Q2 2018 Earnings Call

Company Participants

- Adrian Gore, Group Chief Executive Officer
- Christopher Gilmour, Chairman & Investment Analyst

MANAGEMENT DISCUSSION SECTION

Christopher Gilmour {BIO 1510052 <GO>}

Good morning, ladies and gentlemen. My name is Chris Gilmour, I'm the Chairman of the Investment Analysts Society. And it's truly a pleasure to introduce Adrian Gore and his management team today on the occasion of the Release of the Interim Results to December 2017. And it's especially gratifying to be able to experience this presentation within the confines of Discovery's brand spanking new building here in Sandton.

Some years ago, I was chatting to an ex-colleague of mine at a Discovery presentation at the Sandton Convention Centre and he remarked that Discovery may be running out of road, in inverted commas. Oh ye, of little faith. Not long after Discovery Invest was launched, and you only have to look at the exponential growth of their assets under management to appreciate what a visionary project that was. And the list goes on. In the next few months, we'll see the launch of the new bank, a move that will obviously have repercussions across the broader banking industry, as it will no doubt be another disruptor in that sector.

So, with that, I'm going to ask you to switch off your phones or put them to silent, sit back and listen to what is undoubtedly going to be yet another virtuoso performance from CEO, Adrian Gore. Thank you.

Adrian Gore {BIO 3068929 <GO>}

Nothing like a little pressure to get you kind of... So firstly, everybody, welcome. It really is a great pleasure to have you in our new building, it really is. You'll see I hope through the presentation that this is an organization of integration, of cooperation, many businesses that are working together in a coordinated way. And therefore, our decision sometime back to go out of five buildings all over the place into one large building, deep space where people could mix and coordinate and work as teams is crucial to us. So, it's really great to have you and a real, real pleasure.

For me, it is an honor to present our results for the six months to 31 December, 2017. It has been a very, very complex period, I must say. I think every market we operate, it is complex politically, economically, but no more so than here in South Africa. And how things have turned out is miraculous, to say the least, and quite remarkable. And I think as many have done, we are extremely excited by the future. We've committed to the leadership.

We've committed to doing what we can to build the country and really achieve inclusive growth. It's fundamental.

But I will say to you, that maybe uniquely about Discovery, is a very strong belief that it's in difficult times that you build great businesses. I strongly believe, and I keep kind of relearning that. If you can do that, if you can get the timing right, you have the ability when things emerge to be in a very strong position.

So, we to an extent, have kept our foot down, we've kept investing, we have kept focusing, and I think the results really reflect to my mind a focus on our purpose, a focus on our unique business model and on execution and fundamentally on value for money. In virtually all of our businesses there's an obsession with the excellence of the product, making sure that it works properly for the customer. And to a large extent, I would argue that our performance is a function of that. And again, I keep relearning just the simple power of meeting the needs of our customers is what builds a great business.

So, you can see at the top line, new business up a robust 16%, operating profit up 19%. Normalized headline earnings up 30%, really effect of the efficiency in tax as our new businesses turn to profitability. But overall, I think, from our side, a strong performance and very pleasing.

I do want to contextualize though what Discovery is trying to do. We built the organization on a fairly simple purpose, make people healthier. And that's taken us on a journey that's kind of discovered this very powerful shared-value model of incentivizing behavior change. That behavior change driving our profitability and our new business and quality. And that profitability allowing us to incentivize more behavior change and getting this kind of virtuous cycle.

To a large extent, it is the synthesis between that and, I think, excellent businesses in life, health, financial services that creates what we're trying to do. And to an extent this why/how/what framework has been very, very powerful for us and has guided us along our growth and along our process.

I would also say that the relevance of it globally, I think the way it resonates with customers anywhere, has given us confidence - it gave us confidence five years ago - to set out this kind of almost I'd say a ludicrous ambition that we set for 2018 to be best globally, and we have articulated that in three dimensions. And I think in the past presentations, I have taken you through this but I would like to do the presentation in the context of this because, to a large extent, we are focused on achieving this ambition. It's now the start of 2018, we've literally got 11 months or so to get there. We've got a long way to go, but to an extent, I'd say upfront we've done pretty well. We are tracking very well against this ambition.

So the ambition was about brilliant people, motivated, inspired, based in our purpose, based in our values, on the science and data and technology, our model is the foundation, manifesting in brilliant businesses that are excellent along five measurable factors with an impact socially and financially. Risk-free plus 10% on capital. Earnings growth of CPI plus

10%. Touching 10 million people and making them healthier. And that really was the ambition that we set out to achieve.

I hope you will see by the end of this presentation, we are tracking pretty well. We're not going to get to all of it. I think the currency - I think a good thing: the currency, the rand is too strong to get us to the ZAR 10 billion in earnings. But across most of the ambition, I think we're doing really well. And you need to be the judge of that. I think we have made great, great progress.

So let me start off with kind of the end in mind and make a few observations. I hope you can read them. But really across the board, this is really the story. The rest is, to an extent, commentary. The performance I think exceeded expectation. I've made the point. Operating profit up 19%, normalized headline earnings up 30%, new business up 16%.

The operating model has performed remarkably well. So, we've exceeded risk-free plus 10% on capital. We've exceeded operating earnings growth of CPI plus 10%. Our financial leverage ratio has come down from 28% to about 26.5%. Cash in the center as a buffer has increased to ZAR 2.5 billion, and our businesses are well positioned.

If you look at the businesses, the third point, I think they have all been robust. I think the performances are - is really a function of very strong performance. Across the board our existing businesses have grown by 15%. The emerging businesses are all profitable. But I think more importantly are, I think bigger in potential and scale potential than I think we imagined starting out. So, I think - through a lot of the presentation, I think one of the standout things for me has been just the evolution of the emerging businesses.

And then, finally, we've got four big initiatives: the bank, Vitality Invest in the UK, umbrella funds, and commercial insurance. All in the pipeline, I think largely on track, in budget, and moving towards launch during this 2018 year. So, at a business level, I think the performance is very good.

And then finally to make the point about our shared value, we continue to invest considerably in this kind of underlying Vitality capability that we call the Global Vitality Network. I think this year again - well, the six months has been very, very important. It gives us the ability to create a repeatable, scalable model underpinning all of our businesses and those of our partners.

So, in a nutshell, that really is the observations for the period across performance, the model, the businesses, and underlying capability, shared value, and that's to an extent what we've done.

So, let me go back and take you through three dimensions of the ambition. If you recall it, it had foundation, businesses, impact. I'm going to start with the impact first, and deal with the financial performance across all of the different issues and give you a sense of it, and I hope I do that fairly clearly. It's always a complex story to tell, and we try our best to make it simple and understandable.

The first thing, and I hope this isn't repetitive, is we spent a lot of time on the operating model. I think Discovery is quite unique in having kind of a unique business model in shared value, and this obsession with building businesses from the ground up organically, it takes a long time. It can take a decade, taking them through and getting them to maturity and getting them to integrate with the others.

And that creates a need for a very different growth methodology, a very different approach to capital and capital management, and then finally, a different approach to generating cash and applying it. So, to an extent, I think more and more we are understanding the rigor of these things and how they should play out.

On the growth methodology, I think I've taken you through this but I do think it is very important, it underpins everything we do. Our view is we're trying to get to CPI plus 10%. Our best view if we get this right is new businesses are started, they take typically five years to emerge. In our industry, that's - nothing is overnight. It takes time to emerge, and another three to five to become established businesses. So, they start up, they emerge as profitable, not necessarily cash generative, then ultimately, they become established businesses generating both cash and profitability.

Simply put, if the established businesses generate 90% of the profits; the emerging, 20%; and we spend 10% on new businesses, and the established growth, it's CPI plus 5%, the emerging is CPI plus 30%, what you'll find when you add this up, a simple weighted equation will give you, the overall growth of the group should be CPI plus 10%. So, to an extent, a very simple layout of how this thing should play out.

I also, again, keep relearning just how long it does take to build these businesses. So, it's very a very instructive model to see how we're taking the businesses through and how they become established.

In the middle is a capital plan, the capital plan has three components to it. The first tier is solvency capital. We make sure that all of our entities are strongly capitalized. The second is that we cycle them through the projections over five years to make sure all the plans that we have - bank, Part VII transfer in the UK, whatever they are, are doable on the current capital base. And then, finally, we keep a buffer because there are fluctuations in the system, and our guidance on that is ZAR 1 billion to ZAR 2 billion of cash in the center that we keep, making sure that we can deal with those fluctuations.

What pops out of that if you get that right is the return on capital of risk-free plus 10%, and then two very important risk appetites: a financial leverage ratio of 28% and a cash buffer of ZAR 1 billion to ZAR 2 billion. So that's how the model should work.

The third point I wanted to add and that's become more and more important for us is really how we allocate cash, how we generate and how we spend cash. And to an extent, you will see that the business has generated a lot of cash and we invest that cash of course into tax, dividends, interest, et cetera. But then we fund new business and new business initiatives, and the real issue is how much should we spend, right?

Now, theoretically if the return on capital on these new initiatives and new businesses exceeds the cost of capital, which I would argue in the case of Discovery, it strongly does, we should try and invest as much as possible, right? Obviously, within our bandwidth, if we can do that. But we should invest as much as possible to a point where we hit our risk appetite. In other words, the financial leverage ratio can't go above 28% and our cash buffer can't go below ZAR 1 billion to ZAR 2 billion.

So, to an extent, if we get that all right together, the process hangs together very, very well. And so, what I would like to argue, or I would like to put to you is I'd like you to see the results in the context of this because I think more and more we're starting to understand the importance of this discipline and the self-correcting nature of this organically run model.

So, let me start and deal first with operating profit. I've made the point operating profit up 19% to just under ZAR 4.06 billion. If you look at the businesses, I've split them into established, emerging, and new. You can see there's been a very strong I think robust and consistent performance across the businesses. Discovery Health performed remarkably well. Despite its scale, it continues to perform well with Discovery Health Medical Scheme very, very strong, and I'll take you through that a bit later.

Discovery Life up 4%, a few percentage points under what we'd like to have achieved. There's some claim volatility I'll take you through later, but a robust performance, and I think a robust business and continues to kind of grow, underpinning the power of the model.

Discovery Invest really reflecting just strong growth. The markets grew as well, there's a whole bunch of factors that I think in an additive way drove that profit growth. Vitality has never been a massive profit driver. It also has performed well. The Discovery Card has performed well.

I think one of the real standout performers of the year has been our health insurance business in the UK. VitalityHealth, an absolutely brilliant performance. Service levels, systems, quality, it was really a story of the loss ratio. A fantastic work done on the loss ratio. They brought the claim levels down relative to expectation, drove up cash generation, drove up profitability.

VitalityLife, drifting a bit sideways but the entire focus in the UK on life insurance, I hope you appreciate, are low rates of interest. It has been a feature of ours for the last, I think, two or three reporting periods since June 2016. There's a considerable focus on making sure the business is robust, and I'll show you that later.

And then, the three emerging businesses. Insure, strong growth turning to profitability. Vitality Group, just profitable with considerable investment, and I'll take you through that a bit later. And Ping An Health continues to really grow very strongly, and you'll see the profit of the underlying Ping An Health business. What you're seeing there is our overall profitability after our expenses we spend on it, and you'll see the growth in that.

And then, finally, making the point, Discovery Bank and the other the initiatives. The guidance is to spend up to 10% of our operating profit on new business. As you can see, we spent 8%. And therefore, the effect of 15%, the growth in emerging, and the 8% gives you this CPI plus – it gives us 19% operating profit growth rate, so which is I think very, very pleasing.

The point I made earlier about the emerging businesses, while they're just kind of breaking into profitability, I just wanted you to get a sense of the scale of – I think they're very big and their potential is very high. You can see Discovery Insure total premium revenue growing by 30% to ZAR 1.3 billion for the six months. Ping An Health continues to grow, over 60% growth, written premium over – nearly ZAR 4 billion for the six months. So, the growth is really very, very strong. Vitality Group, the insurance product it is attached to with our partners is nearly ZAR 2 billion worth, 45% growth six-month-on-six-month. So, again, I think very strong growth.

And to an extent, I'd like to say to you that we've got two very strong insurgent businesses coming on stream, Discovery Insure. We've got I think the most sophisticated and biggest, fastest growing health insurer in China in the specialist sense (00:13:58). And then, finally, in the case of Vitality Group, we're insurgents in the sense there are no competitors. We've kind of created a fintech capability that we're scaling into different markets. So, three very different businesses in the emerging category, I think all are emerging I think very strongly.

Turning to new business, up 16%, up to ZAR 9.3 billion. You can see how they're distributed. Discovery Health continues to grow; despite its very large market share, continues to grow strongly and there are very good reasons for that, and I'll take you through that later.

Discovery Life, new business up 6%. The market share has grown. It's been a tough market but Discovery Life continues to grow.

Invest, new business down 5%, net flows up 30%, function of the lapse rate et cetera. Has been a pretty tough market for long-term savings as I think you know, but you'll see the profitability has been very good.

VitalityHealth, in addition to profits, great new business growth, great quality of new business. And then VitalityLife, we've slid slightly backwards. There's been a focus on margin, on sustainability, and you'll see later, I want to take you through the actions done to the new business to make sure that it can really – is fit for purpose for the low interest rate environment.

And then, again, going through the emerging businesses, very strong growth. Insure up 22%, Vitality Group up nearly 34%, and Ping An up 70% in that period. You can see the rate of growth in that way.

I keep coming back to this, but I just want to give the point across of how the emerging businesses are growing. Graphically, you can see Discovery Insure, you can see Ping An

Health really growing strongly, and then the Vitality Group really coming on stream in the last 18 months I would argue. So if you look at operating profit in new business, I think we are very pleased with the performance.

Coming back to the operating model and the growth methodology, you can see what we set out to do, as I explained it to you, the weighted average giving you CPI plus 10%. You can see we've kind of beaten that in each category. A lot of it I think is due to a turnaround of the emerging side. But you can see the overall growth, CPI plus 14% or thereabout. So, I think the growth has been very strong, to an extent, very, very pleasing.

On the capital side, I raised the point about three tiers of capital giving us risk-free plus 10%. First point I would make, in the first tier, all of our entities are very strongly capitalized. So, I think we've put in the books that you have, we put in there the actual coverage ratio with it on the statutory valuation basis, or it's on Solvency II, or medical scheme solvency inside the medical scheme. You will see that all of our entities are strongly capitalized. Very comfortable (00:16:15) that really flowing through a five-year projection, taking into account all the stuff that we know, there's sufficient capital to grow the group and the buffer is strong. So, if you look at the actual position, it's better than the target. We've earned about risk-free plus 11% on the capital. Our FLR has gone down to 26.5% and our cash buffer is sitting at about ZAR 2.5 billion. So, I think it's nicely kind of intact.

Just to reconcile very quickly, and I'm sure you'll have on one-on-ones or whatever with our people, just a sense of the operating profit down to the headline earnings. Operating profit, as I've just shown, has grown by 19%. Pre-tax profit up 17%. The real issue is you can see is the tax rate. It's a simple gearing factor. As businesses turn from loss-making where they've created assessed losses into profit, what happens is you suddenly get profit coming through that isn't taxed. And the effect of that is to create an artificially low tax rate because of the turnaround in those businesses. It actually lasts for a few years, but the effect of that then is you grow headline earnings by 36%. So, the tax rate takes the operating profit at 19% to headline earnings at 36%.

Last point just to make is, you will recall, if you've followed us closely, we had at the center a spend on the brand in the UK that we treated as – we normalized that out, part of the acquisition out of The Prudential. Ostensibly, we spent money over a three-year period to build the brand in the UK, and therefore we keep normalizing it out. So what we've done here, in this period it wasn't present, but it was in the previous, so we've added back the cost of that in the previous period to bring out the base in the previous period, taking the 36% growth down to 30%. So, essentially, normalized headline earnings up 30%, as you can see, to just over ZAR 2.8 billion, where normalized headline earnings per share up 29% to ZAR 4.383. And that's essentially kind of how we've ended. I think it's fairly straightforward, nothing particularly complex in that hopefully.

I want to talk about the dividend and just give you a sense of the rationale behind it. It is, of course, a very – it's a complex issue and we want to make sure that it's always consistent with the operating model in which we are trying to grow. We've kind of set the dividend on a cover level of 4.5 times. Initially, that 4.5 times was based on general reasoning. We looked at the market. We said we need to be higher because we are growing organically, et cetera, et cetera and I think that made sense. And we've been tracking that coverage I think fairly well over the period. But given the operating model and the growth methodology, there's some rationale to check it out. And just follow this reasoning, I think it's actually quite straightforward.

I made the point to you that there's new, emerging, and established. The established businesses theoretically generate 90% of the profit. They should pay a dividend similar to other established companies in our sector. So, established companies are paying about 1.5 to 3 times coverage, so assuming we should pay 2.5 times out of the established businesses. The emerging businesses don't generate cash and therefore they should pay nothing. No dividend to the center at all in our view. And then, finally, the new businesses, we think, conservatively, should be fund from the dividend. In other words, whatever comes out the dividend, hack off the 10% of earnings to pay for new businesses.

If you do that, what you'll find is the established generate 90% of profit, distributing 2.5 times coverage is 40% of profit, plus naught, minus 10%. So, theoretically, we should pay out about 26% of earnings or, crudely, about a 4 times cover.

So, if you follow the operating methodology and you follow the philosophy of our established doing what the market does, nothing out of emerging, and paying for the new businesses out of that dividend, you would get a 4 times cover. And so, the 4.5 times guidance, 4 to 4.5 times seems reasonable and rational given how the group is evolving.

Based on this logic, our board has settled on a dividend declaration of ZAR 1.01. It's about a 15% - slightly, I think slightly below 15% increase. Below the operating profit growth, but comfortably in line. I think the coverage is about 4.3 times, Deon, I think is the right number? So, we're pretty comfortable with that. Strong dividend growth, below the operating profit growth, but very much in line I think with the rationale that the model sets out.

Never open a sparkling water from the podium. A bit of advice from an old hand.

So let me move on to cash generation, the application of cash. And just to understand that our businesses generate cash and then we spend that cash on new business, on new businesses, on new initiatives, et cetera. Some of the new initiatives you won't to see in the earnings in IFRS, because this is cash spend, not IFRS, it could be capitalized. In effect here what you see is cash generation of all our businesses, ZAR 6.1 billion over the six months. It's actually growing quite strongly as you can see. The cash coming out is strongly from Health, ZAR 1.8 billion; from Discovery Life and Invest, ZAR 2.1 billion. The UK now is generating on similar amounts of cash, ZAR 1.7 billion. So, there's quite a reasonable spread of cash generation. And then there's other at the top, ZAR 440 million as you can see.

The question then is what have we spent it on. Well, we spent it on dividend, tax, and finance costs come off the top, and then we spent it on as much new business as we could write. And as I said, we wrote 16% growth in new business. We'd like to do more if we could. We can't, we've tried hard. Hopefully this year we'll do better. But that's as much as we can do. And that new business, we make very sure that it's at risk-free plus 10%. In other words, the slices of new business are priced to make sure that every company and every board in the group is charged with making sure that we are risk-free plus 10%. Even the UK Life business, I think we had about risk-free plus 7% or 8% or thereabout. We're not quite there because of the interest rates, but there's a very strong discipline. So, based on that we try and do as much new business as possible, and we have to fund that new business straight in (00:21:46), typically VitalityLife and Discovery Life. And then new initiatives including the bank, the startups, et cetera cost another ZAR 1.1 billion in cash.

So, what you see is we've generated cash, spent it, and we've had to spend more of it - we'd like to spend more, and we could have spent more given the risk appetite. You can see kind of the rev counter, the FLR went down to 26.5%. The cash buffer is at about ZAR 2.5 billion. So, to an extent, theoretically, our thinking is set the risk appetite in the FLR and the cash buffer, and then the rest follows in terms of what you can and can't do. And I think that self-correcting methodology works very well. So, hopefully this clears out how we generate cash, how we spend it, and then how we balance it out against the risk appetite that we set at a board level. We're comfortable that that's tracking, I think, very well.

Turning to the embedded value. The EV grew, I think, comfortably at 13%. You can see the make-up of the EV earnings or the growth in the EV, ZAR 1.3 billion or thereabout in value of new business. The unwind of the embedded value. Reduction in EV due to new initiatives you can see. And a growth overall to about ZAR 60.4 billion. Experienced variances in total were positive to a tune of ZAR 141 million. So, fairly linear simple generation of the EV from one period to the next.

But one point I did want to make is that a lot of the stuff that we're doing now, we are not calculating any embedded value for, notably Discovery Insure, Vitality Group and specifically Ping An Health. So, a lot of the initiatives we're spending money on that I think reduce the NAV or the shareholders' funds or whatever go into businesses that we're not yet calculating an EV for, I'm not sure we ever will. But giving you a sense, it's going to be hard to grow the EV at the same rate as operating profit if a lot of your revenue on the right-hand side, 15%, is now in businesses that we're not really calculating value for. I think we'll kind of over time, once stability of those businesses and their scale starts to settle, we'll have to give that some thought. But to any extent, I think the 13% growth in EV we're very comfortable with, specifically given that caveat.

So, let me end the first section on impact and results. I hope that's clear. I've gone a bit quickly and I hope it is clear. But I do want to say to you, the 2018 ambition has been the most remarkable - how can I say it - North Star for us. It set out a stretch vision that's forced us and all of our people within Discovery to be focused on what they need to do. Every single leader in the group has got their own pledge about what they will achieve by 2018. It has been a very strong guiding process.

I did want to illustrate to you that we set this in 2013 and give you a sense of how quickly the group has grown and how much has changed. So, in 2013, our operating profit was ZAR 2.4 billion as you can see. On the base, we didn't have a shared value coordinated strategy, we had a bunch of Vitality programs in different businesses, working in different ways; doing great stuff but kind of largely uncoordinated. The businesses were a lot smaller. In the UK, we still had a 50% share of PruHealth and PruProtect. The life insurance business was sitting inside the belly of The Prudential. PruHealth itself was going through some difficult times. Ping An Health was largely embryonic. Although it had been there for a few years, we're experimenting with different kinds of products that might get traction. The AIA Vitality initiative was really embryonic, just an idea, a beta site and trying to figure out how that could be taken out. And then we had a bunch of prospects in the pipeline, fairly small.

If you look at what's happened in just four years, it's been tremendous. The big businesses continue to grow organically. The UK now has fully owned VitalityLife, VitalityHealth and I think both are robustly growing. Ping An Health has become a particularly successful player in the Chinese health insurance market. Vitality Group was formed out of the AIA idea with many, many partners. And then a lot of strong prospects in the pipeline. You can see the operating profit now, I'm guessing now about probably 60%, 70% higher than it was, with new business a lot stronger and a lot more expansion globally.

So, just to give you a sense that I think the kind of power of framing, the power of loss aversion to an extent, because when you set a goal, you've got something to lose and that motivates certainly our ExCo and our entire team, but just kind of the power of setting a goal of the scale has been remarkable for us.

I said to you before, I think we're close to many of the objectives. I'm not sure we'll get to all of them. But credit to our people. I think they've done remarkably well and we've done better than we would have had we not set the goal. So, it has been, I think, a very, very fundamental and important process for us as we go forward in this last year of the ambition.

Let me turn to the foundation. As I said, I'd like to roll out the results in the three dimensions we've set them in the ambition, giving you the impact first, foundation second. I'm not going to talk about people, values and brand. There's a lot to be said for that. I would like to say to you with some pride, I think the Discovery team is remarkable. It's a bunch of people that are committed. They know our purpose. They live our values. I'm proud to work with them and I think so is our ExCo that's here. It's a remarkable bunch of people. I think that at the end of the day is what we're about.

I also think that our brand is getting more and more global significance, particularly Vitality, as we kind of play it out. So, there's a lot of work on people, values and brand.

But I did want to talk about the business model again, the shared value model, and just again make the point. And I think at the last presentation I did show you this, that at the center we're investing considerably in what we call the Global Vitality Network. Really, the foundation, the repeatable model that is technology, it's data, it's partners, it's products, it's programs, clinical programs that can be used and reused by all of the businesses in the Discovery family and on the network. So, whether it's Discovery, it's AIA in different countries, et cetera, we're trying to build a chassis that works to an extent for all.

In the period under review, there's been considerable investment. We've done a lot of work on the data. There are 200,000 members joining each month through the program through various partners. There's a massive amount of data of clinical data, of physical activity data, 40 million life years of mortality and morbidity data. It's becoming more and more important for us to understand this and how this correlates and how the causality plays out in building out this model.

We've also embarked over the last year or so on Vitality One, which is a piece of technology that's going to underpin everything. So, in the past, we've had different Vitality systems servicing different partners and different companies. Vitality One is a significant technology rollout. We spent nearly ZAR 500 million on that piece of technology. Its first rollout will be in Japan with Sumitomo. A lot of work is going down to make sure we achieve that. But once that's in place, it gives us considerable flexibility for more repeatability, more scalability. So a lot is taking place inside the Vitality Network.

You can see in the center there are a number of programs we're busy with, Vitality Family, Healthy Mind, Weight Loss, Nutrition and you'll know this. But there are two I wanted to mention. The one is physical activity, and I think we've spoken a lot about this but I did want to give you some insights coming out of the data. Physical activity for us is a remarkably important issue. Firstly, it's a trigger event. We know that when people are physically active, it triggers other healthy behaviors, which is important. But in addition, you can see from those charts there just how correlated mortality is on the left-hand side to increasing physical activity. And on the right-hand side longitudinally, if you look at health claims, when people change activity from being sedentary to being more active, our claims go down regardless of their starting level of fitness. So these are very, very important issues, and we know more and more that cardio fitness is a fundamental factor in life expectancy and wellness.

So this is a critical issue. We've done a lot of work on this as you know. I think the Active Rewards chassis which is becoming a blueprint for more and more that we do has been incredibly successful. We work with Apple around this idea of get your watch, achieve your goal, get rewarded. Again, it's been - it's just a framework of loss aversion, a loss-framed benefit that has done well.

But what I did want to show you is just the data coming out of it is really compelling. So this is data that we shared with Apple and others around how that benefit is playing out. You can see on the left-hand side whether it's South Africa, the UK, or the U.S., there has been a considerable increase, 30% to 100% increase in physical activity. We've shown there for completeness the distribution for those who are statistically minded how it was in the blue and how it is now. What you're seeing is not only is the average physical activity going up, but in fact you're shifting the distribution, we're not shifting a tail of people on the extreme. Most people in that distribution are becoming more physically active. In the middle you can see that as you move longitudinally from minus six months to zero, in other words, when they take out the benefit, the activity goes up, and we've managed to sustain it. So the kind of loss-framed nature of the benefit keeps people physically active.

And then, finally, I think very importantly and socially very importantly is the fact that this applies to all risk factors. So, if you cut the data by BMI level, low BMI, at risk, to high BMI and you look at it's - the U.S., South Africa or the UK, the data is the same. People get physically active. And in fact, in higher levels at high risk factors, often the levels of engagement delta are even bigger. So, we're getting the right kind of performance out of that.

In the case of shared value, it's good for our customers, it's making them healthy. I think it could be life changing if we get that right. For us, it's fundamental. Health claims are lower for people that are engaged. Persistency is dramatically better in both health and life insurance as you see on the right-hand side. So, there's kind of no trade-off in this, so I think the physical activity piece of what we're doing illustrates the shared value model I think perfectly. So, we need to do more of this. I think the learnings and behavior change. We need to keep doing in broadest parts of the Vitality piece and repeating and scaling it wherever we go.

The other point I wanted to make, and we touched on this I think at a previous presentation. We're doing a lot of work on the idea of healthy aging. This is important for us, for our partners in markets like Europe, Japan obviously, North America. But making Vitality efficient and appropriate in advanced age is crucial.

You can see on the left-hand side that disease patterns and risk factors vary obviously by age. The disease burden increases dramatically as you get older, you can see on the right-hand side. But we've done a considerable amount of work with John Hancock, Columbia University in the U.S. to try and understand where we should be incentivizing behavior change. And it's in areas that are maybe not entirely intuitive. So, things like physical activity and diet are obviously important. But as you get older, it's things like medicine adherence, it's flu vaccinations, it's social connectedness. It's those kind of factors that statistically impact on life expectancy and quality of life, and that's important. So, we're doing a lot of work to get Vitality fit for purpose for seniors, and that will underpin of course Discovery Invest, but very importantly, it's going to underpin the launch in the UK of Vitality Invest.

And our simple kind of view, and I hope this slide is clear, it's maybe a bit confusing, but just hear me out on this. Our simple view is if we could help people live longer in better health, we could create a completely new paradigm, new agenda for retirement. This idea of retiring at 65 is kind of ludicrous. People have a long period post 65 today where they're active, they're healthy, they could have a second career. We need to be part of that and help them do that.

And then we need to help them plan for their retirement. What is life expectancy going to be? How long are you going to live? How can you improve that process? So, the first piece of this is actually to say to someone like myself, you're 53, I don't even know my life expectancy, right? I know what life expectancy is at birth, but I'd like to know my life expectancy, right? I'd like to know the date and time, if anyone has it, right? It would be helpful. But I would like to know my life expectancy. It's an amazing paradox that the retirement savings environment has become super sophisticated on asset managers, active, passive, fees, and whatever. But how long you've got to save for, what your life expectancy is going to be is completely kind of uncharted and unsophisticated.

So, we're trying to get to a point where we can offer tools of saying, you're 53; your life expectancy is 83; there's a confidence band of 70% between 81 and 88 – I haven't got those figures and they're confidential at this stage – and do these three things and you'll get to 90. That's what we have to try and get to in the Vitality for Seniors program. If we can do that, I think we can add real social value to the markets that we operate.

But then the critical thing on the right-hand side is to offer our products that are in (00:33:12) shared value. So, if you do those three things, because you're with us for longer, we earn fees for longer, we can boost your retirement savings. So, simply put, we can tell you how to live longer; and if you do those things, we're going to boost your savings so that your retirement savings stretch out for that period.

So, I do think if we get this right there's an entirely new narrative around retirement savings and I think we do much more socially, and the delta in advanced age and this kind of stuff is dramatic. So, this is still a work in progress. We launch in the UK, I think, early May or June. I think that's the plan. But we are furiously working on this idea of Vitality for Seniors. Unlike (00:33:45) physical activity where I think there were a lot of experience and data, this is an agenda that we are busy with.

And then, the final point to make, there's a lot going on in the chassis. I wanted to make those two points to you. But the final point I wanted to make was just of the architecture and the play-out for our customers. While there's a lot going on inside the Vitality Network on the left-hand side, in fact to our customers, there's three dimensions of their life that we are focusing on: their health, their money and how they drive; three dimensions. And more and more the architecture is simple. Blue through to Gold, so you earn a status and you earn one currency, Vitality Points.

So, as complicated as I'm telling you with all these clinical programs and actuarial mumbo-jumbo, the truth is, at the customer level, you go along these three dimensions, it sits on your mobile. We're already doing that in this country where you can look at your physical activity, other risk factors over time, how you drive and that's really the architecture. So, we're trying to get all the complexity to be foundational behind the scenes. The consumer has a very simple and hopefully excellent drive.

The effect of this on our ability to grow I think is profound. So, if you look at where we are now, it's the same model sitting at the basin. As I said, the magic is bringing in brilliant insurance or financial services companies and plugging it into that capability. So, if you look at Health, Life, we can expand into adjacencies like Discovery Bank in the local market. On the extreme right, we're going to expand through new partners and growth within those partners. In the UK, I see a bit of both: expanding into adjacencies like Vitality Invest which we're in the process of doing, but there may be partner opportunities as well. So, given this organic growth model and given the kind of common base that we've created, the ability to expand and grow organically going forward I think is very, very strong. So the foundation, I think, is very important for the rollout of the group.

So enough said of the foundation. I hope that's fairly clear. I want to turn to the businesses if I have the time. I want to turn to the businesses and make a few points. There's a lot going on here. I can't go through everything. We've tried our best to pick out a number of observations that we think are worthwhile. I'm going to go through the emerging businesses first to give you a sense of them. Then the established, then have a one second mention of the stuff in the pipeline.

Let me start with the emerging businesses, talk about Discovery Insure. The growth is strong. In previous presentations, I've given you great detail in the statistics, the analytics, and whatever, but you can see it coming it through here. New business growth is strong. I made the point written premium has grown strongly, and the business is now strongly profitable and I think will grow going forward.

Factually, at the most simple level, it's an issue of scale. If you look at the jaws widening between premium, claims and expenses, you're just getting - as the business matures and gets scale, you're getting a widening growth in premium versus your growth in claims versus your growth in expenses. They behave differently over time, but that widening jaw is creating the profitability.

But I did want to say this to you that I think is very important. In the traditional insurance, short-term insurance model, customers that are with you for a long time become more and more profitable. Loss ratios go down. But the reason they go down is because what insurers do is they price premiums up, and due to inertia, people typically don't leave. So you get an increasing - you get a better and better loss ratio profile driving profitability.

That is not what is taking place in the Discovery Insure process. This is a shared value process. What's happening here is loss ratios are going down because the book is getting better, right? People are of lower risk. So you can see that taking place. Engagement is increasing. The number of Blue members is going down. The number of Gold is going up. The correlations to driving better is seen in the middle with the loss ratio. As people engage more, claims go down. And then finally, the selective lapsation. The lapses are higher for the Blue members than the Gold. So, instead of the good members going, the good are staying, and that's creating this kind of shared-value cycle.

If you look at the claims ratio by cohort, so don't look at it in total, look at it - people have been with us for a year, people have been with us for two or three years, or four years or more. You can see how downsloping that loss ratio is. So, it's really - it's multiplicative. As you go through that process, you get by duration an improving loss ratio. And it's not due to pricing, it's due to behavior, and I think that's critical.

And then, overall, despite the fact the business itself is not really aging because we're growing so quickly, the overall claims ratio is still coming down by 13%, a lot slower than the cohorts because it's a weighted average, but you can see it coming down, I think, very comfortably. It tells us that the book that's building up there is highly profitable.

And we did an exercise for the Discovery Insure board where we looked at the existing book, the back book, taking out the effect of new business. And what you see is the back book growth, about ZAR 1.1 billion in premiums, as you can see, it threw about ZAR 100 million in profit. So, crudely put, the back book is already generating about a 10% margin, reflecting I think this virtuous cycle of getting people to drive better, to stay with us more, and you get that coming through. So, I think the shared-value model is creating a dynamic I think that is excellent for our customers obviously, but you can see it coming through in the economics.

And then a final point on Discovery Insure is just the distribution channel. So, we started out mainly D2C with some intermediated sales. So, it was mainly in 2011 on that little pie, you can see it was mainly D2C. We've now got the other way around. Our tied agents and brokers are writing a lot of business, as is the D2C channel. So, it's more balanced. But the question is, we're pretty agnostic on whether you go direct or whether you go intermediated. And I know in the industry this is a very big almost religious issue as to what gives better value for money. D2C is better, there is no broker commission, but brokers are better because they represent the client with the insurer. There's a lot of these kind of debates.

I will tell you, in our model, we find that kind of the embedded value on the intermediated business is better, but it's better because the premiums are bigger and there are more kind of benefits bought. If you look at it per unit of risk, they're almost a wash, almost the same. So, on the right-hand side, the exit premium, the price people pay for the same set of benefits whether it's D2C or intermediated is almost exactly the same, and the loss ratio, as we can see, exactly the same, similar, 61% versus 59% and they'll fluctuate over time.

So, the project we made, and I think for us that's an important asset, is we're flying through two different distribution channels, both direct to consumer and through intermediated channels, getting great results in both. But in fact from a TCF perspective, treating customers fairly, they both are equivalent, and therefore we're going to push down both. So, I think Discovery Insure had, I think, a very formative phase and I think doing very well.

Turning to the Vitality Group, just a few comments. You can see that we have a considerable list of partners now on the chassis. Beside the global partners in each market, we've built a very strong Vitality capability and we're pushing out a lot of products. The growth has been really staggering, the last 18 months particularly. You can see the membership now, the number of policyholders linked to Vitality across has grown to about nearly 1.8 million. And the growth in the last year has been really, really strong. So, we're really starting to get traction. I keep making this point, we've been pioneering for a number of years here, learning how to do this. Credit to the Vitality Group team, I think the last year particularly has seen considerable growth in quality.

If you look at the performance, I think I've made these points. The Vitality integrated premium of our partners has grown by 45%. This is a fee income business to us, we get paid a fee. That's grown by 34% and it's now kind of broken even. So you can see we had losses initially, broken even. But the point to make is that this is a geared business. We get fee income coming in. It's grown by 34%. We have expenses that now, at the moment, are about equal to the income, so it's just broken even. But 70% of those expenses are fixed. So, going forward, fully $0.70 (00:41:03) per $1 should flow to profitability as we grow. So, obviously going from now forward - not to put pressure on the team. I see some of my colleagues here looking rather shocked with these expectations. I'll be here in six months to tell you how they do, right, but fully $0.70 (00:41:17) of those fees going forward should fall straight to the bottom line. And that really has given us the confidence of what we said about how that business can grow.

But maybe more important, and this is critical, is making sure that it delivers for our partners. At the end of the day, this is only going to work if we can show to our partners increased competitiveness, better selection, better selective lapsation, better behavior change, resulting in better VONB. That's crucial.

I can't disclose the markets, but I've used two case studies here, two use cases to give you a sense. This is a very developed competitive market. You can see the Vitality take-up or penetration is now 35%. So, of the integratable products being sold by the distribution force, fully 35% now attach the Vitality link. The new business growth has been very strong, engagement has been strong. And you can see in this particular market, when we launched the Active Rewards with Apple, it kind of kicked up the activations or the applications from clients. So, all of the stuff on the surface seems to be going well.

Market two is also I think a very developed market. It's been in place longer, more actuarial data is coming through. The results I think have been staggering. The Vitality take-up has gone to 66%, membership growth is very strong, engagement in the program is very strong. And then you can see numbers coming through, the persistency is dramatically better on the right-hand side. So, lapse rates for Bronze members are 30% lower, for Silver members, 60% lower, and the VONB is 22% higher for integrated versus business nonintegrated products. So, I think the actual delivery for our customers is going remarkably well.

And we continue to expand. We've got good foothold in the AA markets, a great partnership, markets like Hong Kong, Singapore, Australia and others. We continue to roll out with AIA, we're in the process of rolling out South Korea, and that's very important. Generali, we've been quite slow to expand out of Germany on the individual product. The main focus has been on DVAG. If you know the German market, DVAG is one of the most effective broker distributions I think globally, with about 30,000 agents. We've just rolled out into that network and that should have a massive effect.

And then, importantly, we're in the process of rolling out Sumitomo Life, a new partner in July of this year. We announced this I think two years ago. It's taken us two years to go through all the different processes. It's been a very rigorous build between us and Sumitomo in the Japanese market. They are the fourth biggest in the second biggest life insurance market globally. So, there is expectation that we can grow into all of these spaces. And the point to make, if we keep growing, that marginal revenue should drive very good profitability.

Let me turn to China and just make a few points. I wanted to firstly say I think it has been a very, very fundamental period for Ping An Health over the last year, not just the last six months. I wanted to – we've tried our best to give you a sense of the Ping An Health business and its ecosystem.

Today, Ping An Health is a very sophisticated health insurer. We've played our role, I think, and we can and will do more in shifting as much IP technology if we can into Ping An Health. It sits within the Ping An Group's healthcare initiatives which are absolutely massive. So, Ping An Group at a strategic level is involved in SHI products around the country, is involved in good doctor and online capabilities, involves the whole range of massive, massive healthcare initiatives. Ping An Health is one of them but is the health insurance receptacle to an extent.

Ping An Health has three lines of business group: high end, individual, and more and more online business through WeChat and Alipay, et cetera. And there are a number of distribution channels. There's the Ping An Annuity and Ping An P&C, companies that distribute the group products for us, but there's a very powerful synthesis between Ping An Health and the Ping An Life distribution channel, reaching virtually all of China. So, the distribution channels have grown quite substantially. And more and more that synthesis has led to online sales through, as I said, Alipay and other platforms.

What you'll see is that there's kind of work in between the Ping An Health distribution and the Ping An Life distribution. Ping An Health, on the left-hand side, has branches now in most of the big cities. It's an amazing list I think of 15 cities, all of them are bigger than New York. Quite, quite scary to give you a sense of that scale.

Then the Ping An Life agency force, I think operates out of 2,000 branches with 1.4 million agents. It's a remarkable scale. And effectively, there's a number of different issues. In some markets, they sell a product that's white-labeled, that's really – we get part of that profit share, in other markets, it's a cross-sell, other markets there's a reinsurance structure, in the online space there's a bit of cooperation in markets we don't have a branch. So there's a complicated process between these various distribution channels.

What I did want to show you though in the middle is what's really manifesting. You can see 2015, we did I think about ZAR 2 billion of new business. You can see most of it was intermediated. You can see the orange how it's grown by 2017, and in fact nearly 40% of it is online.

And on the right-hand side, we've kind of shown the growth of the different tiers of business, but you can see the online, the growth has been so staggering that it's kind of crowded out the scale of that graph through, as I said, online platforms like we WeChat Store, Alipay and others, working remarkably well.

So, all this comes together to give very, very strong growth. New business, up 70%. Written premium, up 62% to nearly ZAR 4 billion in the six months under review.

Ping An Health itself made nearly ZAR 0.25 billion in the six months. So, the profitability I think is coming through. That is pretty lumpy. There's new business strain (00:46:32) that may reverse out, it may do different things because this business is growing very strongly. But in the six months we speak of, ZAR 244 million of profit.

And then our profitability is dramatically lower. We get 25% of it, and then we take off our expenses in backing up Ping An Health. So again, I think a geared opportunity; as Ping An Health grows in profitability, it should cover our expenses comfortably and grow our profitability. So, the inherent growth of Ping An Health has been quite staggering. The quality I think is very, very pleasing.

Let me move to established businesses and get away from the emerging stuff and talk firstly through Discovery Health. It's kind of difficult to find the right thing to focus on Discovery Health's performance. Credit to the team, it's been absolutely remarkable across virtually every metric. The growth continues in new business. Membership in total continues to grow. Operating profit off a high base has grown by 12%, which is strong in this environment.

The Discovery Health Medical Scheme has performed remarkably well over the calendar year. It now has 56% market share, over 40,000 new lives in the period, stability is remarkable. And this is very constant year to year; nearly 95% of members from year to year are staying on the plans they're at. 3% are buying up, 3% buying down. Lapse rate is very low. And on the right-hand side, the reserve levels are over ZAR 16 billion, solvency level is nearly 27.5%. So, considerable stability inside the Discovery Health Medical Scheme.

In addition, we keep winning the closed scheme tenders. I think we've won 14 out of 16 of the last tenders of closed schemes. So, Discovery Health has been super, super competitive in every respect.

But the question, of course, is why. And it's difficult to answer. I would argue the sophistication of Discovery Health is allowing us to kind of solve this very famous healthcare trilemma. You'll know a trilemma is something where three – you've got three things and you can only have two, right? You can choose any two of them, but you can't have the third, right? And in healthcare, there's a well-known issue of access, cost and quality. You can have any two but the other one suffers. So, you can control cost and access but then quality suffers or vice versa. So, this is a trilemma. I would argue that given the sophistication of Discovery Health, I think the members that we serve, we solve all three. And I think that's why this continues to grow.

So, if you look at our social mandate, it's about managing the cost per member, that's what we're trying to do. If you break it down into components, that cost per member is the disease burden per member multiplied by the treatment given for the given disease multiplied by the cost for the given treatment, right?

And why we break that down, because I would argue our competitors, certainly in the past, have focused virtually only on the right-hand side. Just paying out benefits, trying to manage the cost. The kind of integrated model from Vitality to shared value to all of the stuff that we're doing really straddles this entire equation. And to an extent, if you go through, and I think we've shown you this, there are so many aspects to the Discovery Health infrastructure, offering, programs, networks, technology, digital technology that straddle these three very important things: to making people healthier, to focusing on quality when they get treated, to focusing on cost. And I would argue that if you're covered by Discovery Health, we can achieve all three, and I think that's crucial.

On the quality side, there's a number of programs in coordinated care that's doing well. Here's some data coming out of our kidney care program and our diabetes program. The data is compelling and single directional: when people join the programs, admission rates go down. In the case of diabetes, the HbA1c testing levels go up, compliance with medicine goes up, et cetera. I think the team is getting remarkable results in terms of quality and making people healthy, and particularly vulnerable people healthy. That's critical socially in addition to the cost issue.

We've done amazingly well on the fraud side. I think this was made public a few weeks ago where the fraud recoveries have now crossed ZAR 0.5 billion is an important initiative. And the reason for the success here is not just investigations or whatever, it's about data. More and more we are understanding through machine learning just the trillions of combinations of codes that you've got to comb through to find where that fraud may be and direct investigators to the right space, and you can see we're getting tremendous results in terms of that.

In terms of scale and access, you can see that 87% of GP visits of our members we serve is within our networks, nearly 90% of the specialists are within our networks and 94% of all hospital claims are paid fully. So the access is broad, linked into the Discovery Health chassis.

And then finally, all of this comes together in terms of cost and savings and competitiveness. On the left-hand side, we estimate the savings from the Vitality impact, all the risk management is about ZAR 6.2 billion during that calendar year. It's about a 14% reduction in risk claims. It's allowed us to put through a rate increase of 7.9% into 2018. We estimate we are 16% cheaper per unit of benefit than our competitors. And we're doing this at an admin fee of about 10%, 10.1% which is in the lowest quartile of the market. So, all aspects I would argue of Discovery Health are hanging together well, and you see that coming through in the performance of the Discovery Health Medical Scheme.

But here is a very important check on the quality. If it is so successful, you should be able to take another scheme, put it on the VitalityHealth (sic) [Discovery Health] (00:51:35) system and have it do well. And to an extent, that's what's happening and that's why we're winning the closed schemes. What you can see on the left-hand side, if you look at all the schemes that we – the closed schemes that have come on to Discovery Health, you can see what the claim inflation levels were on average before and after joining us. Two schemes that are fairly new with a lot of data coming out, Glencore and Bankmed, their claim inflation in the white versus what happened in the blue on the Discovery Health chassis. So to an extent, making the point clearly that all of these factors in an integrated system give us the ability, whether it's the Discovery Health Medical Scheme or other closed schemes, give us the ability to bring costs down, manage quality, drive up access and hopefully solve that complex trilemma. And I'll argue it's doing all of that at the same time that it's driving the success of Discovery Health.

Let me turn to Discovery Life and also I'll just give you a bit more insight, and again, trying our best to raise issues I think are relevant. The growth of Discovery Life was robust. New business up 6%, operating profit up 4%. A couple of percentage point behind where we'd like it to be, largely a function of volatile claims, but the business continues to grow in a very robust form.

The question of course is it appears like incredibly complex – whenever we discuss earnings at Discovery Life, it seems really a complicated issue, how do you work it, release of reserves, accounting policy, et cetera, et cetera. There is a pretty simple, I hope simple general reasoning check. Give me a bit of time to explain this but it is a very simple thing.

This is a business with a profit margin. So, if you look at the value of new business over total premiums, it gives you kind of the margin in every premium. That's about 10% or 11%. So, crudely put, if we were a trading company, 10% of the premiums should be profitable on an expected basis.

Secondly, we build up a very big asset, our negative reserve. The nature of Discovery Life in this business is we incur acquisition costs initially, and we recoup those over 30 or 40 years. So, we then hold an asset of the present value of the future loadings to repay us for the acquisition costs. That's an asset, bit like a mortgage book of a bank.

And the third piece are the fluctuations within the year. So, these are on an unexpected basis. In the year, lapses, mortality, insure rates may differ to what we expect. And so, there's a balancing item of experience variances.

So, simply put, there's kind of a VNB margin and experience variances, and there's a discount rate of the negative reserve. Put it colloquially, there's a profit margin, fluctuations and return on an asset. And in fact, you can do the general reasoning check on the right-hand side. What we've done there is for three periods, the last three periods, simply show the actual profit versus what a general reasoning check would be. Assuming the margins of 10%, 11%, multiply that by the premiums, add or subtract negative or positive experience variances, take the ZAR 44 billion negative reserve, multiply that by an interest rate, the discount rate. Add that together, you get an estimated profit, and what you'll find is it's within, I don't know, 2% or 3% or 4% or 5% of what actually plays out. So, it is a complicated business, but there is a general reasoning check on how it plays out. Just really the return on the assets plus the other factors coming through in profit margin.

The question, of course, then is we accept that, what makes it a quality business is how big is that margin, what are those experience variances, and importantly, how robust is that negative reserve, how robust is that asset.

So, firstly, dealing with the VNB margin in new business, I made the point new business is up 6%. You can see it's been a difficult period for the entire industry on the extreme left-hand side. Our market share continues to grow. So even with a 6% growth rate, our market share now is 27.5%, dramatically higher I think than many of our competitors.

It has been really a tale of two quarters. In the first quarter of the six months, we were actually trailing behind the previous year. We did a launch of some really, I think, excellent products, global education products and segmented products that has grown the new business quite strongly. I mean, you can see the margin period by period is coming up. So, we're doing I think great quality new business and that's important. So, the margin I think largely is intact.

If you look at the fluctuations, the experience variances, I'm showing in the extreme left-hand side the variances over time. You can see in the last period, they were overall positive. So, the business in total is performing ahead of expectation. In the previous period it was quite – it was significantly negative and it's been kind of up and down over the years. You can see in the middle there the positive variances and then the negative below the line.

The question of course is how we're managing those negative experience variances. So firstly, policy alterations are people buying up and buying down. On balance, we're getting more value of people – we're getting affected (00:55:54) people buying down more than we expect and that's a ZAR 98 million variance. You can see on the right-hand side, it's significantly lower than the previous period and we continue to manage that down. The mortality and morbidity is what I said, minus ZAR 45 million. So, we're ZAR 45 million off the pace where we thought we'd be. And that's important to understand where that came from.

So, the first point to make is our mortality experience is absolutely exceptional I think, and it's a function of the model. What this shows you here is our reinsurer statistics that they share with us. You can see that the Discovery Life book is fully 20% lower in claims levels than the rest of the industry. So, the effect of the model of attracting, of selection, of behavior changes, selective lapsation is creating a book that performs 20% better in mortality. And then, as you go down the statuses, I think Gold is 70% better than the industry average. So, the actual levels of mortality are very good.

So, what we're looking at now is how we perform versus what we expected. And what you'll see on the left-hand side, I made the point about volatility in claims, really suicide claims have been fairly volatile. On the extreme right-hand side with that first piece, you can see that in this period suicide claims amounted to 16% of claims, dramatically higher than previous periods. So, areas of MVA, cancer, those other things have been fairly stable. We've seen a bubbling up of suicide claims. It's not a massive trend. It's more a few big claims on the right-hand side that's driven that, but that's been enough to take off 3% or 4% of the growth of the earnings. So, it's a volatility in claims. It may recur, it may not, but it doesn't give us major cause for concern.

The model itself I think is working remarkably well because, at the end of the day, the mortality is 20% lower than you'd see in the rest of the industry.

But an insight I wanted to give you that I think for the first time we're showing these statistics was just how the model works and the level of engagement. I will tell you, when we started Vitality, our thinking was that 2% to 3% of people would get to the Gold level. That was kind of the premium basis in, I think, 2000. What's happened in the Discovery Life book, there's been massive engagement, and that's a fantastic thing. That's what we're trying to do. 21% of our membership are Gold and Diamond, and by value, by sum assured, 26%. It's a remarkable level of engagement in the program.

Now bear in mind how this thing works. The idea is, as you get engaged, your premiums come down. If you don't engage, your premiums drift up. So, making sure that the whole model hangs together is fundamental. We've got to get the right engagement. We've got to make sure the engagement correlates to mortality curves that we've codified. And I will argue the results coming out are exceptionally strong. So, we more and more continue to work on the model to make sure the behavior is right, to make sure the program has efficacy. Over the last few years, you can see on the left-hand side, we've continued to focus on making points-earning activities not just simple online stuff that people can do in a day, but durationally making sure it's about exercise; physical activity; nutrition; screening; outputs, not just inputs, and I think that's getting an impact. In the middle, you can see the level of physical engagement has just dramatically increased.

And then on the right-hand side, just interestingly, you can see how people chase their points. So, this is in the last calendar year month by month. What you see are things like a Vitality Check, flu vaccinations. Amazingly, everyone went for a flu vaccination in December, which is obviously the right time to get yourself vaccinated. So, we're see amazing behavior, but that's I think all good stuff.

What we have to do, though, is we have to make sure there's no slippage, we have to make sure that the model hangs together. So, we're offering considerable value, premium discounts, payback benefits, and more. We need to make sure there isn't slippage. So more and more we're using data, machine learning, all the stuff we get together to make sure there isn't slippage.

We estimate about 0.8% of the members in the Gold level are kind of gaming the system in some way. We're doing a lot of work on the device side, on the provider side, on the broker advisor side to see where we can pick this up. On the device side, we have people sharing devices. We've got professional sharers of one Apple Watch. We know who they are. Some in this room. I'm kidding. Not true at all. I shouldn't have said that. Not true at all. We've got nurses and other providers putting in – filling out tests (00:59:47) using interesting statistical techniques to understand that, more and more understanding kind of behaviors of – are these things relevant, do they correlate to the person's risk factors, to their heart rate.

So, we're getting on top of this. We've picked up 3,000 we know are problematic. This is on the margin, we'll manage it. But trying to make the point here that we want that engagement, but we need to make sure that a Gold is a Gold. If you're a Gold, you exhibit on average Gold mortality. And I think we're getting closer and closer to that ability. So the program itself, I think, gets more and more efficacy, lets us offer real value to get it to the right place.

So, finally coming back to that kind of profit check I gave you. Comfortable with how the model plays out. I think we're comfortable with the experience variances. Always a challenge, it will fluctuate year to year.

But then finally, just to make the point about the asset, the negative reserve, we're holding ZAR 44.2 billion on the balance sheet. That's the present value of future loans, like a mortgage book in a sense. But there's ZAR 20 billion of first and second tier margins. So, if you flex assumptions, if you assume claims go up 5% and they're forever there, that will eat about 10% of that margin. If you flex interest rates, if you flex lapses, those are things that we typically check to make sure that there's sensitivity. So, finally, to make the point, I think the negative reserve is carefully calculated and is robust and conservative.

You bring them all together, I think you get a business that's giving shared value; at the end of the day, we're making our customers healthier, they're engaged at a tremendous level. We're giving them cash backs, premium discounts, but financially for us it's incredibly beneficial. And hopefully that point comes across. So, sorry, a long-winded explanation of a pretty complex business. I hope you follow the general reasoning check and you can just get a sense of it.

Let me turn quickly to Discovery Invest. It has been I think a very good period. I think the six months under review have been a tough period for the industry. Net inflows have been slow. Despite that, our net inflows were strong. Over the period, operating profit up 29%. Really a function of all variables being good. Assets under management growing 22% to just under ZAR 78 billion. The business mix, nearly 80% of the fund choices are within the Discovery funds, it's better for us. You can see the value of new business margin has climbed. And then fund performance has been very strong. So, our top – our five biggest funds have all been in the first or second quartile, one in the fourth, but generally very, very good. So, all aspects of the business I think has done well. The sum of it has been a very strong growth in operating profit.

Sorry, I'm flying through this stuff. I hope you're following me, because I'm not. Let me turn to the UK. And I must say this has been a very important and fundamental year for VitalityLife/Health in the UK. The business overall has grown and got scale. You can see new business for the first time has crossed ZAR 1 billion in that period, £61 million. We haven't shown like-for-like currencies, the fluctuations haven't been that dramatic. So, whether you look at it pounds or rands, I don't think it makes a dramatic difference.

Operating profit up 54%. Really a function of the remarkable performance of VitalityHealth. For the first time, you can see the profit rate is dramatically over ZAR 1 billion a year. So, we've had this kind of sense getting to ZAR 1 billion of profit would be a good thing. We're getting there I think quite comfortably. And then, I think important as well, just a milestone for our team, we crossed 1 million lives covered in the UK on substantive products, life and health. So, I think the business in terms of scale has done well.

The Vitality offering has been tremendous. The UK team has been fundamental in the Global Vitality Network. Active Rewards came out of the UK that we're learning from. So, the Vitality chassis partnering Disney, Apple, Starbucks, it's been a tremendously powerful chassis. And you can see in the middle of the graph really high rates of engagement whether it's physical activity, points-earning activities generally.

And then on the right-hand side, 52,000 Apple Watches sold through the Active Rewards program. I think that's really, really good. It's something that we've done I think very well together with Apple. We bought over 5 million cups of Starbucks coffee rewarding people for physical activity. So, it has been a kind of an incredibly well put together - the customer journey is very good in the UK, and I think that plays out well.

The other thing at the center I would just mention to you is the brand, right? And I raise it now because as I said a few years ago when we made the acquisition of Standard Life Healthcare, we moved away from The Prudential, we had this very big worry about how would we survive post using the Prudential brand. And so we set aside a large amount of money at the center that we would spend over a three-year period I think in terms of building the brand. And now that's over. And the question is, has the brand worked well. I would say it's worked remarkably well.

And credit to the team and the advisors we've used that had this brilliant insight of using this dog called Stanley, right? There's a lot of equity in this one dachshund. There's more than one. I think he actually lives in Cape Town funnily enough, as far as I know. But be that as it may, this has been a very, very important insight. And how this strategy has worked has been about kind of this dog is - it's us, slothful, cynical, doesn't want to do exercise, et cetera, et cetera. And juxtaposing this antagonist against our inspirational ambassadors like Jessica Ennis, Olympic gold medalist who's humble, has got it all. You know what I mean? It's kind of showing the everyman versus what you should be in a very nice way. And it's given us the most amazing ability - in the top right-hand corner, you can see kind of the showdown between Jessica and this dog. And it's played through in all the stuff that we've done.

On the bottom side, we've chosen very carefully the Premiership, cricket and different areas, parkruns and all kinds of things to get this into the right audience. I think it's done remarkably well.

If you look at the actual statistics coming out, when we started this program, we had a real - our board had a real concern about how we'd survive without the Prudential brand. At the time in 2014, PruHealth and PruProtect are not The Prudential, those are JV names, so they're not - PruProtect is not a name like The Prudential, but it still had the Pru on it. You can see the prompted awareness was about 40% to 50%. So, if you ask people have you heard of these people in that space, typically half of the UK would say yes. When we started out, Vitality, which was known, we had the Vitality program, had about a 14%, so 1 in 10 would now us in the UK.

You can see post this period, by the end of the six months, November 2017, we did the study, close to 46% prompted awareness, which I think is very good. And in fact it's similar levels or exceeds where the PruHealth, PruProtect brands were. So I would argue, if you do the numbers, it's actually they've done a remarkably good job at building that Vitality brand. And I'd like to think that it stands for something very different to what the PruHealth, PruProtect brands stand for. It's modern, it's pink, it's different, it's exciting and I think that's what we're doing.

You can see on the right-hand side, leads generated through direct channels, because of the power of the brand, they've been remarkably strong. So this has, I think, been a very, very important piece of the progression in the UK. So I think the UK businesses are of scale, I think the chassis built is excellent, I think the brand built is very, very strong. Long may that dog live. We hope longer than seven years, right?

Turning to the businesses themselves, VitalityLife firstly. I've made the point, there's a lot of different dynamics on VitalityLife and you can see that in the various disclosures. I want to make the point to you that this is about managing interest rates in the UK. This is a long-term life insurance selling, in the past, whole life business over a long period of time on a certain assumption of interest rates and they've been artificially low. They have been low. So the focus on new business, of profit has all been all about the quality of the book and that's what we've focused on.

If you look at rates of interest, I've showed this slide before. You can see the gradual decline post the financial crisis to levels never seen in the UK and then a significant drop during I think the 2016 year, and it's kind of meandered around there over the period. In fact, in this last six months, at the valuation date, it dropped further. So it's really been challenging in that regard. At the same time, if you look at real rates of return, in other words, adjust for inflation in the white, what you'll see is very high negative rates of return over the last 18 months or so.

For us, it's kind of a double whammy. We've got lower reinvestment rates of our premiums, so the liabilities grow effectively. At the same time, our expenses grow with inflation. So you kind of get the worst of both. That's taken about £75 million to £80 million off our margins to sustain that, right? So we've had to work very hard to make sure that the business is fit for purpose.

I think the team has done an amazing job. You can see the operating profit continues to be stable and to grow. But the real focus has been on making sure that the business that we write achieves profitability in the low interest rate environment. So, there's been three distinct issues done. One is we've moved from whole life to term insurance more and more. Second is we're selling more and more indexed business linked to inflation which immunizes the block. And finally, we're selling more and more stuff linked to the Vitality Optimizer, making sure that it's indexed, you get the right behavior. Typically, people buy more benefits with it. You get high premiums.

The effect of that altogether, you can see on the right-hand side, the VNB margin has climbed up again. Not quite to where it was, but very good. And to an extent, I would argue we've kind of rightsized the business for a much lower rate environment. So to an extent, we are where we are. I think stably and strongly, the new business flows now, I think, very strong with great quality. And then hopefully as interest rates do and should rise, we should see the upside.

If you look since the valuation date since the end of December, you can see, as you I think well know, it looks like quantitative easing is coming to an end. But it seems like the bond rate is weakening and rates are going up. The rates that we look on are climbing very nicely. And a nice rule of thumb, every basis point that rates go up adds nearly £1 million to our reserves. So, a rising interest rate environment off this base that we created will be highly profitable. That may manifest in second-tier margins, in IFRS profits, in EV. We'll see as it plays out. But I think we're feeling good about where Discovery Life (sic) [VitalityLife] (01:09:04) has got to and confident about how we think we can grow.

Let me end off on VitalityHealth and make the point the year has been staggering, a very strong growth in new business, great mix of business. Operating profit, as you can see, it's been volatile, up dramatically over the period. All the system issues are buttoned down. Service issues are buttoned down, the business in a very strong position.

But the overriding issue has been on quality of the loss ratio, and there have been a number of things that we've driven through that. The business mix, I think, has been careful. Vitality engagement has been critical and we're pricing that into the premiums. There's been a very clear focus on selective retention, making sure we price up bad groups and keep good groups. And then, finally, our work with Aviva through the Health Purchasing Alliance is making sure that we keep – the tariffs we pay, the price we pay for healthcare is competitive.

The fourth thing that we've done – and it's a remarkable guide for the future – is using AI and machine learning to price our premiums for new and retention purposes. So, to an extent, all of this data goes into the statistical thinking. So it's quite remarkable. All the data sets, demographic data, how that integrates with the healthcare system. Vitality, even new members where they will become Vitality members, we're trying to predict. And through that process, setting a price based on price elasticity that we can learn from. So, this is not yet at the point where the machine does all the learning and we don't know why it's doing it. It's still supervised by humans. But effectively, through these sophisticated techniques, we're setting prices kind of maximizing value and price elasticity.

And the function of all of that together with the other stuff is having a very, very additive effect. If you look at the loss ratio on the left-hand side, the white line is how we expected it to progress. You can see what's happened over the last years, just kind of come down very comfortably. And in fact, our claims levels are lower in absolute terms per member than they were few years ago. It's a remarkable outcome.

You can see on the right-hand side of the chart, cash generation from the in-force block has touched nearly £48 million for the six months under review, covering comfortably the acquisition costs. So, in our capital claim we had to think about how we would fund VitalityHealth. To an extent it's freed up on the bottom right £26 million of capital into the group, in effect into the UK group from the performance of the loss ratio. So, the performance I think has been staggering. I think the team has done an absolutely remarkable job.

So enough said on the businesses, on the emerging and established. As I said, I hope I've given some insight. There's a lot to say. We've tried our best to pull out of it those areas that we think are relevant.

I want to just make the point on the new businesses, there's a lot in the pipeline. We are focused on the Discovery Bank, Vitality Invest in the UK, commercial insurance in South Africa and umbrella funds in South Africa. There's a lot of work going down. We have done a lot of building and I think we're on track within budget for these four initiatives.

There's a lot of speculation around the bank and what we're going to do and all the rest of it. I wanted to just make maybe a boring point to you, all right? This is the kind of chart that's really gets me worked up, right? But we haven't taken any shortcuts in building of the bank. We never did a JV. We took a view we're going to build this in properly, build a fully functional bank. Wrapped around this will be a whole lot of things that we think will be differentiating. But I wanted to make a point that on the best technology with the best team, we built a bank. And the bank is kind of largely functional already.

So, we're only going to be launching this later in the year where you'll see the value proposition to customers and we think we're going to differentiate on a whole lot of things. But I wanted to give you a message. The bank is largely built, credit to the team. And there's no shortcuts. This is a fully functioning bank in all the payment systems, SWIFT, SAMOS (01:12:36) interacting with different banks.

And to make the point, I want to show you quite a boring video, credit to our CO, Barry here, but a fairly boring video that I found is one of the most emotional videos I've seen to see this actually work, right? It's just in simple payments happening through the bank. So, we've got people now banking with Discovery Bank in our staff, paying accounts, using their credit card, et cetera. So, there's a lot to be done, but I want to tell you the core of it is built. So, watch this and I hope it makes it clear.

[Video Presentation] (01:13:08-01:13:43)

(01:13:41) the functionality. But I will tell you, and I'm sure Barry and the team here will agree, when you see payment approved, right, you realize the plumbing that's been built and what has to be done. So, I just wanted to make the point that we're moving swiftly, excuse the pun. We're moving swiftly towards the launch of the bank. Of course how it will look and feel and the functionality will be completely different, but the core stuff I think is there.

So, let me end off by just saying, getting back to the four observations. The performance at a high level, I think we think is robust with strong growth in the earnings, headline earnings and new business. The operating model is working well and performing a fantastic counterbalance with return on capital earnings growth. Our risk appetite very much intact. The business I think has performed really well, to a T. The new businesses I think are very well positioned. And then finally, the foundation is getting considerable investment. I think if we continue to play this out as it is playing out, I think the potential for future growth is quite substantial.

So, enough said from me. What I'd like to do is we have our entire team here as usual. They all will be available for you in the back for questions. We've got our staff outside for some announcements. If you're comfortable, I'd like to adjourn. I've kept you already for 20 minutes too long. Can I shut it down and move on? And thank you for your time and for your interest and thank you for attending. Thank you.