FY 2013 Earnings Call

Company Participants

- Adrian Gore, CEO
- Alain Peddle, Head of Health Research & Development
- Ricky Farber, CFO, Finance Director, Executive Director
- Unidentified Speaker, Unknown

Other Participants

- Unidentified Participant, Analyst

Presentation

Unidentified Speaker

Good morning, ladies and gentlemen. My name's Arthur Thompson [ph]. I'm on the Executive Committee of the Investment Analysts Society. And its my pleasure on behalf of this committee and all our members that are here today to welcome you. And specifically to welcome Discovery, for coming and talking to us as they so regularly do and keeping the investment community informed about what is happening with the Company and its prospects.

This is a company that is -- enormous strides within South Africa, not only in the investment community. But also in the daily lives of many South Africans. So these are very important results and very important for us to know what is happening with the Company. And, of course, there's all the international operations as well.

We've seen quite a bit of activity in the share price recently following a recent announcement on SENS. And I'm sure Adrian and his team will elucidate all of this and tell us about the Company and where it's going in the future.

So over to you, Adrian Gore, the Chief Executive. Thank you, sir.

Adrian Gore {BIO 3068929 <GO>}

Arthur, thank you for that kind introduction. Ladies and gentlemen, good morning. A lot to get through this morning and a lot to tell you. It's always my honor and pleasure on behalf of our team at Discovery, some of whom are here. But our team back at the office and around the world, it's a great pleasure to have the opportunity to tell you about our results for the full year to June 30, 2013.

It has been a remarkable year, a remarkably successful year; a year of very strong robust growth. And I hope you'll see that throughout the presentation. But at the same time, a year we invested considerably in new startups and new growth initiatives. And we invested in our model to understand how to build it out, how to repeat it, how to scale it. And how, in a sense to make it global. And that to an extent as well I think was a feature of the year under review.

The organization looks as you see it on the chart. A number of businesses; we're now in five territories. You may recall literally six weeks or so ago we announced a joint venture with AIA in Asia. I think a very exciting venture that's taken us some time to get done, commencing in Singapore, a pan-Asian opportunity that across from that, we're now in five territories. And I would say to you that in the year under review, there's been frenetic activity across the entire Group. And a lot of work done, a lot of good work done that I think you hopefully will see throughout the presentation.

Let me just start by making a comment about the Discovery approach. And I think it's fairly clear that we are known as being innovative, as being disruptive in a sense that our business model being quite different.

I'd like to put it to you that the model itself is different. But it's not out there in any sort of way. To an extent I would put to you that the world is changing. And the changes are profound in terms of financial services, social security systems, etc. And, therefore, it's imperative that insurance systems to an extent change with that.

And I would argue that the Discovery system is fit for purpose. And that's what we're busy building out in markets and finding unbelievable receptivity in the markets we go into. And the partners like an AIA, or a Ping An, or a Prudential, to what we're doing, because I think the world is changing.

And it's changing in four distinct ways. This is our view; I hope you agree with it. Four distinct ways. I've raised this before but I would like to frame them again.

The first is that the causes of death are changing. And this has a profound effect on healthcare systems, on mortality, on morbidity. In the 19th century, the focus was on sanitation, hygiene; in the 20th century, curative care, etc. These of course are additives [ph].

This century it's about prevention and wellness, because we're learning more and more, which is three lifestyle choices, smoking, poor physical activity, poor nutrition lead to four conditions that drive more than 50% of all mortality. Once you've grasped that reality, you realize that things have to change; models have to change, systems have to change.

The second important trend is the stubborn cost of healthcare, known as the Baumol Effect; the idea that healthcare costs always rise at a rate above price inflation. I mentioned this at the last announcement. The fact is that healthcare costs are a function of scarce expensive resources like doctors and other healthcare professionals.

But a fundamental thing about healthcare, it's a function of technology that unlike other industries, technology drives cost up in healthcare, not down. And so the healthcare industry tends to inflate at rates higher than other industries. And once you understand that price inflation is an average, then you accept that medical inflation is structurally higher.

And you can see across the world in that chart on the right-hand side that we are like other countries. Medical [ph] inflation tends to be at CPI plus 3% to 5% every year. And this goes on for decades. That's a major problem and it has to be addressed. And institutions like ours have to take that head on. That's a fundamental social objective.

The third important trend is the power of what's becoming known as behavioral economics. We're learning more and more that people don't make rational choices. Systems may be rational. But individuals don't make rational choices. They're biased; they're prejudiced. They act with loss aversion. They want instant gratification. And therefore understanding this irrationality is fundamental in choices about healthcare and other social security systems.

Even regulators around the world, like in the UK, the FCA, as you can see on the chart, are kind of applying behavioral economics to understanding issues of conduct and product design, etc. And I think that's a very important change.

And then a final point. And I guess overlaying everything that you would know very, very well, is that we live in a world of great uncertainty. A lost decade in the investment markets. But I hope those will recover. I think the big issues is that's there's mega geopolitical changes taking place; there are masses demographic shifts; countries with dramatically aging populations. All of these coalesce to create complicated issues for social security systems, for healthcare, etc.

And so I'll put it to you that the Discovery approach we believe is fit for purpose in a world where trying to make people healthier, trying to get them to make the right lifestyle choices, is fundamental to building a system that's sustainable and offers value for money. And the core of our idea is a very simple idea; building brilliant disruptive businesses and putting that on the top of a chassis, a set of incentives, a systematized method of making people healthier.

The effect on healthcare financing is dramatic. It incentivizes better behavior, reducing healthcare costs, creating better selection in the whole process. The effect on life insurance is remarkable; better value for money, matching price and risk in a better way; better for the policyholder, better for the insurer, better for society. And that's what we're setting out to do.

And I would argue that the model is kind of generic in the sense that we're just starting out. We're learning so much about the power of the model. And hopefully, the presentation that you will see that every one of our businesses is getting benefits from what we're trying to achieve. And to an extent, I wanted to make the point to you that if you look on the chart, that organogram by geography is less relevant than the organogram by strategy. And you can see that the strategy's fairly fixed across every business. Vitality runs in different forms. And the businesses tend to sit on that wherever they may be.

And I would say to you that in the year under review, there's been a relentless focus on a dissident [ph] approach to rolling out the business model, to making it work. And I hope that's fairly clear throughout the presentation as I go through it.

Let me turn to the results for the year itself. I think it has been a staggeringly good year for us in every respect. New business has grown remarkably strongly on an annualized premium basis; up 15%, higher than our 10-year average. And I think that's very gratifying given the scale of the base we're dealing with.

Earnings has grown strongly; normalized headline earnings up 20%, despite the fact we invested 12% in new starts and growth initiatives. We've typically invested 5% to 7%. There's been a considerable focus on a number of initiatives, most particularly Discovery Insure. And I believe that will pay real dividends going forward. So despite that, earnings up a robust 20%.

Very strong cash generation; up 45%, over ZAR2 billion. We have an internal guideline of a return of capital of risk-free plus 10%. In the period under review, we achieved risk-free plus 13%. Again, I think that's of course very pleasing.

The quality of business has been exceptional. I need to tell you no matter how complex insurance businesses are, the fact is you have to get your lapse rate right, you have to get your loss ratio right. If those are not in control, you have difficulty. If they are in control, you have a great asset. And to an extent, you'll see throughout the presentation that the focus on quality comes through I think in every single business.

Embedded value up 18% to close to ZAR36 billion; return on EV amongst the highest in the history of the organization, exceeding 20%. And then something I'd say to you from maybe a qualitative perspective rather than a numerical perspective, I think the market positioning of Discovery in all the markets in which we're operating is disruptive and a leadership role. In all of them, we're in a very strong position from a new business perspective.

Our real desire is get to the top three in any market we're in in terms of new business. And I would say to you that we're doing that in a very, very strong way. And I think the period under review has been excellent in that regard.

Let me go through the numbers with you and give you a bit of a sense of them. And I've pulled out, I've tried my best -- it's difficult everywhere as the Group gets bigger to pull out the observations that we think are relevant. There's a lot of moving parts. But I've tried my best here to give you a sense of what's going on.

Firstly, new business up 15%, as you can see numerically to just under ZAR10.8 billion. If you go down the chart, you can see, I think, a robust performance.

In the established businesses, Discovery Health off a high base had a fantastic period of 13% increase.

Discovery Life up 8% to just under ZAR1.9 billion. There was an acceleration in the second half of the year. And I'll take you through that a bit later.

In the emerging businesses, the one feature of these results that I think is spectacular, our UK businesses have outperformed all expectation. The results have been absolutely and totally remarkable. You can see the new business strongly up, close to 50% to just under ZAR1.6 billion. The performance has been really good.

Discovery Invest up 11%. Very strong growth in the single premium side. So when you divide it out by 10 to get to an annualized basis, it comes out to up 11%. But I think a very good performance there.

In the new businesses, Discovery Insure, just two years out of the gate has done a remarkable job. I think an excellent year. New business up to ZAR366 million, an increase of 53% period on period.

In the US, The Vitality Group, up 65%.

Humana Vitality; you may recall the structure we have with Humana, where they've put a whole bunch of their business, of their chassis, onto Vitality. That is very lumpy. And in fact, I think that will slow down because they've put a lot of the existing block, a couple million lives, onto Vitality. So that naturally will reduce I think over time.

And in Ping An, we focused a lot on steering the business towards the insurance market, away from some of the stuff that Ping An was doing before. We became a shareholder. So you can see a slight reduction in that. But the real thing we're focusing on. And I'll take you through that later in the presentation, is the insurance business, the core insurance business, up close to 60%. So I think a robust growth in terms of new business.

Looking at it graphically, I'm not sure it adds much value. But you can see the growth in the period under review I think is very strong. And I think very much stronger than previous periods.

On the right-hand side, just giving you a sense of the long run growth rate at about 13%. So 15% growth off a high base we are very pleased with and I think it does reflect a very strong endorsement of what we're doing in the markets in which we're operating.

A few comments that I thought are really relevant. I made the point that Discovery Health's new business increased by 13% off a very high base. The performance at

Discovery Health was, in fact, remarkable.

There are two sources of new businesses for Discovery Health. One is what we call additions to existing employers. So a big company is with us. And that company itself grows. So we get new members through that process. That is largely a function of the economy. And that's been a contributor over the years of course to the growth of the Discovery Health medical scheme.

But the more important one I think is absolutely what we call type one [ph] business on the extreme left-hand side, new companies and new employees join in Discovery Health and the Discovery Health medical scheme. And you can see in the period under review, that was particularly strong.

So to an extent, the second type is a function of the economy. The first type, I would argue, is a function of competitiveness. And to an extent, I think it illustrates how well Discovery Health and the Discovery Health medical scheme have performed.

Discovery Life, I made the point; up 8%. You can see the acceleration in the second half of the year. I hope I'll give you a bit of an insight into that later. In reality, the performance of the products in the second half of the year was tremendous.

And in Discovery Invest, just making the point that the growth was largely in single premiums, up 20% year on year.

Let me turn to earnings; operating and normalized headline earnings up 20% on the back of operating profit up 18% to ZAR4 billion. If you look at it graphically, I think the progression continues very much in line with previous years. But I want to take you through the breakdown of the earnings and try and reconcile what is clearly an ambiguous trading update that we put out. So let me try and explain this to you and hopefully get it right.

Normalized profit from operations up 18% to just over ZAR4 billion. It's made up of three components; the established business growth up 15%, the emerging business is up 54%; and then, as I said, we invested 12% of our earnings in new starts, predominately Discovery Insure. But a whole mass of things that we hope will lead to great growth going forward.

You can see in the established business, I think the performance is very robust. Discovery Health is growing its operating profit, up 13%. Discovery Life I think exceeding expectations, up 16%.

Once again, you can see the incredible performance of the UK businesses. The life insurance business, PruProtect, up 56% in profit; the health insurance business, up 60% after system costs. The combination of them has been a remarkable performance. And then Discovery Invest being -- starting to get scale and up 46% year on year.

So you can see the summation of all that leading to an increase in operating profit; up 18% to just over ZAR4 billion.

Now you can see at the bottom of the slide that brings down normalized headline earnings up 20% year on year. Very much in line with operating profit; slight tax efficiency that came through. So from 18% to 20%.

Now to try and reconcile the trading update where we illustrated that headline earnings are down about 3% to 4% yet normalized headline earnings were up 20%. What is the difference? The difference is, in fact, quite simple. And it's really a paradox. It's really a function of how well the Prudential joint venture has done.

Just to give you a sense of it -- I think I've lost a slide here, they've taken it away. To give you a sense of it, as I've said, new business up close to 60%; operating profit, as you can see, coming through in that regard. The business has really, really grown.

Now two distinct things were done in the year under review. One is from an accounting perspective; the other is from a tactical perspective. Let me explain to you the joint venture.

We own 75% of the joint venture and Prudential own 25% of the JV. When we went up from 50% to 75% and Prudential became a minority, the agreement was a put option and a call option structure to give them flexibility to exit over time. So from 2015 onwards. And I think we've mentioned this before, from 2015 onwards, they have a put on their 25% and we have a call. And this happens every year thereafter. Right?

The way the accounting standards work is that you have to actually set up a liability for the value of that put option. So you actually have to estimate the value of the business and then discount that back. And that's essentially charged to your earnings as a liability. That's fairly clear.

Now we've done that in the years that have passed. What happened this year is, given the rapid growth of the business, we had to revalue the strike [ph] price of the business and bring that in. So you can see on the left-hand side of the slide, the value of that put option or the value of that 25% in terms of the formula generated out in terms of what our auditors felt was appropriate was about ZAR3.5 billion. That had to be brought into the accounts; the difference between that and what was held in the accounts before. So that's clearly of a one-off nature and really reflects the exceptional performance of the Prudential joint venture.

The other point is on the right-hand side. And I think this is a very, very sound strategy. The business has been sitting on about ZAR2.4 billion of cash. And over the last number of years or about 18 months, we've been focusing hard on how to, in fact, get yield out of that market.

It's a market, as I think you know, that has incredibly low levels of investment returns. We were earning about 70 basis points on that money for a long period of time. In the year under review, we generated a further ZAR400 million to ZAR500 million of cash and that created some problem for us.

So over the last 18 months, we've been working hard trying to rebalance the portfolio that will give us better yield. I think the guys have done a great job. We've moved, I hope you can see, from about 70 basis points to about 2.5% by restructuring the investments into a portfolio we think is appropriate.

But given the very strong cash generation this year, we took a view that the early reinsurance refinancing was costing us about 5%. We were earning only 2.5% on the money. So clearly, it made sense to take that extra cash and recapture that reinsurance financing, which is exactly what we did.

But reinsurance financing once you recapture it is a charge to the income statement. So the sum of those two gave a charge of about ZAR600 million that really is the difference between headline earnings and normalized headline earnings. So essentially, what we've done in the main is to take our earnings and add that back to give you a sense of like versus like; and therefore, normalized headline earnings increasing by 20%. Yet when you take these one-off charges from the Prudential due to the performance of the business, it goes down by 3%.

So just to reconcile it from the slide, normalized headline earnings up 20% to just over ZAR2.8 billion. You can see the impact of the put option and the reinsurance recapture, close to ZAR600 million. And when you bring that through, the headline earnings are down 3%.

So I hope that's fairly clear. We should have maybe explained that in the trading update but we put that fairly blandly. It is quite a complicated issue. But I hope it's fairly clear. And I hope it's clear that it's a function of the performance, kind of the outperformance of the Prudential businesses.

Let me make a few other comments on the earnings. I guess this is graphic. But just to show you the cash generation, up by 45%. In 2011, we generated very little cash; 2012, a reasonable amount; 2013, this year, it's grown by 45%. I think that's excellent.

Return on capital up to risk-free plus 13%. Our internal target is risk-free plus 10%. So I think the performance in that regard I think has been very, very good.

A point I wanted to make that is I think quite exceptional is the focus on quality across all of our businesses. So the focus on new business, the focus on lapse rates, the focus on loss ratios and claim levels is fundamental. I cannot over-state the importance of getting these dynamics right in an insurance business.

So in the year under review, in the period under review, there's been a strong focus on quality across all of our businesses. And I think the results have been staggering.

If you look at the established and emerging businesses, in virtually every single one of them to a business, new business has grown strongly, lapse rates have some down and loss ratios have come down. So virtually every aspect of quality I think has come through. And I think that is fundamental to the ability to grow, the ability to drive profitability going forward. And I think for me certainly, that's one of the highlights of the period under review.

Turning to the embedded value, up 18% -- I made the point at the outset -- to about just over ZAR35 billion, as you can see. The growth continues I think in line with previous years.

The return on EV, up over 20%, I think reflecting the quality. And to an extent higher than previous periods, in line with some of the highest periods that we've had in the organization's history.

And then finally a point of just judgment that I would say to you that I think the organization is incredibly well positioned. Across all the markets we're in, we're a leader, we're a disrupter. We're recognized as such.

We're dominant in the South African space.

In the UK, our UK businesses in both life and health are in the fourth position.

PruProtect is remarkable. Off a standing start of zero a couple of years ago, it's the fourth largest writer of life insurance in the UK. And I would argue in terms of using Vitality and how it integrates, it's done remarkably well to establish a very strong position right at the top of the market.

I'll talk about China a bit later. But it has achieved a number one position in what we call the Group high-end market, the corporate high-end specialist health insurance space. And that venture is really embryonic; that will take some time. But we do have great faith that with AIA as a partner, there's great potential. I'll take you through that a bit later.

And then just to make the point, I guess, across all of the different countries and markets, we're well established as a leader in every respect.

Let me turn to the specific businesses and take you through some observations.

It is very difficult as we get larger to keep illustrating every single thing in great, great detail. I'm going to try my best to give a sense of the strategies in each of our businesses and to give you a sense of where we're focusing.

I made the point that Discovery Health had a fantastic performance exceeding expectation in virtually every single regard. Operating profit up 13%; new business up 13%; fantastic performance of the Discovery Health medical schemes. Service levels are, I think, exceptional. And the focus on building the healthcare system for all South Africans, I think that's critical.

Discovery Life's performance exceeding expectation; operating profit up 15%. ZAR400 million of cash generated in that -- in the year under review. A very sharp focus on building out the agency force. That has growing in quality and in size. And fantastic performance in terms of lapse rates and mortality experience.

Discovery Invest; I made the point exceeding expectation. Operating profit side really getting, I think, a benefit of scale; assets increasing to over ZAR30 billion. And a really good receptivity of the products that have been rolled out in that regard.

Discovery Insure too is out of the gate; strong new business growth. I think the exciting thing has been the receptivity to the product. And I'm hoping the virtuous cycle we're creating -- I'll take you through that a bit later and this focus on trying to make people better drivers and in the process make them healthier. And I think that the virtuous cycle of that process should be very powerful and the business, we think, will add value.

On the Vitality side, all of our Vitality businesses had a considerable investment in every respect of everything we're doing; trying to make the capability global, repeatable, scalable. We invested in every aspect of it, in how we negotiate with partners, how the structures work, the technology, the philosophy. Everything about Vitality is being worked that and can be repeatable and can be foundational to virtually everything we do.

I've made a point about the Prudential business, the joint venture. It's been remarkable in every respect. Quality, size, growth; I think it is really well set for future growth.

And in the case of China, we've taken a very careful view about not getting side-tracked into businesses we don't think are right. We're focusing the business on the specialist health insurance market. And I'll give you insight into that.

We have captured about 30% of that market. It's a small market. But we believe it will grow very, very quickly. I have great excitement about really building a call option to an extent on what I think might be the biggest -- one of the biggest health insurance markets in the world.

Let me start by just giving you a sense of some of these points. And I'll just get my order right here.

I want to talk firstly about Vitality. We have spent a lot of time on investing in Vitality, in the capability. And making sure that it's fit for purpose as a foundation to everything we do. It is fundamental; it is really the driver of the business model. And I made the point at the outset, we're trying to build brilliant, excellent insurance businesses sitting on this foundation of Vitality.

It is a remarkable capability. And around the world, people are embracing this idea of incentivizing people to be healthier and seeing the financial benefits of that in the kind of industries that we're in.

So there's been a strong focus on Vitality as a foundational piece to every single thing we do. I would say to you that in virtually every market, the receptivity is fantastic, the growth is fantastic. ZAR5.5 million lives now sit on the Vitality chassis. We're learning more and more about engagement, how to get people engaged in Vitality.

In the US, which is the epicenter of wellness. And I think you may appreciate this that in the Affordable Care Act, the Obama healthcare reforms, wellness and a focus on incentivizing wellness, is a fundamental piece of that. So that is really the epicenter of the stuff.

In the US we're rated now number one in terms of wellness in that regard. We've launched a number of initiatives around Vitality around the world to make this capability I think very, very substantial.

In every respect we're getting the philosophy right. Very simplistically, get people to understand their health, know their health; get healthier. And get rewarded for doing so. And going around this virtuous cycle is really the simple philosophy of Vitality.

But of course, underpinning it is a whole range of tools and assets and structures and technology that is developed over time. Vitality Age, working hard on investing in every market, it's academically accepted as a gold standard. Personal pathways need to be clinically sound; a lot of investment in that regard as well.

All of the wellness network's tools have been worked on to make sure they're global, they can be repeated, they can be scaled. And ultimately, the idea is a Vitality capability that's credible, that works. And creates a foundation that we need. And I think the focus has been exceptional.

You can see the growth has been very, very strong in every respect. We've just started out in Singapore. And I want to talk about that a bit later. But I think amazingly on the right-hand side, just to give you a sense of perception, Aon Hewitt in the US did a survey across the corporate market in the US. And you can see they rate it number one in terms of wellness providers, ahead of UnitedHealthcare and some of the other major players.

So I think the performance of Vitality and its positioning is remarkable. And it is gratifying that if you look at some of the quotes, the Economist, the New York Times, McKinsey, whoever it is, I think some of the most credible journals in the world, cite Vitality as a kind of a gold standard.

Amazingly, in the Economist just two or three weeks ago, they made the point that it's a pity the NHS does not have a Vitality program like South Africa. That is very gratifying to us. But I think it illustrates the potential opportunity we have. And therefore, a very, very strong focus on getting this capability to an extent to a global point.

I need to say this to you that we're learning more and more about the verticals that work in Vitality; nutrition, physical activity, prevention, etc. And we're learning about how to structure benefits that engage people. So for example, nutrition, HealthyFood, has been one of our most successful benefits in the context of Vitality.

We've pioneered this as Pick n Pay in the South African market. It's not just about the idea of getting a 25% discount, it's the entire experience of the process. You go into the supermarket. At the till, Vitality tags tell you that it's a Vitality food. You get the discount, etc. It's a very physical experiential process.

You can see the success of that benefit. Our members have cumulatively spent ZAR10 billion through that benefit of Pick n Pay. It's quite remarkable. So we want to scale that to an extent and repeat that.

We've done that with Woolworths over the last few months. We are now starting [ph] the end of the calendar year. And that's now available to a certain subset of our membership base. It gets Woolworths as well [ph], if they want. You can see the growth of that is staggering; about 40,000 or 50,000 fans already to date have activated that, been using it actively.

And then we're seeing the same kind of thing repeated in other markets. In the case of Humana and our Vitality business in the US, we've done the same deal with Wal-Mart, although it's a 5% discount. But despite that, you can see the take-up over the last number of months has been quite staggering.

We're also investing in the science of Vitality. So together with Rank [ph] Corporation in the US, we've done a study, an academic study, on how people respond to these incentives. And it's quite remarkable that when you subsidize healthy food and you guide people in the right way, people in their trolley increase the proportion of healthy food and decrease the portion of unhealthy food. And that, of course, is a fantastic finding.

So these are the kinds of things that we're doing around the world. And I think that is absolutely critical.

At the same time, we're learning about how to get Vitality out there in the perception of people. That's fundamental. So in the UK, we've come up with the idea of Vitality ambassadors working with certain key people that take the message out there. I think at the last presentation, we spoke about Jessica Ennis, the Olympic gold medalist, who's a Vitality ambassador. Jonny Wilkinson is a Vitality ambassador.

And then we formed a Vitality advisory board in the UK with Lord Sebastian Coe, one of the greatest athletes of all time and the Chairman of the London Olympics. He's a most remarkable individual who's helping us think through how to get Vitality pervasive in the UK, how to lead in that regard, how to deal with policymakers in that regard. I thought it may be worthwhile just listening to him in the context of Vitality for one moment.

(video playing)

He looks pretty good for 55-or so [ph], Sebastian Coe. He can run, apparently. He chased (technical difficulty) at the airport. I'll tell you, very impressive.

So really, the idea is actually working with some top people and getting them out there, telling the Vitality message. And I think that's absolutely critical.

At the same time, we're investing in the size of Vitality. We launched the Vitality Institute in the US. And bringing in some of the top thinkers to help us think through Vitality, to think through R&D, to think through policy issues, to think about how you can prevent preventable chronic illness. And the one of I think the cornerstones of the Institute is getting some of the smartest thinkers in the US to work in a commission with us about thinking through these issues.

It is quite remarkable that given the newness of this field, despite the fact that we're a for-profit insurance organization, we're sucking in the best thinkers to help us think that through. That is the kind of the -- how can I say? -- the seriousness and the sensitivity and the importance of this work. And so I'd say to you that in getting some of the greatest thinkers to help us think through in the US, it will spread out elsewhere how we should be thinking about Vitality, how we should be taking it forward.

Also, I thought just seeing some of the speakers at the Vitality Institute launch maybe worthwhile to give you a bit of a context.

(video playing)

Just to give you a bit of a context for some of the work which we're doing, internationally [ph] trying to build out the perception of Vitality. And I think more importantly, the science of Vitality that really is foundational to everything we do.

So that is foundation. Let me turn to Discovery Health. I've made the point that Discovery Health's performance has been remarkable; new business up 13%; operating profit up 13%. The Discovery Health Medical Scheme has performed well in every single dimension. No matter how you cut the data, the performance is strong.

The growth in the Discovery Health Medical Scheme continues. And in fact, has accelerated slightly. You can see the surplus generated. In fact, is dramatically higher. We estimate about ZAR1.3 billion of surplus, of member surplus will be generated inside the Discovery Health Medical Scheme over this calendar year.

And you can see the reserve build-up on the right-hand side. By the year end, we estimate close to ZAR10 billion of cash, or near cash, is sitting inside the Discovery Health Medical Scheme on behalf of members. So I think the scale of the endeavor and its success financially is quite remarkable.

At healthcare level, our fundamental goal and obligation is to make healthcare affordable. So the focus is on making healthcare costs as low as possible, driving up quality. If you look on the left-hand side, we managed to keep over the least five years medical inflation to CPI plus 3%. That's about 1.5% to 2% lower than the market average.

On a compound basis, that's dramatic. It's about a 12% to 15% lower healthcare cost benefit for benefit to our competitors. And I think that's critical.

On the right-hand side, just to make the point, we continue to pass on efficiencies to the Discovery Health Medical Scheme. Administration fees were around 13%. You can see the graph path down. We're trying to get to about 10% in a short space of time. So there's a very, very strong focus in that regard.

In the year under review, one of the -- very important developments took place with the Discovery Health Medical Scheme. There's been a lot of debate around the scale of administration fees of medical schemes and our fees in particular; is the medical scheme giving value for money, etc.

The trustees of the Discovery Health Medical Scheme at the last AGM brought in Deloitte's to do a proper public process to actually look at those administration fees and come out with a finding. The report was, in fact, released at the Discovery Health Medical Scheme AGM just a few months back. And I think the findings are very, very compelling and illustrate I think very clearly, not only the performance of the scheme in Discovery Health. But the value for money members get.

It's an interesting point to make that the Discovery Health model is a sophisticated, integrated health insurance model. Everything hangs together to integrate it in a model that works well. And I think to an extent, it is the anthropic principle that works well because we're the leader. And that's factual.

But it requires some investigation. When you compare to our competitors, they have largely an administrative structure and they outsource certain elements of their administration and managing of care.

I think the report is very conclusive that the integrated approach works better. They make the point clearly that the Scheme performs best amongst its benchmark competitors. And amazingly, some of the findings that came out of it I think are staggering.

The integrated model costs members about ZAR11 per month higher in administration fees per beneficiary. But the savings on healthcare cost is about ZAR160 per month lower. So for a family, the collective savings is about ZAR600 per month. That's a remarkable finding. And I think it does show the value for money that members get out of the administration of Discovery Health.

And then just an ROI calculation there estimated in the Deloitte's report. For every one ZAR1 spent on the administration fees, the scheme beneficiaries get close to ZAR1.77 to ZAR2 coming back.

So a very conclusive set of findings and I think we're on the right track. And I think the value for money to the scheme, hopefully, is very, very clear. But we'll continue of course to drive down costs, to drive our administration costs. And to pass those on to beneficiaries. But I think we're well positioned based on that.

When we look forward and say to you the contents of Discovery Health we're [ph] fairly clear of the scale of our obligations, it is quite remarkable that the market share of Discovery Health and the Discovery Health Medical Scheme is nearly half the market. And what I find really, really instructive was the latest Sunday Times top brand survey that came out literally a few weeks ago in which in every category, you get a number of companies competing, telecoms, or whatever it might be, in a first place, second place, third place.

In the case of medical aids, there was one company mentioned, Discovery. It's quite remarkable. There was no statistical significance of other responses. It's on one hand very, very gratifying. On the other, it tells you the enormity of our task.

We're seen as the Kleenex; we're seen as a generic. We're the utility. We are really building the private healthcare system. And I really think that puts an onus of brilliance on to us. We have to make sure that every aspect of what we do is exceptional, not just at a system level but for every individual that we care for. And that's an absolutely critical thing.

We need to understand as well. And I've said this before, I feel there's an expectation gap that rationally the odds are stacked against us in terms of member perceptions. Just listen to this fairly simple, logic tree.

We deal with people's most important asset, their healthcare. The product itself consumes 15% of their salaries; probably the highest, most expensive product they'll buy. It's structurally inflates above inflation. So it eats more and more of their salary. And because of the 80/20 rule, 20% of the people consume most of the money, 80% of our membership base pay in more than they get out.

So simply put, it's the most expensive product they'll buy. It inflates and they get nothing back for it. So I'll put to you -- I shouldn't be doing this at this presentation -- 80% of people should really dislike us. But they don't, they really don't. In fact, I think they do like us. And it's things like Vitality that give people value for money.

But it does tell you that the odds are stacked against you. The rational consumer should be stacked against us. And any difference, any possible -- any problem when they do claim is amplified [ph] by I've paid all this and I get nothing back. It's a very difficult, probabilistic product.

I would argue that the first few points are probably the same for private education. It's a critically expensive issue. It inflates above inflation. The difference is with education it's not probabilistic. Everyone uses it. You see a child go to school every day. It's visible. With healthcare, the sick use it and are happy with it. But the 80% that don't are dissatisfied. And that means that we have to be absolutely brilliant in everything that we do. We can never rest.

And this is not just at a system level. We have to make sure that we make it clear that health is accessible, we bring the price down as much as possible, we offer people benefit options. And we're brilliant in the interactions. And that's what we are focused on. It is very, very complex and difficult.

And a great example about this, you may have seen in The Star just a few weeks ago, life versus medical scheme. Now these are very painful headlines to deal with. We're on the side of the medical scheme I hate to tell you in this article. But a very difficult case that we dealt with.

It was a cancer sufferer; I think a 26-year-old male where there was a debate about what medication he should take. Amazingly, we were arguing for medication that's more expensive than was prescribed by the doctor. But the disagreement led to this front page article.

But it gives you -- if you look at the funnel [ph], it gives you a sense of what we're dealing with. We manage about close to 760,000 hospital authorizations a year. It's about 60,000 a month. Close to 96% of them are approved almost immediately; a further 3% are chucked out, underwriting ineligibility; and then 0.3% of them end up in this kind of debate around the clinical appropriateness.

We are careful to use the best independent clinical advisors to work with societies to make sure we're focusing on quality. And any slip-up is not acceptable. We can never look at this in a statistical way. Every single individual has got to have the best quality care. And that's what we're focused on. But it gives you a sense of the tolerances that we're dealing with.

There is no room for error here. We're dealing with people's lives and we're dealing with statistics that are to an extent stacked against us.

So we are focused on building up the best healthcare system. And to an extent, to Discovery Health's credit, there's a very, very strong focus on not just building an administrative capability. But building a seamless brilliant healthcare system that people have access to.

I think two presentations back I illustrated to you the HealthID capability that medicine is changing. Doctors aren't sitting in a consulting room in isolation. HealthID gives them on an iPad access to electronic patient records, scripting medicine, senior pathology results; really giving them an entire history in a dynamic interconnected way.

At the last presentation, I think I showed you the member apps that really create this idea that the health plan is on the phone, the smartphone that people have. And they have access to it.

But I think the power we're building is really the healthcare of the future. And to an extent we're often negative about our healthcare system and don't appreciate it. I think one of the exciting things about South Africa is the private system is small enough and we're big enough to straddle. We can make systemic change. We can drive quality. And that's what we're doing.

So one thing I wanted to show you that I think is quite fascinating is we're now moving ahead with biotelemetry, focusing on areas where we can use this technology to make people healthier.

One of the areas of focus we've done is diabetes. Diabetics every day have to check their blood sugar. They have to check that over time; understand the trends of what that means; how they eat; how they manage it. These are critical things. And this kind of technology rollout has the ability to make a difference.

You can see the member take-up in terms of our member access has been dramatic. And that's created the impetus for the ability to do this.

So what I wanted to do at the risk of actually -- of taking some risks, I thought I wanted to show you the power of this diabetic telemetry pilot. We're in the process of rolling it out to 50,000 diabetics. The feedback from the pilot that we've done has been absolutely remarkable.

So let me show this to you. The idea is that someone suffering from diabetes at home would have their member apps and have the apps that we provide. I'm going to ask Alain Peddle, who is our Head of Health R&D and a proud diabetic -- let me say that for him, he's a remarkable individual -- what he's going to do for us. And I hope I get this right, next year, we're going to do a hemorrhoid op live . Alain's dropped the phone.

Okay. So what we're going to do here is Alain every day, I think a few times, checks his blood sugar. Right? Now in the old world, that would just be written down; he'd lose history, whatever. Here, I have the application. It gives you his bloods. I hope it's on the screen. He's now going to --

Alain Peddle

I'm going to do the test. So that's the device. I put the strip in. Everything seems to be working. I prick my finger. Take my blood. (inaudible) . Look. I do this 5 times a day, or so. And of course, I've stuffed it up first time. Don't worry. Sorry. That's just me doing it clumsy.

So a four-second countdown. I've had a high reading. I'll take the strip out; get rid of it. Right? And then it should start to communicate.

Adrian Gore {BIO 3068929 <GO>}

So that device now communicates through the application, the smartphone. And hopefully, what will happen is this latest reading will appear on his phone . I've done this a few times and --

Alain Peddle

Something's happening. I'm not --

Adrian Gore {BIO 3068929 <GO>}

Maybe keep going. I hope it's clear. We wanted to show you blood anyway, which you did see. And the idea is, as you can see -- sorry, ring the phone up again -- as you can see, supposedly his reading would be live in the phone. But more importantly, the entire history would be available. He could see it graphically. He could look at it before he eats, after he eats. He gets a complete and total management of what's going on on his phone. And I think that's critical for a diabetic to understand.

But the real power of it is -- let me go to HealthID where it's now updated at the doctor level. So almost immediately, the doctor now has access to what Alain's records are. He or she can track that, see what's going on. And amazingly, understand proactively that if there's a problem, there can be a callout. If Alain calls in to the doctor or the registered nurse, they have access to the records, what's going on, what the history is.

And then what we've done as well through that record is in terms of Alain's electronic health record, everything that's related to diabetes, all ICD codes that are related to diabetes, are sucked into this. So all the other treatments as well, besides the blood reading, is pulled up as well. So the doctor/healthcare professional at the point of care has access to the entire cross-section of Alain's state in addition to his history.

The quality of care is quite remarkable in that regard. And quite soon, we're going to start coalescing that with Vitality data around health risks and how behavioral aspects come into being. The effect on quality of care immediately is dramatic.

And when you think about 50,000 diabetics, you get a sense of the scale of what we're dealing with. 50,000 diabetics in terms of health, in terms of healthcare cost, is a dramatic burden to the Discovery Health Medical Scheme, the opportunity to make people healthier.

So to an extent, trying to give you a sense of where healthcare is going and our ability, I guess, as Discovery Health in a relatively small healthcare system to make structural change. And that is on the foundation of what we're doing.

At the same time, we're investing heavily in the healthcare system. The Discovery Foundation has an express goal of uplifting the number of medical specialists by 10%. So we have about 6,000 specialists in the country; we'd like to make that 10% higher. We're gaining exceptional traction. We've been offering grants to exceptional people to specialize. We've got about 200 people now specializing. ~So we're nearly one-third of the way there to uplifting the number of specialists by 10%.

On the right-hand side, I just wanted to mention to you, during the period under review, we launched an initiative with Massachusetts General Hospital, it's the Harvard teaching hospital, about taking some of our smartest PhD students in the universities, getting them to Mass Gen, getting them to learn super specialties and bringing them back to the country. And the idea is to train the trainer through the universities which we're working with we're going to build a healthier system.

So we're not starting bottom. But starting in the middle and the top with specialists, increasing that number; and at the same time going right to the top to actually get a trickle-down effect of training the trainer and making the universities hopefully at the cutting edge of what we're trying to do.

I do believe that we can make a difference. I do believe the healthcare system is sustainable. And I do believe along with other initiatives like the NHI, we can build a better healthcare system for all South Africans. And I think that that is critical.

Let me turn to Discovery Life. The performance has been absolutely staggering, I think, in terms of operating profit up 16%. Strong new business growth, robust, off a very high base of 8%. I made the point that the second half of the year was better.

But it's fundamental to just talk about the Discovery Life model because I think it is remarkable in its execution. And the effect of it has been tremendous. So the highlight [ph] is actually very simple.

As I said at the outset, the causes of death today are different. They're dynamic. 50% of mortality is driven by choices that people make day to day. So the concept of underwriting someone at a point in time when they enter. And that rate applying for 40 years, is completely and totally incomplete. The approach behind Discovery Life is you get underwritten, of course. But then based on how you manage your health, how you engage, your premiums flex. If you (technical difficulty) your premiums if they come down.

So actuarially, it provides the dynamic pricing mechanism. The effect of that is dramatic. Better value for money to the policyholder, a better matching of price and risk from an actuarial perspective, better for the insurer and better for society. Hopefully, people are getting healthier.

The model has played out I think remarkably well. We're learning more and more about how the product should be constructed. Over the evolution of Discovery Life, we've had different iterations of getting in the right.

In the period under review, we've focused on a number of things. The first is the actual benefits and the triggers that make people think about lapsing and behaving differently. We've had an incredible success with the side of [ph] getting cash back, releasing some of the actuarial reserves and giving that back to people if they engage.

So the concept we've established, every five years you get a cash-back; or if you roll out during the second half of the year, there's annual cash-backs. The flexibility of Vitality status [ph] have been remarkably well received. And have had an impact of bringing lapse [ph] rates down.

The other very exciting initiative that I have great hopes for is the idea of using how people drive with the risk factor. I'll show you a bit later. But for the first time, we're pricing life insurance based on the VitalityDrive of how people drive.

It's kind of intuitive and obvious. And I remember when we rolled out Vitality Insure, people guessed that at some point we'd link that as a risk factor. But it took us some time to understand the statistics. But both of those were rolled out in the last number of months. And I think the receptivity to both has been quite exceptional.

The effect of that has been that Discovery Life remains at the top of the pile in terms of market share. On right-hand side, you can see the second half of the year has grown quicker than the first half of the year, I think illustrating the receptivity to the new products.

But I think most important is how powerful the model is working. The idea is that people behave better. We rate them better over time. Lapse rates come down; mortality's better than expected. And that's exactly what we're seeing.

Lapse rates, as you can see on the left-hand side in the red, or the orange, are lower than expected. In the blue across all durations of the period under review, mortality's better than expected. So things flipped around, the other way round. Mortality levels are lower than expected. Despite that, from [ph] every couple of years, we've been strengthening that expectation in the embedded value basis. And I think that's critical.

All the correlations are playing out. If you look at lapse status, if you look at claim experience, all of them are strongly correlated to engagement and mortality status. So as people engage more, lapse rates go down. As people engage more, claims experience tends to be better. So there's kind of a gain here, a virtual cycle of how the model works.

And therefore, to an extent, we are agnostic as to how people engage. The more they engage, the less they pay; but the less they pay, the better the performance tends to be. And it's that virtuous cycle that I think plays out so well.

It is quite remarkable if you see what's actually happening in the dynamics of the Discovery Life policyholder base, the relative frequency of people in the different statuses is getting higher. So if you look at the gold and silver status on the -- of the gold and diamond status on the left-hand side, there are 3.5 times as many people there as there were in 2009, adjusted for growth, as you can see.

In the middle, you can see the extent of cash-backs and premium discounts people are earning is dramatic. Cumulatively over the 2013 year, we've paid back about ZAR5 billion cumulatively to policyholders. So people are getting considerable value by engaging in Vitality status.

And then I found the last in there, this is very, very revealing, that shows you how the Discovery Life model really works. It's really the experience variances of Discovery Life. What you can see is a strong negative variance around premium income.

So in fact, people are engaging faster than we expected, which means that they pay less in premiums than we expected. So it's a negative variance. But the concomitant entry on the other side is effectively a far better lapse experience and far better mortality experience. And, therefore, you get this kind of -- the model playing out dynamically through the experience variances of the embedded value. And I would argue the model is working remarkably well.

The effect then on the quality has been to continue to grow the Discovery Life, EV, I think, is around 20%, as you can see; strong growth over the period. And continues to do so.

So to an extent, I'm confident of Discovery Life's ability to grow. But we'll be [ph] more importantly, hopefully, we're creating a virtuous cycle of this engagement, driving down lapses, driving better mortality experience. And I think driving a better result with no real trade loss in that regard.

You can see the value of new business margin is staying at about 10%. So despite a very competitive market, I think we're managing to maintain our new business margins where they were.

Let me touch briefly on the AIA joint venture. Why I've put it here in the order of the presentation is that it's completely new. We have great hopes for it. It's a pan-Asian partnership with AIA. And it is a good segue.

Of course, to an extent, what we're doing with AIA is exactly what we've done with Discovery Life. What we're trying to do with them is integrate Vitality into the life insurance business. And by the way, joint venture we've called AIA Vitality that really does both. It builds the Vitality chassis; it integrates into the life insurance policies. And they are in search of exactly what Discovery Life has done.

So to an extent, all of the learnings of Vitality, in building the Vitality chassis; at the same time, all of the learnings about how you integrate this into life insurance with dynamic pricing, all of that has been rolled out into the Singapore market with AIA.

It's been a remarkable process. AIA itself is a fantastic company. It's one of the largest -- in fact, I think the fifth largest insurer in the world. It's the Asian arm of AIG. And in fact, when AIG was taken over the by US Government, you may know the story, AIA was their most valuable asset. So they sold it off to the public in effect and became a standalone massive listed insurer in Asia.

It's of remarkable quality. If you do any reading on it, you'll be very, very impressed. Total assets under management, I think ZAR1.5 trillion [ph]. They're a remarkable franchise throughout Asia, starting 90 years ago in Shanghai. So it really has a real powerful position in the Asian market.

Their focus very much is in -- idea of doing what we've done with Discovery Life; pushing out protection products in a market that's increasingly buying them. And their idea of making people healthier in the same way that Discovery has done has been at the cornerstone of their strategy.

What we've done is built a very strong Vitality chassis in Singapore. It's a fantastic market in the sense it's dense; high GDP per head. It has a whole range of potential parties. I think what's interesting about it, the point I made earlier, is we've learned in a disciplined way all of the issues around the verticals of nutrition, physical activity. So while the parties are different, the philosophy is the same. Structures are very similar; and using the power of AIA, we've built some very powerful dynamic partnerships.

So for example, Cold Storage, which I think is the largest grocer in Singapore, is our partner on the nutrition side. And we've built it piece by piece in a very similar way to we've done in the South African market, in the UK market. I think that bodes well for the future of the joint venture.

And then on top of that, AIA has done the actuarial work to dynamically price life insurance with us in this JV. So it really replicates the Discovery Life model that we've done in South Africa into the pan-Asian market, starting in Singapore.

I thought it may be worthwhile just hearing from AIA as part of the launch process; give you an insight into their thinking.

(video playing)

It's a very exciting venture, I must say. Going to the launch in Singapore was like a kind of a Monty Python moment for me. We sat in audience listening to CEO Huckley [ph] tell us our own story in a different language. It's quite a remarkable experience if you ever get it.

Let me move on to Discovery Invest. I'd like to move quickly and try and give you an insight. I think the Company has done well. I made the point about getting scale. And you see that coming through in the operating profit, up 46%.

There's been a very strong focus on product excellence in Discovery Invest. Understand that the hypothesis behind the business is very simple. It's like other -- like its competitors, it offers a list [ph] platform, open architecture in terms of choosing any asset manager, any fund. It has all of that. But the key thing is offering value and protect your own using integration and efficiency of our model.

So two products I think with two initiatives that have got real traction in the period under review. The Retirement Optimizer is an incredibly smart actuarial concept. The idea of giving Discovery Life policyholders, essentially post retirement, their unnecessary, or too much life cover you have post-retirement, using the excess life cover, taking the actuarial value of that and putting it into your retirement annuity, supplementing your retirement income. It really transfers life cover into income post-retirement.

The efficiency of that is dramatic. And work is done on that Retirement Optimizer getting excellent traction in the period under review. And illustrating, I think, the power of to an extent integrating investments of life insurance at a structural level. I think that is very powerful.

On the right-hand side, we've used the tax efficiency and the structure of Discovery Life to give people a simple, powerful boost up front when they invest. So if you invest in Discovery Fund, if you're a Discovery Life policyholder, you can get up to 26% up front in your investment as a booster.

In the period under review, we extended that to non-Discovery funds at a lower booster. And to people that don't have a life plan. So using that same kind of structure has got great traction.

And I think to an extent, what you'll see on the left-hand side is the new business fairly flat in the previous financial period. In this period, it has responded to those. And in fact has accelerated over the second half of the year.

I made the point before about single premiums being up 20%. You can see that on the right-hand side of the chart.

So a very strong focus on getting all the aspects of Discovery Invest right. But I think an excellent focus on products that is getting traction in the marketplace.

Let me turn to Discovery Insure. Discovery Insure really has been a focus of ours for the last two years. It really is two years out of the gate. We are very excited about what is being built and have great expectations it will become one of the great Discovery businesses.

New business up 53%, as I said. The base has grown to nearly 50,000 vehicles; in-force premium over ZAR600 million. You can see that graphically there; very strong new business from the get-go, to be fair. Even in its first full year, I think they've got very, very good traction. But in the second year, you can see the traction has accelerated and the premium in-force is tending to grow at a rapid rate.

We estimate that Discovery Insure is getting about 10% of the market share, of the personal lines market. And hopefully, that will grow quite significantly.

I think what is most exciting is in fact the behavioral aspect that we set out to achieve. The simple idea here is the same irrationality with driving. People think they're good drivers but they're not. And if we can change the choices around and make them better drivers, we can, of course, lower the costs of insurance. But I think more importantly, make people healthier and safer. And that's the idea behind Discovery Insure.

I think the results have been remarkable. You can see how quickly people respond to the incentives. So in Month 2 typically, only 27% -- on the bottom left-hand side -- only 27% of our policyholders in that month either advanced and engaged in terms of the measures that we measure. By Month 12, just 10 months later, nearly 50% are.

So it turns out that people do respond quickly to the incentives, to the tools, all the kinds of things we do in Discovery Insure, to get them to drive better. It's a fantastic opportunity.

And as you would guess, on the right-hand side, it turns out to be measuring the right things. People who drive better have less frequency of accidents. And the accidents they have are of lower severity. And therefore again, I think at a health level, at a safety level, at a claim level, the effects are quite powerful.

In addition to that, the lapses are all positively correlated. So as people driver better, their lapse status tends to drop. So as they get engaged in our system, they tend to become more sticky. And on the right-hand side, the longer they stay with us, the lower their lapse rates tend to be. And the lower their claims tend to be.

So I would say to you again, I'm hoping that in Discovery Insure, we're developing a virtuous cycle. People are incentivized to change behavior and drive better. When they do that, claims go down, they lapse less frequently and the process goes on. And in that process, hopefully over time, we'll see the value being created and we'll see the effect on society. Early days. But I have great hopes that we can achieve it.

Now it's important we maybe state that in the case of short-term insurance, most products are fairly commoditized. The market we're in largely competes on distribution channel. Either you're a D2C player, that's above-the-line advertising and that's really the focus, or you're a broker player and the focus is on working with brokers, giving them an underwriting pen, giving them a whole load of things to get them to sell your products.

So that it [ph] teaches people to have better death [ph] perception, peripheral perception; there are a lot of tools that are online. We've done a joint venture within that [ph] which is available to our drivers to get them to drive better, to have better perception of what things are going on [ph] around them.

We've done an amazing amount of work on this concept of Driver DNA. In fact, I wanted to show it to you in a much more complicated form; we didn't have the time.

It's really worked out on an actuarial theme [ph] Discovery Insure around a very simple idea. If you look at how people drive and the statistics coming from that, everyone has a unique fingerprint, to an extent. And it turns out that that's true. You can model it carefully and you can predict who's driving the car. So every individual has their own DNA of how they drive.

And once you have that tool to predict, we have the ability to tell who's driving the car. Is it the driver? Is it someone else? It has a whole load of applications. If someone has stolen the car, we should know just from the statistics coming through in real time on a real-time basis. And so I think it has an amazing opportunity for all kinds of applications in Discovery Insure.

But the point I'm really trying to make is just the power of the product is driving what we're doing. And to an extent, that's where the focus has to be.

It's interesting, just to go back to the Sunday Times survey, I think it's interesting just to get a sense of perception that I think the strategy works.

So we are spending far less, even in our D2C initiatives than our competitors. You can see on the left-hand side. That's public data. It gives you a sense of the ad spend above the line. Yet, amazingly, in the Sunday Times brand survey, Discovery Insure was number two in the category in which it competes. Really it says I think the ability to capture the hearts and minds of people with a product that makes a difference. And that's what our focus has to be. And we'll continue doing that going forward.

And one exciting thing that I made a point of earlier is just the exciting link of VitalityDrive to Discovery Life and its (technical difficulty) to affect how people drive. It turns out that if they drive better, their chance of fatalities are lower. And therefore, we can use their driving statistics as a risk factor.

So for the first time in the period under review just a few months ago, we've rolled out the idea that you get a 10% discount on your life insurance. And that premium flexes like Vitality does through VitalityDrive by using how you drive as a risk factor.

And I think that offers fantastic value for money. It offers us an increasing learning in Discovery Life about what drives mortality. But fundamentally as well, our distribution channel; for the first time it gives our distribution channel, our brokers, the ability to link these two products. And I think from a distribution perspective that is incredibly powerful.

Let me turn to Ping An, to China, moving in a bit of a haphazard order. I wanted to just talk about this very briefly and give you a sense of I think we're building a very special company here. I do believe it's going to take time. We've been careful in saying to all stakeholders this is a very slow process. China's health insurance market is embryonic. But

I do believe in, as do the most sophisticated commentators, that it's one of the largest insurance markets emerging.

Just to give you the case for China again, it's actually quite simple; ignore all the big numbers that you hear. But effectively, China spends very little on healthcare per person. You can see $221 per annum on healthcare versus $8,000 per annum spent in the US. But amazingly, their total healthcare market is pretty big. It's about 10 times the size of ours and growing at a rapid rate.

But the really interesting thing is private expenditure. Nearly one-half of all spending in China on healthcare is private, not government. And of that, 80% is out of pocket; it's not covered. So 80% of 50% gives you close to 40% of the entire spend that is out of pocket. Clearly, that is a massive, massive insurance opportunity.

The products being sold into there currently are crude, critical illness dread [ph] disease policies. There isn't yet a sophisticated health insurance market developed yet, except right at the top end. And that's where we're focused, on developing a proper, specialized health insurance business.

Some of the analysis done by McKinsey, Munich Re and others, will show that the current health insurance market is only RMB1 billion, on the left-hand side. But the expectations are that this market is likely to grow at 40% a year as opposed to the life insurance, or P&C, property and casualty, at far lower rates.

The expectation of growth is by 2018 that it is a 6 million market and it continues to grow. So our strategic response together with Ping An is to focus on building a company that's fit for purpose in that market. We've been very careful there. And I made the point about some of the peripheral products that have been sold; fund and service products we felt were wasteful, have very low margins, don't make sense. We've tried to get the company not to do that. And we've focused on really the proper health insurance business.

You can see on the left-hand chart, trying to give a sense of size, we estimate by the end of the 2013 calendar year, we'll have about RMB330 million of premium in that market. And that's about 30% of the total high-end space in the Chinese market.

We'll have competition on the group high-end space in terms of just positioning. We are now the biggest writer of group high-end health insurance. Second place is now Sigma [ph] of the US, which is a very, very fierce -- it's fierce competition. And make sure we keep that place. But the focus I think is correct here in terms of what we're doing.

Sorry, let me go back one.

I want to just show you one other thing; just give you insight into China. Virtually all healthcare delivery is public, in public hospital. And it's of good quality. But, to an extent, there's a differentiation between general wards -- even then, there's a lot of out-of-pocket exposure -- and these private VIP wards. And understanding the ability to have access to the private wards is what people want when they buy health insurance. So I thought a very quick video might give you some context and insight.

(video playing)

I'm not sure what they chose . So its queues [ph] like our -- our people at team development assured me you'd see beautiful private wards. But I assure you, when you go to their public facilities, don't be fooled. They are of considerable quality. But there is a very vast difference between private VIP wards versus what you see in a typical public hospital setting. I think that is our advantage.

I'd like to end up on the British businesses, on PruHealth and PruProtect. As I said to you, to me, the performance over the year has been absolutely remarkable and staggering.

I made the point about the growth. When you look at it graphically, you can see combined, the business, new business, up by net close to 50%; and the materiality substantial to nearly ZAR1.6 billion. Operating profit up 40% to just under ZAR600 million, if you look at the core operating profit. So the performance I think is remarkable.

And then giving you a sense of materiality; in terms of Discovery's overall picture, the new business of the joint venture's about 15% of our total. And the profit contribution's about 12% of our total. So it's a substantial business and forming that way.

I do need to say to you that our vision for the business is to build the best protection business in the UK. And that's what we're doing. It is interesting that a number of years ago, all of the life insurers were thinking about long-term savings; that's where the market is. In truth, there's a re-focus on protection. And I think we have the amazing opportunity to build in the UK, like we've done here, Vitality, Health and Life Insurance through an integrated approach. And that's what we're doing.

And I would argue that it is largely embryonic. PruHealth itself has had a fantastic period. We've digested the acquisition into the Standard Life Healthcare; operating profit up 23% when you take into account the system costs. New business approaching ZAR1 billion, up by 54%. So despite the acquisition, the team has done remarkably well now getting the structures there to compete for new business and I think doing very well.

The Vitality Ambassador process has allowed us in the direct-to-consumer space to use our ambassadors. And that's had a fantastic effect on responsiveness. Core rates are up, conversion rates are up. So we're getting into that very profitable individual market. And I think doing very, very well there.

And then the most important point is the quality of the business. If you recall our earlier presentations in PruHealth, we had a lot of difficulty on the loss ratio and those kinds of aspects. The guys have done a remarkable job. Our lapse rates are now in the industry. Our loss ratio is the lowest in the industry. And you can see that coming through on the embedded value growth of 24%.

So you can see that lapse rates are coming down off the low base and continue to do so. A very strong focus on conservation. And our loss ratios are coming down; and again, 12% lower than the industry average. It's a remarkable performance, I think.

And then the final point I would make. And this is maybe just a prediction, just to make the point that we are still busy with the process of the acquisition. So we still have a number of system platforms working concurrently inside PruHealth. We believe that once those disappear and we're on one platform, which is in the process of happening, I would estimate in 18 to 24 months' time, ZAR100 million or so per annum of saving should fall off PruHealth. We hope that that takes place. And that's really the aim.

So in addition to the quality, I believe over time, the duplication administration costs should recede and the profitability should emerge very, very strongly.

From a Vitality perspective, we've done a huge amount of work on the Vitality chassis. We're getting fantastic traction. You can see on the right-hand side, I hope it's clear, in terms of gym activations, healthy food activations, it's climbing strongly month by month. And interestingly, movies, which are a kind of low-value, high-frequency benefit, we're finding in Vitality, it's an incredibly powerful way of incentivizing people. People use them at a rapid rate.

And we see that here. We've seen it in the UK. As you can see, in August, 40,000 people a month are using that benefit.

So to an extent giving you a sense of the work done on Vitality. We've had a 70% take-up on people buying up Vitality to Vitality Plus. And I think as well we're getting great traction at the perception level.

I wanted to show you this. It comes out of Britain's healthiest company survey we did together with the Daily Telegraph to just give you a sense of the traction we're getting.

(video playing)

So we've got really good traction around what we are doing in every respect. And I think PruProtect hopefully will also be the beneficiary of that. PruProtect's performance is absolutely staggering. From a standing start from nothing. Purely organically built from the ground up. You can see on the left-hand side the policyholder count is just absolutely up-sloping.

New business has grown year by year very, very -- at a rate that's absolutely remarkable. And then operating profit this year, as you can see on the right-hand side, growing by close to 60%, illustrating the quality of the business.

Lapse rates continue to go down. Mortality experience in the blue continues to be lower than expected. So every aspect of the business tends to be I think frankly brilliant.

The business mix is excellent. And all of that is driving quality. You can see that coming out in the embedded value calculations, the value of in-force nearly doubling; the value of new business a substantial ZAR450 million, up nearly 50%; so illustrating, I think, the ability to give both scale and quality at the same time.

And I really believe that PruProtect is embryonic. There's a lot we can and will do with the business together with PruHealth going forward.

In terms of distribution channels, the ability to write [ph] I think is substantial. Over 70% of the new business on the left-hand side comes from our franchise face-to-face channels. I think that's critical because it's high-advice [ph], quality business.

And amazingly, on the right-hand side, our account managers inside the franchise, it's the people that call on the brokers; the longer they are with us, you get a dramatic uplift in business. So as the business ages and matures and the franchises mature, we expect additional growth from that.

And then a final point to make is that on September 16, we're running out a really powerful integrated product for the first time into the UK very much along the line of the Discovery Life Vitality integration. We've had that before where there has been some integration. But not at a deep level.

A lot of work has taken place on the learnings over the last year of Vitality, of the Discovery Life model. And a very deep integration model is being built in the UK. I think the effects of it will be dramatic on new business and on the market. So great hopes for a launch that's coming up in just a few weeks' time.

Let me end off by saying it has been a great year. Just to end off with a summary, strong new business up 15%, earnings growth on a like-for-like bases 20%. A considerable investment in new initiatives we believe will grow rapidly going forward. Strong cash generation. Great EV growth, I believe. And excellent return on the EV. Quality of business in every respect, lapse rates, loss ratios down across the entire Group. Embedded value, strong growth. And finally, I think, probably most importantly about the future, very strong market position for the way forward.

So we are very alive to our core purpose of making people healthier. And believe in our ambition of building the best insurance organization in the world. That's what we set out to do.

I appreciate the time that you've made of all of our key executives and directors here with us. Can I just share the questions if you come for [ph] (inaudible). Thank you for the time.

Ricky Farber, our CFO, I think you know well, is joining me up on the podium. Can I take some questions?

Questions And Answers

A - Unidentified Speaker

Nice to have you and nice to see you.

Q - Unidentified Participant

Mr. Gore, I don't want you to misunderstand me when I make certain comments. And this is not a backhanded compliment, I mean everything that I say.

I would suggest that everyone takes the time to read the three-page overview, to which you did not refer. Within this overview, you used the word strong 13 times . There's also the liberal use of the words exceptional, excellent, unmatched, outstanding. And in your presentation, you used the words staggering, brilliant, fantastic, remarkable. And for all that, I detected no sense of boastfulness; rather a justifiable sense of pride. So my congratulations to you and your team.

A - Adrian Gore {BIO 3068929 <GO>}

Si those are versus expectation, I suppose, aren't they? .

Q - Unidentified Participant

Now I have about 100 questions. But I'll stick to just about three or four, if I may.

Your balance sheet shows an item -- got to get to it first. Forgive me while I turn to it. Under liabilities headed investment contracts at fair value through profit and loss at just over ZAR6 billion. Now is there any link with that item and a similarly-worded item on your income statement headed net fair value gains on financial assets [ph] at fair value through profit and loss at just over ZAR2 billion? Is there any link between the two? And if there is a link, why is there a difference in the numbers?

A - Ricky Farber {BIO 5884718 <GO>}

You're 100% correct. There is a link between the two. That's policyholder liabilities. So this is Discovery Invest. And the policyholder liability increases one of two ways.

Either the assets that we hold for those policyholders increase through market gains. And that's the net fair value gains; or alternatively, they can invest more money with us. And that would come through as a premium revenue; and that would reconcile the difference between the two numbers.

Q - Unidentified Participant

Okay. Then staying with the balance sheet, there are a number of items that show substantial increases from the year before; equity securities, debt securities, money market loans and receivables, total ZAR15.5 billion; which has reduced by ZAR5.2 billion on the equity-linked notes.

Now I'm fully aware that the market has been strong in the last -- there's the use of the word strong -- has been strong in the last year. But still, I doubt if that explains the massive increase in these items that I've just mentioned, particularly since the cash flow statement shows only ZAR737 million being net purchase of financial assets. So what in effect was the reason for the strong increases in those items I've just mentioned?

A - Ricky Farber {BIO 5884718 <GO>}

Sure. So the bulk of the increase is pretty much the same thing; it's policyholder assets. And you're quite correct; they have increased once again through the market value gains. But they've also increased through further investments by the policyholders.

Included in that is a small amount of shareholder assets. And that's the part that's gone up by ZAR737 million. So only the shareholder assets is included in our cash flow. The policyholder assets comes in and out a little bit higher up.

The only one that's probably worth explaining in a little bit more detail than that is the equity-linked notes, which looks a bit odd because it's gone down.

You'll recall that. And we discussed this six months ago, Discovery took a view that we were previously offering a guaranteed product on the back of an equity-linked note offered by one of the international banks. And we restructured that in, I think, October last year, where we instead brought it -- we colloquially say onto our balance sheet.

But we took the underlying assets at the equities, the money market and debt securities. And instead of holding a note from this bank, we now hold the underlying assets.

We were worried in part about the credit of that bank. And also the ability to manage it. And so we now have taken it on ourselves. So that's also driven an increase in equity securities, money market and debt securities. But the resulting decrease in equity-linked notes.

Q - Unidentified Participant

Thank you for that, Mr. Farber. Finally, please, Mr. Gore, I'm turning to the table headed normalized profit from operations, which features the contributions from different divisions. And the last line -- sorry, the second last line, is a negative ZAR470 million being development in other segments. Can I conclude that that is a catch-all for Ping An, the Pru companies, Discovery Insure. And also Vitality USA, all lumped together?

A - Adrian Gore {BIO 3068929 <GO>}

You can. And the bulk of that is Discovery Insure. More than half of that is Discovery Insure.

Q - Unidentified Participant

Thank you.

A - Adrian Gore {BIO 3068929 <GO>}

Thank you. I've got Pru -- sorry, did you say the Pru, not the Pru? I missed that (inaudible) the point.

Q - Unidentified Participant

(inaudible).

A - Adrian Gore {BIO 3068929 <GO>}

Not PruProtect. Thank you.

Are there other questions? We're going to have -- tea and coffee will be here. Are there any other --?

Q - Unidentified Participant

Mr. Gore, you need to obviously reward your shareholders as well as your policyholders. And you very fleetingly mentioned your dividends in your presentation. Could you just perhaps say a bit about your dividend policy, your cover? You've lots of cash in the business. Are you going to give it back to the shareholders?

A - Adrian Gore {BIO 3068929 <GO>}

It was on the slide. I never mentioned it. Sorry, I got stuck in the strategy. But the dividend has increased for the half year, ZAR0.645, about 20%. So we're increasing the dividend in line with the normalized headline earnings per share. So the dividend will increase by 20%.

We've taken the same view. We have a crudely 4.5 times cover based on the formula we've used. And that remains unchanged. So it's really just a formula we continue to apply. Ricky, is there something you want to say? Is that okay?

Sorry. That's fairly important stuff I glossed over.

Any further questions? Can I suggest then, I've been a bit long winded, we break for coffee? Once again, I really appreciate the time. And we're all out here for questions.

Appreciate the time. Thank you.