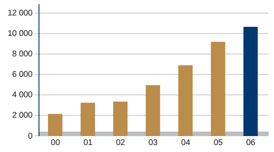
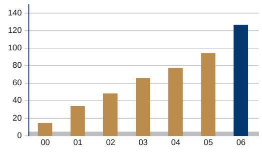
Discovery

# Audited results for the year ended **30 June 2006**

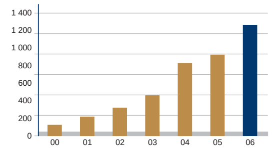
**Embedded value** (R million)




**Diluted headline earnings per share before BEE expenses and abnormal items** (cents)




**Operating profit before BEE expenses** (R million)




Operating profit (before BEE expenses) **+37%** to **R1,3 billion**

Net profit after tax (before BEE expenses) **+51%** to **R827 million**

Diluted HEPS (before BEE expenses) **+34%** to **126,4 cents per share**

New business annualised premium income **+3%** to **R4,5 billion**

Maiden dividend of **27c per share** declared

## INTRODUCTION

The year under review has been a successful one for Discovery, with important developments in each of its businesses, strong earnings growth and the declaration of a maiden dividend. The Group's core purpose of "making people healthier and enhancing and protecting their lives" imposes an ethos wherein always meeting clients' needs first and foremost leads to superior growth and profitability. The year under review illustrates the continued efficacy of this approach. As in previous years, all of Discovery's businesses focused intensely on significant developments and innovations designed to meet specific client needs in rapidly changing markets – resulting in strong organic growth.

Discovery has consistently followed a philosophy of pursuing organic growth, funded from internal resources without recourse to debt. Discovery is now in a position of having built both scale and platforms for future growth, but is now concurrently strongly cash-generative. Discovery Life's significant growth since its commencement in 2001 required substantial investment of the Group's cash resources. The company is now turning cashflow-positive and so, while Discovery will continue to pursue aggressively a wide range of new initiatives, the Group is expected to be cash-generative going forward. The level of the maiden dividend has been set taking into account Discovery's future capital and growth needs.

## DISCOVERY LIFE

Discovery Life's performance exceeded expectation. The core driver of Discovery Life's performance is the leadership position that it has achieved in the protection market. Discovery's ethos of focusing on clients' needs first has translated into a strategy that leads to both growth and profitability. The key success factors in this market are price competitiveness and product innovation, which lead to growth, superior mortality and morbidity experience and higher levels of persistency. During the year, the launch of the Discovery Life Card Integrator, which integrates the DiscoveryCard with the Discovery LIFE PLAN in order to achieve lower premiums, was a further step in using Discovery's unique product platform to generate value for clients, while creating a strong product differentiation. A substantial portion of Discovery Life's profitability was generated from mortality and morbidity profits, illustrating the success of the strategies followed.

The significant embedded value of the new business transacted, combined with the positive experience variances of the in-force embedded value, reflect the quality and scale of the company's protection business.

During the year, Discovery Life entered the retirement funding market with the launch of the Discovery retirement Optimiser. While still early in its evolution, the company estimates that its market share of new business amounted to approximately 17% of the independent broker recurring premium Retirement Annuity market, in just its first year of entry. Given this, Discovery Life is evaluating a broader long-term savings offering.

Discovery Life's joint protection initiative with the Prudential plc was launched into the UK assurance market during July 2006. The strategy followed was a controlled roll-out to select broker houses to ensure that both Discovery Life and the Prudential could gain a deep and rapid insight into the dynamics of the market to ensure success, given the fundamental differences to existing products that the joint protection product represents. While early signs are positive, Discovery Life remains cautiously optimistic for the prospects of this initiative. The financial structure of the joint venture requires limited capital for infrastructural development from Discovery, but exposes Discovery to the upside of the embedded value created.

## DISCOVERY HEALTH

Discovery Health's performance was pleasing. Operating profit increased by 20% to R655 million (2005: R548 million) and the number of lives covered on the Discovery Health Medical Scheme and other medical schemes under management increased by 8% to R1,94 million from 1,78 million.

Discovery Health's purpose is clear: to create affordable access to quality healthcare on a sustainable basis for its clients. It is uniquely positioned to do so due its size and unique assets. The size of the DMHS is now 3,8 times greater than that of its nearest competitor, and just this year's growth is larger than the fourth largest medical scheme in the market.

During the year under review, considerable progress was made in discussions with hospital and other provider groups toward the managing of healthcare costs, which continue to increase at stubbornly high medical inflation rates, despite a lower price inflation environment. The company is close to launching a series of provider initiatives aimed at providing quality care at affordable and sustainable rates, while ensuring members' service experience is positive and effortless. It is anticipated that these developments will benefit members directly and will further serve to entrench Discovery Health's competitive position, enabling future growth.

The company continued its growth in the lower income market through its KeyCare product range and to this end formed a proprietary network of 2 055 doctors and 64 hospitals specifically to care for KeyCare members.

Considerable investment in operations and technology was made in the previous year, and this yielded substantial results during the year under review. Discovery Health's business is of a highly transactional nature, with large volumes of administrative transactions taking place every day. In this context, the implementation of a small number of well-executed initiatives can have a significant impact. Service levels reached their highest levels yet, and importantly substantial efficiencies emerged, with staff headcount per thousand lives covered reducing by 13,2% over the year. The combination of organic growth and expense efficiencies drove the increase in operating profit.

## DESTINY HEALTH

Destiny Health's performance was disappointing for the financial year, although its performance for the last six months was in line with expectations set at the interim results stage. Operating losses increased by 68% to R151 million (2005: R90 million) and recurring premium new business reduced by 2% to R796 million (2005: R809 million).

The poor performance reflects a significant shift in the competitive dynamics of the markets in which Destiny operates. While the concept of Consumer-Driven Healthcare continues to grow significantly in the US health insurance markets – presenting a substantial and unique opportunity for Discovery given the Group's experience and capabilities – it became clear during the first six months of the year that Destiny was poorly positioned to make positive progress. A positive underwriting cycle and significantly deeper discounts available to our major competitors, created an environment in which Destiny is simply not price competitive – particularly in Illinois, Destiny's major market – resulting in slow growth and worse-than-expected loss ratios.

In addition, Destiny's pace of expansion into other markets wherein it could compete was inadequate and contingent upon partner influences. Since the half year, substantial steps have been taken to address the situation:

- The appointment of a new CEO
- A focus on appropriately increasing premium rates to address the elevated loss ratio and return it to the correct level
- A mutual agreement with Tufts Health Plan to terminate our joint venture to allow for correct focus on growth opportunities
- A significant leaning down of the operations to reflect the realities of the business
- The recruitment of senior resources
- A focus on obtaining competitive network discounts
- The expansion into more promising markets, like Texas.

The resulting operating losses reflect the tail-end of the issues, and the steps taken have had a significant impact. It is anticipated that the emerging losses will be minimised and reduced rapidly.

However, Discovery has made the decision that the business model and strategy is not sustainable and must change. Discovery, Destiny Health and the Guardian Life Assurance Company of New York (Destiny Health's exclusive distribution partner in the US) are in the process of revisiting their partnership arrangement. Potential changes may include a construct wherein Destiny will provide the intellectual capital and an operational platform for the Guardian in return for a fixed fee per member in some states in the US, while Destiny Health will market its own products in other US states. However, it must be stressed that any growth outside of this will be opportunistic, confined to those markets where competitive pricing can be obtained and will be pursued with great care to limit any downside.

## VITALITY AND THE DISCOVERYCARD

Vitality performed well over the period. Operating profit increased by 11% to R41 million (2005: R37 million), Vitality membership increased by 7% to 522 516 members (2005: 486 416 members), and the number of primary DiscoveryCard-holders increased by 120% to 307 688 (2005: 139 563).

Vitality's function is foundational across Discovery, and focus continues to be applied to ensuring that its structure achieves the correct levels of engagement and behavioural change. Its performance in this regard and in creating a competitive advantage for all of Discovery's businesses has been remarkable. To ensure continual improvement, many of the benefit structures were reworked during the year, most notably the introduction of kulula.com as an air travel partner in addition to British Airways. This strengthens the incentives for members to engage in healthy behaviours, thereby boosting their Vitality statuses. The number of Vitality flights booked on kulula.com per day exceeds 1 000 – which is greater than the historic total monthly usage of the British Airways flight benefit. Over 200 000 Vitality members are now actively training at the gyms in the Vitality network.

The growth of the DiscoveryCard has been pleasing. Its central purpose is to offer a platform for both Discovery Health and Discovery Life to enhance their value propositions for their clients. This has been a particularly successful strategy and the launch of the Discovery Life Card Integrator during the year is a clear and powerful illustration of this. In addition to this, in and of itself, the DiscoveryCard represents a powerful entry into the credit card marketplace and the growth of the advances portfolio to in excess of R1,1 billion is testimony to its success. Discovery remains confident and optimistic that its value proposition places it in a uniquely competitive position. Discovery expects continued evolution and growth from and through the DiscoveryCard.

## PRUHEALTH

The performance of PruHealth, Discovery's 50% joint venture with the Prudential plc, was particularly pleasing. Members covered increased 696% to 58 912 (2005: 7 400), while new business increased by 705% to R282 million (2005: R35 million).

During the year under review, the company has made a significant impact on the UK private medical insurance (PMI) market. It has taken a leadership position intellectually and in terms of product construct, and its operational execution has been robust and thorough. The central Vitality philosophy of incentivising better health has been exceptionally well received in the marketplace and is wholly consistent with government policy and practice. The impressive levels of new business production over the year reflect a successful strategy in every respect.

PruHealth distributes its products through both broker (IFA) and direct-to-consumer (D2C) distribution channels. The IFA channel has been remarkably receptive from the outset and over the year exceeded our target, with continued growth in both depth and breadth. A pleasing development during the year has been the increasing success of the D2C channel and, in particular, the online channel. Importantly, the D2C channel attracts individual business, which is significantly more profitable. This bodes well for future growth and profitability.

From an actuarial perspective, a central strategy designed to ensure price competitiveness is the use of the Vitality structure to induce greater persistency, thereby leading to superior durational morbidity experience. Early indications are positive, with 100% of small and medium size companies (SME's) renewing their coverage.

Going forward, PruHealth is well positioned for continued growth. It is pursuing a number of key strategies, including the broadening of its distribution channels to the generalist IFA's and an acceleration of its D2C execution.

**LL Dippenaar**
Chairman

**A Gore**
Chief Executive Officer

5 September 2006


**Directors**
LL Dippenaar (Chairman), A Gore (Chief Executive Officer), JM Robertson*, Dr BA Brink, JP Burger, Dr NJ Dlamini, SB Epstein (USA), MI Hilkowitz (Israel), NS Koopowitz*, Dr TV Maphai**, HP Mayers*, S Sebotsa**, B Swartzberg*, SV Zilwa, SD Whyte*

*Executive **Appointed 8 December 2005

**Transfer secretaries**
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**Sponsors**
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**Secretary and registered office**
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Discovery Holdings Limited
(Incorporated in the Republlic of South Africa)
(Registration number: 1999/007789/06)
JSE share code: DSY
ISIN: ZAE000022331


## INCOME STATEMENT

for the year ended 30 June 2006

| R million | Group 2006 | Group 2005 | % Change |
|---|---|---|---|
| Insurance premium revenue | **2 824** | 1 838 | |
| Reinsurance premiums | **(456)** | (378) | |
| **Net insurance premiums** | **2 368** | 1 460 | |
| Fee income | **1 961** | 1 670 | |
| Investment income | **161** | 106 | |
| Net realised gains | **157** | 53 | |
| Net fair value gains on financial assets at fair value through profit and loss | **121** | 122 | |
| Vitality income | **654** | 521 | |
| **Net income** | **5 422** | 3 932 | |
| Insurance benefits and claims | **(1 348)** | (828) | |
| Insurance claims recovered from reinsurers | **374** | 251 | |
| **Net insurance benefits and claims** | **(974)** | (577) | |
| Acquisition costs | **(908)** | (714) | |
| Marketing and administration expenses | **(2 624)** | (2 168) | |
| Transfer from assets/liabilities under insurance contracts | **468** | 572 | |
| Fair value adjustment to liabilities under investment contracts | **(121)** | (122) | |
| **Profit before BEE expenses** | **1 263** | 923 | 37 |
| BEE expenses | **(161)** | – | |
| **Profit from operations** | **1 102** | 923 | |
| Finance costs | **(21)** | (64) | |
| Foreign exchange loss – unrealised | **(7)** | (8) | |
| Share of profit from associate | **2** | 2 | |
| **Profit before taxation** | **1 076** | 853 | 26 |
| Taxation | **(410)** | (305) | |
| **Profit for the year** | **666** | 548 | 22 |
| **Attributable to:** | | | |
| Equity holders | **669** | 557 | |
| Minority interests | **(3)** | (9) | |
| | **666** | 548 | |
| **Earnings per share for profit attributable to the equity holders during the year (cents):** | | | |
| – basic | 126.5 | 107.3 | 18 |
| – diluted | 121.0 | 103.0 | 17 |
| Weighted number of shares in issue (000's) | 528 946 | 519 188 | |
| Diluted weighted number of shares (000's) | 574 871 | 553 227 | |

## BALANCE SHEET

at 30 June 2006

| R million | Group 2006 | Group 2005 |
|---|---|---|
| **ASSETS** | | |
| Property and equipment | **186** | 219 |
| Intangible assets including deferred acquisition costs | **66** | 46 |
| Assets arising from insurance contracts | **2 463** | 1 881 |
| Investment in associate | **7** | 4 |
| Financial assets | | |
| – Equity investments | **1 600** | 1 259 |
| – Equity linked notes | **77** | – |
| – Government and public authority stocks | **233** | 186 |
| – Money market | **206** | 159 |
| – Loans and receivables including insurance receivables | **559** | 556 |
| Deferred income tax | **41** | 35 |
| Reinsurance assets | **32** | 19 |
| Cash and cash equivalents | **1 322** | 916 |
| **Total assets** | **6 792** | 5 280 |
| **EQUITY** | | |
| **Capital and reserves** | | |
| Share capital and share premium | **1 348** | 1 336 |
| Other reserves | **640** | 330 |
| Retained earnings | **2 224** | 1 557 |
| | **4 212** | 3 223 |
| **Minority interest** | **–** | 67 |
| **Total equity** | **4 212** | 3 290 |
| **LIABILITIES** | | |
| Liabilities arising from insurance contracts | **464** | 309 |
| Liabilities arising from reinsurance contracts | **24** | 31 |
| Financial liabilities | | |
| – Investment contracts at fair value through profit and loss | **604** | 483 |
| – Borrowings at amortised cost | **161** | 136 |
| Deferred income tax | **518** | 323 |
| Deferred revenue | **203** | 254 |
| Provisions | **36** | 30 |
| Trade and other payables | **522** | 407 |
| Current income tax liabilities | **48** | 17 |
| **Total liabilities** | **2 580** | 1 990 |
| **Total equity and liabilities** | **6 792** | 5 280 |

## CASH FLOW STATEMENT

for the year ended 30 June 2006

| R million | Group 2006 | Group 2005 |
|---|---|---|
| **Cash flow from operating activities** | **580** | 408 |
| Cash generated by operations | **439** | 575 |
| Working capital changes | **217** | 10 |
| | **656** | 585 |
| Dividends received | **33** | 23 |
| Interest received | **122** | 72 |
| Financing costs | **(22)** | (93) |
| Taxation paid | **(209)** | (179) |
| **Cash flow from investing activities** | **(138)** | (210) |
| Net purchases of investments | **(46)** | (77) |
| Purchase of property and equipment | **(59)** | (106) |
| Proceeds on disposal of property and equipment | **1** | – |
| Purchase of intangible assets | **(34)** | (30) |
| Decrease in loans receivable | – | 3 |
| **Cash flow from financing activities** | **(39)** | (134) |
| Proceeds from shares issued | **23** | 71 |
| Share issue costs written off against share capital | **(4)** | (1) |
| Dividends paid to Destiny Health preference shareholders | **(1)** | (1) |
| Minority share buy-back | **(6)** | (1) |
| Increase/(repayment) of borrowings | **16** | (202) |
| Redemption of Destiny preference shareholders | **(67)** | – |
| Net increase in cash and cash equivalents | **403** | 64 |
| Cash and cash equivalents at beginning of year | **916** | 845 |
| Exchange gains on cash and cash equivalents | **3** | 7 |
| Cash and cash equivalents at end of year | **1 322** | 916 |

# STATEMENT OF CHANGES IN EQUITY

for the year ended 30 June 2006

| R million | Share capital and share premium | Share-based payment reserve | Investment reserve | Translation reserve | Hedging reserve | Retained earnings | Minority interest | Total |
|---|---|---|---|---|---|---|---|---|
| | Attributable to equity holders of the Company | | | | | | | |
| 30 June 2005 | | | | | | | | |
| Balance at 1 July 2004 | 1 276 | – | 51 | 69 | (6) | 1 002 | 67 | 2 459 |
| Issue of capital | 61 | – | – | – | – | – | 9 | 70 |
| Share issue expenses | (1) | – | – | – | – | – | – | (1) |
| Movement in share-based payment reserve | – | 20 | – | – | – | – | – | 20 |
| Unrealised gains on investments | – | – | 240 | – | – | – | – | 240 |
| Capital gains tax on unrealised gains on investments | – | – | (34) | – | – | – | – | (34) |
| Realised gains on investments transferred to income statement | – | – | (53) | – | – | – | – | (53) |
| Capital gains tax on realised gains on investments | – | – | 5 | – | – | – | – | 5 |
| Translation of foreign subsidiary | – | – | – | 29 | – | – | – | 29 |
| Transfer to hedging reserve | – | – | – | – | 9 | – | – | 9 |
| Net profit for the period | – | – | – | – | – | 557 | (9) | 548 |
| Dividends paid to Destiny Health preference shareholders | – | – | – | – | – | (1) | – | (1) |
| Realised loss on minority share buy-back | – | – | – | – | – | (1) | – | (1) |
| Balance at 30 June 2005 | 1 336 | 20 | 209 | 98 | 3 | 1 557 | 67 | 3 290 |
| **30 June 2006** | | | | | | | | |
| **Balance at 1 July 2005** | **1 336** | **20** | **209** | **98** | **3** | **1 557** | **67** | **3 290** |
| **Issue of capital** | **16** | – | – | – | – | – | **3** | **19** |
| **Share issue expenses** | **(4)** | – | – | – | – | – | – | **(4)** |
| **Movement in share-based payment reserve** | – | **185** | – | – | – | – | – | **185** |
| **Unrealised gains on investments** | – | – | **288** | – | – | – | – | **288** |
| **Capital gains tax on unrealised gains on investments** | – | – | **(39)** | – | – | – | – | **(39)** |
| **Realised gains on investments transferred to income statement** | – | – | **(157)** | – | – | – | – | **(157)** |
| **Capital gains tax on realised gains on investments** | – | – | **18** | – | – | – | – | **18** |
| **Translation of foreign subsidiary** | – | – | – | **14** | – | – | – | **14** |
| **Transfer to hedging reserve** | – | – | – | – | **1** | – | – | **1** |
| **Net profit for the period** | – | – | – | – | – | **669** | **(3)** | **666** |
| **Dividends paid to Destiny Health preference shareholders** | – | – | – | – | – | **(1)** | – | **(1)** |
| **Realised loss on minority share buy-back** | – | – | – | – | – | **(1)** | – | **(1)** |
| **Redemption of Destiny Health preference shares** | – | – | – | – | – | – | **(67)** | **(67)** |
| **Balance at 30 June 2006** | **1 348** | **205** | **319** | **112** | **4** | **2 224** | – | **4 212** |

# SEGMENTAL INFORMATION

for the year ended 30 June 2006

| R million | Health: South Africa | Health: United States of America | Health: United Kingdom | Life | Vitality | Total |
|---|---|---|---|---|---|---|
| **30 June 2006** | | | | | | |
| New business annualised premium income* | **2 505** | **796** | **282** | **789** | **107** | **4 479** |
| Gross inflows under management* | **16 542** | **1 322** | **141** | **1 768** | **654** | **20 427** |
| **Income statement** | | | | | | |
| Insurance premium revenue | **74** | **911** | **71** | **1 768** | **–** | **2 824** |
| Reinsurance premiums | **(2)** | **(81)** | **–** | **(373)** | **–** | **(456)** |
| Fee income | **1 961** | **–** | **–** | **–** | **–** | **1 961** |
| Investment income and gains | **34** | **9** | **4** | **382** | **10** | **439** |
| Vitality income | **–** | **–** | **–** | **–** | **654** | **654** |
| **Net income** | **2 067** | **839** | **75** | **1 777** | **664** | **5 422** |
| Insurance benefits and claims | **(57)** | **(656)** | **(43)** | **(592)** | **–** | **(1 348)** |
| Insurance claims recovered from reinsurers | **2** | **76** | **–** | **296** | **–** | **374** |
| Acquisitions costs | **–** | **(82)** | **(8)** | **(752)** | **(66)** | **(908)** |
| Marketing and administration expenses | **(1 319)** | **(242)** | **(153)** | **(363)** | **(547)** | **(2 624)** |
| Transfer from assets/liabilities under insurance contracts | **(4)** | **(77)** | **(13)** | **562** | **–** | **468** |
| Fair value adjustment to liabilities under investment contracts | **–** | **–** | **–** | **(121)** | **–** | **(121)** |
| **Expenses** | **(1 378)** | **(981)** | **(217)** | **(970)** | **(613)** | **(4 159)** |
| Profit from operations | **689** | **(142)** | **(142)** | **807** | **51** | **1 263** |
| BEE expenses | | | | | | **(161)** |
| Finance costs | | | | | | **(21)** |
| Foreign exchange loss – unrealised | | | | | | **(7)** |
| Share of profit from associate | | | | | | **2** |
| Profit before taxation | | | | | | **1 076** |
| Taxation | | | | | | **(410)** |
| **Profit for the year** | | | | | | **666** |
| **30 June 2005** | | | | | | |
| New business annualised premium income* | 2 776 | 809 | 35 | 629 | 93 | 4 342 |
| Gross inflows under management* | 14 571 | 914 | 11 | 1 278 | 521 | 17 295 |
| **Income statement** | | | | | | |
| Insurance premium revenue | 18 | 537 | 5 | 1 278 | – | 1 838 |
| Reinsurance premiums | (3) | (53) | – | (322) | – | (378) |
| Fee income | 1 670 | – | – | – | – | 1 670 |
| Investment income and gains | 26 | 4 | 6 | 237 | 8 | 281 |
| Vitality income | – | – | – | – | 521 | 521 |
| **Net income** | 1 711 | 488 | 11 | 1 193 | 529 | 3 932 |
| Insurance benefits and claims | (3) | (392) | (3) | (430) | – | (828) |
| Insurance claims recovered from reinsurers | – | 43 | – | 208 | – | 251 |
| Acquisitions costs | – | (42) | – | (617) | (55) | (714) |
| General marketing and administration expenses | (1 134) | (183) | (150) | (272) | (429) | (2 168) |
| Transfer from assets/liabilities under insurance contracts | – | – | – | 572 | – | 572 |
| Fair value adjustment to liabilities under investment contracts | – | – | – | (122) | – | (122) |
| **Expenses** | (1 137) | (574) | (153) | (661) | (484) | (3 009) |
| Profit from operations | 574 | (86) | (142) | 532 | 45 | 923 |
| Finance costs | | | | | | (64) |
| Foreign exchange loss – unrealised | | | | | | (8) |
| Share of profit from associate | | | | | | 2 |
| Profit before taxation | | | | | | 853 |
| Taxation | | | | | | (305) |
| **Profit for the year** | | | | | | 548 |

* New business annualised premium income and gross inflows under management includes flows of the schemes Discovery administers and 100% of the business conducted together with its joint venture partners.

# EMBEDDED VALUE STATEMENT

for the year ended 30 June 2006

The embedded value of Discovery at 30 June 2006 is calculated as the sum of the following components:

- the excess assets over liabilities at the valuation date (i.e. net asset value); and
- the value of in-force business at the valuation date (less an allowance for the cost of capital and secondary tax on companies (STC)).

The value of in-force business is calculated as the value of projected future after-tax profits of the business in force at the valuation date, discounted at the risk discount rate.

In the past, Life has based the embedded value on the Financial Soundness Valuation Method (FSV). A change in actuarial guidance note (PGN107) effective for financial year-ends on or after 31 December 2005 now requires long-term insurers to base the embedded value on the Statutory Valuation Method (SVM). The key difference between the two bases for Life is that the value capatalised in the assets under insurance contracts on the FSV basis may not be reflected as an insurance asset under the SVM. The net asset value shown on the published balance sheet has been adjusted to reflect the elimination of the assets under insurance contracts as per the Life statutory accounts. The value of the assets under insurance contracts on the FSV basis is released in the value of in-force of the Statutory Valuation Method over time. The capital maintained for Life throughout the projection term is based on the statutory capital as defined by the SVM.

The value of in-force and the value of new business at 30 June 2006 are shown on both the SVM and the FSV bases to allow comparison to prior periods.

The value of new business is determined at the point of sale as the projected future after-tax profits of the new business written by Discovery, discounted at the risk discount rate, less an allowance for the cost of capital and STC.

For PruHealth, no value has been placed on the current in-force business.

PricewaterhouseCoopers Assurance Services (Pty) Ltd has reviewed the calculation of the value of in-force business, the value of new business, including the methodology and assumptions underlying these calculations. They have reported that the accompanying embedded value and disclosure complies in all material respects with the actuarial principles as set out in Professional Guidance Note 107 of the Actuarial Society of South Africa. A letter from PricewaterhouseCoopers Assurance Services (Pty) Ltd, summarising the results of their review, is included in the annual report.

## Table 1: Group embedded value

at 30 June

| R million | 2006 SVM Basis | 2006 FSV basis | 2005 | % change |
|---|---|---|---|---|
| Shareholders' funds | **4 212** | **4 212** | 3 290(1) | 28 |
| Minority interest | **–** | **–** | (67) | |
| Elimination of assets under insurance contracts | **(2 088)** | **–** | – | |
| Shareholders' funds excluding assets under insurance contracts and minority interest | **2 124** | **4 212** | 3 223 | |
| Value of in-force business before cost of capital | **8 774** | **7 141** | 6 483 | |
| Cost of capital | **(60)** | **(492)** | (533) | |
| Cost of STC(2) | **(251)** | **(222)** | – | |
| **Discovery Holdings embedded value** | **10 587** | **10 639** | **9 173** | **15** |
| Number of shares (millions) | **533,4** | **533,4** | 528,2 | |
| Embedded value per share | **R19,85** | **R19,95** | R17,37 | 14 |
| Diluted number of shares (millions) | **553,2** | **553,2** | 553,2 | |
| Diluted embedded value per share(3) | **R19,47** | **R19,57** | R16,93 | 15 |

*(1) The shareholders' funds balance has been adjusted following the adoption of IFRS.*

*(2) In line with Discovery's current dividend policy, the cost of secondary tax on companies (STC) is calculated assuming a 4,5 times dividend cover on the after-tax profits as they emerge over the projection term. The after-tax profits will differ depending on whether the SVM or FSV basis is used. The total STC charge has been allocated between the different business entities based on their contribution to the total value of in-force. Previously, Discovery's policy was not to declare dividends and therefore no allowance was made in the embedded value calculation for STC. The cost of STC at 30 June 2005 would have been R171 million on the same basis.*

*(3) The diluted embedded value per share is calculated by increasing the embedded value by the value of the loan to the Discovery Holdings share trust, and by increasing the number of shares by the number of shares issued to the share incentive trust which have not been delivered to participants. No allowance has been made for Discovery's BEE transaction as the impact would be anti-dilutive due to the transaction price exceeding the current embedded value per share.*

## Table 2: Value of in-force business

| R million | Value before cost of capital and STC | Cost of capital | Cost of STC | Value after cost of capital and STC |
|---|---|---|---|---|
| **at 30 June 2006 – SVM Basis** | | | | |
| Health and Vitality | 4 258 | – | (122) | 4 136 |
| Life(1) | 4 496 | (45) | (129) | 4 322 |
| Destiny Health(2) | 20 | (15) | (0) | 5 |
| **Total** | **8 774** | **(60)** | **(251)** | **8 463** |
| **at 30 June 2006 – FSV Basis** | | | | |
| Health and Vitality | 4 258 | – | (133) | 4 125 |
| Life(1) | 2 863 | (477) | (89) | 2 297 |
| Destiny Health(2) | 20 | (15) | (0) | 5 |
| **Total** | **7 141** | **(492)** | **(222)** | **6 427** |
| **at 30 June 2005** | | | | |
| Health and Vitality | 3 844 | – | – | 3 844 |
| Life(1) | 2 349 | (517) | – | 1 832 |
| Destiny Health | 290 | (16) | – | 274 |
| **Total** | **6 483** | **(533)** | **–** | **5 950** |

*(1) On the SVM basis, the Life cost of capital is based on a capital adequacy requirement at June 2006 of R94 million. On the FSV basis, the Life cost of capital is based on a capital adequacy requirement at June 2006 of R2 240 million (June 2005: R1 507 million on the FSV basis).*

*(2) The reduction in the value of Destiny Health follows a review of the long term assumptions for the existing business taking account of the poor performance experienced over the past year and changes to the alliance with Tufts Health Plan. The values for Destiny Health reflect Discovery's 98.05% shareholding in Destiny Health at 30 June 2006.*

## Table 3: Group embedded value earnings

for the year ended 30 June

| R million | 2006 | 2005 |
|---|---|---|
| Embedded value at end of period | **10 587** | 9 173 |
| *Less:* Embedded value at beginning of period | **(9 173)** | (6 832) |
| Increase in embedded value | **1 414** | 2 341 |
| Net issue of capital | **(12)** | (60) |
| Dividends paid to Destiny preference shareholders | **1** | 1 |
| Realised loss on minority share buy-back | **1** | – |
| Transfer to hedging reserve | **(1)** | (9) |
| Embedded value earnings | **1 403** | 2 273 |
| Return on embedded value | **15,3%** | 33,3% |

## Table 4: Components of Group embedded value earnings

for the year ended 30 June

| R million | 2006 | 2005 | % change |
|---|---|---|---|
| Total profit from new business (at point of sale) | **572** | 783 | (27) |
| Profit from existing business | | | |
| • Expected return(1) | **756** | 602 | |
| • Change in methodology and assumptions(2) | **(540)** | 307 | |
| • Experience variances(3) | **262** | 363 | |
| PruHealth start-up costs | **(128)** | (120) | |
| Adjustment for minority interest in Destiny Health | **10** | 4 | |
| Adjustment for Guardian profit share in Destiny Health(4) | **1** | (28) | |
| Foreign exchange rate movements | **(4)** | 43 | |
| Interest on loan capital | **–** | (50) | |
| IFRS Adjustment | **–** | (8) | |
| Return on shareholders' funds(5) | **474** | 377 | |
| Embedded value earnings | **1 403** | 2 273 | |

*(1) The expected return is based on the FSV method.*

*(2) The change in methodology and assumptions item will vary over time to reflect adjustments to the model and assumptions as a result of changes to the operating and economic environment. The current period's changes are described in detail in Table 5 below (for previous periods refer to previous embedded value statements). The methodology and assumption changes are based on the FSV method. The modelling change, moving from the FSV method to the SVM, is included as the last step in the change in methodology and assumptions.*

*(3) The experience variances are shown on the FSV methodology.*

*(4) In terms of the agreement between Destiny Health and the Guardian Life Insurance Company of America, Guardian shares in 50% of the profits from business written by Destiny Health prior to the agreement with Guardian (i.e. non-alliance business) once the business written by Guardian reaches the contractual new member threshold. This threshold has now been reached.*

*(5) Return on shareholders' funds is shown net of tax and management charges and includes the return on assets under insurance contracts, under the FSV method.*

## Table 5: Methodology and assumption changes

for the year ended 30 June 2006

| R million | Health and Vitality: Net worth | Health and Vitality: Value of in-force | Destiny Health: Net worth | Destiny Health: Value of in-force | Life: Net worth | Life: Value of in-force | Total |
|---|---|---|---|---|---|---|---|
| Lapses | – | 68 | – | (32) | (62) | (94) | (120) |
| Economic assumptions | – | (45) | – | – | (18) | (90) | (153) |
| Premium Increases | – | – | – | 23 | 101 | 8 | 132 |
| Administration Fees(1) | – | (443) | – | – | – | – | (443) |
| Benefit Enhancements(2) | – | – | – | – | (33) | (30) | (63) |
| Expenses(3) | – | 462 | – | (78) | 4 | 7 | 395 |
| Cash Settled Share Based Payments(4) | – | (67) | – | – | – | (11) | (78) |
| Vitality benefits(5) | – | 79 | – | – | – | – | 79 |
| Mortality and Morbidity | – | – | – | (160) | – | – | (160) |
| Tax(6) | – | – | – | – | – | (20) | (20) |
| Cost of STC(7) | – | (119) | – | – | – | (114) | (233) |
| Modelling changes(8) | – | – | – | 20 | (1 527) | 1 634 | 127 |
| Other | – | – | – | (3) | 0 | 0 | (3) |
| Total | – | (65) | – | (230) | (1 535) | 1 290 | (540) |

*(1) The Health administration fee change relates to a reduction in Discovery Health Medical Scheme administration fees from 1 July 2006.*

*(2) The Life benefit enhancements relate primarily to enhancements on the Integrator product.*

*(3) The Health and Vitality renewal expense assumption change is based on the results of the most recent expense analysis and allows for the expense efficiencies achieved by management over the past six months.*

*(4) This assumption reflects the capitalised cost of cash-settled share-based payments made over the past year, and assumes a similar cost in each future year for the full projection term.*

*(5) The Health and Vitality assumption change includes an allowance for a reduction in the expected benefit cost on Vitality in line with recent experience.*

*(6) The tax variance reflects the movement in the value of the tax deferral related to the deferred tax liability under the FSV method.*

*(7) Following the change to Discovery's dividend policy, the cost of STC is now modelled assuming a 4,5 times dividend cover.*

*(8) The Life modelling change includes a R1 536 million decrease in the net worth and a R1 470 million increase in the value of in-force in respect of the change from the Financial Soundness Valuation basis to the Statutory Valuation Method used to calculate the embedded value. The R1 470 million increase in the value of in-force includes a reduction of R311 million in the Cost of Capital.*

*The value of in-force includes a further reduction of R200 million in the cost of capital due to changes in the future projection of the Statutory CAR.*

## Table 6: Experience variances

for the year ended 30 June 2006

| R million | Health and Vitality: Net worth | Health and Vitality: Value of in-force | Destiny Health: Net worth | Destiny Health: Value of in-force | Life: Net worth | Life: Value of in-force | Total |
|---|---|---|---|---|---|---|---|
| Renewal expenses | 37 | – | (49) | – | 6 | – | (6) |
| Other expenses(1) | – | – | (2) | – | (25) | – | (27) |
| Inflation(2) | (6) | (67) | – | – | 32 | 18 | (23) |
| Extended modelling term(3) | – | 212 | – | 23 | – | 6 | 241 |
| Lapses(4) | 21 | 177 | (0) | (118) | (40) | (16) | 24 |
| Policy alterations(5) | – | 6 | – | – | 24 | 29 | 59 |
| Mortality and morbidity | – | – | (122) | – | 60 | 21 | (41) |
| Deferred profits released | – | – | – | – | 31 | (31) | – |
| Commission(6) | – | – | – | – | (12) | – | (12) |
| Vitality premium and benefits | 25 | – | – | – | – | – | 25 |
| Other | 13 | 1 | 2 | 16 | (8) | (2) | 22 |
| Total | 90 | 329 | (171) | (79) | 68 | 25 | 262 |

*(1) For Life, the non-recurring expenses relate to costs incurred as a result of the venture with Prudential in the UK.*

*(2) The negative variance for Health and Vitality is due to a lower increase in the Health administration fees in 2006 compared with that assumed in June 2005.*

*The Life variance is primarily due to automatic premium increases being higher than expected.*

*(3) The projection term for Health, Vitality, Destiny Health and Group Life at 30 June 2006 has not been changed from that used at 30 June 2005. Thus, an experience variance arises because the total term of the in-force business is effectively increased by twelve months.*

*(4) Included in the Health and Vitality lapse experience variance is an amount of R392 million in respect of members joining existing employer groups during the period, offset by an amount of R244 million in respect of members leaving existing employer groups. A positive variance of R59 million is due to lower than expected lapses.*

*(5) The Life policy alterations relate to benefit alterations to risk benefits. The impact of existing policies adding the Discovery Retirement Optimiser is included in the value of new business.*

*(6) The commission variance includes a provision for bad debts on commission clawbacks and includes commissions paid in respect of business incepting after the valuation date.*

## Table 7: Embedded value of new business

for the year ended 30 June

| R million | 2006 SVM Basis | 2006 FSV basis | 2005 | % change |
|---|---|---|---|---|
| **Health and Vitality** | | | | |
| Gross profit from new business at point of sale | **115** | **115** | 229 | |
| Cost of capital | **–** | **–** | – | |
| Cost of STC | **(3)** | **(3)** | – | |
| Net profit from new business at point of sale | **112** | **112** | 229 | (51) |
| New business annualised premium income(1) | **1 121** | **1 121** | 1 734 | (35) |
| **Life** | | | | |
| Gross profit from new business at point of sale | **532** | **679** | 676 | |
| Cost of capital | **(7)** | **(129)** | (157) | |
| Cost of STC | **(15)** | **(21)** | – | |
| Net profit from new business at point of sale | **510** | **529** | 519 | (2) |
| New business annualised premium income(2) | **592** | **592** | 470 | 26 |
| Annualised profit margin(3) | **10,8%** | **11,3%** | 13,5% | |
| **Destiny Health** | | | | |
| Gross profit from new business at point of sale | **(50)** | **(50)** | 36 | |
| Cost of capital(4) | **(0)** | **(0)** | (1) | |
| Cost of STC | **0** | **0** | – | |
| Net profit from new business at point of sale(5) | **(50)** | **(50)** | 35 | |
| New business annualised premium income(1) | **457** | **457** | 603 | (24) |
| New business annualised premium income (US$ million) | **71** | **71** | 97 | (27) |

*(1) Health and Destiny Health new business annualised premium income is the gross contribution. For embedded value purposes, Health and Destiny Health new business is defined as individuals and members of new employer groups, and includes additions to first year business.*

*The new business annualised premium income shown above has been adjusted to exclude premiums in respect of members who join an existing employer after the first year, as well as premiums in respect of new business written during the period but only activated after 30 June 2006.*

*The total Health and Vitality new business annualised premium income written over the period was R2 612 million (June 2005: R2 869 million). The value of Health and Vitality new business has been calculated using a renewal expense assumption based on an average cost per policy rather than a marginal cost per policy. The average cost assumption, combined with an increase in sales of lower margin business, has resulted in a reduction in the new business margin. For Destiny Health, the total new business annualised premium income written over the period was R796 million (June 2005: R809 million).*

*(2) Life new business is defined as policies which incepted during the reporting period and which are on risk at the valuation date.*

*The new business annualised premium income of R592 million shown above is net of automatic premium increases and servicing increases in respect of existing business. The total Life new business annualised premium income written over the period, including both automatic premium increases of R103 million and servicing increases of R94 million was R789 million. Single premium business is included at 10% of the value of the single premium. R24 million of single premium business was written over the period.*

*Discovery Retirement Optimisers added to existing Life Plans have been included in the value of new business.*

*(3) The annualised profit margin is the value of new business expressed as a percentage of the present value of future premiums.*

*(4) As most of the new business is written on the Guardian and Tufts insurance licences, Destiny Health is not required to hold statutory capital for this business. An explicit charge for the use of their capital is payable to Guardian and Tufts, and this cost is deducted from gross profit in the new business calculation.*

*(5) The Destiny Health value of new business allows for the actual new business expenses incurred over the past year. Actual new business expenses include infrastructure development costs related to developing new business capacity. This value includes acquisition costs in respect of Tufts new business written over the past year which is expected to run-off over the next 18 months.*

## Table 8: Embedded value assumptions

at 30 June

| | | 2006 | 2005 |
|---|---|---|---|
| Risk discount rate (%) | | | |
| – Health and Vitality | | **12,00** | 11,00 |
| – Life | | **12,00** | 11,00 |
| – Destiny Health | | **10,00** | 10,00 |
| Medical inflation (%) | | | |
| South Africa | | **8,00** | 7,00 |
| United States | | **Current levels reducing to 13,00% over the projection period** | Current levels reducing to 12,50% over the projection period |
| Expense inflation (%) | | | |
| South Africa | | **5,00** | 4,00 |
| United States | | **3,00** | 3,00 |
| Pre-tax investment return (%) | | | |
| South Africa | – Cash | **7,50** | 6,50 |
| | – Bonds | **9,00** | 8,00 |
| | – Equity | **11,00** | 10,00 |
| United States | – Bonds | **3,00** | 3,00 |
| Dividend cover ratio | | **4,5 times** | – |
| Income tax rate (%) | | | |
| – South Africa | | **29,00** | 29,00 |
| – United States Federal Tax Rate(1) | | **34,00** | 34,00 |

*(1) Various additional State taxes also apply.*

Life mortality, morbidity and lapse assumptions were derived from internal experience, where available, augmented by reinsurance and industry information. Renewal expense assumptions were based on the results of the latest expense and budget information.

The Health lapse assumptions were based on the results of recent experience investigations. Renewal expense assumptions were based on the results of the latest expense investigation.

The Destiny Health morbidity and lapse assumptions were based on the results of recent experience investigations as well as management's expectations of the likely impact of future premium increases on experience. Renewal expense assumptions were based on the results of the latest expense investigation.

The investment return assumption was based on a single interest rate derived from the risk free zero coupon yield curve. Other economic assumptions were set relative to this yield. The risk discount rate has been set relative to the risk-free rate, increased by a risk premium. The current and projected tax position of the policyholder funds within the Life company has been taken into account in determining the net investment return assumption.

It was assumed that the capital adequacy requirements in future years will be backed by surplus assets consisting of 70% equities and 30% fixed interest securities for the purposes of calculating the cost of capital at risk. Allowance has been made for tax and investment expenses in the calculation of the cost of capital.

## Sensitivity to the embedded value assumptions

In order to illustrate the effect of using different assumptions, the sensitivity of the embedded value at 30 June 2006 to changes in the key assumptions is shown below. For each sensitivity illustrated, all other assumptions have been left unchanged. No allowance has been made for management action such as risk premium increases where future experience is worse than the base assumptions.

## Table 9: Embedded value sensitivities

| R million | Shareholders' funds excluding assets under insurance contracts | Health and Vitality: Value in-force | Health and Vitality: Cost of capital | Health and Vitality: Cost of STC | Destiny Health: Value in-force | Destiny Health: Cost of capital | Destiny Health: Cost of STC | Life: Value in-force | Life: Cost of capital | Life: Cost of STC | Embedded value | % change |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Base | 2 124 | 4 258 | – | (122) | 20 | (15) | (0) | 4 496 | (45) | (129) | **10 587** | |
| Impact of: | | | | | | | | | | | | |
| Risk discount rate +1% | 2 124 | 4 107 | – | (116) | 18 | (16) | (0) | 4 201 | (52) | (119) | **10 147** | (4) |
| Risk discount rate –1% | 2 124 | 4 419 | – | (129) | 23 | (13) | (1) | 4 841 | (35) | (142) | **11 087** | 5 |
| Lapses +10% | 2 124 | 4 175 | – | (120) | 17 | (14) | (0) | 4 258 | (40) | (122) | **10 278** | (3) |
| Investment return –1%(1) | 2 124 | 4 258 | – | (121) | 17 | (17) | (0) | 4 310 | (55) | (123) | **10 393** | (2) |
| Renewal expenses +10% | 2 124 | 3 755 | – | (108) | (50) | (15) | 1 | 4 452 | (45) | (128) | **9 986** | (6) |
| Mortality and Morbidity +10% | 2 124 | 4 258 | – | (122) | (234) | (15) | 6 | 3 934 | (45) | (113) | **9 793** | (7) |
| Health, Vitality and Destiny Health: Projection term +1 year | 2 124 | 4 469 | – | (128) | 31 | (16) | (1) | 4 496 | (45) | (129) | **10 801** | 2 |

*(1) For Life, both investment return and inflation assumptions were reduced by 1%.*

The following table shows the effect of using different assumptions on the value of new business.

## Table 10: Value of new business sensitivities

| R million | Health and Vitality: Value in-force | Health and Vitality: Cost of capital | Health and Vitality: Cost of STC | Destiny Health: Value in-force | Destiny Health: Cost of capital | Destiny Health: Cost of STC | Life: Value in-force | Life: Cost of capital | Life: Cost of STC | Value of new business | % change |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Base | 115 | – | (3) | (50) | (0) | 0 | 532 | (7) | (15) | **572** | |
| Impact of: | | | | | | | | | | | |
| Risk discount rate +1% | 104 | – | (3) | (51) | (0) | 1 | 452 | (8) | (14) | **481** | (16) |
| Risk discount rate –1% | 126 | – | (4) | (49) | (0) | 1 | 627 | (6) | (16) | **679** | 19 |
| Lapses + 10% | 108 | – | (3) | (51) | (0) | 1 | 469 | (6) | (14) | **504** | (12) |
| Investment Return –1%(1) | 115 | – | (3) | (50) | (0) | 1 | 480 | (9) | (14) | **520** | (9) |
| Renewal expenses +10% | 75 | – | (2) | (71) | (0) | 2 | 520 | (7) | (15) | **502** | (12) |
| Mortality and Morbidity +10% | 115 | – | (3) | (105) | (0) | 3 | 399 | (7) | (13) | **389** | (32) |
| Health, Vitality and Destiny Health: Projection Term +1 year | 128 | – | (4) | (48) | (0) | 1 | 532 | (7) | (15) | **587** | 3 |
| Acquisition expenses +10% | 95 | – | (3) | (59) | (0) | 0 | 497 | (7) | (15) | **508** | (11) |

*(1) For Life, both investment return and inflation assumptions were reduced by 1%.*

# REVIEW OF GROUP RESULTS

Gross inflows under management, increased 18% for the year ended 30 June 2006. Gross inflows under management includes flows of the schemes Discovery administers and 100% of the business conducted together with its joint venture partners.

## Gross inflows under management

| R million | June 2006 | June 2005 | % change |
|---|---|---|---|
| Discovery Health | **16 542** | 14 571 | 14 |
| Discovery Life | **1 768** | 1 278 | 38 |
| Discovery Vitality | **654** | 521 | 26 |
| Destiny Health | **1 322** | 914 | 45 |
| PruHealth | **141** | 11 | |
| Gross inflows under management | **20 427** | 17 295 | 18 |
| *Less:* collected on behalf of third parties | **(14 988)** | (13 266) | |
| Discovery Health | **(14 507)** | (12 883) | |
| Destiny Health | **(411)** | (377) | |
| PruHealth | **(70)** | (6) | |
| Gross income of Group | **5 439** | 4 029 | 35 |

## Earnings

The following table shows the main components of the increase in Group profit from operations excluding investment income for the year:

## Earnings source

| R million | June 2006 | June 2005 | % change |
|---|---|---|---|
| Discovery Health | **655** | 548 | 20 |
| Discovery Life | **546** | 417 | 31 |
| Discovery Vitality | **41** | 37 | 11 |
| Destiny Health | **(151)** | (90) | (68) |
| PruHealth | **(146)** | (148) | 1 |
| Group operating profit before investment income | **945** | 764 | 24 |
| Investment income | **161** | 106 | |
| Realised and unrealised gains and losses | **278** | 175 | |
| Fair value adjustment to liabilities under investment contracts | **(121)** | (122) | |
| Profit from operations before BEE expense | **1 263** | 923 | 37 |

## Headline earnings

Headline earnings in compliance with International Financial Reporting Standards (IFRS) increased by 36% excluding the impact of the BEE transaction.

Unrealised gains of R288 million on available-for-sale investments for the year have been taken directly to equity and are not included in earnings or headline earnings.

The reconciliation between earnings and headline earnings is shown below:

| R million | June 2006 | June 2005 | % change |
|---|---|---|---|
| Net profit attributable to equity shareholders | **669** | 557 | 20 |
| Adjusted for: | | | |
| – realised profit on available-for-sale investments net of CGT | **(139)** | (48) | |
| – impairment of property and equipment | **1** | – | |
| Headline earnings | **531** | 509 | 4 |
| BEE expenses | **161** | – | |
| Headline earnings before BEE transaction | **692** | 509 | 36 |
| Headline earnings per share before BEE transaction (cents)* | | | |
| – undiluted | **130,8** | 98,0 | 33 |
| – diluted | **126,4** | 94,2 | 34 |
| Headline earnings per share (cents) | | | |
| – undiluted | **100,4** | 98,0 | 2 |
| – diluted | **97,0** | 94,2 | 3 |

**For this purpose, the impact of the BEE deal has been excluded from both earnings and the number of shares in issue.*

## Taxation

All South African entities are in a tax paying position. Destiny operations have significant tax losses but no deferred tax asset has been accounted for on the foreign losses incurred in the US.

An asset has been accounted for on 50% of the PruHealth losses for which Group tax relief is available to Prudential plc in the UK. No deferred tax asset has been accounted for on the balance of the PruHealth losses.

## Investments

Equity investments have increased due to additional investments and the continued strong performance of the equity markets. This has resulted in an increase in investment income.

## Balance sheet

The increase in the assets arising from insurance contracts of R582 million is as a result of profitable new business written by Discovery Life.

The deferred tax liability is primarily attributable to the application of the Financial Services Board directive 145. This directive allows for the zeroing on a statutory basis of the assets arising from insurance contracts. The statutory basis is used when calculating tax payable for Discovery Life, resulting in a timing difference between the tax base and the accounting base.

During the year, Destiny redeemed US$9 million of Series A preference shares leading to a reduction in outside shareholders of R67 million.

## BEE transaction

In December 2005, Discovery issued 38,7 million shares in terms of its BEE transaction. The special purpose vehicles and trusts to which these shares have been issued, have been consolidated into the accounts of Discovery, eliminating the share issue.

These shares have been included in the calculation of diluted HEPS and diluted EPS.

The International Financial Reporting Interpretations Committee (IFRIC) released IFRIC 8 "Scope of IFRS 2" confirming that BEE transactions should be accounted for under IFRS 2.

Discovery has early adopted IFRIC 8, resulting in a charge to the income statement of R161 million in the year ended 30 June 2006. This charge represents the financial effects of the BEE transaction.

An additional R24 million in respect of equity settled share based payments and R6 million in respect of cash settled share based payments, granted under employee share incentive schemes, has been expensed in the income statement in accordance with the requirements of IFRS 2.

## Accounting policies

The annual financial statements have been prepared in accordance with IFRS as well as the South African Companies Act 61 of 1973, as amended.

These are Discovery's first IFRS annual financial statements and the provisions of IFRS 1 *First-time adoption of International Financial Reporting Standards*, have been applied.

Shareholders are referred to the IFRS announcement published 24 February 2006, regarding details of the financial restatement impact as a consequence of the IFRS adoption. All comparatives have been restated as published in that announcement.

## Directorate

Dr T V Maphai and Mrs S Sebotsa were appointed as non-executive directors to the board of Discovery, with effect from 8 December 2005.

## Dividend policy and capital

The directors are of the view that the Discovery Group is adequately capitalised at this time. On the statutory basis the capital adequacy requirements of Discovery Life were R94 million (2005: R77 million) and were covered 14.0 times (2005: 12.9 times).

**Dividend declaration**

The board has declared a maiden dividend of 27 cents per share. The salient dates are as follows:

| | |
|---|---|
| – Last date to trade "cum" dividend | Friday, 13 October 2006 |
| – Date trading commences "ex" dividend | Monday, 16 October 2006 |
| – Record date | Friday, 20 October 2006 |
| – Date of payment | Monday, 23 October 2006 |

Share certificates may not be dematerialised or rematerialised between Monday, 16 October 2006 and Friday, 20 October 2006, both days inclusive.

## Audit

The auditors, PricewaterhouseCoopers Inc., have issued their opinion on the Group financial statements for the year ended 30 June 2006. A copy of the auditors' unqualified report is available for inspection at the company's registered office.