

Asian growth

Prudential's long-term growth potential is based on its substantial presence across Asia, the largest geographical contributor to group profits. The region benefits from overall economic growth but also the increasing insurance penetration that this brings. In mature markets, Prudential has shown a disciplined approach to new business and has focused on realising value from the back-book, to provide a significant source of cash to the group. Overall, Prudential has a balanced portfolio of businesses that provide opportunities to invest in high-growth and high-profitability areas while also generating sufficient cash earnings to fund new business investment, pay progressive dividends and maintain capital strength. The group appears on track to meet its 'growth and cash' objectives, set in 2010, to double Asian IFRS operating and EEV new business profits by end 2013, while delivering substantial cash remittances to the group from each business unit.

Q3 IMS shows continued growth

The recent Q3 IMS shows further growth in new business profits (+13% ytd vs +7% at H1). Asian new business profits are +15% ytd or +23% if based on similar economic assumptions y-o-y. There is actually some slowdown in Asia during Q3 as Prudential says it traded volume for value in Korea, Taiwan and Malaysia. JNL had a very strong Q3 for sales of variable annuities, which will slow in Q4 as it limits sales of guaranteed products for the rest of the year to maintain the portfolio diversification by vintage that should protect returns across economic and market cycles. In the UK, new business profits were +56% (+17% ytd) and M&G saw net inflows of £6.4bn, making it the best nine months on record (+£11.3m). The (IGD) capital surplus has increased from £3.9bn to £4.1bn year-on-year.

New York investor conference: Focus on US business

Prudential will be holding its annual investor seminar in New York on 28-29 November 2012 and we expect a strong focus on the strategy and growth prospects for the US. The event provides an opportunity to explain how JNL manages and adequately prices for the risks contained in product guarantees, and why it believes it can avoid the problems faced by many other providers in the recent past. A number of competitors have seen periods of market weakness expose underpriced and poorly hedged risk.

Consensus estimates

Year end	New business profit (£m)	EEV per share (p)	IFRS op EPS (p)	DPS	P/EEV	P/E (x)	Yield (%)
12/10	2,028	658	62	23.85	1.34	14.2	2.7
12/11	2,151	713	64	25.19	1.24	13.8	2.9
12/12e	2,259	784	69	26.62	1.13	12.8	3.1
12/13e	2,445	873	76	29.53	1.01	11.6	3.3

Source: Consensus supplied by company. Note: EEV is European embedded value per share excluding goodwill. IFRS operating EPS is based on longer-term investment returns after tax and minorities. New business profits are on an EEV basis before tax.

Financials

23 November 2012

Price 883p
Market cap £23bn

Shares in issue 2,557m
Free float 100%
Code PRU
Primary exchange LSE
Other exchanges Hong Kong, Singapore, New York

Share price performance



52-week high/low 555.0p 889.0p

Business description

Prudential is an international financial services company, focused on life assurance and asset management, with total AUM of £363bn as at 30 June 2012. Headquartered in London, it has significant operations in Asia, the US, and the UK.

Next events

Investor conference, New York 28-29 November 2012

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Growth and cash

Strategy

Prudential views Asia as the most significant profitable growth opportunity, with a rapidly expanding middle class with an enduring propensity to save and an increasing demand for protection products. It identifies seven South-East Asia markets that make up a sweet spot with a combined population of more than 500 million and total GDP of more than US\$2trn, equivalent to that of a G5 economy. In mature markets, in the US and the UK, Prudential takes a disciplined approach to new business, focusing on value over volume and managing its back book to maximise returns and cash.

Recent performance

Prudential performed well in H1 against its key metrics of IFRS profits, EEV new business profits, and cash generation, in spite of macroeconomic headwinds. The recent Q3 IMS shows further growth in new business sales (+14% ytd vs 11% at H1) and profit (+13% ytd vs +7% at H1) with a new business profit margin of 56%.

Asia continues to grow strongly, with new business profits +15% ytd or +23% if based on similar economic assumptions year-on-year. There is actually some slowdown in Asia during Q3 as Prudential says it traded volume for value in Korea, Taiwan and Malaysia. The longer-term opportunity is based on overall economic growth, but also the increasing insurance penetration that this brings. Prudential benefits from a multi-channel distribution platform that is growing agent numbers and their productivity as well as increasing numbers of bank distribution partners. It has a leading position in more markets than any other life insurer, with a bias towards less volatile regular premium savings and protection business.

JNL has shown a disciplined approach to pricing, but had become a top three US variable annuity writer by H1 and enjoyed a very strong Q3 (new business profits +47% and 10% ytd). Given the problems faced by other writers in the past, who have expanded too quickly or at the wrong time, with inadequate hedging of investment guarantees that was exposed by bouts of market weakness, we expect Prudential to use the investor seminar to try and reassure investors about its pricing discipline and risk controls. Following Q3 growth, JNL will limit sales of guaranteed products for the balance of the year, to maintain the portfolio diversification by vintage that should protect returns across economic and market cycles.

In the UK, new business profits were +56% (+17% ytd) and M&G saw net inflows of £6.4bn, making it the best nine months on record (+£11.3m). M&G has been the UK retail leader in gross fund flows for 16 consecutive quarters and is now the largest by funds under management. H1 saw further progress towards the key objectives of doubling Asian new business profits to £1.4bn from 2009 to 2013 (H1: £547m) and Asian IFRS profits to £930m (H1: £440m), while strongly growing group free cash generation. The (IGD) capital surplus has increased from £3.9bn to £4.1bn year-on-year.

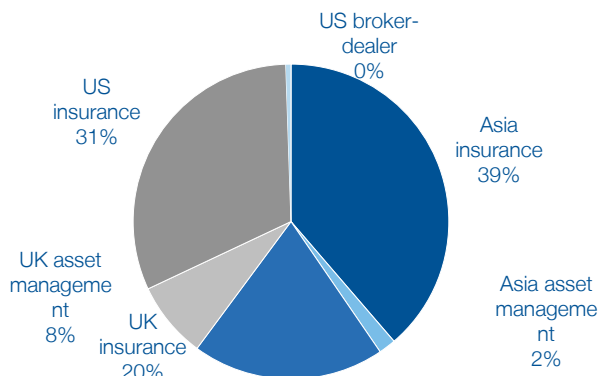
Outlook

The macroeconomic outlook remains challenging, with low economic growth and continued low government bond yields. As a large insurance company with a substantial balance sheet, Prudential is not immune to these factors, but it is defensively positioned, its capital position is strong, and it has shown itself able to withstand difficult conditions in recent years and capitalise on business opportunities. Those opportunities are clearest in South-East Asia where the growth in long-term savings and protection is central to the economic and social transformation that is still at an early stage and provides the prospect of expansion for many years to come.

Topics for discussion

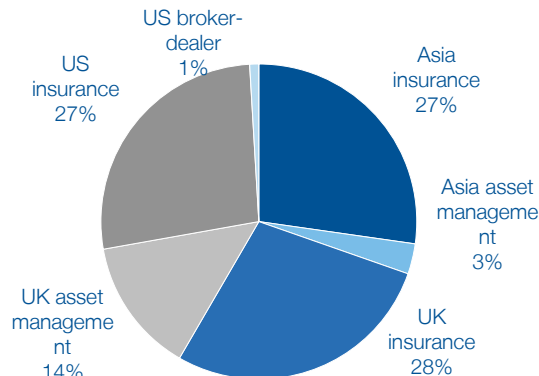
- Why has management chosen IFRS profits, EEV new business profits and cash remittances to group as the primary performance metrics for the group and what is the appropriate balance between these?
- How confident is management of meeting its target to double Asian IFRS profits and EEV new business profits between 2009 and 2013 and substantially increase cash remittances from each business unit? What are the main threats to these targets being met?
- Government bond yields have remained persistently low. In what ways is this impacting the group and what are the implications of this continuing?
- What are the risks and implications of JNL not being able to operate with equivalent status under Solvency II?
- Several competitors have run into problems in the US variable annuity market in the past. What are the key risks and how can investors be confident that JNL has adequately priced for these and sought adequate protection/hedging?
- Some of Prudential's larger existing Asian markets (such as Hong Kong, Singapore and Malaysia) have already experienced substantial growth. Is there much more to go for in these markets and which markets do management expect to provide the strongest growth in coming years?
- Prudential is market leader in a number of key South-East Asian markets. Thailand was an obvious exception until the recently signed bank distribution agreement. Was the proposed AIA transaction a special case or does management see the need/opportunity for external growth?
- How secure are these bank agreements and is there a risk to the long-term ownership of customers?
- Given the apparent scale of the South-East Asian opportunity, would Prudential be better off exiting mature markets to focus on the region?
- Does management believe that its asset management business, Eastspring and M&G, would be more highly valued outside of the group?
- Prudential has a progressive dividend policy. Given the growth on internal cash generation, how should investors think about future dividend growth prospects?
- There has been speculation that Prudential may re-domicile away from the UK. Under what circumstances would the group undertake this and what would be the implications for shareholders?

Exhibit 1: 2011 EEV pre-tax segment operating profit (£m)



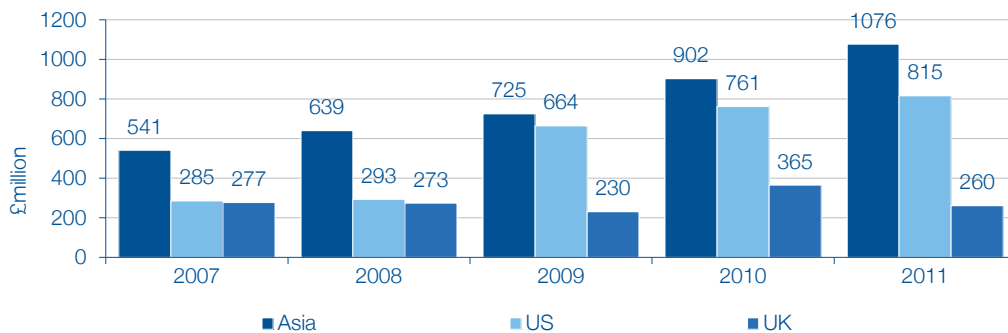
Source: Prudential, Edison Investment Research

Exhibit 2: 2011 IFRS pre-tax segment profit (£m)



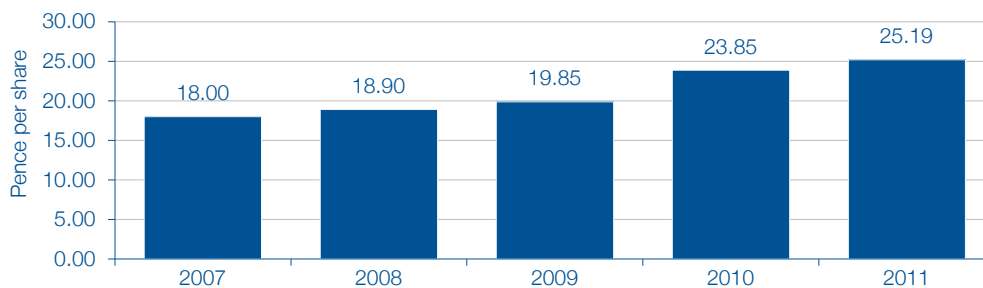
Source: Prudential, Edison Investment Research

Exhibit 3: Pre-tax new business profits by geography.



Source: Prudential, Edison Investment Research. Note: Asia excludes discontinued Japanese business.

Exhibit 4: Dividends per share (p)



Source: Prudential, Edison Investment Research

Exhibit 5: Financial summary

	2008	2009	2010	H111	H211	2011	H112
EEV basis £m							
Asian operations							
New business	634	713	901	465	611	1,076	547
Business in force	579	392	549	309	379	688	325
Total long term business	1,213	1,105	1,450	774	990	1,764	872
Eastspring investments	52	55	72	43	37	80	34
Development expenses	(26)	(6)	(4)	(2)	(3)	(5)	(3)
Total Asian operations	1,239	1,154	1,518	815	1,024	1,839	903
US operations							
New business	293	664	761	458	357	815	442
Business in force	293	569	697	373	243	616	363
Total long term business	586	1,233	1,458	831	600	1,431	805
Broker-dealer and asset management	7	4	22	17	7	24	17
Total US operations	593	1,237	1,480	848	607	1,455	822
UK operations							
New business	273	230	365	146	114	260	152
Business in force	764	640	571	391	202	593	338
Total long term business	1,037	870	936	537	316	853	490
General insurance commission	44	51	46	21	19	40	17
M&G	286	238	284	199	158	357	199
Total UK operations	1,367	1,159	1,266	757	493	1,250	706
Other income & expenditure							
Investment return & other income	89	22	30	5	17	22	5
Interest payable on core structural borrowing	(172)	(209)	(257)	(140)	(146)	(286)	(140)
Corporate expenditure	(171)	(203)	(223)	(118)	(101)	(219)	(120)
Unwind of expected asset management margin	(42)	(38)	(44)	(28)	(25)	(53)	(30)
Total other income & expenditure	(334)	(460)	(568)	(273)	(293)	(566)	(322)
Operating profit based on longer-term investment returns	2,865	3,090	3,696	2,147	1,831	3,978	2,109
Short-term fluctuation in investment returns	(4,967)	351	(30)	(111)	(796)	(907)	225
Mark to market value movements on core borrowings	656	(795)	(164)	(74)	60	(14)	(113)
Actuarial gains & losses on defined benefit pension schemes	(14)	(84)	(11)	(8)	31	23	103
Effect of changes in economic assumptions	(398)	(910)	(10)	(111)	(47)	(158)	(371)
Other	(248)	91	(374)	0	0	0	42
Profit before tax	(2,106)	1,743	3,107	1,843	1,079	2,922	1,995
DPS	18.90	19.85	23.85	7.95	17.24	25.19	8.40
Basic EPS	-54	50	102	50	34	85	57
Operating EPS	85	89	107	62	54	116	61
EEV tangible net asset value per share	546	550	658	745	713	713	806
Operating return on opening embedded value	14.1%	14.9%	17.7%	17.1%	14.4%	16.1%	15.7%
Other financial data							
IFRS operating profit based on longer term investment return	1,212	1,564	1,941	1,028	1,042	2,070	1,162
IFRS operating EPS based on longer term investment return	40	48	62	31	32	64	35
Group annual premium equivalent (APE)	0	0	3,485	1,824	1,857	3,681	2,030
Group pre-tax new business profit	1,205	1,619	2,028	1,069	1,082	2,151	1,141
Net remittances from business units	515	688	935	690	415	1,105	726
IGD surplus	1500	3,400	4,300	4,100	4,000	4,000	4,200
IGD surplus versus required (x)	1.5	2.8	3.1	2.9	2.8	2.8	27.0

Source: Prudential accounts

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