Discovery

Audited Group results and cash dividend declaration for the year ended **30 June 2009**

Results & commentary

Financial highlights

- Operating profit +32% to R1.7 billion
- New business API excluding Destiny +20% to R5 775 million
- Diluted embedded value per share +12% to R35.83
- Total dividend for the year +31% to 58.5 cents

Introduction

The performance of Discovery Holdings Ltd ("Discovery") over the year has exceeded expectation, despite the difficult economic conditions and the environment's complexity. The period has been characterised by sound performances across all businesses, record levels of new business production, and strong earnings growth. Discovery's methodology of organic growth through innovation to meet our clients' needs has proved successful in negating the impact of adverse market conditions, with the following features contributing to the Group's strong performance and success:

1. Client-centric innovation through Discovery's integration strategy: Discovery's success is based on meeting the needs of its clients. To this end, the product strategy is based on innovation that provides efficiency, value for money and sustainability. Discovery offers consumers an integrated product suite that spans their financial and protection needs, providing them with a range of unique benefits and cost efficient, comprehensive product solutions that are particularly appropriate in the current recessionary environment.

   The launch of Vitality's HealthyFood™ Benefit in 2009 is one such innovation, saving consumers up to 25% on a range of products at Pick n Pay while promoting healthy nutrition. Other innovations rolled out during the period included Discovery Health's Delta Plans, which have generated a saving of 20% on contributions for consumers, and the introduction of lower income bands within the KeyCare Plans, resulting in a contribution saving of 30% for families at the lowest income levels. Discovery Life's Cover Integrator has made life assurance more cost-efficient, enabling policyholders to purchase additional life cover at a saving of up to 50% on the additional cover.

   The combination of these factors culminated in the announcement in August 2009 that Discovery Health and Discovery Life were voted the best medical aid and long-term insurance brands respectively in the business to business category of the 2009 Sunday Times Top Brands survey.

2. Quality and financial strength: It is well documented that during difficult economic times, consumers migrate to companies that display the attributes of quality and financial strength. Discovery's reputation for financial stability, quality and innovation has proven to be a great asset in attracting new business

and retaining existing clients. Importantly, Discovery's ethos and methodologies are based on financial prudence as well as product innovation and excellence. Discovery has no gearing and all its risk-taking entities enjoyed record-levels of capital strength in the period. This enabled Discovery to accelerate its investment into research and development, and other growth strategies.

3. Distribution excellence: Discovery's distribution capability is uniquely powerful, comprising a substantial and efficient broker distribution network and recently-formed tied agency force of exceptional quality. This combination has also contributed strongly to Discovery's resilience during the recessionary cycle.

Discovery Health

Discovery Health's performance exceeded expectation. The company operates in a complex environment marked by continuous regulatory and policy shifts. Further, it operates in areas of great necessity, impact and consequence. To ensure its relevance and sustainability, Discovery Health's fundamental strategy is to create for its members an excellent healthcare system that is affordable, comprehensive and sustainable. The central measure of Discovery Health's success, therefore, is its performance on behalf of the members of the Discovery Health Medical Scheme and other schemes under its management.

In terms of this performance, the Scheme's contribution inflation is comfortably in line with member expectation while the value of benefits paid per member has grown in excess of inflation. Over the 12 months to June 2009, Scheme reserves are estimated to have grown by R700 million and are on track to reach the R6 billion mark by the end of the calendar year, while membership increased by 45 000 lives. In addition, the scale of Discovery Health's network arrangements has expanded, enabling more members to access care without co-payments. Discovery Health's GP Network now covers nearly 80% of members and payment arrangements with specialists grew to 85%. The Delta Plan technology and KeyCare Networks have enabled Discovery Health to offer affordable plans across the widest range of income groups.

The strength and consistency of this performance has enabled the company to grow its profitability, scale and infrastructure significantly, placing it in a particularly strong position going forward. Discovery Health estimates that the combination of its risk-management capability, provider networks, payment arrangements and managed care interventions has created a healthcare network that is 10% less expensive to scheme members than its competitors, within a robust, high-touch service environment.

Due to its size and impact, Discovery Health is committed to building and improving the healthcare system – not for its members alone, but for all South Africans. Our aim is to work with Government in its pursuit of healthcare reform and the implementation of a National Health Insurance System (NHI) to the benefit of all South Africans. Discovery Health is convinced that the NHI will require the constructive and creative co-operation of all stakeholders to make it workable and sustainable. To this end, Discovery will continue to make available its expertise and resources, and will engage positively and constructively.

Discovery Life

Discovery Life's performance over the period was particularly pleasing. The company's strategy is to pursue product and distribution excellence, based on a foundation of financial strength, and to use the Group's assets to innovate and integrate its products in order to meet the needs of its clients. During the period, the rigorous application of these strategies yielded excellent results, with new business increasing by 31% and profits growing by 20%.

The product strategy was particularly successful during the period, with new products gaining significant traction. Policyholders purchased life cover to the value of approximately R30 billion through the new Cover Integrator. The Lifetime Benefit technology, also launched during the period and applied to severe illness and disability benefits, served to increase the take-up of the Severe Illness Benefit by 10%, Capital Disability Benefit by 5% and Income Continuation Benefit by 10%.

In addition, the level of broker support increased, with the number of brokers selling Discovery Life products increasing by more than 650 brokers to 5 722 brokers. Discovery's tied agency force grew from 149 to 206 agents nationwide, achieving exceptional levels of productivity.

During recessionary cycles, lapses of life policies tend to increase, and Discovery Life's lapse rate did escalate during this period. However, the lapse rate remained below the assumptions used in the company's reserving basis, leading to a fairly minimal impact on Discovery Life's profitability.

Applying a more conservative view of future lapses did affect the embedded value. However, the other aspects of performance were exceptional and sufficient to offset the effect of lapses, enabling the company to generate positive experience variances despite the environment. In addition, record levels of quality new business were transacted, with margins being maintained, enabling the company to increase its embedded value by 8% to R8 686 million.

Having restructured its negative reserve during the period, Discovery Life continues to enjoy considerable capital robustness and flexibility. This positions it strongly for continued future growth with limited recourse to shareholder funding.

Discovery Invest

Discovery Invest's performance was pleasing, especially in the context of the economic environment. Launched towards the end of 2007, the company began actively trading during 2008, precisely at the start of the economic crisis and the resulting turmoil in the financial markets. Discovery has used this time to build significant capability and capacity within Discovery Invest, manifesting in a business that is well positioned for its market, and assets under management of R4.2 billion by year-end.

Using Discovery's integration capabilities to offer differentiated and superior products has proven a successful strategy. For example, Discovery Invest recently launched the Upfront Investment Integrator, a product structure that utilises the efficiency of integration to boost investors' fund allocations by up to 26%, thereby mitigating the effects of falling markets.

Despite the depressed investment market, Discovery Invest's new business production was pleasing and in line with expectation. Importantly, Discovery Invest's distribution channels were increased and enhanced to facilitate Discovery Invest's offerings.

Initiatives like the Discovery Invest Leadership Summit were rolled out to build the company's presence, brand, and to showcase its capabilities. Operating losses were narrowed during the period as assets under management continue to grow.

Discovery Vitality

Vitality's performance during the period exceeded expectation. The company's role is foundational within the broader group and Vitality's role of facilitating integration, driving better selection and enhancing mortality and morbidity experience was particularly important during the period under review.

In the early phases of Vitality's roll-out, the company focused on creating rewards and structures to drive behavioural change. During the period under review, the focus shifted to understanding the science behind Vitality and measuring the clinical and actuarial effects of Vitality on mortality, morbidity, and persistency. Academic studies were conducted with researchers from the Universities of Cape Town and the Witwatersrand and the Harvard Medical School, manifesting in key papers that have been accepted for publication in a range of international journals.

It is this understanding that provides the foundation for the further integration of Discovery's products, and their ability to offer unique value to our clients. Particularly important was the launch of the HealthyFood Benefit™ with Pick n Pay. This has been one of the boldest steps in the evolution of Vitality and provides an exceptional foundation for future product innovation. Some of the key Discovery innovations for 2010 will incorporate elements of the HealthyFood™ Benefit. The market's reception of the benefit has been exceptional and, by the end of the four-month start-up period, over 715 000 trolleys of HealthyFood™ had been purchased.

PruHealth

The deep recession in the UK has had an impact on the performance of PruHealth, Discovery's health insurance joint venture with the Prudential plc ("Prudential"). Despite this, solid progress was made on a number of fronts and the business remains well-positioned in the UK private medical insurance market.

Leveraging off Discovery's consumer-directed health assurance and operational infrastructure and Prudential's established brand strength in the UK financial services market, PruHealth's performance since its launch has been characterised by clear product leadership and consistent new business growth. The number of lives insured grew to 212 000, an increase of 20% for the period. PruHealth's market share accounts for 2.5% of the market in terms of in-force lives, and it currently ranks 5th in the UK's private medical insurance market overall. Premiums written in the period for the in-force business increased by 37% to £86 million.

Loss ratios have deteriorated to some extent during the past six months, largely due to the recessionary environment in the UK. Discovery's share of the losses reduced by 34% to R103 million. The deterioration in loss ratios will delay the reaching of the breakeven target. However, evidence from previous recessionary periods indicates that short-term increases in the loss ratio are an industry phenomenon and are likely to return to normal as the economy stabilises.

PruHealth has a comprehensive set of initiatives underway to manage the profitability of the business and to position it well to continue to take advantage of opportunities in the market. The UK is showing early signs of economic recovery, and as government budgets tighten, the National Health Service will face increasing funding pressure. This leaves private health insurers to play a bigger role going forward.

PruHealth will continue to develop its competitive position through amendments to the product offering, improving the clinical and financial robustness of the Vitality programme, the introduction of lower cost hospital network plans, and enhanced managed care initiatives.

Vitality is a key competitive differentiator for PruHealth and the level of engagement of Pruhealth members continues to be encouraging. Vitality impacts positively on health costs, and has a significant impact on retention levels.

The focus for PruHealth continues to be on increasing sales, growing the in-force book and managing its loss ratio, leading to sustainable profitability over the longer term.

PruProtect

PruProtect's performance was pleasing. During the period, the company focused extensively on enhancing the product range and ensuring its appropriateness for the UK market, as well as building a substantial distribution capability. This resulted in a significant increase in the levels and quality of new business, with average premiums and ancillary benefits purchased exceeding expectation.

While the UK life assurance market is of considerable scale, transacting business is highly capital intensive, and traditional products are commoditised with low margins. PruProtect's strategy of focusing on product innovation and high-advice, face-to-face distribution capabilities are crucial to penetrating the market and building a profitable business.

During the period, considerable development took place within the company's funding and capital structures to ensure the business is not overly capital intensive and with scale, becomes highly profitable with significant returns on capital. This approach uses the actuarial structures built within Discovery Life, where the negative reserves generated by new business are funded by the positive reserves within the Prudential's Life Fund. This enables the capital intensive nature of the business to be mitigated substantially, and ensures that with increasing scale, the returns on capital will be superior.

Discovery remains optimistic about the potential of PruProtect, particularly because of the combination of product receptivity, distribution capability and capital efficiency.

Destiny Health and Vitality

The wind-down of Destiny Health, Discovery's US health insurance subsidiary, has progressed according to plan. Membership has reduced from 60 000 lives to approximately 600 lives, with the cost base being dynamically realigned to support the diminishing scale of the business. In addition to the wind-down, we are in the process of building out the core Vitality capability in the United States. This will serve as the research and development and clinical and scientific hub for Vitality globally. The positioning of Vitality in the US will enable Discovery to access the latest clinical and behavioural research needed to support and enhance the Vitality programme, as well as to pursue niche opportunities in the US as they arise.

MI Hilkowitz	A Gore
Chairperson	*Chief Executive Officer*

Income statement

for the year ended 30 June 2009

R million	Group 2009	Group 2008	% change
Insurance premium revenue	**5 186**	4 293	21
Reinsurance premiums	**(870)**	(780)	
Net insurance premiums	**4 316**	3 513	
Fee income from administration business	**2 885**	2 532	14
Receipt arising from reinsurance contracts	**750**	–	
Investment income	**236**	210	
Net realised gains on available-for-sale financial assets	**65**	252	
Net fair value (losses)/gains on financial assets at fair value through profit or loss	**(9)**	25	
Vitality income	**944**	791	19
Net income	**9 187**	7 323	
Claims and policyholders' benefits	**(2 583)**	(2 156)	
Insurance claims recovered from reinsurers	**707**	601	
Net claims and policyholders' benefits	**(1 876)**	(1 555)	
Acquisition costs	**(1 313)**	(1 132)	
Marketing and administration expenses	**(4 329)**	(3 784)	
Recovery of expenses from reinsurers	**223**	148	
Transfer from assets/liabilities under insurance contracts	**106**	749	
– change in assets arising from insurance contracts	**1 292**	791	
– change in liabilities arising from insurance contracts – Premium deficiency reserve	**(21)**	–	
– change in liabilities arising from insurance contracts – Other	**(306)**	(55)	
– change in liabilities arising from reinsurance contracts	**(859)**	13	
Fair value adjustment to liabilities under investment contracts	**(35)**	(14)	
Profit before impairment and BEE expenses	**1 963**	1 735	13
Impairment of financial instruments held as available-for-sale	**(96)**	–	
BEE expenses	**(13)**	(23)	
Profit from operations	**1 854**	1 712	
Finance costs	**(16)**	(52)	
Foreign exchange (loss)/profit	**(23)**	4	
Share of loss from associate	**(1)**	–	
Profit before taxation	**1 814**	1 664	9
Taxation	**(590)**	(506)	
Profit for the year	**1 224**	1 158	6
Attributable to:			
Equity holders	**1 212**	1 156	
Minority interests	**12**	2	
	1 224	1 158	
Earnings per share for profit attributable to the equity holders during the year (cents):			
– basic	**219.9**	212.9	3
– diluted	**219.3**	211.1	4

Balance sheet

at 30 June 2009

R million	Group 2009	Group 2008
ASSETS		
Property and equipment	**199**	291
Investment property	**20**	–
Intangible assets including deferred acquisition costs	**520**	243
Assets arising from insurance contracts	**5 449**	4 165
Investment in associate	**–**	1
Financial assets		
– Equity securities	**2 469**	2 055
– Equity linked notes	**693**	459
– Debt securities	**488**	173
– Inflation linked securities	**20**	65
– Money market	**958**	1 034
– Derivatives	**68**	35
– Loans and receivables including insurance receivables	**1 846**	1 478
Deferred income tax	**239**	128
Current income tax asset	**83**	–
Reinsurance contracts	**142**	99
Cash and cash equivalents	**1 737**	812
Total assets	**14 931**	11 038
EQUITY		
Capital and reserves		
Share capital and share premium	**1 548**	1 468
Other reserves	**540**	721
Retained earnings	**4 925**	3 975
Total equity	**7 013**	6 164
LIABILITIES		
Liabilities arising from insurance contracts	**1 778**	1 061
Liabilities arising from reinsurance contracts	**1 104**	260
Financial liabilities		
– Investment contracts at fair value through profit or loss	**2 161**	1 230
– Borrowings at amortised cost	**32**	37
– Derivatives	**12**	6
Deferred income tax	**1 402**	1 031
Deferred revenue	**86**	70
Provisions	**65**	54
Trade and other payables	**1 278**	1 116
Current income tax liabilities	**–**	9
Total liabilities	**7 918**	4 874
Total equity and liabilities	**14 931**	11 038

Headline earnings

for the year ended 30 June 2009

R million	Group 2009	Group 2008	% change
Headline earnings per share (cents):			
– undiluted	**224.7**	172.0	31
– diluted	**224.1**	170.5	31
The reconciliation between earnings and headline earnings is shown below:			
Net profit attributable to equity shareholders	**1 212**	1 156	
Adjusted for:			
– realised profit on available-for-sale investments net of CGT	**(56)**	(222)	
– impairment on available-for-sale investments net of CGT	**82**	–	
Headline earnings	**1 238**	934	33
Weighted number of shares in issue (000's)	**551 043**	543 016	1
Diluted weighted number of shares (000's)	**552 591**	547 530	1

Cash flow statement

for the year ended 30 June 2009

R million	Group 2009	Group 2008
Cash flow from operating activities	**1 211**	385
Cash generated by operations	**2 649**	1 103
Policyholder net investments	**(1 270)**	(638)
Dividends received	**67**	33
Interest received	**216**	194
Interest paid	**(16)**	(25)
Taxation paid	**(435)**	(282)
Cash flow from investing activities	**(50)**	(269)
Net disposals/(purchases) of investments	**105**	(76)
Purchase of equipment	**(21)**	(132)
Purchase of intangible assets	**(134)**	(66)
Decrease in loans receivable	**–**	5
Cash flow from financing activities	**(177)**	(334)
Proceeds from issuance of ordinary shares	**111**	50
Dividends paid to equity holders	**(278)**	(236)
Minority share buy-back	**(5)**	(8)
Loan to share trust participants	**–**	(109)
Repayment of borrowings	**(5)**	(31)
Net increase/(decrease) in cash and cash equivalents	**984**	(218)
Cash and cash equivalents at beginning of year	**812**	996
Exchange (losses)/gains on cash and cash equivalents	**(59)**	34
Cash and cash equivalents at end of year	**1 737**	812

Statement of changes in equity

for the year ended 30 June 2009

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 2008								
Balance at 1 July 2007	1 393	257	542	115	(2)	3 057	–	5 362
Staff scheme shares released	75	–	–	–	–	–	–	75
Minority share buy-back	–	–	–	–	–	–	(2)	(2)
Share-based payments	–	32	–	–	–	–	–	32
Unrealised losses on investments	–	–	(25)	–	–	–	–	(25)
Capital gains tax on unrealised gains on investments	–	–	4	–	–	–	–	4
Realised gains on investments transferred to income statement	–	–	(252)	–	–	–	–	(252)
Capital gains tax on realised gains on investments	–	–	30	–	–	–	–	30
Currency translation differences	–	–	–	36	–	–	–	36
Transfer to hedging reserve	–	–	–	–	(16)	–	–	(16)
Net profit for the period	–	–	–	–	–	1 156	2	1 158
Dividends paid to equity holders	–	–	–	–	–	(236)	–	(236)
Realised loss on minority share buy-back	–	–	–	–	–	(2)	–	(2)
Balance at 30 June 2008	1 468	289	299	151	(18)	3 975	–	6 164
30 June 2009								
Balance at 1 July 2008	**1 468**	**289**	**299**	**151**	**(18)**	**3 975**	**–**	**6 164**
Staff scheme shares released	**103**	**–**	**–**	**–**	**–**	**–**	**–**	**103**
Minority share buy-back	**–**	**–**	**–**	**–**	**–**	**–**	**(12)**	**(12)**
Increase in treasury shares	**(23)**	**–**	**–**	**–**	**–**	**–**	**–**	**(23)**
Share-based payments	**–**	**18**	**–**	**–**	**–**	**–**	**–**	**18**
Unrealised losses on investments	**–**	**–**	**(253)**	**–**	**–**	**–**	**–**	**(253)**
Capital gains tax on unrealised gains on investments	**–**	**–**	**39**	**–**	**–**	**–**	**–**	**39**
Realised gains on investments transferred to income statement	**–**	**–**	**(65)**	**–**	**–**	**–**	**–**	**(65)**
Capital gains tax on realised gains on investments	**–**	**–**	**9**	**–**	**–**	**–**	**–**	**9**
Impairment of investments transferred to income statement	**–**	**–**	**96**	**–**	**–**	**–**	**–**	**96**
Capital gains tax on impairment of investments	**–**	**–**	**(13)**	**–**	**–**	**–**	**–**	**(13)**
Currency translation differences	**–**	**–**	**–**	**(55)**	**–**	**–**	**–**	**(55)**
Transfer from hedging reserve	**–**	**–**	**–**	**–**	**43**	**–**	**–**	**43**
Net profit for the period	**–**	**–**	**–**	**–**	**–**	**1 212**	**12**	**1 224**
Dividends paid to equity holders	**–**	**–**	**–**	**–**	**–**	**(269)**	**–**	**(269)**
Realised profit on minority share buy-back	**–**	**–**	**–**	**–**	**–**	**7**	**–**	**7**
Balance at 30 June 2009	**1 548**	**307**	**112**	**96**	**25**	**4 925**	**–**	**7 013**

Segmental information

for the year ended 30 June 2009

R million	Health			Life				
	South Africa	United States of America	United Kingdom	South Africa	United Kingdom	Vitality	Holdings	Total
30 June 2009								
Income statement								
Insurance premium revenue	25	234	679	4 218	30	–	–	5 186
Reinsurance premiums	(2)	(11)	(115)	(730)	(12)	–	–	(870)
Net insurance premiums	23	223	564	3 488	18	–	–	4 316
Fee income from administration business	2 751	–	4	101	–	29	–	2 885
Receipt arising from reinsurance contract	–	–	–	750	–	–	–	750
Investment income – shareholders	31	1	6	148	3	14	21	224
Investment income – policyholders	–	–	–	12	–	–	–	12
Net realised gains on financial instruments held as available-for-sale	–	–	–	65	–	–	–	65
Net fair value gains on financial instruments at fair value through profit or loss	–	–	–	(9)	–	–	–	(9)
Vitality income	–	37	–	–	–	907	–	944
Net income	2 805	261	574	4 555	21	950	21	9 187
Claims and policyholders' benefits	(10)	(376)	(515)	(1 679)	(3)	–	–	(2 583)
Insurance claims recovered from reinsurers	1	37	29	638	2	–	–	707
Net insurance benefits and claims	(9)	(339)	(486)	(1 041)	(1)	–	–	(1 876)
Acquisition costs	–	(11)	(52)	(1 096)	(96)	(58)	–	(1 313)
Marketing and administration expenses	(1 737)	(186)	(371)	(1 050)	(144)	(838)	(3)	(4 329)
Recovery of expenses from reinsurer	–	–	188	–	35	–	–	223
Transfer from assets/liabilities under insurance contracts								
– change in assets arising from insurance contracts	–	–	–	1 209	83	–	–	1 292
– change in liabilities arising from insurance contracts – Premium deficiency reserve	–	(21)	–	–	–	–	–	(21)
– change in liabilities arising from insurance contracts	–	103	50	(479)	20	–	–	(306)
– change in liabilities arising from reinsurance contracts	–	–	–	(788)	(71)	–	–	(859)
Fair value adjustment to liabilities under investment contracts	–	–	–	(35)	–	–	–	(35)
Profit/(loss) before BEE expenses	1 059	(193)	(97)	1 275	(153)	54	18	1 963
Impairment on financial instruments held as available-for-sale								(96)
BEE expenses								(13)
Profit from operations								1 854
Finance costs								(16)
Foreign exchange loss								(23)
Share of loss from associate								(1)
Profit before taxation								1 814
Taxation								(590)
Profit for the year								1 224

Segmental information

for the year ended 30 June 2009

R million	Health South Africa	Health United States of America	Health United Kingdom	Life South Africa	Life United Kingdom	Vitality	Holdings	Total
30 June 2008								
Income statement								
Insurance premium revenue	23	667	520	3 076	7	–	–	4 293
Reinsurance premiums	(2)	(70)	(109)	(599)	–	–	–	(780)
Net insurance premiums	21	597	411	2 477	7	–	–	3 513
Fee income from administration business	2 458	–	–	43	–	31	–	2 532
Investment income	39	7	22	109	–	20	13	210
Net realised gains on financial instruments held as available-for-sale	–	–	–	252	–	–	–	252
Net fair value gains on financial instruments at fair value through profit or loss	–	–	–	25	–	–	–	25
Vitality income	–	9	–	–	–	782	–	791
Net income	2 518	613	433	2 906	7	833	13	7 323
Claims and policyholders' benefits	(12)	(629)	(290)	(1 222)	(3)	–	–	(2 156)
Insurance claims recovered from reinsurers	2	56	60	481	2	–	–	601
Net insurance benefits and claims	(10)	(573)	(230)	(741)	(1)	–	–	(1 555)
Acquisition costs	–	(34)	(54)	(956)	(36)	(52)	–	(1 132)
Marketing and administration expenses	(1 582)	(236)	(359)	(775)	(102)	(712)	(18)	(3 784)
Recovery of expenses from reinsurer	–	–	136	–	12	–	–	148
Transfer from assets/liabilities under insurance contracts								
– change in assets arising from insurance contracts	–	–	–	791	–	–	–	791
– change in liabilities arising from insurance contracts	4	45	(59)	(31)	(14)	–	–	(55)
– change in liabilities arising from reinsurance contracts	–	–	–	13	–	–	–	13
Fair value adjustment to liabilities under investment contracts	–	–	–	(14)	–	–	–	(14)
Profit/(loss) before BEE expenses	930	(185)	(133)	1 193	(134)	69	(5)	1 735
BEE expenses								(23)
Profit from operations								1 712
Finance costs								(52)
Foreign exchange profit – unrealised								4
Profit before taxation								1 664
Taxation								(506)
Profit for the year								1 158

Embedded value statement

for the year ended 30 June 2009

The embedded value of Discovery at 30 June 2009 consists of the following components:

- the free surplus attributed to the covered business at the valuation date;
- plus: the required capital to support the in-force covered business at the valuation date;
- plus: the present value of future shareholder cash flows from the in-force business;
- less: the cost of required capital and secondary tax on companies (STC).

The present value of future shareholder cash flows from the in-force covered business is calculated as the value of projected future after-tax shareholder cash flows of the business in force at the valuation date, discounted at the risk discount rate.

The value of new business is the present value, at the point of sale, of the projected future after-tax shareholder cash flows of the new business written by Discovery, discounted at the risk discount rate, less an allowance for the reserving strain (for Life), initial expenses, cost of capital and STC. The value of new business is calculated using the current reporting date assumptions.

For Life, the shareholder cash flows are based on the release of margins under the Statutory Valuation Method (SVM) basis.

The embedded value includes the insurance and administration profits of all the subsidiaries in the Discovery Holdings Group. In particular, it covers business written through Discovery Life, Discovery Invest, Discovery Health, Discovery Vitality and PruHealth. For Destiny Health and PruProtect, no published value has been placed on the current in-force business.

The auditors, PricewaterhouseCoopers Inc., have reviewed the consolidated value of in-force business and value of new business of Discovery Holdings Limited and its subsidiaries as included in the embedded value statement for the year ended 30 June 2009. A copy of the auditors' unqualified report is available for inspection at the company's registered office.

Impact of Changes to Professional Guidance

The Actuarial Society of South Africa's updated Professional Guidance Note PGN 107: Embedded Value Reporting (Version 4) applies for all reporting periods ending on or after 31 December 2008. The embedded value of Discovery was calculated in accordance with the updated guidance for the first time in December 2008. The 30 June 2008 results shown below for Life, Invest, Health and Vitality have been restated. The PruHealth embedded value continues to be calculated using European Embedded Value Principles and Guidance as specified by the CFO Forum, accordingly no restatement of the PruHealth results are required.

The updated professional guidance has resulted in a number of changes to the calculation methodology since June 2008 for Life, Invest, Health and Vitality:

- The risk discount rate has been determined using a top-down weighted average cost of capital approach, with the required equity return calculated using Capital Asset Pricing Model (CAPM) theory. The risk discount rate has been set equal to the risk-free rate increased by a risk premium determined as a market equity risk premium multiplied by the company's beta coefficient. To avoid short-term volatility, the Discovery beta coefficient is determined using a 3-year moving average. Specifically for PruHealth, the risk discount rate includes an additional margin to allow for additional risk and uncertainty for this more recently established subsidiary in the current economic environment.

  This change in methodology has resulted in a reduction in the risk margin from 3% previously to 1.575% at 30 June 2009. The risk discount rate, calculated using the CAPM approach with specific reference to the Discovery beta coefficient, reflects the historic performance of the Discovery share price relative to the market and contains a lower allowance for non-market related and non-financial risk. Previously, these risks were allowed for through a higher margin in the risk discount rate. Investors may want to consider the impact of the change in methodology and form their own view on an appropriate allowance for the non-financial risks which have not been modelled explicitly. The sensitivities of the value of in-force covered business and the value of new business to changes in the risk discount rate are shown in Tables 10 and 11 below.

- The cost of capital has been calculated using the greater of the level of statutory capital and the level of economic capital required to cover the risks inherent in the in-force business. For Life, the required capital was set equal to two times the statutory Capital Adequacy Requirement (CAR). For Health and Vitality, the required capital was set equal to two times the monthly renewal expense and Vitality benefit cost. For PruHealth, the required capital was set equal to the statutory requirement and was calculated as 18% of the annualised premium income.

  It is assumed that, for the purposes of calculating the cost of required capital, the Life required capital amount will be backed by surplus assets consisting of 100% equities and the Health, Vitality and PruHealth required capital amounts will be fully backed by cash. Allowance has been made for tax and investment expenses in the calculation of the cost of capital. In calculating the CGT liability, it is assumed that the portfolio is realised every 5 years. The Life cost of capital is calculated using the difference between the gross of tax equity return and the equity return net of tax and expenses. The Health and PruHealth cost of capital is calculated using the difference between the risk discount rate and the net of tax cash return.

The impact of these changes is shown in Table 1 below:

Table 1: Impact of PGN 107 changes on embedded value and value of new business

R million	30 June 2008
Embedded value	16 482
Impact of:	
Change to risk discount rate margin	1 527
Change to cost of required capital	(128)
Restated embedded value	17 881
Published value of new business	805
Impact of:	
Change to risk discount rate margin	284
Change to cost of required capital	(16)
Restated value of new business	1 073

Table 2: Group embedded value

R million	30 June 2009	30 June 2008 Restated	% change
Shareholders' funds	**7 013**	6 164	14
Adjustment to shareholders' funds from published basis(1)	**(4 012)**	(3 861)	
Adjusted net worth	**3 001**	2 303	
– Free Surplus	**2 096**	1 561	
– Required Capital(2)	**905**	742	
Run-down costs for Destiny Health(3)	**(42)**	(190)	
Value of in-force covered business before cost of capital	**17 939**	16 560	
Cost of required capital	**(327)**	(203)	
Cost of STC(4)	**(531)**	(589)	
Discovery Holdings embedded value	**20 040**	17 881	12
Number of shares (millions)	**553.6**	546.0	
Embedded value per share	**R36.20**	R32.75	11
Diluted number of shares (millions)	**591.3**	592.0	
Diluted embedded value per share(5)	**R35.83**	R32.05	12

(1) The published Shareholders' funds has been adjusted to eliminate net assets under insurance contracts, deferred tax and deferred acquisition costs at June 2009 of R3 984 million (June 2008: R3 827 million) in respect of Life and R28 million (June 2008: R34 million) in respect of PruHealth.

(2) The required capital at June 2009 for Life is R460 million (June 2008: R348 million), for Health and Vitality is R333 million (June 2008: R291 million) and for PruHealth is R112 million (June 2008: R103 million).

(3) The run-down costs for Destiny Health relate to the expected future operational costs and risk profits/losses expected in the course of running down the existing block of in-force business.

(4) In line with Discovery's current dividend policy, the cost of STC is calculated assuming a 4.5 times dividend cover on the after-tax profits as they emerge over the projection term. An STC rate of 10% is assumed. The total STC charge has been allocated between the different business entities based on their contribution to the total value of in-force covered business.

(5) The diluted embedded value per share allows for Discovery's BEE transaction where the impact is dilutive i.e. where the current embedded value per share exceeds the current transaction value.

Table 3: Value of in-force covered business

R million	Value before cost of capital and STC	Cost of required capital	Cost of STC	Value after cost of capital and STC
at 30 June 2009				
Health and Vitality	**8 531**	**(115)**	**(252)**	**8 164**
Life and Invest[(1)]	**9 118**	**(162)**	**(270)**	**8 686**
PruHealth[(2)]	**290**	**(50)**	**(9)**	**231**
Total	**17 939**	**(327)**	**(531)**	**17 081**
at 30 June 2008 (Restated)				
Health and Vitality	7 798	(108)	(277)	7 413
Life and Invest[(1)]	8 401	(60)	(299)	8 042
PruHealth[(2)]	361	(35)	(13)	313
Total	16 560	(203)	(589)	15 768

(1) Included in the Life and Invest value of in-force covered business is R172 million (June 2008: R47 million) in respect of investment management services provided on off balance sheet investment business. The net assets of the investment service provider are included in the adjusted net worth.

(2) The values shown for PruHealth reflect Discovery's 50% shareholding in PruHealth.

Table 4: Group embedded value earnings

R million	Year ended 30 June 2009	Year ended 30 June 2008 Restated
Embedded value at end of period	**20 040**	17 881
Less: Embedded value at beginning of period	**(17 881)**	(15 395)
Increase in embedded value	**2 159**	2 486
Net issue of capital	**(68)**	(73)
Dividends Paid	**269**	236
Minority share buy-back	**(7)**	2
Transfer to hedging reserve	**(43)**	16
Embedded value earnings	**2 310**	2 667
Annualised return on opening embedded value	**12.9%**	17.3%

Table 5: Components of Group embedded value earnings

R million	Net worth	Cost of required capital	Value of in-force covered business less Cost of STC	Embedded value
Total profit from new business (at point of sale)	(1 697)	(62)	2 863	1 104
Profit from existing business				
• Expected return	2 122	3	(98)	2 027
• Change in methodology and assumptions[(1)]	1 283	(43)	(1 945)	(705)
• Experience variances	(227)	(31)	634	376
Other initiative costs[(2)]	(303)	–	–	(303)
Acquisition costs	(4)	–	–	(4)
Foreign exchange rate movements	(49)	9	(64)	(104)
Cost of STC[(3)]	–	–	46	46
Return on shareholders' funds[(4)]	(127)	–	–	(127)
Embedded value earnings	998	(124)	1 436	2 310

(1) The profits from changes in methodology and assumptions 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 6 below (for previous periods refer to previous embedded value statements).

(2) This item reflects the expenses relating to the establishment of PruProtect and Discovery Invest and the support of Destiny Health. These costs have not been projected on a recurring basis in the embedded value due to the fact that income from business sold under these initiatives has not been projected or the costs are not expected to recur.

(3) The positive change in the cost of STC is due to the increase in the present value of STC credits following a reduction in the risk discount rate.

(4) Return on shareholders' funds is shown net of tax and management charges.

Table 6: Methodology and assumption changes

R million	Health and Vitality		Life and Invest		PruHealth		Total
	Net worth	Value of in-force	Net worth	Value of in-force	Net worth	Value of in-force	
Modelling changes	–	–	126	(192)	–	–	(66)
Economic assumptions	–	(47)	(26)	546	–	102	575
Benefit Enhancements[(1)]	–	22	(134)	(2)	–	–	(114)
Lapse assumption[(2)]	–	(35)	47	(1 205)	–	(93)	(1 286)
Premium Increases	–	–	3	60	–	–	63
Mortality and Morbidity[(3)]	–	–	45	330	–	(53)	322
Expenses	–	(90)	(3)	(6)	–	1	(98)
Commission	–	–	–	–	–	(68)	(68)
Tax	–	–	–	(42)	–	–	(42)
Reinsurance[(4)]	–	–	1 037	(1 019)	188	(174)	32
Vitality	–	–	–	–	–	(23)	(23)
Total	–	(150)	1 095	(1 530)	188	(308)	(705)

(1) The Life and Invest benefit enhancements relate to improvements in the risk benefits following the June 2008 product launch being made available to existing policyholders.

(2) The Life and Invest lapse assumption has been increased following higher than expected lapse experience, and to allow for higher lapses in future as a result of the uncertain economic environment. The lapse rate has been increased above current actual experience in the short term.

(3) Mortality and severe illness assumptions have been reduced marginally following consistently better than expected claims experience in the past.

(4) The reinsurance change for Life relates to the impact of financing reinsurance arrangements which were effective from 31 December 2008.

Table 7: Experience variances

R million	Health and Vitality		Life and Invest		PruHealth		Total
	Net worth	Value of in-force	Net worth	Value of in-force	Net worth	Value of in-force	
Renewal expenses	30	–	(13)	–	–	–	17
Other expenses[(1)]	(51)	–	(5)	–	–	–	(56)
Economic assumptions[(2)]	5	98	34	180	–	–	317
Extended modelling term[(3)]	–	203	–	12	–	22	237
Lapses and surrenders[(4)]	9	83	(61)	(290)	–	51	(208)
Policy alterations	–	29	(152)	187	–	–	64
Mortality and morbidity	–	–	167	9	(77)	–	99
Backdated Cancellations	–	–	(15)	(51)	–	–	(66)
Tax	(7)	–	(9)	27	(61)	(8)	(58)
Reinsurance	–	–	(14)	–	10	–	(4)
Other	35	12	(36)	34	(16)	5	34
Total	21	425	(104)	108	(144)	70	376

(1) Other expenses include expenses which are not expected to recur in future.

(2) For Life and Invest, the economic assumptions variance relates primarily to higher than expected premium and benefit increases due to higher than expected inflation over the period. For Health and Vitality, it relates to the inflation-linked administration and managed care fee increase in 2009 which was higher than the long-term inflation assumption in the embedded value model due to higher than expected inflation over the period.

(3) The projection term for Health, Vitality, PruHealth and Group Life at 30 June 2009 has not been changed from that used in the 30 June 2008 embedded value. Thus, an experience variance arises because the total term of the in-force covered business is effectively increased by one year.

(4) Included in the Health and Vitality lapse experience variance is an amount of R630 million in respect of members joining existing employer groups during the period, offset by an amount of negative R553 million in respect of members leaving existing employer groups. A positive variance of R15 million is due to lower than expected lapses.

Table 8: Embedded value of new business

R million	Year ended 30 June 2009	Year ended 30 June 2008 Restated	% change
Health and Vitality			
Present value of future profits from new business at point of sale	**295**	246	
Cost of required capital	**(11)**	(9)	
Cost of STC	**(9)**	(9)	
Present value of future profits from new business at point of sale after cost of required capital and STC	**275**	228	21
New business annualised premium income(1)	**1 204**	1 079	12
Life and Invest			
Present value of future profits from new business at point of sale(2)	**863**	855	
Cost of required capital	**(34)**	(18)	
Cost of STC	**(23)**	(29)	
Present value of future profits from new business at point of sale after cost of required capital and STC	**806**	808	(0)
New business annualised premium income(3)	**1 246**	964	29
Annualised profit margin(4)	**7.7%**	9.5%	
Annualised profit margin excluding Invest Business	**9.9%**	10.6%	
PruHealth(5)			
Present value of future profits from new business at point of sale	**41**	48	
Cost of required capital	**(17)**	(10)	
Cost of STC	**(1)**	(1)	
Present value of future profits from new business at point of sale after cost of required capital and STC	**23**	37	(38)
New business annualised premium income(6)	**188**	219	(14)
Annualised profit margin(4)	**0.9%**	2.3%	

(1) Health new business annualised premium income is the gross contribution to the medical schemes. For embedded value purposes, Health new business is defined as individuals and members of new employer groups, and includes additions to first year business. There have been no changes to the definition of new business since the previous valuation.
The new business annualised premium income shown above excludes 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 2009.
The total Health and Vitality new business annualised premium income written over the period was R3 191 million (June 2008: R2 834 million).

(2) Included in the Life and Invest value of new business is R58 million in respect of investment management services provided on off balance sheet investment business.

(3) Life new business is defined as Life policies or Discovery Retirement Optimiser policies which incepted during the reporting period and which are on risk at the valuation date. Invest new business is defined as business where at least one premium has been received and which has not been refunded after receipt.
The new business annualised premium income of R1 246 million (single premium APE: R198 million) shown above excludes 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 R415 million and servicing increases of R259 million was R1 920 million (single premium APE: R198 million). Single premium business is included at 10% of the value of the single premium.
Policy alterations, including Discovery Retirement Optimisers added to existing Life Plans are shown in Table 7 as experience variances and not included as new business. Previously, Discovery Retirement Optimisers added to existing Life Plans were included in the value of new business.
Term extensions on existing contracts are not included as new business.

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

(5) The values shown in this table for PruHealth reflect Discovery's 50% shareholding in PruHealth.

(6) PruHealth new business is defined as individuals and employer groups which incepted during the reporting period. The new business annualised premium income shown above has been adjusted to exclude premiums in respect of members who join an existing employer group after the first month as well as premiums in respect of new business written during the period but only activated after 30 June 2009.

Table 9: Embedded value economic assumptions

		30 June 2009	30 June 2008 Restated
Beta coefficient			
South Africa		**0.45**	0.44
United Kingdom		**0.45**	0.74
Equity risk premium			
South Africa		**3.50**	3.50
United Kingdom		**4.00**	4.00
Risk discount rate (%)			
– Health and Vitality		**10.575**	12.54
– Life and Invest		**10.575**	12.54
– PruHealth		**6.40**	8.70
Rand/GB Pound Exchange Rate			
Closing		**12.71**	15.60
Average		**14.08**	14.66
Medical inflation (%)			
South Africa		**8.00**	10.00
United Kingdom		**Current levels reducing to 7.00% over the projection period**	Current levels reducing to 7.50% over the projection period
Expense inflation and CPI (%)			
South Africa		**5.00**	7.00
United Kingdom		**3.75**	4.00
Pre-tax investment return (%)			
South Africa	– Cash	**7.50**	9.50
	– Bonds	**9.00**	11.00
	– Equity	**12.50**	14.50
United Kingdom	– Cash	**2.65**	5.25
Dividend cover ratio		**4.5 times**	4.5 times
Income tax rate (%)			
South Africa		**28.00**	28.00
United Kingdom		**28.00**	28.00
Projection term			
– Health and Vitality		**20 years**	20 years
– Group Life		**10 years**	10 years
– PruHealth		**20 years**	20 years

Life mortality, morbidity and lapse assumptions were derived from internal experience, where available, augmented by reinsurance and industry information. An additional lapse rate is assumed over the next 24 months to allow for the potential impact of the current economic climate on policyholder lapses. A further increase to the future lapse rate assumptions has been made to allow for the impact of the uncertain economic environment.

The Health lapse assumptions were based on the results of recent experience investigations. The lapse rate for the projection term after 10 years was set above current experience. An additional lapse rate is assumed over the next 24 months to allow for the potential impact of the current economic climate on lapses.

The PruHealth assumptions were derived from internal experience augmented by industry information. Best estimate morbidity assumptions and forecast Vitality costs allow for the impact of management actions. The lapse rate over the next 24 months for group business is assumed to be higher than the long-term expected lapse rate to allow for the impact of the current economic climate on lapses.

Renewal expense assumptions were based on the results of the latest expense and budget information. A notional allocation of corporate overhead expenses has been made to each of the subsidiary companies based on managements' view of each subsidiary's contribution to overheads.

The initial expenses included in the calculation of the value of new business are the actual costs incurred, except for Invest business where the initial expenses are based on medium term expectations which are lower than the current total costs. This reflects a realistic position for Invest.

The investment return assumption was based on a single interest rate derived from the risk-free zero coupon government bond yield curve. Other economic assumptions were set relative to this yield. 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.

Sensitivity to the embedded value assumptions

The sensitivity of the embedded value and the value of new business at 30 June 2009 to changes in the 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 10: Embedded value sensitivity

R million	Adjusted net worth less Destiny run-down costs	Health and Vitality: Value of in-force	Health and Vitality: Cost of capital	Health and Vitality: Cost of STC	Life: Value of in-force	Life: Cost of capital	Life: Cost of STC	PruHealth: Value of in-force	PruHealth: Cost of capital	PruHealth: Cost of STC	Embedded value	% change
Base	2 959	8 531	(115)	(252)	9 118	(162)	(270)	290	(50)	(9)	20 040	
Impact of:												
Risk discount rate + 1%	2 959	8 060	(129)	(227)	8 227	(143)	(232)	241	(47)	(7)	18 702	(7)
Risk discount rate – 1%	2 959	9 052	(98)	(286)	10 206	(185)	(323)	343	(55)	(11)	21 602	8
Lapses – 10%	2 959	8 837	(120)	(260)	9 939	(179)	(293)	347	(50)	(10)	21 170	6
Interest rates – 1%(1)	2 959	8 506	(109)	(270)	9 501	(170)	(302)	245	(55)	(8)	20 297	1
Equity and property market value – 10%	2 843	8 531	(115)	(252)	9 091	(162)	(269)	290	(50)	(9)	19 898	(1)
Equity and property return + 1%	2 959	8 531	(115)	(252)	9 155	(172)	(271)	290	(50)	(9)	20 066	0
Renewal expenses – 10%	2 959	9 337	(106)	(276)	9 217	(162)	(273)	316	(50)	(9)	20 953	5
Mortality and morbidity – 5%	2 959	8 531	(115)	(251)	9 704	(162)	(286)	480	(50)	(14)	20 796	4
Health, Vitality and PruHealth: Projection term + 1 year	2 959	8 611	(116)	(254)	9 118	(162)	(270)	310	(52)	(9)	20 135	0

(1) All economic assumptions were reduced by 1%.

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

Table 11: Value of new business sensitivity

	Health and Vitality			Life			PruHealth				
R million	Value of in-force	Cost of capital	Cost of STC	Value of in-force	Cost of capital	Cost of STC	Value of in-force	Cost of capital	Cost of STC	Value of new business	% change
Base	295	(11)	(9)	863	(34)	(23)	41	(17)	(1)	1 104	
Impact of:											
Risk discount rate + 1%	269	(12)	(8)	669	(30)	(20)	25	(15)	(1)	877	(21)
Risk discount rate – 1%	323	(9)	(10)	1 100	(39)	(28)	56	(18)	(2)	1 373	24
Lapses – 10%	314	(11)	(9)	1 046	(37)	(25)	56	(18)	(2)	1 314	19
Interest rates – 1%[(1)]	294	(10)	(9)	964	(35)	(26)	27	(16)	(1)	1 188	8
Acquisition costs – 10%	307	(11)	(9)	924	(34)	(23)	48	(16)	(1)	1 185	7
Renewal expense – 10%	347	(10)	(10)	888	(34)	(23)	49	(16)	(1)	1 190	8
Mortality and morbidity – 5%	295	(11)	(9)	976	(34)	(25)	95	(16)	(3)	1 268	15
Health, Vitality and PruHealth: Projection term + 1 year	298	(11)	(9)	863	(34)	(23)	45	(17)	(1)	1 111	1
Equity and property return + 1%	295	(11)	(9)	879	(36)	(23)	41	(17)	(1)	1 118	1

(1) All economic assumptions were reduced by 1%.

Review of Group results

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

New business annualised premium income excluding Destiny increased 20% for the year ended 30 June 2009.

New business annualised premium income

R million	June 2009	June 2008	% change
Discovery Health	**3 039**	2 731	11
Discovery Life	**1 920**	1 407	36
Discovery Vitality	**152**	103	48
PruHealth	**559**	533	5
PruProtect	**105**	25	320
New business API excluding Destiny	**5 775**	4 799	20
Destiny Health*	**91**	345	(74)
New business API of Group	**5 866**	5 144	14

**New business in Destiny Health relates to new members joining existing business in the current year*

Gross inflows under management increased 20% for the year ended 30 June 2009.

Gross inflows under management

R million	June 2009	June 2008	% change
Discovery Health	**23 853**	21 118	13
Discovery Life	**3 675**	3 118	18
Discovery Invest	**3 290**	903	264
Discovery Vitality	**936**	813	15
Destiny Health	**411**	999	(59)
PruHealth	**1 366**	1 040	31
PruProtect	**60**	15	300
Gross inflows under management	**33 591**	28 006	20
Less: collected on behalf of third parties	**(24 576)**	(20 390)	21
Discovery Health	**(21 077)**	(18 637)	
Discovery Invest	**(2 646)**	(903)	
Destiny Health	**(140)**	(323)	
PruHealth	**(683)**	(520)	
PruProtect	**(30)**	(7)	
Gross income of Group	**9 015**	7 616	18

The following table shows the main components of the increase in Group profit from operations for the year ended 30 June:

Earnings source

R million	June 2009	June 2008	% change
Discovery Health	**1 028**	891	15
Discovery Life	**1 184**	989	20
Discovery Vitality	**40**	49	(18)
PruHealth	**(103)**	(155)	34
Operating profit from established businesses	**2 149**	1 774	21
Discovery Invest	**(122)**	(157)	22
PruProtect	**(156)**	(134)	(16)
Destiny Health	**(173)**	(192)	10
Group operating profit before premium deficiency reserve and corporate costs	**1 698**	1 291	32
Transfer to premium deficiency reserve	**(21)**	-	
Corporate costs*	**(3)**	(18)	83
Profit from operations before investment income, impairment and BEE expenses	**1 674**	1 273	32

**Corporate costs include costs relating to the odd-lot offer in the current year and the FirstRand unbundling in the prior year.*

Taxation

All South African entities are in a tax paying position. South African income tax has been provided at 28% (2008: 28%) and secondary tax on companies at 10% in the financial statements and embedded value statements.

Discovery obtained no tax relief for the PruHealth losses for the year ended 30 June 2009. For the six-month period ending 31 December 2007, Discovery obtained tax relief for 100% of the PruHealth losses as this tax asset was ceded to Prudential Assurance Company in the UK ("Prudential"). R26 million was included in finance charges relating to a settlement discount on early payment by Prudential for these tax losses in that period.

Tax relief is obtained for 100% of the PruProtect losses through Prudential.

Reinsurance contracts

Included in cash and cash equivalents at 30 June 2009 is the balance of R750 million received in terms of a quota share treaty entered into by Discovery Life in December 2008. This treaty effectively reinsures approximately 15% of the negative reserve as at that date. The liability in respect of this treaty has been included in liabilities arising from reinsurance contracts. This amount has been shown as a receipt arising from reinsurance contract on the face of the income statement and the full amount has been transferred out through the change in liabilities under reinsurance contracts.

In December 2008, Discovery Life also entered into a reinsurance contract to reinsure lapse risk (for the next five years) of up to 22% of the negative reserve in force as at that date.

Investments

Investments have increased due to the sale of Discovery Invest products.

Discovery has classified its shareholder investments as available-for-sale financial instruments. As such, gains and losses are ordinarily taken directly to reserves, until realised. When realised, the resulting gain or loss is taken to profit and loss but excluded from the calculation of headline earnings.

Due to the significant decrease in the equity markets during the 2009 financial year, Discovery had to assess whether objective evidence existed that the equity instruments classified as available-for-sale financial assets were impaired at 30 June 2009. A significant or prolonged decline in the fair value of an investment in an equity instrument below its cost is objective evidence of impairment. Discovery has taken the view that a 30% decline in the fair value of an investment in an equity instrument below cost would be classified as significant and a period of nine months or more would be a prolonged decline.

Based on this view, Discovery has impaired equity instruments classified as available-for-sale financial assets that had a decline of 30% or more in the fair value of the asset below cost or has met the prolonged decline criteria. This amounted to R96 million and has been taken through profit and loss.

Balance sheet

The increase in the assets arising from insurance contracts of R1 284 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.

At 30 June 2009, Destiny Health raised a Premium Deficiency Reserve of US$2.4 million (R21 million). This relates to future losses that will be incurred on a block of business due to an onerous contract. This reserve has been included in liabilities arising from insurance contracts.

Accounting policies

The annual financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) including IAS34, as well as the South African Companies Act 61 of 1973, as amended, and are consistent with the accounting policies applied in the annual report and the corresponding prior year period.

Share-based payments

The issue of 38.7 million shares by Discovery in terms of its BEE transaction in 2005 has been accounted for in terms of IFRS 2. These shares are not accounted for as issued in the consolidated accounts of Discovery but rather as a share option transaction. These shares have been considered in the calculation of diluted HEPS and diluted EPS.

The BEE transaction has resulted in a charge to the income statement of R13 million in the year ended 30 June 2009 (2008: R23 million) in accordance with the requirements of IFRS 2.

An additional R60 million (2008: R19 million) in respect of options granted under employee share incentive schemes has been expensed in the income statement for the year in accordance with the requirements of IFRS 2.

The Group entered into transactions to hedge its exposure in the phantom share scheme related to changes in the Discovery share price. As at 30 June 2009, approximately 51.4% (2008: 66.6%) of this exposure was hedged.

Directorate

Dr Judy Dlamini resigned as non-executive director from the board of Discovery Holdings Limited, with effect from 30 November 2008, to pursue her philanthropic and business interests. Judy has added tremendous value to the Discovery board during her tenure and her contribution will be missed.

Mr Richard Farber was appointed as an executive director of the board of Discovery with effect from 1 July 2009.

Dividend policy and capital

An interim dividend of 25,5 cents per share was paid on 23 March 2009.

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 was R230 million (2008: R174 million) and was covered 7.7 times (2008: 7.0 times).

Cash dividend declaration

The board has declared a final dividend of 33 cents per share. The salient dates are as follows:

– Last date to trade "cum" dividend	Friday, 9 October 2009
– Date trading commences "ex" dividend	Monday, 12 October 2009
– Record date	Friday, 16 October 2009
– Date of payment	Monday, 19 October 2009

Share certificates may not be dematerialised or rematerialised between Monday, 12 October 2009 and Friday, 16 October 2009, both days inclusive.

Comparative figures

Assets arising from insurance contracts where shown net of the associated Liabilities arising from reinsurance contracts. These amounts have now been disclosed on a gross basis and the comparative balance sheet has been restated. The restatement results in an increase of R245 million in relation to the Assets arising from insurance contracts and a corresponding increase in the Liabilities arising from reinsurance contracts. The restatement has no impact on the Group's comparative net profit, nor the Group's comparative basic and diluted earnings per share, nor the Group's comparative cash flows.

Audit

The auditors, PricewaterhouseCoopers Inc., have issued their opinion on the Group financial statements for the year ended 30 June 2009. A copy of the auditors' unqualified report is available for inspection at the company's registered office.

Transfer secretaries

Computershare Investor Services (Pty) Limited
(Registration number 2004/003647/07)
Ground Floor, 70 Marshall Street,
Johannesburg 2001
PO Box 61051, Marshalltown 2107

Sponsors

Rand Merchant Bank (A division of FirstRand Bank Limited)

Secretary and registered office

MJ Botha Discovery Holdings Limited
(Incorporated in the Republic of South Africa)
(Registration number: 1999/007789/06)
JSE share code: DSY ISIN: ZAE000022331
155 West Street, Sandton 2146
PO Box 786722, Sandton 2146
Tel: 011 529 2888 Fax: 011 529 2958

Directors

MI Hilkowitz *(Chairperson)*,
A Gore* *(Chief Executive Officer)*, Dr BA Brink,
P Cooper, SB Epstein *(USA)*, R Farber* **,
NS Koopowitz*, Dr TV Maphai, HP Mayers*,
AL Owen *(UK)*, A Pollard*, JM Robertson* *(CIO)*,
SE Sebotsa, T Slabbert, B Swartzberg*, SV Zilwa

**Executive*
***Appointed 1 July 2009*

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