# INTEGRATED FINANCIAL SERVICES

FIRSTRAND

unaudited interim results for the six months ended 31 December 2005

FIRSTRAND


1996/010753/06 Share code: FSR
ISIN: ZAE 0000 66304 ("FSR")


*A booklet containing supplementary information on the Banking Group is available from our website or on request from the company secretary's office

# FIRSTRAND GROUP

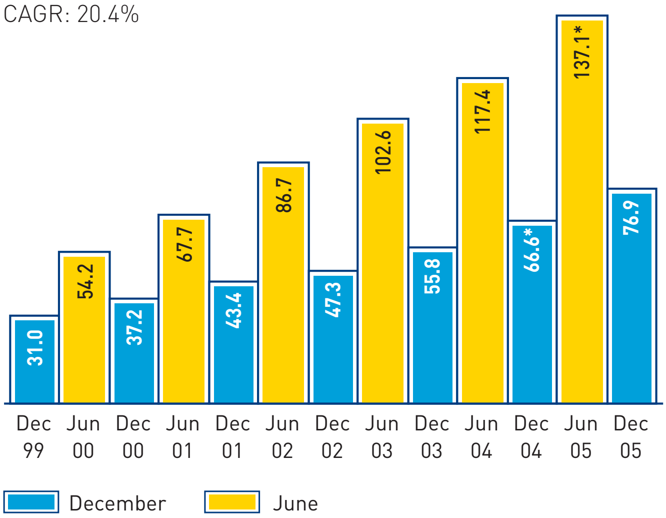
FIRSTRAND

## INTRODUCTION

This report covers the financial results of FirstRand Limited ("FirstRand"), its wholly-owned subsidiaries FirstRand Bank Holdings Limited ("the Banking Group") and Momentum Group Limited, and its 66.5% (2004: 64.5%) subsidiary Discovery Holdings Limited. Comprehensive reports relating to these subsidiaries are included in this circular and should be read in conjunction with this report.

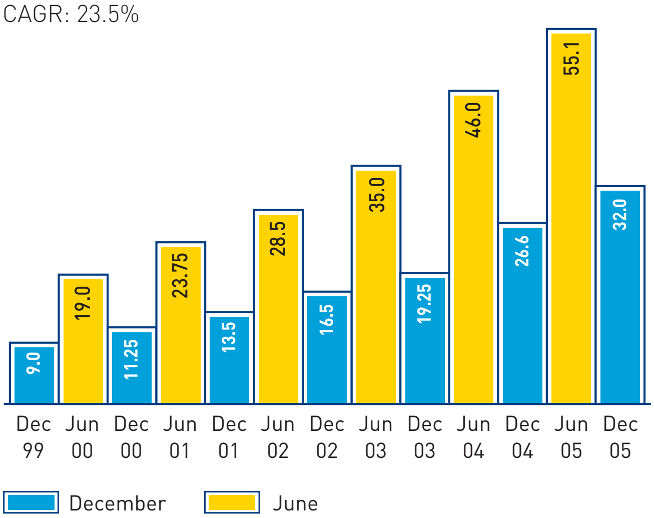
## FINANCIAL HIGHLIGHTS

**Normalised earnings per share**
(Cents per share)
CAGR: 20.4%




*Restated – compliant with IFRS

**Dividends per share**
(Cents per share)
CAGR: 23.5%




| Six months to December 2005 | % change |
|---|---|
| Diluted headline earnings per share | +20 |
| Normalised earnings | +19 |
| Dividend per share | +20 |
| Net asset value growth | +19 |
| Asset under management or administration | +21 |
| Return on equity (%) | 30 |

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# Statement of headline earnings and dividends

| R million | Unaudited Six months ended 31 December 2005 | 2004 | % change | Audited Year ended 30 June 2005 |
|---|---|---|---|---|
| Banking Group | **3 658** | 2 844 | 29 | 6 062 |
| Momentum Group | **652** | 583 | 12 | 1 270 |
| Discovery Group | **101** | 118 | (14) | 324 |
| FirstRand Limited | **(102)** | (116) | 12 | (304) |
| Consolidation of Share Trusts | **(134)** | (78) | (72) | (155) |
| **Sub-total** | **4 175** | 3 351 | 25 | 7 197 |
| Dividend payment on non-cumulative non-redeemable preference shares | **(114)** | – | (100) | (68) |
| **Sub-total** | **4 061** | 3 351 | 21 | 7 129 |
| FirstRand shares held by policyholders (Fair value movement) | **(131)** | – | 100 | – |
| **Headline earnings attributable to ordinary shareholders** | **3 930** | 3 351 | 17 | 7 129 |
| **Return on average equity (based on normalised earnings) (%)** | **29.9** | 24.0 | | |
| **Earnings per share (cents)** | | | | |
| – Basic | **79.8** | 63.3 | 26 | 137.3 |
| – Diluted | **77.1** | 62.5 | 23 | 135.5 |
| **Headline earnings per share (cents)** | | | | |
| – Basic | **76.9** | 63.8 | 20 | 137.1 |
| – Diluted | **74.8** | 62.9 | 19 | 135.3 |
| **Dividend per ordinary share (cents)** | | | | |
| – Interim | **32.0** | 26.6 | 20 | 26.6 |
| – Final | **–** | – | | 28.5 |
| **Total** | **32.0** | 26.6 | 20 | 55.1 |

| R million | Unaudited Six months ended 31 December 2005 | 2004 | % change | Audited Year ended 30 June 2005 |
|---|---|---|---|---|
| **Dividend information** | | | | |
| Dividend on non-cumulative non-redeemable preference share (cents) | | | | |
| **"B" preference share** | | | | |
| – 27 February 2006/28 February 2005 | **–** | – | | 228 |
| – 29 August 2005 | **380** | – | | 360 |
| Total | **380** | – | | 588 |
| **"B1" preference share** | | | | |
| – 27 February 2006/28 February 2005 | **–** | – | | 37 |
| Ordinary dividends declared (R million) | **1 797** | 1 457 | 23 | 3 057 |
| Dividends on non-cumulative non-redeemable preference shares (R million) | **273** | – | 100 | 182 |

## Headline earnings reconciliation

| | | | | |
|---|---|---|---|---|
| Attributable earnings of: | | | | |
| Banking Group | **3 654** | 2 806 | 30 | 5 967 |
| Momentum Group | **778** | 584 | 33 | 1 341 |
| Discovery Group | **129** | 128 | 1 | 356 |
| **Sub-total** | **4 561** | 3 518 | 30 | 7 664 |
| FirstRand Limited | **(102)** | (116) | 12 | (304) |
| Consolidation of Share Trusts | **(134)** | (78) | 72 | (155) |
| **Sub-total** | **4 325** | 3 324 | 30 | 7 205 |
| *Less:* Dividend paid to non-cumulative non-redeemable preference shareholders | **(114)** | – | (100) | (68) |
| **Sub–total** | **4 211** | 3 324 | 27 | 7 137 |
| FirstRand shares held by policyholders (Fair value movement) | **(131)** | – | (100) | – |
| **Attributable earnings to ordinary shareholders** | **4 080** | 3 324 | 23 | 7 137 |
| **Adjusted for:** | | | | |
| *Plus:* Goodwill | **95** | – | | – |
| *Less:* (Profit)/Loss on sale of strategic associates/subsidiaries | **(82)** | 17 | 100 | 67 |
| *Add:* Loss on sale of assets | **6** | (1) | >100 | 7 |
| *Less:* (Profit)/Loss on sale of available-for-sale financial instruments | **(169)** | 11 | (>100) | (82) |
| **Headline earnings attributable to ordinary shareholders** | **3 930** | 3 351 | 17 | 7 129 |

# Reconciliation of normalised earnings to headline earnings

| R million | Six months ended 31 December 2005 | 2004 | % change | Year ended 30 June 2005 |
|---|---|---|---|---|
| Banking Group headline earnings (excluding translation impact under SA GAAP) | **3 640** | 3 046 | 20 | 6 228 |
| Momentum Group's headline earnings (pre-IFRS and National Treasury Settlement charge) | **742** | 592 | 25 | 1 287 |
| Discovery Group (pre-IFRS and BEE) | **209** | 126 | 66 | 350 |
| FirstRand Limited | **(102)** | (116) | 12 | (304) |
| Consolidation of staff share schemes | **(134)** | (78) | (72) | (155) |
| **Sub-total** | **4 355** | 3 570 | 22 | 7 406 |
| *Less:* Dividend payment on non-cumulative non-redeemable preference shares | **(114)** | – | (100) | (68) |
| **Sub total pre-IFRS** | **4 241** | 3 570 | 19 | 7 338 |
| **IFRS adjustments** | **(79)** | (64) | (19) | (158) |
| Banking Group (excluding translation impact) | **(4)** | (47) | 91 | (115) |
| Momentum Group | **(63)** | (9) | (>100) | (17) |
| Discovery Group | **(12)** | (8) | (50) | (26) |
| **Normalised earnings** | **4 162** | 3 506 | 19 | 7 180 |
| Banking Group (translation gains/(losses)) | **22** | (155) | >100 | (51) |
| **Sub-total** | **4 184** | 3 351 | 25 | 7 129 |
| National Treasury settlement charge | **(27)** | – | (100) | – |
| Discovery BEE transaction | **(96)** | – | (100) | – |
| FirstRand shares held by policyholders (Fair value movement) | **(131)** | – | (100) | – |
| **Headline earnings attributable to ordinary shareholders** | **3 930** | 3 351 | 17 | 7 129 |

# Consolidated income statement

| R million | Unaudited Six months ended 31 December 2005 | 2004 | % change | Audited Year ended 30 June 2005 |
|---|---|---|---|---|
| **Net interest income** | **7 792** | 6 811 | 13 | 14 571 |
| Interest and similar income | **15 642** | 14 237 | 11 | 28 807 |
| Interest expense and similar charges | **(7 850)** | (7 426) | 8 | (14 236) |
| Impairment losses on loans and advances | **(576)** | (409) | 41 | (706) |
| **Net fee and commission income** | **5 036** | 3 675 | 33 | 8 109 |
| Fee and commission income | **7 452** | 5 509 | 33 | 11 888 |
| Fee and commission expense | **(2 416)** | (1 834) | 32 | (3 779) |
| **Net insurance premium income** | **4 346** | 3 641 | 19 | 7 377 |
| Insurance premium revenue | **4 575** | 3 786 | 21 | 7 755 |
| Premium ceded to reinsurers | **(229)** | (145) | 58 | (378) |
| **Net claims and benefits paid** | **(4 446)** | (4 248) | 5 | (8 863) |
| Gross claims and benefits paid on insurance contracts | **(4 648)** | (4 347) | 7 | (9 125) |
| Reinsurance recoveries | **202** | 99 | 104 | 262 |
| Gains and losses from banking and trading activities | **1 016** | 1 000 | (12) | 2 187 |
| Gains and losses from investment activities | **4 193** | 6 285 | (32) | 7 687 |
| Increase in fair value of policyholder liability and life fund | **(3 202)** | (5 142) | (38) | (5 650) |
| Other operating income | **742** | 121 | >100 | 754 |
| **Net operating income** | **14 901** | 11 734 | 26 | 25 466 |
| **Operating expenses** | **(8 592)** | (6 894) | | (14 311) |
| Other operating expenses | **(8 587)** | (6 894) | 29 | (14 311) |
| Other impairments | **(5)** | – | – | – |
| Share of profit of associated and joint venture companies | **716** | 409 | 109 | 981 |
| **Income before discontinued operations** | **7 025** | 5 249 | 27 | 12 136 |
| (Loss)/Profit on disposal of discontinued operations | **–** | (17) | 100 | (67) |
| **Operating profit before income tax** | **7 025** | 5 232 | 28 | 12 069 |
| Taxation expense | **(2 486)** | (1 622) | 31 | (4 113) |
| **Profit for the period** | **4 539** | 3 610 | 26 | 7 956 |
| **Attributable to:** | | | | |
| Non-cumulative non-redeemable preference shares | **114** | – | 100 | 68 |
| Equity holders of FirstRand Limited | **4 080** | 3 324 | 23 | 7 137 |
| Minority interest | **345** | 286 | 43 | 751 |
| Earnings per share (cents) | **80** | 63 | 26 | 137 |
| Diluted earnings per share (cents) | **77** | 63 | 24 | 136 |

# Balance sheet

| R million | Unaudited At 31 December 2005 | 2004 | Audited At 30 June 2005 |
|---|---|---|---|
| **ASSETS** | | | |
| Cash and short-term funds | **22 541** | 38 550 | 36 272 |
| Advances | **246 326** | 206 018 | 222 379 |
| – at amortised cost | **203 802** | 155 667 | 176 003 |
| – held-to-maturity | **662** | 9 174 | 7 449 |
| – available-for-sale | **1 857** | 1 733 | 1 648 |
| – fair value | **40 005** | 39 444 | 37 279 |
| Derivative financial instruments | **40 652** | 56 349 | 39 727 |
| – qualifying for hedging | **861** | 884 | 811 |
| – trading | **39 791** | 55 465 | 38 916 |
| Investment securities and other investments | **147 516** | 126 509 | 130 731 |
| Financial instruments held for trading | **16 603** | 22 438 | 20 728 |
| Investment securities and other investments | **121 281** | 97 072 | 101 383 |
| – held-to-maturity | **1 284** | 1 205 | 1 822 |
| – available-for-sale | **18 949** | 18 382 | 15 413 |
| – elected fair value | **101 048** | 77 485 | 84 148 |
| Commodities | **1 135** | 1 110 | 439 |
| Non-recourse investments | **8 497** | 5 889 | 8 181 |
| Investment properties | **5 068** | 3 500 | 4 159 |
| Policy loans originated | **–** | 577 | 530 |
| Retirement benefit asset | **38** | – | – |
| Reinsurance assets | **299** | 224 | 217 |
| Insurance assets including unit-linked assets | **14 742** | 1 780 | 2 169 |
| Loans and receivables | **14 467** | 8 560 | 4 066 |
| Investments in associated companies | **3 582** | 3 164 | 16 009 |
| Taxation | **6** | – | 118 |
| Intangible assets | **3 018** | 804 | 1 177 |
| Property and equipment | **4 720** | 4 298 | 4 623 |
| Deferred taxation | **1 000** | 849 | 593 |
| **Total assets** | **503 975** | 451 182 | 462 770 |

| R million | Unaudited At 31 December 2005 | 2004 | Audited At 30 June 2005 |
|---|---|---|---|
| **SHAREHOLDERS' EQUITY AND LIABILITIES** | | | |
| **LIABILITIES** | | | |
| Deposits | **264 437** | 235 966 | 245 793 |
| – deposits and current accounts | **255 940** | 230 077 | 237 612 |
| – non-recourse deposits | **8 497** | 5 889 | 8 181 |
| Trading liabilities | **20 417** | 16 786 | 19 919 |
| Derivative financial instruments | **27 307** | 46 505 | 30 264 |
| – qualifying for hedging | **366** | 523 | 249 |
| – trading | **26 941** | 45 982 | 30 015 |
| Creditors and accruals | **21 301** | 14 475 | 23 186 |
| Insurance contract liabilities, including unit-linked liabilities | **–** | 785 | 1 027 |
| Liabilities under investment contracts | **78 394** | 47 932 | 48 725 |
| Liability under insurance contracts and life fund | **43 998** | 44 900 | 48 844 |
| Post-retirement fund liabilities | **1 660** | 1 690 | 1 771 |
| Debentures and long-term liabilities | **6 505** | 6 491 | 5 380 |
| Provisions | **2 038** | 1 290 | 1 565 |
| Taxation | **173** | 962 | 185 |
| Deferred taxation liabilities | **4 338** | 2 228 | 3 877 |
| **Total liabilities** | **470 568** | 420 010 | 430 536 |
| **Shareholders' equity** | | | |
| Ordinary share capital and share premium | **2 694** | 6 268 | 4 396 |
| Non-cumulative non-redeemable preference shares | **4 518** | 2 975 | 2 992 |
| Distributable reserves | **21 849** | 17 544 | 20 284 |
| Non-distributable reserves | **1 978** | 2 310 | 2 238 |
| Shareholders funds | **31 039** | 29 097 | 29 910 |
| Minority shareholders' interest | **2 368** | 2 075 | 2 324 |
| Total shareholders' equity | **33 407** | 31 172 | 32 234 |
| **Total shareholders' equity and liabilities** | **503 975** | 451 182 | 462 770 |

## Summarised cash flow statement

| R million | Unaudited Six months ended 31 December 2005 | 2004 | Audited Year ended 30 June 2005 |
|---|---|---|---|
| Cash inflow/(outflow) from operations | **5 032** | (1 214) | 8 479 |
| Working capital changes | **675** | 634 | 2 004 |
| Cash inflow/(outflow) from operations | **5 707** | (580) | 10 483 |
| Taxation paid | **(3 282)** | (1 527) | (5 292) |
| Dividends paid | **(1 714)** | (1 387) | (2 835) |
| **Net cash inflow from/(to) operating activities** | **711** | (3 494) | 2 356 |
| **Net cash outflow from investment activities** | **(20 973)** | (7 659) | (12 567) |
| **Net cash inflow/(outflow) from financing activities** | **4 253** | 9 450 | 6 386 |
| **Net (decrease)/increase in cash and cash equivalents** | **(16 009)** | (1 703) | (3 825) |
| **Cash and cash equivalents at beginning of year** | **38 550** | 40 253 | 40 097 |
| **Cash and cash equivalents at end of year** | **22 541** | 38 550 | 36 272 |

## Assets under management

| R million | Unaudited At 31 December 2005 | 2004 | % change | Audited At 30 June 2005 |
|---|---|---|---|---|
| FirstRand Limited | **(4 711)** | (2 178) | >100 | 114 |
| Banking Group | **372 378** | 337 107 | 10 | 344 101 |
| Momentum | **130 700** | 112 168 | 16 | 113 735 |
| Discovery | **5 928** | 4 086 | 45 | 4 820 |
| Total on balance sheet assets | **504 295** | 451 183 | 11 | 462 770 |
| Off-balance sheet assets managed or administered on behalf of clients | **193 000** | 127 142 | 43 | 153 609 |
| Total assets under management or administration | **685 491** | 578 325 | 19 | 616 379 |

# Sources of profit

for the six months ended 31 December 2005

| R million | 2005 | % composition | 2004 | % composition | % change |
|---|---|---|---|---|---|
| **Banking Group** | 3 636 | 92 | 2 999 | 89 | 21 |
| FNB | **1 794** | 46 | 1 558 | 47 | 15 |
| RMB | **809** | 20 | 610 | 18 | 33 |
| WesBank | **603** | 15 | 474 | 14 | 27 |
| FNB Africa | **159** | 4 | 166 | 5 | (4) |
| OUTsurance | **96** | 2 | 72 | 2 | 34 |
| Support | **179** | 5 | 199 | 6 | (10) |
| Ansbacher | **–** | – | (33) | (1) | – |
| Impact of IFRS | **(4)** | – | (47) | (1) | – |
| **Momentum Group** | 679 | 17 | 583 | 17 | 16 |
| Insurance operations | **423** | 11 | 299 | 9 | 41 |
| Asset management operations | **151** | 4 | 107 | 3 | 41 |
| Investment income on shareholders' assets | **168** | 4 | 186 | 6 | (10) |
| Impact of IFRS | **(63)** | (2) | (9) | (1) | – |
| **Discovery Group** | 197 | 5 | 118 | 4 | 67 |
| **FirstRand Limited** | (102) | (3) | (116) | (3) | (12) |
| **Consolidation of Share Trusts** | (134) | (3) | (78) | (2) | 72 |
| **Operating performance** | 4 276 | 108 | 3 506 | 105 | 22 |
| Dividend payment on non-cumulative non-redeemable preference shares | (114) | (3) | – | – | >100 |
| Normalised earnings | 4 162 | 103 | 3 506 | 105 | 19 |
| Settlement with National Treasury | (27) | (1) | – | – | – |
| **Operational performance (Normalised earnings)** | 4 135 | 104 | 3 506 | 105 | 18 |
| Discovery BEE transaction | (96) | (2) | – | – | – |
| FirstRand shares held by policyholders | (131) | (3) | – | – | – |
| Currency translation profits/(losses) | 22 | 1 | (155) | (5) | (113) |
| **Headline earnings attributable to ordinary shareholders** | 3 930 | 100 | 3 351 | 100 | 17 |

*Notes:*

*1. Taxation relating to the FirstRand Banking Group has been allocated across the Bank's operating divisions on a pro-rata basis.*

# Statement of changes in equity

for the six months ended 31 December

| | Attributable to equity holders of the Group | | |
|---|---|---|---|
| R million | Share capital and share premium | Non-distributable reserves | Distributable reserves |
| As reported under SA GAAP at 30 June 2005 | 4 396 | 1 893 | 20 575 |
| IFRS adjustments at 30 June 2005 | – | 345 | (281) |
| Restated IFRS at 30 June 2005 | 4 396 | 2 238 | 20 284 |
| IFRS adjustments | (296) | (174) | (857) |
| Restated balance at 1 July 2005 | 4 100 | 2 064 | 19 427 |
| Issue of share capital | | | |
| Share issue expense | | | |
| Currency translation differences | | (269) | |
| Revaluation of cash flow hedges | | (217) | |
| Revaluation of AFS assets | | 292 | |
| Movement in other reserves | | 9 | |
| Treasury shares in insurance subsidiary | (429) | | |
| Consolidation of Share Trust | (977) | (2) | |
| Transfer (to)/from reserves | | 101 | (101) |
| Share options (IFRS 2) | | | 43 |
| Earnings attributable to shareholders | | | 4 080 |
| Ordinary dividends | | | (1 600) |
| Preference dividends | | – | |
| **As reported under IFRS at 31 December 2005** | **2 694** | **1 978** | **21 849** |

| | Perpetual preference shareholders' funds | | | | |
|---|---|---|---|---|---|
| Total ordinary shareholders' funds | Non-cumulative preference share capital | Non-cumulative preference share premium | Total preference shareholders' funds | Minority interest | **Total shareholders' funds** |
| 26 864 | – | 2 992 | 2 992 | 2 290 | **32 146** |
| 54 | – | – | – | 34 | **88** |
| 26 918 | – | 2 992 | 2992 | 2 324 | **32 234** |
| (1 327) | – | – | – | 18 | **(1 345)** |
| 25 591 | – | 2 992 | 2 992 | 2 306 | **30 889** |
| – | | 1 530 | 1 530 | | **1 530** |
| – | | (4) | (4) | | **(4)** |
| (269) | | | | | **(269)** |
| (217) | | | | | **(217)** |
| 292 | | | | | **292** |
| 9 | | | | | **9** |
| (429) | | | | | **(429)** |
| (979) | | | | | **(979)** |
| – | | | | | **–** |
| 43 | | | | | **43** |
| 4 080 | | 114 | 114 | 345 | **4 539** |
| (1 600) | | | | (283) | **(1 883)** |
| | | (114) | (114) | | **(114)** |
| **26 521** | **–** | **4 518** | **4 518** | **2 368** | **33 407** |

# Additional information

Shares in issue

| R million | Unaudited Six months ended 31 December **2005** | 2004 | Audited Year ended 30 June 2005 |
|---|---|---|---|
| Opening balance | **5 613 566 954** | 5 476 374 833 | 5 476 374 833 |
| Movements: | | | |
| Odd-lot | **–** | (49 850) | (49 850) |
| Outperformance conversion May 2005 | **–** | – | 18 241 971 |
| Share issue (May 2005 – BEE transaction) | **–** | – | 119 000 000 |
| Shares in issue | **5 613 566 954** | 5 476 324 983 | 5 613 566 954 |
| Outperformance conversion October 2005 | **1 465 514** | – | – |
| Number of shares in issue | **5 615 032 468** | 5 476 324 983 | 5 613 566 954 |
| *Less:* Treasury shares | **522 505 423** | 284 350 608 | 427 161 493 |
| Staff schemes | **293 531 494** | 284 350 608 | 247 760 418 |
| BEE Staff Trusts | **179 401 072** | – | 179 401 072 |
| FirstRand shares held by policyholders | **49 572 857** | – | – |
| Number of shares in issue (after treasury shares) | **5 092 527 045** | 5 191 974 375 | 5 186 405 464 |
| Number of shares in issue | **5 613 566 954** | 5 476 374 833 | 5 476 374 833 |
| Adjustments: | | | |
| Odd-lot offer weighting | **–** | (19 341) | (38 787) |
| Outperformance conversion weighting | **732 757** | – | 2 298 988 |
| BEE transaction weighting | **–** | – | 14 997 260 |
| Weighted number of shares before treasury shares | **5 614 299 711** | 5 476 355 492 | 5 493 632 294 |
| *Less:* Treasury shares | **503 799 247** | 228 056 324 | 293 768 089 |
| Staff schemes | **274 825 318** | 228 056 324 | 271 158 639 |
| BEE Staff Trusts | **179 401 072** | – | 22 609 450 |
| FirstRand shares held by policyholders | **49 572 857** | – | – |
| Weighted number of shares in issue | **5 110 500 465** | 5 248 299 168 | 5 199 864 205 |
| Weighted number of shares | **5 110 500 465** | 5 248 299 168 | 5 199 864 205 |
| *Add:* Outperformance | **24 215 125** | 72 254 988 | 42 395 169 |
| Staff schemes | **112 758 848** | 42 145 844 | 26 608 190 |
| BEE Staff Trusts | **42 588 026** | – | – |
| *Less:* Fair value adjustment relating to share-based payments | **(39 472 462)** | (42 217 785) | (37 572 714) |
| Diluted weighted number of shares in issue | **5 250 590 002** | 5 320 482 215 | 5 268 867 564 |

# Introduction

## BASIS OF PRESENTATION

The information presented has been prepared in accordance with interpretations of IFRS applicable at 31 December 2005. It should be noted that IFRS is continuing to evolve through the issue and/or endorsement of new Standards and Interpretations and developments in the application of recently issued Standards. For that reason, it is possible that the financial impact and adjustments reflected below may change before they are presented as comparatives to the IFRS financial information issued by the Group in respect of the year ending 30 June 2006. A full transitional report for the adoption of IFRS has been prepared and has been circulated to shareholders in a separate booklet.

## FINANCIAL PERFORMANCE

The FirstRand Group of companies ("FirstRand" or "the Group") produced excellent results, growing normalised earnings by 19%. Headline earnings grew 17%. Headline earnings were impacted by the cost of the Discovery BEE transaction, the settlement with the National Treasury, the impact of currency translations and the movement in fair value of FirstRand shares held by policyholders.

FirstRand believes that normalised earnings reflect the true performance of the Group. The table below reflects the reconciliation between normalised earnings and headline earnings.

| Six months to December 2005 | % change |
|---|---|
| **Headline earnings** | +17 |
| • Currency translations | (6) |
| **Sub-total** | +11 |
| • FirstRand shares held by policyholders | 4 |
| • Impact of BEE transaction (Discovery) | 3 |
| • National Treasury Settlement Charge | 1 |
| **Normalised earnings** | +19 |

These results were achieved in a positive economic environment, which provided strong organic growth opportunities for all the Group's businesses and in particular for the Banking Group which produced headline earnings growth of 20% to R3.0 billion. Sustained low interest rates continued to result in strong advances growth which was to some extent offset by margin pressure. The Banking Group's capacity expansion strategies resulted in continued high growth in expenses, notwithstanding this the overall cost to income ratio improved, reflecting the Banking Group's sustained positive operational leverage. Strong equity markets and a high level of Black Economic Empowerment ("BEE") activity positively impacted on the Group's investment banking operations.

Momentum increased headline earnings, excluding the National Treasury settlement and IFRS, by 25% to R742 million, with earnings attributable to ordinary shareholders increasing by 33%. If the settlement and IFRS adjustments are included the headline earnings increased by 12%. These results were characterised by strong retail new business growth, particularly in individual risk and discretionary lump-sum investments, the positive impact of the Sage acquisition and significant growth in asset management earnings due to increased equity market growth and strong retail product inflows. Investment income on shareholder assets reduced as a result of recent acquisitions.

Discovery delivered a strong performance for the year under review with headline earnings, excluding the impact of its BEE transaction, increasing by 64% to R296 million. If the BEE transaction is included headline earnings reduced by R144 million.

### Group earnings and headline earnings per share

| | Unaudited 31 December 2005 | 2004 | % growth |
|---|---|---|---|
| **Earnings per share (cents)** | | | |
| • Basic | **79.8** | 63.3 | 26 |
| • Diluted | **77.1** | 62.0 | 24 |
| **Headline earnings per share (cents)** | | | |
| • Basic | **76.9** | 63.8 | 20 |
| • Diluted | **74.8** | 62.9 | 19 |

The relative contributions to operational earnings by the various operating companies were:

| | Six months to 31 December 2005 | 2004 |
|---|---|---|
| Banking Group | **79%** | 81% |
| Momentum | **16%** | 16% |
| Discovery | **5%** | 3% |
| Total | **100%** | 100% |

## OPERATING ENVIRONMENT

### Economic review

The South African economy remained strong during the six-month period ended 31 December 2005, characterised by renewed strength in the Rand, lower than expected inflation, stable domestic interest rates and sharply higher equity markets.

The Rand strengthened by 5%, from a level of R6.65:US$1 at 30 June 2005, to R6.32:US$1 at 31 December 2005, mainly due to the run in precious metals prices, with the US$ gold price increasing by almost 19% over the period. Despite the rising oil price and resultant petrol price increases, CPIX inflation performed better than expected, with an average CPIX for the six-month period of 4.3%. The South African Reserve Bank's targeted range is 3% to 6% CPIX.

Demand for credit accelerated, with private sector credit extension increasing by more than 20% on a year-on-year basis, reflecting households' strong appetite for asset-backed credit.

Equity markets continued to reflect strong gains, with the FTSE-JSE Top 40 Index increasing by 28% during the six months under review.

Discretionary retail investment product providers, comprising mainly Collective Investment Schemes ("CIS") and Linked Investment Service Providers ("LISP"), continued to benefit from increased lump-sum inflows. The Association of Collective Investments Schemes reported that total CIS assets increased by 19% for the six months to R415 billion at 31 December 2005.

## STRATEGIC ISSUES

### Settlement with National Treasury

FirstRand welcomes the settlement reached with National Treasury on 12 December 2005 regarding minimum standards on early termination values on savings and retirement annuity products. The after tax impact of the settlement on Momentum and Sage amounted to R204 million.

As a provision of R73 million after tax was made at 30 June 2005, the balance of the settlement has been charged against current period earnings.

As reported in the 2005 year-end results announcement, Momentum proactively reduced profit margins on its Investo range in the interests of improved "value for money" to clients, and will continue to improve the value proposition to clients through innovative product design.

### International strategy

FirstRand continues to drive its international expansion strategy at business unit level, facilitated and supported by the FirstRand Africa and Emerging Markets unit ("FRAEM").

In 2005 FirstRand committed US$30 million to AIFH, a private equity fund which had the mandate to invest in retail bank privatisations in Sub-Saharan Africa. The US$30 million was not drawn down and FirstRand, together with the other shareholders, voted to dissolve the fund on 27 January 2006.

Celpay, which operates a cellphone payments enabling platform in the DRC and Zambia, was acquired from Celtel during the period under review. A new CEO has been appointed and the focus has been on reducing costs and refining the business model. Cellphone banking is regarded as an alternative retail banking strategy.

Further expansion opportunities are currently being explored in Africa and other emerging markets.

### African Life Health

During the period Momentum disposed of its 34%-shareholding in African Life ("Aflife") to Sanlam and simultaneously made an offer to acquire the entire shareholding of African Life Health ("ALH") from Aflife for a cash consideration of R176 million. The acquisition of ALH significantly strengthens Momentum's position in the health care arena with principal members under administration now exceeding 240 000. This broadens Momentum's presence in market segments serving both lower income and local government employee medical schemes.

### Capital management actions

In November 2005 the Group raised R1.5 billion through the issue of non-cumulative non-redeemable preference shares, to further enhance the level and structure of its capital base. R500 million was deployed to Momentum for its acquisition strategy and R1 billion was utilised to refinance the Vendor component of the BEE transaction. The effect of this refinancing was the elimination of capital impairment in FirstRand Bank Limited.

## OVERVIEW OF RESULTS

### Banking Group

The Banking Group produced excellent results for the six months to 31 December 2005, benefiting from very strong performances from RMB, FNB and WesBank.

This performance was achieved in a very favourable environment which positively impacted the majority of the businesses. Exceptional growth in consumer credit demand, particularly for asset-backed finance, combined with increased client numbers and transaction volumes positively impacted FNB and WesBank.

The strong equity markets were positive for RMB's equity businesses, particularly private equity, equities trading and corporate finance.

Non-interest revenue experienced particularly strong growth in the period, increasing 28%. Fee and commission increased by 18% driven by higher customer numbers and transaction volumes.

Equity trading activities across the board proved highly profitable in buoyant market conditions. However, difficult conditions in the foreign exchange and interest rate markets dragged down the overall trading performance.

The significant growth in both Investment income (up 38%) and Income from associates (up 90%) was driven mainly by the Private Equity businesses. Profits were realised on the disposal of both local and offshore investments.

Margin pressure continued in the period, mainly due to increased competitive activity, funding pressure and the R207 million reduction in contribution from the hedges. Operating costs increased by 22%, however, the cost to income ratio continued its downward trend.

## First National Bank ("FNB")

FNB produced excellent results with profit before taxation increasing by 18% from R2 121 million to R2 503 million.

The buoyant South African economy, strong consumer demand for credit, a significant increase in customer numbers, market share gains and excellent volume growth, all contributed to this increased profitability, despite low interest rates continuing to place pressure on margins.

Interest income grew by 11%, attributable to both the strong balance sheet growth in the last quarter of the previous financial year as well as in the current period, offset to some extent by a reduced benefit from the hedges put in place in prior periods.

Bad debts remained low at 0.3% (2004: 0.4%) of advances, due in the main to the continued benign interest rate environment.

Non-interest revenue grew by 22% as a result of increased customer numbers and higher transactional volumes, particularly in the Mass, Consumer and Commercial segments, Card Issuing and Card Acquiring. Average fee increases were kept below inflation.

Operating expenses increased by 18%. A significant portion of this increase was driven by investments in growth initiatives and variable costs associated with increased volumes (such as In-Contact), and HomeLoans acquisition costs resulting in the base cost increased by only 8%.

FNB actively pursued a strategy to attract deposits through product innovations such as the Million-a-Month Account. Deposits grew by R20 billion or 18%, with Commercial, Corporate and Consumer segments being the major contributors.

Assets under Management in the Wealth segment have grown by 55% to R18 billion, benefiting from substantial equity market growth, good investment selection and strong net new business inflows.

Advances increased by R27 billion or 29%, with HomeLoans, Card Issuing, Wealth and Commercial being the major contributors. HomeLoans increased advances by 41% to R69 billion as a result of the 81% growth in new business written. In addition, the One Account continued to perform very well increasing its loan book to R3.5 billion from R1.3 billion at June 2005.

Card Issuing grew advances by 42% to R8 billion, resulting from the growth in customer numbers, success in selling balance transfers and the continued high levels of customer spending. Cardholder turnover increased by 38%. The growth in customer numbers was driven by an increased sales focus and success in cross-selling to existing FNB customers combined with the successful launch of the Discovery Card, all of which resulted in an increase of 34% in new customer accounts.

Corporate advances continued to decline as a result of low credit demand and increased pricing competition.

## Rand Merchant Bank ("RMB")

RMB produced an exceptional performance increasing profit by 33% before tax to R809 million strong performance in the first half of 2006 with the equity related businesses dominating due to buoyant equity markets and sustained low interest rates. The robust economic environment and strong BEE activity were also conducive to good originated debt and advisory services performances. The proprietary trading and arbitrage businesses enjoyed varied success in the volatile and often unpredictable forex, debt, credit and commodity markets. The strategic focus on equity related basis businesses in prior years has yielded a more balanced portfolio of businesses.

Private Equity produced an exceptional performance, generating 90% growth on the prior year comparative with the continued favourable environment conducive to realisations both locally and abroad. The strong growth in equity accounted earnings and a number of new investments, contributed to an increase in the carrying value of the portfolio.

The robust market conditions and strong earnings projections also boosted unrealised profits in the remainder of the portfolio.

Corporate Finance outperformed its prior year result. M&A fees and investment activities were significant contributors, driven by high levels of BEE activity and strong equity markets.

Equity Trading activities across the board proved highly profitable in buoyant market conditions.

Foreign Exchange Treasury Trading posted lower earnings than the prior period as the foreign exchange and interest rate markets proved inactive.

SPJ International's performance was below that of the comparable period having run down the remainder of the high yield corporate positions and reduced its exposures to emerging markets in the current environment of extremely tight credit spreads.

Structured Finance capitalised on its market leading position and robust market conditions to post strong earnings growth over the prior period. Project Finance's focus on Africa contributed substantially to a strong half year performance.

## WesBank

WesBank had an exceptionally good six months with earnings increasing by 31% due mainly to increases in new business volumes and market share. Advances increased by R15.1 billion, up 26%, and new business written was R25 billion, an increase of 34% over the previous period.

Car sales continue at record highs with the number of new units sold for the six-month period increasing by 24% over the corresponding prior period. This trend is expected to continue.

Bad debts were 0.65% and non-performing loans 1.0% of gross advances compared to the previous comparable period of 0.6% and 0.8% respectively.

Margins declined to 3.50% from 3.65% due to competitive pressure on customer rates, the run off of existing fixed-rate advances and the compression of short-term funding rates.

Non-interest revenue increased by 31% as a result of the high new business volumes, greater penetration of insurance products and an increase in the contribution from WesBank Auto.

Expenses increased by 23% (against business growth of 34%). The main reason behind this increase was the investment in capacity and staff required for the current new business volumes as well as the expected future growth in the motor industry. WesBank cost growth includes the profit sharing payments to the joint venture partners. In spite of the increase in expenses, internal efficiency initiatives led to improved cost ratios, with cost to income and cost to asset ratios both showing positive trends (reducing from 47.5% to 44.5%, and from 2.56% to 2.38% respectively).

MotorOne Finance, the start-up retail finance operation in Australia, wrote R156 million of new business in the period under review and the consolidated Australian WesBank businesses contributed R18 million to pre-tax profit.

Associate income increased significantly, as a result of the performances of Toyota Financial Services, DirectAxis (the personal loans business) and the Australian operations.

## African subsidiaries

The growth in profitability was driven mainly by the largest subsidiaries, FNB Botswana and FNB Namibia.

Botswana continued to perform well with profit before tax increasing by 15% in Pula terms, however, due to the Pula weakening against the Rand's profit growth in Rand terms was 2.1%.

Gross advances grew by 10% in line with the current average credit growth in the economy. Assets increased by 15% due to growth in deposits and the raising of fixed term funding. Non-interest revenue grew by 18% on the back of increased product offerings and transaction volumes.

Operating costs increased by 9%, below the country's current inflation rate of 11%. The cost to income ratio of 36% (2004: 38%) is the lowest in the local banking industry.

Namibia grew income before tax by 7% to N$160.0 million (9% at headline earnings level). Net interest income, before impairment in advances, grew by 19% mainly due to the growth in advances of 15%, which was predominantly driven by HomeLoans and WesBank. Non-interest revenue grew by 17% as a result of higher volumes from new accounts and exchange earnings.

Operating costs increased by 17% as a result of additional infrastructure and new business costs. Despite this large increase, the cost to income is within industry norms at 50.5%.

Swaziland faced continued challenging conditions as a result of the depressed state of the economy.

Lesotho performed well achieving a small maiden profit for the month of December 2005 on the back of high volumes.

## OUTsurance

OUTsurance once again produced an excellent set of results increasing headline earnings by 34%. The increase in gross premium income was driven by good organic growth in both Personal and Business lines. Business OUTsurance gained real traction during the period, increasing gross premium income by 144%.

The increase in operating profit of 26% was as a result of the strong organic growth and continued gains in efficiencies. The claims ratio of 57.4% (including OUTbonus costs) was similar to that experienced in the previous year. Expenses as a percentage of net premium revenue improved slightly from 16.6% to 16.5%.

## Momentum Group

The Momentum Group generated a strong performance in a challenging sales environment. Good organic growth was achieved in individual recurring risk, savings and lump-sum retail investment inflows. The integration of Sage into the Momentum Group was completed in under 100 days.

Headline earnings before the once-off impact of the National Treasury settlement, pre-IFRS, increased by 25% to R742 million for the six months ended 31 December 2005. Headline earnings, after the impact of the National Treasury settlement and IFRS adjustments, increased by 12% to R652 million. Earnings attributable to ordinary shareholders increased by 33% to R778 million.

Total assets under management and administration increased by 24% during the six months to R334 billion mainly due to the growth in equity markets, strong net inflows in the collective investments and linked product businesses, and the acquisition of Sage which increased Momentum's on balance sheet asset base by 10%.

The embedded value increased from R11.8 billion at 30 June 2005 to R13.0 billion at 31 December 2005. This growth resulted mainly from the impact of strong equity markets and a 28% increase in the value of new business compared with the prior period. The embedded value profit represents an annualised return of 27%.

### *Insurance operations*

The operating profit generated by local insurance operations increased by 25% to R420 million. The continued strong new business growth, together with good growth in investment markets, impacted positively on the results. The value of new business, which represents the present value of profits from new business, increased by 28% to R246 million. Including the turnaround in the results of the international operations, the overall insurance operations increased operating profit by an excellent 41% to R423 million.

The acquisition of Sage reduces Momentum's unit cost per policy and contributes positively to the growth strategy by providing access to an agency force that is expected to significantly enhance future new business growth. Following the conversion of the Sage Life policies onto the Momentum IT systems, the combined maintenance cost per policy has been reduced by 14%, with a commensurate increase in the embedded value of in force policies. A total of R28 million in operating profit is included for Sage from 1 September 2005, whilst an amount of R10 million is included in investment income on shareholder assets.

### *Asset management operations*

The asset management operations comprise the retail and institutional asset management operations of RMB Asset Management ("RMBAM"), RMB Properties and 87% of Ashburton. Momentum's 40%-shareholding in Futuregrowth was sold to Wiphold, the majority shareholder, during the period under review.

The asset management operations generated an increase in net profit after tax of 41% to R151 million. The local asset management operations, represented mainly by RMBAM, generated an excellent 64% increase in headline earnings. Strong market growth in the institutional business resulted in increased asset values and consequently higher fee income, whilst a significant increase in retail collective investment scheme net inflows has also benefited income levels.

## Discovery

Discovery's operating profits grew strongly by 32% during the period under review to R526 million (2004: R399 million), despite a disappointing performance from Destiny Health. Headline earnings and earnings per share were negatively impacted by the the once-off expense associated with Discovery's recent BEE transaction.

### *Discovery Health*

Discovery Health delivered robust growth and financial performance with operating profit increasing by 9% to R266 million (2004: R245 million), despite a reduction in real terms of administration fees and loss of reinsurance income over time. The combined membership of the schemes under Discovery Health's administration grew to 1 883 879 as at 1 January 2006 (2005: 1 704 240 members). This reflects continued growth in new business to R1 211 million (2004: R1 175 million) which, coming off a high base, exceeded our expectations, as well as a reduction in the lapse rate to 3.3% (2004: 3.7%).

Discovery's KeyCare product (aimed at the R3 500 – R6 500 income market) now exceeds 100 000 members, more than half of which are new entrants to the private health care industry and the development of Discovery Health's primary care network has progressed well with over 1 500 doctors now represented within the network.

### *Discovery Life*

Discovery Life's performance exceeded expectations with operating profit growing 29% to R246 million (2004: R190 million) and new business growing 18% to R392 million (2004: R332 million). Discovery Life's ability to accurately price health risk and encourage health improvements through integration with Vitality and Discovery Health, has translated into better than expected mortality and morbidity rates, resulting in exceptional growth in underwriting profits during the period under review from R126 million to R216 million.

### *Destiny Health*

Disappointingly, the period under review saw further operational losses of R80 million (2004: R41 million) for Destiny Health despite strong new business growth in the Mid-Atlantic, Wisconsin and Massachusetts markets. The operating losses were the result of slower than anticipated expansion into new markets and an over-concentration in the Illinois market, where a significant pricing disadvantage exists relative to the dominant insurer in that market. This placed Destiny under increasing price pressure, resulting in increased lapses and underwriting losses during the period under review.

Consumer-driven health care is gaining increasing support in the US, creating favourable conditions for Destiny Health, particularly in the Texas market. Discovery's consumer-driven health care capability combined with the joint ventures with Guardian and Tufts Health Plan, should result in significant opportunities for Destiny Health in the year ahead.

The immediate short-term target is to achieve a run-rate of 3 000 new members per month and consistently improve quarter-on-quarter financial results. Discovery remains cautiously optimistic that the achievement of these goals will lead to a viable business and profitability in the medium term.

### *PruHealth*

PruHealth has quickly developed a nationwide Vitality footprint, providing clients with access to Vitality wellness benefits across the UK. To date, PruHealth's performance has been exceptional. The investment in PruHealth of R68 million (2004: R80 million) and new business growth of R77 million (2004: R5 million) over the period were in line with our forecasts.

Based on its strong foundational position, we are cautiously optimistic of the outlook for PruHealth and have set a bold short-term goal of 100 000 lives by 1 January 2007.

## FirstRand Limited – central cost

The costs incurred by FirstRand decreased to R102 million as reflected below:

| R million | Six months to 31 December 2005 | 2004 |
|---|---|---|
| Operating expenses | **(21)** | 2 |
| Taxation | **(30)** | (67) |
| Dividend on cumulative redeemable preference shares | **(51)** | (51) |
| Total | **(102)** | (116) |

The increase in operating expenses relates to the issue of R1.5 non-cumulative non-redeemable preference shares. The reduction in taxation is due to reduced Secondary Tax on Companies charged.

In addition, the Group issued R730 million Cumulative Preference shares in December 2005. During the period under review R500 million of Cumulative Preference shares were redeemed.

## CAPITAL MANAGEMENT

The Group actively manages its capital base with the objective of enhancing shareholder value through its capital management framework. Capital is allocated to FirstRand business units on an economic risk assumed basis, founded on Basel II principles.

The restructure of the vendor finance component of the BEE transaction creates capacity for further debt capital raising to fund future growth requirements in the Banking Group. During the year under review Momentum obtained AA+/AA/Stable counterparty credit ratings from Fitch Ratings. This rating reflects Momentum's financial strength and creates further opportunities to enhance and optimise its capital structure.

In terms of FirstRand's integral capital management framework ongoing optimisation of capital within its subsidiaries and at holding company will be explored to enhance shareholder value.

## DIVIDEND POLICY

### Ordinary shareholder dividend

The Group bases its dividend policy on sustainable earnings growth. The dividend cover will be based on normalised earnings or net asset value growth. For the period under review the Group based the dividend cover on normalised earnings.

The Group will retain its dividend cover of 2.5 times based on normalised earnings. The Group believes this is a sustainable dividend cover given the internal earnings generation capacity and organic growth potential of the businesses.

The interim dividend of 32.0 cents reflects an increase of 20% over the interim dividend per share for 2004.

## INTERNATIONAL FINANCIAL REPORTING STANDARDS

FirstRand had for the accounting period ended 30 June 2005, prepared its consolidated financial statements under South African Statements of Generally Accepted Accounting Practice ("SA GAAP").

In accordance with the Listing Requirements of the JSE Limited ("JSE"), the Group adopted International Financial Reporting Standards, International Accounting Standards and interpretations issued by the International Financial Reporting Interpretation Committee and its predecessor body (collectively referred to as "IFRS") with effect from 1 July 2005.

The change to IFRS applies to all financial reporting for financial years beginning on or after 1 January 2005. Consequently, FirstRand's first IFRS results are for the six-month period ended 31 December 2005. As FirstRand publishes comparative information for the previous financial year in its Annual Report, the date of transition to IFRS is 1 July 2004 ("the transition date"), the start of the earliest period for which comparative information is presented. The interim results for the six-month period ended 31 December 2005, as well as the financial statements for the year ended 30 June 2006 will, therefore, include comparative information restated in compliance with IFRS, subject to certain exemptions to full retrospective adoption as set out in the "transitional arrangements section" of the IFRS transitional report.

A separate booklet called "IFRS transitional report" has been circulated to all shareholders. A copy can be obtained from the company secretary's office detailed below or at www.firstrand.co.za.

## FINANCIAL IMPACT OF THE BLACK ECONOMIC EMPOWERMENT ("BEE") TRANSACTION

### Background

IFRS 2 – Share-based Payments requires that all share-based payment transactions for goods or services received must be expensed with effect from financial periods commencing on or after 1 January 2005.

During the past 18 months there has been ongoing debate on whether BEE equity-linked transactions result in the receipt of "goods" or "services", and therefore should be expensed in terms of IFRS 2.

The International Financial Reporting Interpretations Committee issued an interpretation IFRIC 8 – the Scope of IFRS 2 ("IFRIC 8") during January 2006.

IFRIC 8 clarifies that IFRS 2 applies to all share-based payment transactions where the consideration received or to be received, either through identifiable or unidentifiable goods or services, is less than the fair value of the equity instruments issued or granted.

IFRIC 8 is applicable for financial periods commencing on or after 1 May 2006, on a fully retrospective basis, using the transitional provisions of IFRS 2 read with IFRS 1.

### Financial impact on the FirstRand Group

The Accounting Practices Committee and Accounting Practices Board of South Africa are in the process of finalising a South African interpretation dealing with the method of accounting for BEE transactions in terms of IFRS 2. Consequently, FirstRand will apply IFRS 2 to the non-staff component of the Group's BEE transaction, which had an effective date of 17 May 2005, with effect from the financial year commencing 1 July 2006, in accordance with the requirements of IFRIC 8.

As a result, the full financial impact in terms of IFRS 2 of the non-staff component of the BEE transaction, amounting to R1.655 billion, will be accounted for as an opening reserve transfer on 1 July 2005, and will have no income statement impact on comparative financial information reported during the 2006 financial year.

Consequently, FirstRand accounted for its BEE transaction in term of IAS 32/39 during the financial year ended 30 June 2005.

Discovery Holdings Limited ("Discovery"), a subsidiary of FirstRand, has early adopted IFRIC 8, resulting in a charge to the income statement, attributable to the Group of R96 million. To be consistent with the Group accounting policy, Discovery's BEE transaction was accounted for in terms of IAS 32/39 on a similar charge.

## CORPORATE GOVERNANCE

FirstRand has embraced the recommendations of King II on Corporate Governance and strives to provide reports to shareholders that are timely, accurate, consistent and informative.

## PROSPECTS

The economic upswing currently experienced in South Africa, does not yet show any sign of slowing and possibly represents a sustainable structural shift to an era of low interest rates and inflation. Therefore consumer credit demand, particularly asset-backed, is expected to remain buoyant, and this will be positive for the Group's retail and wholesale banking and vehicle financing operations.

Continued strong equity markets should drive growth in the banking and insurance investment business.

The settlement between the insurance industry and National Treasury together with the recently announced reduction in Retirement Funds Tax, have resulted in a more favourable savings environment.

The challenge going into 2006 is to at least maintain growth at current levels and improve efficiencies. Margins are likely to remain under pressure given current low interest rates which are not expected to increase during the next six-month period.

Against this background, the Group believes that it will continue to achieve its stated target of 10% real growth, in the second half of the financial year to June 2006.

For and on behalf of the board

**GT Ferreira**
Chairman

**PK Harris**
Chief Executive Officer

Sandton
27 February 2006

## DIVIDEND DECLARATIONS

Ordinary Shares

The following ordinary cash dividend was declared on 28 February 2006 in respect of the six months ended 31 December 2005:

| Cents per share | **2005** | 2004 |
|---|---|---|
| Interim (declared 28 February 2006) | **32.0** | 26.60 |

**The last day to trade in FirstRand shares on a cum-dividend basis in respect of the final dividend will be 16 March 2006 and the first day to trade ex-dividend will be 17 March 2006. The record date will be 24 March 2006 and the payment date 27 March 2006. No dematerialisation or rematerialisation of shares may be done during the period 17 March 2006 and 24 March 2006, both days inclusive.*

### *Preference Shares*

Dividends on the "A" preference shares are calculated at a rate of 65% of the prime lending rate of banks and the following dividends have been declared for payment:

Dividends on the "B" preference shares are calculated at a rate of 68% of the prime lending rate of banks and the following dividends have been declared for payment:

| Cents | "B" preference share | "B1" preference share |
|---|---|---|
| Period 30 August 2005 – 27 February 2006 | 356 | 356 |

*Note:*

*Dividends on the "B" and "B1" preference shares are calculated at a rate of 68% of the prime lending rate of banks and the following dividends have been declared for payment in respect of the period 30 August 2005 to 27 February 2006.*

**AH Arnott**
Company Secretary

27 February 2006

### Directors
GT Ferreira (Chairman), PK Harris (CEO), VW Bartlett, DJA Craig (British), LL Dippenaar, DM Falck, PM Goss, NN Gwagwa, MW King, YI Mahomed, G Moloi, AP Nkuna, SE Nxasana, SEN Sebotsa, KC Shubane, BJ van der Ross, Dr F van Zyl Slabbert, RA Williams.

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# FIRSTRAND BANKING GROUP

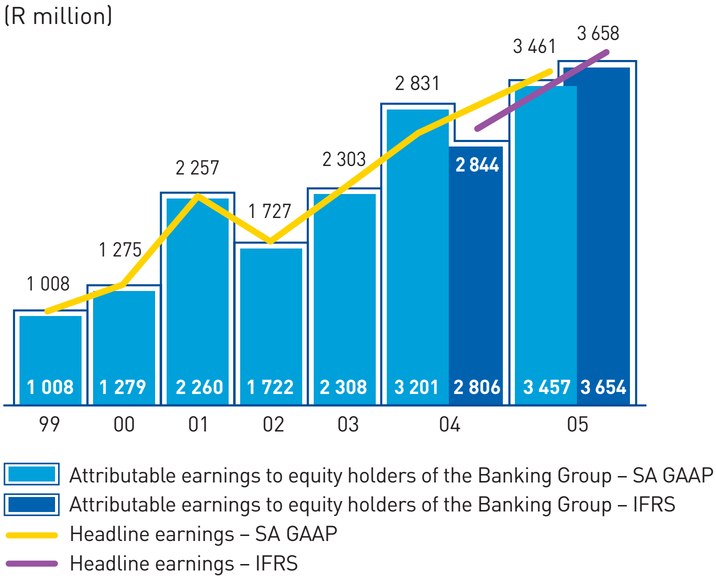
FIRSTRAND
Banking Group

## INTRODUCTION

This report reflects the results and financial position of the banking interests of FirstRand Limited ("the Banking Group"), and should be read in conjunction with the report on FirstRand Limited ("FirstRand").

## FINANCIAL HIGHLIGHTS

**Earnings performance**
Six months to December
(R million)




Attributable earnings December – CAGR: 23.9% (SA GAAP: 22.8%)
Headline earnings December – CAGR: 24.0% (SA GAAP: 22.8%)

| Unaudited – six months ended 31 December 2005 – IFRS compliant | % change |
|---|---|
| Attributable earnings | 30 |
| Headline earnings | 29 |
| Headline earnings (excluding translation gains) | 21 |
| | % |
| Return on average ordinary shareholders' equity (including translation gains)[1] | 28.2 |
| Return on average ordinary shareholders' equity (excluding translation gains)[2,3] | 28.0 |
| Cost to income ratio (including translation gains) | 53.8 |
| Cost to income ratio (excluding translation gains) | 53.9 |

1. *Based on headline earnings including translation gains attributable to ordinary shareholders.*
2. *Based on headline earnings excluding translation gains attributable to ordinary shareholders.*
3. *Refer pages 33 and 34 of this document for pre-IFRS calculations.*

*A booklet containing supplementary information on the Banking Group is available on our website or on request from the company secretary's office.*

# Income statement – IFRS compliant

| R million | Unaudited Six months ended 31 December 2005 | 2004 | % change | Audited Year ended 30 June 2005 |
|---|---|---|---|---|
| Interest and similar income | **13 245** | 11 813 | 12 | 23 375 |
| Interest expense and similar charges | **(7 840)** | (7 236) | 8 | (13 915) |
| **Net interest income before impairment of advances** | **5 405** | 4 577 | 18 | 9 460 |
| Impairment losses on loans and advances | **(576)** | (409) | 41 | (706) |
| **Net interest income after impairment of advances** | **4 829** | 4 168 | 16 | 8 754 |
| **Non-interest revenue** | **6 888** | 5 363 | 28 | 11 626 |
| – fees and commissions | **4 305** | 3 644 | 18 | 8 188 |
| – trading income | **1 016** | 1 155 | (12) | 2 238 |
| – net investment income | **825** | 600 | 38 | 497 |
| – other non-interest revenue | **720** | 119 | >100 | 754 |
| | **6 866** | 5 518 | 24 | 11 677 |
| – translation gains/(losses) | **22** | (155) | >100 | (51) |
| **Net income from operations** | **11 717** | 9 531 | 23 | 20 380 |
| Operating expenses | **(7 025)** | (5 758) | 22 | (12 498) |
| **Net income from operations** | **4 692** | 3 773 | 24 | 7 882 |
| Share of profits of associate and joint venture companies | **772** | 407 | 90 | 987 |
| **Income before discontinued operations** | **5 464** | 4 180 | 31 | 8 869 |
| Loss on disposal of discontinued operations | **–** | (17) | (100) | (67) |
| **Income before taxation** | **5 464** | 4 163 | 31 | 8 802 |
| Indirect taxation | **(318)** | (276) | 15 | (409) |
| **Income before direct taxation** | **5 146** | 3 887 | 32 | 8 393 |
| Direct taxation | **(1 212)** | (907) | 34 | (2 132) |
| **Income after taxation** | **3 934** | 2 980 | 32 | 6 261 |
| **Attributable to:** | | | | |
| Equity holders of the Banking Group | **3 654** | 2 806 | 30 | 5 967 |
| Minority interests | **280** | 174 | 61 | 294 |
| | **3 934** | 2 980 | 32 | 6 261 |

**Notes:**

1. *The comparative results for the six-month period ended 31 December 2004 and the year ended 30 June 2005 in the income statement as well as at 31 December 2004 and 30 June 2005 in the balance sheet have been restated for the adoption of IFRS. Detailed information on the IFRS adjustments are set out on pages 7 to 22 of a separate IFRS booklet which is available on the company's website or on request from the company secretary's office.*
2. *Additional information relating to other restatements of comparative period numbers are set out on page 34 of the supplementary document.*

# Balance sheet – IFRS compliant

| R million | Unaudited At 31 December 2005 | 2004 | % change | Audited At 30 June 2005 |
|---|---|---|---|---|
| **Assets** | | | | |
| Cash and short-term funds | **20 961** | 24 191 | (13) | 23 400 |
| Derivative financial instruments | **31 814** | 41 177 | (23) | 27 752 |
| – qualifying for hedging | **861** | 884 | (3) | 811 |
| – trading | **30 953** | 40 293 | (23) | 26 941 |
| Advances | **250 330** | 208 053 | 20 | 226 436 |
| – at amortised cost | **207 706** | 157 702 | 32 | 180 060 |
| – held-to-maturity | **762** | 9 174 | (92) | 7 449 |
| – available-for-sale | **1 857** | 1 733 | 7 | 1 648 |
| – fair value | **40 005** | 39 444 | 1 | 37 279 |
| Investment securities and other investments | **52 114** | 52 805 | (1) | 51 878 |
| Financial securities held for trading | **18 551** | 22 448 | (17) | 20 738 |
| Investment securities | **33 563** | 30 357 | 11 | 31 140 |
| – held-to-maturity | **420** | 1 203 | (65) | 1 011 |
| – available-for-sale | **15 388** | 16 100 | (4) | 14 385 |
| – elected fair value | **9 258** | 7 165 | 29 | 7 563 |
| – non-recourse investments | **8 497** | 5 889 | 44 | 8 181 |
| Commodities | **1 135** | 1 109 | 2 | 439 |
| Loans to Insurance Group | **6 469** | 3 691 | 75 | 7 268 |
| Accounts receivable | **3 626** | 2 804 | 29 | 2 819 |
| Investment in associated companies | **3 271** | 2 372 | 38 | 2 936 |
| Property and equipment | **4 109** | 3 707 | 11 | 4 015 |
| Deferred taxation assets | **492** | 832 | (41) | 595 |
| Intangible assets | **502** | 442 | 14 | 498 |
| **Total assets** | **374 823** | 341 183 | 10 | 348 036 |
| **Liabilities** | | | | |
| Deposits | **268 747** | 236 814 | 13 | 247 084 |
| – deposit and current accounts | **260 250** | 230 925 | 13 | 238 903 |
| – non-recourse deposits | **8 497** | 5 889 | 44 | 8 181 |
| Short trading positions | **20 417** | 16 786 | 22 | 19 919 |
| Derivative financial instruments | **28 395** | 37 565 | (24) | 25 467 |
| – qualifying for hedging | **366** | 523 | (30) | 249 |
| – trading | **28 029** | 37 042 | (24) | 25 218 |
| Loans from Insurance Group | **8 003** | 8 347 | (4) | 9 424 |
| Creditors and accruals | **7 379** | 4 686 | 57 | 7 313 |
| Provisions | **1 795** | 1 335 | 34 | 1 357 |
| Taxation liability | **(1)** | 933 | (100) | 104 |
| Post-retirement benefit fund liability | **1 585** | 1 393 | 14 | 1 504 |
| Deferred taxation liabilities | **2 686** | 1 431 | 88 | 2 833 |
| Policy holder liabilities under insurance contracts | **5 052** | 3 896 | 30 | 3 356 |
| Long-term liabilities | **136** | 112 | 21 | 109 |
| **Total liabilities** | **344 194** | 313 298 | 10 | 318 470 |
| **Equity** | | | | |
| Ordinary shares | **106** | 106 | – | 106 |
| Share premium | **1 632** | 1 615 | 1 | 1 632 |
| Non-distributable reserves | **2 012** | 2 603 | (23) | 2 576 |
| Distributable reserves | **21 612** | 18 290 | 18 | 20 216 |
| **Total ordinary shareholders' equity** | **25 362** | 22 614 | 12 | 24 530 |
| Non-redeemable preference shares | **3 100** | 3 000 | 3 | 3 000 |
| Cumulative redeemable preference shares | **1 045** | 1 301 | (20) | 1 045 |
| **Total shareholders' equity** | **29 507** | 26 915 | 10 | 28 575 |
| **Minority interest** | **1 122** | 970 | 16 | 991 |
| **Total equity** | **30 629** | 27 885 | 10 | 29 566 |
| **Total equity and liabilities** | **374 823** | 341 183 | 10 | 348 036 |
| **Contingencies and commitments** | **26 844** | 22 058 | 22 | 26 465 |

## IMPLEMENTATION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS ("IFRS")

The Banking Group, a division of FirstRand, prepared its consolidated financial statements under South African Statements of Generally Accepted Accounting Practice ("SA GAAP") for the accounting period ended 30 June 2005. The Banking Group adopted IFRS with effect from 1 July 2005.

Details relating to the changes resulting from the adoption of IFRS on the Banking Group are set out on pages 7 to 22 of the separate IFRS document. The IFRS document presents the Banking Group's opening balance sheet at 1 July 2004, comparative IFRS financial information for the six months ended 31 December 2004, the year ended 30 June 2005 as well as the restated balance sheet on 1 July 2005. The document also presents and explains the differences between the Banking Group's results and shareholders' equity under IFRS and the amounts previously reported for these periods or on the specific balance sheet dates under SA GAAP.

The change from SA GAAP to IFRS has primarily impacted the following areas:

- revaluing the carrying value of certain properties and adjusting the depreciation methodology used;
- expensing the cost of share options awarded to employees and other share-based payment transactions on a fair value basis;
- transferring the accumulated foreign currency translation reserve and unrecognised actuarial deficit on the employee benefit funds on 1 July 2004 to retained income;
- introducing the concept of "functional currency" which affects the historically reported foreign currency translation gains or losses in the income statement;
- applying the "incurred loss" basis with respect to credit impairments as opposed to the "expected loss" basis;
- reallocating certain fees and expenses from non-interest revenue and operating expenses, respectively, to interest income, and recognising the fees and expenses on an effective yield basis; and
- reclassifying certain instruments between debt and equity.

IFRS is continuing to evolve through the issue and/or endorsement of new interpretations and developments in the application of recently issued Standards. This may impact on future reported results and disclosure.

A summary of the impact of the adoption of IFRS on the attributable earnings, headline earnings and headline earnings excluding translation impact as well as on key ratios of the Banking Group are set out in the tables below:

| Reconciliation from IFRS to SA GAAP | Unaudited Six months ended 31 December | | | Audited Year ended 30 June |
|---|---|---|---|---|
| R million | **2005** | 2004 | % change | 2005 |
| **Attributable earnings as reported under IFRS** | **3 654** | 2 806 | 30 | 5 967 |
| **Adjusted for:** | | | | |
| Loss on sale of Ansbacher | **–** | 17 | (100) | 67 |
| (Loss)/Profit on sale of property and equipment | **6** | (1) | >100 | 7 |
| Goodwill | **(9)** | – | (100) | – |
| Loss on sale of available-for-sale assets | **7** | 22 | (68) | 21 |
| **Headline earnings as reported under IFRS** | **3 658** | 2 844 | 29 | 6 062 |
| Translation (gains)/losses | **(22)** | 155 | (<100) | 51 |
| **Headline earnings excluding translation impact under IFRS** | **3 636** | 2 999 | 21 | 6 113 |
| IFRS adjustment (excluding translation impact) | **4** | 47 | (91) | 115 |
| **Headline earnings excluding translation impact under SA GAAP** | **3 640** | 3 046 | 20 | 6 228 |

| | Unaudited Six months ended 31 December | | | |
|---|---|---|---|---|
| | **2005** | | 2004 | |
| Performance measurement | **IFRS** | **SA GAAP** | IFRS | SA GAAP |
| Return on average ordinary shareholders' equity excluding translation gains and losses (%) | **28.0**[1] | **28.1**[1,2] | 27.6[1] | 28.0[1,2] |
| Headline earnings (R million) | **3 658** | **3 461** | 2 844 | 2 831 |
| Cost to income ratio excluding translation gains and losses (%) | **53.9** | **53.4** | 54.8 | 54.5 |
| Interest margin on average gross advances (%) | **4.5** | **4.4** | 4.4 | 4.4 |
| Impairment charge as percentage of average gross advances (%) | **0.48** | **0.44** | 0.38 | 0.39 |

1. *Based on headline earnings excluding translation gains attributable to ordinary shareholders.*
2. *Refer pages 34 and 35 of this document for calculations.*

| Reconciliation between IFRS and SA GAAP income statement | Unaudited Six months ended 31 December 2005 | | |
|---|---|---|---|
| R million | SA GAAP | IFRS adjustment | IFRS |
| Net interest income before impairment of advances | 5 208 | 197 | 5 405 |
| Impairment losses on loans and advances | (526) | (50) | (576) |
| Non-interest revenue | 6 671 | 217 | 6 888 |
| – gross (excluding translation (losses)/gains) | 6 850 | 16 | 6 866 |
| – translation gains/(losses) | (179) | 201 | 22 |
| Operating expenses | (6 839) | (186) | (7 025) |
| Share of profits of associates and joint ventures | 757 | 15 | 772 |
| Indirect taxation | (320) | 2 | (318) |
| Direct taxation | (1 214) | 2 | (1 212) |
| Income after taxation (including translation gains/(losses)) | 3 737 | 197 | 3 934 |
| Minorities | (280) | – | (280) |
| Attributable earnings | 3 457 | 197 | 3 654 |
| Headline earnings adjustments | 4 | – | 4 |
| Headline earnings | 3 461 | 197 | 3 658 |
| Translation losses/(gains) | 179 | (201) | (22) |
| Headline earnings (excluding translation (gains)/losses) | 3 640 | (4) | 3 636 |

## FINANCIAL PERFORMANCE

### Overview

On a pre-IFRS basis, the Banking Group achieved attributable earnings of R3 457 million (+8%), headline earnings of R3 461 million (+22%) and headline earnings excluding translation gains/(losses) of R3 640 million (+20%) during the six months under review. Reconciliations to the IFRS compliant results are set out in the tables above.

The performance of the Banking Group must be judged in the context of the operating environment during the period, which included:

- exceptional growth in consumer credit demand, particularly for asset-backed finance;
- strong equity markets, which benefited the Banking Group's equity trading businesses;
- strong growth in the economy, which contributed to increased client numbers;
- marginally lower average domestic interest rates relative to the comparative period (December 2005: 10.50%; December 2004: 11.13%) which placed pressure on liability margins and reduced endowment income; and
- competitive pricing pressure on advances, especially in mortgages and instalment finance.

### Business unit performance

FNB increased profit before direct tax by 18% benefiting from:

- a significant increase in customer numbers as well as gains in absolute market share in certain advances categories;
- organic growth of 29% in gross advances, with growth in excess of 40% in home loan and card advances;
- 11% growth in interest income; and
- strong non-interest revenue growth of 22% as a result of the increased client numbers and higher transaction volumes.

WesBank increased profit before direct tax by 31% primarily as a result of:

- new business growth of 34%, benefiting from buoyant car sales as well as an increase in market share across all divisions;
- a 26% increase in gross advances; and
- a 31% increase in non-interest revenue due to high new business volumes, higher penetration of insurance products and an increase in the contribution from WesBank Auto.

RMB increased profit before direct tax by 41%, benefiting from:

- realisations in the private equity businesses;
- strong deal flow in Corporate and Structured Finance; and
- the significant increases in the equity markets during the period which benefited the equity businesses.

FNB Africa experienced a challenging six months, characterised by:

- satisfactory balance sheet growth in the respective African business units;
- low growth in profitability in FNB Namibia, primarily due to significant cost increases; and
- a further strengthening of the Rand against the Pula, which negatively impacted results in FNB Botswana.

*Performance against targets*

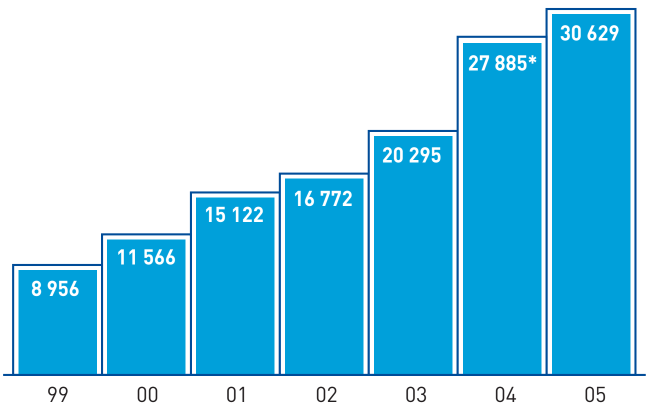
The Banking Group achieved the following results against internal performance targets for the six months under review:

| Performance measurement | Performance target | Actual achievement SA GAAP | Actual achievement IFRS |
|---|---|---|---|
| Return on equity[1] (%) | 20.1 | 29 | 28 |
| Headline earnings growth[2] (%) | 14.3 | 20 | 21 |
| Cost to income ratio[3] (%) | 54.0 – 56.0 | 53.4 | 53.9 |
| Non-performing loans percentage[4] | 3.0 | 1.3 | 1.3 |
| Impairment charge as a percentage of average gross advances[5] | 0.5 – 0.8 | 0.44 | 0.48 |
| Growth in ordinary shareholders' equity[6] | 14.3 | 12 | 12 |

**Notes:**

1. *Calculated as headline earnings excluding currency translation impact as a percentage of total ordinary shareholders' equity. The Banking Group targets a return on equity figure of weighted average cost of capital + 10 percentage points.*
2. *The Banking Group targets a growth of average CPIX + 10 percentage points.*
3. *The Banking Group has set a medium-term objective of maintaining a cost to income ratio (excluding the impact of currency translation gains or losses) of between 54.0% and 56.0%.*
4. *Calculated as non-performing loans as a percentage of gross advances.*
5. *Medium-term objective given current risk profile.*
6. *The Banking Group targets a growth of average CPIX + 10 percentage points.*

Total shareholders' equity
(R million)
CAGR 22.7%




*Includes a positive IFRS impact of R88 million

## ECONOMIC OVERVIEW

The South African economy performed well in the six-month period ended 31 December 2005. The period was characterised by renewed strength in the Rand, lower than expected inflation, stable domestic interest rates, strong economic growth and sharply higher equity markets.

The Rand strengthened by 5%, from a level of R6.65:US$1 at 30 June 2005, to R6.32:US$1 at 31 December 2005. The appreciation of the currency can be attributed mainly to the run in precious metals prices, with the US$ gold price increasing by almost 19% over the period. The destruction caused by Hurricane Katrina saw international oil prices jump in the second half of 2005, with Brent crude averaging US$60/barrel. Despite the resultant petrol price increases, CPIX inflation performed better than expected, hovering around the mid-point of the South African Reserve Bank's targeted range of 3% – 6% with an average CPIX for the six-month period of 4.3%.

The prime overdraft rate remained stable over the period, following the cumulative 6.5% reduction since June 2003. Money market interest rates jumped in the final quarter of 2005, in response to concerns expressed by the central bank over the outlook for inflation, but receded thereafter following the unchanged stance adopted by the Monetary Policy Committee at its December meeting.

Demand for credit in the economy accelerated in the period under review, with private sector credit extension increasing by more than 20% on a year-on-year basis. This rapid take-up of debt can be ascribed mainly to households' strong appetite for asset-backed credit. Non-resident investors' aggressive purchases of shares drove the local equity market 28% higher in the final two quarters of 2005, while house price growth decelerated on reduced affordability concerns.

## FINANCIAL REVIEW

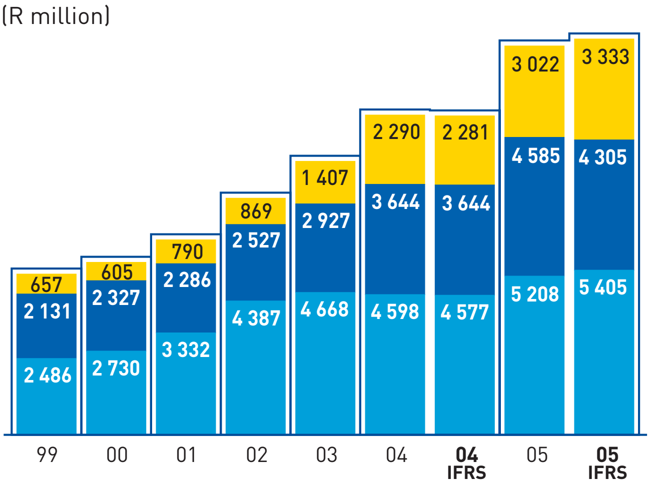
### Profit before tax

The Banking Group produced excellent results with outstanding performances from FNB, WesBank, RMB and its insurance associate, OUTsurance.

### *Analysis of total income*

The graph below provides a breakdown of total income:

**Total income**
(R million)




Other non-interest revenue – CAGR 31.1% (SA GAAP: 29.0%)
Fee and commissions – CAGR 12.43% (SA GAAP: 13.6%)
Interest income – CAGR 13.8% (SA GAAP: 13.1%)

**Note:**

*Total income = interest income before impairment of advances + fee and commission income + other non-interest revenue (excluding translation gains or losses) and income from associates*

### *Net interest income ("NII") – up 18%*

*Excluding the impact of IFRS, NII increased by 13%. The positive IFRS impact of 5% (R197 million) results from the capitalisation of certain fees and expenses recognised respectively as non-interest revenue and operating expenses under SA GAAP, which are included as part of the yield (NII) in terms of IFRS.*

Interest rates remained unchanged during the six months ended 31 December 2005 (after a 1% decline during the 2005 financial year).

The volume impact of year-on-year growth of 20% in advances, together with the Banking Group's hedging strategies, compensated for the pressure on margins experienced during the period. Strong competitive pressure for funding, a change in the mix of funding as well as pressure on certain asset pricing, exacerbated the margin squeeze on liabilities.

Interest margins showed a slight decrease from 4.40% at 31 December 2004 to 4.38%, on a pre-IFRS basis. Including the impact of IFRS, margins increased from 4.40% to 4.54% in December 2005.

Net interest income and interest margins were positively influenced by:

- the volume effect from organic growth in advances;
- the increase in the average capital base following the retention of earnings in the previous year; and
- the improved mix arising from an increase in retail advances and a decrease in corporate advances.

Negative factors included:

- the impact of the lower interest rate environment on the endowment effect;
- the general impact of a structurally lower interest rate environment on margins;
- the continued margin squeeze, partially as a result of competitive pressure, on the prime-linked portion of the banking book;
- the run-off of the hedges on the endowment and funding portfolios;
- the run-off of the existing fixed-rate book, primarily in WesBank; and
- compression of short-term funding rates.

A reconciliation of the interest margin is set out below:

| | Net interest income R million | Interest margin % |
|---|---|---|
| **Pre-IFRS NII and margin – December 2004** | 4 598 | 4.40 |
| Volume impact | 640 | – |
| Impact of preference share funding | 105 | 0.09 |
| Endowment effect on capital | (93) | (0.08) |
| Endowment effect on deposits | (47) | (0.04) |
| Reduced protection provided by hedges | (207) | (0.17) |
| Other (mainly product mix) | 212 | 0.18 |
| **Pre-IFRS NII and margin – December 2005** | 5 208 | 4.38 |
| Impact of IFRS | 197 | 0.16 |
| **Post-IFRS margin – December 2005** | 5 405 | 4.54 |

An analysis of the margin per product type is set out below:

| | Pre-IFRS margin (%) | |
|---|---|---|
| | **2005** | 2004 |
| **Margin assets** | | |
| Asset-backed mortgages | | |
| (excluding Commercial Property) | **2.31** | 2.68 |
| Instalment sales and finance leases | **3.72** | 3.79 |
| Card debtors | **8.33** | 8.00 |
| Overdrafts and managed | | |
| account debtors | **4.55** | 4.79 |
| Personal loans | **7.51** | 6.62 |
| Other banking advances | **4.20** | 5.48 |
| FNB Africa | **6.69** | 6.40 |
| Capital centre | **1.79** | 1.85 |
| Weighted average | **3.27** | 3.34 |
| **Margin liabilities** | | |
| Current and savings deposits | **3.51** | 3.55 |
| Call accounts | **1.65** | 1.55 |
| Notice deposits | **1.30** | 1.35 |
| Fixed deposits | **0.73** | 0.76 |
| Weighted average | **1.16** | 1.14 |
| Total weighted average | **4.43** | 4.48 |

A further detailed margin analysis is set out on page 5 of the supplementary document.

### *Non-interest revenue ("NIR") – up 28%*

*Excluding the impact of IFRS, NIR increased by 25%. The positive IFRS impact of 3% (R217 million) results from a combination of a change in the disclosure to reflect certain revenue related expenses in operating expenses, bringing the Banking Group's disclosure in line with industry practice, and the capitalisation of certain fees disclosed as non-interest revenue under SA GAAP, which are included as part of the yield in terms of IFRS.*

*On a pre-IFRS basis,* NIR increased to R6 671 million (2004: R5 334 million). NIR excluding currency translation gains/(losses) increased by 19% to R6 850 million (2004: R5 549 million).

A detailed analysis of non-interest revenue is set out on pages 6 to 9 of the supplementary information document.

The various components of non-interest revenue are discussed in more detail below:

### *Fee and commission income – up 18%*

*Excluding the impact of IFRS, fee and commission income increased by 26%. The negative IFRS impact of 8% (R280 million) results from the capitalisation of certain fees recognised as non-interest revenue under SA GAAP, which are included as part of the yield in terms of IFRS.*

Banking fee and commission revenue increased by 25%.

FNB's operations benefited from increases in customer numbers and higher transaction volumes:

- the Consumer segment showed an 11% increase in active accounts and a more than 40% increase in both the card and home loan books;
- the Mass segment increased active accounts by 20%;
- the Corporate segment's growth was mainly the result of increased electronic channel use;
- the Commercial segment's growth was predominantly driven by a 13% growth in active accounts; and
- the Wealth segment benefited from higher transaction volumes and new business inflows.

Average price increases were kept below inflation.

WesBank's non-interest revenue growth of 31% resulted from the continued high new business growth, greater penetration of insurance products and an increased contribution from the Auto division (fleet management operation).

Increased mergers and acquisitions and BEE activities contributed to strong deal flow in Corporate Finance while Structured Finance capitalised on its market leading position and robust market conditions to show strong earnings growth. Absolute year-on-year growth was negatively affected by the fact that the comparative numbers included the results of Ansbacher for four months. As a result, total knowledge-based fee income decreased by 26%.

FNB Africa's growth was mainly from increased transactional volumes and new account growth across all the operations.

### *Trading income – down 12%*

Equity trading activities across the board proved highly profitable in buoyant market conditions. However, difficult conditions in the foreign exchange and interest rate markets dragged down the overall trading performance.

### *Investment income – up 38%*

Investment income includes realised gains and losses from the Banking Group's private equity businesses.

The private equity businesses had an outstanding six months. Profits were realised on the disposal of investments locally and offshore. The unrealised profit on the Private Equity portfolio attributable to the Banking Group amounted to R910 million at 31 December 2005 (December 2004: R868 million and 30 June 2005: R1.07 billion), after accounting for the above realisations. Consistent with prior years, this profit is not recognised until realised.

### *Income from associate companies – up 90%*

*The conversion to IFRS had an immaterial impact on income from associate companies.*

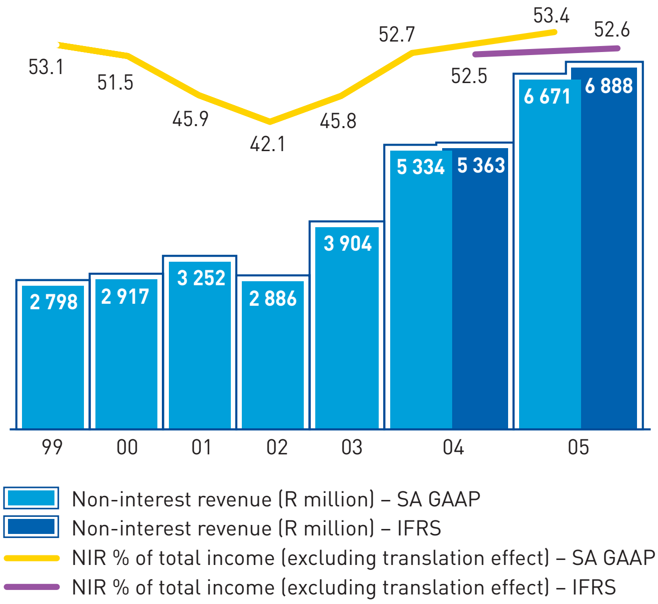
Share of income from associate companies increased to R772 million (2004: R407 million). The increase is as a result of:

- outstanding results from OUTsurance, which showed good organic growth, continued low claims ratio and lower expenses;
- a significant increase in the contribution from WesBank associates reflecting strong underlying business performance;

- an increase in excess of 100% in income from private equity associate companies due to the benefits derived from the strong economic environment; and
- the realisation of the underlying assets of a private equity associate, resulting in an attributable profit on sale of R144 million, which is reflected as income from associates.

The graph below shows the diversity ratio of income:

**Non-interest revenue**




### *Operating expenditure – up 22%*

*Excluding the impact of IFRS, operating expenditure increased by 19%. The negative IFRS impact of 3% (R186 million) results from the capitalisation of certain expenses recognised as operating expenses under SA GAAP, which are included as part of the yield in terms of IFRS, offset by a change in the disclosure to reflect certain revenue related expenses in operating expenses, bringing the Banking Group's disclosure in line with industry practice.*

The non-interest expenditure increase resulted primarily from the growth in the South African operations.

Staff costs increased by 12% on like-for-like basis, due to increased staff numbers to support the significant new business growth experienced in WesBank, FNB and RMB. Furthermore, staff costs were affected by the annual salary increases in August 2005.

Cost increases directly related to income, including commissions, incentives, eBucks, loyalty accruals and profit share, increased by 59% from R184 million to R292 million.

Other operating costs increased by 28% primarily due to:

- significantly higher acquisition costs of R243 million (2004: R128 million) relating to new business volumes in the home loans book;
- an increase in advertising and marketing spend of 32%;
- branch enhancement costs in FNB; and
- infrastructure expansion costs relating to the current and expected future new business growth in HomeLoans, WesBank and RMB.

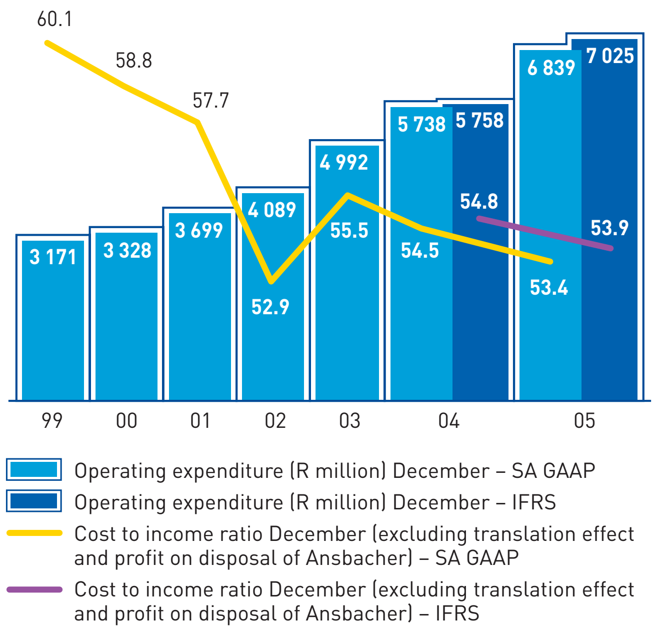
### *Cost to income ratio*

On a like-for-like basis, the cost to income ratio (excluding the effect of currency translation gains or losses) improved from 54.5% at 31 December 2004 to 53.4%. Under IFRS, the ratio improved from 54.8% to 53.9%.

The improvement was mainly as a result of the increase in net interest income and the strong growth in non-interest revenue and income from associates, which compensated for the increase in operating expenses.

The historic trend in the cost to income ratio, excluding the effect of translation gains or losses, is shown below:

**Operating efficiency**




### *Direct and indirect taxation*

The direct tax charge as a percentage of income before direct tax increased from 22.3% to 23.6%. The year-on-year increase has brought the charge in line with historical trends.

## Balance sheet

### *Advances – up 20%*

*The conversion to IFRS had an immaterial effect on disclosed advances.*

The Banking Group distinguishes between advances generated from its primary brand franchise ("originated advances"), and those advances which are purchased and sold as part of RMB's activities.

The Banking Group achieved exceptional growth of 25% in originated advances.

FNB achieved growth of 29% in gross advances.

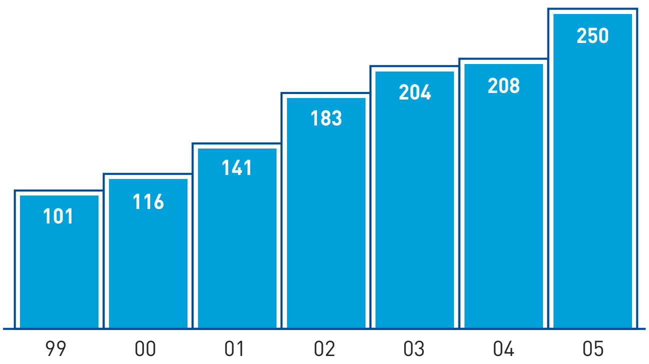
- HomeLoans, benefiting from the continued growth shown in the residential property market, grew by more than 40%. This increase was driven by an 81% increase in new business written as well as a 43% increase in re-advances payouts. New business market share increased to 20% from 16% at December 2004;
- Card Issuing advances grew by 42% and Personal Loans by 29% benefiting from the continued consumer demand for credit;
- advances in FNB's Wealth segment grew by 35% as a result of strong growth in their target market;
- advances in the Commercial segment, which includes mid-corporates, grew by 21% driven mainly by the Commercial Property Finance division's growth of 75% (albeit it off a low base) as well as a 41% increase in agriculture term loans mainly as a result of market share gains; and
- large corporate advances declined due to the low credit demand from cash flush corporates and price competition in this section of the market.

WesBank's advances grew by 26% over the previous period due to the record retail car market leading to increases in new business. WesBank further grew market share in all operational segments during the six-month period.

The African subsidiaries increased advances by 13%. The growth in the instalment finance and the home loan books in Namibia accounted for the majority of this growth. FNB Botswana's advances increased by 10%, in line with average credit growth in the economy. Notwithstanding the depressed economic conditions in Swaziland, advances growth of 11% was recorded as a result of increases in overdrafts and home loans. FNB Lesotho showed general volume growth.

Fair value advances (including collateralised debt and emerging market advances) remained flat year-on-year. The Collateralised Debt Obligation (CDO) portfolio was closed out during the period in line with previously stated intention to actively reduce exposures to these instruments.

**Net advances**
(R billion)
CAGR: 16.3%




### *Deposits – up 13%*

Growth in deposits was driven primarily by the need to fund the growth in advances. There is a continued focus by management to optimise the mix of the deposit book.

FNB's deposits increased overall by 18% with the Commercial, Consumer and Corporate segments being the main contributors. Increased market share of transactional banking and savings and investment products in Consumer led to an increase of 13% in the retail side of the book. Growth of 20% and 26% in Commercial and Corporate respectively was as a result of cash flush medium and large corporates, a reflection of the economy. Deposit margins in the Corporate segment were placed under pressure.

Growth in deposits reflects a trend towards shorter-dated products and increase in disposable income of consumers, both individual and corporate.

Overall FNB Africa increased deposits by 13%, mainly due to growth in Botswana and Lesotho.

### *Non-performing loans ("NPLs") and impairment of advances*

#### *Non-performing loans*

The credit quality of the Banking Group's originated advances book improved further relative to the comparative period, despite a year-on-year increase of R42 billion (20%) in net advances, as reflected in the table below.

| | At 31 December | | | At 30 June |
|---|---|---|---|---|
| | **2005** | 2004 | % change | 2005 |
| NPLs as % of gross advances | **1.3** | 1.6 | (19) | 1.3 |
| Gross non-performing loans (R million) | **3 357** | 3 358 | – | 3 045 |

The current improved level of non-performing advances can be ascribed to:

- the continued low interest rate environment;
- the increase of disposable income of customers, assisting their ability to service higher levels of debt; and
- continued improvement in credit assessment and collection processes.

Arrears, a leading indicator of credit quality has, however, deteriorated marginally.

## Credit quality overview

FirstRand Bank uses credit ratings extensively in its business and credit processes. The various business units' rating systems have been mapped to the master FirstRand rating scale, ranging from FR 1 to FR 100. FR 1 is the best rating with the lowest probability of default, similar to AAA ratings assigned by rating agencies.

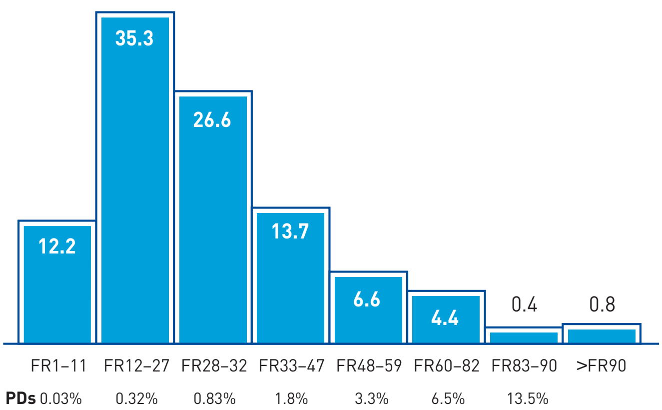
The credit quality of the book remained constant during the six months under review. The internal counterparty rating, ignoring collateral effects, was FR 42 at 31 December 2005 (FR 42 at June 2005). The rating is equivalent to a national scale credit rating of zaBBB (zaBBB at 30 June 2005).

The graphs in the section below describe the main credit portfolios in terms of distribution across rating grades. These distributions provide an overview of the credit quality of the book.

### *Wholesale portfolio (Corporate and SME exposures)*

The following graph indicates the credit distribution based on the counterparty's probability of default (and FR rating):

**Wholesale and SME credit portfolio**
Exposure distribution across rating buckets (%)




Notes:

1. *The above graph includes the exposures of RMB and FNB to large corporate counterparties, the FNB Commercial exposures to mid-corporate counterparties as well as the WesBank exposures to corporate counterparties. It excludes exposures to financial institutions and sovereigns.*
2. *The mid-point PDs noted in the graph above, can be mapped to international scale and national scale rating equivalents as follows:*

| FR rating | Mid-point PD | International scale | National scale equivalent (zaf) |
|---|---|---|---|
| FR 1 – 11 | 0.03% | AAA,AA,A | AAA, AA+ |
| FR 12 – 27 | 0.32% | BBB | AA, AA- |
| FR 28 – 32 | 0.83% | BB+, BB | A |
| FR 33 – 47 | 1.84% | BB- | BBB |
| FR 48 – 59 | 3.38% | B+ | BB |
| FR 60 -82 | 6.52% | B | B+ |
| FR 83 – 90 | 13.55% | B- | B |
| Above FR 90 | | Below B- | CCC |

Probability of default, illustrated in the above graph by the FR ratings, represents the likelihood, as a percentage, that the counterparty might default over a one year horizon. It does not take into account potential recovery due to collateral or effective collection processes in the event of a default, as this is measured by loss given default ("LGD"). The LGD measurement for wholesale lending typically ranges between 30% and 50%, but is substantially lower where financial collateral is held.

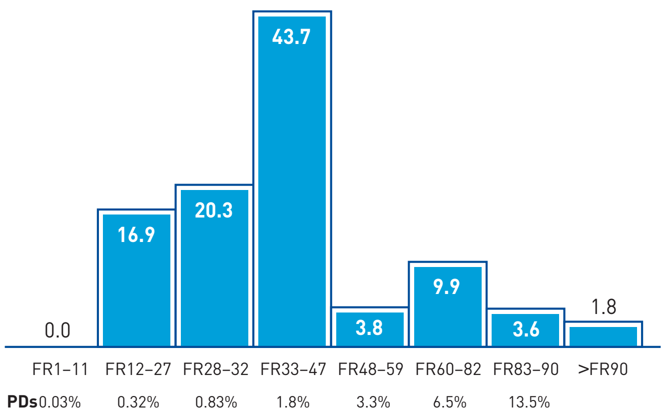
### *Retail credit portfolios*

In accordance with the requirements of Basel II pillar 3, the retail credit portfolio can be divided into three product classes, based on the characteristics of each product type. The Basel II capital calculations use different formulae for each of these classifications. The graphs below show the counterparty credit rating distributions in terms of the FR ratings (ie ratings excluding the impact of collateral) for each of the main retail asset classes, as defined by Basel II.

#### *Residential mortgages*

The residential mortgages category includes exposures of FNB HomeLoans and RMB Private Bank. The exposures in this category are secured by residential property and typically have LGDs of between 10% and 40%. The graph below presents the credit rating distribution of the residential mortgage book.

**Retail residential mortgages portfolio**
Exposure distribution across rating buckets (%)

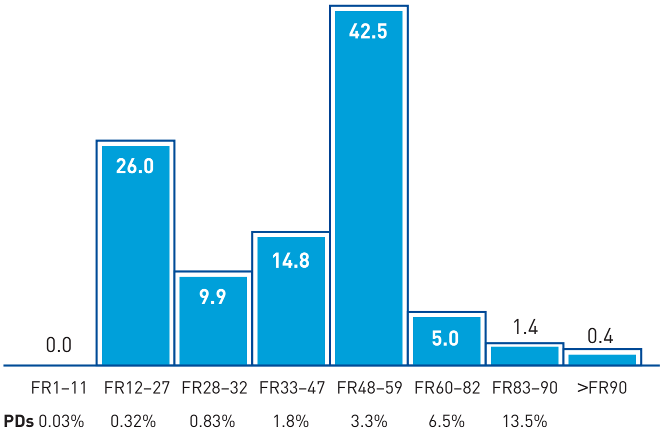


*Revolving retail exposures*

Basel II defines unsecured exposures to individuals in the form of overdraft facilities or credit cards as revolving exposures. These exposures are classified separately due to lower risk, based on the high level of diversification inherent in these portfolios. This category includes the revolving retail facilities of FNB (credit cards and overdrafts) and RMB Private Bank. Due to the unsecured nature of the facilities, the LGD is typically between 50% and 70%. The graph below indicates the counterparty credit rating distribution of this asset class.

**Revolving retail portfolio**

Exposure distribution across rating buckets (%)

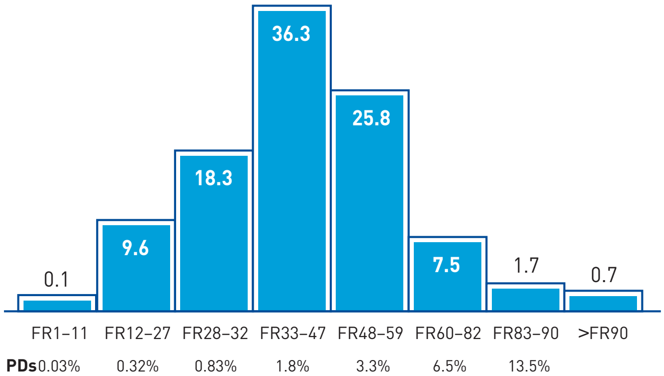



*Basel II "Other retail" assets – including SMEs treated as Retail*

Retail exposures other than residential mortgages or revolving facilities are classified into a broad "Other retail" category. This category includes small business exposures that qualify as retail SMEs and also other secured or unsecured personal loans and instalment loans per the Basel II definition. The LGD for this category depends on the level of collateral in place. For secured transactions, it ranges between 20% and 40% and for unsecured transactions, between 50% and 70%. The following graph indicates the counterparty credit rating distribution of the "Other retail" assets in FirstRand Bank, which include personal loans to FNB's retail customers, WesBank's retail exposures and FNB Commercial's exposures that qualify as retail SMEs:

**Retail – Other retail portfolio**

Exposure distribution across rating buckets (%)




*Impairment charge*

Specific and portfolio impairments reflected in the balance sheet represent a conservative 1.1% of gross advances (2004: 1.5%).

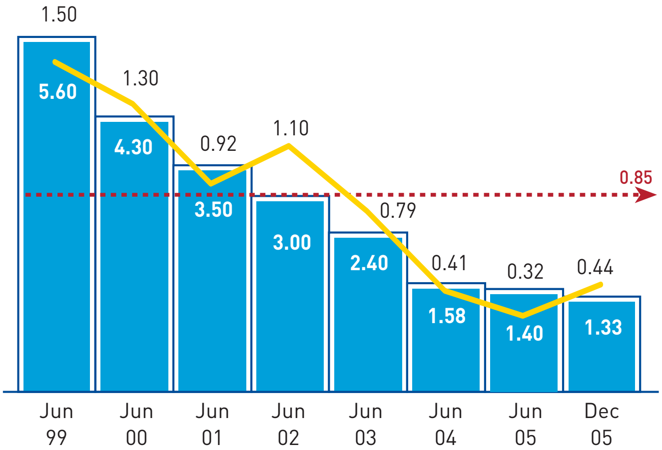
| | At 31 December | | | At 30 June |
|---|---|---|---|---|
| | **2005** | 2004 | % change | 2005 |
| Impairment charge (R million) – SA GAAP | **526** | 409 | 29 | 706 |
| Impairment charge – IFRS | **576** | 409 | 41 | 706 |
| Impairment charge as a % of average gross advances – SA GAAP | **0.44** | 0.39 | 13 | 0.32 |

Under IFRS, growth in IBNR provisions more closely reflects growth in underlying advances than was the case under SA GAAP.

The additional provisions created under IFRS are thus a reflection of the growth in advances, rather than a reflection of change in credit quality.

The graph below indicates the history of the Banking Group's actual losses reflected by the impairment charge percentage and non-performing loans as at 31 December 2005. The historical loss rate since 1999 was 0.85%.

### NPLs and impairment charge percentages
(%)




**Note:**

*Non-performing loans are classified as such based on the definition of default used by the Banking Group. The non-performing loans percentage includes the total value of non-performing loans classified into this category in the current year, as well as those of previous years that are still being collected/worked out. The impairment charge percentage is the bad debt charge to the income statement as a percentage of total advances in the current year based on the application of the Bank's internal provisioning policies.*

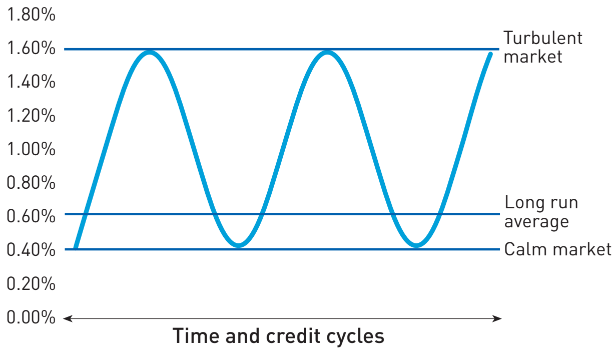
*Expected loss*

The combination of the measurement of probability of default and loss given default results in a valuable credit risk measure, namely expected loss ("EL"). The EL measure incorporates the ratings assigned to counterparties and the historical losses associated with each rating category and collateral type. Based on the current portfolio composition, the Bank's expected loss at 31 December 2005 is estimated as 0.64% (June 2005: 0.74%).

Different calculation methodologies are employed for the calculation of expected loss and IFRS accounting specific and portfolio impairments. The differences lie in the timing of the recognition of losses and the discount rates used. Although these differences are recognised, a high degree of commonality exists between the underlying data and estimates used. Consequentially, the expected loss provides a useful measure of credit risk and the potential extent of the likely ranges of accounting impairments in the long run.

The Bank conducts scenario and stress analysis on the likely variations around the long run average expected loss, incorporating potential changes to the economic environment. The graph below indicates the results of these analyses for the Bank's portfolios, which are largely representative of the Banking Group's portfolios. The expected loss in a turbulent market scenario is estimated at 1.6% and in a calm market scenario estimated at 0.4%.

### Expected credit losses




## CAPITAL

### Return on equity

The Banking Group achieved a return (after preference share dividends) on average ordinary shareholders' equity of 28.1% (2004: 28.0%) during the six-month period under review on a pre-IFRS basis.

The following tables provide the information for the calculation of return on ordinary shareholders' equity on a pre-IFRS basis:

*Shareholders' equity analysis*

| R million | Six months ended 31 December 2005 | Six months ended 31 December 2004 | Year ended 30 June 2005 |
|---|---|---|---|
| Total shareholders' equity | **29 407** | 26 827 | 28 461 |
| *Less:* Non-redeemable preference shares | **(3 000)** | (3 000) | (3 000) |
| *Less:* Cumulative redeemable preference shares | **(1 045)** | (1 301) | (1 045) |
| Ordinary shareholders' equity | **25 362** | 22 526 | 24 416 |
| Average ordinary shareholders' equity | **24 889** | 21 592 | 22 537 |

### *Return analysis*

| R million | Six months ended 31 December 2005 | 2004 | Year ended 30 June 2005 |
|---|---|---|---|
| Headline earnings excluding translation gains and losses | **3 640** | 3 046 | 6 228 |
| Non-redeemable preference share dividend | **(108)** | – | (68) |
| Cumulative redeemable preference share dividend | **(34)** | (22) | (43) |
| Headline earnings after preference dividends | **3 498** | 3 024 | 6 117 |

### *ROE*

| % | Six months ended 31 December 2005 | 2004 | Year ended 30 June 2005 |
|---|---|---|---|
| Return on average ordinary shareholders' equity after preference share dividends | **28.1** | 28.0 | 27.1 |

## Economic profit

Economic profit (also referred to as net income after capital charge), is a function of the headline earnings and the capital utilised in the businesses. It represents the surplus profit that the Banking Group generates for shareholders, after deducting an appropriate charge for the cost of the equity utilised.

Economic profit = headline earnings (excluding translation gains and losses and preference share dividends) – [Cost of equity x average shareholders' equity and reserves].

### *Net economic profit for the period under review*

| R million | Six months ended 31 December 2005 | 2004 | Year ended 30 June 2005 |
|---|---|---|---|
| Headline earnings after preference dividends | **3 498** | 3 024 | 6 117 |
| Charge for capital | **(1 480)** | (1 436) | (2 862) |
| Net economic profit | **2 018** | 1 588 | 3 255 |

Additional information on the segmental analysis of ROE is contained in the supplementary information document on page 27.

The table below indicates the growth in economic profit and the internally estimated average cost of equity for the Banking Group:

| Growth in economic profit | June 2000 | June 2001 | June 2002 | June 2003 | June 2004 | June 2005 | Six months to December 2005 |
|---|---|---|---|---|---|---|---|
| Economic profit (R million) | 572 | 791 | 1 107 | 1 925 | 2 521 | 3 255 | **2 018** |
| Average cost of equity (%) | 18.4 | 16.7 | 15.5 | 14.3 | 13.5 | 12.7 | **11.9** |

## Capital adequacy

The regulatory capital adequacy of the registered banks is determined with reference to the regulations of the South African Reserve Bank and the home regulators of foreign subsidiaries.

### *FirstRand Bank Limited*

| | At 31 December | | At 30 June |
|---|---|---|---|
| | **2005** | 2004 | 2005 |
| Tier 1 % | **8.3** | 10.7 | 7.9 |
| Total capital adequacy (%) | **11.8** | 14.3 | 11.1 |
| Risk weighted assets (R'000) | **188 935** | 145 974 | 164 309 |

The aggregated capital adequacy position of the domestic and international regulated banking entities in the Banking Group is set out below:

### *FirstRand Banking Group – regulated banking entities*

| | At 31 December | | At 30 June |
|---|---|---|---|
| | **2005** | 2004 | 2005 |
| Tier 1 % | **9.2** | 11.1 | 8.8 |
| Total capital adequacy (%) | **12.5** | 14.4 | 11.8 |
| Risk weighted assets (R'000) | **215 545** | 168 894 | 191 566 |

*Ansbacher capital was included in 2004 and not in 2005.*

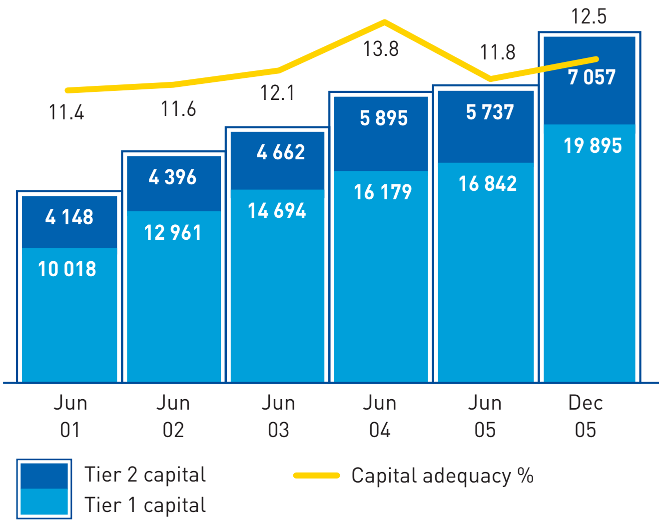
### *FirstRand Banking Group – regulated bank and non-bank entities*

| | At 31 December | | At 30 June |
|---|---|---|---|
| | **2005** | 2004 | 2005 |
| Total capital adequacy (%) | **13.5** | 14.7 | 13.8 |
| Risk weighted assets (R'000) | **228 089** | 185 036 | 191 022 |

## Regulatory capital history

The graph below provides a five year overview of the regulatory capital position of the banking operations in FirstRand Banking Group since June 2001:

**FirstRand Banking Group regulatory capital position**




### *Comments on regulatory capital position*

The Banking Group applies three distinct principles in managing its capital:

- Internally generated capital is paid out to shareholders based on a sustainable dividend cover, referenced to sustainable earnings.
- Capital is then deployed for growth opportunities, whether acquisitive or organic.
- After the exploitation of the above, excess capital is then returned to shareholders on the most cost efficient manner.

The Banking Group had excess capital of R1 billion as at 31 December 2005, resulting from strong earnings growth and the restructure of the vendor finance element of the Black Economic Empowerment transaction. This capital will be used as part of the business' requirement to fund growth opportunities. Once these opportunities have been exploited, it will be applied to either reduce debt at the holding company level or be returned to shareholders via a share buy-in programme.

Further information on the capital adequacy position of the Banking Group has been included in the supplementary information document on page 27.

### Analysis of book capital

Total shareholders' equity and reserves of the Banking Group amounted to R29 507 million at 31 December 2005 (R28 461 million at 30 June 2005 on a pre-IFRS basis).

The movements in ordinary shareholders' equity and reserves can be analysed as follows:

| R million | Shareholders' equity | % change |
|---|---|---|
| Balance at 1 July 2005 – SA GAAP | 28 461 | |
| IFRS impact – opening balance | 114 | |
| Balance at 1 July 2005 – IFRS[1] | 28 575 | |
| Internally generated – attributable income – IFRS | 3 654 | 13 |
| Internally generated – other reserves | (725) | (3) |
| Dividends paid | (1 997) | (7) |
| Total shareholders' equity and reserves at 31 December 2005 – IFRS | 29 507 | 3 |

*1. Per balance sheet refer page 23.*

### Basel II implementation

The Banking Group's Basel II implementation is progressing well. Current focus areas include the analysis of the new regulatory reporting requirements, model refinements and preparation for the model approval process that will be conducted by the South African Reserve Bank.

## ACCOUNTING POLICIES

The Banking Group's audited consolidated financial statements have been prepared in accordance with IFRS.

The Banking Group prepares its audited consolidated financial statements on a going concern basis using the historical cost basis, except for certain financial assets and liabilities where it adopts the fair value basis of accounting. These financial assets and liabilities include:

- financial assets and liabilities held for trading;
- financial assets classified as available-for-sale;
- derivative assets and liabilities; and
- financial assets and liabilities elected to be carried at fair value.

The preparation of audited consolidated financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Banking Group's accounting policies.

In accordance with the transitional provisions set out in IFRS 1, "First-time adoption of International Financial Reporting Standards" and other relevant Standards, the Banking Group has applied IFRS expected to be in force as at 30 June 2006 in its financial reporting with effect from the Banking Group's transition date on 1 July 2004, with the exception of the Standards relating to financial instruments and insurance contracts which were prospectively applied from 1 July 2005. Therefore the impact of adopting IAS 32, IAS 39 and IFRS 4 are not included in the 2005 comparatives in accordance with IFRS 1. The Banking Group previously followed South African accounting standards.

As part of the adoption of IFRS, the Banking Group has changed its accounting policy in respect of accounting for joint ventures from proportionate consolidation to equity accounting, with effect from 1 July 2005.

Further information pertaining to the adoption of IFRS is set out in a separate IFRS booklet, which is available on the company's website and from the company secretary's office.

## CONTINGENT LIABILITIES

There are a number of claims or potential claims made or pending against the Banking Group, the outcome of which cannot be quantified. The potential financial impact of these claims is not expected to be material for the Banking Group either on an individual or a combined basis. Provision is made for all liabilities as defined in IAS 37 – Provisions, contingent liabilities and contingent assets, which are assessed as probable at the reporting date.

## PROSPECTS

With a combination of low inflation, low interest rates, a mildly expansionary fiscal stance, strong public and private sector fixed investment as well as healthy domestic demand, the prospects for continued strong economic growth in South Africa are good. Inflation is expected to remain within the South African Reserve Bank's target range and rates are expected to remain unchanged for the rest of the financial year.

The economic upswing currently experienced shows every sign of being sustainable into the future and consumer credit demand, especially for the asset-backed variety, should remain strong.

The challenge going into 2006 will be to maintain growth at current levels and improve efficiencies. Increased competition and the resultant impact on margins and fees remain a challenge going forward.

The Banking Group is confident that it is well positioned to continue to achieve real growth in earnings for shareholders in the second half of the 2006 financial year.

## MANAGEMENT CHANGES

Sizwe Nxasana, previously chief executive officer ("CEO") of Telkom, and a director of the Banking Group, was appointed CEO of FirstRand Bank Holdings Limited with effect from 1 January 2006, succeeding Paul Harris who was appointed CEO of FirstRand Limited from the same date.

On behalf of the directors

**GT Ferreira**
Chairman

**SE Nxasana**
Chief Executive Officer

FirstRand Bank Holdings Limited

# MOMENTUM GROUP

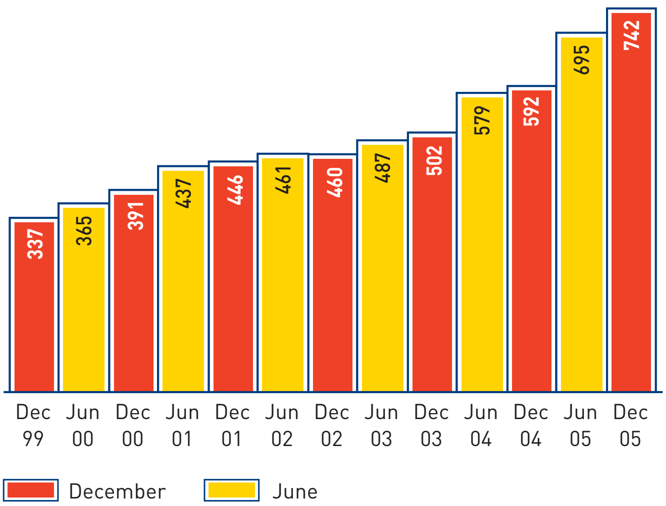
momentum

## INTRODUCTION

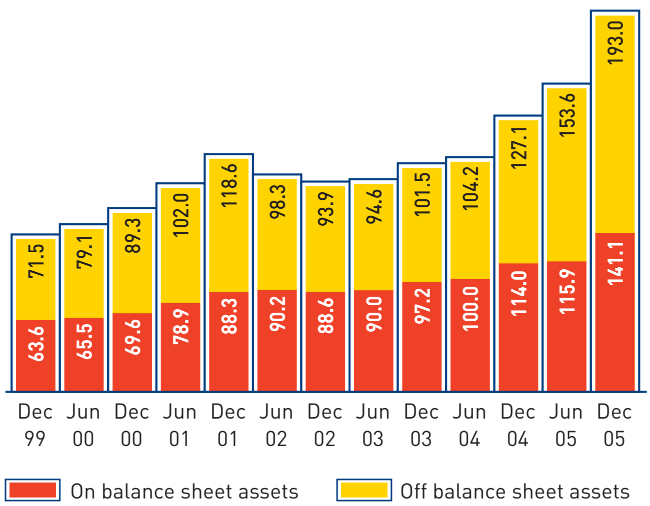
This report reflects the results and financial position of the insurance and asset management interests of FirstRand Limited ("the Momentum Group"), and should be read in conjunction with the report on FirstRand Limited ("FirstRand").

## FINANCIAL HIGHLIGHTS

**Normalised headline earnings**
(R million)




**Assets under management or administration**
(R billion)




| | |
|---|---|
| Annualised return on embedded value | 27% |
| Value of new business | + 28% |
| Normalised Group headline earnings | + 25% |
| Assets under management or administration | + 24% to R334.1 billion |

# Income statement

| R million | Unaudited Six months ended 31 December 2005 | 2004 | % change | Audited Year ended 30 June 2005 |
|---|---|---|---|---|
| Income from operations | **1 018** | 689 | 48 | 1 563 |
| Share of income of associated companies | **47** | 66 | (29) | 118 |
| Income before direct taxation | **1 065** | 755 | 41 | 1 681 |
| Direct taxation[1] | **(276)** | (166) | (66) | (324) |
| Income after taxation | **789** | 589 | 34 | 1 357 |
| Earnings attributable to outside shareholders | **(11)** | (5) | >(100) | (16) |
| **Earnings attributable to ordinary shareholders (post-IFRS)** | **778** | 584 | 33 | 1 341 |
| **Headline earnings reconciliation** | | | | |
| Earnings attributable to ordinary shareholders | **778** | 584 | 33 | 1 341 |
| *Add:* Impairment of goodwill | **104** | – | – | – |
| *Less:* Profit on sale of available-for-sale assets | **(148)** | (1) | – | (71) |
| *Less:* Profit on sale of associated companies | **(82)** | – | – | – |
| **Group headline earnings (post-IFRS)** | **652** | 583 | 12 | 1 270 |
| Insurance operations | **423** | 299 | 41 | 685 |
| Asset management operations | **151** | 107 | 41 | 247 |
| Group operating profit | **574** | 406 | 41 | 932 |
| Investment income on shareholders' assets | **168** | 186 | (10) | 355 |
| Normalised Group headline earnings[2] | **742** | 592 | 25 | 1 287 |
| National Treasury Settlement Charge | **(27)** | – | – | – |
| Group headline earnings (pre-IFRS) | **715** | 592 | 21 | 1 287 |
| Impact of IFRS | **(63)** | (9) | >(100) | (17) |
| **Group headline earnings (post-IFRS)** | **652** | 583 | 12 | 1 270 |

*1. Direct taxation excludes all policyholder taxation and includes only direct taxation on shareholders.*

*2. Headline earnings adjusted for the impact of the National Treasury settlement charge and IFRS.*

# Balance sheet

| R million | Unaudited 31 December 2005 | Unaudited 31 December 2004 | Audited 30 June 2005 |
|---|---|---|---|
| **ASSETS** | | | |
| Financial assets | | | |
| Cash and cash equivalents | **2 874** | 1 219 | 1 634 |
| Money market investments | **14 386** | 13 344 | 11 380 |
| Loans and receivables | **6 073** | 5 915 | 5 491 |
| Government and Public Authority stocks | **17 234** | 14 074 | 14 592 |
| – available-for-sale | **253** | 395 | 91 |
| – at elected fair value through profit and loss | **16 981** | 13 679 | 14 501 |
| Debentures and other loans | **8 963** | 8 139 | 8 906 |
| – available-for-sale | **723** | 672 | 565 |
| – at elected fair value through profit and loss | **8 240** | 7 467 | 8 341 |
| Policy loans | **–** | 577 | 530 |
| Equity investments | **69 664** | 50 221 | 54 785 |
| – held to maturity | **864** | 786 | 824 |
| – available-for-sale | **1 125** | 1 328 | 703 |
| – at elected fair value through profit and loss | **67 675** | 48 107 | 53 258 |
| Derivative financial instruments | **12 627** | 15 172 | 11 975 |
| Current income tax asset | **6** | 231 | 118 |
| Reinsurance contracts | **299** | 224 | 217 |
| Deferred taxation | **465** | 50 | 40 |
| Investments in associates | **234** | 696 | 978 |
| Intangible assets | **1 649** | 251 | 619 |
| Deferred acquisition cost asset | **1 076** | – | – |
| Retirement benefit asset | **38** | 38 | 38 |
| Investment properties | **5 068** | 3 500 | 4 159 |
| Property, plant and equipment | **397** | 387 | 391 |
| **Total assets** | **141 053** | 114 038 | 115 853 |
| **LIABILITIES AND EQUITY** | | | |
| **LIABILITIES** | | | |
| Financial liabilities | | | |
| Accounts payable | **4 590** | 4 331 | 4 177 |
| Derivative financial instruments | **4 639** | 8 940 | 4 797 |
| Long-term liabilities | **1 316** | 1 380 | 1 717 |
| Policyholder liabilities under investment contracts | **77 829** | 44 560 | 48 350 |
| Provisions | **212** | 115 | 178 |
| Current income tax liabilities | **130** | – | 50 |
| Deferred taxation | **1 504** | 611 | 797 |
| Post-retirement medical aid liability | **75** | 297 | 267 |
| Deferred revenue liability | **144** | – | – |
| Policyholder liabilities under insurance contracts | **39 467** | 47 768 | 48 585 |
| Liabilities arising to third parties as a result of consolidating collective investment schemes | **4 356** | 785 | 1 027 |
| **Total liabilities** | **134 262** | 108 787 | 109 945 |
| **EQUITY** | | | |
| Share capital and share premium | **1 541** | 1 041 | 1 041 |
| Reserves | **5 060** | 4 189 | 4 722 |
| | **6 601** | 5 230 | 5 763 |
| Minority interest | **190** | 21 | 145 |
| **Total equity** | **6 791** | 5 251 | 5 908 |
| **Total liabilities and equity** | **141 053** | 114 038 | 115 853 |

# Commentary on results

## OVERVIEW FOR THE SIX MONTHS

The Momentum Group generated a solid performance in a challenging sales environment. Good organic growth was achieved in individual recurring risk, savings and lump-sum retail investment inflows, despite the increased consumerism in the life insurance industry. In this regard, Momentum welcomes the settlement reached with National Treasury regarding minimum standards on early termination values on savings and retirement annuity products. As mentioned in the 2005 year-end results announcement, Momentum proactively reduced profit margins on its Investo range in the interest of improved value for money to all clients, and will continue to improve the value proposition to clients through innovative product design.

The integration of Sage into the Momentum Group has progressed well, with the conversion of Sage Life policies to the Momentum IT platform being completed within a 100-day timeframe. The integration of the Sage agency force into the Momentum distribution environment has also been completed. The early signs are that agency production is increasing steadily.

The following corporate action took place during the period under review:

- **Acquisition of Sage:** Momentum's acquisition of 100% of the issued shares of Sage Group Limited ("Sage") was sanctioned by the High Court of South Africa on 16 August 2005, and approved by the Competition Authorities on 24 August 2005. The consideration payable in terms of the scheme was R634 million, or 175 cents per Sage share, comprising an initial payment of 142 cents per share and a subsequent potential maximum payment of 33 cents per share relating to an escrow account. As security for certain contingent taxation related liabilities, an amount of R120 million of the cash consideration is being held in an escrow account managed by Hofmeyr Herbstein & Gihwala Inc. The Sage acquisition has reduced Momentum's overall maintenance cost per policy by 14%, and has tripled the size of Momentum's agency force to 911 agents.
- **Disposal of African Life and acquisition of African Life Health:** Momentum's disposal of its 34%-shareholding in African Life ("Aflife") to Sanlam became effective on 30 November 2005 when the High Court of South Africa sanctioned Sanlam's acquisition of the ordinary share capital of Aflife on that date. A total consideration of R22.05 per share (or R864 million) was received on 12 December 2005. Momentum's separate offer to acquire the entire shareholding in African Life Health ("ALH") from Aflife for a cash consideration of R176 million plus a reimbursement of transaction costs of R11 million (plus VAT), was approved unconditionally by the Competition Appeals Court on 2 February 2006.
- **Acquisition of the remaining 50% of Advantage Asset Managers, and Advantage BEE transaction:** The announcement on 17 November 2005 regarding Momentum's offer to acquire mCubed's entire interest in Advantage Asset Managers ("Advantage") for a cash consideration of R140 million, has not yet received the necessary shareholder approval at the date of this results announcement. Effective 15 December 2005, WDB Holdings and Advantage's Black Staff Share Trust acquired a stake of 11.5% and 3.5% respectively in Advantage Asset Managers.
- **Disposal of 40% in Futuregrowth:** Momentum disposed of its remaining 40%-shareholding in Futuregrowth to the majority shareholder, Wiphold, during the six months.

In addition to the above, Momentum issued R500 million in perpetual preference shares to its holding company, FirstRand, on 1 September 2005. This issue of shares, which was approved by the Financial Services Board ("FSB"), has enabled Momentum to lower its weighted average cost of capital.

## BASIS OF PRESENTATION

The consolidated figures in this report comprise the operations of Momentum Group Limited and its divisions, associates and subsidiary companies, including Momentum Life, Sage Group, RMB MultiManagers (UK), RMB Asset Management, RMB Properties, Sovereign Health, 87% of Ashburton, 70% of Lekana Employee Benefits Solutions and 42.5% of Advantage Asset Managers (50% prior to BEE transaction), collectively referred to as the Momentum Group ("the Group").

The commentary in this report focuses on the operating performance of the Group prior to the implementation of International Financial Reporting Standards ("IFRS"). This is due to the fact that Momentum has, together with the rest of the FirstRand Group, elected in terms of IFRS1 – First-time Adoption of IFRS, not to restate certain comparative numbers. Details regarding the impact of IFRS on the Momentum Group, including Momentum's elections in terms of IFRS1, are set out on FirstRand's website at www.firstrand.co.za.

## OPERATING ENVIRONMENT

Equity markets continued to reflect strong gains, with the FTSE-JSE Top 40 Index increasing by 28% during the six months under review. The Rand strengthened against the currencies of South Africa's major trading partners during the period, and CPIX ended the period stable at 4%.

Discretionary retail investment product providers, comprising mainly Collective Investment Schemes ("CISs") and Linked Investment Service Providers ("LISPs"), continue to benefit from increased lump-sum inflows. The Association of Collective Investment Schemes reported that total CIS assets increased by 19% to R415 billion for the six months to 31 December 2005.

As mentioned in the overview, the insurance industry has come under pressure during the six months as a result of increased consumerism and the focus on value for money. This culminated in the settlement between the industry and National Treasury regarding minimum standards on early termination values on retirement and savings products.

## GROUP OPERATING RESULTS

Group headline earnings before the once-off impact of the National Treasury settlement, pre-IFRS, increased by 25% to R742 million for the six months ended 31 December 2005. Group headline earnings after the impact of the National Treasury settlement, post-IFRS, increased by 12% to R652 million. Earnings attributable to ordinary shareholders increased by 33% to R778 million.

Upon transition to IFRS, Momentum has elected not to redesignate the measurement of shareholders' available-for-sale assets to profit and loss, but to rather continue to measure these assets at fair value directly to a revaluation reserve as part of shareholders' equity. If Momentum had accounted for the fair value movements on these assets through earnings, normalised Group headline earnings would have increased by 63% to R962 million for the six months.

These results were characterised by:

- strong retail new business growth, especially in individual risk and discretionary lump-sum investments;
- a significant increase in asset management earnings due to increased equity market growth and strong retail product inflows; and
- lower investment income on shareholder assets as a result of recent acquisitions.

Total assets under management or administration increased by 24% during the six months to R334.1 billion mainly due to the growth in equity markets, strong net inflows in the collective investments and linked product businesses, and the acquisition of Sage.

The annualised headline return on equity ("ROE") for the six months amounted to 25% (before the impact of the settlement with National Treasury and pre-IFRS), in line with the 25% in the prior period. This ROE is in excess of Momentum's internal target, representing the weighted average cost of capital plus 10%, which currently equals 21.1%. The annualised return on embedded value for the six months totalled 27%.

The following table reflects the main components of the increase in Group headline earnings for the six months, with the impact of the National Treasury settlement, referred to above, reflected separately:

### Earnings source

| R million | Unaudited Six months ended 31 December **2005** | 2004 | % change | Audited Year ended 30 June 2005 |
|---|---|---|---|---|
| Insurance operations | **423** | 299 | 41 | 685 |
| – Local | **420** | 337 | 25 | 744 |
| – International | **3** | (38) | >100 | (59) |
| Asset management operations | **151** | 107 | 41 | 247 |
| – Local | **123** | 75 | 64 | 178 |
| – International | **28** | 32 | (13) | 69 |
| **Group operating profit** | **574** | 406 | 41 | 932 |
| Investment income on shareholders' assets | **168** | 186 | (10) | 355 |
| **Normalised Group headline earnings** | **742** | 592 | 25 | 1 287 |
| National Treasury settlement charge | **(27)** | – | – | – |
| **Group headline earnings (pre-IFRS)** | **715** | 592 | 21 | 1 287 |
| Impact of IFRS[1] | **(63)** | (9) | >(100) | (17) |
| **Group headline earnings (post-IFRS)** | **652** | 583 | 12 | 1 270 |

*1. The impact of IFRS represents mainly the change in profit recognition on investment contracts, and the adjustment of listed property subsidiary and associate investments to net asset value. A summary of this impact is set out in the section on "Implementation of IFRS" in this report, and also on the FirstRand website at www.firstrand.co.za.*

The commentary below is based on the pre-IFRS numbers in the table above, with separate comments on the impact of IFRS and the treatment of the National Treasury Settlement Charge.

## Insurance operations

The operating profit generated by local insurance operations increased by 25% to R420 million. The continued strong new business growth, together with good growth in investment markets, impacted positively on the results for the period. It is also pleasing to note that the value of new business, which represents the present value of profits from new business, increased by 28% to R246 million. Including the turnaround in the results of the international operations, the overall insurance operations increased operating profit by an excellent 41% to R423 million.

The acquisition of Sage is not only a means to reduce Momentum's unit cost per policy, it also contributes positively to the growth strategy by providing access to an agency force that is expected to significantly enhance future new business growth. Following the conversion of the Sage Life policies onto the Momentum IT systems, the combined maintenance cost per policy has been reduced by 14%, with a commensurate increase in the embedded value of in-force policies. A total of R28 million in operating profit is included for Sage from 1 September 2005, whilst an amount of R11 million is included in investment income on shareholder assets, representing the income yield on the Sage shareholder assets from 1 September 2005. It should be noted that, in terms of IFRS 3, Momentum has identified intangible assets totalling R636 million (net of deferred tax) in the Sage balance sheet at the effective date, represented mainly by the value of in-force business. In terms of IFRS 3, these intangible assets must be amortised against Group earnings over their useful lives, and this will impact on future earnings, however, there will be no impact on the embedded value. The amortisation of these intangibles included in these results amounts to R2 million.

As mentioned in the year-end results to 30 June 2005, the back-office function of Momentum's offshore retail-linked product provider was relocated from the UK to South Africa in order to reduce the cost base. The result is a turnaround in the earnings from offshore operations, from a loss of R38 million incurred during the prior period, to a profit of R3 million during the current period.

The following table summarises the total retail new business produced during the period:

## Retail new business

| R million | Unaudited Six months ended 31 December 2005 | 2004 | % change | Audited Year ended 30 June 2005 |
|---|---|---|---|---|
| New annualised recurring premiums | **569** | 469 | 21 | 946 |
| Total lump-sum inflows | **4 748** | 3 881 | 22 | 8 895 |
| Single premium endowments | **662** | 614 | 8 | 1 580 |
| Lump-sum annuities | **1 119** | 909 | 23 | 1 694 |
| Linked products – local | **2 353** | 1 206 | 95 | 3 127 |
| Linked products – offshore[1] | **614** | 1 152 | (47) | 2 494 |
| **Total retail new business** | **5 317** | 4 350 | 22 | 9 841 |
| **Annualised retail new business[2]** | **1 044** | 857 | 22 | 1 836 |

*1. Linked investment products sold by RMB MultiManagers (UK).*
*2. Represents annualised new recurring premiums plus 10% of all lump-sum inflows.*

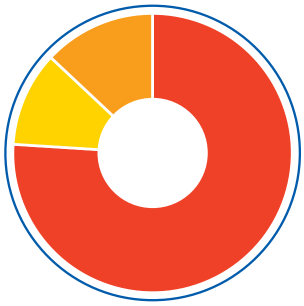
New individual life recurring premium business increased by an excellent 21%. This growth was driven by a number of factors, including:

- an increase of 24% in sales of our Myriad risk product;
- an increase of 9% in recurring savings product sales, comprising a decline of 3% in recurring RA sales and an increase of 17% in recurring endowment sales;
- an increase of 85% in sales from the two bancassurance initiatives, namely FNB Life in the mass market, and Aspire in the middle market;
- the expansion of our agency force, which now comprises 911 agents; and
- an increase in Momentum's share of the products sold by FNB Financial Consultants, whose own production increased significantly during the period under review.

The following pie charts provide a breakdown of the individual life new recurring premium production by distribution channel:

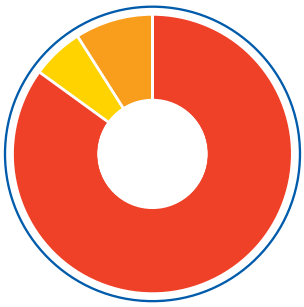
**Distribution split – new recurring premiums**
**for the six months ended 31 December 2005**

Brokers 76%
Agents 11%
Bancassurance 13%



**Distribution split – new recurring premiums**
**for the six months ended 31 December 2004**

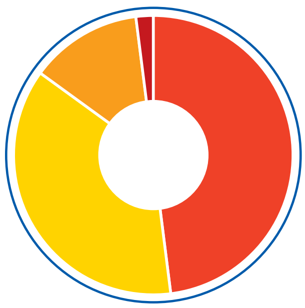
Brokers 85%
Agents 6%
Bancassurance 9%



The contribution to the individual life new recurring premium production from the various lines of business is illustrated in the following pie charts:

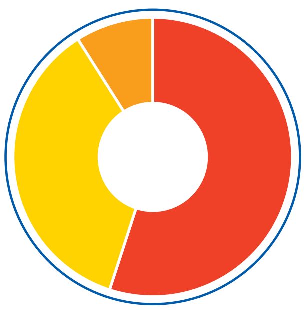
**Product split – new recurring premiums**
**for the six months ended 31 December 2005**

Savings 48%
Risk 37%
Bancassurance 13%
Sage 2%



**Product split – new recurring premiums**
**for the six months ended 31 December 2004**

Savings 55%
Risk 36%
Bancassurance 9%



The increased proportion of agency production does not yet include any significant impact from the Sage agents as these were only integrated into the Momentum distribution network from 1 December 2005.

Sales of linked investment products increased significantly as equity markets continued to show strong gains. Momentum's strategy to focus on selected specialist investment brokers has yielded excellent results, with sales from these brokers increasing by 52% during the six months to December 2005. Approximately 70% of the retail-linked investment product sales represent discretionary investments in collective investment schemes, whilst the remainder represent investments in retirement fund vehicles such as retirement annuities, preservation funds and living annuities.

The focus in Momentum's offshore multimanager and linked product business, RMB MultiManagers (UK), was on reducing costs during the period under review with a view to providing a solid base from which to grow future earnings. The business is now shifting to a growth focus through the establishment of a distribution capacity in the Middle and Far East.

The disposal of Momentum's stake in Aflife is in line with the preferred strategy of targeting the mass and middle-income market through the FNB branch network, rather than through a traditional life insurance distribution model. This strategy has produced strong growth in sales through FNB for the six months, especially in the mass market through FNB Life. The middle market initiative, Aspire, launched a number of new products during the six months and early indications are that these products are well accepted by the market.

Momentum's strategy surrounding the health offering was focused on the acquisitions of Sovereign Health ("Sovereign") and African Life Health ("ALH"). The acquisition of Sovereign provides Momentum with a strong presence in the restricted schemes market. The Momentum Health scheme, which is administered by Sovereign, currently has 60 000 principal members, which was boosted by 20% growth in new member activations at 1 January 2006. Momentum's acquisition of ALH provides access to complementary market segments such as local government, the emerging black market and Africa markets.

Momentum's new short-term insurance venture is progressing well, with a good conversion rate of 24% on new quotes to date. The scale benefits of the utilisation of the existing Group infrastructure will limit cost increases as sales volumes increase.

Advantage has increased its assets under management from R39 billion to R43 billion during the period under review. Momentum announced an offer to acquire mCubed's entire remaining stake in Advantage, however, mCubed's shareholder approval for the acquisition is still outstanding.

## Asset management operations

The asset management operations comprise the institutional asset management and collective investment operations of RMB Asset Management ("RMBAM"), RMB Properties and 87% of Ashburton. The Group's 40%-shareholding in Futuregrowth was disposed of to Wiphold, the majority shareholder, during the period under review.

The asset management operations generated an increase in headline earnings of 41% to R151 million. The local asset management operations, represented mainly by RMBAM, generated an excellent 64% increase in headline earnings.

Strong market growth in the institutional business has resulted in increased asset values and consequently higher fees, whilst a significant increase in retail collective investment scheme net inflows has also benefited income levels.

The offshore asset management operations were impacted negatively by an operational loss of R22 million. Although full provision has been made in these results for this loss, an insurance claim has been instituted against the Group's insurers, which could result in a reversal of a large portion of this loss.

The total funds managed by the asset management operations are summarised in the following table:

### Asset management operations – Funds under management

| R million | 31 December 2005 | 30 June 2005 | % change |
|---|---|---|---|
| Group assets managed on balance sheet | **58.7** | 51.7 | 14 |
| Off balance sheet assets – retail | **29.6** | 22.5 | 32 |
| Off balance sheet assets – institutional | **122.0** | 105.4 | 16 |
| **Total funds under management** | **210.3** | **179.6** | **17** |

### National Treasury Settlement Charge

The total impact on Momentum and Sage of the settlement with National Treasury that was reached on 12 December 2005 amounts to R204 million after tax. This can be split between the impact on historical business of R145 million, and the prospective impact of R59 million. The impact on Momentum is R100 million, with the balance representing Sage.

As a provision of R73 million after tax was already made at 30 June 2005, the full balance of the charge of R131 million after tax has been taken against current period earnings. A total of R27 million of this impact has been accounted for against headline earnings, whilst the balance of R104 million relating to Sage is reflected outside of headline earnings as an impairment of the value of goodwill arising from the acquisition of Sage.

### Investment income on shareholders' assets

The investment income earned on shareholders' assets decreased by 10% to R168 million. The negative impact of the acquisition of Sovereign and Sage, together with the repayment of loans relating to the original acquisition of Ashburton and the repayment of funding for the RMB MultiManagers (UK) accumulated losses, resulted in a reduction in investment income.

The directors' valuation of shareholders' assets at 31 December 2005, as well as the investment income earned on the shareholders' portfolio investments, are set out in the following table:

### Shareholders' assets

| R million | Directors' valuation 31 December 2005 | Directors' valuation 31 December 2004 | Investment income earned after tax 31 December 2005 | Investment income earned after tax 31 December 2004 |
|---|---|---|---|---|
| **Strategic subsidiary investments**[1]**:** | | | | |
| – Asset management operations | **2 092** | 1 830 | **–** | – |
| – Advantage (42.5%)[2] | **105** | 35 | **–** | – |
| – Lekana Employee Benefit Solutions (70%) | **98** | 97 | **–** | – |
| – Sovereign Health | **183** | – | **–** | – |
| – Sage[3] | **1 221** | – | **11** | – |
| **Shareholders' portfolio investments**[1]**:** | | | | |
| – African Life (34%) | **–** | 723 | **47** | 60 |
| – Fixed interest instruments[4] | **569** | 94 | **29** | 30 |
| – Preference shares | **560** | 516 | **25** | 12 |
| – Equities[4] | **748** | 1 145 | **11** | 10 |
| – Share Trust and subsidiary loans | **1 011** | 656 | **19** | 21 |
| – Cash and near cash[5] | **1 425** | 1 954 | **26** | 53 |
| **Shareholders' assets at directors' values** | **8 012** | 7 050 | **168** | 186 |
| Adjustment for move from published to statutory basis for calculating value of in-force | **(32)** | – | **–** | – |
| **Shareholders' net worth for embedded value purposes** | **7 980** | 7 050 | **168** | 186 |
| Attributable to preference shareholders | **(570)** | – | **–** | – |
| **Ordinary shareholders' net worth** | **7 410** | 7 050 | **168** | 186 |

1. *Strategic subsidiary investments are reflected at directors' valuation. The income from strategic subsidiary investments is included in Group operating profit, whilst the income on the shareholders' portfolio investments is reflected separately in earnings.*
2. *The comparative number represents the investment in Momentum MultiManagers prior to the acquisition of mCubed Asset Management.*
3. *The investment in Sage is reflected at the embedded value of Sage.*
4. *The equity exposure was reduced to rebalance the portfolio following the reduction in cash due to the acquisition of Sage and the reduction in net asset value arising from the opening IFRS 4 adjustment.*
5. *The earnings on the cash balance reduced due to lower interest rates earned, the negative impact of the cash utilised to acquire Sage and the decline in the net asset value due to the opening IFRS 4 adjustment. This was partly offset by the cash received for the disposal of African Life, however, this cash was only received in December 2005.*

## Implementation of IFRS

Momentum prepared its consolidated financial statements under South African Statements of Generally Accepted Accounting Practice ("SA GAAP") for the accounting period ended 30 June 2005. As a subsidiary of FirstRand, the Momentum Group adopted IFRS with effect from 1 July 2005.

Details relating to the changes resulting from the adoption of IFRS are set out on FirstRand's website at www.firstrand.co.za. The IFRS document on the website presents the Momentum Group's restated comparative IFRS financial information for the six months ended 31 December 2004 and the year ended 30 June 2005. It also presents and explains the differences between the Group's results and shareholders' equity under IFRS and the amounts previously reported for these periods under SA GAAP.

The change from SA GAAP to IFRS has primarily impacted the following areas:

- Reclassification of policy contracts between the insurance and investment categories based on the IFRS 4 insurance contracts criteria;
- The creation of a deferred acquisition cost ("DAC") asset by deferring the costs that are directly attributable to the acquisition of an investment management contract over the life of the service contract. The previous reduction in policyholder liabilities arising from the capitalisation of future fees used to recover acquisition costs, has been reversed;
- The deferral of direct front-end fees that are charged to recover the acquisition costs related to an investment management contract, by creating a deferred revenue liability. These fees are recognised as the related service is provided;
- Expensing the cost of share options awarded to employees and other share-based payment transactions on a fair value basis;
- Adjusting the depreciation methodology used on property, plant and equipment;
- Consolidation of certain collective investment schemes controlled by the Momentum Group, which were previously recognised at fair value;
- Reclassification of policy loans;
- Reclassification of the accumulated foreign currency translation reserve to retained earnings; and
- Recording of the unrecognised actuarial gain on defined benefit plans as at 1 July 2004.

The migration to IFRS for insurers will, in its full extent, take a number of years. The interim results have been prepared in accordance with the current interpretations of IFRS. Future results may be impacted upon completion of Phase II of the International Accounting Standard Board's review of accounting for insurance contracts.

A summary of the impact of the adoption of IFRS on the attributable earnings of the Momentum Group is set out in the table below:

## Reconciliation from IFRS to SA GAAP

| R million | Unaudited Six months ended 31 December 2005 | 2004 | % change | Audited Year ended 30 June 2005 |
|---|---|---|---|---|
| **Attributable earnings as reported under IFRS** | **778** | 584 | 33 | 1 341 |
| **IFRS adjustments for:** | | | | |
| IFRS 4/IAS 18 | **47** | – | – | – |
| – Change in profit recognition on investment contracts in terms of IAS 39 and IAS 18 | **(19)** | – | – | – |
| – Adjustment of listed property subsidiary and associate to NAV | **66** | – | – | – |
| Business combinations – amortisation of intangible assets | **7** | – | – | – |
| Property, plant and equipment | **1** | 2 | | 3 |
| Share-based payments | **8** | 7 | | 14 |
| **Attributable earnings in terms of SA GAAP** | **841** | 593 | 42 | 1 358 |

| R million | Unaudited Six months ended 31 December 2005 IFRS | SA GAAP | Unaudited Six months ended 31 December 2004 IFRS | SA GAAP | Audited Year ended 30 June 2005 IFRS | SA GAAP |
|---|---|---|---|---|---|---|
| **Attributable earnings** | **778** | **841** | 584 | 593 | 1 341 | 1 358 |
| *Add:* Impairment of goodwill | **104** | **104** | – | – | – | – |
| *Less:* Profit on sale of available-for-sale assets | **(148)** | **(148)** | (1) | (1) | (71) | (71) |
| *Less:* Profit on sale of associated companies | **(82)** | **(82)** | – | – | – | – |
| **Headline earnings** | **652** | **715** | 583 | 592 | 1 270 | 1 287 |

## CAPITAL ADEQUACY

The excess of assets over liabilities of Momentum Group Limited, calculated on the statutory valuation basis, was R4 975 million (June 2005: R4 510 million). The capital adequacy requirement ("CAR") of R2 035 million was covered 2.4 times (June 2005: 2.2 times) by the excess of assets over liabilities. This is higher than the targeted range of 1.8 to 2.2 times. However, the acquisitions of ALH and mCubed's remaining stake in Advantage, which is expected to take place in the second six months of the financial year, should bring the CAR cover ratio closer to the targeted range.

## MARKETING AND ADMINISTRATION EXPENSES

Total marketing and administration expenses for the Group amounted to R1 105 million, an increase of 38% over the prior period. The following table provides a breakdown of these expenses:

### Marketing and administration expenses

| R million | Unaudited Six months ended 31 December **2005** | 2004 | % change | Audited Year ended 30 June 2005 |
|---|---|---|---|---|
| Insurance operations | **617** | 573 | 8 | 1 192 |
| – Local | **565** | 495 | 14 | 1 036 |
| – Offshore | **52** | 78 | (33) | 156 |
| Asset management operations | **192** | 167 | 15 | 335 |
| – Local | **135** | 111 | 22 | 247 |
| – Offshore | **57** | 56 | 2 | 88 |
| Existing operations | **809** | 740 | 9 | 1 527 |
| New acquisitions[1] | **230** | 11 | >100 | 58 |
| New initiatives[2] | **66** | 48 | 38 | 90 |
| **Total marketing and administration expenses** | **1 105** | 799 | 38 | 1 675 |

*1. Represents the expenses of Sage, Sovereign and Advantage.*
*2. Represents the expenses of the Health initiative, the bancassurance initiative and Momentum's lifestyle programme ("Multiply").*

Excluding the impact of the expenses incurred by the newly acquired Sage, Advantage and Sovereign, the local insurance operations increased expenses by 14%. The offshore insurance operations reduced costs by relocating to Momentum's head office in South Africa. In addition, the comparative figure included the once-off Ansbacher disengagement costs, such as the cost of setting up a new license with the Financial Services Authority in the UK.

## RESULTS OF THE EMBEDDED VALUE CALCULATION

The embedded value of the Momentum Group increased from R11.8 billion at 30 June 2005 to R13.0 billion at 31 December 2005. This growth resulted mainly from the positive impact of increasing equity markets, and a 28% increase in the value of new business compared with the prior period. The embedded value profit for the period represents an annualised return of 27% on the opening embedded value at 30 June 2005. The analysis of the main components of the embedded value is reflected in the following table:

### Embedded value

| R million | 31 December 2005 | 30 June 2005 Pro forma[1] | 30 June 2005 as originally reported |
|---|---|---|---|
| Directors' valuation of shareholders' assets | **8 012** | 7 639 | 7 639 |
| Adjustment for move from published to statutory basis | **(32)** | (417) | – |
| Shareholders' net worth | **7 980** | 7 222 | 7 639 |
| Attributable to preference shareholders[2] | **(570)** | – | – |
| Ordinary shareholders' net worth | **7 410** | 7 222 | 7 639 |
| Value of in-force insurance business | **5 589** | 4 597 | 4 180 |
| Present value of future profits | **6 280** | 5 326 | 4 909 |
| Opportunity cost of capital | **(691)** | (729) | (729) |
| **Embedded value attributable to ordinary shareholders** | **12 999** | 11 819 | 11 819 |

*1. Effective from the current period, the value of in-force insurance business is calculated using the statutory valuation method for liabilities (as opposed to the published liability valuation basis previously).*

*2. The value of R570 million attributable to preference shareholders reflects the market value of the preference share issue of R500 million at 31 December 2005.*

The value of new business is a measure of the value added to the overall embedded value as a result of writing new business. The value of new business is set out in the following table:

### Value of new business

| R million | Six months ended 31 December 2005 | Six months ended 31 December 2004 | % change | Year ended 30 June 2005 |
|---|---|---|---|---|
| Present value of future profits | **277** | 211 | 31 | 421 |
| *Less:* Opportunity cost of capital | **(31)** | (19) | (55) | (53) |
| **Value of new business** | **246** | 192 | 28 | 368 |
| Annualised new business premiums | **1 191** | 965 | 23 | 1 973 |
| Margin | **20.7%** | 19.9% | | 18.7% |

The 28% increase in the value of new business is due to both an increase in new business volumes and an increase in new business margins. The new business margin, being the value of new business expressed as a percentage of new business premiums, totalled 20.7% for the period, compared with a margin of 19.9% for the same period in the prior year. The increased proportion of more profitable individual life risk products resulted in the increased margin.

The following table provides a reconciliation between the new business table set out later in this results announcement, and the new business inflows used in the calculation of the value of new business:

### New business inflows

| R million | Annualised recurring premiums | Lump-sum inflows |
|---|---|---|
| New business inflows per new business table | 689 | 25 694 |
| ***Less:* Items not valued:** | | |
| Policy alterations and other | (36) | (104) |
| Employee benefits (mainly asset managers' pooled funds and Lekana) | | (4 193) |
| Linked products – international | | (614) |
| Collective investments – local | | (6 926) |
| Collective investments – international | | (1 090) |
| Segregated third-party inflows | | (7 812) |
| ***Add:* Additional item valued** | | |
| Term extensions on maturing policies | 2 | 404 |
| **New business inflows included in value of new business** | **655** | **5 359** |

The following table provides an analysis of the embedded value profit for the six months into its main components:

### Analysis of movement in embedded value

| R million | Six months to 31 December 2005 |
|---|---|
| **Embedded value at 30 June 2005** | **11 819** |
| IFRS restatement of opening embedded value | 37 |
| **Embedded value profit** | **1 513** |
| Factors related to operations: | 717 |
| Value of new business | 246 |
| Expected return | 252 |
| Operating variations | 159 |
| National Treasury settlement | (131) |
| Assumption changes | 191 |
| Factors related to market conditions: | 796 |
| Investment return on shareholders' assets | 130 |
| Investment variations | 444 |
| Economic assumption changes | 146 |
| Changes in opportunity cost of capital | 76 |
| *Less:* Dividends paid | (300) |
| *Plus:* Capital raised | 500 |
| *Less:* Embedded value attributable to preference shareholders | (570) |
| **Embedded value attributable to ordinary shareholders at 31 December 2005** | **12 999** |

The following table reflects an alternative breakdown of the embedded value profit:

### Embedded value profit

| | Six months to 31 December 2005 |
|---|---|
| Change in shareholders' net worth | 521 |
| Earnings attributable to ordinary shareholders | 778 |
| Capital gains on shareholders' assets | (407) |
| Assumption changes | 120 |
| Reconciling items to statutory basis | 30 |
| Change in present value of future profits | 992 |
| **Embedded value profit** | **1 513** |

Details regarding the components of the experience assumption changes, the operating experience variations and the investment variations can be found in the comprehensive embedded value report which is available on FirstRand's website at www.firstrand.co.za.

The following table shows the main economic assumptions used in calculating the embedded value at 31 December 2005:

### Economic assumptions

| | 31 December 2005 % | 30 June 2005 % |
|---|---|---|
| Risk discount rate | **10.25** | 11.0 |
| Investment returns (before tax) | **8.75** | 9.5 |
| Expense inflation rate | **5.75** | 6.0 |

The investment return assumption of 8.75% per annum was determined with reference to the market interest rates on South African government stocks at 31 December 2005, taking into account the expected outstanding term of the in-force policy book. An annualised long-term asset distribution was used to calculate a weighted expected investment return, using the same methodology as at 30 June 2005.

Allowance was made for future tax based on the four-fund tax dispensation. Allowance was made for the effect of Capital Gains Tax ("CGT") at face value in the liability to policyholders under investment and insurance contracts. No allowance was made for CGT on strategic shareholders' assets as these are not held with the intention of ultimate disposal. Allowance was made for Secondary Tax on Companies on future dividends ultimately payable to shareholders.

## GROUP ASSETS UNDER MANAGEMENT OR ADMINISTRATION

The Momentum Group managed or administered total assets of R334.1 billion at 31 December 2005 compared with R269.5 billion at 30 June 2005, an increase of 24%. This increase is mainly due to the strong performance from investment markets as well as the acquisition of Sage. The following table provides an analysis of the assets managed or administered by Group companies:

### Assets under management or administration

| R billion | 31 December 2005 | 30 June 2005 | % change |
|---|---|---|---|
| On-balance sheet assets | **141.1** | 115.9 | 22 |
| Segregated third-party funds | **151.7** | 121.1 | 25 |
| Collective investment funds managed | **29.6** | 22.5 | 32 |
| Assets under management | **322.4** | 259.5 | 24 |
| Linked product assets under administration[1] | **11.7** | 10.0 | 17 |
| **Total assets under management or administration** | **334.1** | **269.5** | **24** |

*1. Excludes business written by the Momentum Group's Linked Product Packager on the life company's balance sheet, as these assets are reflected under on-balance sheet assets above. Total linked product assets under administration amounted to R25.3 billion (2005 : R21.1 billion).*

## New business

| R million | Unaudited Six months ended 31 December 2005 | 2004 | % change | Audited Year ended 30 June 2005 |
|---|---|---|---|---|
| Annualised recurring premiums[1] | 689 | 582 | 18 | 1 157 |
| Individual life | 569 | 469 | 21 | 946 |
| Employee benefits | 120 | 113 | 6 | 211 |
| Lump-sum inflows | 17 882 | 11 165 | 60 | 25 945 |
| Single premium endowments | 662 | 614 | 8 | 1 580 |
| Lump-sum annuities | 1 119 | 909 | 23 | 1 694 |
| Institutional policies | 300 | 323 | (7) | 474 |
| Employee benefit inflows | 4 818 | 2 519 | 91 | 5 023 |
| Linked products – Local[2] | 2 353 | 1 206 | 95 | 3 127 |
| Linked products – International | 614 | 1 152 | (47) | 2 494 |
| Collective investments – Local | 6 926 | 3 796 | 82 | 9 742 |
| Collective investments – International | 1 090 | 646 | 69 | 1 811 |
| Segregated third-party inflows | 7 812 | 9 835 | (21) | 15 587 |
| **Total new business inflows** | **26 383** | **21 582** | **22** | **42 689** |
| **Annualised new business inflows[3]** | **3 258** | **2 682** | **21** | **5 310** |

*1. Excludes automatic premium increases.*
*2. Includes inflows relating to products on the life insurance balance sheet totalling R1 040 million (2004: R555 million).*
*3. Represents annualised recurring premiums plus 10% of all lump-sum inflows.*
*All internal transfers of funds have been excluded from the above.*

### New business inflows
New business inflows for the six months totalled R26.4 billion, an increase of 22% compared with the prior period. New recurring premium business growth benefited from increased individual risk, investment and bancassurance business. Most of the lump- sum inflows showed strong growth, with new collective investments and linked product sales increasing significantly, in line with industry trends. A breakdown of the new business inflows is provided in the table above.

### Net flow of funds
The net flow of funds from clients decreased from R3.2 billion in the comparative period, to R1.3 billion in the current period, mainly due to a decrease in segregated third-party net flows. A significant portion of the decrease in net flow of funds from segregated third parties relates to a specific client who is converting from a defined benefit fund to a defined contribution fund. This client has moved its assets into cash in order to preserve value during the restructuring of the fund. This negative impact has been partly offset by significant net positive inflows in the linked products and collective investments businesses. All other product lines reflect an improvement in net fund flows, except the individual life business where a number of known maturities of guaranteed investment and offshore policies were experienced.

The following table sets out the components of this net inflow of funds, representing the total inflows set out below less the payments to clients:

### Net flow of funds

| R million | Unaudited Six months ended 31 December 2005 | 2004 | Audited Year ended 30 June 2005 |
|---|---|---|---|
| Individual life | (282) | (119) | 267 |
| Annuities | 73 | (53) | (209) |
| Institutional policies | (643) | (990) | (3 298) |
| Employee benefits | 1 421 | 1 033 | 1 409 |
| Short-term insurance | 2 | – | – |
| Linked products – Local | 1 643 | 501 | 1 445 |
| Linked products – International | 222 | (123) | 765 |
| Collective investments – Local | 1 422 | 714 | 3 007 |
| Collective Investments – International | 339 | (51) | 225 |
| Segregated third-party funds | (2 889) | 2 296 | (49) |
| **Total net flow of funds** | **1 308** | 3 208 | 3 562 |

## Total funds received from clients

Total funds received from clients, being the sum of the inflows from new and existing business, amounted to R29.2 billion, an increase of 21% over the prior period. The following table provides a summary of these inflows:

## Funds received from clients

| R million | Unaudited Six months ended 31 December **2005** | 2004 | % change | Audited Year ended 30 June 2005 |
|---|---|---|---|---|
| Recurring premium income | **3 440** | 2 921 | 18 | 5 558 |
| Individual life | **2 462** | 1 927 | 28 | 3 949 |
| Employee benefits | **975** | 983 | (1) | 1 597 |
| Institutional policies | **–** | 11 | (100) | 12 |
| Short-term insurance | **3** | – | – | – |
| Lump-sum inflows | **17 882** | 11 165 | 60 | 25 945 |
| Single premium endowments[1] | **662** | 614 | 8 | 1 580 |
| Lump-sum annuities | **1 119** | 909 | 23 | 1 694 |
| Institutional policies | **300** | 323 | (7) | 474 |
| Employee benefits | **4 818** | 2 519 | 91 | 5 023 |
| Linked products – Local | **2 353** | 1 206 | 95 | 3 127 |
| Linked products – International | **614** | 1 152 | (47) | 2 494 |
| Collective investments – Local | **6 926** | 3 796 | 82 | 9 742 |
| Collective investments – International | **1 090** | 646 | 69 | 1 811 |
| Segregated third-party inflows | **7 910** | 9 974 | (21) | 15 723 |
| **Total funds received from clients** | **29 232** | 24 060 | 21 | 47 226 |

*1. Single premiums exclude funds retained through the extension of the original policy term, amounting to R1 660 million (2004: R1 295 million). All internal transfers of funds have been excluded from the above.*

The increase in the individual life recurring premium income is mainly due to the inclusion of Sage recurring premium income for the four months from the effective acquisition date of 1 September 2005.

## Payments to clients

Payments to clients increased by 34% to R27.9 billion. The main reasons for the increase were the impact of higher equity markets on increased payout values, the maturity of a number of guaranteed and offshore products written in the high interest rate and weak Rand environment of 2000, and increased pension fund withdrawals due to multimanager portfolio restructuring and fund rebalancing. The total outflows to clients are shown in the following table:

## Payments to clients

| R million | Unaudited Six months ended 31 December **2005** | 2004 | % change | Audited Year ended 30 June 2005 |
|---|---|---|---|---|
| Individual life | **3 406** | 2 660 | 28 | 5 262 |
| Annuities | **1 046** | 962 | 9 | 1 903 |
| Institutional policies | **943** | 1 324 | (29) | 3 784 |
| Employee benefits | **4 372** | 2 469 | 77 | 5 211 |
| Short-term insurance | **1** | – | – | – |
| Linked products – Local[1] | **710** | 705 | 1 | 1 682 |
| Linked products – International | **392** | 1 275 | (69) | 1 729 |
| Collective investments – Local | **5 504** | 3 082 | 79 | 6 735 |
| Collective investments – International | **751** | 697 | 8 | 1 586 |
| Segregated third-party funds | **10 799** | 7 678 | 41 | 15 772 |
| Total payments to clients | **27 924** | 20 852 | 34 | 43 664 |

*1. Includes outflows relating to products on the life insurance balance sheet amounting to R330 million (2004: R282 million).*

## PROSPECTS

Momentum has experienced strong new business growth over the past two years, especially in individual risk recurring and retail lump-sum investments. Future growth in new business is likely to come from the enlarged agency force, as well as from the bancassurance initiatives together with FNB in the mass and middle-income markets. The extremely strong investment market growth experienced during the past two years is unlikely to continue, and any downward correction can impact negatively on profit growth. It should also be noted that the changes required in terms of IFRS will also result in increased volatility in future earnings.

The settlement reached with National Treasury, together with the recent reduction in Retirement Funds Tax announced by the Minister of Finance, represent significant steps towards the creation of a favourable savings environment.

Momentum is confident that through a combination of innovative product design, strong distribution partnerships and exciting new initiatives, it can continue to grow operational earnings in line with the internal target of CPIX plus 10%.

| | |
|---|---|
| **LL Dippenaar** | **EB Nieuwoudt** |
| Chairman | Managing Director |

20 February 2006

**Momentum Group Limited**
Registration number: 1904/002186/06

**Postal address**
PO Box 7400
Centurion
0046
Telephone: (012) 671-8911

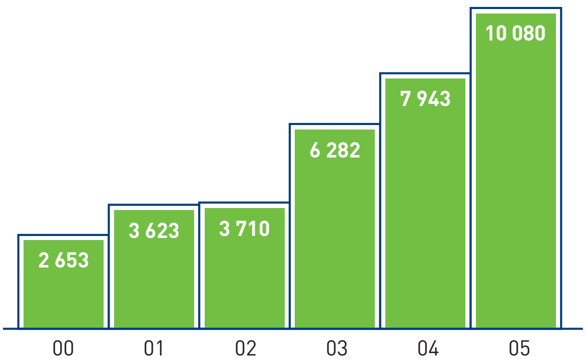
# DISCOVERY

## INTRODUCTION

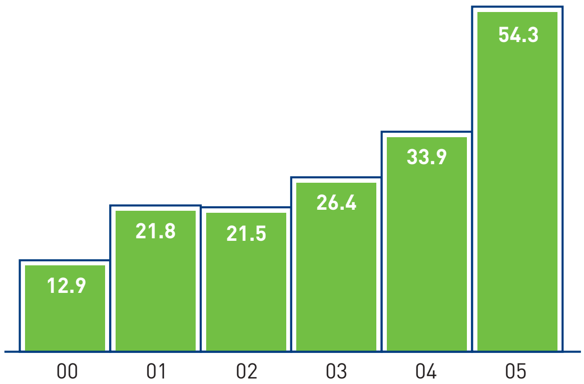
This report reflects the operating results and financial position of Discovery which holds the health and certain related insurance interests of the FirstRand Limited group of companies. Discovery is 66.5% held by FirstRand (2004: 65.7%) and is listed on the JSE Limited. This report should be read in conjunction with the report on FirstRand Limited and is a summary of Discovery's Announcement to shareholders published on 23 February 2006.

## FINANCIAL HIGHLIGHTS

**Embedded value**
(R million)




**Diluted headline earnings per share before BEE expenses**
(Cents)




| | |
|---|---|
| Operating profit | +32% to R526 million |
| Post-tax profits | +73%, after BEE deal -1% |
| New business of | R2.1 billion |
| Embedded value | +27% to R10 billion |

# Income statement

for the six months ended 31 December 2005

| R million | **Unaudited Group Six months ended December 2005** | Unaudited Group Six months ended December 2004 | % change | Audited Group Year ended June 2005 |
|---|---|---|---|---|
| Premium income | **1 277** | 824 | | 1 820 |
| Other income | **1 246** | 1 016 | | 2 209 |
| Gross income of Group | **2 523** | 1 840 | | 4 029 |
| Outward reinsurance premiums | **(229)** | (145) | | (378) |
| Investment income | **105** | 85 | | 124 |
| Realised and unrealised gains and losses | **118** | 82 | | 157 |
| **Net income** | **2 517** | 1 862 | | 3 932 |
| Policyholder benefits | **(681)** | (370) | | (841) |
| Recoveries from reinsurers | **201** | 99 | | 262 |
| **Net policyholder benefits** | **(480)** | (271) | | (579) |
| Acquisition costs | **(440)** | (363) | | (714) |
| Operating and administration expenses | **(1 288)** | (1 034) | | (2 166) |
| Transfer from assets/liabilities under insurance contracts | **293** | 296 | | 574 |
| Fair value adjustment to liabilities under investment contracts | **(76)** | (91) | | (122) |
| **Profit from operations before BEE expenses** | **526** | 399 | 32 | 925 |
| Local operations | **668** | 517 | | 1 154 |
| Foreign operations | **(142)** | (118) | | (229) |
| BEE expenses | **(144)** | – | | – |
| **Profit from operations after BEE expenses** | **382** | 399 | | 925 |
| Financing costs | **(10)** | (28) | | (64) |
| Foreign exchange loss – unrealised | **–** | (33) | | (8) |
| **Profit before taxation** | **372** | 338 | 10 | 853 |
| Taxation | **(178)** | (143) | | (305) |
| **Profit after taxation** | **194** | 195 | (1) | 548 |
| Attributable to: | | | | |
| – ordinary shareholders | **194** | 195 | | 557 |
| – minority shareholders | **–** | – | | (9) |
| | **194** | 195 | | 548 |
| Basic earnings per share (cents) | | | | |
| – undiluted | **36.8** | 37.7 | (2) | 107.3 |
| – diluted | **35.9** | 36.7 | (2) | 103.0 |
| Weighted number of shares in issue (000's) | **528 468** | 518 793 | | 519 188 |
| Diluted weighted number of shares (000's) | **553 749** | 549 271 | | 553 227 |

# Balance sheet

at 31 December 2005

| R million | **Unaudited Group December 2005** | Audited Group June 2005 |
|---|---|---|
| **ASSETS** | | |
| Cash and cash equivalents | **1 031** | 916 |
| Money market | | |
| – available-for-sale | **55** | 53 |
| – at fair value through profit and loss | **110** | 106 |
| Government and public authority stocks | | |
| – available-for-sale | **147** | 146 |
| – at fair value through profit and loss | **49** | 40 |
| Equity investments | | |
| – available-for-sale | **1 142** | 922 |
| – at fair value through profit and loss | **407** | 337 |
| Investment in associate | **7** | 4 |
| Investment assets | **2 948** | 2 524 |
| Loans and receivables | **483** | 557 |
| Deferred taxation | **43** | 35 |
| Assets arising from insurance contracts | **2 186** | 1 881 |
| Intangible assets | **49** | 45 |
| Property and equipment | **216** | 219 |
| **Total assets** | **5 925** | 5 261 |
| **LIABILITIES AND SHAREHOLDERS' FUNDS** | | |
| **Liabilities** | | |
| Trade and other payables | **995** | 951 |
| Provisions | **31** | 30 |
| Taxation | **37** | 17 |
| Deferred taxation | **421** | 323 |
| Financial liabilities | **710** | 619 |
| – Investment contracts at fair value through profit and loss | **554** | 483 |
| – Borrowings at amortised cost | **156** | 136 |
| Liabilities arising from insurance contracts | **12** | – |
| Liabilities arising from reinsurance contracts | **27** | 31 |
| **Total liabilities** | **2 233** | 1 971 |
| **Shareholders' funds** | | |
| Share capital and share premium | **1 346** | 1 336 |
| Reserves | **2 346** | 1 887 |
| | **3 692** | 3 223 |
| Minority interest | **–** | 67 |
| Total shareholders' funds | **3 692** | 3 290 |
| **Total liabilities and shareholders' funds** | **5 925** | 5 261 |

# Segmental information

for the six months ended 31 December 2005

| R million | Health: South Africa | Health: United States of America | Health: United Kingdom | Life | Vitality | Holdings | Total |
|---|---|---|---|---|---|---|---|
| **31 December 2005** | | | | | | | |
| New business annualised premium income | 1 211 | 383 | 77 | 392 | 51 | – | 2 114 |
| Gross inflows under management | 7 874 | 647 | 43 | 820 | 315 | – | 9 699 |
| **Income statement** | | | | | | | |
| Gross income of Group | 931 | 436 | 21 | 820 | 315 | – | 2 523 |
| Outward reinsurance premiums | (2) | (45) | – | (182) | – | – | (229) |
| Investment income | 15 | 3 | 3 | 79 | 4 | 1 | 105 |
| Realised and unrealised gains and losses | – | – | – | 118 | – | – | 118 |
| Net policyholder benefits | (5) | (339) | (15) | (121) | – | – | (480) |
| Acquisition costs | – | (22) | (2) | (382) | (34) | – | (440) |
| Operating and administration expenses | (658) | (110) | (72) | (182) | (265) | (1) | (1 288) |
| Transfer from assets/liabilities arising from insurance contracts | – | – | – | 216 | – | – | 216 |
| Fair value adjustment to liabilities under investment contracts | – | – | – | (76) | – | – | (76) |
| Return on assets arising from insurance contracts | – | – | – | 77 | – | – | 77 |
| Profit/(Loss) from operations before BEE expenses | 281 | (77) | (65) | 367 | 20 | – | 526 |
| BEE expenses | | | | | | | (144) |
| Financing costs | | | | | | | (10) |
| Profit before taxation | | | | | | | 372 |
| **Cash flow statement** | | | | | | | |
| Cash generated by operations | 327 | (90) | (73) | (64) | 19 | (1) | 118 |
| Cash flow from financing activities | – | (39) | – | – | – | 6 | (33) |
| **31 December 2004** | | | | | | | |
| New business annualised premium income | 1 175 | 409 | 5 | 332 | 36 | – | 1 957 |
| Gross inflows under management | 6 884 | 375 | * | 587 | 234 | – | 8 080 |
| **Income statement** | | | | | | | |
| Gross income of Group | 782 | 237 | * | 587 | 234 | – | 1 840 |
| Outward reinsurance premiums | (2) | (3) | – | (140) | – | – | (145) |
| Investment income | 17 | 1 | 2 | 61 | 4 | – | 85 |
| Realised and unrealised gains and losses | – | – | – | 82 | – | – | 82 |
| Net policyholder benefits | (3) | (171) | * | (97) | – | – | (271) |
| Acquisition costs | – | (20) | * | (325) | (18) | – | (363) |
| Operating and administration expenses | (532) | (84) | (80) | (131) | (207) | – | (1 034) |
| Transfer from assets/liabilities under insurance contracts | – | – | – | 232 | – | – | 232 |
| Fair value adjustment to liabilities under investment contracts | – | – | – | (91) | – | – | (91) |
| Return on assets arising from insurance contracts | – | – | – | 64 | – | – | 64 |
| Profit/(Loss) from operations | 262 | (40) | (78) | 242 | 13 | – | 399 |
| Financing costs | | | | | | | (28) |
| Foreign exchange loss – unrealised | | | | | | | (33) |
| Profit before taxation | | | | | | | 338 |
| **Cash flow statement** | | | | | | | |
| Cash generated by operations | 316 | (27) | (77) | 80 | 15 | – | 307 |
| Cash flow from financing activities | – | 42 | – | – | – | 17 | 59 |

**Amount is less than R500 000*

# Executive review of Group results

Discovery's core purpose is to make people healthier and enhance and protect their lives. Discovery's business model revolves around our ability to understand consumer needs and develop products that meet them, positioning Discovery well to capitalise on the worldwide trend towards consumerism. The result is a modern insurance organisation that has grown organically through four distinct businesses built around people's needs.

During the six months under review, we have worked hard to drive this people-centred vision in our local businesses. Discovery Health's consumer-driven health care model provides the platform for health assurance products that place consumers in control of their health care spending. In the case of Discovery Life, we have responded to consumers' demand for flexible life assurance products that meet their benefit expectations. In our international operations, Destiny Health and PruHealth, our focus has been on unlocking our unique consumer-driven health care capability in the context of new, global markets.

Operating profits for the Group grew strongly by 32% during the period under review to R526 million (2004: R399 million), despite a disappointing performance from Destiny Health and before the once-off expense associated with our recent BEE transaction. PruHealth grew strongly and in line with expectations, achieving the 35 000 lives milestone as forecast. Discovery Health's annualised new business premium grew by 8%, off a high base, while Discovery Life achieved new business growth of 18% and a 29% increase in profit.

## PRUHEALTH

In October 2004, we launched PruHealth in partnership with Prudential plc, with the aim of creating a company that would lead the trend towards consumerism in the UK private medical insurance market. To date, PruHealth's performance has been exceptional. The investment in PruHealth of R68 million (2004: R80 million) and new business growth of R77 million (2004: R5 million) over the period were in line with our forecasts.

The growth in PruHealth's distribution footprint and operational capability has exceeded our expectations. We believe this reflects the combination of an elegant, easy-to-use product that is attractive to consumers on the one hand and, on the other, the rapid, effective roll-out of Discovery's operational framework to support product distribution and operations. PruHealth has quickly developed a nationwide Vitality footprint, providing clients with access to Vitality wellness benefits across the UK. We have also been encouraged by the significant broker support across the market by well-known intermediary brands and PruHealth's ability to attract young and healthy lives.

This combination of product and back-office efficiency has allowed us to gain a significant competitive price advantage, further bolstering our growth opportunities. The result is a business of exceptional quality that, despite its small size, has proven its ability to compete against traditional, established players, generating strong new business flows at an acceptable medical loss ratio. Based on its strong foundational position, we are cautiously optimistic of the outlook for PruHealth and have set a bold short-term goal of 100 000 lives by 1 January 2007.

## DESTINY HEALTH

To our disappointment, the period under review saw further operational losses of R80 million (2004: R41 million) for Destiny Health. While new business growth has been strong in the Mid-Atlantic, Wisconsin and Massachusetts markets, the underlying market dynamics in Illinois have negatively impacted Destiny. The operating losses incurred are attributable to slower than anticipated expansion into new markets and an over-concentration in the Illinois market, where a significant pricing disadvantage exists relative to the dominant insurer in that market. This placed Destiny under increasing price pressure, resulting in increased lapses and underwriting losses during the period under review. Destiny Health's progress in the three other markets it competes in has demonstrated that our focus must be on rapid expansion into new markets and on providing the technical sales infrastructure to support new business growth in these new markets.

The strategy which has exposed Destiny to a concentration of risk within the Illinois market has been addressed during the period under review with a view to rapidly reversing the negative financial trend in Destiny's results. Premiums have been significantly increased at policy renewal dates and expansion plans have been accelerated to address the claims losses and market concentration in Illinois. Initial results are promising: the rates adjustments are translating into lower loss ratios with target retention rates having been achieved and we have been operational in the Texas market since 31 January 2006, where we have received a positive response.

The category of consumer-driven health care is gaining increasing support in the US, especially at a national health policy level, creating favourable conditions for Destiny Health; this is especially true of the Texas market. Combined with the power of Discovery's consumer-driven health care capability and our joint ventures with Guardian and Tufts Health Plan, we believe there are significant opportunities for Destiny Health in the year ahead.

A rigorous, disciplined approach to the measurement and evaluation of Destiny's progress is being applied on a quarterly basis. The immediate short-term target is to achieve a run-rate of 3 000 new members per month and consistently improve quarter-on-quarter financial results. We remain cautiously optimistic that the achievement of these goals will lead to a viable business and profitability in the medium term.

## DISCOVERY HEALTH

Discovery Health continues to deliver robust growth and financial performance with operating profit increasing by 9% to R266 million (2004: R245 million), despite a reduction in real terms of administration fees and loss of reinsurance income over time. The combined membership of the schemes under Discovery Health's administration grew to 1 883 879 as at 1 January 2006 (2005: 1 704 240 members). This reflects continued growth in new business to R1 211 million (2004: R1 175 million) – which, coming off a high base has exceeded our expectations – as well as a reduction in the lapse rate to 3.3% (2004: 3.7%).

Over the last 13 years, Discovery Health has demonstrated a capability to deliver innovative products that empower the consumer combined with the ability to navigate a complex, evolving regulatory environment. Going forward, Discovery Health must use its leadership position to ensure access to the best quality of care for its members. This is a function of Discovery Health's unmatched scale, which in the period under review manifested in the launch of the Discovery 911 emergency response network, the Discovery Hospital Rating Index (an objective cost and quality assessment tool), as well as successful negotiations with various provider groups to contain cost increases into 2006. Evidence is also starting to emerge establishing the value of Vitality's role in lowering health care costs.

By combining its scale and focus on lowering health care spend by promoting healthy lifestyles, Discovery Health is able to operate at a discount to its competitors. Coupled with its unique footprint and the quality of its client base, Discovery Health is well-positioned to continue delivering growth and more affordable access to quality health care in its existing market. In addition, these attributes position Discovery Health well to capitalise on developments in the emerging and low income markets. Discovery's KeyCare product (aimed at the R3 500 – R6 500 income market) now exceeds 100 000 members, more than half of which are new entrants to the private health care industry and the development of Discovery Health's primary care network has progressed well with over 1 500 doctors now represented within the network.

Operationally, Discovery Health's performance is at the best levels ever – from service to customer retention to the ability to manage costs on behalf of our members. A significant focus has been applied to improving efficiencies and enhancing service further during the period under review. The front-line servicing and back-office operations, representing over 2 000 staff members, have recently been merged to support this strategy and generate annualised administrative savings in excess of R50 million over the next 12 months.

## DISCOVERY LIFE

Discovery Life's performance has exceeded expectations with operating profit growing 29% to R246 million (2004: R190 million) and new business growing 18% to R392 million (2004: R332 million). Unlike other players in the market who employ a bancassurance model that centres on investments and cross-selling, Discovery Life has adopted a "health-assurance" model. This model integrates our health management capabilities with Discovery's risk management expertise. The ability to accurately price health risk and encourage health improvements through integration with Vitality and Discovery Health, has translated into better-than-expected mortality and morbidity rates, resulting in exceptional growth in underwriting profits during the period under review from R126 million to R216 million.

The same health insurance mindset has informed our entry into the investment market with the Discovery Life retirement Optimiser. The Optimiser makes use of "unneeded" life assurance post-retirement to fund much needed retirement income and provides real guarantees regarding benefit expectations. We are already seeing the Optimiser gain traction, with an estimated 17% of the retirement funding business written by independent brokers being written with Discovery Life, just six months after the launch of the Optimiser product.

We are cautiously optimistic about Discovery Life's future prospects.

In addition to growing its primary risk assurance business by continuing to leverage the integration opportunities with other Discovery products and businesses, Discovery Life will aim to solidify its entry into the retirement funding market by securing 20% of the independent broker new business market during the current financial year.

## THE FUTURE

While each of Discovery's businesses is at a different stage of its evolution, we are cautiously optimistic of their future growth prospects.

# Financial commentary

Gross inflows under management, increased 20% for the six months ended 31 December 2005. Gross inflows under management includes flows of the schemes Discovery administers and 100% of the business conducted together with its joint venture partners.

## Gross inflows under management

| R million | December 2005 | December 2004 | % change |
|---|---|---|---|
| Discovery Health | **7 874** | 6 884 | 14 |
| Discovery Life | **820** | 587 | 40 |
| Discovery Vitality | **315** | 234 | 35 |
| Destiny Health | **647** | 375 | 73 |
| PruHealth | **43** | – | – |
| Gross inflows under management | **9 699** | 8 080 | 20 |
| *Less:* collected on behalf of third parties | **(7 176)** | (6 240) | |
| Discovery Health | **(6 943)** | (6 102) | |
| Destiny Health | **(211)** | (138) | |
| PruHealth | **(22)** | – | |
| Gross income of Group | **2 523** | 1 840 | 37 |

The following table shows the main components of the increase in profit from operations before BEE expense for the six months:

## Earnings source

| R million | December 2005 | December 2004 | % change |
|---|---|---|---|
| Discovery Health | **266** | 245 | 9 |
| Discovery Life | **246** | 190 | 29 |
| Discovery Vitality | **16** | 9 | 78 |
| Destiny Health | **(80)** | (41) | (95) |
| PruHealth | **(68)** | (80) | 15 |
| Discovery Holdings | **(1)** | – | – |
| Profit from operations before investment income | **379** | 323 | 17 |
| Investment income | **105** | 85 | |
| Realised and unrealised gains and losses | **118** | 82 | |
| Fair value adjustment to liabilities under investment contracts | **(76)** | (91) | |
| Profit from operations before BEE expense | **526** | 399 | 32 |

## HEADLINE EARNINGS

Headline earnings in compliance with International Financial Reporting Standards ("IFRS") increased by 64%, excluding the impact of the BEE transaction.

Unrealised gains of R155 million on available-for-sale investments for the six months have been taken directly to equity and are not included in earnings or headline earnings.

The reconciliation between earnings and headline earnings is shown below:

| R million | December 2005 | December 2004 | % change |
|---|---|---|---|
| Net profit attributable to ordinary shareholders pre-IFRS and other adjustments | **356** | 206 | 73 |
| Adjustments for: | | | |
| *IFRS 2:* Share-based payments | **(157)** | (7) | |
| Leases | **(5)** | (4) | |
| Net profit attributable to ordinary shareholders post-IFRS and other adjustments | **194** | 195 | (1) |
| Adjustment for realised profit on available-for-sale investments net of CGT | **(42)** | (15) | |
| Headline earnings | **152** | 180 | (16) |
| Headline earnings per share (cents): | | | |
| – undiluted | **28.8** | 34.7 | (17) |
| – diluted | **28.3** | 33.9 | (17) |
| Headline earnings before BEE transaction | **296** | 180 | 64 |
| Headline earnings per share before BEE transaction (cents): | | | |
| – undiluted | **56.1** | 34.7 | 62 |
| – diluted | **54.3** | 33.9 | 60 |

## TAXATION

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

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

## INVESTMENTS

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

## BALANCE SHEET

The increase in the assets arising from insurance contracts of R305 million is as a result of profitable new business written by Discovery Life.

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

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

## BEE TRANSACTION

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

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

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

Discovery has early adopted IFRIC 8, resulting in a charge to the income statement of R144 million in the six-month period ending 31 December 2005. This charge represents the financial effects of the BEE transaction.

An additional R13 million in respect of options granted under employee share incentive schemes has been expensed in the income statement in accordance with the requirements of IFRS 2.

## ACCOUNTING POLICIES

The interim financial statements have been prepared in accordance with IFRS as well as the South African Companies Act, 1973. This may differ from IFRS actually in effect at 30 June 2006 as a result of ongoing review and possible amendment by interpretive guidance from the International Accounting Standards Board and IFRIC and may therefore be subject to change.

These are Discovery's first IFRS interim financial statements and the provisions of IFRS 1 "First-time Adoption of International Financial Reporting Standards", have been applied. The interim financial statements do not include all of the information required for full annual financial statements.

Shareholders are referred to the Discovery Holdings' IFRS announcement published on 23 February 2005 regarding details of the financial restatement impact as a consequence of the IFRS adoption.

## DIVIDEND POLICY AND CAPITAL

The directors have recommended that no dividend be paid on ordinary shares. The directors are of the view that the Discovery Group is adequately capitalised at this time. On the statutory basis the capital adequacy requirements of Discovery Life were R91.2 million (2004: R65 million) and were covered 12.7 times (2004: 14.9 times).

## DIRECTORATE

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

## EMBEDDED VALUE STATEMENT

for the six months ended 31 December 2005

The embedded value of Discovery at 31 December 2005 is calculated as the sum of the following components:

- the excess assets over liabilities at the valuation date; and
- the value of in-force business at the valuation date (less an allowance for the cost of capital).

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

In the past, Life has based their embedded value on the Financial Soundness Valuation Method ("FSV"). A change in actuarial guidance note (PGN107) effective for interim reporting dates after 31 December 2005 now requires Life Insurers to base the embedded value on the Statutory Valuation Method ("SVM"). The key difference between the two bases for Discovery Life is that the negative reserves calculated on the FSV basis are zeroised under the Statutory Valuation Method. Discovery has adopted this new guidance note for the interim results presented here. The net asset value has been adjusted to reflect the zeroisation of the Life negative reserve in the statutory accounts. The net asset value is thus reduced compared to the amount shown on the Balance Sheet. This has resulted in a significant decrease in the capital adequacy requirement underlying the calculation of the cost of capital. The value capitalised in the negative reserve on the Financial Soundness Valuation basis is released in the value of in-force of the Statutory Valuation Method over time.

The value of in-force and the value of new business at 31 December 2005 are shown on both the SVM and the FSV bases to allow comparison to prior periods.

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

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

PricewaterhouseCoopers Inc. has reviewed the methodology and assumptions used to determine the value of in-force business and the value of new business and have confirmed that, overall, they are reasonable.

## Group embedded value

| R million | Six months to 31 December 2005 SVM basis | Six months to 31 December 2005 FSV basis | Six months to 31 December 2004 | % change | Twelve months to 30 June 2005 |
|---|---|---|---|---|---|
| Shareholders' funds | 3 692 | 3 692 | 2 840[1] | 30 | 3 290[1] |
| Minority interest | – | – | (67) | | (67) |
| Negative reserve zeroised | (1 877) | – | – | | – |
| Shareholders' funds excluding negative reserves | 1 815 | 3 692 | 2 773 | | 3 223 |
| Value of in-force business before cost of capital | 8 466 | 7 028 | 5 604 | | 6 483 |
| Cost of capital | (201) | (675) | (434) | | (533) |
| **Discovery Holdings' embedded value** | **10 080** | **10 045** | **7 943** | **27** | **9 173** |
| Number of shares (millions) | 529.1 | 529.1 | 520.1 | | 528.2 |
| Embedded value per share | R19.05 | R18.98 | R15.27 | 25 | R17.37 |
| Diluted number of shares (millions) | 553.2 | 553.2 | 553.2 | | 553.2 |
| Diluted embedded value per share[2] | R18.56 | R18.49 | R14.62 | 27 | R16.93 |

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

*2. 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 outstanding shares relating to the redemption value of the Discovery Life preference shares, as well as by the number of shares issued to the share incentive trust which have not been delivered to participants. No allowance has been made for Discovery's BEE transaction as the impact would be anti-dilutive due to the transaction price exceeding the current embedded value per share.*

## Value of in-force business

| R million | Value before cost of capital | Cost of capital | Value after cost of capital |
|---|---|---|---|
| at 31 December 2005 – SVM basis | | | |
| Health and Vitality | 3 953 | – | 3 953 |
| Life[1] | 4 334 | (183) | 4 151 |
| Destiny Health[2] | 179 | (18) | 161 |
| Total | 8 466 | (201) | 8 265 |
| at 31 December 2005 – FSV basis | | | |
| Health and Vitality | 3 953 | – | 3 953 |
| Life[1] | 2 896 | (657) | 2 239 |
| Destiny Health[2] | 179 | (18) | 161 |
| Total | 7 028 | (675) | 6 353 |
| at 30 June 2005 | | | |
| Health and Vitality | 3 844 | – | 3 844 |
| Life[1] | 2 349 | (517) | 1 832 |
| Destiny Health[2] | 290 | (16) | 274 |
| Total | 6 483 | (533) | 5 950 |

*1. On the SVM basis, the Life cost of capital is based on a capital adequacy requirement of R92 million. On the FSV basis, the Life cost of capital is based on a capital adequacy requirement of R1.881 million (December 2004: R883 million on the FSV basis; R65 million on the SVM basis).*

*2. Figures for Destiny Health reflect Discovery's 97.92% shareholding in Destiny Health at 31 December 2005.*

## Group embedded value earnings

| R million | Six months to **31 December 2005** | Six months to 31 December 2004 | Twelve months to 30 June 2005 |
|---|---|---|---|
| Embedded value at end of period | **10 080** | 7 943 | 9 173 |
| Embedded value at beginning of period | **9 173** | 6 832 | 6 832 |
| Increase in embedded value | **907** | 1 111 | 2 341 |
| Net issue of capital | **(10)** | (17) | (60) |
| Dividends paid to Destiny Health preference shareholders | **–** | 1 | 1 |
| Transfer to/(from) hedging reserve | **3** | (6) | (9) |
| Embedded value earnings | **900** | 1 089 | 2 273 |
| Annualised return on embedded value | **20.6%** | 34.4% | 33.3% |

## Components of Group embedded value earnings

| R million | Six months to 31 December 2005 | 31 December 2004 | % change | Twelve months to 30 June 2005 |
|---|---|---|---|---|
| Total profit from new business (at point of sale) | **379** | 375 | 1 | 783 |
| Profit from existing business | | | | |
| – Expected return | **342** | 286 | | 602 |
| – Change in methodology and assumptions[1] | **(35)** | 315 | | 307 |
| – Experience variances | **71** | 56 | | 363 |
| Acquisition costs[2] | **(58)** | (60) | | – |
| PruHealth start-up costs | **(56)** | (64) | | (120) |
| Adjustment for minority interest in Destiny Health | **3** | 1 | | 4 |
| Adjustment for Guardian profit share in Destiny Health[3] | **(8)** | (9) | | (28) |
| Foreign exchange rate movements | **(18)** | (38) | | 43 |
| Interest on loan capital | **–** | (20) | | (50) |
| IFRS adjustment | **–** | (4) | | (8) |
| Return on shareholders' funds[4] | **280** | 251 | | 377 |
| Embedded value earnings | **900** | 1 089 | | 2 273 |

1. *The change in methodology and assumptions item will vary over time to reflect adjustments to the model and assumptions as a result of changes to the operating and economic environment. The current period's changes are described in detail in the table below (for previous periods refer to previous embedded value statements).*
2. *A large proportion of Health and Vitality new business was written over the period but only activated on 1 January 2006. Acquisition costs of R45 million (December 2004: R37 million) arise in respect of these members who are not included in the embedded value calculation. Similarly, acquisition costs of R13 million (December 2004: R15 million) arise for Destiny Health.*
3. *In terms of the agreement between Destiny Health and the Guardian Life Insurance Company of America, Guardian will share in 50% of the profits from business written by Destiny Health prior to the agreement with Guardian (ie non-alliance business) once the business written by Guardian reaches the contractual new member threshold. Based on Guardian's progress towards achieving this target, the value attributed to Destiny Health's non-alliance business has been reduced by 33.1% (June 2005: 26.3%) in the embedded value calculation.*
4. *Return on shareholders' funds is shown net of tax and management charges and includes the return on assets under insurance contracts.*

## Methodology and assumption changes

for the six months ended 31 December 2005

| R million | Health and Vitality: Net worth | Health and Vitality: Value of in-force | Destiny Health: Net worth | Destiny Health: Value of in-force | Life: Net worth | Life: Value of in-force | Total |
|---|---|---|---|---|---|---|---|
| Modelling changes[1] | – | – | – | 20 | (1 559) | 1 603 | 64 |
| Lapses | – | – | – | (44) | (33) | (28) | (105) |
| Economic assumptions | – | 71 | – | – | (1) | 113 | 183 |
| Contribution increases | – | – | – | 51 | – | – | 51 |
| Administration fees[2] | – | (74) | – | – | – | – | (74) |
| Expenses[3] | – | (71) | – | (82) | – | – | (153) |
| Mortality and morbidity | – | – | – | (51) | – | – | (51) |
| Vitality benefits[4] | – | 74 | – | – | – | – | 74 |
| Tax[5] | – | – | – | – | – | (23) | (23) |
| Other | – | – | – | (1) | 0 | 0 | (1) |
| Total | – | 0 | – | (107) | (1 593) | 1 665 | (35) |

1. *The Life modelling change includes a R1.555 million decrease in the net worth and a R1.604 million increase in the value of in-force in respect of the change from the Financial Soundness Valuation basis to the Statutory Valuation Method used to calculate the embedded value. The R1.604 million increase in the value of in-force includes a reduction of R404 million in the cost of capital.*
2. *The Health administration fee change relates to an expected below CPIX increase in Discovery Health Medical Scheme administration fees for 2007.*
3. *The Health, Vitality and Destiny Health renewal expense assumption change is based on the results of the most recent expense analysis (31 December 2005).*
4. *The Health and Vitality assumption change includes an allowance for a reduction in the expected benefit cost on Vitality in line with recent experience.*
5. *The tax variance reflects the movements in the value of the tax deferral.*

## Experience variances

for the six months ended 31 December 2005

| R million | Health and Vitality Net worth | Health and Vitality Value of in-force | Destiny Health Net worth | Destiny Health Value of in-force | Life Net worth | Life Value of in-force | Total |
|---|---|---|---|---|---|---|---|
| Renewal expenses | (8) | – | (16) | – | 3 | – | (21) |
| Other expenses[1] | – | – | (2) | – | (10) | – | (12) |
| Inflation[2] | – | (72) | – | – | (3) | 9 | (66) |
| Extended modelling term[3] | – | 94 | – | 13 | – | 3 | 110 |
| Lapses[4] | 4 | 82 | 3 | (45) | (20) | 2 | 26 |
| Policy alterations[5] | – | 4 | – | 3 | 55 | 16 | 78 |
| Mortality and morbidity | – | – | (67) | – | 50 | 2 | (15) |
| Premium variance | – | – | – | – | (16) | – | (16) |
| Commission[6] | – | – | – | – | (8) | – | (8) |
| Other | 5 | 14 | 0 | (9) | (8) | (7) | (5) |
| Total | 1 | 122 | (82) | (38) | 43 | 25 | 71 |

1. *For Destiny Health, other expenses are in respect of Texas office set-up and relocation costs. For Life, the non-recurring expenses relate to costs incurred as a result of the proposed venture with Prudential in the UK.*
2. *The negative variance for Health and Vitality is due to a lower 2006 increase in the Health administration fees compared with that assumed in June 2005.*
3. *The projection term for Health, Vitality, Destiny Health and Group Life at 31 December 2005 has not been changed from that used at 30 June 2005. Thus, an experience variance arises because the total term of the in-force business is effectively increased by six months.*
4. *Included in the Health and Vitality lapse experience variance is an amount of R158 million in respect of members joining existing employer groups during the period, offset by an amount of R114 million in respect of members leaving existing employer groups. A positive variance of R42 million is due to lower than expected lapses.*
5. *The Life policy alterations include the positive effect of existing policies adding the Discovery Retirement Optimiser.*
6. *The commission variance includes a provision for bad debts on commission clawbacks.*

## Embedded value of new business

| R million | Six months to 31 December 2005 SVM basis | 31 December 2005 FSV basis | 31 December 2004 | % change | Twelve months to 30 June 2005 |
|---|---|---|---|---|---|
| Health and Vitality | | | | | |
| Gross profit from new business at point of sale | 60 | 60 | 67 | | 229 |
| Cost of capital | – | – | – | | – |
| Net profit from new business at point of sale | 60 | 60 | 67 | (10) | 229 |
| New business annualised premium income[1] | 369 | 369 | 424 | (13) | 1 734 |
| Life | | | | | |
| Gross profit from new business at point of sale | 332 | 414 | 369 | | 676 |
| Cost of capital | (27) | (98) | (78) | | (157) |
| Net profit from new business at point of sale | 305 | 316 | 291 | 5 | 519 |
| New business annualised premium income[2] | 276 | 276 | 245 | 13 | 470 |
| Annualised profit margin[3] | 13.3% | 13.6% | 14.3% | | 13.5% |
| Destiny Health | | | | | |
| Gross profit from new business at point of sale | 15 | 15 | 17 | | 36 |
| Cost of capital[4] | (1) | (1) | (0) | | (1) |
| Net profit from new business at point of sale[5] | 14 | 14 | 17 | (18) | 35 |
| New business annualised premium income[1] | 246 | 246 | 250 | (2) | 603 |
| New business annualised premium income (US$ million) | 38 | 38 | 41 | (7) | 97 |

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

   *The new business annualised premium income shown above has been adjusted to exclude premiums in respect of members who join an existing employer after the first year, as well as premiums in respect of new business written during the period but only activated after 31 December 2005.*

   *The total Health and Vitality new business annualised premium income written over the period was R1.262 million (December 2004: R1.211 million). For Destiny Health, the total new business annualised premium income written over the period was R383 million (December 2004: R411 million).*
2. *Life new business annualised premium income of R276 million shown above is net of automatic premium increases and servicing increases in respect of existing business. The total Life new business annualised premium income written over the period, including both automatic premium increases of R49 million and servicing increases of R67 million was R392 million. Single premium business is included at 10% of the value of the single premium.*
3. *The annualised profit margin is the value of new business expressed as a percentage of the present value of future premiums.*
4. *As most of the new business is written on the Guardian and Tufts insurance licences, Destiny Health is not required to hold statutory capital for this business. An explicit charge for the use of their capital is payable to Guardian and Tufts, and this cost is deducted from gross profit in the new business calculation.*
5. *The Destiny Health value of new business allows for the actual new business expenses incurred over the six-month period. Actual new business expenses include infrastructure development costs related to developing new business capacity. No allowance has been made for acquisition cost efficiencies which are expected to occur in the future.*

## Embedded value assumptions

| % | 31 December 2005 | 31 December 2004 | 30 June 2005 |
|---|---|---|---|
| Risk discount rate | | | |
| – Health and Vitality | **10.25** | 11.00 | 11.00 |
| – Life | **10.25** | 11.00 | 11.00 |
| – Destiny Health | **10.00** | 10.00 | 10.00 |
| Medical inflation | | | |
| South Africa | **6.75** | 7.00 | 7.00 |
| United States | **Current levels reducing to 12.50% over the projection period** | Current levels reducing to 12.50% over the projection period | Current levels reducing to 12.50% over the projection period |
| Expense inflation | | | |
| South Africa | **3.75** | 4.00 | 4.00 |
| United States | **3.00** | 3.00 | 3.00 |
| Pre-tax investment return | | | |
| South Africa – Cash | **5.75** | 6.50 | 6.50 |
| – Bonds | **7.25** | 8.00 | 8.00 |
| – Equity | **9.25** | 10.00 | 10.00 |
| United States – Bonds | **3.00** | 2.00 | 3.00 |
| Rand/US$ exchange rate | **6.3370** | 5.6250 | 6.6755 |
| Income tax rate | | | |
| – South Africa | **29.00** | 30.00 | 29.00 |
| – United States Federal Tax Rate[1] | **34.00** | 34.00 | 34.00 |

*1. Various additional State taxes also apply.*

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

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

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

The investment return assumption was determined with reference to the cash flow weighted average zero coupon yield curve. Other economic assumptions were set relative to this yield. The risk discount rate has been set relative to the risk-free rate, increased by a risk premium. It is assumed that no tax will be payable on interest earned in the Life Fund over the projection period.

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

The current policy of Discovery is not to declare dividends and therefore no allowance has been made in the embedded value calculation for secondary tax on companies ("STC"). The effect of allowing for STC of 12.5%, and assuming a 20% dividend payout ratio, is to reduce the embedded value at 31 December 2005 by 1.8% from R10.080 million to R9.894 million on the SVM basis and by 1.6% from R10.045 million to R9.880 million on the FSV basis.

# Notes

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