Insurance
UK Life Assurance

HSBC Global Research

Prudential

The Asian Tiger continues to roar

- **Indian summer – the subcontinent represents the most exciting Asian Insurance market for Prudential**
- **The asset management businesses continue to deliver profits and cash, but valuation increases cannot offset the impact of marking-to-market movements in equities and FX**
- **Our new fair value range is 724-802p, with an implied notional target price of 763p (previously 774p). Our rating remains Overweight**

Fundamentals still strong despite volatile markets

The collapse of the proposed Aviva merger and the recent sharp fall in equities has taken Prudential's share price back towards levels at the start of the year. This is despite consensus beating FY2005 results, positive Q1 2006 New Business figures and, more recently, an analyst presentation, which we think demonstrated that the group's asset management businesses are far superior to its peers.

We remain bullish on insurance markets in Asia, highlighting India in particular. With attractive demographics, an expanding economy and foreign entrants eating up market share, we believe that the subcontinent is set to become the jewel in Prudential's Asian crown.

Complementing the persistent growth in Asian Insurance, Asia fund management looks set to follow suit. Familiar macroeconomic arguments of large populations, growing economies and a predominance of cash and deposits, alongside a powerful brand, suggest Prudential is uniquely placed across the region to exploit the opportunity.

We view the current decline in equity markets as a short-term correction rather than the beginning of a longer-term bear market. The fundamentals are still in place and there is increased upside potential on the stock. Presumably CEO Mark Tucker, who purchased over 25,000 shares on 22 May, agrees. We continue to rate the shares Overweight.

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India – sparkling on the global radar

- Emerging markets are home to 86% of the world's population, produce 23% of global output but account for just 12.3% of global life insurance premiums
- China is generating most focus but India is growing faster and foreign companies already have a 30% market share
- ICICI - Prudential has 7.3% of the market and is expanding rapidly. Is India set to be the jewel in the crown?

Emerging markets: India and China

The table below shows the growth in global insurance premiums for 1999-2004:

Global overview

(USD trillion)	1999	2002	2004	5-year CAGR
Insurance premium				
Life premium	1.42	1.54	1.85	5.4%
Non-life premium	0.91	1.09	1.40	8.9%
Total premium	**2.34**	**2.63**	**3.24**	**6.8%**
Premium composition				
Life	60.9%	58.5%	57.0%	
Non-life	39.1%	41.5%	43.0%	
GDP (USD trillion)	30.90	32.26	40.63	5.6%
Population (billion)	6.0	6.2	6.3	1.1%
Insurance penetration				
Life insurance	4.6%	4.8%	4.6%	
Life and non-life combined	7.6%	8.1%	8.0%	

Source: HSBC, Swiss Re Economic research and consulting

Overall, these growth rates are rather pedestrian although this masks a two-paced growth. The developed markets, while containing a large number of wealthy individuals, are closer to reaching maturity and offer low growth coupled with rising margin pressures (and even doubtful profitability). Here the pressure on providers is increasing. By contrast, the emerging markets enjoy higher economic growth and underdeveloped insurance markets. Emerging markets are home to 86% of the world's population and account for 23% of global economic output but just 12.3% of life premiums (and 10.4% of global p&c premiums).

In this report we focus on the Indian market, currently a smaller market than China (which is attracting more focus), but one that offers, in our view, better growth prospects and the opportunity for incoming insurers from the developed world to gain market share. If successfully exploited, the value of the Indian market to global insurers could potentially be huge.

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India and China: a comparison

(USDbn)	China 1999	China 2002	China 2004	China 5-year CAGR	India 1999	India 2002	India 2004	India 5-year CAGR
Premium volumes								
Life premium	10.5	25.1	35.4	27.40%	6.4	12.3	16.9	21.40%
Non-life premium	6.3	11.8	16.8	21.60%	2.3	3.2	4.3	13.40%
Total premium	16.8	36.9	52.2	25.40%	8.7	15.5	21.2	19.50%
Premium composition								
Life	62.50%	68.00%	67.80%		73.60%	79.40%	79.70%	
Non-life	37.50%	32.00%	32.20%		26.40%	20.60%	20.30%	
Share of global market								
Life premium	0.74%	1.63%	1.92%		0.45%	0.80%	0.92%	
Non-life premium	0.69%	1.08%	1.20%		0.25%	0.29%	0.31%	
Total premium	0.72%	1.40%	1.61%		0.37%	0.59%	0.66%	
GDP - old (USDbn)	991	1,271	1,653	9.20%	436	475	670	9.00%
GDP - revised (USDbn)	1,083	1,454	1,931	10.80%	---	---	---	---
Population (million)	1,266.80	1,284.50	1,297.20	0.50%	983.5	1,051.50	1,079.50	1.90%
Insurance penetration (on revised GDP)								
Life insurance	0.97%	1.73%	1.83%		1.47%	2.58%	2.53%	
Life and non-life combined	1.55%	2.54%	2.70%		2.00%	3.26%	3.17%	

Note: the National Bureau of Statistics of China revised GDP for earlier years in December 2005. For 2004, the revision translated into GDP increasing by nearly 17%.

Source: HSBC, Swiss Re, National Bureau of Statistics of China

The macro economic reasons for entering India and China are compelling:

- Huge populations of over one billion each
- Rapidly growing economies
- A strong savings ethic – savings represent c40% of Chinese GDP and 20% of Indian GDP
- The biggest asset class of these savings is cash and bank accounts (representing 40% of Indian household savings)
- Low overall levels of life insurance
- Liberalisation of the market place allowing foreign entrants
- While global insurance premiums grew by a CAGR of 6.8% between 1999 and 2004, China's premiums witnessed a CAGR of 25.4% and India 19.5%

We believe that growth well above the global average will continue in both countries for the foreseeable future. However, we think there are key reasons to believe that India could represent the bigger growth opportunity:

- The demographic impact of China's one-child policy will be that the Chinese work force (of insurance buying age), according to UN projections, should begin to shrink within the next 10 years. By contrast, India's population should see continued growth
- HSBC believes that the development of enterprise pensions in China could mean that the long-term savings market could increasingly become the preserve of fee-paid asset management companies (for more details see our report *PRC Insurance Companies, 16 November 2005*
- In China, the foreign JV companies are generally growing in market segments where margins are low
- The market is growing faster in India (52% in the year to February versus 31% in China)

- While China is ahead of India with regards to GDP, insurance premiums and global insurance market share, India has always been ahead of China with regards to insurance penetration
- While HSBC estimates that both markets will be larger than the US is today by 2035 and that both will have overtaken Japan, we expect India to grow faster than China and that the Indian life market will be larger than the Chinese life market at that time

Regulation and ownership

The Indian market was opened up to foreign investment in 2000 and since then around 25 players have entered alongside the state-run Life Insurance Corporation of India. Entry to the domestic market is via JVs with domestic providers. Different caps on foreign direct investment (FDI) exist for different industries and the maximum for the insurance sector is 26% (versus, for example, telecoms at 74%).

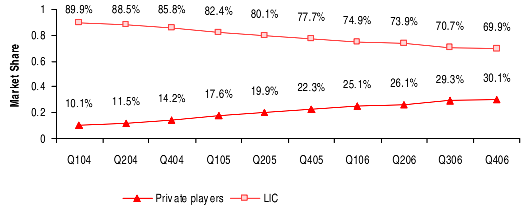
Prudential has stated that it would welcome an increase in the FDI rate above 26%. The insurance regulator, IRDA, recently announced that it would soon submit a report to the government proposing the FDI cap be raised from 26% to 49%. However, this is likely to be a slow process and CEO Mark Tucker indicated at the preliminary results analyst meeting that the company believed any changes could be in a time horizon of 12-24 months. Given the potential growth in the Indian market, we would welcome an increased participation.

Market share

The strongest reason we believe that India presents a greater future market than China is by looking at the market share gained by foreign entrants since the markets were opened to overseas providers. This can be seen in the charts below.

- The total market share of the foreign JVs in China is c3% while in India it is over 30% and growing (as of March 2006 - source: Insurancesurf.com)
- Within the Indian market the two largest foreign JV players are Prudential plc (market share February 2006, 7.44%), and Allianz (ALVG.DE, rating Overweight, price target EUR151) (market share February 2006, 7.38%).
- NB the Indian Fiscal year runs to 31 March so that Q406 is the quarter ending 31/3/2006 and FY06 the year ending 31/03/06

Life insurers: quarterly market share of new business premiums



NB: Market share of new business comprising first year regular premiums and single premiums

Source: IRDA

Market share of top-5 private life insurers

	FY2003a	FY2004a	FY2005a	FY2006a
Allianz Bajaj Life	0.4%	0.9%	3.4%	7.6%
ICICI Prudential	2.1%	3.9%	6.3%	7.3%
HDFC Standard Life	0.8%	1.1%	1.9%	2.9%
SBI Life	0.4%	1.1%	1.9%	2.3%
Birla Sunlife	0.8%	2.3%	2.5%	1.9%

Source: IRDA

The Aviva JV in India with COFCO ranks as the 8th largest foreign player.

Indian valuation – Gbp18p (previously 13p)

The value of ICICI Prudential's existing written business is shown below. This is based on reported NBAP and net asset values for the years ending 31 March 2004, 2005 and the nine months ending 31 December 2005.

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ICICI Prudential JV — value of existing business (INRm)

Period	FY2004	FY2005	FY2006 9M	
Period ending	**31/03/2004**	**31/03/2005**	**31/12/2005**	**Total**
NBAP reported	2,040	3,120	3,110	8,270
Net asset value				2543
Total value of existing business				**10,813**

Source: Company data, HSBC

To this we add our estimate of the valuation of future business (shown at the bottom of the page).In line with calculations for long term business goodwill in UK, US and Asia this is calculated using a DCF model on estimated future profits. The following assumptions are made:

- The 9M figure to 31 December 2005 is annualised to derive the full-year figure to 31 March 2006
- W assume 30% pa growth in FY2007, trending down to 15% in FY2010
- For the following 10 years we grow profits by 12% pa
- After which we hold sales growth flat and decrease the margins into perpetuity
- We use a discount rate based on a cost of capital of 14% derived as per the table opposite
- This yields a value for future business of INR119m

Assumptions to derive Indian cost of capital

Risk-free rate	7.32%
Equity risk premium	7.00%
Corporation tax	35.00%
Company beta	1.43
Weighted average cost of capital	14.0%

Source: HSBC estimates

This gives a total valuation for the India JV of 18p as shown below

ICICI – Prudential Valuation

	INR m	GBP m	*p per share*
Value of existing business	10,813		
Value of future business	119,482		
Total value (INR)	130,295		
Total value (GBP)		**1,682**	***69***
Pru Share @ 26%		437	*18*

Source: HSBC estimates

The table below shows the sensitivity of the valuation of using different growth rates.

India - ICICI Prudential @26%

	FY 07e	FY 08e	FY 09e	FY 10e	Mid Term Growth	Valuation
		NBAP growth				GBp
Scenario 1	30%	25%	20%	15%	12%	18
Scenario 2	30%	25%	20%	15%	5%	14
Scenario 3	30%	25%	20%	15%	15%	21
Scenario 4	35%	30%	25%	20%	12%	23

Source: HSBC estimates

Asset management: profits = cash

- In a typically bullish analyst presentation, management were keen to re-emphasis the success of the past five years and (predictably) decouple this growth from stock market performance
- M&G continues to deliver record net client inflows spurred on by strong fund outperformance and key staff retention
- As with insurance, Asia represents the large growth opportunity. Prudential has a powerful brand to exploit the rapid rise in household financial assets. We raise our Asia FM valuation from 7p to 14p

Asia fund management – following in PCA's footsteps

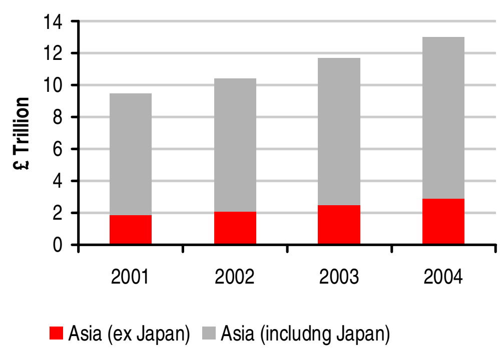
The growth opportunities for Asia Fund Management echo those previously presented for Prudential Corporation Asia (PCA – the insurance arm of Asia). The Asian markets are large, growing and increasingly attractive. Prudential has sufficient scale and the necessary powerful brand to exploit this opportunity.

Asia – the market

The reasons for entering the Asian fund management markets are strong:

- Large and growing populations (Indian and China alone have 2.3bn people)
- Economies are growing faster than their Western counterparts
- A strong savings ethic with cash and deposits representing the largest asset class
- A strong trust in foreign brands

Household financial assets



Source: Prudential (Asia includes Hong Kong, India, Korea, Malaysia, Singapore, Taiwan, Thailand, China and Japan)

The table above shows the growth in Asian household assets.

- Household financial assets grew by a CAGR of 15% excluding Japan and 10% including Japan for 1999-2004
- Sixty per cent of these assets are still in cash or deposits – this is more than the equivalent asset class in the US (source: Citigroup, EIU)

In addition:

- Asian (including Japanese) mutual funds have grown by a CAGR of 20% between 2002 and 2005
- The mutual funds penetration has increased as a percentage of total household financial assets from 4% in 2002 to 6% in 2004. This compares with 16% in Europe and 20% in the US. A 1% increase in penetration in Asia translates into around a £100bn increase in industry FUM (source: Cerulli, Citigroup, EIU)

Prudential in Asia

Prudential has been performing strongly in Asia and is uniquely placed to continue to capitalise on this expanding market:

- FUM have increased by a CAGR of 43% from 1998 to stand at £28bn as at Q1 2006. Third party FUM were £10.1bn as at FY2005
- Underlying profits have grown strongly – excluding one-off charges of £16m in 2005 the CAGR was 56% from 1999 to £28m in 2005. Underlying profit for Q1 2006 was c£12m (though management has warned Q1 is the strongest quarter
- Scale – Prudential Asset Management is the fifth-largest fund management company in Asia (excluding Japan) with only AIG, ING, State Street and HSBC larger(source: Asia Asset Management, September 2005 – FUM as at end-June 2005)
- With operations in nine Asian countries across the region, Prudential AM is uniquely placed to offer pan-Asia services. For comparison, HSBC, Fidelity and Schroders operate in seven, six and six countries respectively.
- Brand is extremely important in Asia. Here Pru has a clear competitive advantage with high brand awareness across the region. Indeed, according to Prudential research, its logo is more recognised than the HSBC hexagon in Malaysia, Singapore, Taiwan, China and Korea

Valuation

We are aligning our valuation of Asia FM with that of M&G and applying a P/E to 2006e (taxed) operating profits.

- We estimate 2006 operating profit of £34m based on a 20% increase on 2005a underlying profits (excluding one-off costs in Taiwan). Given that Q1 2006 profits were c£12m we do not feel this is overly taxing
- To this we apply a central case P/E of 16x. This is higher than that used for M&G (14x) to reflect the stronger growth prospects of the region
- This is increases our valuation for Asia FM to 14p per share compared with our previous valuation of 7p to reflect the potential of this operation

Asia Fund Management valuation

	P/E used		
	14x	16x	18x
Valuation GBPm	306	349	393
Valuation GBp	13	14	16

Source: HSBC estimates

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M&G - 'a relatively simple business'

In addition to record cash inflows for M&G in 2005 (£3.9bn) and a 29% increase in external FUM (to £36bn), there were plenty of other recent highlights:

- Investment performance: 24% of M&G equity funds are top decile over the past three years. This compares favourably with Invesco (c17%), Fidelity (c11%) and Schroders (c4%)
- Net sales: 45% of 2005 total sales already achieved by 1Q06
- Underlying profits up 150% since 2001 or by 40% on average pa (see table opposite)
- The company was keen to point out that this five-year growth has come despite the fall in the FTSE All Share index since 2001. However, we note the majority of these profits have come during an equities and property bull run
- Revenues increased in all asset classes in 2004 and 2005
- Strong growth in both retail up threefold and institutional sales (up 59%) in 2005
- The cost/income ratio has dropped from c82% in 2001 to 66% in 2005
- Q1 2006 underlying profits of £44m were up 42% from Q12005 though management has warned against extrapolating this
- Strong brand is helping to win business. People have a higher brand awareness of M&G than Fidelity, Schroders, Merrill Lynch, Jupiter and Gartmore (source: TNS – total prompted awareness)

M&G profits

GBPm	2001a	2002a	2003a	2004a	2005a
Underlying profit	56	49	70	110	138
Performance related fees	19	20	8	6	8
Carried interest	0	2	5	20	17
Profit before tax	75	71	83	136	163
Average FTSE All Share	2614	2221	1978	2250	2589

Source: Company data

Investment performance

While there is no doubt that recent strong performance was in part due to equity markets being buoyant (up to the end of April), management was keen to point out M&G's market outperformance.

- The life fund outperformed the benchmark by c1.3% in 2004 and 2005 with c£33.5bn of cumulative value added to the life fund since 2001
- Key to strong performance has been staff retention. Net sales suffer when fund managers depart. There has been hiring of some 'big hitters' since 2000

Valuation

- Our valuation range for M&G has increased slightly to £1.4bn-£1.9bn. The mid-point of this range is £1.65bn, which equates to 68p per share (previously 66p)
- We increase our estimate 2006 operating profits to £169m (including £10m of performance fees and carried interest) from our previous estimate of £163. We feel this is certainly achievable given £44m in Q1 2006 underlying profits (excluding performance fees and carried interest and a recent repricing of fees in active equity funds to 1.5% (from 1%), which management expect to add £12m pa).

While we believe that the current sharp decline in Equities markets is more of a correction than the start of a longer-term bear run, we feel it would not be prudent to raise our P/E ratio from the previous range of 12-16x (although we have raised our earnings forecast as detailed above). For comparison, Schroders currently trades on c15x 2006e earnings and Amvescap on c19x. The analyst presentation has strengthened our belief that this valuation is certainly more conservative than aggressive.

Profits = cash

Management pointed out the simplicity of the business from a cash flow point of view and hinted that this may be an area of increased cash flow for the group. In 2005, M&G remitted £74m centrally but it was pointed out that £91m of cash was generated with £16m held back available for future remittance and £13m reinvested. Our cash flow model assumes a remittance of £89m in 2006, which we do not believe is overly aggressive.

PPMA

While not delivering the stellar growth of its UK or Asian counterparts, PPMA (the US Asset Manager) continues to perform quietly in the background without much fuss.

Background:

- Manages $72bn in assets
- As at FY2005 all but 3% of this was internal FUM (including funds managed on behalf of UK and Asia)
- Aims to deliver a 25bp total corporate return
- One-year actual return is +43bps, three-year +46bps
- Tight credit control – 2005 saw $20m of credit impairments versus $135m used in pricing (based on research). Coordinates closely with London on credit
- Like JNL, PPMA is a low-cost operator – it has an investment expenses ratio of 9bps compared with an average across the top-30 large annuities companies of 22bps

We retain our valuation of the US non-life operations with a valuation mid-point of 8p.

Marking to market

- The US dollar and Asian currencies have fallen by 2%-10% YTD against sterling. This impacts negatively on valuation but less than might be imagined due to with higher average rates YDT in 2006
- In addition, volatile equity markets have also dropped sharply from highs in April of +9% YTD, back to the 2006 opening level (as we write)
- The overall impact of marking to market is we decrease our target price by 17p (2%)

FX – what effects?

Movements in the dollar and main Asian foreign exchange rates are shown the table below. The 3 March 2006 date represents the data used for foreign exchanges rates when the 774p target price was arrived at (i.e. balance sheet EEV movements to this date are already incorporated).

Movements in major FX rates since 31/12/2005

Currency	31/12/2005	03/03/2006	19/05/2006	Ave FY2005	2006 Ave (17/05/06)
USD	1.72	1.75	1.87	1.82	1.77
HKD	13.31	13.60	14.65	14.15	13.74
JPY	202.63	204.31	206.80	200.13	205.69
MYR	6.49	6.49	6.83	6.89	6.55
SGD	2.85	2.84	2.98	3.03	2.86
TWD	56.38	56.74	59.76	58.47	57.06

Source: Company data, Thomson Financial Datastream

Impact of movements in USD/GBP rate on JNL 2006e EEV

JNL	As per 774p TP	Currently	USD weakens (from current price)			USD strengthens (from current price)		
GBPm	**03/03/2006**	**19/05/2006**	**-5%**	**-7.5%**	**-10%**	**5%**	**7.5%**	**10%**
Rate	1.75	1.87	1.96	2.01	2.06	1.78	1.73	1.68
2006e EEV £m	3,490	3,274	3,118	3,045	2,976	3,446	3,539	3,637
Difference £m		-217	-156	-228	-298	172	265	364
Pence per share effect on new TP		**-9**	**-6**	**-10**	**-12**	**7**	**11**	**15**

Source: HSBC estimates

Balance sheet impact

The table above shows the impact on our valuation from changes in the dollar-sterling rate.

Our models assume the 2005 year-end FX rates predict 2006e EEV so the effect of fluctuating exchange rates is seen by retranslating these 2006e EEV values. Marking to Market FX rates for the US dollar would take 9p (1.1%) of our previous 774p target price. The impact of further movements on our new target price can also be seen in this table.

The equivalent table for Asia is shown below. The five most significant currencies have been chosen and weighted by sales (2002 – 2005).

Impact of movements in Asian currencies on Asia 2006e EEV

Asian EEV	As per 774p TP	Currently	Weaken (from current price)			Strengthen (from current price)		
GPBm	**03/03/2006**	**19/05/2006**	**5%**	**7.5%**	**10%**	**5%**	**7.5%**	**10%**
HK	13.6	14.6	15.4	15.7	16.1	13.9	13.5	13.2
Japan	204.3	206.8	217.1	222.3	227.5	196.5	191.3	186.1
Malaysia	6.5	6.8	7.2	7.3	7.5	6.5	6.3	6.1
Singapore	2.8	3.0	3.1	3.2	3.3	2.8	2.8	2.7
Taiwan	56.7	59.8	62.8	64.2	65.7	56.8	55.3	53.8
2006e EEV	2401	2274	2166	2116	2067	2394	2459	2527
Difference		-127	-108	-159	-207	120	184	253
Pence per share effect on new TP		**-5**	**-5**	**-7**	**-9**	**5**	**8**	**11**

Source: HSBC estimates

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Impact of movements in USD/GBP rate on JNL long-term business goodwill

			Weaken (from current price)			Strengthen (from current price)		
	2005 Average	**Current average**	**5%**	**10%**	**20%**	**5%**	**10%**	**20%**
Average rate	1.82	1.77	1.91	2.00	2.18	1.73	1.64	1.46
NBC	151	155	144	137	126	159	167	188
NBM	10.5	10.5	10.5	10.5	10.5	10.5	10.5	10.5
LT goodwill	1,587	1,630	1,512	1,443	1,323	1,671	1,764	1,984
Difference		43	-119	-188	-308	40	133	354
Pence per share effect on new TP		**2**	**-5**	**-8**	**-13**	**2**	**6**	**15**

Source: HSBC estimates

P&L impact

The P&Ls from the JNL and Asian operations are translated at average rates and therefore the impact needs to be assessed with reference to these rates. At present, average FX rates for 2006 (to 30/04/06) show stronger dollar and Asian currencies (in 2005 these currencies were mainly relatively weaker, finishing strongly at year-end). As per the EEV calculations, our model assumes the rates in 2005 to forecast future figures. As a result, the stronger average rates in 2006 to date are a positive. This results in a higher new business contribution (NBC), which (when applied to new business multiples, NBM) give us the long-term business goodwill – this forms a significant part of our total valuation (see total valuation on page 15).

The impact of the current rate and the sensitivity to future movements is shown below. For the Asian currencies the movement in the current rate is again taken as the weighted average of the five most significant currencies.

Cash flow impact

While the changes to the balance sheet and P&L figures discussed above impact the valuation it is worth noting these fluctuations are merely translational. There is, however, a transactional impact on foreign money remitted centrally to the group. A weaker dollar reduces the amounts JNL dividends back to the group but at current rates the impact is less than £10m on the $200m we estimate JNL will return in 2006. Management has indicated that Asia will be a net cash generator in 2006 but we do not anticipate the levels of cash being remitted needed to make the FX rates have any material impact.

Impact of movements in Asian currencies on Asian long-term business goodwill

GBPm	**2005 Average**	**Current average**	**Weaken (from current price)**			**Strengthen (from current price)**		
Asia		**3.8%**	5%	10%	20%	5%	10%	20%
NBC	294	305	279	265	235	309	323	353
NBM	13.1	13.1	13.1	13.1	13.1	13.1	13.1	13.1
LT goodwill	3,851	3,998	3,658	3,466	3,081	4,044	4,236	4,621
Difference		147	-340	-532	-917	45	238	623
Pence per share effect on new TP		**6**	**-14**	**-22**	**-38**	**2**	**10**	**26**

Source: HSBC estimates

Estimated impact of equity markets on investment variance

	31/12/2005	Current level	FTSE weakens			FTSE strengthens		
FTSE 100	5,619	5,657	5,500	5,400	5,300	5,750	6,000	6,250
Estimated investment variance £m		-363	-311	-507	-311	195	700	1,206
Pence per share impact on new TP		**-11**	**-9**	**-15**	**-9**	**6**	**20**	**35**

Source: HSBC estimates

Equity markets

- We mark-to-market our target price for current changes in equities and bond markets using the closing rates as per 19/05/2006. At this point, the FTSE 100 was at 5,657 and the yield on a 10-year UK government bond was 4.71% (source: Thomson Financial Datastream)
- This deducts 11p of our previous target price on the assumption that these were the closing rates as at 30/06/2006
- In addition, the table above shows the estimated impact movements in the FTSE 100 would have as at 30/06/2006 on our new target price

Valuation, earnings and cash flow

- Increases in our valuations of the Indian and Asset Management businesses are overshadowed by marking-to-market recent movements in FX and equities markets
- We update our earnings forecasts for investment variance and Asset Management profits but our cash flow model is unchanged
- We arrive at a valuation range of 724p-803p with an implied notional mid-point target price of 763p

Our valuation basis for Prudential is the same as we presented in our report, *Value vs yield*, 7 March 2006. We use a two-year valuation range with the mid-point being the implied target price. The range and target price are shown in the table on the following page

Changes to our previous range and valuation are also shown in the table below as follows:

Changes to our previous valuation (29 March 2006)

	GBp
Previous valuation	774
Mark to Market	-17
India Insurance	5
Asset management	9
Others (Taiwan, change in Number of shares)	-8
Total decrease	-11
New valuation	763

Source: HSBC estimates

Taiwan – legacy issues

- A full recap of the Taiwanese guaranteed rate issue is given in Appendix 1
- The Taiwan 2005 EEV was negative (£311m) as Pru reduced its assumptions in short-term earned rates. This negative EEV is already included in our 2006e EEV
- In addition to this we conservatively deduct an additional £108m (to reflect a further 1% decrease in starting bond rates)
- Overall, we are positive on the Taiwan market – new business increase by 73% in Q1 2006 (with unit linked policies representing 70% of these sales) and the APE margin in Taiwan is a healthy 51%. The negative spread problem is part of the price of entry to this attractive market

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Prudential sum of parts model

Prudential sum of parts model	**NAV- 2005 EEV**	**Low**	**High**	**Mid value of range**	**New Valuation**	**Previous Valuation**	
	GBPm	GBPm	GBPm	GBPm	*GBp per share*	*GBp per share*	**Valuation Basis**
UK & Europe Insurance EEV	5132	5378	5378	5378	*222*	*234*	Modelled
UK goodwill		1878	2242	2060	*85*	*86*	10x-12x 2006e New Business Contribution
total UK	**5132**	**7256**	**7620**	**7437**	***307***	***320***	
US Insurance EEV	3348	3494	3494	3494	*144*	*156*	Modelled
US goodwill		1481	1780	1630	*67*	*66*	*9.5x-11.5x NBC*
total US	**3348**	**4975**	**5275**	**5125**	***212***	***222***	
Asia Insurance	1988	2282	2282	2282	*94*	*100*	Modelled
Asia goodwill		3694	4302	3998	*165*	*160*	*12x-14x NBC*
India		437	437	437	*18*	*13*	Separately valued. See section on India
China		226	226	226	*9*	*9*	Separately valued See previous note Value vs Yield, 7 March 2006
total Asia	**1988**	**6639**	**7247**	**6943**	***287***	***283***	
L&P total	**10468**	**18870**	**20142**	**19505**	***805***	***825***	
M&G	245	1417	1889	1653	*68*	*66*	12x-16x 2006e Operating profit
Egg	303	887	887	887	*37*	*37*	MV Egg pre minority buyout announcement
US Broker Dealer + Curian	70	137	200	169	*7*	*7*	Broker Dealer - 12x-16x 2006e Operating profit. Curian 1%-3% FUM
Asia FM	82	306	393	349	*14*	*8*	14x-18x 2006e Operating profit
Total non insurance operations	**700**	**2747**	**3369**	**3058**	***126***	***118***	
					0		
Others/Deductions:							
Goodwill	1325	0	0	0	*0*	*0*	Remove acquired goodwill
Holding co net borrowings	-1724	-1724	-1724	-1724	*-71*	*-72*	Held at 2005 level
Other net liabilities	-326	-326	-326	-326	*-13*	*-14*	Held at 2005 level
Capitalised central costs	0	-772	-772	-772	*-32*	*-34*	11x 2006e Central costs
Asia Development Expenses	0	-196	-196	-196	*-8*	*-8*	13x 2006e Development expenses
Pension scheme deficit	-142	-142	-142	-142	*-6*	*-6*	Held at 2005 level
Dividends	0	-807	-807	-807	*-33*	*-33*	Deduct dividends
Taiwan bond issue	0	-108	-108	-108	*-4*	*-3*	See Taiwan section
Total others	-867	-4076	-4076	-4076	***-168***	***-169***	
Total	**10301**	17541	19435	18488	***763***	***774***	**Full SOP valuation**
p per share	*425*	*724*	*802*	***763***			

Source: HSBC estimates

Risks

The most significant risks to our valuation are a decline in sales growth and margins. Within that, the emerging markets of Asia, while offering the greatest potential growth, offer the largest area for disappointment with social, political and economic factors all influencing the way these markets emerge.

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EEV profits

	2005a EEV £m	2006e EEV £m	2007e EEV £m	2008e EEV £m	2009e EEV £m	2010e EEV £m
New business APE						
UK + Europe	900	989	1,067	1,131	1,199	1,270
US	515	566	612	648	687	729
Asia	732	849	972	1,076	1,164	1,252
Total APE	2,146	2,404	2,651	2,856	3,050	3,251
UK and Europe operations						
New business contribution	**243**	**267**	**288**	**306**	**324**	**343**
Business in force	183	457	492	530	570	614
Long-term business	426	724	780	835	894	958
M&G	**163**	**169**	**182**	**197**	**207**	**217**
Egg	**44**	**46**	**49**	**51**	**53**	**56**
Total UK and Europe operating profit	**633**	**939**	**1,011**	**1,083**	**1,154**	**1,231**
US operations						
New business contribution	**211**	**232**	**251**	**266**	**282**	**299**
Business in force	530	277	290	305	320	336
Jackson National Life	741	509	541	570	601	634
Broker dealer	**24**	**25**	**26**	**28**	**29**	**31**
Curian	-10	-5	-5	0	5	10
Total US operating profit	**755**	**530**	**562**	**598**	**636**	**675**
Asian operations						
New business contribution	**413**	**479**	**549**	**607**	**657**	**707**
Business in force	163	175	189	204	220	237
Long-term business	576	654	737	811	877	944
Fund management	**12**	**34**	**40**	**48**	**58**	**70**
Development expenditure	-20	-20	-20	-20	-20	-20
Total Asia operating profit	**568**	**668**	**758**	**839**	**915**	**993**
Total other income and expenditure	**-244**	**-230**	**-180**	**-182**	**-185**	**-188**
Operating profit	**1,712**	**1,907**	**2,151**	**2,338**	**2,520**	**2,711**
Non-operating activities						
Goodwill impairment charge	-120	0	0	0	0	0
Short-term fluctuations in investment return	1,001	-363	0	0	0	0
Shareholders' share of pension deficit	-47	0	0	0	0	0
Changes in economic assumptions	**-302**	**0**	**0**	**0**	**0**	**0**
Exceptional items (Egg integration costs)	**0**	**-50**	**0**	**0**	**0**	**0**
Profit on non-operating activities	**532**	**-413**	**0**	**0**	**0**	**0**
Profit on ordinary activities before tax	**2,244**	**1,494**	**2,151**	**2,338**	**2,520**	**2,711**
Total tax	-653	-469	-652	-709	-764	-705
Profit after tax	**1,591**	**1,025**	**1,499**	**1,629**	**1,755**	**2,006**

Source: Company data, HSBC estimates

EEV P&L

There have been no major changes to our assumptions in the forecast P&L since our last update *Cash flow, margins and capital,* 16 March 2006.

- As detailed in the Marking to Market section, 2006e investment variance has been included to reflect current bond and equity markets
- Based on the AM presentation we have increased our earnings estimates for 2006 – this is discussed in the Asset Management section

Holding Co cash flow

	2005a	2006e	2007e	2008e	2009e
UK Life fund transfer	194	223	245	265	286
UK Other dividends	103	0	0	0	0
JNL	85	114	137	151	166
Asia	73	105	126	151	181
M&G	62	74	89	103	113
Egg	0	0	10	20	30
Others	0	0	20	30	40
Total cash remitted to group	**517**	**517**	**628**	**720**	**816**
Net interest paid	-115	-115	-115	-115	-115
Dividends paid	-378	-399	-409	-419	-429
Scrip dividends and share options	55	55	55	55	55
Cash remittances after interest and dividends	**79**	**58**	**159**	**241**	**327**
Tax received	107	0	0	0	0
Corporate activities	-66	0	0	0	0
Cash flow before investments in businesses	**120**	**58**	**159**	**241**	**327**
Investment in business:					
UK and Europe	-249	-230	-150	-150	-150
JNL	0	0	0	0	0
Asia	-169	-90	-90	-90	-90
Other	0	0	0	0	0
Net cash flow before rights issue	**-298**	**-262**	**-81**	**1**	**87**
Rights issue proceeds	0	0	0	0	0
Increase/decrease in cash	**-298**	**-262**	**-81**	**1**	**87**

Source: Company data, HSBC estimates

Cash flow

There have been no major changes to our assumptions in the holding company cash flow since our previous note. We do not adjust for the weakening of the dollar FX rate, which at present would only reduce the remittance by £7m. The only minor change is an increase in the total dividend paid, reflecting the increase in the number of shares.

Appendix 1: Taiwan

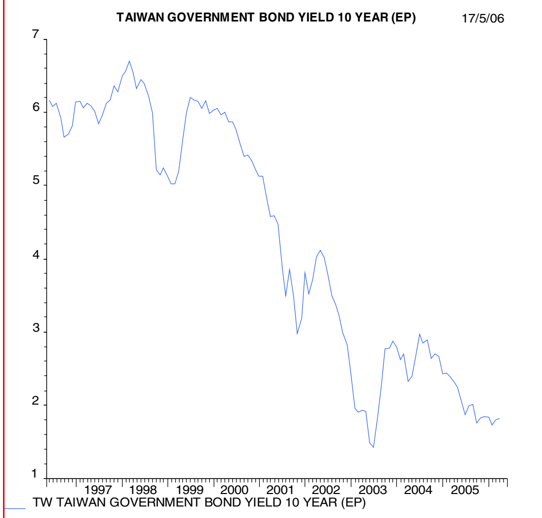
- Legacy of guaranteed products causes negative spreads
- Taiwanese 2005 EEV -£311m as a result of changes to economic assumptions
- Maximum hit to EEV is £700m should interest rates remain below 2% until perpetuity

In our previous note *Value vs yield*, 7 March 2006, we discussed in detail the issue of negative spreads on whole-of-life policies written with guarantees. A quick recap:

- Prudential entered the Taiwanese market in 1999 with the purchase of Chinfon, which wrote solely whole-of-life policies. These had guaranteed rates set by the government
- Prudential continued to write guaranteed business until market deregulation in 2002. Since then the business has moved strongly towards unit linked policies (representing 73% of new business written in 2005 compared with 7% in 2001)
- At the time Chinfon was bought, guarantee rates were as high as 8%. Over the past six years interest rates have fallen and are currently under 2%. As a result, a negative spread has emerged (the fall in the Taiwan Government 10-year bond yield can be seen in the following chart)
- The European embedded value for Taiwan was negative at -£311m as at end 2005 following a change in economic assumptions made by management during 2005. The following assumptions are now in place:

"…Current bond yields of around 2% trend towards 5.5% at 31 December 2012. Allowance is made for the mix of assets in the fund, our future investment strategy and the market depreciation of the bonds as a result of the assumed yield increases. This gives rise to an average assumed fund rate that trends from 2.3% to 5.4% in 2013 and falls below 2.3% for seven years due to the depreciation of bond values as yields rise. Thereafter, the fund earned rate fluctuates around a target of 5.9%" (source: 2005 Annual Report)

- Sensitivities to the starting bond rate were disclosed with the FY2005 results – a 1% reduction would result in a £108m hit to the EEV whereas a 1% increase would add £104m.
- Management has indicated that if bond rates were to remain at the current rate until perpetuity this would result in a further £700m loss to EEV
- The current cost of servicing this negative spread is £30m per annum and even if rates were to stay at current levels management expect Taiwan to become cash positive in 2010



Source: Thomson Financial Datastream

Disclosure appendix

Stock ratings and basis for financial analysis

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- Neutral (Hold)
- Underweight (Sell)

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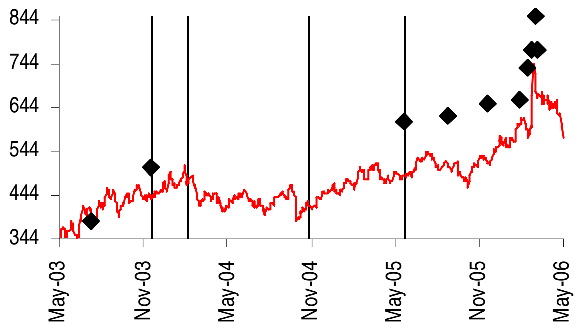
Underweight/Sell	18%	(32% of these provided with Investment Banking Services)

Share price and rating changes for long-term investment opportunities

Prudential share price performance GBp vs HSBC rating history



Source: HSBC

Rating & price target history

From	To	Date
Reduce	Add	10 December 2003
Add	Reduce	24 February 2004
Reduce	N/R	15 November 2004
N/R	Overweight	09 June 2005
Target price	**Value**	**Date**
Price 1	385	29 July 2003
Price 2	505	10 December 2003
Price 3	N/R	15 November 2004
Price 4	613	09 June 2005
Price 5	625	16 September 2005
Price 6	653	08 December 2005
Price 7	663	15 February 2006
Price 8	734	07 March 2006
Price 9	774	16 March 2006
Price 10	851	24 March 2006
Price 11	774	29 March 2006

Source: HSBC

Issuer & Analyst disclosures

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Company	Ticker	Recent price	Disclosure
Prudential	PRU.L	5.745	1, 2, 3, 5, 6, 7

Source: HSBC

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