Discovery

Unaudited interim results and cash dividend declaration for the six months ended 31 December 2008

RESULTS & COMMENTARY

Financial highlights

Operating profit from established businesses **+31%** to **R1 052 million**

New business API excluding Destiny **+28%** to **R2 798 million**

Headline earnings increase **19%** to **R489 million**

Diluted embedded value per share **+20%** to **R36.17**

Interim dividend of **25.5 cents per share**

Introduction

The results under review are for the first half of Discovery's 2009 financial year.

During this period, Discovery performed exceptionally well. Discovery's business model is based on organic growth driven by innovation to meet clients' needs. Today, Discovery stands for financial strength and product excellence. This placed the Group in a strong position during difficult economic conditions where consumer behaviour is often driven by caution, a flight to quality and a pursuit of value for money. Combined with an intense focus on driving excellence in all of its businesses, this has led to increased financial strength, continued innovation, and record levels of new business. Discovery also used the opportunity to focus on its capital base, increasing its capabilities and flexibility, positioning it well for further growth and additional opportunities.

Operating profit of established businesses – Discovery Health, Discovery Life, Discovery Vitality and PruHealth – increased 31% to R1.1 billion. For all businesses, operating profit, including Discovery Invest, PruProtect and the wind-down of Destiny Health Inc., increased by 21% to R746 million.

Record levels of new business

Discovery's strong conviction that innovation is a fundamental strategy that determines success, ensured that despite the economic conditions, the businesses continued growing. This has enabled the Group to create further product differentiation and excellence in markets that are often commoditised and highly price-sensitive. A wide range of new products and structures were rolled out across all of Discovery's businesses. For example, Discovery Life launched the Cover Integrator that significantly reduces the cost of life cover, while Discovery Health launched the Delta Plans, thereby bringing down the cost of health cover for those members who use its hospital network. Vitality launched the HealthyFood™ benefit in partnership with Pick n Pay that saves members up to 25% on HealthyFood™ products. In the UK, PruHealth significantly enhanced its Vitality offering, and PruProtect restructured its life insurance offering significantly to ensure enhanced price competitiveness. The effect of this approach generated record levels of new business, and assisted in strengthening the Group's distribution channels.

New business annualised premium income increased by 28% from R2.2 billion to R2.8 billion (excluding Destiny Health).

Capital strength and structure

Discovery's approach to capital management is based on prudence and a commitment to conservative gearing levels. The Group focused on enhancing its capital strength and increasing its flexibility. In particular, within Discovery Life, considerable work was done with Discovery Life's R4.5 billion negative reserve. This asset is of considerable quality with substantial margins and returns that are consistent and more than the Group's risk discount rate. However, it lacks flexibility and as it grows, it constitutes a concentration of resources. Two distinct structural changes were made:

- The first was to convert R750 million of the negative reserve into cash through a reinsurance financing structure and, in the process, transfer risk from the Discovery Life balance sheet, while retaining the upside margins of the negative reserve.
- The second, the transfer of the lapse risk of up to a further R1 billion of the negative reserve through a reinsurance structure, created the opportunity for Discovery Life to raise R1 billion of cash by selling retail investment products that can be backed by the remaining guaranteed negative reserve. This enables Discovery Invest to offer uniquely competitive investment products.

The combination of these initiatives was created to enable Discovery to realise up to R1.8 billion in cash and transfer risk while maintaining margins.

Overall, Discovery's financial position is excellent: the Group has no debt; Discovery Life covers its capital adequacy requirement by 6.4 times; the Discovery Health Medical Scheme's solvency reserves amount to more than R5.2 billion thereby exceeding the 25% statutory level, and in the UK, PruHealth covers its minimum capital requirements 2.2 times.

Discovery Health

Discovery Health's fundamental purpose is to provide affordable access to quality healthcare on a sustainable basis. The company's performance over the period exceeded expectation. Given its size and social relevance, there can be no compromise in operating and building Discovery Health. The results illustrate that across every aspect of the business, its performance was excellent. In addition, the scale and sophistication of its assets and positioning will enable it to assist in building a robust healthcare system, not only for its members, but for broader society.

Through Discovery Health's network, relationships with healthcare professionals and hospitals, as well as further research and development, healthcare costs were kept under control, and benefit choices to members increased further. Notably, despite the difficult financial environment, new business increased to its highest level in the company's history. An important barometer of success and a counter-intuitive result to the current economic climate, less than 3% of members reduced their benefit choices, while 97% of members opted to stay at or enhance their current benefit choice. An important milestone has been achieved with the Discovery Health Medical Scheme crossing the 25% statutory reserve level with more than R5.2 billion reserves. From an inter-structural perspective, Discovery Health achieved significant efficiencies while providing the most consistent service in the company's history. This positions Discovery Health uniquely from a competitive standpoint.

Operating profit grew by 22% to R475 million, while members grew by 4% to 2.1 million lives. The lapse rate remained at less than 4%.

Discovery Life

Discovery Life's performance was pleasing and exceeded expectation. The company is committed to leadership in the life insurance industry by developing a business of unique quality that meets clients' needs. The company's methodology focuses strongly on product distribution and financial excellence. The results illustrate this with new business (including Discovery Invest) growing by 58% to R993 million and operating profit growing by 29% to R618 million.

Nearly all strategies followed during the period were successful: the roll-out of the Cover Integrator and LifeTime benefits assisted in the growth of new business to record levels, while in terms of distribution, Discovery Life's agency force, Discovery Financial Consultants, continued to grow with agents' production significantly more than industry standards. The restructuring of the negative reserve created considerable capital robustness and flexibility, enabling the company to continue its growth going forward without recourse to additional shareholder funding. This also provides an open market check on the value of the negative reserve, embedded value and the assumptions underlying them.

The business transacted has been of exceptional quality resulting in positive experience variances over the period, notably, the claims loss ratio continues to exceed expectation and is dramatically below industry levels. This shows the sound risk management strategies applied and the benefits of integration with Vitality. Although the lapse rate did increase over the period, reflecting the tough economic conditions, it was not significantly above expectations. Considerable work has been done on conservation and the company's embedded value assumptions have been strengthened appropriately. Discovery is committed to building a life assurer of considerable scale and quality and, to this end, has invested in excess of R2 billion into Discovery Life since inception. The embedded value generated reflects a return on capital of 24%. Given its product, capital and distribution strength, Discovery Life is well positioned going forward.

Discovery Invest

Discovery Invest's performance was in line with expectations. Clearly, given market conditions, the environment in which Discovery Invest operates is a difficult one and, in this context, expectations have to be moderated. Having said this, Discovery Invest's approach of harnessing the market's asset management sophistication and choice of open architecture, together with products that protect investors from volatility and downside, have resonated well. During this period Discovery Invest was focused on building its capabilities and products to ensure that it is well positioned as market conditions improve. Distribution channels continue to grow with more than 1 600 brokers transacting business for Discovery Invest. Significant resources were put toward new product technology and online capabilities to ensure competitiveness. Many of these initiatives will be rolled out in the next quarter.

Vitality and DiscoveryCard

Vitality's performance exceeded expectation in terms of its strategic role. Its foundational purpose of making people healthier and providing a platform for all of Discovery's businesses, is well entrenched. The usage of its wide range of benefits increased substantially over the period, indicating a strong engagement of Discovery's clients in their wellness and in the Group's products. Over the last two years, considerable work has been done on the behavioural economics and incentives required to achieve the appropriate behavioural change. During the period, Vitality Age, Vitality Interactive and Personal Pathways were rolled out in the UK and will be rolled out in South Africa during the year. Vitality provides an excellent foundation for Discovery's future competitiveness, risk management and integration capabilities. A fundamental gap in the Vitality strategy has been the need to focus on nutrition. The new HealthyFood™ Benefit was developed to address this and is one of the largest Vitality initiatives to date. It involves international experts in the creation of its methodology and algorithms and importantly, will be a key product differentiator for Vitality and Discovery. Vitality is particularly well placed going forward.

DiscoveryCard's performance over the period was pleasing. Clearly, given the difficult economic environment brought about by the credit crisis, and the impact of the National Credit Act, the environment in which DiscoveryCard operates was a difficult one. DiscoveryCard's focus was therefore on the quality of its book, careful risk management, and developing further product offerings. The effect of these strategies has been positive with the credit book performing pleasingly and a continued steady growth in the number of cards being issued. DiscoveryCard's link to the HealthyFood™ Benefit will provide added impetus to its potential going forward.

PruHealth

PruHealth, Discovery's joint venture with the Prudential plc, performed well and is on track to achieve profitability during the calendar year. From a strategic perspective, in addition to profitability, the quality and scale of PruHealth is of considerable importance to Discovery, as it forms the foundation for the Discovery business model in the UK. Vitality and the integration of PruProtect and PruHealth will provide the same product, risk management and integration advantages as in the South African market. This is particularly important, given the level of commoditisation and price-competitiveness. To this end, there is considerable focus on the quality of PruHealth and its competitive position. Despite the difficult economic environment in the UK, PruHealth made substantial progress, with considerable new business transacted, and improvements in the claims loss ratio and expense levels. Lapse rates, particularly for SMEs and corporates, remain particularly low while levels of new business remain in line with expectation. New business grew by 9% to R271 million.

An important development during the period was the revision of the Vitality Gym Benefit Structure. Vitality's benefits are traditionally tiered by Vitality status, enabling members to enjoy richer benefits the higher their status level. The PruHealth Gym Benefit was structured on a usage basis where members paid lower monthly gym subscriptions based on their usage. While this is intellectually consistent with the Vitality Behaviour Model, it created considerable opportunities for adverse selection – members purchasing PruHealth products to gain access to the gyms, simply because they were already high gym users. During the early part of 2008 it became evident that a considerable number of individual members acquired online had joined PruHealth only for this reason. The incentives created by the usage model also resulted in a dramatic increase in gym usage among existing members. The analysis indicated that while this activity supported a very low level of health claims, it created considerable Vitality subsidy costs in the short term. It was felt that while a long-term argument for keeping these members on the existing gym structure could be made, it was necessary to secure the business model from adverse selection and to ensure that products meet the right customer need. PruHealth therefore followed a prudent approach to change the gym benefit to a status-based model, despite the fact that a proportion of members were likely to lapse. The decision took place during the period under review and has been rolled out successfully. A considerable number of those members lapsed, as expected, and therefore despite high volumes of new business, the total number of members covered by PruHealth has increased at a lower rate than what would otherwise have been the case.

Importantly, the short-term cost of this adverse selection amounted to £3 million and reversing this out of the operating loss of PruHealth illustrates more accurately the company's progress to profitability.

The quality of the business and its leadership position in the UK market, places PruHealth in a positive position going forward.

PruProtect

PruProtect, Discovery's UK life assurance joint venture with the Prudential plc, had a particularly active and pleasing period. At the previous announcement, PruProtect's performance was significantly below expectation, and in particular, the distribution channels were poorly developed. During the period under review, the company particularly focused on:

i. Improving the franchise distribution channel with more efficient incentive and management structures. By January 2009, there were 12 franchises with 91 account managers actively deployed across the UK. Early signs of traction are good. The company focused on building a telephone account management system which is the more traditional approach to distribution in the UK. PruProtect has also been working actively to secure contracts with a variety of multi-tier and single-tier organisations that will be serviced by these two distribution channels. The combination of these distribution channels will provide a significant distribution capability for PruProtect.

ii. The product structure was relaunched during November 2008. While Discovery Life's Vitality and Life Assurance technology resonated well in the UK market, the concept of increasing premium rates during the term of the policy was difficult to market. To overcome this, Vitality was streamlined with premium rates declining with health engagement. Early indications are that this has been well received by the UK market.

While many of these strategies are in their infancy, early signs are particularly positive. The application count has increased from 25 applications per day at the start of the period to 75 applications at the end. From a financial perspective, PruProtect's operating losses are largely in line with expectation.

Destiny

The wind-down of Destiny Health has progressed in line with budget. The membership base has decreased from 33 282 in March 2008 to 3 000 in February 2009. Discovery stated that the wind-down would cost approximately US$30 million and the company is on target to achieve this. In addition to the financial rigour applied, Discovery is pleased that service levels to members, and engagement with our partners and regulators have been performed in such a way as to maintain our reputation. Discovery continues to support the existing Vitality business and to explore opportunities in this regard.

MI Hilkowitz	A Gore
Chairperson	*Chief Executive Officer*

Income statement

for the six months ended 31 December 2008

R million	Group Six months ended December 2008 Unaudited	Group Six months ended December 2007 Unaudited	% change	Group Year ended June 2008 Audited
Insurance premium revenue	**2 535**	1 995		4 293
Reinsurance premiums	**(384)**	(361)		(780)
Net insurance premiums	**2 151**	1 634		3 513
Fee income from administration business	**1 356**	1 159		2 532
Receipt arising from reinsurance contract	**750**	–		–
Investment income	**115**	99		210
Net realised gains on financial instruments held as available-for-sale	**62**	147		252
Net fair value (losses)/gains on financial instruments at fair value through profit or loss	**(93)**	17		25
Vitality income	**443**	387		791
Net income	**4 784**	3 443		7 323
Claims and policyholder benefits	**(1 238)**	(1 007)		(2 156)
Insurance claims recovered from reinsurers	**362**	275		601
Net claims and policyholder benefits	**(876)**	(732)		(1 555)
Acquisition costs	**(753)**	(559)		(1 132)
Marketing and administration expenses	**(2 116)**	(1 783)		(3 784)
Recovery of expenses from reinsurers	**101**	42		148
Transfer from assets/liabilities under insurance contracts	**(337)**	452		749
– change in assets arising from insurance contracts	**584**	428		806
– change in liabilities arising from insurance contracts – Premium deficiency reserve	**(27)**	–		–
– change in liabilities arising from insurance contracts – Other	**(120)**	25		(55)
– change in liabilities arising from reinsurance contracts	**(774)**	(1)		(2)
Fair value adjustment to liabilities under investment contracts	**59**	(20)		(14)
Profit before impairment and BEE expenses	**862**	843	2	1 735
Impairment of financial instruments held as available-for-sale	**(63)**	–		–
BEE expenses	**(7)**	(11)		(23)
Profit from operations	**792**	832	(5)	1 712
Finance costs	**(9)**	(36)		(52)
Foreign exchange profit – unrealised	**–**	4		4
Profit before taxation	**783**	800	(2)	1 664
Taxation	**(282)**	(259)		(506)
Profit for the period	**501**	541	(7)	1 158
Attributable to:				
Equity holders	**490**	538		1 156
Minority interests	**11**	3		2
	501	541		1 158
Earnings per share for profit attributable to the equity holders during the period (cents):				
– basic	**89.3**	99.5	(10)	212.9
– diluted	**88.7**	98.4	(10)	211.1

Balance sheet

at 31 December 2008

R million	Group December 2008 Unaudited	Group June 2008 Audited
ASSETS		
Property and equipment	**231**	291
Intangible assets including deferred acquisition costs	**414**	243
Assets arising from insurance contracts	**4 504**	3 920
Investment in associate	**1**	1
Financial assets	**5 567**	5 299
– Equity securities	**1 839**	2 055
– Equity linked notes	**901**	459
– Debt securities	**247**	173
– Inflation linked securities	**64**	65
– Money market	**864**	1 034
– Derivatives	**58**	35
– Loans and receivables including insurance receivables	**1 594**	1 478
Deferred income tax	**181**	128
Current income tax asset	**36**	–
Reinsurance contracts	**115**	99
Cash and cash equivalents	**1 507**	812
Total assets	**12 556**	10 793
EQUITY		
Capital and reserves		
Share capital and share premium	**1 579**	1 468
Other reserves	**524**	721
Retained earnings	**4 338**	3 975
Total equity	**6 441**	6 164
LIABILITIES		
Liabilities arising from insurance contracts	**1 358**	1 061
Liabilities arising from reinsurance contracts	**785**	15
Financial liabilities	**1 495**	1 273
– Investment contracts at fair value through profit or loss	**1 442**	1 230
– Borrowings at amortised cost	**47**	37
– Derivatives	**6**	6
Deferred income tax	**1 209**	1 031
Deferred revenue	**76**	70
Provisions	**67**	54
Trade and other payables	**1 125**	1 116
Current income tax liabilities	**–**	9
Total liabilities	**6 115**	4 629
Total equity and liabilities	**12 556**	10 793

Headline earnings

for the six months ended 31 December 2008

R million	Group Six months ended December 2008 Unaudited	Group Six months ended December 2007 Unaudited	% change	Group Year ended June 2008 Audited
Headline earnings per share (cents):				
– undiluted	**89.2**	75.8	18	172.0
– diluted	**88.6**	74.9	18	170.6
The reconciliation between earnings and headline earnings is shown below:				
Net profit attributable to equity shareholders	**490**	538		1 156
Adjusted for:				
– realised profit on available-for-sale investments net of CGT	**(55)**	(128)		(222)
– impairment on available-for-sale investments net of CGT	**54**	–		–
Headline earnings	**489**	410	19	934
Weighted number of shares in issue (000's)	**548 060**	540 929	1	543 016
Diluted weighted number of shares (000's)	**551 819**	547 095	1	547 530

Cash flow statement

for the six months ended 31 December 2008

R million	Group Six months ended December 2008 Unaudited	Group Six months ended December 2007 Unaudited	Group Year ended June 2008 Audited
Cash flow from operating activities	**458**	61	385
Cash generated by operations	**1 184**	256	972
Policyholder net investments	**(652)**	(67)	(638)
Working capital changes	**(4)**	(146)	131
	528	43	465
Dividends received	**27**	23	33
Interest received	**107**	85	194
Interest paid	**(9)**	(11)	(25)
Taxation paid	**(195)**	(79)	(282)
Cash flow from investing activities	**264**	(164)	(269)
Net sales/(purchases) of investments	**328**	(30)	(76)
Net sales/(purchases) of equipment	**30**	(91)	(132)
Purchase of intangible assets	**(94)**	(43)	(66)
Decrease in loans receivable	**–**	–	5
Cash flow from financing activities	**(17)**	(77)	(334)
Proceeds from issuance of ordinary shares	**111**	35	50
Dividends paid to equity holders	**(134)**	(131)	(236)
Minority share buy-back	**(4)**	(5)	(8)
Loan to share trust participants	**–**	–	(109)
Increase/(repayment) of borrowings	**10**	24	(31)
Net increase/(decrease) in cash and cash equivalents	**705**	(180)	(218)
Cash and cash equivalents at beginning of the year	**812**	996	996
Exchange gains on cash and cash equivalents	**(10)**	(12)	34
Cash and cash equivalents at end of the period	**1 507**	804	812

Statement of changes in equity

for the six months ended 31 December 2008

	Attributable to equity holders of the Company							
R million	Share capital and share premium	Share-based payment reserve	Investment reserve	Translation reserve	Hedging reserve	Retained earnings	Minority interest	Total
31 December 2008								
Balance at 1 July 2008	**1 468**	**289**	**299**	**151**	**(18)**	**3 975**	**–**	**6 164**
Issue of capital	**111**	**–**	**–**	**–**	**–**	**–**	**(11)**	**100**
Share-based payments	**–**	**9**	**–**	**–**	**–**	**–**	**–**	**9**
Unrealised losses on investments	**–**	**–**	**(230)**	**–**	**–**	**–**	**–**	**(230)**
Capital gains tax on unrealised gains on investments	**–**	**–**	**34**	**–**	**–**	**–**	**–**	**34**
Realised gains on investments transferred to income statement	**–**	**–**	**(62)**	**–**	**–**	**–**	**–**	**(62)**
Capital gains tax on realised gains on investments	**–**	**–**	**7**	**–**	**–**	**–**	**–**	**7**
Impairment of investments transferred to income statement	**–**	**–**	**63**	**–**	**–**	**–**	**–**	**63**
Capital gains tax on impairment on investments	**–**	**–**	**(9)**	**–**	**–**	**–**	**–**	**(9)**
Currency translation differences	**–**	**–**	**–**	**(21)**	**–**	**–**	**–**	**(21)**
Transfer from hedging reserve	**–**	**–**	**–**	**–**	**12**	**–**	**–**	**12**
Net profit for the period	**–**	**–**	**–**	**–**	**–**	**490**	**11**	**501**
Dividends paid to equity holders	**–**	**–**	**–**	**–**	**–**	**(134)**	**–**	**(134)**
Realised profit on minority share buy-back	**–**	**–**	**–**	**–**	**–**	**7**	**–**	**7**
Balance at 31 December 2008	**1 579**	**298**	**102**	**130**	**(6)**	**4 338**	**–**	**6 441**
31 December 2007								
Balance at 1 July 2007	1 393	257	542	115	(2)	3 057	–	5 362
Issue of capital	34	–	–	–	–	–	(3)	31
Share-based payments	–	16	–	–	–	–	–	16
Unrealised gains on investments	–	–	10	–	–	–	–	10
Capital gains tax on unrealised gains on investments	–	–	(5)	–	–	–	–	(5)
Realised gains on investments transferred to income statement	–	–	(147)	–	–	–	–	(147)
Capital gains tax on realised gains on investments	–	–	19	–	–	–	–	19
Currency translation differences	–	–	–	(7)	–	–	–	(7)
Transfer from hedging reserve	–	–	–	–	3	–	–	3
Net profit for the period	–	–	–	–	–	538	3	541
Dividends paid to equity holders	–	–	–	–	–	(131)	–	(131)
Realised loss on minority share buy-back	–	–	–	–	–	(2)	–	(2)
Balance at 31 December 2007	1 427	273	419	108	1	3 462	–	5 690

Segmental information

for the six months ended 31 December 2008

R million	Health			Life			
	South Africa	United States of America	United Kingdom	South Africa	United Kingdom	Vitality	Total
31 December 2008							
Income statement							
Insurance premium revenue	12	211	350	1 951	11	–	2 535
Reinsurance premiums	(1)	(10)	(55)	(318)	–	–	(384)
Net insurance premiums	11	201	295	1 633	11	–	2 151
Fee income from administration business	1 302	–	–	43	–	11	1 356
Receipt arising from reinsurance contract	–	–	–	750	–	–	750
Net fair value losses on financial instruments at fair value through profit or loss backing investment contracts	–	–	–	(59)	–	–	(59)
Vitality income	–	17	–	–	–	426	443
Net income	1 313	218	295	2 367	11	437	4 641
Claims and policyholder benefits	(4)	(257)	(236)	(738)	(3)	–	(1 238)
Insurance claims recovered from reinsurers	1	29	35	295	2	–	362
Net claims and policyholder benefits	(3)	(228)	(201)	(443)	(1)	–	(876)
Acquisition costs	–	(10)	(25)	(658)	(33)	(27)	(753)
Marketing and administration expenses	(835)	(113)	(211)	(494)	(76)	(387)	(2 116)
Recovery of expenses from reinsurer	–	–	88	–	13	–	101
Transfer from assets/liabilities under insurance contracts							
– change in assets arising from insurance contracts	–	–	–	584	–	–	584
– change in liabilities arising from insurance contracts – Premium deficiency reserve	–	(27)	–	–	–	–	(27)
– change in liabilities arising from insurance contracts – Other	–	14	(10)	(106)	(18)	–	(120)
– change in liabilities arising from reinsurance contracts	–	–	–	(774)	–	–	(774)
Fair value adjustment to liabilities under investment contracts	–	–	–	59	–	–	59
Profit/(loss) before investment income, impairment and BEE expenses	475	(146)	(64)	535	(104)	23	719
Investment income							115
Net realised gains on financial instruments held as available-for-sale							62
Net fair value losses on financial instruments at fair value through profit or loss backing insurance contracts							(34)
Impairment on financial instruments held as available-for-sale							(63)
BEE expenses							(7)
Profit from operations							792
Finance costs							(9)
Profit before taxation							783
Taxation							(282)
Profit for the period							501

Segmental information (continued)

for the six months ended 31 December 2007

R million	Health			Life				
	South Africa	United States of America	United Kingdom	South Africa	United Kingdom	Vitality	Hold-ings	Total
31 December 2007								
Income statement								
Insurance premium revenue	7	347	215	1 424	2	–	–	1 995
Reinsurance premiums	(1)	(33)	(45)	(282)	–	–	–	(361)
Net insurance premiums	6	314	170	1 142	2	–	–	1 634
Fee income from administration business	1 137	–	–	22	–	–	–	1 159
Net fair value losses on financial instruments at fair value through profit or loss backing investment contracts	–	–	–	20	–	–	–	20
Vitality income	–	–	–	–	–	387	–	387
Net income	1 143	314	170	1 184	2	387	–	3 200
Claims and policyholder benefits	(7)	(330)	(140)	(530)	–	–	–	(1 007)
Insurance claims recovered from reinsurers	2	25	25	223	–	–	–	275
Net claims and policyholder benefits	(5)	(305)	(115)	(307)	–	–	–	(732)
Acquisition costs	–	(16)	(23)	(490)	(4)	(26)	–	(559)
Marketing and administration expenses	(752)	(108)	(153)	(374)	(38)	(340)	(18)	(1 783)
Recovery of expenses from reinsurer	–	–	41	–	1	–	–	42
Transfer from assets/liabilities under insurance contracts								
– change in assets arising from insurance contracts	–	–	–	428	–	–	–	428
– change in liabilities arising from insurance contracts	3	35	(3)	(7)	(3)	–	–	25
– change in liabilities arising from reinsurance contracts	–	–	–	(1)	–	–	–	(1)
Fair value adjustment to liabilities under investment contracts	–	–	–	(20)	–	–	–	(20)
Profit/(loss) before investment income and BEE expenses	389	(80)	(83)	413	(42)	21	(18)	600
Investment income								99
Net realised gains on financial instruments held as available-for-sale								147
Net fair value losses on financial instruments at fair value through profit or loss backing insurance contracts								(3)
BEE expenses								(11)
Profit from operations								832
Finance costs								(36)
Foreign exchange profit – unrealised								4
Profit before taxation								800
Taxation								(259)
Profit for the period								541

Embedded value statement

The embedded value of Discovery at 31 December 2008 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 on revised assumptions as at the current reporting date.

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 six months ended 31 December 2008. A copy of the auditors' unqualified report is available for inspection at the company's registered office.

Impact of changes to Professional Guidance

The embedded value of Discovery has been calculated in accordance with the Actuarial Society of South Africa's updated Professional Guidance Note PGN 107: Embedded Value Reporting (Version 4). The prior period results 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.

This has resulted in a number of changes to the calculation methodology 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 1.54% at 31 December 2008. 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.

- 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 are shown in Table 1:

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

R million	30 June 2008	31 December 2007
Published embedded value	**16 464**	15 350
Impact of:		
Change to risk discount rate margin	**1 527**	1 573
Change to cost of required capital	**(128)**	(114)
Restated embedded value	**17 863**	16 809
Published value of new business	**805**	444
Impact of:		
Change to risk discount rate margin	**284**	153
Change to cost of required capital	**(16)**	(7)
Restated value of new business	**1 073**	590

Table 2: Group embedded value

R million	31 December 2008	31 December 2007 Restated	% change	30 June 2008 Restated
Shareholders' funds	**6 441**	5 690	13	6 164
Adjustment to shareholders' funds from published basis[(1)]	**(3 809)**	(3 318)		(3 879)
Adjusted net worth	**2 632**	2 372		2 285
– Free Surplus	**1 734**	1 651		1 543
– Required Capital[(2)]	**898**	721		742
Run-down costs for Destiny Health[(3)]	**(75)**	(300)		(190)
Value of in-force covered business before cost of capital	**18 536**	15 348		16 560
Cost of required capital	**(245)**	(173)		(203)
Cost of STC[(4)]	**(425)**	(438)		(589)
Discovery Holdings embedded value	**20 423**	**16 809**	**22**	**17 863**
Number of shares (millions)	**554.4**	542.7		546.0
Embedded value per share	**R36.84**	R30.97	19	R32.71
Diluted number of shares (millions)	**592.0**	592.0		592.0
Diluted embedded value per share[(5)]	**R36.17**	R30.15	20	R32.02

(1) The published Shareholders' funds has been adjusted to eliminate net assets under insurance contracts and deferred acquisition costs at December 2008 of R3 777 million (December 2007: R3 287 million; June 2008: R3 845 million) in respect of Life and R32 million (December 2007: R31 million; June 2008: R34 million) in respect of PruHealth.

(2) The required capital at December 2008 for Life is R484 million (December 2007: R365 million; June 2008: R348 million), for Health and Vitality is R314 million (December 2007: R281 million; June 2008: R291 million) and for PruHealth is R100 million (December 2007: R75 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 is calculated by increasing the embedded value by the value of the loan to the Discovery Holdings share trust, and by increasing the number of shares by the number of shares issued to the share incentive trust which have not been delivered to participants. An allowance has been made for Discovery's BEE transaction where the impact is dilutive i.e. where the current embedded value per share exceeds the current transaction value.

Embedded value statement (continued)

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 31 December 2008				
Health and Vitality	**8 613**	**(105)**	**(196)**	**8 312**
Life and Invest(1)	**9 515**	**(113)**	**(220)**	**9 182**
PruHealth(2)	**408**	**(27)**	**(9)**	**372**
Total	**18 536**	**(245)**	**(425)**	**17 866**
at 31 December 2007 (Restated)				
Health and Vitality	7 128	(94)	(203)	6 831
Life and Invest(1)	7 910	(58)	(226)	7 626
PruHealth(2)	310	(21)	(9)	280
Total	15 348	(173)	(438)	14 737
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 R121 million (December 2007: R7 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	Six months ended 31 December **2008**	Six months ended 31 December 2007 Restated	Year ended 30 June 2008 Restated
Embedded value at end of period	**20 423**	16 809	17 863
Less: Embedded value at beginning of period	**(17 863)**	(15 395)	(15 395)
Increase in embedded value	**2 560**	1 414	2 468
Net issue of capital	**(100)**	(31)	(73)
Dividends paid	**134**	131	236
Minority share buy-back	**(7)**	5	2
Transfer to hedging reserve	**(12)**	(3)	16
Embedded value earnings	**2 575**	1 516	2 649
Annualised return on opening embedded value	**30.9%**	20.7%	17.2%

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)	(885)	(29)	1 611	**697**
Profit from existing business				
– Expected return	121	2	857	**980**
– Change in methodology and assumptions[(1)]	774	(16)	162	**920**
– Experience variances	(55)	(3)	334	**276**
Other initiative costs[(2)]	(186)	–	–	**(186)**
Acquisition costs[(3)]	(35)	–	–	**(35)**
Foreign exchange rate movements	(21)	4	(52)	**(69)**
Cost of STC[(4)]	–	–	114	**114**
Return on shareholders' funds[(5)]	(122)	–	–	**(122)**
Embedded value earnings	(409)	(42)	3 026	**2 575**

(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) Acquisition costs relate to commission paid on Life business and expenses incurred in writing Health and Vitality business that has been written over the period but that 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 thus the costs are excluded.

(4) 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.

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

Embedded value statement (continued)

Table 6: Methodology and assumption changes

R million	Health and Vitality Net worth	Health and Vitality Value of in-force	Life Net worth	Life Value of in-force	PruHealth Net worth	PruHealth Value of in-force	Total
Modelling changes	–	–	6	(52)	–	–	**(46)**
Economic assumptions	–	577	(71)	1 766	–	139	**2 411**
Benefit enhancements(1)	–	(152)	(82)	(177)	–	–	**(411)**
Lapse assumption(2)	–	–	103	(933)	–	(29)	**(859)**
Premium increases	–	–	(1)	(13)	–	–	**(14)**
Mortality and morbidity	–	–	1	(1)	–	(55)	**(55)**
Expenses(3)	–	(106)	–	–	–	32	**(74)**
Tax	–	–	–	(20)	–	–	**(20)**
Reinsurance(4)	–	–	818	(833)	–	–	**(15)**
Vitality	–	–	–	–	–	3	**3**
Total	**–**	**319**	**774**	**(263)**	**–**	**90**	**920**

(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. The change also includes benefit enhancements relating to the launch of the 2009 Vitality benefits.

(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.

(3) The Health and Vitality expense assumption has been increased to allow for higher costs due to the provision of Pharmaceutical Benefit Management (PBM) services to the Discovery Health Medical Scheme.

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

Table 7: Experience variances

R million	Health and Vitality Net worth	Health and Vitality Value of in-force	Life Net worth	Life Value of in-force	PruHealth Net worth	PruHealth Value of in-force	Total
Renewal expenses	23	–	(10)	–	(19)	–	**(6)**
Other expenses(1)	(23)	–	(5)	–	–	–	**(28)**
Economic assumptions(2)	(1)	118	14	123	–	–	**254**
Extended modelling term(3)	–	101	–	5	–	13	**119**
Lapses and surrenders(4)	–	27	(11)	(87)	–	(39)	**(110)**
Policy alterations	–	3	(104)	165	–	–	**64**
Premium income	–	–	3	5	–	–	**8**
Mortality and morbidity	–	–	89	7	(28)	–	**68**
Backdated cancellations	–	–	(16)	(47)	–	–	**(63)**
Tax	(1)	–	12	(10)	(12)	–	**(11)**
Gym start-up costs	–	–	–	–	(11)	–	**(11)**
Reinsurance	–	–	–	–	94	(76)	**18**
Other	14	–	(32)	30	(31)	(7)	**(26)**
Total	**12**	**249**	**(60)**	**191**	**(7)**	**(109)**	**276**

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

(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 31 December 2008 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 six months.

(4) Included in the Health and Vitality lapse experience variance is an amount of R281 million in respect of members joining existing employer groups during the period, offset by an amount of negative R302 million in respect of members leaving existing employer groups. A positive variance of R48 million is due to lower than expected lapses.

Table 8: Embedded value of new business

R million	Six months ended 31 December 2008	31 December 2007 Restated	% change	Year ended 30 June 2008 Restated
Health and Vitality				
Present value of future profits from new business at point of sale	**158**	95		246
Cost of required capital	**(4)**	(4)		(9)
Cost of STC	**(2)**	(3)		(9)
Present value of future profits from new business at point of sale after cost of required capital and STC	**152**	88	73	228
New business annualised premium income(1)	**499**	449	11	1,079
Life and Invest				
Present value of future profits from new business at point of sale(2)	**540**	504		855
Cost of required capital	**(21)**	(9)		(18)
Cost of STC	**(12)**	(14)		(29)
Present value of future profits from new business at point of sale after cost of required capital and STC	**507**	481	5	808
New business annualised premium income(3)	**654**	435	50	964
Annualised profit margin(4)	**8.3%**	11.8%		8.4%
Annualised profit margin excluding Invest Business	**10.2%**	12.1%		9.2%
PruHealth(5)				
Present value of future profits from new business at point of sale	**45**	25		48
Cost of required capital	**(4)**	(3)		(10)
Cost of STC	**(3)**	(1)		(1)
Present value of future profits from new business at point of sale after cost of required capital and STC	**38**	21	81	37
New business annualised premium income(6)	**108**	94	15	219
Annualised profit margin(4)	**3.9%**	3.0%		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 31 December 2008.
The total Health and Vitality new business annualised premium income written over the period was R1 505 million (December 2007: R1 311 million; June 2008: R2 834 million).
The increase in the value of new business is due mainly to a favourable change in the mix of business driven by strong membership growth on the non-Keycare Discovery Health Medical Scheme benefit options over the period.

(2) Included in the Life and Invest value of new business is R26 million in respect of investment management services provided on off balance sheet investment business.

(3) Life new business is defined as 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. There have been no changes to the definition of new business since the previous valuation.
The new business annualised premium income of R654 million (single premium APE: R88 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 R201 million and servicing increases of R138 million was R993 million (single premium APE: R88 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 31 December 2008. There have been no changes to the definition of new business since the previous valuation.

Embedded value statement (continued)

Table 9: Embedded value economic assumptions

		31 December 2008	31 December 2007 Restated	30 June 2008 Restated
Beta coefficient				
South Africa		**0.44**	0.41	0.44
United Kingdom		**0.44**	0.70	0.74
Equity risk premium				
South Africa		**3.50**	3.50	3.50
United Kingdom		**4.00**	4.00	4.00
Risk discount rate (%)				
– Health and Vitality		**9.04**	10.19	12.54
– Life and Invest		**9.04**	10.19	12.54
– PruHealth		**6.00**	8.00	8.70
Rand/GB Pound exchange rate				
Closing		**13.60**	13.63	15.60
Average		**14.75**	14.00	14.66
Medical inflation (%)				
South Africa		**7.50**	7.75	10.00
United Kingdom		**Current levels reducing to 6.00% over the projection period**	Current levels reducing to 7.50% over the projection period	Current levels reducing to 7.50% over the projection period
Expense inflation and CPI (%)				
South Africa		**4.50**	4.75	7.00
United Kingdom		**3.00**	4.00	4.00
Pre-tax investment return (%)				
South Africa	– Cash	**6.00**	7.25	9.50
	– Bonds	**7.50**	8.75	11.00
	– Equity	**11.00**	12.25	14.50
United Kingdom	– Cash	**3.75**	5.25	5.25
Dividend cover ratio		**4.5 times**	4.5 times	4.5 times
Income tax rate (%)				
South Africa		**28.00**	29.00	28.00
United Kingdom		**28.00**	28.00	28.00
Projection term				
– Health and Vitality		**20 years**	20 years	20 years
– Group Life		**10 years**	10 years	10 years
– PruHealth		**20 years**	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 18 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.

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. An additional lapse rate is assumed over the next two years for group business to allow for the potential 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 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 31 December 2008 to changes in the risk discount rate is shown below. In determining the values at different risk discount rates, all other assumptions have been left unchanged.

Table 10: Embedded value sensitivity to risk discount rate

R million	Risk discount rate –1%	Published risk discount rate	Risk discount rate +1%
Adjusted net worth less run-down costs for Destiny Health	2 557	**2 557**	2 557
Value of in-force covered business before cost of capital	20 398	**18 536**	16 976
Cost of required capital	(233)	**(245)**	(255)
Cost of STC	(475)	**(425)**	(385)
Discovery Holdings embedded value	**22 247**	**20 423**	**18 893**

Table 11: Value of new business sensitivity to risk discount rate

R million	Risk discount rate –1%	Published risk discount rate	Risk discount rate +1%
Present value of future profits from new business at point of sale	919	**743**	600
Cost of required capital	(32)	**(29)**	(28)
Cost of STC	(20)	**(17)**	(13)
Present value of future profits from new business at point of sale after cost of required capital and STC	**867**	**697**	**559**

Review of Group results

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

New business annualised premium income (excluding Destiny Health) increased by 28% for the six-months ended 31 December 2008.

New business annualised premium income

R million	**December 2008**	December 2007	% change
Discovery Health	**1 456**	1 265	15
Discovery Life	**993**	627	58
Discovery Vitality	**49**	46	7
PruHealth	**271**	248	9
PruProtect	**29**	5	>100
New business API excluding Destiny Health	**2 798**	2 191	28
Destiny Health*	**80**	209	(62)
New business API of Group	**2 878**	2 400	20

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

Gross inflows under management increased by 18% for the six-months ended 31 December 2008.

Gross inflows under management

R million	**December 2008**	December 2007	% change
Discovery Health	**11 211**	9 977	12
Discovery Life	**2 380**	1 446	65
Discovery Vitality	**437**	387	13
Destiny Health	**283**	520	(46)
PruHealth	**701**	431	63
PruProtect	**22**	3	>100
Gross inflows under management	**15 034**	12 764	18
Less: collected on behalf of third parties	**(10 700)**	(9 223)	16
Discovery Health	**(9 897)**	(8 833)	
Discovery Life	**(386)**	–	
Destiny Health	**(55)**	(173)	
PruHealth	**(351)**	(216)	
PruProtect	**(11)**	(1)	
Gross income of Group	**4 334**	3 541	22

Earnings

The following table shows the main components of the increase in Group profit from operations for the six-months ended 31 December 2008:

Earnings source

R million	**December 2008**	December 2007	% change
Discovery Health	**475**	389	22
Discovery Life	**618**	479	29
Discovery Vitality	**23**	21	10
PruHealth	**(64)**	(83)	23
Operating profit from established businesses	**1 052**	806	31
Discovery Invest	**(83)**	(66)	(26)
PruProtect	**(104)**	(42)	>100
Destiny Health	**(119)**	(80)	(49)
Group operating profit before premium deficiency reserve and unbundling costs	**746**	618	21
Transfer to premium deficiency reserve	**(27)**	–	
Unbundling costs	**–**	(18)	
Profit from operations before investment income, impairment and BEE expenses	**719**	600	20

Taxation

All South African entities are in a tax paying position. South African income tax has been provided at 28% (2007: 29%) and secondary tax on companies at 10% in the financial statements and embedded value statements.

Destiny operations have significant tax losses but no deferred tax asset has been accounted for on the foreign losses incurred in the US.

Discovery obtained no tax relief for the PruHealth losses for the six-month period to 31 December 2008. 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 December 2008 is R750 million received in terms of a quota share treaty entered into by Discovery Life. This treaty effectively reinsures approximately 15% of the negative reserve as at 31 December 2008. 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.

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 31 December 2008.

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 last six months of 2008, Discovery had to assess at 31 December 2008 whether objective evidence existed that the equity instruments classified as available-for-sale financial assets were impaired at that date. 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. This amounted to R63 million and has been taken through profit and loss. Had a decline of 20% or more been used, an impairment of R89 million would have been taken through profit and loss.

The 'prolonged decline' criteria was not met at this date.

Balance sheet

The increase in the assets arising from insurance contracts of R584 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 31 December 2008, Destiny Health raised a Premium Deficiency Reserve of US$2.8 million (R27 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.

Review of Group results (continued)

Accounting policies

The interim results have been prepared in accordance with International Financial Reporting Standards (IFRS) including IAS 34, as well as the South African Companies Act 61 of 1973, as amended, and are consistent with the accounting policies applied in the last annual report as well as 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 IFRS2. 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 R7 million in the six-month period ended 31 December 2008 (2007: R11 million) in accordance with the requirements of IFRS 2.

An additional R37 million (2007: R19 million) in respect of options granted under employee share incentive schemes has been expensed in the income statement for the period in accordance with the requirements of IFRS 2.

Discovery has acquired cash-settled share options to hedge approximately 66.6% of its obligations in respect of options granted under the employee share incentive scheme.

Directorate

Dr Judy Dlamini has 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.

Dividend policy and capital

A final dividend of 23 cents per share was paid on 20 October 2008.

The directors are of the view that the Discovery Group is adequately capitalised at this time. On the statutory basis the capital adequacy requirement of Discovery Life was R242 million (2007: R183 million) and was covered 6.4 times (2007: 7.4 times).

Cash dividend declaration:
The board has declared an interim cash dividend of 25.5 cents per share. The salient dates are as follows:

– Last date to trade "cum" dividend	Friday, 13 March 2009
– Date trading commences "ex" dividend	Monday, 16 March 2009
– Record date	Friday, 20 March 2009
– Date of payment	Monday, 23 March 2009

Share certificates may not be dematerialised or rematerialised between Monday, 16 March 2009 and Friday, 20 March 2009, both days inclusive.

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

**Executive   **Resigned 30 November 2008* www.discovery.co.za