DISCOVERY LIMITED
(Incorporated in the Republic of South Africa)
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("Discovery" or "the Group")

Trading Statement for the year ending 30 June 2020 and update regarding the COVID-19 pandemic

1. Preamble: the COVID-19 context

Over the past four months, COVID-19 has caused significant disruption to lives and economies worldwide. As at 14 June 2020, total infections and deaths climbed to over 65,000 and 1,400 respectively in South Africa; 290,000 and 40,000 in the United Kingdom; and two million and 110,000 in the US. In addition to its health impacts, the pandemic has driven extreme market volatility, as evidenced by interest rates and equity market movements. For insurers specifically, COVID-19 has created a uniquely-complex operating and economic environment, with pressure on new business, lapse rates, and potential future claims; and volatility in interest rates and investment returns.

2. Financial performance

The financial performance of Discovery for the full year ending 30 June 2020 is expected to consist of:

- A resilient operating performance despite the uniquely-complex COVID-19 environment;
- The creation of a significant provision for expected future COVID-19 effects so that on the Group's expected scenario all claims and economic effects of the pandemic are carried fully in the FY20 year; and
- Materially volatile long-term interest rates in both SA and the UK negatively affecting headline earnings.

In the financial performance commentary that follows, normalised operating profit and normalised headline earnings exclude the impact of long-term interest rate changes but not the impact of COVID-19 effects. Basic earnings and headline earnings include the impact of interest rate effects.

The financial performance is summarised as follows:

- **New business** increased 4% for the eleven months ended 31 May 2020 compared to the prior corresponding period.
- **Normalised profit from operations before providing for potential future COVID-19 impacts** for the year ending 30 June 2020 is expected to be between 15% to 25% higher excluding the results of Discovery Bank, and between 5% to 15% higher including the results of Discovery Bank.
- **Approximately R3.3 billion will be provided for potential future COVID-19 impacts**.
- **Normalised profit from operations** is expected to be between 18% and 28% lower than the prior year, after including the potential future COVID-19 impacts.
- **Normalised headline earnings** is expected to be between 20% and 30% lower than the prior year.
- **Headline earnings** will be affected by the significant rise in interest rates in South Africa due to COVID-19 and the ratings downgrade, and the historically low rates in the UK. Given basic and headline earnings include this effect, these measures are very difficult to predict with a reasonable degree of certainty, and could potentially result in a decline of those measures between 70% to 90% compared to the prior year.

The following table summarises the position.

Table 1: Forecast change over prior year

Metrics	Forecast % change over prior year
Group normalised profit from operations before allowing for COVID-19 impacts	+5% to +15%
Group normalised profit from operations after allowing for COVID-19 impacts[1]	-18% to -28%
Group normalised headline earnings	-20% to -30%
Headline earnings (after the impact of long-term interest rates)[2]	-70% to -90%

1 See section 4.4.
2 See section 4.5.

3. Responding to the pandemic: priorities and methodology

The Group's COVID-19 response prioritised three groups: employees, clients and broader society.

3.1 Protecting employees

Interventions were two-pronged: first, ensuring employee safety, including developing and implementing sophisticated methodology to identify and protect roughly 2,200 high-risk individuals across SA and UK. Second, balancing employee safety with business continuity. This involved enabling over 11,000 employees globally to work remotely, with transport and safety provisions for those deemed essential workers unable to work from home. Throughout, service levels have remained stable.

3.2 Supporting clients

Using Discovery's data and modelling expertise, interventions focused on identifying members most at risk; and product innovation across SA and the UK to ensure relevant cover in the current context, while maintaining financial resilience. Discovery data corroborates published data that the elderly and those with co-morbidities are disproportionately affected; with emerging evidence that a healthy lifestyle, as measured by Vitality engagement – and formalised in a proprietary Resilience Index – protects against COVID-19 complications. As a result, more than 30,000 medium to high risk individuals were identified across the Group, followed by personalised contact. In addition, Discovery enabled employers to further reach out to their over 100,000 medium to high risk employees.

Innovations included the launch of new COVID-19 specific products (such as the WHO Global Outbreak Benefit and COVID-19 cash benefit); product enhancements across markets and business lines to cater for COVID-19; and adapting Vitality to account for the "at home" context (more than 300,000 workouts have been logged online during the COVID-19 crisis in SA and the UK). Furthermore, the Vitality Shared-Value Insurance model lends itself to COVID-19 concessions, by effectively unlocking financial value contained in future good health; and over R700 million has been offered to individuals and employers to date.

3.3 Bolstering communities

Discovery leveraged assets and resources towards providing industry support and playing a nation building role. Discovery has worked closely with the relevant industry and community bodies to share knowledge and expertise; and has extended access of its digital platform (DrConnect) for free COVID-19 doctor consultations, to all South Africans.

4. Resilient operating performance amidst a challenging and volatile macro environment

4.1 Actuarial dynamics during the early COVID-19 cycle

While the impacts of COVID-19 are still in the early stages of the cycle, the operating performance of Discovery has been resilient in volatile and even extreme conditions:

1. The nature of the products is deemed essential. In the case of COVID-19 the need for both life and health insurance has increased, and the lapse experience below illustrates the trade-off between essential need and affordability.
2. The specific Vitality Shared-Value Insurance model creates value for both the healthy and sick, thereby creating a stickier client base. The integrated nature of the products adds to this stickiness, with the lapse rate differential between clients with one product, compared to those with three or more, being more than 60%.
3. The Vitality Shared-Value Insurance model creates unique structures that have been used to offer valuable concessions to customers experiencing difficulties - Discovery Life's Payback Benefit allows clients to unlock the financial value contained in their future good health and Discovery Insure's Vitality Drive enables cash to be refunded based on the extent of driving, and has reduced lapse rates dramatically. As mentioned above, over R700 million has been offered to individuals and employers to date.
4. Discovery's client base is weighted towards the retail affluent segment wherein affordability through difficult economic conditions is more robust. The average sum assured in Discovery Life is roughly R2.8 million and 87% of clients are classified in the highest socio-economic rating class (earning above R50,000 p.m. or having a tertiary degree).

The following table illustrates the effect of these dynamics.

Table 2: Key indicators for April and May 2020 experience to either prior year or expected levels

April and May 2020 experience	2 months' new business to prior year	2 months' lapses Actual vs Expected	2 months' claims Actual vs Expected
Discovery Life	80-90%	80-90%	90-100%
Schemes administered by Discovery Health	60-70%	Less than 0%	Less than 60%
Discovery Insure (personal lines)	50-60%	60-70%	Less than 60%
Discovery Invest	60-70%	130-140% Paid-ups	70-80% Withdrawals
Vitality Health	70-80%	80-90%	Less than 60%
Vitality Life	70-80%	90-100%	130-140%

- Discovery Life's new business[1] held up well in April and May, and lapses have been low, possibly due to the premium relief options that have been made available to clients. Total claims were below expectation during the two months, and there were less than five COVID-19 related lump sum claims.
- Discovery Health's new business growth slowed, due to minimal new employees being added by existing customers. Schemes under Discovery Health's administration experienced much lower withdrawals and claims during the two months. The reduction in claims was driven by the postponement of discretionary and elective healthcare procedures, which is expected to reverse.COVID-19 related claims are expected for the period.
- Discovery Insure's personal lines lapses were much lower than expected, potentially a result of the dynamic pricing structure that was introduced. However as expected, motor downgrades increased during the two months. Motor claims were significantly below expectation, but should return to normal levels as lockdown restrictions ease.
- Discovery Invest saw an increase in paid-up policies during the two months, but funds were sticky with withdrawals much lower than expected.
- Vitality Health saw lower lapses than expected, potentially also a result of the premium relief products that were introduced. Similar to Discovery Health, it experienced much lower claims due to the postponement of elective treatment as well as the NHS co-opting private hospitals to support patient treatment. Vitality Health intends to reserve for this temporary drop in claims volumes given the expectation for claims to be caught up once the pandemic is over. This will be included in the Group's reserve for potential future COVID-19 impacts.
- Vitality Life lapses showed no sign of increase due to the pandemic, but claims were higher than expected, largely driven by COVID-19 related mortality claims as the UK is further in the pandemic cycle.

4.2 New business

Despite the effects of COVID-19 illustrated above, core new business annualised premium income for the Group increased by 4% for the eleven months ended 31 May 2020, compared to the same period in the prior year. The SA and UK businesses responded to the social distancing and lockdowns in place with strong digital support for advisors.

Ping An Health saw its strongest sales throughout the COVID-19 period, to some degree benefitting from the lockdown, as the product can be completed through an online channel, enabling the sales to continue via brokers or direct-to-consumer through Ping An Health's own app during the lockdown period.

Table 3: Core new business annualised premium income for the Group for the eleven months ended 31 May 2020

Business (Rm)	11 months ended 31 May 2020	11 months ended 31 May 2019	% change
SA composite	11 138	11 754	-5
UK composite	2 241	2 428	-8
Ping An Health[2]	3 237	2 276	42
Other new businesses[3]	751	296	154
Core new business API of Group	**17 367**	**16 754**	**4**

4.3 Normalised profit from operations before potential future COVID-19 impacts

Discovery expects normalised profit from operations before potential future COVID-19 impacts for the year to be 15% to 25% up before, and between 5% to 15% up after including the results of Discovery Bank when compared to the prior year.

Table 4: Forecast change in normalised profit from operations over prior year, before potential future COVID-19 impacts

Business (Rm)	Forecast % change over prior year
SA composite[4]	5% to 15%
UK composite[5]	40% to 50%
Vitality Group	65% to 75%
Ping An Health	30% to 40%
Group normalised profit from operations including new initiatives, excluding the results of Discovery Bank	15% to 25%
Group normalised profit from operations including Discovery Bank, but before COVID-19 impacts	5% to 15%

- SA Composite: Resilient performance across the businesses, with a quick response to COVID-19. Discovery Health in particular has increased its spend on servicing and infrastructure to ensure greater support to clients during the early stages of the pandemic. Discovery Life's performance for the eleven months was bolstered by positive experience variances across key metrics. Discovery Invest's revenue is linked to the market value of underlying funds managed –

[1] Includes automatic contribution increases
[2] For the eleven months ended 31 May 2020, Ping An Health's gross written premium increased to RMB 12.1 billion compared to RMB 7.6 billion for the prior period. Ping An Health's earned premium increased to RMB 7.4 billion for the 11 months ending 31 May 2020 (2019: RMB 4.2 billion). This includes the earned premium of policies written on Ping An Health's own insurance license, as well as a portion of the gross written premium written on Ping An Life's license and directly reinsured to PAH based on the reinsurance treaty terms.
[3] Other new businesses consist of Umbrella Funds, Discovery Commercial and Vitality Invest.
[4] Excludes new initiatives.
[5] Excludes new initiatives.

which reduced significantly during March and April 2020, however these have improved more recently. Discovery Insure was one of the the first short term insurers to adjust its premiums and rewards criteria for customers driving less.

- UK Composite: Vitality Health had a strong performance due to claims dynamics explained above. Vitality Life's experience is framed by challenges created by the low interest rate environment that has reduced significantly since the Brexit vote, and combined with the emerging COVID-19 environment, the effect is an additive deterioration in the claims and lapse experience. As communicated, management have instituted an intense programme to right size Vitality Life for this environment which consists of a number of key initiatives to be largely completed by the start of the Group's FY21 year. In addition, provisions are being made in this year for future COVID-19 impacts based on the Group's prudent best estimate COVID-19 modelling scenario, as part of the Group's overall provision.
- Vitality Group: Good performance despite a temporary slow-down of insurance partner sales due to COVID-19 lockdowns. The business is well diversified across geographies, with a significant part of its earnings being USD based, and revenue arrangements are a blend of fixed and performance-based fees.
- Ping An Health: Strong performance driven by the exceptional new business experience.
- Investment in new initiatives: New initiatives remain a key strategic focus, despite revenue growth expected to be more challenging in the period. The Group remains confident about the potential of new initiatives having taken some strategic shifts to allow for the different market conditions over the next few periods.
- Discovery Bank: The migrations of the Discovery Card client base into the Bank have been successful and progressing rapidly, with the full migration expected to be completed by end July 2020. The Bank continues to attract new clients with its fully digital 24/7 on boarding process – with over 177,000 clients and 330,000 accounts. Deposit growth has also continued at a strong trajectory. Discovery Bank has over R2.1 billion in retail deposits. Overall credit utilisation has declined during the lockdown and arrears including non-performing loans are still within expectation.

4.4 Approximately R3.3 billion for future potential COVID-19 impacts

Discovery anticipates reserving R3.3 billion for the potential claims and lapse impact of COVID-19 that are projected to emerge in future periods. This will be partially offset by discretionary margins, with the result that normalised profit from operations is expected to be between 18% and 28% lower than the prior year. As set out below, the modelling has been done on a prudent actuarial basis, and is continually being refined by incorporating trends in actual infections and mortality.

The COVID-19 provision has been calculated to estimate the future mortality, morbidity and economic effects of the pandemic by estimating excess mortality and excess lapses expected to arise in 2021 and 2022 on a variety of scenarios by setting a stressed, central (prudent best estimate) and light scenario. The central scenario has been used to set the provision, while the stressed scenario used to test capital and liquidity; the light scenario would result in a material release of provisions in future years.

In terms of mortality, the key areas of impact are Discovery Life and Vitality Life and the modelling uses the United Kingdom's Imperial College studies as a basis for Infection Fatality Rates, in combination with SEIR models based on local observed and modeled infection reproductive rates to ascertain the duration and impact of the pandemic on the Discovery Life and Vitality Life insured populations. While the UK is at a more advanced stage of the epidemic than SA, both markets are still subject to significant uncertainty at this stage, hence a prudent modeling approach has been assumed in both cases.

Excess Health claims in the UK will arise due to the delay of elective surgeries during the COVID-19 period as private hospital capacity has been co-opted by the NHS. These delayed effects have been modeled and estimated as part of the central scenario, in addition to claims arising for COVID-19 admissions.

The economic effects were modeled to take account of the economic stresses, particularly on policy lapses, in all of Discovery's businesses under the range of scenarios.

In summary, approximately two thirds of the R3.3 billion COVID-19 provision is made up of mortality and morbidity impacts, with a third from economic impacts. The provision is the aggregate value of these effects expected in 2021 and 2022.

Included in presentation of normalised headline earnings

Although the allowance for the COVID-19 impact is an abnormal provision for future impacts, it is not excluded in the presentation of normalised headline earnings because it is seen as part of the core operations and will impact future cash flows.

4.5 The effect of long-term interest rates on IFRS reported earnings

There has been substantial volatility in global markets and in particular, material increases in long-term nominal and real interest rates in South Africa and low interest rates in the United Kingdom. These result in materially different valuation rates that are used to discount future cash flows and will emerge as economic assumption changes. For Discovery Life this impact manifests as a lower discounted value of future cash flows, even though the actual cash flows themselves are not materially affected. Solvency and liquidity within Discovery Life are not negatively impacted by the higher long- term interest rates in South Africa.

Based on yields as at 31 May 2020, the impact on profit from operations due to the economic basis change in Discovery Life would be an approximately R2.7 billion negative effect compared to what it would have been at rates prevailing at the previous year-end. The effect on the Group's headline earnings of these interest rate movements will depend on the actual level of long-term interest rates at the year-end reporting date.

In the UK, Vitality Life's yield-sensitive back book was protected against further interest rate declines, achieved through a 25-year interest rate hedge that was implemented in October 2019. The hedge reduces cash flow and capital requirement volatility. The passive interest rate used to discount future cash flows is expected to be reset for the first time at 30 June 2020 and will lead to an IFRS valuation strain in Vitality Life, partially offset by the valuation of the hedge. As communicated at interims, excluding any basis risk, this would equate to a net negative impact of approximately GBP 40 million for the financial year.

Excluded in presentation of normalised headline earnings
The recent significant interest rate movements resulted in IFRS valuation strains in respect of Discovery Life and Vitality Life. Should the observed reference interest rates revert, these valuation strains will reverse. Given there is no bearing on operating performance, Discovery will exclude the effect in the reported normalised earnings measures. Doing so (excluding the effect of economic assumptions in the normalised earnings), is directionally consistent with the treatment in IFRS 17 Insurance Contracts, which permits the changes in economic assumptions to be presented in Other Comprehensive Income (OCI).

4.6 Headline earnings

Shareholders are therefore advised that:
Normalised headline earnings per share (NHEPS) will be between 20% and 30% lower (to between 617.52 cps and 540.33 cps compared to reported 771.9 cps for the prior period).

When including the economic basis changes in headline earnings per share (HEPS) and earnings per share (EPS), the final outcome is very volatile as it is largely dependent upon movement in the real and nominal interest rates in South Africa towards the end of the year. Shareholders are further advised that using current estimates of long-term interest rates in South Africa:

- Headline earnings per share are expected to be between 70% and 90% lower (to between 236.7 cps and 78.9 cps compared to reported 789.0 cps for the prior period).
- Basic earnings per share are expected to be between 70% and 90% lower (to between 300.5 cps and 100.2 cps compared to reported 1 001.5 cps for the prior period).

4.7 Capital and liquidity

Discovery is confident that the Group is strong under high stress scenarios, with sufficient liquidity and solvency to weather uncertain conditions. Capital ratios are expected to remain broadly in the same range as December levels, and above targeted levels, even after the above considerations. The cash buffer is expected to remain within or above the target range, with minimal recourse to additional debt.

The resilience of the Group was tested by extensive claims and lapse stresses, with deliberately prudent scenarios. Detailed epidemiological models were deployed to inform actuarial provisions, and to develop a wide range of scenarios both nationally and for Discovery's insured population.

4.8 Dividend policy

Due to the uncertain and potentially volatile economic environment caused by the COVID-19 pandemic, Discovery will not be recommending the payment of ordinary dividends. The reintroduction of dividends will be considered when appropriate.

5. Outlook

Despite a very complex and difficult trading environment the Group remains optimistic about potential growth and continues to build for the future. In particular:

- In a post COVID-19 environment the issues of health, wellness, and resilience are likely to be fundamental and Discovery's Shared-Value Insurance model will be well placed to capitalise on this in the markets in which it operates.
- The provision for expected COVID-19 effects going forward will mean that on the Group's prudent best estimate assumption, strong growth should revert.

It must be pointed out that the operating environment is complex and volatile and scenarios going forward may be worse than expected, in which case the Group's growth would be lower than expected. The Group is confident that it maintains sufficient liquidity and solvency to weather uncertain conditions.

The Group continues to cautiously monitor how the impact of COVID-19 evolves and its impact on trading conditions.

The information contained in this announcement, including any forecast financial information on which this trading statement is based, has not been reviewed and reported on by Discovery's external auditors.

Conference call

A conference call for investors and analysts will take place at 15h00 (South African time) today. Investors and analysts who wish to participate in the conference call should register as indicated below.

Audio dial-in facility

A dial-in facility will be available. Please register at https://www.diamondpass.net/1893014 for the call. Registered participants will receive their dial-in number upon registration.

Recorded playback will be available until 18 June 2020.
Access Numbers for Recorded Playback:
Access code for recorded playback: 35430

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Sandton
15 June 2020

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