues to deliver high levels of growth, with PruFund APE sales in the first half alone growing by 80 per cent to £438 million. As flagged at our full year results in March, we have withdrawn from bulk annuities, writing no business in the first half of 2016 given the onerous capital impact under the Solvency II regime. Overall, we are pleased to report steady progress on life IFRS operating profit up 8 per cent to £473 million, with ongoing with-profits and in-force annuity earnings broadly in line with prior year at £306 million, management actions to support solvency contributing £140 million (2015: £61 million) and profits from new annuity sales reducing to £27 million (2015: £66 million) following our change of stance on annuities. Underlying free surplus generation was up 66 per cent to £514 million with Solvency II surplus of £2.9 billion (equivalent to a ratio of 138 per cent) which supported a £215 million remittance to Group.

Our asset management business, M&G, as expected has continued to experience significant net outflows in the first half. M&G reported IFRS operating profit of £225 million, reflecting the impact of these outflows partially offset by lower costs. Although this is likely to impact short-term earnings prospects, M&G remains a highly regarded franchise and the skills and capabilities that saw external assets under management double between 2008 and 2015 are very much intact. Anne Richards, who joined us in June following her appointment as M&G Chief Executive, is already working closely with the executive team to improve performance and address the operational impacts of the outcome of the UK referendum on EU membership.

Capital and risk management

We remain disciplined in our approach to capital management. Operating capital generation in the first half of 2016 continued to make a sizeable contribution, adding to the surplus at the beginning of the year and helping to absorb market effects during the period. At 30 June 2016, the Group Solvency II capital surplus was estimated at £9.1 billion[7], which is equivalent to a Group Solvency II capital ratio of 175 per cent (31 December 2015: £9.7 billion, equivalent to a ratio of 193 per cent).

£9.1bn
Group Solvency II capital surplus

175%
Group Solvency II capital ratio

Outlook

Our future prospects remain underpinned by the compelling structural growth fundamentals in Asia and our premium franchises across the Group, which operate with distinctive skills and capabilities to outperform our peers. In addition, the diversity and quality across the Group allows us to be disciplined across the cycle while still delivering overall progress.

Although the macro-economic context looks certain to be challenging and unpredictable in the short term, the Group has proven its ability to manage through external change. Our absolute position is strong and we believe our relative position will be a source of competitive advantage in times of market disruption. Through the durable demand for products which assist our customers in reducing risk, the growing scale of stable recurring income, and proactive management of our product mix and balance sheet, the Group has the flexibility to adapt to market conditions and deliver robust earnings and shareholder value.

Notes

1 Gross earned premiums including Group's share of joint ventures.
2 Comparable to 31 December 2015 on local currency basis.
3 Comparable to 31 December 2015.
4 Excluding UK bulk annuities as Prudential has withdrawn from the market.
5 Awarded highest customer service in 2015 – Financial Industry by Service Quality Measurement Group.
6 On Expense to Asset (Statutory) basis. Source: SNL Financial LLC report on industry-wide data as at Q1 2016.
7 Before allowing for first interim dividend (31 December 2015: second interim dividend).