Group finance director's report

The group continued to experience tough operating conditions over the past year that manifested in lower than expected earnings. Despite the challenging conditions the group was able to secure solid new business flows albeit at lower margins, while keeping a strong control over expense growth.

Mary Vilakazi

Deputy chief executive officer and group finance director

Introduction

This review provides a high-level overview of the group results. Additional financial disclosure can be found in the annual financial statements and additional operating performance information can be found in the segmental reports.

The results of MMI for the financial year ended 30 June 2017 reflect a difficult operating environment with the main financial metrics being under pressure. The following themes impacted on the financial results of the group:

- The balance sheet of the group is highly geared towards equity markets. Muted equity market growth over the past three years have impacted the level of asset based fees and discretionary margin releases, resulting in flat earnings year-on-year.
- Lower than expected underwriting profits remain a feature in the corporate group disability business. The underwriting results of the rest of the life insurance book recovered well from the previous financial year.
- The group's International short-term insurance and health businesses continued to face headwinds, resulting in decisions taken to exit numerous businesses outside of South Africa to preserve the group's capital resources going forward.
- The return on embedded value (ROEV) was impacted by negative investment variances resulting from weak market returns, lower than expected value of new business and the write down of asset valuations following the decisions to exit certain business lines and countries.
- Reasonable new business volumes given the tough economic environment but with new business margins under pressure.

The group's various strategic initiatives are on track and are discussed in the CEO report.

Group performance scorecard

MMI assesses its operational performance against a set of key performance indicators that are annually reviewed and approved by the group's Remuneration Committee. The set of indicators include both short-term and long-term objectives.

Short-term deliverables are measured over a period of 12 months and are reviewed on an annual basis. The group set stretching targets for F2017 in line with the aspirational ROEV targets. For the financial year ended 30 June 2017, the following set of short-term deliverables applied to the group as a whole:

Performance scorecard 2017

	Weight	F2017 target	Actual	Achieved
Return on embedded value[1]	20%	**12.2%**	8.9%	↓
Core headline earnings	20%	**13% growth**	0%	↓
Value of new business	15%	**R801m**	R547m	↓
Optimisation and expense savings programme	10%	**R200m**	R219m	↑
Strategic initiatives	35%	**Exco assessment**	3.4 (max 5.0)	↑

[1] For the short term performance scorecard ROEV is measured excluding the impact of investment variances

The above scorecard relates to group-wide targets and deliverables. In addition specific targets are set for individual business units. This report only discusses the financial metrics of the group performance scorecard. The progress on key strategic initiatives is discussed in the group CEO's overview.

The group delivered a muted ROEV of 8.9% (excluding investment variances) well below the group's target ROEV of Risk Free + 3% (12.2% based on 10-year RFR at start of year). ROEV inclusive of investment variances was 4.7% for the year.

The group saw a decline in overall new business growth of 6% on a present value of premiums (PVP) basis and 3% on an annual premium equivalent (APE) basis. The value of new business (VNB) declined sharply by 23% as a result of lower volumes as well as lower margins at product level.

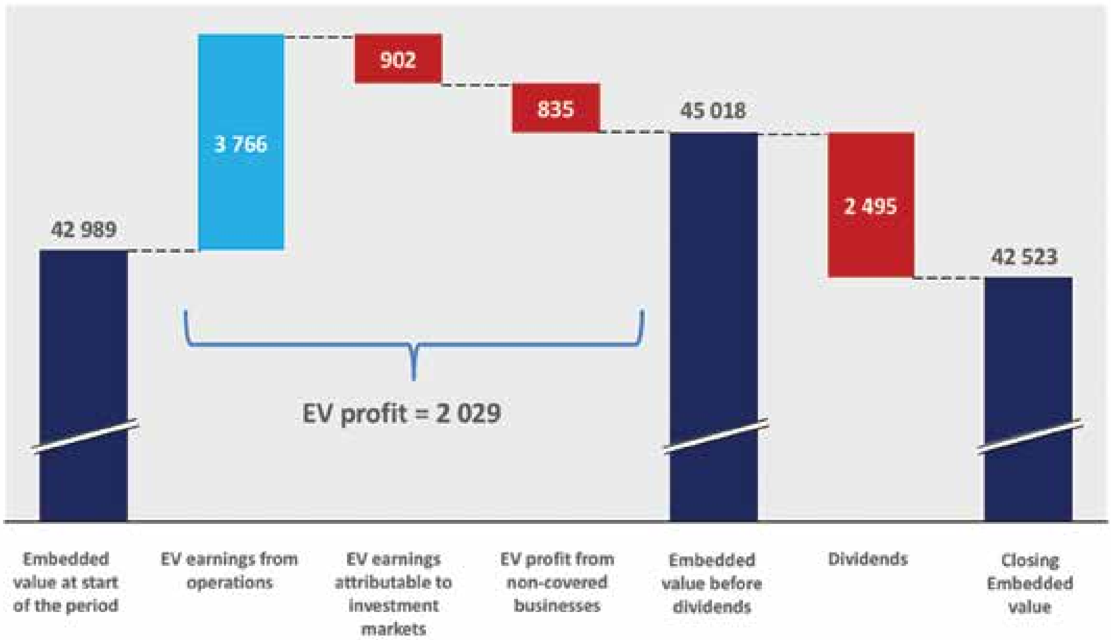
The flat core headline earnings were satisfactory in difficult operating circumstances. Improved group risk results were offset by an increase in lapse rates in the Metropolitan Retail market as well as the ongoing impact of flat equity markets on our asset based fees and discretionary margin releases.

Expense management was good with the group achieving R219 million in savings against a target of R200 million for the 2017 financial year. Note that these savings are part of the cost efficiency program to take out R750 million of operating expenses by the 2019 financial year.

The group's performance in terms of each of the key financial metrics in the scorecard is discussed below.

Return on embedded value (ROEV)

The graph below shows an attribution between the ROEV of the current and previous financial year:

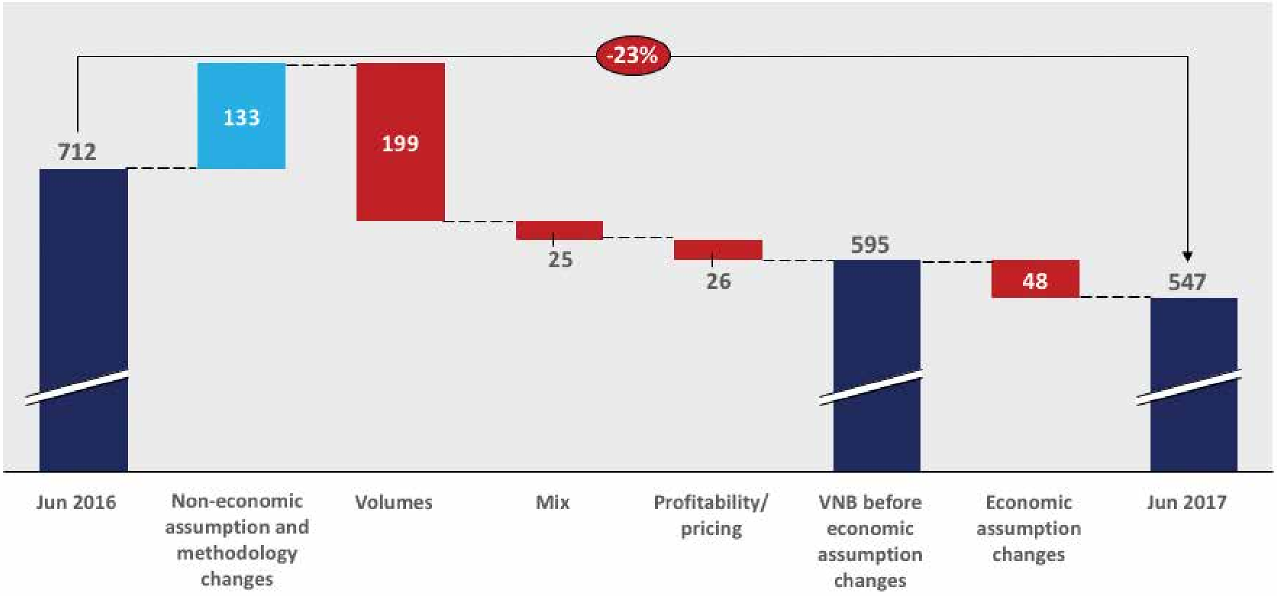


The diluted embedded value of the MMI group amounts to R42 523 million (R26.51 per share) as at 30 June 2017. Adding back the payment of dividends and other capital movements (R2 495 million) the overall return on embedded value (ROEV) amounts to R2 029 million, an annualised return of 4.7% on the opening embedded value. This is below the targeted return on embedded value of 12.2% for the year to 30 June 2017.

Significant items impacting negatively on the ROEV include flat equity markets leading to negative investment variances. The impact of weak investment markets is visible in the ROEV contributions from both our life business and our asset management operations. In addition poor underwriting results in the corporate disability and International short-term and life insurance businesses continued. We continue to increase premium rates on our corporate disability business in order to return to acceptable underwriting margins and we have initiated exits from some of the underperforming International operations. We thus expect underwriting results to improve in F2018.

Value of new business (VNB)

The graph below shows an attribution between the VNB of the current and previous financial year:



The overall value of new business (VNB) for the 12 months to June 2017 amounts to R547m at a PVP margin of 1.3%, compared with a margin of 1.6% for the prior year. The decline in VNB from the prior year comparative is largely attributable to the negative impact of the decrease in sales volumes (R199m impact).

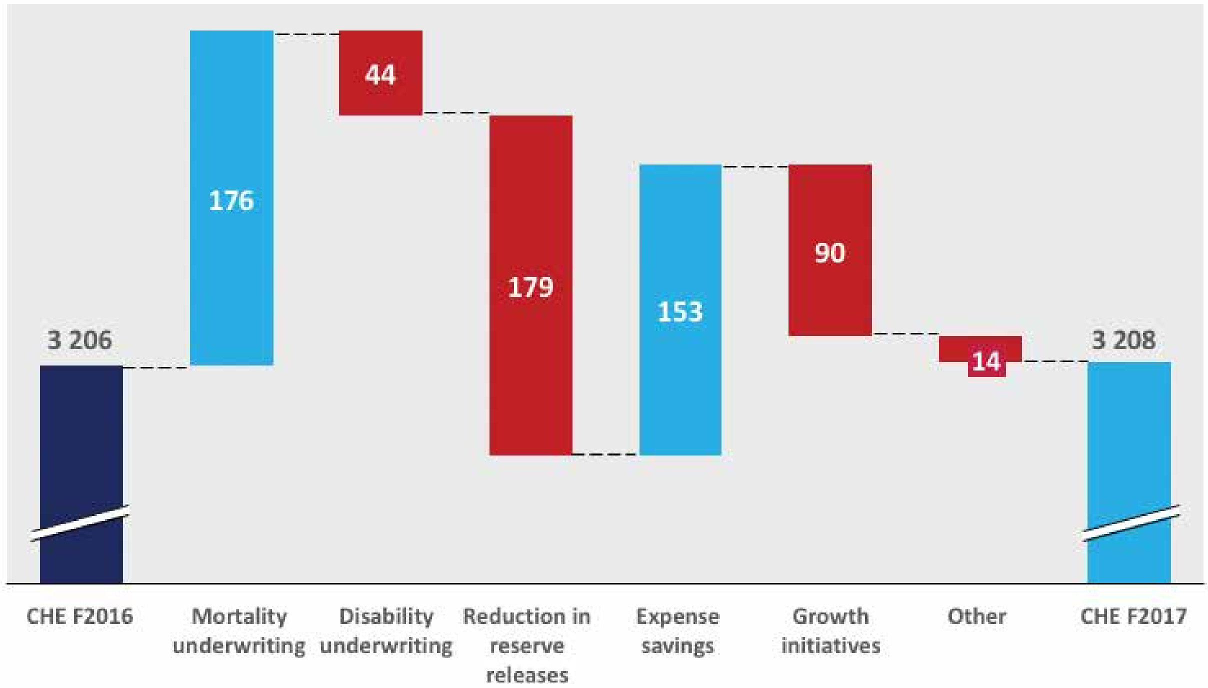
Value of new business per segment

	June 2017 Rm	June 2016 Rm	1 year change %	PVP margin %
Momentum Retail	228	251	(9)	1.0
Metropolitan Retail	178	191	(7)	3.4
Corporate and Public Sector	68	199	(66)	0.6
International	73	71	3	2.9
Total	**547**	**712**	**(23)**	
New business margin (PVP)	1.3%	1.6%		

The Momentum Retail VNB deteriorated due to the reduction in the more profitable business during the current financial year. This is particularly the case on single premium products where the sales mix migrated to lower margin solutions. Metropolitan Retail's VNB decreased largely due to acquisition costs increasing faster than sales volumes. Market conditions remains highly competitive in the Corporate and Public Sector market and our sales channels experienced some disruptions during the current financial year. This resulted in significant pressure on sales volumes for traditional large corporate business and a weak VNB number. The International VNB was positively impacted by a slight increase in sales in Namibia and in Botswana.

Contribution to diluted core headline earnings

The graph below highlights the significant factors impacting on core headline earnings.



The core headline earnings for the group for the current year was supported by better overall underwriting results, especially on mortality and non-life risks. The lacklustre investment market growth comes through core earnings mainly in the 'reduction in reserve releases' item. Excellent expense management contributed positively to core earnings over the year. Business exits also contributed positively to the overall core headline earnings.

The table below sets out the segmental split of the core earnings.

MMI group core headline earnings

	12 months to 30 June 2017 Rm	12 months to 30 June 2016 Rm	% Change
Momentum Retail	1 271	1 493	(15)
Metropolitan Retail	660	700	(6)
Corporate and Public Sector	835	680	23
International	(166)	(156)	(6)
Operating Segments	2 600	**2 717**	**(4)**
Shareholder Capital	608	489	24
Total MMI	3 208	**3 206**	**0**

Momentum Retail's core headline earnings declined by 15% compared with the prior year largely due to the impact of weak investment market returns on discretionary reserve releases, as well as the impact of higher discounts offered on Myriad (life insurance product) as a result of clients migrating to higher Multiply status levels. Losses from Momentum Short-term Insurance declined during the year in line with the business plan to reach break-even within the next two years.

Metropolitan Retail's core headline earnings decreased by 6%. This is mainly due to an increase in new business strain as well as worse than expected lapse experience, especially during the last quarter. Increased new business strain reflects that acquisition costs increased faster than sales volumes during the year. The higher growth in acquisition costs is explained by a greater number of new advisers in the workforce (whose productivity is initially weak relative to their cost impact) and poor performance from our telesales channels.

Group finance director's report (continued)

The Corporate and Public Sector core headline earnings, which increased by 23% compared to the prior year, was positively impacted by an improvement in group risk experience profits in the current financial year, and the positive impact of efficiency savings in the Health business. Disability underwriting profits remains under pressure given the poor economic climate and a very competitive market. The segment continues to monitor this closely, increasing rates where appropriate. Premiums have also started to harden over the past 12 months. Guardrisk also contributed positively to the pleasing increase in earnings.

MMI International's decrease in core headline earnings is largely due to the worse than expected short-term and life insurance results, especially in Kenya. The group continues with its plans to improve focus by exiting certain loss-making business lines and by fully disposing of some operations.

The Shareholder Capital core headline earnings increased by 24% as a result of better investment performance on shareholder capital and lower shareholder expenses.

Capital management

The table below sets out the group's capital position at 30 June 2017:

	Rbn
Net asset value as per embedded value statement	16.3
Qualifying debt	3.6
Less: net asset value of strategic subsidiaries	(3.6)
Less: required capital	(10.1)
Capital before deployment	6.2
Deployed	(2.5)
Final dividend	(1.5)
Committed capital – strategic initiatives	(1.0)
Capital buffer after deployment	3.7

At 30 June 2017, the solvency position of MMI Holdings remained satisfactory with a capital buffer of R3.7bn after allowing for deployment for strategic initiatives. The above position is on the current Statutory Valuation Method (SVM) basis, but group Balance Sheet Management continued with the focus on preparing for Solvency Assesment and Management (SAM) implementation during the year. The results of the investigations indicated that a targeted range of 1.3 to 1.6 times the Solvency Capital Ratio (SCR) for MMI Holdings would be appropriate. The target range for the solo insurance entity (Momentum Group Ltd) will be higher than for MMI Holdings.

Dividend

Despite the ongoing earnings pressure experienced during the year, the current capital position of the group, in addition to management's confidence in MMI's longer-term earnings generating capacity and the decision to exit certain loss-making businesses, supports MMI's ability to declare an unchanged final dividend compared to the prior year. The final dividend of 92 cents per share results in a total dividend for the year of 157 cents per share. The group plans to revert to its target dividend cover ratio of 1.5 to 1.7 times core headline earnings in due course.

The table below shows the groups dividend declarations over the last three years.

Dividend per share (cents)

	2017	2016	2015
Interim ordinary dividend	65	65	63
Final ordinary dividend	92	92	92
Total ordinary dividend	157	157	155

Conclusion

The group continued to experience difficult operating conditions over the past year that manifested in lower than expected earnings. Despite the challenging conditions the group was able to secure solid new business flows albeit at lower margins, while keeping a strong control over expense growth.

The group has made good progress on some key growth initiatives. The Indian health insurance joint venture with Aditya Birla is one deserving of a special mention. Early top line growth has exceeded business plans and we remain excited about this opportunity. We are also optimistic about the prospects of our lending and insurance joint venture with African Bank that will become operational during F2018.

However, tough operating conditions are likely to persist for the more mature domestic life insurance operations and revenue is likely to remain under pressure in the near term. Despite the modest revenue outlook we plan to invest selectively in expanding our distribution presence in the SA retail market and we also continue to invest in client engagement solutions to ensure that we have differentiated client solutions. We believe that these investments will enable us to capture increased share of the market and to position us to generate attractive returns once the economic conditions improve.

MARY VILAKAZI
Deputy chief executive officer and group finance director