





# FINANCIAL STATEMENTS

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## Statement of financial position

at 30 June 2018

R million	Group 2018 Audited	Group 2017 Audited
<b>Assets</b>		
Assets arising from insurance contracts	43 625	37 691
Property and equipment	4 272	1 210
Intangible assets	5 491	4 071
Deferred acquisition costs	1 150	1 025
Goodwill	2 247	2 107
Investment in equity-accounted investments	1 159	979
Financial assets		
– Available-for-sale investments	7 547	7 298
– Investments at fair value through profit or loss	71 246	58 948
– Derivatives	494	392
– Loans and receivables including insurance receivables	7 543	6 470
Deferred income tax	1 968	1 337
Current income tax asset	38	34
Reinsurance contracts	308	263
Cash and cash equivalents	10 894	9 098
<b>Total assets</b>	<b>157 982</b>	<b>130 923</b>
<b>Equity</b>		
<b>Capital and reserves</b>		
Ordinary share capital and share premium	8 308	8 306
Perpetual preference share capital	779	779
Other reserves	1 280	346
Retained earnings	27 227	22 859
	37 594	32 290
Non-controlling interest	*	*
<b>Total equity</b>	<b>37 594</b>	<b>32 290</b>
<b>Liabilities</b>		
Liabilities arising from insurance contracts	61 488	52 477
Liabilities arising from reinsurance contracts	8 918	6 746
Financial liabilities		
– Negative reserve funding	–	847
– Borrowings at amortised cost	14 079	8 524
– Investment contracts at fair value through profit or loss	17 927	14 867
– Derivatives	78	135
– Trade and other payables	9 043	7 369
Deferred income tax	8 007	6 963
Deferred revenue	324	291
Employee benefits	232	191
Current income tax liability	292	223
<b>Total liabilities</b>	<b>120 388</b>	<b>98 633</b>
<b>Total equity and liabilities</b>	<b>157 982</b>	<b>130 923</b>

\* Amount is less than R500 000.

## Income statement

for the year ended 30 June 2018

R million	Group 2018 Audited	Group 2017 Audited	% change
Insurance premium revenue	36 685	33 533	
Reinsurance premiums	(4 356)	(3 837)	
<b>Net insurance premium revenue</b>	<b>32 329</b>	29 696	
Fee income from administration business	9 252	8 372	
Vitality income	4 491	4 267	
Investment income	895	758	
– investment income earned on shareholder investments and cash	209	150	
– investment income earned on assets backing policyholder liabilities	686	608	
Net realised gains on available-for-sale financial assets	10	8	
Net fair value gains on financial assets at fair value through profit or loss	5 823	2 108	
<b>Net income</b>	<b>52 800</b>	45 209	17
Claims and policyholders' benefits	(20 714)	(19 237)	
Insurance claims recovered from reinsurers	2 735	2 816	
Recapture of reinsurance	–	(858)	
<b>Net claims and policyholders' benefits</b>	<b>(17 979)</b>	(17 279)	
Acquisition costs	(5 594)	(5 237)	
Marketing and administration expenses	(17 219)	(15 652)	
Amortisation of intangibles from business combinations	(123)	(171)	
Recovery of expenses from reinsurers	2 542	2 985	
Net transfer to/from assets and liabilities under insurance contracts	(4 859)	(3 362)	
– change in assets arising from insurance contracts	5 141	5 346	
– change in assets arising from reinsurance contracts	36	(109)	
– change in liabilities arising from insurance contracts	(8 088)	(6 625)	
– change in liabilities arising from reinsurance contracts	(1 948)	(1 974)	
Fair value adjustment to liabilities under investment contracts	(1 308)	(248)	
<b>Profit from operations</b>	<b>8 260</b>	6 245	32
Finance costs	(959)	(478)	
Foreign exchange losses	(4)	(21)	
Share of net profits from equity-accounted investments	115	26	
<b>Profit before tax</b>	<b>7 412</b>	5 772	28
Income tax expense	(1 677)	(1 278)	(31)
<b>Profit for the year</b>	<b>5 735</b>	4 494	28
Profit attributable to:			
– ordinary shareholders	5 652	4 411	28
– preference shareholders	83	83	
– non-controlling interest	*	*	
	5 735	4 494	28
<b>Earnings per share for profit attributable to ordinary shareholders of the company during the year (cents):</b>			
– undiluted	876.1	684.2	28
– diluted	875.6	683.6	28

\* Amount is less than R500 000.



## Statement of other comprehensive income

for the year ended 30 June 2018

R million	Group 2018 Audited	Group 2017 Audited	% change
<b>Profit for the year</b>	<b>5 735</b>	4 494	
<b>Items that are or may be reclassified subsequently to profit or loss:</b>			
<b>Change in available-for-sale financial assets</b>	<b>37</b>	17	
– unrealised gains	<b>64</b>	29	
– capital gains tax on unrealised gains	<b>(19)</b>	(6)	
– realised gains transferred to profit or loss	<b>(10)</b>	(8)	
– capital gains tax on realised gains	<b>2</b>	2	
<b>Currency translation differences</b>	<b>840</b>	(1 575)	
– unrealised gains/(losses)	<b>856</b>	(1 581)	
– tax on unrealised (gains)/losses	<b>(16)</b>	6	
<b>Cash flow hedges</b>	<b>2</b>	33	
– unrealised gains	<b>200</b>	159	
– tax on unrealised gains	<b>(32)</b>	(25)	
– gains recycled to profit or loss	<b>(188)</b>	(123)	
– tax on recycled gains	<b>22</b>	22	
<b>Share of other comprehensive income from equity-accounted investments</b>	<b>42</b>	(58)	
– change in available-for-sale financial assets	<b>(9)</b>	(1)	
– currency translation differences	<b>51</b>	(57)	
<b>Other comprehensive income/(losses) for the year, net of tax</b>	<b>921</b>	(1 583)	
<b>Total comprehensive income for the year</b>	<b>6 656</b>	2 911	129
Attributable to:			
– ordinary shareholders	<b>6 573</b>	2 828	132
– preference shareholders	<b>83</b>	83	
– non-controlling interest	<b>*</b>	*	
<b>Total comprehensive income for the year</b>	<b>6 656</b>	2 911	129

\* Amount is less than R500 000.

## Headline earnings

for the year ended 30 June 2018

R million	Group 2018 Audited	Group 2017 Audited	% change
<b>Basic earnings per share (cents):</b>			
– undiluted	876.1	684.2	28
– diluted	875.6	683.6	28
<b>Headline earnings per share (cents):</b>			
– undiluted	899.6	683.1	32
– diluted	899.0	682.5	32
<b>Normalised headline earnings per share (cents):</b>			
– undiluted	837.4	722.2	16
– diluted	836.9	721.5	16
<b>The reconciliation between earnings and headline earnings is shown below:</b>			
Net profit attributable to ordinary shareholders	5 652	4 411	28
Adjusted for:			
– gain on disposal of property and equipment net of CGT	(3)	(1)	
– impairment of intangible assets net of tax	162	–	
– realised gains on available-for-sale financial assets net of CGT	(8)	(6)	
<b>Headline earnings</b>	<b>5 803</b>	<b>4 404</b>	<b>32</b>
– accrual of dividends payable to preference shareholders	1	(1)	
– amortisation of intangibles from business combinations net of deferred tax	109	154	
– deferred tax asset raised on assessed losses	(352)	–	
– deferred tax timing difference related to new 'adjusted IFRS' tax basis	(119)	–	
– duplicate building costs	37	–	
– unrealised gains on foreign exchange contracts not designated as hedges	(77)	–	
– initial expenses related to Prudential Book transfer	(1)	–	
– rebranding and business acquisitions expenses	–	99	
<b>Normalised headline earnings</b>	<b>5 401</b>	<b>4 656</b>	<b>16</b>
Weighted number of shares in issue (000's)	645 014	644 651	
Diluted weighted number of shares (000's)	645 408	645 236	

Refer to 'Significant transactions affecting the current results' for details on the accounting treatment of Discovery's new head office.

Normalised operating profit per the segmental information, reflects the cash rental costs separately from the International Financial Reporting Standards (IFRS) finance lease treatment, as individual business expenses and margins are managed on underlying cash rental costs incurred by each business.

Normalised headline earnings adjusted for the impact of the accounting treatment of the new head office lease, would result in an increase of R208 million in normalised headline earnings to R5 609 million (increase of 20% compared to the prior financial year). The adjustment is calculated by replacing the depreciation of R126 million and finance charges of R210 million recognised in line with IFRS, with the actual market related rentals of R128 million.

Normalised headline earnings per share (with market related cash rentals)(cents) would be 869.5 on an undiluted basis and 869.0 on a diluted basis.



## Statement of changes in equity

for the year ended 30 June 2018

R million (audited)	Attributable to equity holders of the Company		
	Share capital and share premium	Preference share capital	Share-based payment reserve
<b>Year ended 30 June 2018</b>			
<b>At beginning of year</b>	<b>8 306</b>	<b>779</b>	<b>314</b>
<b>Total comprehensive income for the year</b>	<b>-</b>	<b>83</b>	<b>-</b>
Profit for the year	-	83	-
Other comprehensive income	-	-	-
<b>Transactions with owners</b>	<b>2</b>	<b>(83)</b>	<b>13</b>
Delivery of treasury shares	2	-	-
Employee share option schemes:			
- Value of employee services	-	-	13
Dividends paid to preference shareholders	-	(83)	-
Dividends paid to ordinary shareholders	-	-	-
<b>At end of year</b>	<b>8 308</b>	<b>779</b>	<b>327</b>
<b>Year ended 30 June 2017</b>			
<b>At beginning of year</b>	<b>8 300</b>	<b>779</b>	<b>319</b>
<b>Total comprehensive income for the year</b>	<b>-</b>	<b>83</b>	<b>-</b>
Profit for the year	-	83	-
Other comprehensive income	-	-	-
<b>Transactions with owners</b>	<b>6</b>	<b>(83)</b>	<b>(5)</b>
Increase in treasury shares	(4)	-	-
Delivery of treasury shares	11	-	-
Share buy-back	(1)	-	-
Employee share option schemes:			
- Share schemes cancelled	-	-	(19)
- Value of employee services	-	-	14
Dividends paid to preference shareholders	-	(83)	-
Dividends paid to ordinary shareholders	-	-	-
<b>At end of year</b>	<b>8 306</b>	<b>779</b>	<b>314</b>

<sup>1</sup> This relates to the fair value adjustments of available-for-sale financial assets.

\* Amount is less than R500 000.



Attributable to equity holders of the Company						
Available- for-sale investments <sup>1</sup>	Foreign currency translation reserve	Hedging reserve	Retained earnings	Total	Non- controlling interest	Total
180	(147)	(1)	22 859	32 290	*	32 290
28	891	2	5 652	6 656	-	6 656
-	-	-	5 652	5 735	-	5 735
28	891	2	-	921	-	921
-	-	-	(1 284)	(1 352)	-	(1 352)
-	-	-	-	2	-	2
-	-	-	-	13	-	13
-	-	-	-	(83)	-	(83)
-	-	-	(1 284)	(1 284)	-	(1 284)
208	744	1	27 227	37 594	*	37 594
164	1 485	(34)	19 594	30 607	*	30 607
16	(1 632)	33	4 411	2 911	-	2 911
-	-	-	4 411	4 494	-	4 494
16	(1 632)	33	-	(1 583)	-	(1 583)
-	-	-	(1 146)	(1 228)	-	(1 228)
-	-	-	-	(4)	-	(4)
-	-	-	(11)	-	-	-
-	-	-	1	-	-	-
-	-	-	12	(7)	-	(7)
-	-	-	-	14	-	14
-	-	-	-	(83)	-	(83)
-	-	-	(1 148)	(1 148)	-	(1 148)
180	(147)	(1)	22 859	32 290	*	32 290





## Statement of cash flows

for the year ended 30 June 2018

R million	Group 2018 Audited	Group 2017 Audited
<b>Cash flow from operating activities</b>	<b>3 414</b>	(832)
Cash generated by operations	10 875	9 672
Purchase of investments held to back policyholder liabilities	(24 217)	(32 104)
Proceeds from disposal of investments held to back policyholder liabilities	16 179	25 020
Working capital changes	250	(4 146)
	<b>3 087</b>	(1 558)
Dividends received	252	197
Interest received	2 062	1 711
Interest paid	(759)	(437)
Taxation paid	(1 228)	(745)
<b>Cash flow from investing activities</b>	<b>(2 433)</b>	15
Purchase of financial assets	(23 631)	(14 083)
Proceeds from disposal of financial assets	23 621	16 208
Purchase of property and equipment	(470)	(239)
Proceeds from disposal of property and equipment	7	5
Purchase of software and other intangible assets	(1 940)	(1 353)
Proceeds from the sale of intangible assets	-	7
Increase in investment in associate	(20)	(530)
<b>Cash flow from financing activities</b>	<b>609</b>	1 913
Dividends paid to ordinary shareholders	(1 284)	(1 152)
Dividends paid to preference shareholders	(83)	(83)
Increase in borrowings	2 654	3 514
Repayment of borrowings	(678)	(366)
Net increase in cash and cash equivalents	1 590	1 096
Cash and cash equivalents at beginning of year	9 097	8 614
Exchange losses on cash and cash equivalents	201	(613)
<b>Cash and cash equivalents at end of year</b>	<b>10 888</b>	9 097
<b>Reconciliation to statement of financial position</b>		
Cash and cash equivalents	10 894	9 098
Bank overdraft included in borrowings at amortised cost	(6)	(1)
<b>Cash and cash equivalents at end of year</b>	<b>10 888</b>	9 097

## Additional information

at 30 June 2018

### Fair value hierarchy of financial instruments

The Group's financial instruments measured at fair value have been disclosed using a fair value hierarchy. The hierarchy has three levels that reflect the significance of the inputs used in measuring fair value. These are as follows:

**Level 1** includes financial instruments that are measured using unadjusted, quoted prices in an active market for identical financial instruments. Quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency and those prices represent actual and regularly occurring market transactions on an arm's length basis.

**Level 2** includes financial instruments that are valued using techniques based significantly on observable market data. Instruments in this category are valued using:

- (a) quoted prices for similar instruments or identical instruments in markets which are not considered to be active or
- (b) valuation techniques where all the inputs that have a significant effect on the valuation are directly or indirectly based on observable market data.

**Level 3** includes financial instruments that are valued using valuation techniques that incorporate information other than observable market data and where at least one input (which could have a significant effect on instruments' valuation) cannot be based on observable market data.

30 June 2018				
R million (audited)	Level 1	Level 2	Level 3	Total
<b>Financial assets</b>				
Financial instruments at fair value through profit or loss:				
– Equity securities	29 769	873	-	30 642
– Equity linked notes	-	211	-	211
– Debt securities	15 120	534	-	15 654
– Inflation linked securities	1 096	-	-	1 096
– Money market securities	610	5 255	-	5 865
– Mutual funds	17 778	-	-	17 778
Available-for-sale financial instruments:				
– Equity securities	166	9	-	175
– Equity linked notes	-	20	-	20
– Debt securities	840	573	-	1 413
– Inflation linked securities	2	-	-	2
– Money market securities	2 382	1 787	-	4 169
– Mutual funds	1 768	-	-	1 768
Derivative financial instruments at fair value:				
– Hedges	-	337	-	337
– Non-hedges	-	157	-	157
	69 531	9 756	-	79 287
<b>Financial liabilities</b>				
Derivative financial instruments at fair value:				
– Hedges	-	51	-	51
– Non-hedges	-	27	-	27
	-	78	-	78

There were no transfers between level 1 and 2 during the current financial year.



## Additional information *continued*

at 30 June 2018

### Fair value hierarchy of financial instruments *continued*

#### Specific valuation techniques used to value financial instruments in level 2

- Discovery has invested in equity linked notes offered by international banks in order to back certain unit-linked contract liabilities. The calculation of the daily value of the equity linked investments is made by the provider of the note. Discovery has procedures in place to ensure that these prices are correct. Aside from the daily reasonableness checks versus similar funds and movement since the prior day's price, the fund values are calculated with reference to a specific formula or index, disclosed to the policyholders, which is recalculated by Discovery in order to check if the price provided by the provider is correct.
- If a quoted market price is not available on a recognised stock exchange or from a broker for non-exchange traded financial instruments, the fair value of the instrument is estimated by the asset managers, using valuation techniques including the use of recent arm's length market transactions, reference to the current fair value of another instrument that is substantially the same, discounted cash flow techniques, option pricing models or other valuation techniques that provide a reliable estimate of prices obtained in actual market transactions.
- The fair value of the hedged derivatives is calculated as follows:
  - (a) The fair value of call options is calculated on a Black-Scholes model.
  - (b) The fair value of the return swaps is calculated by discounting the future cash flows of the instruments.
  - (c) The fair value of interest rate swaps is calculated as the present value of the estimated future cash flows based on observable yield curves.

		30 June 2017			
R million (audited)		Level 1	Level 2	Level 3	Total
<b>Financial assets</b>					
Financial instruments at fair value through profit or loss:					
- Equity securities		24 069	-	-	24 069
- Equity linked notes		-	2 557	-	2 557
- Debt securities		11 815	462	-	12 277
- Inflation linked securities		386	-	-	386
- Money market securities		590	5 628	-	6 218
- Mutual funds		13 441	-	-	13 441
Available-for-sale financial instruments:					
- Equity securities		145	-	-	145
- Equity linked notes		-	17	-	17
- Debt securities		94	147	-	241
- Inflation linked securities		5	-	-	5
- Money market securities		642	1 588	-	2 230
- Mutual funds		4 660	-	-	4 660
Derivative financial instruments at fair value:					
- Hedges		-	354	-	354
- Non-hedges		-	38	-	38
		55 847	10 791	-	66 638
<b>Financial liabilities</b>					
Derivative financial instruments at fair value:					
- Hedges		-	29	-	29
- Non-hedges		-	106	-	106
		-	135	-	135

Exchange rates used in the preparation of these results

	USD	GBP
<b>30 June 2018</b>		
- Average	<b>12.86</b>	<b>17.33</b>
- Closing	<b>13.81</b>	<b>18.16</b>
<b>30 June 2017</b>		
- Average	13.61	17.29
- Closing	13.12	17.03



## Segmental information

for the year ended 30 June 2018

R million (audited)	SA Health	SA Life	SA Invest	SA Vitality
<b>Income statement</b>				
Insurance premium revenue	30	11 103	12 056	-
Reinsurance premiums	(2)	(2 141)	-	-
Net insurance premium revenue	28	8 962	12 056	-
Fee income from administration business	6 911	31	1 875	-
Vitality income	-	-	-	2 323
Investment income earned on assets backing policyholder liabilities	-	472	44	-
Finance charge on negative reserve funding	-	-	-	-
Inter-segment funding <sup>1</sup>	-	(708)	708	-
Net fair value gains on financial assets at fair value through profit or loss	2	589	3 741	-
Net income	6 941	9 346	18 424	2 323
Claims and policyholders' benefits	(2)	(6 943)	(7 375)	-
Insurance claims recovered from reinsurers	1	1 534	-	-
Net claims and policyholders' benefits	(1)	(5 409)	(7 375)	-
Acquisition costs	(3)	(1 606)	(1 046)	(76)
Marketing and administration expenses				
- depreciation and amortisation	(305)	(8)	-	(3)
- impairment	(7)	-	-	-
- other expenses	(3 855)	(1 639)	(808)	(2 186)
Recovery of expenses from reinsurers	-	-	-	-
Transfer from assets/liabilities under insurance contracts				
- change in assets arising from insurance contracts	-	3 405	-	-
- change in assets arising from reinsurance contracts	-	25	-	-
- change in liabilities arising from insurance contracts	(1)	(35)	(8 031)	-
- change in liabilities arising from reinsurance contracts	-	(239)	-	-
Fair value adjustment to liabilities under investment contracts	-	(3)	(279)	-
Share of net profits from equity-accounted investments	8	-	-	-
<b>Normalised profit/(loss) from operations</b>	<b>2 777</b>	<b>3 837</b>	<b>885</b>	<b>58</b>
Investment income earned on shareholder investments and cash	66	39	26	30
Net fair value gains on financial assets at fair value through profit or loss	-	-	-	-
Net realised gains on available-for-sale financial assets	-	6	1	-
Initial expenses related to Prudential Book transfer	-	-	-	-
Amortisation of intangibles from business combinations	-	-	-	-
Market rentals related to Head Office building adjusted for finance costs and depreciation	-	-	-	-
Finance costs	(41)	(9)	-	-
Foreign exchange (losses)/gains	(3)	-	(9)	-
<b>Profit before tax</b>	<b>2 799</b>	<b>3 873</b>	<b>903</b>	<b>88</b>
Income tax expense	(718)	(929)	(253)	(25)
<b>Profit for the year</b>	<b>2 081</b>	<b>2 944</b>	<b>650</b>	<b>63</b>

<sup>1</sup> The inter-segment funding of R708 million reflects a notional allocation of interest earned on the negative reserve backing policyholders' funds of guaranteed investment products and hence is transferred to Discovery Invest.

	UK Health	UK Life	All other segments	Segment total	IFRS reporting adjustments			IFRS total
					UK Life <sup>2</sup>	DUT <sup>3</sup>	Normalised profit adjustments <sup>4</sup>	
	7 471	4 031	2 665	37 356	(671)	-	-	36 685
	(1 165)	(1 559)	(160)	(5 027)	671	-	-	(4 356)
	6 306	2 472	2 505	32 329	-	-	-	32 329
	30	-	401	9 248	-	-	4	9 252
	444	91	1 633	4 491	-	-	-	4 491
	11	18	141	686	-	-	-	686
	-	(160)	-	(160)	160	-	-	-
	-	-	-	-	-	-	-	-
	(1)	92	18	4 441	-	1 312	70	5 823
	6 790	2 513	4 698	51 035	160	1 312	74	52 581
	(4 029)	(997)	(1 590)	(20 936)	447	(225)	-	(20 714)
	938	584	125	3 182	(447)	-	-	2 735
	(3 091)	(413)	(1 465)	(17 754)	-	(225)	-	(17 979)
	(536)	(1 887)	(280)	(5 434)	(160)	-	-	(5 594)
	(238)	(18)	(242)	(814)	-	-	(126)	(940)
	(193)	-	-	(200)	-	-	-	(200)
	(2 849)	(1 620)	(3 163)	(16 120)	(27)	-	68	(16 079)
	625	1 917	-	2 542	-	-	-	2 542
	-	2 855	-	6 260	(1 119)	-	-	5 141
	5	6	(1)	35	1	-	-	36
	76	(10)	(49)	(8 050)	(1)	(21)	(16)	(8 088)
	-	(2 828)	-	(3 067)	1 119	-	-	(1 948)
	-	-	-	(282)	-	(1 066)	40	(1 308)
	-	-	107	115	-	-	-	115
	589	515	(395)	8 266	(27)	-	40	8 279
	1	6	41	209	-	-	-	209
	-	-	110	110	-	-	(110)	-
	-	-	3	10	-	-	-	10
	-	(2)	-	(2)	-	-	2	-
	-	-	(123)	(123)	-	-	-	(123)
	-	-	(208)	(208)	-	-	208	-
	(1)	(2)	(713)	(766)	-	-	(193)	(959)
	-	(3)	11	(4)	-	-	-	(4)
	589	514	(1 274)	7 492	(27)	-	(53)	7 412
	(13)	(85)	303	(1 720)	27	-	16	(1 677)
	576	429	(971)	5 772	-	-	(37)	5 735

The segment information is presented on the same basis as reported to the Chief Executive Officers of the reportable segments. The segment total is then adjusted for accounting reclassifications and entries required to produce IFRS compliant results. These adjustments include the following:

- The VitalityLife results, for business written on the Prudential Assurance Company license, are reclassified to account for the contractual arrangement as a reinsurance contract under IFRS 4.
- The Discovery Unit Trusts (DUT) are consolidated into Discovery's results for IFRS purposes. In the Segment information the DUT column includes the effects of consolidating the unit trusts into Discovery's results, effectively being the income and expenses relating to units held by third parties.
- The effects of eliminating intercompany transactions on consolidation and normalised operating profit adjustments.



## Segmental information *continued*

for the year ended 30 June 2017

R million (Audited and restated)	SA Health	SA Life	SA Invest	SA Vitality Restated <sup>2</sup>
<b>Income statement</b>				
Insurance premium revenue	16	9 993	11 515	-
Reinsurance premiums	(2)	(1 838)	-	-
Net insurance premium revenue	14	8 155	11 515	-
Fee income from administration business	6 314	26	1 677	-
Vitality income	-	-	-	2 059
Investment income earned on assets backing policyholder liabilities	-	431	38	-
Finance charge on negative reserve funding	-	-	-	-
Inter-segment funding <sup>1</sup>	-	(573)	573	-
Net fair value gains on financial assets at fair value through profit or loss	-	476	1 317	-
Net income	6 328	8 515	15 120	2 059
Claims and policyholders' benefits	(1)	(6 241)	(6 800)	-
Insurance claims recovered from reinsurers	1	1 365	-	-
Recapture of reinsurance	-	-	-	-
Net claims and policyholders' benefits	-	(4 876)	(6 800)	-
Acquisition costs	-	(1 565)	(1 022)	(79)
Marketing and administration expenses				
- depreciation and amortisation	(303)	(15)	-	-
- other expenses	(3 520)	(1 521)	(663)	(1 955)
Recovery of expenses from reinsurers	-	-	-	-
Transfer from assets/liabilities under insurance contracts				
- change in assets arising from insurance contracts	-	3 577	-	-
- change in assets arising from reinsurance contracts	-	(4)	-	-
- change in liabilities arising from insurance contracts	-	(124)	(5 867)	-
- change in liabilities arising from reinsurance contracts	-	(397)	-	-
Fair value adjustment to liabilities under investment contracts	-	(2)	(24)	-
Share of net profits from equity-accounted investments	-	-	-	-
<b>Normalised profit/(loss) from operations</b>	2 505	3 588	744	25
Investment income earned on shareholder investments and cash	55	26	21	17
Net realised gains on available-for-sale financial assets	-	1	7	-
Rebranding and business acquisitions expenses	-	-	-	-
Amortisation of intangibles from business combinations	-	-	-	-
Finance costs	(49)	(8)	-	-
Foreign exchange losses	-	-	(8)	-
<b>Profit before tax</b>	2 511	3 607	764	42
Income tax expense	(685)	(1 008)	(214)	(13)
<b>Profit for the year</b>	1 826	2 599	550	29

<sup>1</sup> The inter-segment funding of R573 million reflects a notional allocation of interest earned on the negative reserve backing policyholders' funds of guaranteed investment products and hence is transferred to Discovery Invest.



UK Health	UK Life	All other segments Restated <sup>2</sup>	Segment total	IFRS reporting adjustments			IFRS total
				UK Life <sup>3</sup>	DUT <sup>4</sup>	Normalised profit adjustments <sup>5</sup>	
7 040	3 617	2 076	34 257	(724)	-	-	33 533
(1 335)	(1 183)	(203)	(4 561)	724	-	-	(3 837)
5 705	2 434	1 873	29 696	-	-	-	29 696
24	-	331	8 372	-	-	-	8 372
538	94	1 576	4 267	-	-	-	4 267
15	18	106	608	-	-	-	608
-	(43)	-	(43)	43	-	-	-
-	-	-	-	-	-	-	-
-	(109)	-	1 684	-	424	-	2 108
6 282	2 394	3 886	44 584	43	424	-	45 051
(4 376)	(740)	(1 426)	(19 584)	347	-	-	(19 237)
1 125	407	265	3 163	(347)	-	-	2 816
(858)	-	-	(858)	-	-	-	(858)
(4 109)	(333)	(1 161)	(17 279)	-	-	-	(17 279)
(574)	(1 744)	(210)	(5 194)	(43)	-	-	(5 237)
(214)	(6)	(161)	(699)	-	-	-	(699)
(2 533)	(1 431)	(2 926)	(14 549)	(103)	(202)	(99)	(14 953)
1 566	1 419	-	2 985	-	-	-	2 985
-	1 406	-	4 983	363	-	-	5 346
(111)	8	-	(107)	(2)	-	-	(109)
(25)	(14)	(35)	(6 065)	2	-	(562)	(6 625)
-	(1 214)	-	(1 611)	(363)	-	-	(1 974)
-	-	-	(26)	-	(222)	-	(248)
1	-	25	26	-	-	-	26
283	485	(582)	7 048	(103)	-	(661)	6 284
2	6	23	150	-	-	-	150
-	-	-	8	-	-	-	8
(91)	-	(8)	(99)	-	-	99	-
-	-	(171)	(171)	-	-	-	(171)
(2)	(1)	(418)	(478)	-	-	-	(478)
-	-	(13)	(21)	-	-	-	(21)
192	490	(1 169)	6 437	(103)	-	(562)	5 772
(21)	(119)	117	(1 943)	103	-	562	(1 278)
171	371	(1 052)	4 494	-	-	-	4 494

The segment information is presented on the same basis as reported to the Chief Executive Officers of the reportable segments. At each reporting date, Discovery must review whether the segments being disclosed still comply with IFRS 8 – Segment reporting. Based on this review, the following change was required:

2 The management control over the credit card operations in the Group has moved from Discovery Vitality to Discovery Bank and disclosed accordingly in the segmental report in the 'All other segments'.

The segment total is then adjusted for accounting reclassifications and entries required to produce IFRS compliant results. These adjustments include the following:

3 The VitalityLife results, for business written on the Prudential Assurance Company license, are reclassified to account for the contractual arrangement as a reinsurance contract under IFRS 4.

4 The Discovery Unit Trusts (DUT) are consolidated into Discovery's results for IFRS purposes. In the Segment information the DUT column includes the effects of consolidating the unit trusts into Discovery's results, effectively being the income and expenses relating to units held by third parties.

5 The effects of eliminating intercompany transactions on consolidation and normalised operating profit adjustments.



## Review of Group results

for the year ended 30 June 2018

### New business annualised premium income

The new business annualised premium income (API) set out below provides a view of the scale of new business across all operations of the Group and does not necessarily reflect the new business attributable to the legal entities within the Group. For instance, Discovery Health Medical Scheme (DHMS) new business is attributable to the medical scheme but is under the administration and marketing of Discovery Health which earns a fee in respect of such services.

Core new business API increased by 10% for the year ended 30 June 2018 when compared to the prior financial year.

R million	June 2018	June 2017	% change
Discovery Health – DHMS	5 422	5 157	5
Discovery Health – Closed Schemes <sup>1</sup>	1 151	952	21
Discovery Life	2 188	2 175	1
Discovery Invest	2 454	2 496	(2)
Discovery Insure	1 047	895	17
Discovery Vitality	162	167	(3)
VitalityHealth	1 107	972	14
VitalityLife	1 172	1 068	10
Ping An Health <sup>2</sup>	1 434	778	84
<b>Core new business API of Group</b>	<b>16 137</b>	<b>14 660</b>	<b>10</b>
New Closed Schemes <sup>1</sup>	96	623	(85)
<b>New business API of Group including new Closed Schemes</b>	<b>16 233</b>	<b>15 283</b>	<b>6</b>
Gross revenue Vitality Group <sup>3</sup>	645	634	2
<b>Total new business API and other new business</b>	<b>16 878</b>	<b>15 917</b>	<b>6</b>

1 The new business API for Closed Schemes includes additional lives on existing closed schemes. The new business API for New Closed Schemes includes contracted new business API and business in the first twelve months of on-boarding. Closed Schemes refer to those restricted to certain employers and industries.

2 Previously Ping An Health included 100% of the new business API. This has been restated to only include 25% in line with the Group's effective shareholding of 25% of this associate.

3 Vitality Group new business includes gross recurring and lump sum revenues earned by Vitality Group and specifically excludes revenue related to cost recoveries and rewards.

### Calculation of new business API

New business API is calculated at 12 times the monthly premium for new recurring premium policies and 10% of the value of new single premium policies. It also includes both automatic premium increases and servicing increases on existing long-term insurance policies. The amounts exclude indirect taxes.

The new business API in the table above differs from the new business API disclosed in the embedded value largely as a result of:

- *Inclusion of automatic premium increases and servicing increases on existing life policies* – These are included in the table above but excluded in the embedded value API values disclosed.

- *The timing of inclusion of policyholders in the calculation of new business API* – In the embedded value, new business is included from the earlier of the date that the first premium has been received or when the policy is on risk, whereas in the table above, new business is included when the policy has been contractually committed.

Refer to the footnotes to Table 7: Embedded Value of New Business for a more detailed description of the differences in new business disclosures between the embedded value and the table above.

## Gross inflows under management

Gross inflows under management measures the total funds collected by Discovery. Gross inflows under management increased by 9% for the year ended 30 June 2018 when compared to the prior financial year.

R million	June 2018	June 2017	% change
Discovery Health	75 430	68 226	11
Discovery Life	11 134	10 019	11
Discovery Invest	19 901	19 461	2
Discovery Insure	2 694	2 099	28
Discovery Vitality <sup>1</sup>	2 323	2 059	13
VitalityHealth	7 945	7 602	5
VitalityLife	4 122	3 711	11
All other businesses	2 005	1 884	6
<b>Gross inflows under management</b>	<b>125 554</b>	115 061	9
Less: collected on behalf of third parties	(74 459)	(68 165)	9
Discovery Health	(68 489)	(61 896)	11
Discovery Invest	(5 970)	(6 269)	(5)
<b>Gross income of Group per the segmental information</b>	<b>51 095</b>	46 896	9
Gross income is made up as follows:			
– Insurance premium revenue	37 356	34 257	9
– Fee income from administration business	9 248	8 372	10
– Vitality income	4 491	4 267	5
<b>Gross income of Group per the segmental information</b>	<b>51 095</b>	46 896	9

<sup>1</sup> The comparative has been restated to include the DiscoveryCard joint arrangement gross inflows under management in 'All other businesses', which was previously included in Discovery Vitality gross inflows under management. This restatement was necessary as the management control over the credit card operations in the Group has moved from Discovery Vitality to Discovery Bank and disclosed accordingly in the segmental report. The DiscoveryCard joint arrangement gross inflows amounts to R427 million (2017: R413 million).

## Normalised profit from operations

The following table shows the main components of the normalised profit from operations for the year ended 30 June 2018:

R million	June 2018	June 2017	% change
Discovery Health	2 777	2 505	11
Discovery Life	3 837	3 588	7
Discovery Invest	885	744	19
Discovery Vitality <sup>1</sup>	58	25	132
VitalityHealth	589	283	108
VitalityLife	515	485	6
<b>Normalised profit from established businesses</b>	<b>8 661</b>	7 630	14
Emerging businesses	158	(170)	193
– Discovery Insure	68	(21)	424
– Vitality Group	90	(149)	160
Development and other segments	(553)	(412)	(34)
<b>Normalised profit from operations</b>	<b>8 266</b>	7 048	17

<sup>1</sup> The comparatives have been restated to reallocate the DiscoveryCard joint arrangement and the additional 54.99% DiscoveryCard profit share from established businesses to the 'Development and other segments'. This restatement was necessary as management control over the credit card operations in the Group has moved from Discovery Vitality to Discovery Bank and disclosed accordingly in the segmental report. The Discovery Card joint arrangement and 54.99% DiscoveryCard profit share amounts to R259 million (2017: R165 million). The latter in the form of after tax dividends.



## Review of Group results *continued*

for the year ended 30 June 2018

Emerging businesses are those businesses that have achieved sufficient scale to be profitable or profitable in the near future, although not yet significant in cash generation for the Group and likely to require funds to support new business growth. These businesses are approximately 5 years into their launch. Discovery Insure, which has been disclosed in 'Emerging businesses', excludes the commercial offering which is a new venture that commenced during the year under review and is shown in 'Development and other segments'.

'Development and other segments' include costs of start-up businesses and expenses incurred to investigate new products and markets. Start-up costs include costs in relation to the Discovery Bank, Vitality Invest which is the recently launched UK investment business, a commercial offering in Discovery Insure, and an Umbrella Fund offering in Discovery Invest. Unallocated head office costs are also included in this segment.

### Significant transactions affecting the current results

#### Discovery's new head office

Discovery has entered into a 15 year lease agreement for its new head office which comprises two phases of development. The lease commenced November 2017 and March 2018 for Phase I and Phase II respectively. Discovery started taking occupancy of the buildings at those dates, on a phased approach.

*IAS 17: Leases*, requires a lessee to classify a lease as either a finance lease or an operating lease. A lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership. All other leases are classified as operating leases.

In terms of the indicators provided in IAS 17.10 and IAS 17.11, Discovery has classified the lease as a finance lease given that the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset. This accounting treatment has resulted in the recognition of an asset of R3 155 million, which has been disclosed in 'Property and equipment' and a corresponding lease liability, which has been disclosed in 'Borrowings' in the Statement of financial position. It should be noted that ownership of the building does not transfer at the end of the lease period but remains that of the landlord.

The treatment under *IFRS 16: Leases*, effective for reporting periods commencing on or after 1 January 2019, would result in a similar treatment with the lease capitalised and as a result the accounting treatment in respect of this particular lease is aligned with the future accounting standard effective not yet adopted by Discovery.

The recognised asset is depreciated over the lease term, using the straight-line method. R126 million depreciation has been recognised in profit or loss for the respective periods since beneficial occupancy. Finance charges of R210 million have been recognised in profit or loss in respect of the finance lease liability. Normalised profit from operations includes the market related rental paid.

As Discovery took occupancy of the new building on a phased approach various building costs, such as rental, have been duplicated during the transitional period in the current financial year as costs were incurred on both the new and old premises. For the calculation of normalised headline earnings, duplicate rental charges of R37 million have been added back.

## Borrowings at amortised cost

R million	Reference	June 2018	June 2017
Bank borrowings		9 050	6 774
– United Kingdom borrowings	i	1 810	2 174
– South African borrowings	ii	7 240	4 600
Redeemable preference shares		1 402	1 400
Finance lease liability		3 621	349
– New building		3 237	–
– Other finance lease liabilities		384	349
Bank overdraft		6	1
<b>Total borrowings at amortised cost</b>		<b>14 079</b>	<b>8 524</b>

### i. United Kingdom borrowings

Discovery previously entered into term facilities totaling GBP 150 million. These borrowings have been used to fund the new business acquisition costs incurred by VitalityLife, which were previously funded by The Prudential Assurance Company Limited (Prudential) and disclosed as Negative Reserve Funding in the Statement of financial position.

Discovery repaid GBP 15 million of this facility in previous financial periods and a further GBP 28 million of this facility during 2018, of which GBP 13 million was a voluntary prepayment. The balance owing at 30 June 2018 amounts to GBP 99.7 million (R1 810 million) (2017: GBP 127.5 million (R2 174 million)).

Interest rates on these facilities are floating, linked to 3 month LIBOR, payable quarterly in arrears. Finance charges of R40 million (2017: R50 million) in respect of these borrowings have been recognised in profit or loss.

### ii. South African borrowings

R million	Reference	June 2018	June 2017
Balance at beginning of the period		4 600	1 620
Issuance of listed debt	a.	1 500	–
Draw down on existing and new facilities	b. c.	1 154	2 996
Repayment of borrowings	b.	(80)	(48)
Accrued interest		77	34
Raising fees capitalised		(11)	(2)
<b>Balance at end of the period</b>		<b>7 240</b>	<b>4 600</b>

Moody's assigned a Aa3.za issuer rating to Discovery Limited on 20 October 2017.

- a. During the current financial year, Discovery registered an unsecured R10 billion Domestic Medium Term Note (DMTN) programme. In terms of this programme, Discovery issued R1.5 billion JSE Listed Notes in its inaugural issuance on 21 November 2017, with the following profile:

Interest	Interest payable in arrears	Capital repayment maturity date	Amount (R million)
Floating rate linked to 3 month JIBAR, plus 161 bps <sup>1</sup>	Quarterly	21 November 2022	500
Floating rate linked to 3 month JIBAR, plus 191 bps <sup>2</sup>	Quarterly	21 November 2024	800
Fixed rate at 10.46% per annum	Semi-annually	21 November 2024	200
			<b>1 500</b>

<sup>1</sup> Interest rates on these notes have been fixed at 9.71% per annum, through an interest rate swap.

<sup>2</sup> Interest rates on these notes have been fixed at 10.31% per annum, through an interest rate swap.



## Review of Group results *continued*

for the year ended 30 June 2018

- b. Discovery Central Services, a subsidiary of the Discovery Group, concluded a 10 year loan facility agreement of R650 million in December 2016, of which R495 million was utilised in the previous financial year. The remaining portion of this facility of R155 million was utilised during this financial period and R73 million was repaid in terms of the agreement. Interest rates on the facility are fixed at a weighted average rate of 11.56% per annum, with capital and interest repayable in instalments over the duration of the loan facility.
- c. Discovery Limited entered into a new unsecured R1 billion 5 year loan facility agreement in March 2018, which was fully drawn down in June 2018. Interest rates on this facility is linked to 3 month JIBAR, plus 245 bps. Interest is payable quarterly in arrears and capital is repayable in full at maturity on 2 March 2023. Interest rates on this facility have been fixed at 10.275% per annum, through an interest rate swap.

Finance charges of R512 million (2017: R368 million) in respect of these South African borrowings have been recognised in profit or loss.

### Negative reserve funding (acquisition cost funding)

This liability represents the acquisition costs in respect of business written on the Prudential Assurance Company's (Prudential) life insurance license and were funded by Prudential. The liability is repaid on a matched basis as the cash flows emerge from this business. In the event that the cash flows do not emerge as anticipated, VitalityLife would be required to repay these liabilities from other resources.

In terms of the level premium reinsurance treaty entered into in respect of this business, a security deposit was required to be placed by the reinsurer, to reduce counterparty risk. At 30 June 2018, GBP 169 million (R3 065 million) (2017: GBP 147 million (R2 501 million)) was held as a security deposit. The contractual arrangement in respect of the business written on the Prudential license is accounted for as a reinsurance contract under IFRS 4 and as a result, the 'deposit back' held has been disclosed as a reduction of the negative reserve funding liability.

During the 2018 financial year, additional amounts were received as 'deposit back' in excess of the negative reserve funding. The agreements indicate that offset is applicable up to the amount of the negative reserve funding. Any additional amounts of the deposit back received thereafter, are included in cash. The corresponding liability to the reinsurer has been accounted for in Trade and other payables.

The decrease in the negative reserve funding liability in the current financial year, relates to the partial repayment of funding by VitalityLife as well as an increase in the amount of deposit back held, which has been offset against the liability. There is still an amount payable to Prudential of GBP 120.5 million (R2 189 million) at 30 June 2018.

### Consolidation of Discovery Unit Trusts

The Discovery Unit Trusts are consolidated into Discovery's results for accounting purposes, which results in the recognition of the underlying assets and liabilities of each of the funds.

Assets and liabilities of the Discovery Unit Trusts increased by R7 689 million respectively compared to the prior financial year with movements in the following line items on the Group's Statement of financial position:

- Investments at fair value through profit or loss increased by R8 269 million.
- Investment contracts at fair value through profit or loss increased by R7 836 million.
- Cash and cash equivalents decreased by R617 million.
- Trade and other payables decreased by R144 million.
- Other assets increased by R37 million.
- Other liabilities decreased by R3 million.

As these policies are linked, the consolidation of the Discovery Unit Trusts has no impact on the net asset value for Discovery shareholders.

### Other significant items in these results

#### Material transactions with related parties

Discovery Health administers the Discovery Health Medical Scheme (DHMS) and provides managed care services for which it charges an administration fee and a managed healthcare fee respectively. These fees are determined on an annual basis and approved by the trustees of DHMS. The fees totalled R5 496 million for the year ended 30 June 2018 (2017: R5 090 million). Discovery offers the members of DHMS access to the Vitality programme.

#### Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss have increased by R12.3 billion due to market growth and the sale of Discovery Invest products. This includes the impact of consolidating the Discovery Unit Trusts into the Group's results. The increase in the financial assets at fair value through profit or loss has been presented in 'Purchase of investments held to back policyholder liabilities' of R24 217 million in the Statement of cash flows.

#### Deferred tax

With the promulgation of the South African Insurance Act 18 of 2017, in January 2018, the new 'adjusted IFRS' tax basis, effective 1 July 2018, has been substantively enacted as at 30 June 2018. As a result, deferred tax has been calculated on this basis and reflects the values at which the tax liabilities will ultimately be settled. A reduction in the deferred tax liability of R119 million has been recognised as a timing difference, and has been adjusted for in the calculation of normalised headline earnings.

During the current year a deferred tax asset has been recognised on the assessed loss in Discovery Insure. Further amounts were raised during the current year in respect of the VitalityHealth assessed losses. These amounted to R243 million and R109 million respectively, and have been added back in the calculation of normalised headline earnings.

## Taxation

For South African entities that are in a tax paying position, tax has been provided at 28% (2017: 28%) in the financial statements. Where an entity is in an assessed loss position, a deferred tax asset is recognised to the extent that it is probable that there will be future taxable profits against which assessed losses can be utilised.

## Shareholder information

### Directorate

Changes to the Board of Discovery Limited from 1 July 2017 to the date of this announcement are as follows:

- Mr R Farber relinquished his role as Chief Financial Officer and Group Financial Director of Discovery in the prior financial year and remained a director of the Board of Discovery Limited. Effective 1 April 2018, Mr R Farber was redesignated as a non-executive director.
- Mr JM Robertson has retired as executive director and Group Chief Information Officer from the Board of Discovery Limited with effect from 31 August 2018.

Dr BA Brink, Ms SE De Bruyn Sebotsa, Dr TV Maphai and Mr TT Mboweni retire by rotation at the forthcoming Annual General Meeting of shareholders and are eligible and available for re-election.

## Dividend and capital

### Interim dividends paid in respect of the 2018 financial year

The following interim dividends were paid during the current financial year:

- B preference share dividend of 518.15068 cents (414.52054 cents net of dividend withholding tax), paid on 12 March 2018.
- Ordinary share dividend of 101 cents per share (80.8 cents net of dividend withholding tax), paid on 19 March 2018.

### Final dividend declaration in respect of the 2018 financial year

#### B preference share cash dividend declaration:

On 23 August 2018, the directors declared a final gross cash dividend of 501.91781 cents (401.53425 cents net of dividend withholding tax) per B preference share for the period 1 January 2018 to 30 June 2018, payable from the income reserves of the Company. A dividend withholding tax of 20% will be applicable to all shareholders who are not exempt.

The issued preference share capital at the declaration date is 8 million B preference shares.

The salient dates for the dividend were as follows:

Last day of trade to receive a dividend	Tuesday, 11 September 2018
Shares commence trading "ex" dividend	Wednesday, 12 September 2018
Record date	Friday, 14 September 2018
Payment date	Monday, 17 September 2018

B preference share certificates may not be dematerialised or rematerialised between Wednesday, 12 September 2018 and Friday, 14 September 2018, both days inclusive.

#### Ordinary share cash dividend declaration:

Notice is hereby given that the directors have declared a final gross cash dividend of 114 cents (91.2 cents net of dividend withholding tax) per ordinary share, out of income reserves for the year ended 30 June 2018. A dividend withholding tax of 20% will be applicable to all shareholders who are not exempt.

The issued ordinary share capital at the declaration date is 646 844 992 ordinary shares.

The salient dates for the dividend will be as follows:

Last day of trade to receive a dividend	Tuesday, 2 October 2018
Shares commence trading "ex" dividend	Wednesday, 3 October 2018
Record date	Friday, 5 October 2018
Payment date	Monday, 8 October 2018

Share certificates may not be dematerialised or rematerialised between Wednesday, 3 October 2018 and Friday, 5 October 2018, both days inclusive.





## Review of Group results *continued*

for the year ended 30 June 2018

### Capital requirements

The table below summarises the capital adequacy requirement (CAR) on the statutory basis, across the Group subsidiaries, and the actual solvency capital held in relation to this requirement, at 30 June.

	Statutory CAR	2018 cover	Statutory CAR	2017 cover
Discovery Life	<b>R866 million</b>	<b>3.5 times</b>	R705 million	3.9 times
Discovery Insure	<b>R630 million</b>	<b>2.0 times</b>	R473 million	2.2 times
Vitality Health	<b>GBP 87 million (R1 580 million)</b>	<b>1.4 times</b>	GBP 83 million (R1 420 million)	1.5 times
Vitality Life	<b>GBP 133 million (R2 414 million)</b>	<b>1.9 times</b>	GBP 87.5 million (R1 490 million)	2.1 times

### Events after reporting date

#### Banking

As detailed in the operating commentary, subsequent to balance sheet date, Discovery and FirstRand Investment Holdings Limited (FRIHL) have agreed that it would be preferable for FRIHL to exit their shareholding in Discovery Bank as soon as practically possible.

The proposed transaction includes:

- (i) the acquisition of the effective 25.01% interest of FRIHL in Discovery Bank
- (ii) Acquiring the remaining 25.01% economic interest that FirstRand Bank currently owns in the Discovery Card joint venture business
- (iii) Discovery Bank acquiring all rights to the Discovery card book and related assets which will be migrated over time

The transaction is subject to approval by the regulatory authorities including The Chief Executive Officer of the Prudential Authority, SARB and The Competition Authorities.

The total combined acquisition price payable by Discovery to the FirstRand Group will be R1.8 billion. Since the acquisition of the remaining 25% constitutes a new initiative and presents an important opportunity for the Discovery Group, the Board have decided that this acquisition should be funded by way of an equity issuance, limited to the purchase price. Given the relative immateriality, the transaction does not require shareholder approval.

#### Listed debt issue

On 29 August 2018, as part of its ongoing capital management process, Discovery Limited issued further Floating Rate Notes in terms of its Domestic Medium Term Note Programme (DMTN) totalling R700 million. Capital repayment is on maturity date being 21 August 2026. The coupon interest rate in respect of the notes is linked to 3 month JIBAR plus 180 bps, with interest payable quarterly in arrears. Interest rates on these notes have been fixed at 10.29% per annum, through interest rate swap. This brings the total nominal value in issue under the DMTN programme to R2.2 billion.

### Basis of preparation

The summary consolidated financial statements are prepared in accordance with the requirements of the JSE Limited Listings Requirements, and the requirements of the Companies Act applicable to summary financial statements. The Listings Requirements require reports to be prepared in accordance with the framework concepts and the measurement and recognition requirements of International Financial Reporting Standards (IFRS) and the SAICA Financial Reporting Guides as issued by the Accounting Practices Committee and Financial Pronouncements as issued by the Financial Reporting Standards Council and to also, as a minimum, contain the information required by IAS 34 Interim Financial Reporting. The accounting policies applied in the preparation of the consolidated financial statements from which the summary consolidated financial statements were derived are in terms of International Financial Reporting Standards and are consistent with those accounting policies applied in the preparation of the previous consolidated annual financial statements.

### Audit

The summary consolidated financial statements are extracted from audited information, but are not audited. The annual financial statements were audited by PricewaterhouseCoopers Inc., who expressed an unmodified opinion thereon.

The audited annual financial statements and the auditor's report thereon are available for inspection at the company's registered office, together with the financial statements identified in the respective auditor's reports.

The directors of Discovery take full responsibility for the preparation of this report and that the financial information has been correctly extracted from the underlying annual financial statements.

## Embedded value statement

for the year ended 30 June 2018

The embedded value of Discovery consists of the following components:

- the adjusted net worth attributed to the business at the valuation date;
- plus: the present value of expected future shareholder cash flows from the in-force covered business;
- less: the cost of required capital.

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 required capital are the assets attributed to the covered business above the amount required to back covered business liabilities, whose distribution to shareholders is restricted as they are allocated to cover regulatory and internal capital requirements.

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, initial expenses and cost of required capital. The value of new business is calculated using the current reporting date assumptions.

For Discovery 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 the covered business in the Discovery Limited group. Covered business includes business written in South Africa through Discovery Life ("Life"), Discovery Invest ("Invest"), Discovery Health ("Health") and Discovery Vitality ("Vitality"), and in the United Kingdom through VitalityLife and VitalityHealth. For Vitality Group, Ping An Health, MyOwn Health, Discovery Insure and VitalityInvest, no published value has been placed on the current in-force business as the businesses have not yet reached suitable scale with predictable experience.

In August 2011, Discovery raised R800 million through the issue of non-cumulative, non-participating, non-convertible preference shares. For embedded value purposes this capital, net of share issue expenses, has been excluded from the adjusted net worth.

The 30 June 2018 embedded value results and disclosures were subjected to an external review.



## Embedded value statement *continued*

for the year ended 30 June 2018

Table 1: Group embedded value

R million	30 June 2018	30 June 2017	% change
Shareholders' funds	<b>37 594</b>	32 290	16
Adjustment to shareholders' funds from published basis <sup>1</sup>	<b>(32 261)</b>	(27 558)	
Adjusted net worth <sup>2</sup>	<b>5 333</b>	4 732	
Value of in-force covered business before cost of required capital	<b>62 702</b>	54 756	
Cost of required capital	<b>(2 411)</b>	(2 194)	
Discovery Limited embedded value	<b>65 624</b>	57 294	15
Number of shares (millions)	<b>645.1</b>	645.0	
Embedded value per share	<b>R101.73</b>	R88.83	15
Diluted number of shares (millions)	<b>646.2</b>	646.2	
Diluted embedded value per share <sup>3</sup>	<b>R101.56</b>	R88.67	15

<sup>1</sup> A breakdown of the adjustment to shareholders' funds is shown in the table below. An additional adjustment has been included as at 30 June 2018 to reverse the IAS 17 accounting treatment of the 1 Discovery Place lease contract. Future rental payments in respect of the covered businesses under the lease are capitalised in the value of in-force for covered business, consistent with the treatment of other renewal expenses. Note that where relevant, adjustments have been converted using the closing exchange rate of R18.16/GBP (June 2017: R17.03/GBP):

R million	30 June 2018	30 June 2017
Life net assets under insurance contracts	(21 479)	(18 354)
Vitality Life Limited and Discovery funded VitalityLife business on the Prudential licence net assets under insurance contracts	(4 834)	(3 620)
VitalityHealth financial reinsurance asset	(1 898)	(1 440)
VitalityHealth and VitalityHealth Insurance Limited deferred acquisition costs (net of deferred tax)	(331)	(252)
VitalityLife receivable relating to the Unemployment Cover benefit (net of deferred tax)	(27)	(27)
Goodwill and intangible assets (net of deferred tax) relating to the acquisition of Standard Life Healthcare and the Prudential joint venture	(3 121)	(3 086)
Net preference share capital	(779)	(779)
Reversal of 1 Discovery Place IAS 17 financial lease accounting	208	-
	<b>(32 261)</b>	<b>(27 558)</b>

<sup>2</sup> The following table sets out the capital position of the covered businesses with the required capital on a consistent basis to that used in the embedded value:

R million	30 June 2018	30 June 2017
Shareholders' funds	37 594	32 290
Adjustment to shareholders' funds	(32 261)	(27 558)
Adjusted net worth	5 333	4 732
Excess of available regulatory capital over adjusted net worth	5 411	4 100
Available regulatory capital	10 744	8 832
Regulatory required capital	5 691	4 477
Required capital buffer	3 224	2 664
Required capital	8 915	7 141
Excess available capital	1 829	1 691

The excess of available regulatory capital over adjusted net worth reflects the difference between the adjusted net worth and the available regulatory capital. This includes the net preference share capital of R779 million which is included as available regulatory capital. At 30 June 2018, this adjustment also includes the difference between Vitality Life Limited's Solvency II Pillar 1 Own Funds and its adjusted net worth and adds back the negative reserves eliminated on the Discovery funded VitalityLife business on the Prudential licence.

The required capital at June 2018 for Life is R1 732 million (June 2017: R1 409 million), for Health and Vitality is R840 million (June 2017: R797 million), for VitalityHealth is R2 133 million (June 2017: R1 984 million) and for VitalityLife is R4 210 million (June 2017: R2 951 million). For Life, the required capital was set equal to two times the statutory Capital Adequacy Requirement. For Health and Vitality, the required capital was set equal to two times the monthly renewal expense and Vitality benefit cost. For VitalityHealth, the required capital amount was set equal to 1.35 times (previously 1.4 times) the Solvency II Pillar 1 Solvency Capital Requirement. For the VitalityLife business on the Prudential licence, the required capital was set equal to the UK Solvency I long term insurance capital requirement as per the agreement with Prudential. For the business sold on the Vitality Life Limited licence, the required capital was set equal to the excess of 1.4 times the Solvency II Pillar 1 Solvency Capital Requirement. The Regulatory Required Capital is calculated as the relevant regulatory solvency capital requirement for each insurance business.

<sup>3</sup> 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 2: Value of in-force covered business

R million	Value before cost of required capital	Cost of required capital	Value after cost of required capital
<b>at 30 June 2018</b>			
Health and Vitality	21 046	(380)	20 666
Life and Invest <sup>1</sup>	28 066	(909)	27 157
VitalityHealth <sup>2</sup>	7 057	(336)	6 721
VitalityLife <sup>2</sup>	6 533	(786)	5 747
<b>Total</b>	<b>62 702</b>	<b>(2 411)</b>	<b>60 291</b>
<b>at 30 June 2017</b>			
Health and Vitality	18 595	(352)	18 243
Life and Invest <sup>1</sup>	25 102	(780)	24 322
VitalityHealth <sup>2</sup>	5 959	(307)	5 652
VitalityLife <sup>2</sup>	5 100	(755)	4 345
<b>Total</b>	<b>54 756</b>	<b>(2 194)</b>	<b>52 562</b>

<sup>1</sup> Included in the Life and Invest value of in-force covered business is R1 317 million (June 2017: R1 153 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.

<sup>2</sup> The value of in-force has been converted using the closing exchange rate of R18.16/GBP (June 2017: R17.03/GBP).

Table 3: Group embedded value earnings

R million	Year ended	
	30 June 2018	30 June 2017
Embedded value at end of period	65 624	57 294
Less: Embedded value at beginning of period	(57 294)	(53 080)
Increase in embedded value	8 330	4 214
Net change in capital <sup>1</sup>	(2)	4
Dividends paid	1 367	1 231
Transfer to hedging reserve	3	(29)
Employee share option schemes	(13)	(7)
Embedded value earnings	9 685	5 413
Annualised return on opening embedded value	16.9%	10.2%

<sup>1</sup> The net change in capital reflects an increase (decrease) in treasury shares in the period.



## Embedded value statement *continued*

for the year ended 30 June 2018

Table 4: Components of Group embedded value earnings

R million	Year ended 30 June 2018			Year ended 30 June 2017	
	Net worth	Cost of required capital	Value of in-force covered business	Embedded value	Embedded value
Total profit from new business (at point of sale)	(4 151)	(205)	7 182	<b>2 826</b>	2 437
Profit from existing business					
• Expected return	5 450	(39)	544	<b>5 955</b>	5 220
• Change in methodology and assumptions <sup>1</sup>	1 025	141	(379)	<b>787</b>	858
• Experience variances	580	(45)	(230)	<b>305</b>	66
Impairment, amortisation and fair value adjustment <sup>2</sup>	(54)	-	-	<b>(54)</b>	(95)
Increase in goodwill and intangibles	(246)	-	-	<b>(246)</b>	(203)
Other initiative costs <sup>3</sup>	(308)	-	23	<b>(285)</b>	(691)
Non-recurring expenses <sup>4</sup>	(30)	-	-	<b>(30)</b>	(103)
Acquisition costs <sup>5</sup>	(124)	-	2	<b>(122)</b>	(196)
Finance costs	(714)	-	-	<b>(714)</b>	(500)
Foreign exchange rate movements	272	(70)	814	<b>1 016</b>	(1 569)
Other <sup>6</sup>	(6)	1	(10)	<b>(15)</b>	4
Return on shareholders' funds <sup>7</sup>	262	-	-	<b>262</b>	185
Embedded value earnings	1 956	(217)	7 946	<b>9 685</b>	5 413

<sup>1</sup> The 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).

<sup>2</sup> This item reflects the amortisation of the intangible assets reflecting the DiscoveryCard profit share arrangement, banking costs and the PrimeMed acquisition.

<sup>3</sup> This item includes costs of start-up businesses and expenses incurred to investigate new products and markets. Start-up costs include costs in relation to the Discovery Bank, the recently launched UK investment business, Vitality Invest, a commercial offering in Discovery Insure, and an Umbrella Fund offering in Discovery Invest. Head office costs which relate to non-covered business are also included in this item.

<sup>4</sup> This item includes once-off costs relating to systems development spend in Discovery Health.

<sup>5</sup> Acquisition costs relate to commission paid on the VitalityLife and Life business and expenses incurred in writing Health and Vitality business that has been written over the period but will only be activated and on risk after the valuation date. These policies are not included in the embedded value or the value of new business and therefore the costs are not deducted from the value of new business.

<sup>6</sup> This item includes, among other items, the tax benefits or losses that will emerge as the VitalityHealth DAC and intangible software assets amortise or increase.

<sup>7</sup> The return on shareholders' funds is shown net of tax and management charges.

Table 5: Experience variances

R million	Health and Vitality		Life and Invest		VitalityHealth		VitalityLife		Total
	Net worth	Value of in-force	Net worth	Value of in-force	Net worth	Value of in-force	Net worth	Value of in-force	
Renewal expenses	210	-	46	(7)	(17)	-	15	-	<b>247</b>
Lapses and surrenders	18	226	(176)	254	-	(191)	(141)	(68)	<b>(78)</b>
Mortality and morbidity <sup>1</sup>	-	-	57	(21)	673	-	27	-	<b>736</b>
Policy alterations	-	60	(473)	399	-	-	(21)	(32)	<b>(67)</b>
Premium and fee income <sup>2</sup>	(26)	(691)	(34)	11	-	-	8	11	<b>(721)</b>
Economic assumptions	-	-	10	(383)	-	-	-	-	<b>(373)</b>
Commission	-	-	-	-	(95)	-	-	-	<b>(95)</b>
Tax <sup>3</sup>	76	-	230	(267)	172	-	99	-	<b>310</b>
Reinsurance	-	-	-	-	(43)	-	46	(4)	<b>(1)</b>
Maintain modelling term <sup>4</sup>	-	304	-	77	-	9	-	-	<b>390</b>
Vitality benefits	(14)	-	-	-	-	-	-	-	<b>(14)</b>
Other	52	(1)	(111)	98	(22)	-	14	(59)	<b>(29)</b>
<b>Total</b>	<b>316</b>	<b>(102)</b>	<b>(451)</b>	<b>161</b>	<b>668</b>	<b>(182)</b>	<b>47</b>	<b>(152)</b>	<b>305</b>

<sup>1</sup> The mortality and morbidity experience for VitalityHealth arises due to improvements in risk management, sales and retention models, claim payment processes, and an increase in Vitality engagement, resulting in lower experience loss ratios over those expected.

<sup>2</sup> The premium and fee income experience for Health and Vitality reflects the impact on administration and managed care fees due to the in-period inflation being lower than that assumed.

<sup>3</sup> The tax variance for Life and Invest arises due to a movement in the deferred tax asset which delays the payment of tax.

<sup>4</sup> The projection term for Health and Vitality, Group Life and VitalityHealth at 30 June 2018 has not been changed from that used in the 30 June 2017 embedded value calculation. Therefore, an experience variance arises because the total term of the in-force covered business is effectively increased by twelve months.

Table 6: Methodology and assumption changes

R million	Health and Vitality		Life and Invest		VitalityHealth		VitalityLife		Total
	Net worth	Value of in-force	Net worth	Value of in-force	Net worth	Value of in-force	Net worth	Value of in-force	
Modelling changes <sup>1</sup>	-	-	(279)	(610)	-	343	(68)	(101)	<b>(715)</b>
Expenses <sup>2</sup>	-	726	(19)	(118)	-	-	75	17	<b>681</b>
Lapses <sup>3</sup>	-	-	316	(1 744)	-	-	(16)	(59)	<b>(1 503)</b>
Mortality and morbidity	-	-	-	-	-	-	-	-	-
Benefit enhancements	-	-	(20)	(21)	-	-	-	-	<b>(41)</b>
Vitality benefits	-	-	-	-	-	-	-	-	-
Tax	-	-	-	38	-	-	-	3	<b>41</b>
Economic assumptions <sup>4</sup>	-	798	(651)	2 127	-	(23)	232	245	<b>2 728</b>
Premium and fee income	-	(317)	-	-	-	-	(1)	(64)	<b>(382)</b>
Reinsurance <sup>5</sup>	-	-	1 746	(1 772)	(18)	(33)	-	-	<b>(77)</b>
Other <sup>6</sup>	-	-	(53)	62	-	-	(219)	265	<b>55</b>
<b>Total</b>	<b>-</b>	<b>1 207</b>	<b>1 040</b>	<b>(2 038)</b>	<b>(18)</b>	<b>287</b>	<b>3</b>	<b>306</b>	<b>787</b>

<sup>1</sup> For Life and Invest, the modelling change item includes a change to the projection term limit of the value of in-force from valuing shareholder cash flows over their full term to a shorter 40 year projection term. VitalityHealth changed their methodology to calculate the value in-force from 30 June 2018. Under the new methodology, the value in-force at the valuation date is derived as the in-force written premium multiplied by the Margin multiplied by the Annuity Factor. The assumptions for the Margin and Annuity Factor are shown in Table 8.

<sup>2</sup> For Health and Vitality, the expenses item reflects a revision to the renewal expense assumption in light of the lower in-period inflation relative to expected.

<sup>3</sup> An increase was made to the Life lapse rate as a proxy for the impact of net policy alterations.

<sup>4</sup> The South African investment return assumptions for Life, Invest, Health and Vitality were changed from being applied in the model as a single interest rate to the full yield curve. Consistent with this, the real yield assumption was set relative to the observed real yield curve, adjusted to remove volatility due to the nature of the index linked government bond market. VitalityLife have adopted a passive investment return and real yield assumption, with the assumptions remaining fixed unless market conditions depart significantly from the assumptions at the financial year end.

<sup>5</sup> For Life the reinsurance item primarily relates to the impact of the financing reinsurance arrangements.

<sup>6</sup> For VitalityLife, the other item relates to the margin reset to offset acquisition costs and assumption and methodology changes, as per the accounting policy, and an alignment of the compulsory margins in VitalityLife to those used by Life.



## Embedded value statement *continued*

for the year ended 30 June 2018

Table 7: Embedded value of new business

R million	Year ended		
	30 June 2018	30 June 2017	% change
<b>Health and Vitality</b>			
Present value of future profits from new business at point of sale	<b>985</b>	820	
Cost of required capital	<b>(29)</b>	(31)	
Present value of future profits from new business at point of sale after cost of required capital	<b>956</b>	789	21
New business annualised premium income <sup>1</sup>	<b>4 086</b>	4 533	(10)
<b>Life and Invest</b>			
Present value of future profits from new business at point of sale <sup>2</sup>	<b>1 376</b>	1 304	
Cost of required capital	<b>(74)</b>	(73)	
Present value of future profits from new business at point of sale after cost of required capital	<b>1 302</b>	1 231	6
New business annualised premium income <sup>3</sup>	<b>2 773</b>	2 840	(2)
Annualised profit margin <sup>4</sup>	<b>5.6%</b>	5.5%	
Annualised profit margin excluding Invest business	<b>10.7%</b>	10.2%	
<b>VitalityHealth<sup>5</sup></b>			
Present value of future profits from new business at point of sale	<b>263</b>	157	
Cost of required capital	<b>(44)</b>	(46)	
Present value of future profits from new business at point of sale after cost of required capital	<b>219</b>	111	97
New business annualised premium income (Rand) <sup>6</sup>	<b>1 161</b>	958	21
Annualised profit margin <sup>4</sup>	<b>3.1%</b>	1.8%	
<b>VitalityLife<sup>7</sup></b>			
Present value of future profits from new business at point of sale	<b>407</b>	432	
Cost of required capital	<b>(58)</b>	(126)	
Present value of future profits from new business at point of sale after cost of required capital	<b>349</b>	306	14
New business annualised premium income (Rand)	<b>898</b>	844	6
Annualised profit margin <sup>4</sup>	<b>5.4%</b>	5.2%	

1 Health new business annualised premium income is the gross contribution to the medical schemes. The new business annualised premium income shown above excludes premiums in respect of members who join an existing employer where the member has no choice of medical scheme, as well as premiums in respect of new business written during the period but only activated after 30 June 2018.

The total Health and Vitality new business annualised premium income written over the period was R6 735 million (June 2017: R6 276 million).

2 Included in the Life and Invest embedded value of new business is R110 million (June 2017: R109 million) in respect of investment management services provided on off balance sheet investment business.

Risk business written prior to the valuation date allows certain Invest business to be written at financially advantageous terms, the impact of which has been recognised in the value of new business.

3 Life new business is defined as Life policies to which Life became contractually bound during the reporting period, including policies whose first premium is due after 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. Invest new business also includes Discovery Retirement Optimiser policies to which Life and Invest became contractually bound during the reporting period, including policies whose first premium is due after the valuation date.

The new business annualised premium income of R2 773 million (June 2017: R2 840 million) (single premium APE: R1 195 million (June 2017: R1 169 million)) shown above excludes automatic premium increases and servicing increases in respect of existing business. The total new business annualised premium income written over the period, including automatic premium increases of R1 254 million (June 2017: R1 172 million) and servicing increases of R615 million (June 2017: R659 million), was R4 642 million (June 2017: R4 671 million) (single premium APE: R1 248 million (June 2017: R1 277 million)). Single premium business is included at 10% of the value of the single premium.

Policy alterations and internal replacement policies, including Discovery Retirement Optimisers added to existing Life Plans, are shown in Table 5 as experience variances and not included as 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 VitalityHealth value of new business is calculated as the value at point of sale of the new business written premium in-force at the valuation date multiplied by the Margin multiplied by the Annuity Factor less the new business cash flows from point of sale to the valuation date. The assumptions for the Margin and Annuity Factor are shown in Table 8.

6 VitalityHealth new business is defined as individuals and employer groups which inceptioned 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 2018.

7 VitalityLife new business is defined as policies to which VitalityLife became contractually bound during the reporting period, including policies whose first premium is due after the valuation date.



## Basis of preparation

Table 8: Embedded value economic assumptions

	30 June 2018	30 June 2017
Beta coefficient	<b>0.75</b>	0.75
Equity risk premium (%)	<b>3.5</b>	3.5
Risk discount rate (%)		
Health and Vitality <sup>1</sup>	<b>12.155</b>	12.125
Life and Invest <sup>1</sup>	<b>12.875</b>	12.875
VitalityHealth	<b>4.02</b>	3.90
VitalityLife	<b>4.725</b>	4.755
Rand/GB Pound exchange rate		
Closing	<b>18.16</b>	17.03
Average	<b>17.33</b>	17.29
Margin over Expense inflation to derive Medical inflation (%)		
South Africa	<b>3.00</b>	3.00
Expense inflation (%)		
South Africa <sup>2</sup> – Health and Vitality	<b>6.85</b>	6.25
– Life and Invest	<b>7.48</b>	6.25
United Kingdom	<b>3.30</b>	3.25
Pre-tax investment return (%)		
South Africa – Cash <sup>1</sup>	<b>8.75</b>	8.75
– Life and Invest bonds <sup>3</sup>	<b>10.25</b>	10.25
– Health and Vitality bonds <sup>3</sup>	<b>9.53</b>	9.50
– Equity <sup>1</sup>	<b>13.75</b>	13.75
United Kingdom – VitalityHealth investment return	<b>1.40</b>	1.28
– VitalityLife investment return	<b>2.50</b>	2.13
Income tax rate (%)		
South Africa	<b>28</b>	28
United Kingdom – long term <sup>4</sup>	<b>17</b>	17
VitalityHealth Assumptions		
– Margin (net of tax and cost of capital) (%)	<b>14.1</b>	–
– Annuity Factor	<b>6.00</b>	–
Projection term		
– Health and Vitality	<b>20 years</b>	20 years
– Discovery Life – ViF	<b>40 years</b>	No cap
– Group Life	<b>10 years</b>	10 years
– VitalityLife	<b>No cap</b>	No cap
– VitalityHealth <sup>5</sup>	<b>20 years</b>	20 years

<sup>1</sup> Derived as a margin over (or below for cash) the respective pre-tax investment return for bonds.

<sup>2</sup> The inflation assumption is derived as the difference between the nominal and real yield curve at each duration. As an indication, the cash flow weighted average inflation is shown in the table.

<sup>3</sup> As indications, the cash flow weighted averages derived from the relevant yield curve(s) are shown.

<sup>4</sup> The United Kingdom Corporation tax rate assumed is 20% in 2017, 19% in 2018 to 2020, and 17% beyond that.

<sup>5</sup> The VitalityHealth projection term of 20 years is used in the derivation of the Annuity Factor.



## Embedded value statement *continued*

for the year ended 30 June 2018

The Discovery Limited embedded value is calculated based on a risk discount rate using the CAPM approach with specific reference to the Discovery beta coefficient. The assumed beta is fixed at 0.75. This has been set such that the risk discount rate proxies the result of a Weighted Average Cost of Capital approach with reference to the capital structure of the Group and the observed beta calculated using daily returns over a long time period. The observed beta is calculated with reference to the ALSI. The assumed beta will only change if the capital structure of the Group and/or the observed beta calculated using daily returns over a long time period suggest the beta assumption should depart significantly from the assumption at the financial year end. As beta values reflect the historic performance of share prices relative to the market they may not allow fully for non-market related and non-financial risk. Investors may want to form their own view on an appropriate allowance for these risks which have not been modelled explicitly.

Life and Invest mortality, morbidity, lapse and surrender assumptions were derived from internal experience, where available, augmented by reinsurance and industry information.

The Health and Vitality lapse assumptions were derived from the results of recent experience investigations.

The VitalityHealth assumptions were derived from internal experience.

VitalityLife assumptions were derived from internal experience, where available, augmented by reinsurance, industry and Discovery Limited group information.

Renewal expense assumptions were based on the results of the latest expense and budget information.

The initial expenses included in the calculation of the embedded value of new business are the actual costs incurred excluding expenses of an exceptional or non-recurring nature.

From 30 June 2018, the South African investment return assumptions for Life, Invest, Health and Vitality were based on the publicly available Prudential Authority risk-free nominal yield curve. The real yield assumption was set based on the publicly available Prudential Authority risk-free real yield curve, adjusted to remove volatility due to the nature of the index linked government bond market. Other economic assumptions were set relative to these two yield curves. The 30 June 2017 investment return assumptions, and other related economic assumptions, were based on a single interest rate derived from the risk-free zero coupon government bond yield curve.

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.

The best estimate investment return assumption for VitalityHealth was based on the single interest rate derived from the risk-free zero coupon sterling yield curve.

From 30 June 2018, VitalityHealth calculate the value in-force at the valuation date as the in-force written premium multiplied by the Margin multiplied by the Annuity Factor, as set out in the table above. The Annuity Factor assumption is derived from assumed future lapse rates and premium increases. The Margin assumption reflects profit margins after tax and Cost of Capital. The assumptions underlying the Annuity Factor and Margin are set taking into account the current experience in the business at different durations.

VitalityLife adopts a passive approach for setting economic assumptions. The nominal investment return and real return rate are fixed unless market conditions depart significantly from the assumptions at the financial year end. Other economic assumptions were set relative to these two passive yields.

It is assumed that, for the purposes of calculating the cost of required capital, the Life and Invest required capital amount will be backed by surplus assets consisting of 100% equities and the Health, Vitality, and VitalityHealth required capital amounts will be fully backed by cash. Vitality Life Limited and the VitalityLife business on the Prudential licence required capital amount is assumed to earn the same return as the assets backing the VitalityLife policyholder liabilities. Allowance has been made for tax and investment expenses in the calculation of the cost of required capital. In calculating the capital gains tax liability, it is assumed that the portfolio is realised every 5 years. The Life and Invest cost of required capital is calculated using the difference between the gross of tax equity return and the equity return net of tax and expenses. The Health, Vitality, and VitalityHealth cost of required capital is calculated using the difference between the risk discount rate and the net of tax cash return. Vitality Life Limited and the VitalityLife business on the Prudential licence cost of required capital is calculated using the difference between the risk discount rate and the net of tax asset return assumption.

The embedded value has been calculated in accordance with the Actuarial Society of South Africa's Advisory Practice Note ("APN") 107: Embedded Value Reporting, except the recommended disclosure of Free Surplus and Required Capital has been adjusted to take into account the revised capital requirements and resources arising from Solvency II in the United Kingdom as can be seen in Table 1 note 2.



## Embedded value statement *continued*

for the year ended 30 June 2018

### Sensitivity to the embedded value assumptions

The risk discount rate uses the CAPM approach with specific reference to the Discovery beta coefficient. As beta values reflect the historic performance of share prices relative to the market they may not allow fully for non-market related and non-financial risk. Investors may want to form their own view on an appropriate allowance for these risks which have not been modelled explicitly. The sensitivity of the embedded value and the embedded value of new business at 30 June 2018 to changes in the risk discount rate is included in the tables below.

For each sensitivity illustrated below, 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 sensitivity

R million	Adjusted net worth <sup>2</sup>	Health and Vitality	
		Value of in-force	Cost of required capital
Base	5 333	21 046	(380)
Impact of:			
Risk discount rate +1%	5 333	19 790	(413)
Risk discount rate -1%	5 333	22 442	(342)
Lapses -10%	5 191	21 775	(398)
Interest rates -1% <sup>1</sup>	4 295	20 981	(365)
Equity and property market value -10%	5 267	21 046	(380)
Equity and property return +1%	5 333	21 046	(380)
Renewal expenses -10%	5 408	23 071	(352)
Mortality and morbidity -5%	5 508	21 045	(380)
Projection term +1 year	5 333	21 379	(385)

<sup>1</sup> All economic assumptions were reduced by 1%.

<sup>2</sup> The sensitivity impact on the VitalityLife net of tax change in negative reserves is included in the adjusted net worth column.

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

Table 10: Value of new business sensitivity

R million	Health and Vitality	
	Value of new business	Cost of required capital
Base	985	(29)
Impact of:		
Risk discount rate +1%	921	(32)
Risk discount rate -1%	1 092	(26)
Lapses -10%	1 064	(31)
Interest rates -1% <sup>1</sup>	1 010	(28)
Equity and property return +1%	985	(29)
Renewal expenses -10%	1 137	(28)
Mortality and morbidity -5%	985	(29)
Projection term +1 year	1 023	(30)
Acquisition costs -10%	1 010	(29)

<sup>1</sup> All economic assumptions were reduced by 1%.

Life and Invest		VitalityHealth		VitalityLife		Embedded value	% change
Value of in-force	Cost of required capital	Value of in-force	Cost of required capital	Value of in-force	Cost of required capital		
28 066	(909)	7 057	(336)	6 533	(786)	<b>65 624</b>	
25 316	(811)	6 648	(316)	6 156	(939)	<b>60 764</b>	(7)
31 357	(1 028)	7 507	(357)	6 965	(572)	<b>71 305</b>	9
30 240	(976)	7 942	(377)	6 936	(554)	<b>69 779</b>	6
28 469	(956)	7 582	(357)	6 290	(1 266)	<b>64 673</b>	(1)
27 740	(909)	7 057	(336)	6 533	(786)	<b>65 232</b>	(1)
28 384	(909)	7 057	(336)	6 533	(786)	<b>65 942</b>	-
28 460	(907)	7 558	(336)	6 594	(743)	<b>68 753</b>	5
29 861	(893)	8 094	(336)	6 645	(769)	<b>68 776</b>	5
28 252	(914)	7 110	(338)	6 533	(786)	<b>66 184</b>	1

Life and Invest		VitalityHealth		VitalityLife		Value of new business	% change
Value of new business	Cost of required capital	Value of new business	Cost of required capital	Value of new business	Cost of required capital		
1 376	(74)	263	(44)	407	(58)	<b>2 826</b>	
1 109	(66)	210	(46)	297	(64)	<b>2 329</b>	(18)
1 691	(84)	323	(51)	532	(45)	<b>3 432</b>	21
1 647	(79)	385	(54)	558	(71)	<b>3 419</b>	21
1 449	(78)	317	(51)	331	(82)	<b>2 868</b>	1
1 418	(74)	263	(44)	407	(58)	<b>2 868</b>	1
1 422	(74)	330	(44)	427	(54)	<b>3 116</b>	10
1 505	(73)	411	(44)	443	(54)	<b>3 144</b>	11
1 393	(74)	271	(49)	407	(58)	<b>2 883</b>	2
1 516	(74)	306	(44)	459	(58)	<b>3 086</b>	9