WATER PIK TECHNOLOGIES INC
Form 10-KT
December 14, 2004

QuickLinks -- Click here to rapidly navigate through this document

United States Securities and Exchange Commission Washington, D.C. 20549

Form 10-K

o Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

ý Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from January 1, 2004 to September 30, 2004
Commission file number **1-15297**

Water Pik Technologies, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**25-1843384**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

23 Corporate Plaza, Suite 246
Newport Beach, CA 92660 (Address of principal executive offices, including zip code)

Registrant's telephone number, including area code: **(949) 719-3700**

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, $.01 par value	**New York Stock Exchange**
Preferred Share Purchase Rights	**New York Stock Exchange**

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
ý Yes o No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in the definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.
o

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2)
ý Yes o No

The aggregate market value of the voting and non-voting stock held by non-affiliates of the registrant as of June 25, 2004 was approximately $190,990,879, based on the closing sale price on that date of the Common Stock of $16.83 as reported by the New York Stock Exchange. Shares of voting stock known by the registrant to be beneficially owned by executive officers or directors of the registrant are not included in the computation; however, shares of voting stock reported to be beneficially owned by holders of 5 percent or more of the voting stock are included in the computation. The registrant has made no determination whether any such persons are "affiliates" within the meaning of Rule 405 under the Securities Act of 1933 and Rule 12b-2 under the Securities Exchange Act of 1934.

The number of shares of Common Stock outstanding as of December 3, 2004 was 12,124,949 shares.

Documents incorporated by reference: None

WATER PIK TECHNOLOGIES, INC.

PART I

Item 1 Business

Overview

Water Pik Technologies, Inc. (the "Company," "Water Pik Technologies," "we," "our," or "us") was incorporated in Delaware on August 23, 1999. Our principal executive offices are located at 23 Corporate Plaza, Suite 246, Newport Beach, California 92660 (telephone number 949-719-3700). Water Pik Technologies was formed as a result of the spin-off of the consumer products segment of Allegheny Teledyne Incorporated, now known as Allegheny Technologies Incorporated ("ATI"), which included the operations of the Teledyne Water Pik division and the Teledyne Laars division, both with operations in the U.S. and Canada. On November 29, 1999, Water Pik Technologies became an independent public company when ATI distributed all of the common stock of Water Pik Technologies to the stockholders of ATI in a tax-free transaction (the "spin-off").

As used herein, references to the Company together with its consolidated subsidiaries include the historical results and activities of the business and operations transferred to the Company in the spin-off unless the context otherwise indicates. Water Pik Technologies is a leader in designing, manufacturing and marketing a broad range of well-recognized personal health care products, swimming pool products and water-heating systems. Water Pik Technologies operates in two business segments the Personal Health Care segment and the Pool Products and Heating Systems segment.

We compete in several distinct product categories, including:

- Water Pik® showerheads
- Water Pik® oral health products
- Water Pik® and Instapure® water filtration products
- Laars® and Jandy pool and spa heaters, and Jandy® controls, valves, pumps, filters and water features
- Air Energy heat pumps
- ClorMatic® salt chlorine generators
- Water Pik and Jandy pool and spa accessories, including cleaning and maintenance supplies, white goods, ladders, solar reels, floating lounges, pool toys and games
- Laars® residential and commercial boilers and water-heating products

We have manufactured personal health care products for over 40 years. We have manufactured water-heating products for over 50 years and pool equipment for over 30 years.

An extensive distribution network allows us to distribute our products across various distribution channels to reach a greater number of consumers and distributors. We manufacture and distribute products principally through ten facilities located in the United States and Canada. Sales for the nine months ended September 30, 2004 ("Fiscal Year 2004") and in the twelve months ended December 31, 2003 and 2002 were $251.2 million, $305.1 million and $281.8 million, respectively.

In July 2004, we began to pursue an orderly exit of personal stress relief products within our Personal Health Care segment. The Personal Stress Relief product line, introduced in 2001, includes foot spas and personal massagers. The orderly exit, which may extend over a period greater than 12 months, is intended to focus our product development, marketing and selling resources on our core personal health care product lines toward the goal of improving our operating margin and return on capital.

In December 2002, we formalized a plan to dispose of our Ozone product line, a category of the Personal Health Care segment. The Ozone product line included the Aquia® home sanitizing product introduced in September 2001. The disposition was completed during Fiscal Year 2004. Discussions and amounts herein for all years presented relate to continuing operations only unless otherwise noted. See Note 14 to the consolidated financial statements for further discussion on discontinued operations. See also "Management's Discussion and Analysis of Financial Condition and Results of Operations."

We operate on a 52- or 53-week fiscal year. In January 2004, our board of directors approved a change in our fiscal year-end from the last Sunday closest to December 31 to the last Sunday nearest to September 30, effective in 2004. In view of this change, this Form 10-K is a transitional report, and includes information for the nine-month transitional period ended September 30, 2004, and for the twelve-month periods ended December 31, 2003 and 2002. Our public filings are available free of charge on our web site at http://www.waterpik.com and may also be obtained through the Securities and Exchange Commission ("SEC") at its web site at http://www.sec.gov.

Industry Overview

We believe that we can take advantage of current market and industry trends for the Personal Health Care segment and the Pool Products and Heating Systems segment, such as:

- demographic trends reflecting the aging of the U.S. population;
- an increased emphasis on a personal health care lifestyle;
- an increased emphasis on spending time at home or "cocooning;" and
- an increased use of the backyard for outdoor living, recreation and relaxation.

The U.S. population consists of approximately 77 million "baby boomers" ranging from 40 to 58 years of age. These consumers generally wish to remain active and seek personal health care products to maintain a high quality of life. Moreover, "baby boomers" typically have more discretionary income, which they are more likely to spend on home remodeling projects, including projects to improve their backyards, pools and spas. In addition, many consumers now view the backyard as an extension of their indoor living environment and are improving backyards as they would the interiors of their homes.

Our products complement these existing trends and provide us with the opportunity to expand our product offerings to satisfy consumers' current and emerging preferences. We believe that these trends will continue, and that Water Pik Technologies, with our strong brand name recognition and extensive product offerings, is well positioned to be a market leader in this evolving marketplace.

Competitive Strengths

We are a strong competitor for the following reasons:

Strong Brand Names. Over many years, we have developed an extensive portfolio of company-owned brand names. These strong brand names include Water Pik® personal health care products, Jandy® swimming pool and spa products and Laars® water-heating products. As consumers turn more and more to brand name merchandise to validate their product purchase decisions, we believe that our strong brand names will provide the platform for future growth and will enable us to expand our product offerings into new and existing product categories and channels of distribution.

Reputation for Innovative Products. We have a strong history of innovative product development with our Water Pik® personal health care products, Jandy® swimming pool and spa products and Laars® water-heating products. We have developed and introduced many products which are considered the first of their kind and that resulted in the formation of new markets, such as: the Water Pik® oral irrigator; The Original Shower Massage® showerhead; the Instapure® end-of-faucet water filter; the Laars® swimming pool heater; the Jandy® automatic swimming pool cleaner; and the Jandy® AquaLink® electronic swimming pool control system. In response to changing consumer preferences, we continue to develop and introduce new and innovative products such as the Cascadia® drenching showerhead, the New Visions® showerheads, the Waterpik® flosser, the Laars® Hi-E2® high efficiency swimming pool heater and the Endurance modulating residential boiler. We have received numerous awards for our product design, innovation and quality.

Extensive Distribution Network. We distribute our products through more than 45,000 retail and wholesale outlets in North America, which allows us to reach a greater number of consumers and distributors than many of our competitors. Our personal health care products are distributed directly to consumers through mass merchandisers, home centers, drug stores and cooperative hardware chains. Our pool and water-heating products are sold through various channels of distribution, including pool wholesalers, pool builders and a network of plumbing and heating, ventilation and air conditioning ("HVAC") wholesalers, as well as retailers and service companies. We believe that this distribution network will allow us to quickly realize desired sales volumes for new products as they are brought to market.

Proven Manufacturing Capabilities. We have proven skills in transitioning the product development process into high quality, lower cost manufacturing, utilizing our own facilities as well as global sourcing. We are skilled in production manufacturing processes, including plastic injection molding, metal processing, final assembly and testing, logistics and customer fulfillment. We utilize lean manufacturing techniques in our manufacturing facilities to improve product quality, reduce product cost, and plant square footage and capital expenditures while achieving high customer product fulfillment satisfaction.

Experienced Management Team. We have an experienced management team with expertise in a variety of disciplines. Our President and Chief Executive Officer has over 25 years experience in the manufacturing, distribution and marketing of a wide variety of consumer products. Collectively, our senior management team has a broad range of experience in marketing and merchandising, financial management and acquisitions, and multinational production and distribution.

Business Strategy

Our vision is to create a growth-oriented consumer products company that capitalizes on our well-recognized brand names and develops innovative products that provide outstanding value to our customers as follows:

Introduction of Innovative New Products. We intend to continue the development and introduction of new and innovative products to achieve our growth objectives. Our success in product development will continue to be driven by consumer and commercial customer needs, market trends and the vulnerability of our competitors. We intend to sharpen our focus on the regular development of new products and extensions to the existing product lines. These developments may range from significant new product functions or features to innovative design changes to satisfy changing consumer preferences. We intend to increase the flexibility of our design and manufacturing processes to enhance our ability to be responsive to consumer preferences and to enable us to introduce new products and product extensions with shorter development cycles than our competitors.

Broaden Product Offerings. We also intend to increase served markets by offering related new products and product extensions. We market a variety of personal health care, pool and water-heating system products that enable us to offer our customers and distributors a single source for a wide range of products. We have continually increased the number of our product offerings and intend to continue to regularly introduce new products. The wide array of products allows us to provide category management for our retail customers and one-stop shopping capability for our wholesale and contractor customers.

Leverage Strong Brand Name Recognition. We believe that our strong Water Pik®, Jandy® and Laars® brand names will allow us to more rapidly market and sell new products. The strength of these brand names provides new products with consumer credibility and acceptance. By building on our brand names, we expect to increase market share, expand our product offerings, enhance consumer brand loyalty and expand our distribution channels.

Capitalize Upon Existing Distribution Channels. As we continue the introduction of innovative new products and broaden our product offerings, we anticipate being able to rapidly offer these products to existing retail and wholesale distribution channels through our well-established distribution network. We believe that we can utilize all of our distribution channels to effectively distribute more of our product lines to allow us to reach a greater number of consumers and distributors. We believe that we also will have an opportunity to capitalize on our distribution strengths in specific product segments by pursuing new channels of distribution.

Utilize Proven Manufacturing Capabilities to Become a Lower Cost Producer. We believe that we can more fully utilize proven manufacturing capabilities to add more value to our customers through continuous improvements in product quality, cost reductions and product delivery. We are in the process of fully integrating state-of-the-art production techniques throughout our business in order to reduce our total product cycle time and reduce our total product cost, using a "quality first" discipline in everything we do. We also are in the process of integrating and streamlining our manufacturing capabilities and facilities when and where appropriate to lower our costs and improve delivery performance. We intend to continue to look for innovative ways to become a lower cost manufacturer, including outsourcing manufacturing to overseas suppliers. We believe that achieving world-class capabilities will provide us with a dynamic structure of high product quality, lower product cost and an efficient product delivery system as we strive to continuously exceed our customers' requirements.

Leverage Customer Service Capabilities. We intend to satisfy our customers' expectations and enhance our sales and profitability by leveraging our customer service capabilities in product delivery and after-sales service. We will continue to improve our on-time product delivery through our state-of-the-art production initiatives; establish a one-stop, closed loop communication and response system for technical after-sales service; and regularly update our customers' sales and technical service representatives with training programs and new tools, hardware and software.

Pursue Selected Acquisitions and Strategic Alliances. We may pursue selected acquisitions and strategic alliances that complement and expand our existing product lines and business. Specifically, we will seek acquisitions that provide us with:

- broader product offerings;
- access to product innovation and unique product design capabilities;
- access to advanced manufacturing processes;
- lower cost manufacturing capabilities;
- new and efficient distribution channels; and
- increased access to product categories, markets and industries that are experiencing rapid consolidation.

Business Segments

See Note 15 to the consolidated financial statements for financial information by reportable segment and by geographical area. Information related to business acquisitions is set forth in Note 13 to the consolidated financial statements. See also Management's Discussion and Analysis of Financial Condition and Results of Operations.

PERSONAL HEALTH CARE

The Personal Health Care segment designs, manufactures and markets showerheads, consumer and professional oral health care products, water filtration products and personal stress relief products which are sold primarily under the Water Pik® brand name.

Showerheads. Through the development and production of pulsating showerheads, we became recognized as an industry leader for personal health care products. We developed The Original Shower Massage® product line, the first massaging showerhead. The Original Shower Massage® showerhead has been redesigned and refined as consumer preferences have changed. The Flexible Shower Massage®, an award winning showerhead that adjusts to a wide variety of positions and height settings, was based on The Original Shower Massage®. We continue to refine and develop innovations to The Original Shower Massage® product line. In May 2001, we incorporated patented technology into new drenching showerheads with luxurious styling: the Cascadia®and AquaFall® lines of showerhead products. Cascadia® has become the best selling drenching showerhead. In August 2001, we launched New Visions®, a complete line upgrade of our core pulsating showerheads. The new line provides the features, styles and price points demanded by the marketplace as well as the opportunity to expand the showerhead product offering with retailers across the country. In September 2002, we launched the Full-Body Shower Panel , an affordable and easy-to-install product offering a spa-like shower experience. In June and September 2004, we launched Elements and Dual Massage , respectively, which are performance showerheads.

Our showerhead products are marketed under the following product names:

Super Saver® showerheads
The Original Shower Massage® showerhead
The Adjustable Shower Massage showerhead
The Flexible Shower Massage® showerhead
Misting Massage® showerhead
Water Massage® showerhead
Water Pik® shower filter
AquaFall® showerhead
Cascadia® showerhead
New Visions® showerheads, including Grace®, Avante' , Charleston® and Linea®
Full-Body Shower Panel
Medallion® showerhead
Elements showerhead
Dual Massage showerhead

Oral Health Products. We manufacture a broad line of consumer and professional oral health care products. In 1962, we developed and introduced the original Water Pik® oral irrigator. Our consumer oral health products are designed to reduce plaque, stains and gingivitis with many of the products accepted by the American Dental Association. Products include personal and family Water Pik® dental systems ("oral irrigators") and the SenSonic® plaque removal instrument, an electronic toothbrush that generates 30,000 sonic brush strokes per minute. In September 2002, we introduced the SynchroSonic® toothbrush, an advanced action sonic toothbrush with dual motors. In January 2003, we relaunched the Waterpik® Vibe toothbrush, a low cost disposable toothbrush that provides a step-up performance alternative to manual toothbrushes. In August 2003, we introduced the Waterpik® dental water jet, a cordless, rechargeable version of the proven oral irrigator.

The oral health care products are marketed under the following product names:

Waterpik® flosser
Water Pik® professional oral irrigator
Water Pik® personal oral irrigator
Water Pik® family oral irrigator

Water Pik® travel oral irrigator
Waterpik Plus® plaque control system
SenSonic® plaque removal instrument
SenSonic® ADVANCED plaque removal instrument
SenSonic Plus® plaque control system
Waterpik® Vibe® toothbrush
Waterpik® SynchroSonic® toothbrush
Waterpik® dental water jet

We also manufacture and market a broad range of professional oral health products. We currently market over 600 products that are distributed in over 60 countries for use by dental professionals. Our professional oral health products include articulators, which are instruments used to replicate jaw movements for fabrication of dental prosthetics, prophy cups and angles, which are used in conjunction with a polishing compound to polish teeth, radiographic positioning devices, which are used to position x-ray equipment, and various laboratory products used by dental labs to fabricate dental prosthetics.

Water Filtration Products. We manufacture and market a line of end-of-faucet water filtration products for consumers. We developed the first end-of-faucet water filter in the mid-1970's. The high performance water filtration products are designed to reduce lead, chlorine, pesticides, cryptosporidium and giardia cysts, asbestos, sediment, bad taste and odors to provide consumers with healthier, better tasting water. In May 2004, we launched the Instapure® water filter, an innovative end-of-faucet filter that reduces 53 contaminants, as well as chlorine taste and odor.

The water filtration products are marketed under the following product names:

Water Pik® electronic faucet filter
Water Pik® faucet filter
Water Pik® undersink water filter
Water Pik® wholehouse water filter
Water Pik® compact water filter
Water Pik® dual process undersink water filter
Water Pik® water filter canister kit
Water Pik® Instapure® filtration systems

Personal Stress Relief Products. In 2001, we introduced a new line of Personal Stress Relief products. The Foot Retreat Spa®, launched in July 2001, provided the foundation for the launch of additional new products in this category. In July 2002, we extended our foot spa product offering with the launch of the Pedicure foot spa and Sport foot spa. Also in July 2002, we launched the AccuReach® precision massager with a unique design that allows for an effortless, pinpoint massage experience.

The Personal Stress Relief products are marketed under the following product names:

Waterpik® Foot Retreat Spa®
Waterpik® AccuReach® precision massager

In July 2004, we began to pursue an orderly exit of personal stress relief products within our Personal Health Care segment. The Personal Stress Relief product line, introduced in 2001, includes foot spas and personal massagers. The orderly exit, which may extend over a period greater than 12 months is intended to focus our product development, marketing and selling resources on our core personal health care product lines toward the goal of improving our operating margin and return on capital.

POOL PRODUCTS AND HEATING SYSTEMS

The Pool Products and Heating Systems segment designs, manufactures and markets swimming pool and spa heaters, heat pumps, electronic controls, valves, pumps, filters, automatic salt chlorine generators and water features and residential and commercial water-heating systems.

Pool and Spa Products. We are a leader in the design, manufacture and marketing of swimming pool and spa equipment, which is sold primarily under the Jandy® and Laars® brand names. Our pool and spa products include:

- a wide range of swimming pool and spa heaters;
- swimming pool and spa heat pumps;
- technologically advanced electronic controls to automate all functions of swimming pools, spas and water effects;
- automatic pool cleaners;
- an extensive line of swimming pool and spa plumbing products, such as 3-way diverter valves, check valves, ball valves, backwash valves and valve actuators;
- multi-color pool and spa lights;
- automatic salt chlorine generators;
- a comprehensive line of water features such as waterfalls, rock falls, fountains, laminar flow jets, deck jets and decorative pool accents;
- a line of swimming pool pumps and filters; and
- pool and spa accessories, including cleaning and maintenance supplies, white goods, ladders, solar reels, floating lounges, pool toys and games.

These products are marketed under the following brand names:

PRODUCT CATEGORY	BRAND NAME
Pool Heaters	Jandy Laars Lite®, Jandy Laars LX®, Jandy Laars® LT, Jandy
High-efficiency Pool Heater	Jandy Laars® Hi-E2®
Oil Pool Heater	Jandy Laars® XL-3®
Commercial Pool Heater	Jandy Laars® AP , Pennant® pool heater
Heat Pumps	Air Energy heat pumps
Electronic Controls	Jandy® AquaLink® RS control system
Valves	Jandy® valve, Jandy® NeverLube® valve, Jandy® 3-way valve
Valve Actuator	Jandy® valve actuators
Automatic Pool Cleaner	Jandy® RayVac®
Automatic Salt Chlorine Generators	ClorMatic® salt chlorine generator
Water Features	Jandy Sheer Descent®, Aqua Accents , Laminar Flow Jets and Deck Jets
Pumps and Filters	Jandy® pump, Jandy® filter
Maintenance Equipment and Accessories	Olympic (in Canada), Water Pik®, Jandy®

We are a leading manufacturer and marketer of swimming pool and spa heaters, including natural gas-, propane- and oil-fired residential and commercial pool heaters. We manufacture both standard-efficiency and high-efficiency heaters.

In 1996, we acquired Jandy, one of the leading producers of electronic control systems, automatic valves, automatic cleaners and other water features for the swimming pool and spa industry. Jandy® electronic pool and spa controls are recognized as some of the highest quality, most technologically advanced and innovative products in the pool and spa industry. We produce a wide array of electronic control systems ranging from basic systems which adjust only one or two functions to sophisticated systems that completely automate a pool, spa, lighting, pumps, filters, water features and landscape features.

Jandy developed one of the first automatic pool cleaners. In addition, we manufacture valves and valve actuators, which automate pool and spa plumbing to switch water circulation between pool and spa, control spa overflow, drain water and control fountains, waterfalls, pumps, filters and other water features. Jandy® valves and valve actuators also are used by original equipment manufacturers for many automation applications.

In August 1999, we acquired substantially all the assets of Olympic ("Olympic"), which does business in Canada as Olympic Pool Accessories. Olympic manufactures and distributes cleaning and maintenance supplies, white goods, ladders, solar reels, floating lounges and pool toys and games. The acquisition of Olympic complements our existing pool and spa products. These pool accessories are being distributed in the U.S. and Europe under the Water Pik® and Jandy® brand names.

In June 2003, we acquired substantially all of the assets of Air Energy Heat Pumps, Inc. and affiliates ("Air Energy"), a privately held manufacturing company located in Ft. Lauderdale, Florida. Air Energy manufactures premium heat pumps for swimming pools and spas. The addition of heat pumps to our product line gives us a significant market position in regions of the country where heat pumps are the preferred technology to heat pools and spas.

In January 2004, we acquired substantially all of the assets of Huron Tech Systems, a division of Finnchem USA, Inc., located in Jacksonville, Florida. Huron Tech Systems manufactures automatic salt chlorine generators used for swimming pool and spa water sanitation and titanium heat exchangers, a component used in premium heat pumps. The addition of the ClorMatic® salt chlorine generator product line allows us to integrate a high-growth pool equipment category into our Jandy® system, a comprehensive line of pool and spa products designed to meet all the equipment needs of our customers. Additionally, the vertical integration into the manufacture of titanium heat exchangers used in our heat pumps has provided margin improvement for the heat pump product line.

We also offer a complete line of water features to enhance pool construction, which produce a range of water effects, including the Sheer Descent®, Sheer Arc , Sheer Curtain and Sheer Rain waterfalls; and the Aqua Accents .

Water-Heating Systems. We produce a comprehensive line of Laars® brand water-heating systems for commercial and residential applications. In August 1998, we acquired substantially all the assets of Trianco Heatmaker, Inc. ("Trianco"), a manufacturer of high efficiency, sealed combustion gas and oil fuel boilers and water-heating products, to enhance our capabilities in commercial and residential heating systems.

These products are marketed under the following brand names:

PRODUCT CATEGORY	BRAND NAME
Commercial Boilers and Water Heaters	Laars® Mighty Therm®, Laars® Mighty Max®, Laars® Mighty Stack®, Laars® Rheos®, Laars®Pennant®
Residential Boiler	Laars® Mini-Therm®
Residential Combination Boiler	Laars® Mini-Combo®
High-efficiency Boilers	Laars® CB , Laars®Summit®, Laars® Endurance , Laars® Rheos® Plus
Residential Oil Boilers	Laars® Max , Laars® Newport , Laars® Horizon

We have manufactured gas water-heating products for over 50 years, and have expanded our product line to include residential oil boilers and high efficiency boilers and water heaters for residential and commercial heating applications. These products include:

Mighty Therm® series of commercial boilers and water heaters which are natural draft appliances for propane or natural gas fuels;

Mighty Max® series of commercial boilers and water heaters which are high-efficiency fan assisted sealed combustion appliances for propane or natural gas fuels;

Mini-Therm® induced draft series of residential boilers;

Mini-Combo® atmospheric and induced draft combination hydronic boiler and domestic water heater;

Mighty Stack® atmospheric and automatic circulating water heater;

Newport high-efficiency residential oil boiler;

MAX high-efficiency residential oil boiler;

Laars® Rheos® high-efficiency modulating commercial boiler; and

Laars® Pennant® high-efficiency stage-fired commercial boiler.

In January 1999, we launched an innovative residential gas boiler, the Laars® Endurance boiler, which is fully modulating to match a home's changing heat load and is designed to provide homeowners with precise temperature control throughout the home while reducing energy consumption. The Endurance boiler is the first modulating residential boiler manufactured and distributed in North America. In August 2002, we introduced the Laars® Rheos® boiler, a high-efficiency, modulating commercial boiler. In April 2003, we introduced the Laars® Pennant® boiler, a high-performance, fan-induced unit designed for ease of installation.

Sales, Marketing and Distribution

We sell our products using a combination of inside sales representatives, manufacturer's representatives and distributors. This provides a broad distribution network that allows us to efficiently distribute our products across a number of distribution channels to reach a greater number of consumers and distributors than many of our competitors. International sales are primarily to Canada, Japan and Europe and accounted for 15 percent of our total sales for the nine months ended September 30, 2004. Approximately 49 percent of our international sales were in Canada.

PERSONAL HEALTH CARE

Water Pik® showerheads are marketed to consumers through mass merchandisers and home centers such as Wal-Mart, Target, Home Depot, Lowe's and Bed Bath & Beyond.

Water Pik® consumer oral health products are marketed to consumers through mass merchandisers and drug stores such as Wal-Mart, Target, Walgreens, Bed Bath & Beyond, Eckerds, CVS, Intersante in Germany and Biomed in Switzerland.

Professional oral health products are marketed under the Denar®, Getz® and Hanau® brands through professional dental supply dealers such as Sullivan-Schein, a Henry Schein® Company and Patterson Dental Supply Inc.

Water Pik® and Instapure® water filtration products are sold to consumers through mass merchandisers, home centers, drug stores and cooperative hardware chains such as Home Depot and Wal-Mart.

Water Pik® Personal Stress Relief products are currently being sold through traditional retail and liquidation distribution channels consistent with our pursuit of an orderly exit of Personal Stress Relief products.

Professional dental products and select showerheads, consumer oral health products, as well as replacement parts, also may be purchased on-line from our web site at http://www.waterpik.com. The web site also offers product information literature, including instructions for product use and service advice and the locations of retail outlets carrying Water Pik® products.

POOL PRODUCTS AND HEATING SYSTEMS

The Jandy® and Laars® swimming pool and spa equipment products are sold through an international network of wholesale distributors, contractors, retailers and service companies. Laars® water-heating systems are sold through a network of sales representatives and plumbing and HVAC wholesalers in the United States, Canada and internationally.

Competition

We compete with domestic and international companies. Competition is based on price, quality, service, product features, product innovation, marketing and distribution. Our success depends on our ability to introduce innovative products before our competitors and to design, manufacture and market a broad range of reliable products that incorporate technological innovations and that satisfy current consumer needs. Among the most significant competitors are larger companies that may have greater financial and technical resources than we do.

Competitors in personal health care products include companies such as The Gillette Company, which manufactures Braun® products; The Clorox Company, which manufactures Brita® products; Procter & Gamble Co., which manufactures PUR® and Crest® products; Colgate-Palmolive Company, which manufactures Actibrush®; Salton, Inc., which manufactures Ultrasonex® products; Masco Corporation, which manufactures Delta® products; Fortune Brands, Inc., which manufactures Moen® products; as well as a number of private companies including, Homedics, and Conair Corporation, which manufactures Pollenex® products.

Competitors in pool products include companies such as Pentair, Inc., which includes PacFab, Inc. and includes Pentair Pool Products® and Sta-Rite® products, Rheem Manufacturing Company, which manufactures Raypak® products and Hayward Industries, Inc., which manufactures Hayward® products. Competitors in water-heating products include companies such as SPX Corporation, whose subsidiary Weil-McLain manufactures boilers, Burnham Corporation, which manufactures boilers and water heaters, and A.O. Smith Corporation, which manufactures boilers and water heaters.

Research and Product Development

We support research and product development through cross-functional teams led by our marketing and engineering departments. The marketing team, together with outside consultants, researches both demographics and lifestyle trends to identify product concepts related to unmet consumer and commercial customer needs. Product concepts are then expressed in engineering prototypes in the early stage of new product development. Research and development continues as product concepts evolve through interaction with consumer focus groups until the final product is launched in the marketplace. In some cases, products may require sustaining engineering resources to fully meet the consumer and commercial customer needs. At any point in time, we generally have products in various stages of development. Our research and product development expenditures were approximately $4,955,000, $7,152,000 and $8,341,000 for the nine months ended September 30, 2004 and for the twelve months ended December 31, 2003 and 2002, respectively.

We develop and introduce new personal healthcare products targeted toward capitalizing on emerging consumer trends, such as the AquaFall® and Cascadia® drenching showerheads, the Water Pik® SynchroSonic® toothbrush, the New Visions® showerheads. We also regularly conduct clinical research to validate the safety and effectiveness of our consumer and professional oral health products. We develop and introduce new pool products targeted toward capitalizing on the growing pool owner desire for low maintenance pool care, such as the Jandy® AquaLink® RS control system, the Jandy® pumps, the Jandy® filters and the ClorMatic® salt chlorine generator. Research and product development efforts also focus on continuing to develop improved and innovative products that meet increasing energy efficiency performance requirements and stricter environmental regulations, such as the Laars® Summit®, a high-efficiency, modulating commercial boiler and water heater, the Laars® Pennant® commercial boiler and the Laars® Rheos® commercial boiler. Our research and development efforts have resulted in numerous awards for design and innovation.

Manufacturing and Materials

Our manufacturing operations consist of manufacturing finished products from components and subassemblies that we either produce or acquire from a wide range of vendors.

An increasing percentage of our products and components are manufactured by third-party original equipment manufacturers. While global sourcing has reduced overall product costs, it has also resulted in increased complexity in supply chain management, requiring a greater working capital investment.

We utilize two primary methods of fulfilling demand for products: building products to a demand forecast and building products to a customer order. In building products to a demand forecast, capabilities are employed to maximize manufacturing productivity and cost efficiencies by producing high volumes of basic product configurations. Building products to a customer order permits configuration of units to the particular specific customization requirements of the customer. Both methods are designed to generate high customer fill rates and on-time delivery relating to just-in-time manufacturing, inventory management and distribution practices.

We believe that there are a sufficient number of suppliers for most of our raw materials, components and subassemblies. A small number of raw materials and components, however, are purchased from single sources due to technology, availability, price, quality or other considerations. Order lead times and cancellation requirements vary by supplier and component. Key components and processes currently obtained from single sources include certain electrical components. In addition, newly introduced products may initially utilize custom components obtained from only one source until we have evaluated the need for additional suppliers.

Like other participants in the manufacturing industry, we ordinarily acquire materials and components through a combination of blanket and scheduled purchase orders released to position the supplier to support our requirements for periods averaging 90 to 180 days. From time to time we have experienced price increases and limited availability of certain components that are not available from multiple sources. At times, we have been constrained by raw materials and components availability in meeting product orders and future constraints could have an adverse effect on our operating results. On occasion, we acquire raw materials and components inventory in anticipation of supply constraints. A restoration of raw materials and components availability and resulting decline in raw materials and components pricing more quickly than anticipated could have an adverse effect on our operating results.

Patents and Trademarks

Our subsidiaries hold a number of patents registered in the U.S., Canada and other countries. Our subsidiaries also hold the exclusive rights with respect to certain technology included in their products. We rely primarily upon a combination of trademark, copyright, know-how, trade secrets, proprietary information, patents, licenses and contractual restrictions to protect our intellectual property rights. We believe that such measures afford only limited protection and, accordingly, there can be no assurance that the steps taken to protect our intellectual property rights will be adequate to prevent misappropriation of our technology or the independent development of similar technology by others. Despite our efforts to protect our proprietary rights, unauthorized parties may attempt to copy aspects of our products or obtain and use information that we regard as proprietary.

Seasonality

Our business is highly seasonal, with operating results varying from quarter to quarter. The Personal Health Care segment has historically experienced higher sales in the quarter ending in December of each fiscal year due to stronger retail demand during the holiday season. The Pool Products and Heating Systems segment has historically experienced higher sales in the quarters ending in June and December of each fiscal year as customers purchase such products in preparation for the cooler weather and in anticipation of the warm spring and summer months. In addition, as a result of the seasonality of sales, the Pool Products and Heating Systems segment offers incentive programs and extended payment terms to encourage pool product customers to purchase products from September through December, as is consistent with industry practice. Seasonal variations in operating results can also occur due to short-term trends such as changes in the economic environment and weather patterns. See also "Management's Discussion and Analysis of Financial Condition and Results of Operations."

Backlog

Backlog consists of firm orders for our products that are generally shipped within the next year. Backlog was $12,452,000 as of September 30, 2004 and $10,277,000 as of December 31, 2003. The increase in the backlog was due to the higher sales volume in 2004 combined with the seasonal nature of our business.

Employees

Our work force consists of approximately 1,500 employees as of September 30, 2004. We are not a party to a collective bargaining agreement with respect to any of our employees. We consider our relations with our employees to be good.

Available Information

Financial and other information about the Company is available on our website (http://www.waterpik.com). We make available, free of charge, on our Internet website, our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act as soon as reasonably practicable after we electronically file such material with or furnish it to the SEC.

Executive Officers

The information regarding our executive officers is contained in Item 10 of Part III of this Form 10-K.

Forward-Looking Statements

This report contains disclosures that are forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act. These forward-looking statements are based on current expectations, estimates, forecasts and projections about us, our future performance, our business or others on our behalf, our beliefs and our management's assumptions. All statements regarding our expected future financial condition, results of operations, cash flows, dividends, financing plans, business strategy, budgets, projected costs or cost savings, capital expenditures, competitive positions, growth opportunities for existing products or products under development, benefits from new technology, plans and objectives of management for future operations and markets for stock are forward-looking statements that involve certain risks and uncertainties. In addition, forward-looking statements include statements in which we use words such as "expect," "believe," "anticipate," "intend," or similar expressions. We have based our forward-looking statements on our management's beliefs and assumptions based on information available to our management at the time the statements are made. Although we believe the expectations reflected in such forward-looking statements are based on reasonable assumptions, we cannot assure you that such expectations will prove to have been correct and actual results may differ materially from those reflected in the forward-looking statements. We do not have any intention or obligation to update forward-looking statements, even if new information, future events or other circumstances make them incorrect or misleading.

Factors that could cause our actual results to differ from the expectations reflected in the forward-looking statements in this document include the following:

We may be unable to successfully enhance our existing products and develop and market enhanced or new products in a timely and cost-effective manner.

Our growth and future success will depend upon our ability to enhance our existing products and to develop and market enhanced or new products in a timely and cost effective manner. We may not be successful in developing or marketing enhanced or new products, and the market may not accept our products. The resulting level of sales of any of our enhanced or new products may not justify the costs associated with their development and marketing. In addition, certain new products require greater testing and governmental agency regulatory approvals than our existing product lines. Such testing and approval processes are designed to determine whether a new product is safe and effective. The process of developing data to support product effectiveness claims and/or applications for regulatory approval is costly and may not ultimately prove to be successful.

We may not have sufficient capital resources to fund planned product line extensions, new product development, capital expenditures and possible acquisitions.

We cannot satisfy all of our planned product line extensions, new product development plans, capital expenditure programs and possible acquisitions without additional capital. While we believe that our working capital and general financing requirements for our existing business can be satisfied from the anticipated cash flow from operations and available borrowings under our credit facility, we cannot assure that this will continue to be the case. Our ability to raise additional capital will depend on a variety of factors, some of which will not be within our control, including investor perceptions of us, our business and the industries in which we operate, and general economic and market conditions. We may be unable to successfully raise needed capital and the amount of net proceeds that will be available to us may not be sufficient to meet our needs. Even if we are successful in raising capital, it may not be on favorable terms. Failure to successfully raise needed capital on a timely basis or to obtain any needed additional financing on favorable terms could have a material adverse effect on our business, results of operations and financial condition.

The failure of our growth strategy could have a material adverse effect on our business.

As part of our growth strategy, we plan to:

- develop high quality, lower cost manufacturing capabilities;
- pursue product line extensions for existing categories and enhance existing products;
- expand into new channels of distribution with existing products;
- develop a self-sustaining product development process; and

seek complementary acquisitions and alliances to enhance our market presence.

We cannot assure you that our strategic objectives will be realized or, if realized, will result in increased revenue, profitability or market presence.

Executing our strategy may also place a strain on our production, information systems and other resources. To manage growth effectively, we must maintain a high level of manufacturing quality and efficiency, continue to enhance our operational, financial and management systems, including our database management, inventory control and distribution systems, and expand, train and manage our employee base. We cannot assure you that we will be able to effectively manage our expansion in any one or more of these areas, and any failure to do so could have a material adverse effect on our business, results of operations and financial condition.

Well-financed competitors could attempt to capture our market share.

The markets in which we operate are highly competitive. We compete with domestic and international companies. Among our most significant competitors are larger companies that have greater financial and technical resources than we do. In our Personal Health Care segment, our competitors include companies such as The Gillette Company, which manufactures Braun® products, The Clorox Company, which manufactures Brita® products, and Procter & Gamble Co., which manufactures PUR® and Crest® products; Colgate-Palmolive Company, which manufactures Actibrush®; Salton, Inc., which manufactures Ultrasonex® products; Masco Corporation, which manufactures Delta® products; Fortune Brands, Inc., which manufactures Moen® products, as well as a number of private companies including Homedics and Conair Corporation, which manufactures Pollenex® products. In our Pool Products and Heating Systems segment, our competitors include companies such as Pentair Pool Products®, which includes PacFab, Inc.; and Sta-Rite® products, Rheem Manufacturing Company, which manufactures Raypak® products; Hayward Industries, Inc., which manufactures Hayward® products; SPX Corporation, whose subsidiary Weil-McLain manufactures boilers, Burnham Corporation, which manufactures boilers and water heaters, and A.O. Smith Corporation, which manufactures boilers and water heaters. Because these companies have greater financial and technical resources than we do, they may be willing to commit significant resources to protect their own market shares or to capture market share from us. As a result, we may need to incur greater costs than previously incurred for trade and consumer promotions and advertising to preserve or improve market share, to introduce and establish new products and line extensions and to enhance existing products. At the same time, we may need to undertake additional production-related cost-cutting measures to enable us to respond to competitors' price reductions and marketing efforts without reducing our margins. We cannot assure that we will be able to make such additional expenditures or implement such cost-cutting measures or that, if made or implemented, they will be effective.

We are dependent on certain key customers and the general retail environment and are subject to significant pricing pressures.

Our top ten customers, including the effects of acquisitions, accounted for 47 and 43 percent of our net sales for the nine months ended September 30, 2004 and for the twelve months ended December 31, 2003, respectively. SCP Pool Corporation ("SCP"), The Home Depot, Inc., and Wal-Mart Stores, Inc. were our largest customers, accounting for 18 percent, 5 percent and 5 percent, respectively, of our net sales for the nine months ended September 30, 2004 and 15 percent, 6 percent and 5 percent, respectively, of our net sales for the twelve months ended December 31, 2003. SCP accounted for approximately 7 percent of our accounts receivable as of September 30, 2004.

The loss of, or a substantial decrease in, the volume of purchases by top customers such as SCP, The Home Depot or Wal-Mart Stores Inc. or any of our other top customers could have a material adverse effect on our business, results of operations and financial condition. A change in seasonal buying patterns by our top customers or a greater emphasis on inventory management by SCP or other top pool customers could impact their purchases of Jandy® and Laars® products and have an adverse impact on the business.

We also face pricing pressures from our trade customers. Because of the highly competitive retail environment, retailers have increasingly sought to reduce inventory levels and obtain pricing concessions from vendors. From time to time, we need to reduce the prices for some of our products to respond to competitive and consumer pressures. We are also subject to the risk that high-volume customers could seek alternative pricing concessions or better trade terms. In our Pool Products business, we offer rebate programs and other sales concessions in order to remain competitive, which may erode our profitability.

Our performance also is dependent upon the general health of the retail environment and financial condition of our customers. We sell to a diverse customer base. We grant credit terms in the normal course of business to our customers. We perform on-going credit evaluations of our customers and adjust credit limits based upon payment history and the customer's current credit worthiness, as determined through review of their current credit information. We also monitor collections and payments from customers and maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. However, we cannot assure that any of our efforts will protect us from non-payment by or insolvency of our customers. Changes in the retail environment and the financial difficulties of customers could have a material adverse effect on our business, results of operations and financial condition.

Acquisitions involve inherent risks that may adversely affect our operating results and financial condition.

Our growth strategy includes acquisitions of existing businesses and product lines. Acquisitions involve various inherent risks, such as:

- our ability to assess accurately the value, strengths, weaknesses, contingent and other liabilities and potential profitability of acquisition candidates;
- the potential loss of key personnel of an acquired business;

- our ability to integrate acquired businesses and to achieve identified financial and operating synergies anticipated to be achieved from an acquisition; and
- unanticipated changes in business and economic conditions affecting an acquired business.

Our business is highly seasonal which may adversely affect our operating results and financial condition.

Our business is highly seasonal, with operating results varying from quarter to quarter. Our Personal Health Care segment has historically experienced higher sales in the quarter ending in December of each fiscal year due to stronger retail demand during the holiday season. Our Pool Products and Heating Systems segment has historically experienced higher sales in the quarters ending in June and December of each fiscal year as customers purchase such products in preparation for the cooler weather and in anticipation of the warm spring and summer months. In addition, as a result of the seasonality of sales, our Pool Products and Heating Systems segment offers incentive programs and extended payments terms to encourage pool product customers to purchase products from September through December, as is consistent with industry practice. This increases the risk that our customers will build-up excess inventory in response to purchase incentives and increase our accounts receivables as we have high outstanding balances for a number of months following these incentive programs. In addition, seasonality increases the risk of having insufficient cash to invest in product development at critical times. Poor weather can also have a material adverse impact on sales of pool products.

We are subject to the risks associated with international sales.

During the nine months ended September 30, 2004, international sales accounted for approximately 15 percent of our total sales, of which approximately 49 percent were sales made in Canada. We anticipate that future international sales will increase and may account for a more significant percentage of our sales. Risks associated with such increased international sales include:

- political and economic instability;
- export controls;
- changes in legal and regulatory requirements;
- U.S. and foreign government policy changes affecting the markets for our products; changes in tax laws and tariffs;
- convertibility and transferability of international currencies; and
- exchange rate fluctuations (which may affect sales to international customers and the value of and profits earned on international sales when converted into dollars).

We are subject to the risks associated with foreign suppliers.

We purchase a significant and growing portion of our Personal Health Care products from foreign suppliers and use foreign suppliers for some Pool Products and Heating Systems products, components and subassemblies as well. These products are primarily produced by contract manufacturers in China and Malaysia and are shipped on ocean vessels to global distribution locations. Among other risks associated with doing business abroad (see international sales risks above), our use of international suppliers causes increased risk to our business due to:

- increases in transportation costs;
- import duties;
- transportation delays;
- foreign work stoppages;
- potential war, terrorism and political unrest;

the need to maintain higher inventory levels at distribution centers in the U.S. to partially offset fluctuations in foreign production and shipping; and

exchange rate fluctuations which could increase the cost of foreign manufactured goods.

Product liability claims, product recalls, rising insurance costs and rising warranty costs could have a material adverse effect on our results of operations and financial condition.

As a manufacturer and distributor of consumer products, product liability claims challenging the safety of our products are periodically asserted against us. While we vigorously defend such claims and the integrity of our products, the cost of defending and resolving claims and the adverse publicity, which could result from such claims, may have a material adverse effect on our results of operations and financial condition. In addition, the costs associated with defending and resolving our product liability claims, and the overall insurance market in general, has led to an increase in our insurance costs, including our payments of higher premiums and deductibles, which may ultimately affect our ability to obtain insurance coverage and may have a material adverse effect on our results of operations.

In addition, if the federal Consumer Products Safety Commission or state or local authority requires us to recall or repurchase our products, or if we institute a voluntary recall of our products, the repurchase or recall could be costly to us financially and could damage our reputation. If we were required to remove, or we voluntarily removed our products from the market, our reputation could be tarnished and we might have large quantities of finished products that could not be sold. This could have a material adverse effect on our business, results of operations and financial condition. In addition, development of new products creates increased risk of higher warranty claims. We experienced an increase in warranty cost during 2004.

There has been an increase in asbestos-related lawsuits against multiple defendant companies, some of which historically may have manufactured or sold products that had asbestos-containing components. Many of these companies have not been historically associated with having asbestos risks. We have been named in a number of such suits. In many of these suits the alleged ties to our products are either unclear or we have been able to demonstrate that the identified product did not contain asbestos. We do not expect to incur any material liabilities in connection with these lawsuits. However, there is no assurance that we will continue to be successful in defending asbestos claims. In addition, our historic insurance coverage, including that of our predecessors, may not cover asbestos claims or the defense of such matters, as coverage depends on the year of purported exposure and other factors.

Failure to protect our intellectual property could reduce our competitiveness.

Our intellectual property rights are important to our business because they protect our investment in valuable research and development incorporated in our patents and goodwill we build up in our trademarks. We rely primarily upon a combination of trademark, copyright, know-how, trade secrets, proprietary information, patent and contractual restrictions to protect our intellectual property rights. We believe that such measures afford only limited protection and, accordingly, we cannot assure you that the steps taken by us to protect these intellectual property rights will be adequate to prevent misappropriation of our technology or the independent development of similar technology by others. The costs associated with protecting our intellectual property rights, including litigation costs, may be material. We also cannot be sure that we will be able to successfully assert our intellectual property rights or that these rights will not be invalidated, circumvented or challenged. In addition, the laws of some foreign countries in which our products are sold do not protect our intellectual property rights to the same extent as the laws of the United States. Our failure or our inability to protect our intellectual property rights, a successful intellectual property challenge or infringement proceeding against us, could make us less competitive and have a material adverse effect on our business, operating results and financial condition.

There are inherent limitations in all control systems, and misstatements due to error or fraud may occur and not be detected.

While we continue to take action to assure compliance with the internal controls, disclosure controls and other requirements of the Sarbanes-Oxley Act of 2002 and the new Securities and Exchange Commission and New York Stock Exchange rules, there are inherent limitations in our ability to control all circumstances. Our management, including our Chief Executive Officer and Chief Financial Officer, does not expect that our internal controls and disclosure controls will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. In addition, the design of a control system must reflect the fact that there are resource constraints and the benefit of controls must be relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, in our Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple error or mistake. Further, controls can be circumvented by individual acts of some persons, by collusion of two or more persons, or by management override of the controls. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, a control may be inadequate because of changes in conditions or the degree of compliance with the policies or procedures may deteriorate. Because of inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

Other risk factors.

There are numerous other factors, many of which are outside of our control, which could adversely impact our results of operations and financial condition. Such factors include: adverse weather conditions, natural disasters, large scale medical outbreaks, such as SARS, acts of international or domestic terrorism and international, political and military developments which may, among other things, impair distribution of our products and reduce consumer spending on our products; labor disputes, which could increase costs and disrupt production of our products; price increases in commodities such as steel, copper, aluminum, titanium, oil and resin, which would increase our product costs; changing public and consumer tastes, which could result in lower spending on our products; and legal and regulatory developments that could impact how we operate with respect to environmental activities, safety, protection of intellectual property, importing or exporting of products, delays at West Coast ports and other areas.

Any of these factors could have a material adverse effect on our business, results of operations and financial condition. See "Management's Discussion and Analysis of Financial Condition and Results of Operations."

Item 2 Properties

Our principal facilities as of December 3, 2004 are listed below. Five of the ten facilities are owned and, of those owned, the facilities located in the U.S. are pledged as collateral on mortgage notes under our real estate financing agreement. Although the facilities vary in terms of age and condition, we believe that the facilities have been well maintained. Each of the manufacturing facilities conducts manufacturing operations in a relatively autonomous manner, supported by its own manufacturing, assembly and fulfillment areas, quality assurance department, and other support functions. We have instituted quality assurance programs to provide that our products comply with the Consumer Products Safety Act and other similar laws. Our Fort Collins and Loveland, Colorado facilities are ISO 9001:2000, EN ISO 13485:2000 and Canadian Medical Device Conformity Assessment System certified. We are currently evaluating the benefits and costs of continuing to maintain ISO certifications at some or all of our facilities.

FACILITY LOCATION	PRINCIPAL USE	SQUARE FOOTAGE (OWNED/LEASED)	
Fort Collins, Colorado	Manufacturing of professional oral health products and distribution of Water Pik® consumer products.	250,000	(owned)
Loveland, Colorado	Manufacturing of showerheads and water filtration products.	136,000	(owned)
Montreal, Canada (2 buildings)	Manufacturing and distribution of pool and spa accessories, including cleaning and maintenance supplies, white goods, ladders, solar reels, floating lounges, pool toys and games.	55,000 47,000	(leased) (leased)
Moorpark, California	Manufacturing and distribution of pool and spa heaters, pool pumps and filters, valves, actuators, electronic controls, automated cleaners, water features, boilers and water heaters.	200,000	(owned)
Oakville, Canada	Distribution of Laars® and Jandy® products.	40,000	(owned)
Petaluma, California	Sales, marketing and customer service for pool products.	21,000	(leased)
Rochester, New Hampshire	Manufacturing of commercial boilers, water heaters and Trianco products.	80,000	(owned)
Markham, Canada	Sales and marketing.	4,900	(leased)
Ft. Lauderdale, Florida	Manufacturing of pool and spa heat pumps.	52,000	(leased)
Jacksonville, Florida (2 buildings)	Manufacturing of automatic salt chlorine generators for pool and spa use and titanium heat exchangers used in heat pumps.	15,000 2,200	(leased) (leased)

Our executive offices are located in Newport Beach, California and are leased from a third party. Our facilities are modern and sufficient to carry on current activities.

Item 3 Legal Proceedings

A number of lawsuits, claims and proceedings have been or may be asserted against us relating to the conduct of our business, including those pertaining to product liability, personal injury, patent infringement, commercial, employment and employee benefits. While the outcome of litigation cannot be predicted with certainty, and some of these lawsuits, claims or proceedings may be determined adversely to us, we do not believe that the disposition of any such pending matters is likely to have a material adverse effect on our financial condition or liquidity, although the resolution in any reporting period of one or more of these matters could have a material adverse effect on our results of operations for that period and ultimately could affect the cost of our insurance premiums or our ability to obtain insurance coverage.

As a consumer goods manufacturer and distributor, we are subject to continuing risk of product liability and related lawsuits involving claims for substantial monetary damages. We are party to various personal injury and property damage lawsuits and claims relating to our products and other litigation incidental to our business. We have general liability, product liability and workers' compensation insurance coverage. Our insurance coverage provides that we are responsible for policy deductibles and legal costs and expenses. Loss accruals have been recorded in accordance with Statement of Financial Accounting Standards ("SFAS") No. 5, "Accounting for Contingencies" to cover the portion of general liability, product liability and workers' compensation claims, both asserted claims and incurred but not reported claims, that are not covered by insurance policies. Such accruals are based on estimates which include information provided by our insurance company, claims adjusters and insurance broker, taking into account prior experience, numbers of claims, discussions with legal counsel and other relevant factors. The methods of making such estimates and establishing the resulting accrual are reviewed on a regular basis and any resulting adjustments are reflected in current operating results.

There has been an increase in asbestos-related lawsuits against multiple defendant companies, some of which historically may have manufactured or sold products that had asbestos-containing components. Many of these companies have not been historically associated with having asbestos risks. We have been named in a number of such suits. In many of these suits the alleged ties to our products are either unclear or we have been able to demonstrate that the identified product did not contain asbestos. We do not expect to incur any material liabilities in connection with these lawsuits. However, there is no assurance that we will continue to be successful in defending asbestos claims. In addition, our historic insurance coverage, including that of our predecessors, may not cover asbestos claims or the defense of such matters, as coverage depends on the year of purported exposure and other factors.

Effective January 1, 2004, we changed our employee medical coverage from a fully-insured plan to a self-insured plan. The plan is partially funded by payroll deductions from participating employees. We have a maximum liability per participant per year in addition to an aggregate maximum liability for all claims. Amounts in excess of the stated maximums are covered under a separate policy provided by an insurance company. We provide for both reported and incurred but not reported medical costs and pay claims and administrative expenses as they become due.

We have recorded loss accruals covering the portion of lawsuits and claims, including our employee medical and dental plan, not covered by insurance policies of $3,542,000 and $3,702,000 as of September 30, 2004 and December 31, 2003, respectively. The amount related to product and general liability lawsuits, asserted claims and incurred but not reported claims was $2,037,000 and $2,382,000 as of September 30, 2004 and December 31, 2003, respectively. The amount related to workers' compensation asserted claims and incurred but not reported claims was $1,505,000 and $1,320,000 as of September 30, 2004 and December 31, 2003, respectively. The amount related to medical and dental self-insured reserves including incurred but not reported claims was $1,230,000 as of September 30, 2004.

Item 4 Submission of Matters to a Vote of Security Holders

There were no matters submitted to a vote of security holders during the quarter ended September 30, 2004.

PART II

Item 5 Market for the Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Price Range of Common Stock

Our Common Stock is listed on the New York Stock Exchange and trades under the symbol "PIK." The following table sets forth, for the periods indicated, the high and low sales prices for our Common Stock as reported by the New York Stock Exchange.

		High		Low
2004				
First Quarter (ended March 31)	$	14.19	$	11.79
Second Quarter (ended June 30)		17.44		13.40
Third Quarter (ended September 30)		16.85		11.60
2003				
First Quarter (ended March 31)		8.49		6.43
Second Quarter (ended June 30)		8.50		6.22
Third Quarter (ended September 30)		10.65		7.70
Fourth Quarter (ended December 31)		13.42		9.83

On December 3, 2004, the closing sale price of our Common Stock as reported by the New York Stock Exchange was $16.86 per share. As of December 3, 2004, there were 4,150 holders of record of our Common Stock.

Dividend Policy

To date, we have paid no cash dividends to our stockholders. We have no plans to pay dividends on our Common Stock in order to conserve cash for use in our business including funding future operations and growth. In addition, the terms of our credit facility limit the amount of cash dividends that we may pay.

Item 6 Selected Financial Data

Selected Consolidated Financial Data

The following table summarizes selected consolidated financial data for Water Pik Technologies, Inc. We derived the following historical data from our audited consolidated financial statements. We have reclassified some amounts reported in previous years to conform to our 2004 presentation. These reclassifications had no effect on our reported results of operations or stockholders' equity. Effective January 2004, we began operating on a 52- or 53-week fiscal year ending on the Sunday closest to September 30. For years prior to 2004, we operated on a 52- or 53-week fiscal year ending on the Sunday closest to December 31.

(in thousands, except for share and per share amounts)	**Nine Months Ended September 30, 2004**	**For the Twelve Months Ended December 31, 2003**	**2002**	**2001**	**2000**
Consolidated Statement of Income Data					
Sales	$ 251,240	$ 305,125	$ 281,802	$ 281,691	$ 288,233
Gross profit	$ 69,230	$ 91,555	$ 90,565	$ 93,036	$ 94,465
Income from continuing operations	$ 7,442	$ 11,045	$ 10,491	$ 12,515	$ 10,734
Income (loss) on discontinued operations, net of tax	52	(80)	(4,992)	(2,398)	(531)
Net income	$ 7,494	$ 10,965	$ 5,499	$ 10,117	$ 10,203
Diluted net income (loss) per common share					
Continuing operations	$ 0.59	$ 0.89	$ 0.85	$ 1.05	$ 1.10
Discontinued operations		(0.01)	(0.41)	(0.20)	(0.05)
Net income	$ 0.60	$ 0.88	$ 0.44	$ 0.85	$ 1.05
Average weighted common shares outstanding diluted	12,571,231	12,394,056	12,413,390	11,948,266	9,722,996
EBITDA[1]					
Income from continuing operations before income taxes	$ 11,926	$ 17,123	$ 16,319	$ 20,641	$ 17,202
Adjusted for:					
Interest expense, net	1,026	1,646	1,929	2,576	3,714
Depreciation and amortization	7,677	10,090	9,658	9,555	

14 Business review Prudential plc Annual Report 2012

Chief Financial Offi cer s overview

Delivering profi table growth and enhanced capital fl exibility

[Graphic Appears Here]

Over the last few years, our success has been founded on attracting new customers and on retaining those who have chosen Prudential for their

For the Twelve Months Ended December 31,

savings and protection needs. We operate in markets where consumer demand for the products that we provide is strong and we have achieved success by providing both value and service to our customers while generating attractive returns for shareholders.

Nic Nicandrou

Chief Financial Offi cer

EEV new business profit
IFRS operating profit based on

longer-term investment returns1

Ł2,452m +14% Ł2,533m +25%

Ł2,151m

Ł2,027m

2011

2012

2011

2012

Our guiding operating principle is simple drive remitting over Ł300 million for the fi rst time in its history and the creation of sustainable shareholder value while exceeding its 2013 cash objective. With IFRS operating profi t, operating within a conservative risk management after development expenses, of Ł988 million in 2012, Asia framework. Over the last four years, through a has also exceeded its 2013 IFRS operating profi t objective. combination of disciplined execution and prudent

EEV new business profi t (new business profi t), our primary management of our balance sheet risks, Prudential has growth measure, increased by 14 per cent to Ł2,452 million delivered profi table growth and enhanced its

For the Twelve Months Ended December 31,

capital

(2011: Ł2,151 million), IFRS operating profi t based on fl exibility, despite the challenging market environment. longer-term investment returns (IFRS operating profi t)

2012 has seen Prudential continue to build on the positive increased by 25 per cent to Ł2,533 million (2011: Ł2,027 million)1 momentum of recent years, with a strong fi nancial performance and net cash remitted from the business units to the Group that included two of our 2013 Growth and Cash fi nancial increased by 9 per cent to Ł1,200 million (2011: Ł1,105 million). objectives being exceeded and continued progress towards the As these results demonstrate, the quality of our businesses rest. This performance refl ects good contributions across our key across Asia, the US and the UK, combined with the strength of fi nancial measures from each of our business operations, despite our balance sheet and fi nancial discipline, underpins the Group s the

challenge of low long-term interest rates and weak growth in ability to deliver both growth and cash in the face of continued the global economy. It is particularly pleasing to note that Asia macroeconomic headwinds. became the largest contributor of cash to the Group in 2012.

Note

1 Comparatives adjusted for retrospective application of the accounting policy change for deferred acquisition costs as discussed in note A5 of the IFRS financial statements.

For the Twelve Months Ended December 31,

Profi tability

Over the last few years, our success has been founded on attracting new customers and on retaining those who have chosen Prudential for their saving and protection needs. We operate in markets where consumer demand for the products that we provide is strong and we have achieved success by providing both value and service to our customers while generating attractive returns for shareholders. In 2012 this approach produced Ł10.5 billion of life business net infl ows on shareholder-backed business, which together with investment-related and other movements, drove an increase in the overall size of our life insurance book of business by 22 per cent to Ł163 billion (2011: Ł133.5 billion). At the same time, our combined asset management operations attracted

Ł18.3 billion of retail and institutional net fl ows, surpassing the previous highs in 2009 and 2010, driving an increase in the third party managed funds by 20 per cent to Ł133 billion (2011: Ł111 billion). By attracting, retaining and growing our customers savings and our obligations towards them, we are able to generate higher revenues, which in 2012 have once again increased at a faster rate than our expenses, culminating in greater overall profi ts.

Group IFRS operating profi t increased by 25 per cent in 2012 to Ł2,533 million (2011: Ł2,027 million)1, driven by strong growth in total contributions2 from Asia and the US, which were up 26 per cent and 49 per cent respectively. Group EEV operating profi t based on longer-term investment returns (EEV operating profi t) increased by 9 per cent to

For the Twelve Months Ended December 31,

Ł4,321 million (2011: Ł3,978 million), with growth in all regions. Non-UK operations now account for a larger proportion of both total IFRS and EEV operating profi t than ever before, while the contribution to these metrics from each business operation and each earnings source remains well balanced, preserving both the quality and the resilience of the Group s earnings.

Our Asia long-term business has continued to build on the progress of recent years, with IFRS operating profi t of Ł920 million (2011: Ł709 million)1 up 30 per cent. This strong performance has been driven by the increase in the size of the in-force portfolio including the growth of our health and protection business. Our largest markets of Indonesia, Hong Kong, Singapore and Malaysia continue to generate good levels of growth, with IFRS operating profi t up 22 per cent collectively. Asia s long-term EEV operating profi t grew by 11 per cent in 2012 to Ł1,960 million (2011: Ł1,764 million), with progress on this measure impacted by lower expected returns as a result of the fall in interest rates during the year.

Notes

1 Comparatives adjusted for retrospective application of the accounting policy change for deferred acquisition costs as discussed in note A5 of the IFRS financial statements.

2 Operating profit from long-term and asset management business.

Chief Financial Offi cer s overview Prudential plc Annual Report 2012 15

Chief

Financial

Offi

For the Twelve Months Ended December 31,

In the US, long-term business IFRS operating profit was up cer s

48 per cent in 2012 to Ł964 million (2011: Ł651 million)1, which

includes a contribution of Ł67 million from REALIC, following its

acquisition in September 2012. The remaining increase primarily overview

reflects higher fee income generated by growth in the separate

account assets, as well as the expected non-recurring impact

of accelerated deferred acquisition cost (DAC) amortisation

of Ł190 million in 2011. This has been partially offset by the

adverse effect on spread income of lower bond yields. Fee Business

income increased by 29 per cent to Ł875 million in 2012

(2011: Ł680 million), as a result of growth in separate account review

asset balances, which stood at Ł49 billion at 31 December

2012 (31 December 2011: Ł38 billion), together with higher

average fee levels. Spread income (including the expected

return on shareholders assets) was Ł757 million in 2012

(2011: Ł813 million), with lower yields reducing the average

spread margin that we earned on general account liabilities

	For the Twelve Months Ended December 31,

from 258 basis points in 2011 to 239 basis points in 2012 as

expected. Jackson s long-term EEV operating profit increased

by 13 per cent to Ł1,610 million (2011: Ł1,431 million) primarily

due to improved new business profits and higher opening value

of in-force business following recent growth in the portfolio.

We are pleased with the acquisition of REALIC as it presents

a financially attractive deal, generating seasoned insurance

income, immediate earnings accretion and a gain on EEV

shareholders funds of Ł453 million.

UK long-term business IFRS operating profit was 3 per cent

higher at Ł703 million (2011: Ł683 million) including Ł431 million

from the shareholder-backed business. The strength of the

with-profits fund, which currently has a surplus estate of

Ł7.0 billion, offers strong policyholder protection and assists

in generating positive returns for both policyholders and

shareholders. EEV long-term operating earnings increased

by 2 per cent in 2012 to Ł866 million (2011: Ł853 million),

representing higher new business profits offset by the

For the Twelve Months Ended December 31,

impact

of lower interest rates on the recognition of in-force profits.

Our asset management businesses generated IFRS operating

profit of Ł485 million in 2012 (2011: Ł461 million), with M&G s

contribution higher at Ł371 million (including Prudential Capital).

M&G continues to benefit from the delivery of strong inflows,

with underlying profits (excluding performance-related

payments and earnings from associates) up 14 per cent in 2012.

This progress reflects higher revenues, up 10 per cent in 2012,

as the scale and proportion of external funds continues to grow,

and improvements in the cost-income ratio, to 59 per cent in

2012 (2011: 61 per cent). IFRS operating profit from Eastspring

Investments of Ł75 million (2011: Ł80 million) was impacted by

lower average margins on funds under management following

a consumer-led shift in business mix away from equities to

fixed income funds, as well as increased costs as the business

For the Twelve Months Ended December 31,

continues to invest in growth opportunities. This included

the opening of its first US office, in Chicago, in June 2012 and

starting operations in Indonesia.

For the Twelve Months Ended December 31,

16 Business review Prudential plc Annual Report 2012

Chief Financial Offi cer s overview continued

Capital generation

We continue to promote disciplined use of our capital resources across the Group, and focus on allocating capital to the growth opportunities that offer the most attractive returns with the shortest payback periods. We have taken several important steps over the last few years to improve the effi ciency and effectiveness of the capital allocation process, which has improved not only our returns on capital invested but also our overall fi nancial fl exibility. In 2012 we have continued to produce signifi cant amounts of free capital, which we measure as free surplus generated.

In 2012, we generated Ł2,700 million of underlying free surplus (before reinvestment in new business) from our life in-force and asset management businesses. This is 6 per cent higher than the Ł2,536 million generated in 2011, refl ecting increases from Asia and the US. We reinvested Ł618 million of the free surplus generated in the period into writing new business (2011: Ł553 million).

Asia continues to be our preferred destination for new capital and accounted for Ł292 million of this reinvestment (2011: Ł297 million), falling despite the growth in new business as we continue to focus on more capital-effi cient products. We have not sought to invest in spread-based products in the region that carry more onerous capital charges and produce insuffi cient returns. In the US, new business investment has increased to

For the Twelve Months Ended December 31,

Ł281 million from Ł202 million in 2011, which primarily refl ects the higher level of new business written, changes in business mix, and the impact on regulatory reserving requirements for new business from the low interest rate environment. In the UK, our capital-effi cient product focus on annuities and with-profi ts bonds means we invested just Ł45 million, yet delivered more new business profi t. The IRRs on invested capital were more than 20 per cent in Asia, the US, and the UK; with payback periods of three years, two years and three years respectively.

Of the remaining free surplus generated after reinvestment in new business, Ł1,200 million was remitted from the business units to Group. This cash was used to meet central costs of Ł205 million, service net interest payments of Ł278 million and meet dividend payments of Ł655 million. The total free surplus balance deployed across our life and asset management operations at the end of the year was Ł3,689 million (2011: Ł3,421 million).

Notes

1 The objectives assume current exchange rates and a normalised economic environment consistent with the economic assumptions made by Prudential in calculating the EEV basis supplementary information for the half-year ended 30 June 2010. They have been prepared using current solvency rules and do not pre-judge the outcome of Solvency II, which remains uncertain.

2 The net remittance objective for Jackson was increased from Ł200 million to Ł260 million to reflect the positive impact of the acquisition of REALIC.

3 Representing the underlying remittances excluding the Ł150 million impact of

For the Twelve Months Ended December 31,

proactive financing techniques used to bring forward cash emergence of the in-force book during the financial crisis.

Growth and Cash fi nancial objectives

The following discussion contains forward-looking statements that involve inherent risks and uncertainties. Prudential s actual future fi nancial condition or performance or other indicated results may differ materially from those indicated in any such forward-looking statement due to a number of important factors (including those discussed under the heading Risk factors in this document). See the discussion under the heading Forward-looking statements at the front of this document.

At our 2010 investor conference, entitled Growth and Cash , we announced new fi nancial objectives demonstrating our confi dence in continued rapid growth in Asia, and increasing levels of cash remittances from all of our businesses. These objectives have been defi ned as follows:

(i) Asia growth and profitability objectives1:

To double the 2009 value of IFRS life and asset management pre-tax operating profit in 2013 (2009: Ł465 million); and

To double the 2009 value of new business profits in 2013 (2009: Ł713 million).

(ii) Business unit cash remittance objectives1:

Asia to deliver Ł300 million of net cash remittance to the Group in 2013 (2009: Ł40 million);

Jackson to deliver Ł260 million2 of net cash remittance to the Group in

For the Twelve Months Ended December 31, 2012 (2009: Ł39 million); and

UK to deliver Ł350 million of net cash remittance to the Group in 2013 (2009: Ł284 million3).

(iii) Cumulative net cash remittances1:

All business units in aggregate to deliver cumulative net cash remittances of at least Ł3.8 billion over the period 2010 to end-2013. These net remittances are to be underpinned by a targeted level of cumulative underlying free surplus generation of Ł6.5 billion over the same period.

As mentioned in the Group Chief Executive s report, we remain focused on these objectives and have continued to make progress towards them. In 2012 we have exceeded our 2013 IFRS operating profi t and net remittance objectives for Asia and we are on track to achieve the rest. We set out below in more detail our progress towards these objectives based on our results for 2012.

Chief Financial Officer s overview Prudential plc Annual Report 2012 17

Chief

Financial

Offi

For the Twelve Months Ended December 31,

Asia profitability objectives Actual (as originally reported) Objective cer s

Change Change

(over(since

2009 2010 2011 2012 2011) 2009) 2013

Łm Łm Łm Łm%% Łm overview

Value of new business 713 901 1,076 1,266 18 78 1,426

IFRS operating profit(note 1) 465 604 784 988 26 112 930

Business unit net cash remittance objectives Actual Objective Business

2009 2010 2011 2012 2013

Łm Łm Łm Łm Łm

Asia(note 2) 40 233 206 341 300 review

Jackson(note 3) 39 80 322 249 260note 6

UK(note 4) 434 420 297 313 350

M&G(note 5) 175 202 280 297

688 935 1,105 1,200

Objectives for cumulative period 1 January 2010 to 31 December 2013 Percent-

age

Actual Objective achieved

1 Jan 2010 1 Jan 2010

to 31 Dec to 31 Dec At 31 Dec

2012 2013 2012

For the Twelve Months Ended December 31,

£m £m%

Cumulative net cash remittances from 2010 onwards 3,240 3,800 85

Cumulative underlying group free surplus generation (which is net of investment in new business) 5,779 6,500 89

Notes

1 Total Asia operating profit from long-term business and Eastspring Investments after development costs. 2012 operating profit includes a one-off gain of £51 million arising on sale of Group s interest in China Life Insurance Company of Taiwan. The comparatives represent results as reported in the respective periods and excludes adjustment for altered US GAAP requirements for deferred acquisition costs as described in note A5 to the IFRS financial statements.

2 Remittances from Asia in 2012 include net remittance of £27 million, representing cash from sale of Group s holding in China Life Insurance Company in Taiwan offset by repayment of funding contingent on future profits of the Hong Kong life insurance operations. 2010 remittances included a one-off remittance of £130 million, representing the accumulation of historic distributable reserves.

3 Net remittances from Jackson in 2011 include releases of excess surplus to Group.

4 In 2009, the net remittances from the UK included the £150 million arising from the proactive financing techniques used to bring forward cash emergence of the in-force book during the financial crisis. The 2010 net remittances included an amount of £120 million representing the releases of surplus and net financing payments.

For the Twelve Months Ended December 31,

5 Including Prudential Capital.

6 The net remittance objective for Jackson was increased from Ł200 million to Ł260 million to reflect the positive impact of the acquisition of REALIC.

For the Twelve Months Ended December 31,

18 Business review Prudential plc Annual Report 2012

Chief Financial Offi cer s overview continued

In 2012, cash remitted to the Group increased by 9 per cent to Ł1,200 million (2011: Ł1,105 million), with considerable amounts of cash remitted

from all our business operations highlighting the improved balance of contributions from across the Group. Asia s remittances increased 66 per cent to Ł341 million (2011: Ł206 million), demonstrating its transition into a highly cash-generative business as a result of signifi cant growth and its focus on health and protection products. Asia s 2012 cash remittance is ahead of its 2013 fi nancial objective of Ł300 million. We remain confi dent of further positive progress underpinned by strong cash generation from the in-force portfolio and continued growth in capital-effi cient new business. The quality of Jackson s post-fi nancial crisis expansion in variable annuities is evidenced by its cash remittance of Ł249 million while continuing to grow the business, and fi nancing the acquisition of REALIC through its internal resources. The positive impact of this fi nancially attractive acquisition will enable Jackson to increase its net remittance objective for Group from Ł200 million to Ł260 million in 2013 and beyond. The UK life operations have continued to make sizeable remittances at Ł313 million (2011: Ł297 million), supported by shareholder transfers from the with-profi ts fund and cash-positive new annuity business. M&G (including Prudential Capital) delivered net remittances of Ł297 million (2011: Ł280 million), refl

For the Twelve Months Ended December 31,

ecting its relatively capital-light business model that facilitates a high dividend payout ratio from earnings.

Against the cumulative 2010 to 2013 net remittance objective of Ł3.8 billion, by 31 December 2012 over Ł3.2 billion has been remitted by business operations. We remain confi dent of achieving this target. Our confi dence is underpinned by the strong underlying free surplus generation of our businesses which, by 31 December 2012, had generated a total of

Ł5.8 billion against our 2010 to 2013 cumulative objective of Ł6.5 billion.

Note

1 The National Association of Insurance Commissioners designed the Risk-Based Capital (RBC) formula as an early warning tool for State regulators to identify potentially inadequately capitalised companies for purposes of initiating regulatory action. The RBC ratio, being the ratio of available capital to regulatory capital, is based on the highest level of capital requirement at which remedial action may be initiated, the Company Action Level.

Capital position, fi nancing and liquidity

Despite the challenging macroeconomic conditions, we continue to operate with a strong solvency position, while maintaining high levels of liquidity and capital generation. This is testament to our capital discipline, the effectiveness of our hedging activities, our low direct Eurozone exposure, the minimal level of credit impairments and our comparatively low interest rate sensitivity.

The Group has maintained a strong capital position.

For the Twelve Months Ended December 31,

At 31 December 2012, our IGD surplus before fi nal dividend is estimated at Ł5.1 billion (31 December 2011: Ł4.0 billion), generating very strong coverage of three times the requirement.

All of our subsidiaries continue to hold strong capital positions on a local regulatory basis. In particular, at 31 December 2012, the value of the estate of our UK with-profi ts funds is estimated at Ł7.0 billion (31 December 2011: Ł6.1 billion), while Jackson s risk-based capital (RBC)1 ratio was 423 per cent at

31 December 2012, excluding the gains on interest rate swaps under permitted practice, which if included would increase the RBC ratio to 478 per cent.

Furthermore, on a statutory (Pillar 1) basis the total credit default reserve for the UK shareholder annuity funds also contributes to protecting our capital position in excess of the IGD surplus. Notwithstanding the absence of defaults in the period, at

31 December 2012 we have maintained our credit default reserves at Ł2.1 billion, representing 40 per cent of the portfolio spread over swaps,

compared with 33 per cent at 31 December 2011.

The delays in fi nalising the implementation measures for Solvency II prolong the uncertainty of the effective date of the capital adequacy regime, a major overhaul for European insurers. We are supportive in principle of the development of a more risk-based approach to capital, but we have concerns as to the potential consequences of some aspects of the Solvency II regime under consideration. With the continued delays to policy development, the fi nal outcome of Solvency II remains uncertain. Despite

For the Twelve Months Ended December 31,

this uncertainty we remain focused on preparing for implementation of the new regime.

For the Twelve Months Ended December 31,

In March 2013, we have agreed with the FSA to revise the calculation of the contribution Jackson makes to the Group s IGD surplus. Until now the contribution of Jackson to the reported IGD surplus was based on an intervention level set at 75 per cent of US Risk-Based Capital Company Action Level (CAL). Going forward the contribution of Jackson to IGD surplus will equal the surplus in excess of 250 per cent of CAL. This is more in line with the level at which we currently report free surplus, which we have set at 235 per cent of CAL. In the absence of an agreed Solvency II approach, we believe that this change makes the IGD surplus a more meaningful measure and one that is more closely aligned with economic reality. The change has no impact on the way that the US business is managed or regulated locally. For consistency we also intend to align our free surplus calibration to 250 per cent of CAL going forward.

On the new basis, the IGD surplus at 28 February 2013 is estimated at Ł4.4 billion1 (equivalent to a capital cover of 2.5 times), which includes the proceeds of Ł0.4 billion of subordinated debt, raised in January 2013, and is after deducting Ł1.3 billion in respect of the Jackson change from 75 per cent to 250 per cent of CAL. The intended change to free surplus will have a negligible effect on EEV and is estimated to reduce total free surplus by around Ł100 million.

Our fi nancing and liquidity position remained strong throughout the period. The issue of US$700 million (Ł0.4 billion) of subordinated debt (perpetual tier 1 notes) in January 2013 further supports the fi nancial fl exibility of the Group, while taking

For the Twelve Months Ended December 31,

advantage of very favourable market conditions. Our central cash resources amounted to Ł1.4 billion at 31 December 2012, up from Ł1.2 billion at 31 December 2011, and we retain a further

Ł2.1 billion of untapped committed liquidity facilities.

Notes

1. The estimated position at 28 February 2013 allows for economic conditions and surplus generation since 31 December 2012 and is stated before the final dividend and the effect of the Thanachart acquisition, and after allowing for a reduction in Jackson s contribution to IGD surplus of Ł1.3 billion.
2. Comparatives adjusted for retrospective application of the accounting policy change for deferred acquisition costs as discussed in note A5 of the IFRS financial statements.

Chief Financial Offi cer s overview Prudential plc Annual Report 2012 19

Chief

Financial

Offi

During Shareholders 2012, investment funds markets continued to experience cer s

considerable volatility, with positive movements in global

equity market indices only towards the end of the year and overview

further falls in long-term interest rates in the US, the UK

and a number of Asian countries, most notably Hong Kong

and Singapore. Despite these effects, the Group s EEV

For the Twelve Months Ended December 31,

shareholders funds increased by 14 per cent during 2012

to Ł22.4 billion (31 December 2011: Ł19.6 billion). On a Business

per share basis EEV at the end of 31 December 2012 stood

at 878 pence, up from 771 pence at 31 December 2011. IFRS review

shareholders funds were 21 per cent higher at Ł10.4 billion

(31 December 2011: Ł8.6 billion)2.

The increases in shareholders funds on both reporting bases

are the result of the Group s strong operating performance,

while our balance sheet continues to benefit from both the

quality of the asset portfolio and the effectiveness of our

proactive approach to risk management.

Summary

The financial progress we have reported in 2012 demonstrates

the Group s resilience to the challenges faced by the global

economy. By maintaining our bias in favour of less volatile types

of income, such as insurance and fee, and by diversifying our

products set and distribution platforms, we have continued

to improve both the quality and the balance of our earnings.

	For the Twelve Months Ended December 31,

Our disciplined approach to value creation and focus on cash

generation, combined with a robust capital position and

a conservative risk management stance, provide us with

a strong foundation for the future.

[Graphic Appears Here]

	For the Twelve Months Ended December 31,

[Graphic Appears Here]

For the Twelve Months Ended December 31,

Insurance operations: Asia Prudential plc Annual Report 2012 21

Our strategy in Asia is focused on

meeting the needs of the emerging

middle class for savings and

protection. The region s positive

demographics, strong economic

growth, sound public finances

and favourable public policy

environment with a clear

preference for private provision of

protection, have all led to a rapidly Business

expanding middle class, with a

strong and growing demand for our unit

savings and protection products. review

insurance 13m+ customers Business

400,000+ review

agents

[Graphic Appears Here]

For the Twelve Months Ended December 31,

22 Business review Prudential plc Annual Report 2012

Insurance operations

Asia: accelerate

Prudential s strategy in Asia is well established and

continues to be highly effective. We are focused on

building high-quality, multi-channel distribution that

provides customers with access to products that are

appropriate for their financial planning needs. Typically

this involves a high proportion of regular premium

policies that combine savings and protection.

Barry Stowe

Chief Executive

Prudential Corporation Asia

New business profit Total IFRS operating 2013 financial objectives

profit Double 2009 value

Ł1,266m +18% Ł920m +30% of IFRS life and asset

management pre-tax

Ł1,076m Ł709m operating profit

Double 2009 value of

new business profits

Deliver Ł300 million

of net cash remittance

For the Twelve Months Ended December 31,

2011 2012 2011 2012

Financial performance AER CER

2012 Łm 2011 Łm Change % 2011 Łm Change %

APE sales 1,897 1,660 14 1,642 16

New business profit 1,266 1,076 18 1,065 19

Total IFRS operating profitnotes (i)(ii) 920 709 30 697 32

Total EEV operating profitnote (i) 1,960 1,764 11 1,747 12

Notes

(i) Operating profit from long-term operations excluding Eastspring Investments, development costs and Asia regional head office costs.

(ii) Comparatives adjusted for retrospective application of the accounting policy change for deferred acquisition costs as discussed in note A5 of the IFRS financial statements.

For the Twelve Months Ended December 31,

Market overview

Asia s rapidly-growing middle class remains a key growth driver for the retail fi nancial services sector, particularly life insurance with an emphasis on protection. Research has shown that as the middle class becomes more established the proportion of income they allocate to fi nancial planning increases from 5 per cent to around 12 per cent1.

The manifestation of this demand varies signifi cantly across the region, refl ecting the various stages of development in each individual market, together with their distinct regulatory and competitive environments, cultural differences and customer preferences. However, across all markets there is increasing recognition among governments and regulators of the social utility of a vibrant private sector life insurance market that provides fi nancial security to families, effi ciently channels long-term savings into fi nancial markets and generates employment opportunities within the industry.

During 2012, Asia s average economic growth rates, although they remained well above the global average, continued to moderate following the post-crisis high seen in 2010. This is to some degree a consequence of the weakness of the economies of North America and Europe. While domestic factors were a signifi cant infl uence in India and China as policymakers grapple with sensitive political situations and economic imbalances, the resilience of many other economies in the region, particularly in South-east Asia, was highlighted by upward revisions to IMF growth forecasts in the second

For the Twelve Months Ended December 31,

half of the year. Hong Kong s economic growth accelerated during the fourth quarter last year and looks set to have an improved year in 2013 and the Singaporean Government has said that the outlook for its economy is cautiously positive as it also had a better than expected fourth quarter. However, the strongest performing regional economies were led by Indonesia, Malaysia, the Philippines and Thailand where growth is increasingly driven by the expansion of domestic demand and is less reliant on exports. Face to face sales, typically through an agent, remains the dominant distribution channel throughout the Asia region and the expertise needed to build and manage agency represents a signifi cant barrier for new entrants. Bancassurance has been growing at a faster rate than agency in recent years from a lower base.

As the life insurance industry continues to grow, so the regulatory environment continues to evolve. Regulators are encouraging insurers to strengthen their risk and solvency management processes and to improve their sales processes to ensure that customers receive good quality advice and buy products suitable to their needs. Most international insurers operating in the region are supportive of these trends and generally aim to operate above current local regulatory standards. The recent recommendations of the Monetary Authority of Singapore s FAIR Panel are indicative of the kind of regulatory efforts under way in the region to improve the overall standard of agency distribution in insurance.

Note

1 HSBC Global Research.

For the Twelve Months Ended December 31,

We believe the Asian life insurance markets remain a highly Business

compelling opportunity for delivering profitable growth over the unit

long term with South-east Asia, including Hong Kong, currently

offering the most attractive market dynamics for insurance review

providers, with increasing opportunities to provide financial

security to the new middle class whose expectations now go

beyond basic subsistence to protecting and improving their

personal finances over the long term. Business

Business performance

Prudential s strategy in Asia is well established and continues to review

be highly effective. The customer is at the heart of our strategy

and Asian customers find our offering of regular premium

savings and protection products distributed principally through

high-quality face to face distribution channels particularly

attractive. The quality of our brand, our products, and of our

distribution allows us to translate our sales into strong returns

to our shareholders.

For the Twelve Months Ended December 31,

Building and strengthening Prudential s multichannel distribution

capabilities is a constant objective for us. Tied-agency remains

a highly effective and efficient distribution channel in Asia and

Prudential has one of the region s largest agency forces. We

focus both on the size and the productivity of our agency force.

Agency activity is a key indicator of quality and performance;

during 2012 Prudential s average active agency manpower rate

increased by 14 per cent (excluding India). In our sweet-spot

of South-east Asia, the increase in active agency manpower of

15 per cent contributed significantly to a 19 per cent increase in

new business profit in the agency channel.

Bancassurance has been growing rapidly in the region in recent

years and Prudential remains a regional leader in this channel

with APE growth of 29 per cent, led by highly productive

relationships including SCB, where APE sales were up 42 per cent

this year and UOB, where APE sales grew at an even faster rate of

For the Twelve Months Ended December 31,

65 per cent year-on-year. In November, Prudential announced a

new and strategically significant, exclusive long-term partnership

with Thailand s Thanachart Bank as part of a deal that will see

Thanachart Life merged with our existing life operation in the

country immediately doubling our market share. The deal is

expected to complete during the first half of 2013.

It is part of our strategy to focus on regular premium products

which allow our customers to invest over the long term and

smooth the impact of timing on their investment returns. We aim

to make most of our sales as regular premiums and in 2012, the

proportion of regular premium in our APE sales was in excess of

90 per cent, which ensures the profitability and resilience of our

growing in-force book. Although single premium products can

provide appropriate opportunities for customers with lump

sums, we believe that regular premium policies with protection

riders best meet the majority of our customers needs. In 2012,

	For the Twelve Months Ended December 31,

32 [illegible]f our new business APE was related to protection,

up 2 percentage points over prior year. Given the recent volatility

in the financial markets, we have seen a shift towards non-linked

products; the proportion of linked products in the new business

APE mix declined to 29 per cent compared to 32 per cent for 2011.

For the Twelve Months Ended December 31,

24 Business review Prudential plc Annual Report 2012

Insurance operations continued

Asia: accelerate

Managing the in-force book is always a high priority as this ensures that the shareholder value that we expect to capture over the life of the product does emerge over time as distributable shareholder profi ts. For 2012 we reported small net positive experience and assumptions change of Ł95 million up from Ł75 million in 2011.

On 2 July, we announced that Prudential has received in-principle approval from Cambodia s Ministry of Economy and Finance to establish a wholly foreign-owned life insurance operation in the country. Although the Cambodian economy is relatively small at present, it has delivered strong GDP growth over the past 10 years and we believe this presents excellent opportunities to develop the life insurance industry in the coming years. The business sold its fi rst policies in January 2013.

In addition to providing value directly to our customers through our products and services, we aim to provide wider benefi ts to the community where we operate. Therefore, Prudential supports a range of corporate social responsibility activities across Asia, with a focus on providing disaster relief, promoting fi nancial literacy and benefi ting children. During 2012, Prudential extended its highly successful children s fi nancial literacy programme, Cha-Ching ; for example, this has now been adopted in the Philippines as part of the school curriculum.

For the Twelve Months Ended December 31,

Financial performance

Prudential Asia has delivered in 2012 IFRS operating profi t and cash remittance ahead of the 2013 objectives with strong operational performances enhanced by some non-recurring items. We remain on track to meet our third objective in the region of doubling the 2009 new business profi t by 2013.

New business APE was Ł1,897 million, an increase of 14 per cent over prior year. During the second half of 2012 the reported growth rates did moderate as the economic climate became generally more challenging and specifi cally in Malaysia, Korea and Taiwan we deliberately and proactively slowed sales of lower margin products.

New business profi t of Ł1,266 million grew at a faster rate than APE at 18 per cent. This refl ects the positive impacts of product participation

decisions as outlined above, proactive pricing actions to mitigate the adverse effects of low interest rates and a shift in country mix. Our agency and bank channels grew their respective contribution to new business profi t at similar rates in 2012.

EEV operating profi t from our in-force business of Ł694 million is in line with prior year as the impact of the signifi cant increase in the unwind that comes from a larger in-force book and the net positive movement in the contribution to profi ts from assumption changes and experience variances was offset by the drag from lower discount rates.

Operating profi t on an IFRS basis from Asia s life businesses, continues to grow strongly at Ł920 million, 30 per cent higher than in 2011. This includes Ł51 million of one-off profi t from the sale of the

For the Twelve Months Ended December 31,

Group s interest in China Life Insurance Company of Taiwan. Excluding this amount, IFRS operating profi t was Ł869 million, 23 per cent higher than last year. This is principally driven by improved in-force profi ts, which grew by 18 per cent in the year, refl ecting the increasing scale of the business.

During 2012, shareholder-backed business policyholder liabilities have increased by 16 per cent to Ł21.2 billion (31 December 2011: Ł18.3 billion), due to strong business fl ows of Ł2.0 billion (up 8 per cent on last year s equivalent amount of

Ł1.8 billion) and higher bond and equity values.

Underlying free surplus generated by the in-force life business was 9 per cent higher at Ł771 million (2011: Ł707 million) refl ecting the increasing scale of the business. Of this total, Ł292 million (2011: Ł297 million) was reinvested in new business at internal rates of return of over 20 per cent and average payback periods of three years. The overall cash generating capacity of the life business is clearly demonstrated by net remittances of Ł384 million to the Group during 2012.

Looking at individual countries:

China AER CER

2012 Łm 2011 Łm Change % 2011 Łm Change %

APE sales

(Prudential s

50 per cent share) 56 59(5) 61(8)

Market conditions in China during 2012 have been challenging as economic growth slowed and the country continued to adjust to

For the Twelve Months Ended December 31,

a changing political environment.

CITIC-Prudential remains one of the leading foreign joint ventures in a market that remains dominated by domestic players. We do anticipate the market liberalising at some point in the future, however the timing of such an opening remains uncertain. In the meantime, we are focused on continuing to build a high-quality, multichannel distribution organisation.

Prudential s 50 per cent share of sales for 2012 was Ł56 million, broadly in line with the prior year. During this year we continued to focus on agent recruitment and on promoting sales of regular premium business. Bancassurance, which accounts for nearly half of our total sales in China, has seen lower productivity from bank branches following the tightening of regulations that came into effect last year.

Hong Kong AER CER

2012 Łm 2011 Łm Change % 2011 Łm Change %

APE sales 396 331 20 336 18

The Hong Kong economy continues to benefi t from its close ties with mainland China and it remains a fi nancial and logistics hub for the region beyond China, which ensures a continued and strong demand for our products.

Prudential Hong Kong delivered strong new business APE growth with an increase of 20 per cent over the prior year to Ł396 million. Prudential remains the only leading player in Hong Kong to have a material presence in both agency and bank distribution, enabling it to reach the widest range of customers. Both channels performed well in 2012.

For the Twelve Months Ended December 31,

India AER CER

2012 Łm 2011 Łm Change % 2011 Łm Change %

APE sales

(Prudential s

26 per cent share) 102 101 1 90 13

The Indian life insurance market has been going through a signifi cant period of change, however there are signs it has begun to grow again following the regulator-driven refocus on savings and protection products, which came into effect in 2010. During the second half the economy faltered, impacted by domestic imbalances and a challenging political environment. Although we remain optimistic about the long-term potential of the market, we expect it will be some time before private sector sales volumes return to pre-2010 levels.

Prudential s joint venture with ICICI continues to be the leader in the private sector.

Indonesia AER CER

2012 Łm 2011 Łm Change % 2011 Łm Change %

APE sales 446 363 23 343 30

The Indonesian economy continues to outperform and this is underpinned by the scale and resilience of its domestic demand. Indonesia has one of the region s largest populations and lowest rates of insurance penetration.

Prudential has a strong market leading position with over 60 per cent of the industry s registered tied-agents and has successfully been building its

For the Twelve Months Ended December 31,

business outside of Jakarta; now around 45 per cent of APE is from outside the capital. New business APE growth of 23 per cent to Ł446 million has been primarily driven by the continued expansion of the agency force. Growth in the agency force is now being supplemented by the smaller but fast growing bancassurance channel which includes partnerships with UOB, BII, Citibank and Permata.

Korea AER CER

2012 Łm 2011 Łm Change % 2011 Łm Change %

APE sales 95 101(6) 101(6)

In Korea, the weak economic climate has resulted in a decline in demand for unit-linked products, with consumers opting instead for interest sensitive products. Against this backdrop, we have chosen to relinquish volume rather than compete for the low margin, capital-intensive guaranteed return segment of the market. Consequently, we have deliberately let our sales via banks and brokers decline. Our business has continued to focus on developing a high-quality proprietary distribution channel which saw active agents increase by 9 per cent in 2012.

Malaysia AER CER

2012 Łm 2011 Łm Change % 2011 Łm Change %

APE sales 218 223(2) 224(3)

Note

1 Source: Life Insurance Association of Singapore.

Insurance operations: Asia Prudential plc Annual Report 2012 25

The latest statistics released by the Malaysian Life

For the Twelve Months Ended December 31,

Insurance Business

Association show that the industry grew by 2.2 per cent during

2012 in terms of weighted premiums relative to 2011 reflecting unit

general concerns about the economic outlook. Prudential

remains the market leader in Malaysia with a highly productive review

agency force and growing bank distribution.

Our focus in 2012 on health and protection rather than lower margin,

higher premium volume savings related top ups has boosted the

mix of these products to around 60 per cent and improved our Business

profitability, at the expense of top line growth. We have continued

to expand in the Takaful sector where we remain market leader. review

Singapore AER CER

2012 Łm 2011 Łm Change % 2011 Łm Change %

APE sales 301 235 28 239 26

The Singapore market continues to perform strongly with the Life

Insurance Association having announced that industry APE grew

by 8 per cent during 2012 with regular premiums growing even

more strongly at 18 per cent.

For the Twelve Months Ended December 31,

Prudential s APE was Ł301 million up 28 per cent on prior year.

Bancassurance was an important driver of growth where we

now have a number of partners including UOB, SCB, Maybank

and Singpost, enabling us to access a broad range of customers.

Our agency channel continues to be one of Singapore s most

productive, and according to the latest available market statistics,

we lead the market in terms of regular premium new business

generated per agent1.

Taiwan AER CER

2012 2011 Change 2011 Change

Łm Łm% Łm%

APE sales 156 148 5 149 5

Taiwan is mainly focused on bank distribution through our

partnership with E.Sun Commercial Bank and SCB, supplemented

by direct marketing and worksite marketing activities which are

growing fast. APE was depressed by our decision not to compete

in the market with products we consider to be uneconomic.

Others Philippines, Thailand and Vietnam

AER CER

For the Twelve Months Ended December 31,

2012 Łm 2011 Łm Change %
2011 Łm Change %

APE sales 127 99 28 99 28

In Vietnam, we saw a very strong recovery during the fourth quarter with new business APE up 23 per cent over prior year, to deliver an overall 7 per cent increase for the year. In Thailand, we saw growth of 37 per cent driven by our bancassurance capabilities. The Philippines delivered growth of 50 per cent, refl ecting increased agency activity and the success of partnership distribution.

[Graphic Appears Here]

Barry Stowe

Chief Executive

Prudential Corporation Asia

For the Twelve Months Ended December 31,

26 Business review Prudential plc Annual Report 2012

[Graphic Appears Here]

For the Twelve Months Ended December 31,

Insurance operations: United States Prudential plc Annual Report 2012 27

The US is the world s largest

retirement savings market, with

large cohorts of the 78 million

baby-boomers1 reaching retirement

age each year, creating significant

demand for retirement income

products. Our strategy in the

US is to take advantage of this

profitable growth opportunity. Business

4m unit

customers review

Note

1 Source: US Census Bureau. Business

review

[Graphic Appears Here]

For the Twelve Months Ended December 31,

28 Business review Prudential plc Annual Report 2012

Insurance operations continued

United States: build on strength

Jackson s strategy remains focused on providing value

to its customers and driving shareholder value while

operating within a conservative risk management

framework. This approach has enabled us to successfully

navigate the significant macroeconomic and financial

market challenges of the last five years and ensured

a continuation of our strong performance in 2012.

Mike Wells

President and

Chief Executive Officer

Jackson National

Life Insurance Company

New business profit Total IFRS operating 2013 financial objective

profit Deliver Ł260 million

Ł873m +7% Ł964m +48% of net cash remittance

Ł815m to the Group*

Ł651m

2011 2012 2011 2012

For the Twelve Months Ended December 31,

Financial performance AER CER

2012 Łm 2011 Łm Change % 2011 Łm Change %

APE sales 1,462 1,275 15 1,290 13

New business profit 873 815 7 825 6

Total IFRS operating profitnote 964 651 48 659 46

Total EEV operating profit 1,610 1,431 13 1,448 11

Note

Comparatives adjusted for retrospective application of the accounting

policy change for deferred acquisition costs as discussed in note A5 of

the IFRS fi nancial statements.

*The net remittance objective for Jackson was increased from Ł200 million

to Ł260 million to refl ect the positive impact of the acquisition of REALIC.

For the Twelve Months Ended December 31,

Market overview

The United States is the world s largest retirement savings market. Each year, many of the 78 million baby-boomers reach retirement age, which will trigger a shift from savings accumulation to retirement income generation for more than US$10 trillion of accumulated wealth over the next decade1.

This demographic transition constitutes a signifi cant opportunity for those companies that are able to provide the baby-boomers with long-term retirement solutions. Jackson takes a selective approach to this opportunity by leveraging its distinctive distribution capabilities and asset liability management expertise to offer prudently priced annuity products.

Despite the challenges faced by the global economy, US equity markets delivered strong gains in 2012. The S&P 500 index increased by 13.4 per cent over the course of the year and market volatility declined notably from the levels experienced in 2011. Interest rates remained historically low with the 10-year treasury rate ending below 180 basis points at year end, while corporate spreads tightened considerably from 2011 year end levels.

The competitive environment continues to favour companies with good fi nancial strength ratings and a track record of fi nancial discipline. Companies that were hardest hit by the market disruptions over the last few years still have to work to regain market share as customers and distributors seek product providers that offer consistency, stability and fi nancial strength. Jackson continues to benefi t from this fl ight to quality and

For the Twelve Months Ended December 31,

risk aversion.

Notes

1 Source: US Census Bureau.

2 Sources: Morningstar Annuity Research Center (MARC) Third Quarter 2012 Sales Report© and Fourth Quarter 2011 Sales Report©. © Morningstar, Inc.

Insurance operations: United States Prudential plc Annual Report 2012 29

Business performance Business

Jackson s strategy remains focused on providing value to its unit

customers and driving shareholder value while operating within

a conservative risk management framework. This approach has review

enabled us to successfully navigate the significant macroeconomic

and financial market challenges of the last five years and ensured

a continuation of our strong performance in 2012.

In 2012, Jackson delivered APE retail sales of £1,424 million, Business

For the Twelve Months Ended December 31,

an increase of 14 per cent over 2011. With the addition of a

modest level of institutional sales, total APE sales increased by

15 per cent to Ł1,462 million. These strong sales levels helped review

to drive annuity net flows higher to Ł8.8 billion during 2012,

a 19 per cent increase over 2011. Although we do not target

volume or market share, our ranking climbed to second in

variable annuity sales in the US through the third quarter of 2012

(latest information available), while market share increased to

14.0 per cent from 11.4 per cent for the full year 20112.

In March 2012, we launched a new variable annuity product,

Elite Access, which has no guaranteed benefits and provides

tax efficient access to alternative investments. The rollout of this

new product has received a positive reaction from distributors,

with close to 100 per cent of them signing up to distribute this

product. Single premium sales in the period since launch were

Ł849 million. We are optimistic about the future of Elite Access

For the Twelve Months Ended December 31,

and will continue to drive product innovation as a way of both

meeting the needs of our customers and driving shareholder value.

For the Twelve Months Ended December 31,

30 Business review Prudential plc Annual Report 2012

Insurance operations continued

United States: build on strength

Jackson continues to be one of the most effi cient operators within the US life insurance market. The ratio of statutory general expenses to average assets improved slightly to 41 basis points in 2012 versus 42 basis points in 2011. This effi ciency has been delivered while maintaining world class standards of customer service for our customers. In 2012, Jackson was rated as a World Class service provider by the Service Quality Measurement Group for the seventh consecutive year.

On 4 September 2012, Jackson completed the acquisition of SRLC America Holding Corp (SRLC) from Swiss Re for a consideration of Ł370 million which is subject to fi nalisation of completion procedures. SRLC was the US holding company of REALIC. The acquisition helps diversify Jackson s sources of earnings by increasing the amount of income generated from underwriting activities. The transaction is expected to add an additional Ł100 million to Jackson s IFRS pre-tax profi ts in the fi rst year, representing stand-alone earnings from REALIC of approximately Ł115 million, less Ł15 million of income foregone on the assets sold to fi nance the transaction. In the four month period since completion, REALIC contributed Ł67 million to Jackson s IFRS operating profi t while having only a modest impact on statutory capital.

Financial performance

For the Twelve Months Ended December 31,

Jackson s IFRS pre-tax operating profi t in 2012 was 48 per cent higher at Ł964 million (2011: Ł651 million)1. This result refl ects the strong underlying growth in fee income, and lower deferred acquisition cost (DAC) amortisation. The result also includes four months of REALIC operating profi t.

At 31 December 2012, Jackson held Ł49 billion in separate account

assets, compared to Ł38 billion in 2011. The increase in separate account assets primarily refl ects the impact of positive net fl ows. This resulted in variable annuity separate account fee income of Ł875 million in 2012, up 29 per cent over the Ł680 million achieved in 2011.

Note

1 Comparatives adjusted for retrospective application of the accounting policy change for deferred acquisition costs as discussed in note A5 of the IFRS financial statements.

With corporate spreads tightening during 2012 and continued low levels of absolute interest rates, total spread income, including the expected return on shareholders assets, was lower at Ł757 million, compared to Ł813 million in the previous year.

Product acquisition costs during 2012 increased slightly compared to 2011, despite the growth in sales as a greater proportion of distributors are opting for asset-based commission. Following the introduction of new DAC guidance in 2012, which was applied retrospectively, acquisition costs are no longer fully deferrable, resulting in IFRS new business strain of Ł174 million in 2012, compared to Ł156 million in 2011.

For the Twelve Months Ended December 31,

DAC amortisation of Ł356 million decreased in 2012, compared to Ł506 million in 2011. This decrease is primarily a result of the negative prior year impact of the reversal of the benefi t received in 2008 from the mean reversion formula. Partially offsetting this decrease was higher amortisation due to the higher earnings base in 2012.

Administration expenses increased to Ł537 million in 2012 compared to Ł412 million in 2011, with the increase due primarily to higher asset-based commissions paid on the larger 2012 separate account balance, which is classifi ed as an administration expense. This increase was also attributable to larger home offi ce staff due to the growing in-force book, the acquisition of REALIC, and certain non-recurring expenditures.

Jackson continues to actively manage its investment portfolio to mitigate investment risk. Net realised gains on debt securities amounted to Ł47 million in 2012 compared to gains of Ł106 million in 2011. This includes a realised loss net of recoveries of Ł10 million (2011: gains of Ł10 million) on credit-related sales of impaired bonds. Write-downs on debt securities were Ł37 million (2011: Ł62 million).

Interest related gains during the period totalled Ł94 million (2011: Ł158 million), primarily due to sales of corporate debt.

For the Twelve Months Ended December 31,

The net unrealised gain position has improved from Ł2,057 million at 31 December 2011 to Ł2,807 million at 31 December 2012 due to the decline in the US Treasury rates and tighter spreads. Gross unrealised losses improved from Ł246 million at

31 December 2011 to Ł178 million at 31 December 2012.

Jackson delivered total APE sales of Ł1,462 million, a 15 per cent increase over 2011. Jackson has achieved these sales levels, while maintaining its pricing discipline, as it continued to write new business at aggregate internal rates of return in excess of 20 per cent.

Variable annuity APE sales of Ł1,245 million were 14 per cent higher than in 2011. Expressed in local currency most of the increase was accounted for by APE sales of Elite Access, which totalled US$135 million. Excluding the contribution of Elite Access variable annuity APE sales of US$1,837 million were 5 per cent higher than those achieved in 2011 of US$1,749 million. In the course of the year and particularly in the second half of 2012, Jackson implemented various product initiatives to continue to balance value, volume, capital and balance sheet strength.

Fixed annuity APE sales of Ł58 million were 23 per cent higher than the level of sales in 2011. Jackson ranked seventh in sales of traditional deferred

fi xed annuities through the third quarter of 2012, with a market share of 3.6 per cent, compared to thirteenth with a 2.1 per cent market share for the full year 20111.

For the Twelve Months Ended December 31,

Fixed index annuity APE sales of Ł109 million in 2012 increased 17 per cent from 2011. Jackson ranked eighth in sales of fi xed index annuities through the third quarter of 2012, with a market share of 4.9 per cent, up from a market share of 4.6 per cent in the full year 20112.

Total EEV basis operating profi t for the long-term business in 2012 was Ł1,610 million, compared to Ł1,431 million in 2011 refl ecting increases in both new and in-force business profi ts. Jackson s new business profi t increased by 7 per cent to Ł873 million, refl ecting active management of sales volumes and mix, higher charges and lower levels of guarantees offered. These actions counteracted the adverse effect of lower long-term yields and tighter spreads. Higher in-force profi t was driven largely by higher unwind of discount, due to growth in the underlying book, and larger positive contributions from operating experience variances and assumption changes.

Notes

1 Sources: LIMRA U.S. Individual Annuities Sales Survey. Third Quarter 2012 and Fourth Quarter 2011.

2 Sources: AnnuitySpecs.com s Indexed Sales & Market Report, Third Quarter 2012 and Fourth Quarter 2011: Copyright © 2012, AnnuitySpecs.com.

Insurance operations: United States Prudential plc Annual Report 2012 31

In 2012, Jackson s life in-force book generated Ł755 million of Business

underlying free surplus (2011: Ł748 million) reflecting an increase unit

For the Twelve Months Ended December 31,

due to the growth in the business and higher operating variances

offset by the impact of low interest rates. Some Ł281 million review

was reinvested to write new business (2011: Ł202 million). The

increase in capital consumption was driven by the significant

decrease in interest rates which in turn caused a large drop in

the valuation rate used to set reserves, resulting in higher strain

compared to 2011. Notwithstanding this effect, the fast payback Business

nature of the products, which in 2012 averaged two years across

the portfolio (2011: one year) means that returns remain review

extremely attractive.

Jackson s RBC level at the end of 2012 was 423 per cent which

compares to 429 per cent at the end of 2011. In 2012, capital

formation was strong reflecting both the good operating

performance, the modest level of impairments and other

market value related net gains. This strong capital formation

enabled Jackson to remit Ł249 million to Group and complete

For the Twelve Months Ended December 31,

the acquisition of REALIC, while supporting its balance sheet

growth and growing total adjusted capital from year end

2011 levels.

[Graphic Appears Here]

Mike Wells

President and Chief Executive Offi cer Jackson National Life Insurance Company

For the Twelve Months Ended December 31,

[Graphic Appears Here]

32 Business review Prudential plc Annual Report 2012

United Kingdom:

focus

For the Twelve Months Ended December 31,

London Eye conceived and designed by Marks Barfi eld Architects

Insurance operations: United Kingdom Prudential plc Annual Report 2012 33

In the UK, Prudential has adopted

a focused strategy and competes

selectively to help Britain s

ageing population convert their

accumulated wealth into retirement

income. We have a clear focus on

writing profitable new business

while generating cash sustainably

and preserving our capital. We

concentrate on areas in which we Business

have a clear competitive advantage,

namely individual annuities and unit

with-profits products, where we review

continue to be market leaders.

7m Business

customers review

[Graphic Appears Here]

For the Twelve Months Ended December 31,

34 Business review Prudential plc Annual Report 2012

Insurance operations continued

United Kingdom: focus

Our ability to deliver value to our customers and the

resulting market franchise allowed us to achieve higher

new business profitability in 2012, as well as increasing

cash generation and preserving our strong capital position,

despite the challenging economic environment and

competitive conditions that prevailed in the

UK marketplace.

Rob Devey

Chief Executive

Prudential UK and Europe

Total IFRS operating 2013 financial objective

profit Deliver Ł350 million

Ł723m Ł736m +2% of net cash remittance

to the Group

2011 2012

Financial performance AER CER

2012 Łm 2011 Łm Change % 2011 Łm Change %

APE sales 836 746 12 746 12

For the Twelve Months Ended December 31,

New business profit 313 260
20 260 20

Total IFRS operating profit
736 723 2 723 2

Total EEV operating profit
899 893 1 893 1

For the Twelve Months Ended December 31,

Market overview

The life and pensions market in the UK is mature and highly regulated. Signifi cant regulatory change occurred in 2012 with the implementation of the conclusions of the Retail Distribution Review (RDR), auto-enrolment for company pension schemes and gender neutral pricing.

These new regulations represent major changes to the way business is conducted in a number of areas of the markets in which we operate in the UK, and impact not only insurance and investments providers, but also distributors and consumers. It is inevitable that regulatory change of this scale and scope creates a period of uncertainty before the shape of the new long-term competitive landscape becomes evident.

The UK market is also characterised by an ageing population and a

concentration of wealth in the 50+ age group, many of whom have built up substantial pension funds in employer-sponsored schemes. These customers require help to convert their wealth into sustainable lifetime income. For the next generation of savers, the responsibility for retirement provision has shifted substantially away from government and employers towards the individual. These customers are typically under-funded for retirement and helping them accumulate saving constitutes a signifi cant opportunity for long-term savings and retirement income providers, at a time when the ability of the state to intervene is signifi cantly diminished.

Prudential UK s longevity experience, multi-asset

For the Twelve Months Ended December 31,

apabilities, long-standing trusted brand and fi nancial strength mean that we are favourably positioned to help consumers translate their accumulated wealth into dependable retirement income through our range of market leading with-profi ts and annuity products.

Insurance operations: United Kingdom Prudential plc Annual Report 2012 35

We do so by focusing on those areas of the market where we are Business

able to bring superior value to our customers and where we enjoy unit

a competitive advantage. The performance of our with-profits

fund in 2012 has allowed us to declare bonuses which mean that review

our policyholders should see year-on-year increases of between

3.5 per cent and 6.5 per cent in accumulating with-profits policy

values and our total bonus payments are expected to top

Ł2.0 billion in 2013. Business

Our ability to deliver value to our customers and the resulting

market franchise allowed us to achieve higher new business

profitability in 2012, as well as increasing cash generation and review

preserving our strong capital position, despite the challenging

economic environment and competitive conditions that

For the Twelve Months Ended December 31,

prevailed

in the UK marketplace.

Business performance

Prudential UK has a well-established individual annuity business, built on a robust pipeline of internal vestings from maturing pension policy customers. The internal vestings pipeline is supplemented by sales through intermediaries and strategic partnerships with third parties where Prudential is the offered annuity provider for customers vesting their pensions at retirement.

Total APE sales for 2012 were Ł836 million (2011: Ł746 million) of which sales of individual annuities of APE Ł241 million were 35 per cent higher than in 2011.

Annuity sales from internal vestings of Ł146 million were 20 per cent higher than 2011, due to a combination of several factors a higher number of customers retiring, higher average fund values and increased client contact activity. Sales of external annuities of APE Ł95 million were 67 per cent higher in 2012 refl ecting an increase in demand for our with-profi ts Income Choice Annuity which offers customers income security with the potential for income growth.

For the Twelve Months Ended December 31,

36 Business review Prudential plc Annual Report 2012

Insurance operations continued

United Kingdom: focus

Onshore bonds sales of APE Ł228 million were up 28 per cent on 2011, including with-profi ts bond sales of APE Ł214 million, which increased by 34 per cent. Our PruFund range made up 75 per cent of with-profi ts bond sales, with 35 per cent higher sales than in 2011. PruFund continues to be popular with consumers, providing smoothed returns and a range of optional guarantees, which offer a degree of security against potential market falls in a post-crisis environment where investors have become much more risk-averse. Although the demand for guarantees remains high, the increase in PruFund sales is based entirely on the non-guaranteed version of the product, which is attractive to those customers who are prepared to accept some risk to their capital but still want to benefi t from the smoothing offered by a with-profi t product.

The RDR, one of a number of current reforms to the UK regulatory framework, was implemented on 31 December 2012. It means that fi nancial advisers can no longer be paid commissions for recommending investment products. This is likely to lead to some short-term disruption in the market as consumers adjust to paying fees for advice and adviser fi rms adapt their business models for the new rules. We have seen an increase in sales of with-profi t bonds in 2012 and, while we have prepared our business for the post-RDR regulatory environment, we expect this transition phase to

For the Twelve Months Ended December 31,

have a negative impact on our sales of investment bonds in 2013.

Corporate pensions sales of APE Ł189 million were 19 per cent lower than the previous year. Sales in 2011 were particularly high due to new defi ned contribution members joining our schemes following closure of a number of defi ned benefi t schemes operated by existing clients. We continue to focus on securing new members and incremental business from our current portfolio of corporate pensions customers rather than acquiring new corporate pensions schemes where market pricing is currently unattractive. Prudential UK remains the largest provider of additional voluntary contribution plans within the public sector, where we now provide schemes for 68 of the 99 public sector authorities in the UK.

Sales of other products, principally individual pensions,

PruProtect, PruHealth and offshore bonds of Ł137 million were 12 per cent higher than in 2011. Individual pensions APE sales (including income drawdown) of Ł80 million were 11 per cent higher, refl ecting increased demand for our Flexible Retirement Plan among advisers and their clients.

In the wholesale market, we aim to continue our selective participation approach to bulk and back-book buyouts using our fi nancial strength, superior investment track record, annuitant mortality risk assessment and servicing capabilities. In line with this opportunistic approach, two bulk annuity buy-in insurance agreements were signed in 2012 totalling APE Ł41 million (2011: single deal APE Ł33 million). We will continue to maintain our focus on value and only participate in transactions that meet our return on capital and payback requirements.

For the Twelve Months Ended December 31,

Our direct advice service, Prudential Financial Planning (PFP), was launched in December 2011 and grew to 129 advisers in 2012, generating APE sales of Ł21 million. PFP offers a complete fi nancial planning service, focused primarily on our existing direct customer base. The response from our customers has been very encouraging and we intend to continue to grow this channel to 200 advisers by the end of 2013.

The combined fi nancial strength and investment performance track record of Prudential s UK With-Profi ts Fund continues to provide a key

source of non-price differentiation in a competitive market. Our with-profi ts customers benefi t from the security of Prudential s large inherited estate, which was valued at Ł7 billion at the year end, and provides a high degree of protection against adverse market movements. The Fund continues to provide customers with solid returns and to outperform the FTSE

All-Share Index over medium to long-term horizons. Over the last 15 years, the Fund has delivered a cumulative investment return of 184.3 per cent on investments covering policyholder liabilities. This compares favourably with other with-profi ts funds and the FTSE All-Share Index total return of 106.5 per cent over the same period, and, by offering customers a smoothed return, helps provide protection from the full impact of volatile market conditions. This performance shows that investing in a strong with-profi ts fund can produce good returns for cautious investors, in spite of the combined pressures of volatile market conditions and UK interest rates remaining at historically low levels.

Retention and management of our customer base of

For the Twelve Months Ended December 31,

approximately seven million remains a key focus for the business. We aim to maintain loyalty by continuing to improve our service year-on-year for both customers and intermediaries. Prudential UK s focus on continuing to deliver excellent customer service was recognised at the 2012 Financial Adviser Service Awards, where we retained our two 5-Star ratings in the Life & Pensions and Investment categories.

For the Twelve Months Ended December 31,

Financial performance

Total APE sales of Ł836 million were 12 per cent higher than 2011, principally due to increased sales of individual annuities and with-profi ts bonds, partly offset by lower sales of corporate pensions. Retail APE sales of Ł795 million were up 12 per cent on the previous year (2011: Ł712 million). Although the lower level of interest rates in 2012 had a negative impact on retail new business profi tability, this was more than offset by the positive mix effect from growth in higher margin products such as individual annuities and with-profi ts bonds.

New business profi t increased by 20 per cent to Ł313 million (2011: Ł260 million), including bulk annuity transactions. Retail new business profi t at Ł274 million was 19 per cent above 2011 (2011: Ł231 million), primarily driven by increased volumes in higher margin product areas.

IFRS life operating profi t was higher than in 2011 at Ł736 million (2011: Ł723 million), with Ł272 million (2011: Ł293 million) from with-profi ts and the balance from shareholder-backed business. Commission received on Prudential-branded General Insurance products contributed Ł33 million to IFRS operating profi t in 2012, Ł7 million lower than in 2011 as the book of business originally transferred to Churchill in 2002 is, as expected, decreasing in size.

At half year 2010 we announced that the business had achieved its cost savings target of Ł195 million per annum. At the end of 2010, an additional series of initiatives to reduce costs by a further

For the Twelve Months Ended December 31,

£75 million per annum by the end of 2013 was announced. By 31 December 2012 these additional annual cost savings of £75 million per annum had also been achieved, one year earlier than planned.

EEV total operating profi t of £899 million was 1 per cent higher than in 2011, refl ecting higher new business profi ts, partly offset by lower in-force profi ts which were impacted by the lower level of interest rates in the period. EEV profi t also included a contribution of £87 million from a change in the long-term tax rate assumption (including future tax rate changes which take effect in April 2013) from 25 per cent to 23 per cent, compared with £79 million from the 2 per cent tax rate reduction in 2011.

Insurance operations: United Kingdom Prudential plc Annual Report 2012 37

Prudential UK writes with-profits annuity, with-profits bond and Business

with-profits corporate and individual pensions business in its unit

Life Fund, with other products backed by shareholder capital.

For shareholder-backed business written in 2012, the weighted review

average post-tax internal rate of return (IRR) on the shareholder

capital allocated to new business was in excess of 20 per cent

and the undiscounted payback period on that new business

was three years. Business

Operating free surplus generated from the long-term in-force

For the Twelve Months Ended December 31,

business in the UK amounted to Ł507 million (2011: Ł503 million).

Of this total, Ł45 million (2011: Ł54 million) was reinvested in review

writing shareholder-backed business at attractive average IRRs.

During 2012 Prudential UK remitted cash of Ł313 million

to the Group (2011: Ł297 million), comprising Ł216 million

(2011: Ł223 million) from the annual with-profits transfer

to shareholders and Ł97 million (2011: Ł74 million) from the

shareholder-backed business. The business expects to generate

Ł350 million per annum of sustainable cash remittances by 2013,

supported by the strength of the with-profits business and

surpluses arising from the large book of shareholder-backed

annuities, maintained into the future by the pipeline of maturing

individual and corporate pensions.

[Graphic Appears Here]

Rob Devey

Chief Executive

Prudential UK and Europe

For the Twelve Months Ended December 31,

38 Business review Prudential plc Annual Report 2012

Asset management: optimise

M&G has continued to focus on

delivering superior investment

performance for our customers

while maximising the strength

of its distribution capabilities.

It has pursued business

diversifi cation both across

geographies and asset classes.

Ł228bn

assets under management

[Graphic Appears Here]

For the Twelve Months Ended December 31,

Asset management Prudential plc Annual Report 2012 39

Eastspring Investments recently

became the largest retail asset

manager in Asia1, and continues to

build a cohesive regional presence,

penetrating the offshore segment

more effectively.

Ł58.1bn Busi

assets under management ness

Note unit

1 Source: survey conducted by Asia Asset

Management Magazine as at 30 June 2012

(based on assets sourced from Asia ex-Japan). review

Business

review

For the Twelve Months Ended December 31,

40 Business review Prudential plc Annual Report 2012

Asset management

Asset management: optimise M&G

M&G has had a record-breaking year in terms of net sales, funds under management and profi ts. It continues to execute against its strategy and deliver strong performance for both clients and its shareholder, the Prudential Group.

Michael McLintock

Chief Executive

M&G

Total IFRS operating External funds under

profit management

Ł357m Ł371m +4% Ł111.9bn +22%

Ł91.9bn

2011 2012 2011 2012

M&G AER CER

2012 Łm 2011 Łm Change % 2011 Łm Change %

Gross investment inflows 36,464 25,981 40 25,981 40

Net investment inflows:

Retail business 7,842 3,895 101 3,895 101

Institutional business 9,039 490 1,745 490 1,745

Total 16,881 4,385 285 4,385 285

Revenue 728 662 10 662 10

For the Twelve Months Ended December 31,

Other income 6 4 50 4 50

Staff costs(289)(270)(7)(270)(7)

Other costs(147)(134)(10)(134)(10)

Underlying profit before performance-related fees 298 262 14 262 14

Share of associate s resultsnote (i) 13 26(50) 26(50)

Performance-related fees 9 13(31) 13(31)

Operating profit from asset management operations 320 301 6 301 6

Operating profit from Prudential Capital 51 56(9) 56(9)

Total IFRS operating profit 371 357 4 357 4

Funds under managementnote (ii) Ł228bn Ł201bn 13 Ł201bn 13

Notes

(i) The 2012 figure represents M&G s 49.99 per cent proportionate share in the operating profit (including performance-related fees) of PPM South Africa following the divestment transaction in 2012. 100 per cent of operating profits were included in 2011.

(ii) Funds under management includes M&G s share of the assets managed by PPM South Africa at 49.99 per cent and 100 per cent for 2012 (Ł4.4 billion) and 2011 (Ł7.9 billion) respectively.

For the Twelve Months Ended December 31,

Market overview

M&G is the UK and European fund manager of the Prudential Group with responsibility for investments on behalf of both internal and

external clients. It is an investment-led business with a clear focus on generating superior long-term returns for investors, whether they are third-party clients or the funds of Prudential s insurance operations. This is achieved by creating an environment that is attractive to talented investment professionals.

Against a backdrop of continued political and macroeconomic uncertainty, M&G continues to deliver strong investment performance. Over the three years to 31 December 2012, 20 funds representing approximately 61 per cent of retail funds under management (FUM) produced fi rst or second quartile investment returns. The performance of funds managed on behalf of institutional fi xed income clients also remains extremely strong with all actively-managed mandates meeting or outperforming their benchmarks over this period.

Business performance

M&G has had a record-breaking year in terms of net sales, funds under management and profi ts.

Total net sales for the 12 months to the end of December 2012 were Ł16.9 billion, 25 per cent higher than the previous full year peak of Ł13.5 billion in 2009 and 285 per cent higher than net sales of Ł4.4 billion in 2011.

For the Twelve Months Ended December 31,

The strength of net fl ows, together with increases in equities and bond values in the year, have led to an increase of 13 per cent in total funds under management, to an all-time high of Ł228 billion. The FTSE All Share Index has increased by 8 per cent over the year and the sterling corporate bond index has increased by 15 per cent. Building on the strength of the net fl ows generated by the business over recent years, M&G was the largest retail fund manager in the UK1, measured by funds under management. M&G s total UK retail FUM is Ł41.2 billion, as noted by the Investment Management Association at the end of December 2012.

Underlying operating profi t for the year was Ł298 million, 14 per cent higher than the previous best of Ł262 million in 2011. Total operating profi t for 2012 was Ł320 million.

This caps a decade of extremely strong growth for M&G. Since 2003 net fund sales have increased at an annual compound rate of 32 per cent and external client assets have grown at an annual compound rate of 19 per cent. Over this period underlying profi t has grown at an annual rate of 22 per cent.

Retail

In the retail market, M&G operates a single fund range from the UK, which it distributes both locally and internationally through increasingly diverse channels. Assets sourced from investors outside the UK now account for 29 per cent of M&G s total retail FUM.

Notes

1 Source: Investment Management Association, data as at end of December 2012.

2 Source: SimFund Global. Data as at end of December

	For the Twelve Months Ended December 31,

2012 in EUR. Based on estimated net sales of funds classed as fund market International (registered for sale in more than five countries). Excludes Money Market and Alternative funds.

Asset management: M&G Prudential plc Annual Report 2012 41

Its reputation for delivering superior long-term investment Business

returns and a high standard of client service enabled M&G to unit

attract a record level of net fund sales in the retail market in 2012.

Excluding the results of our South African associate company, review

where our shareholding reduced from 75 per cent to 49.99 per cent

during 2012, total net sales were Ł8.2 billion. This is 15 per cent

higher than their previous high of Ł7.2 billion in 2010.

In the UK, M&G s core market, net sales totalled Ł3.0 billion, Business

30 per cent lower than the previous year, but still sufficiently

high to rank M&G as the top selling house for the year. M&G has

ranked first for both net and gross fund sales in the UK for four review

consecutive calendar years, an unprecedented achievement.

Fund sales slowed in the second half as a direct consequence

For the Twelve Months Ended December 31,

of a decision in July to limit flows of new money into two of our

best-selling sterling corporate bond funds to ensure continued

flexibility in the management of the funds. We expect UK net

sales to continue to slow in 2013.

By contrast, net fund sales in mainland Europe increased sharply.

Following a minor net outflow in 2011, the business generated

a record Ł5.2 billion of net sales representing 67 per cent of total

retail net sales in 2012. Over the year M&G saw retail assets

sourced from European clients grow by 75 per cent to Ł14.4 billion

(2011: Ł8.2 billion). Today M&G has offices in 15 different countries

and its retail funds are registered for sale in 20 jurisdictions.

A core pillar of M&G s retail business is to offer a diversified range

of investment funds and so be well-placed for changes in investor

trends. The demand for conservatively managed portfolios for

most of 2012 saw strong inflows into the M&G Optimal Income

Fund, a highly flexible international fixed income fund, and into

For the Twelve Months Ended December 31,

the M&G Global Dividend Fund. In Europe, Optimal Income was

the fourth best-selling fund, while Global Dividend ranked ninth

over the year to end of December 2012 and was the top selling

cross border Equity fund in 20122.

No fewer than 10 of M&G s retail funds, across the major asset

classes of fixed income, equities and real estate, each attracted

net sales of at least Ł100 million during the 12 month period.

The Ł8.2 billion of net retail inflows in the UK and Europe were

partially off-set by a Ł0.4 billion net outflow from funds managed

by M&G s associate entity in South Africa. These redemptions

were entirely from the PPM South Africa Dividend Income Fund,

which was closed on 31 March 2012 ahead of the implementation

of new tax legislation on 1 April 2012, which would have had a

materially adverse impact on the treatment of the distribution

made by the fund to its investors. Fund flows into other retail

funds of the South African business have been positive.

Institutional

For the Twelve Months Ended December 31,

In the institutional marketplace, M&G s approach is to leverage investment strategies developed primarily for Prudential s internal funds to create higher margin external business opportunities. M&G offers third-party clients, such as pension funds and sovereign wealth funds, an innovative range of specialist fixed income and real estate strategies, including private debt opportunities and infrastructure investment.

For the Twelve Months Ended December 31,

42 Business review Prudential plc Annual Report 2012

Asset management continued

Asset management: optimise M&G

The institutional business attracted a record level of net funds in 2012, predominantly into fi xed income strategies on the strength of its outstanding record of outperformance. At Ł9.0 billion, net infl ows were 50 per cent higher than the previous best of

Ł6.0 billion in 2009. The 2012 infl ows include a single Ł7.6 billion mandate which is expected to be partially or wholly redeemed within the next 24 months.

M&G continues to grow its business with external institutional clients, including the provision of alternatives to bank lending. The M&G UK Companies Financing Fund, a loan facility for medium-sized companies launched in the wake of the 2008 credit crisis, has increased its total commitments to Ł930 million across 11 individual loans. During the year, loans were made to three new clients, while a fourth advance went to an existing borrower.

Other innovations for third-party clients include a series of investment strategies to manage long-term infl ation-linked liabilities. The business successfully launched the M&G Infl ation Opportunities Fund and the M&G Debt Opportunities Fund, which complement the existing M&G Secured Property Income Fund, a portfolio of long-lease properties with inbuilt infl ation-linked increases. This last fund, which has total investor commitments of Ł1.3

For the Twelve Months Ended December 31,

billion, has delivered an annualised return of 7 per cent above the retail prices index (RPI) over the past three years.

In infrastructure, Infracapital, M&G s unlisted infrastructure equity division, led a consortium (comprising Infracapital and other parties independent of Prudential) in the acquisition of a 90 per cent interest in Veolia Environnement S.A. s (Veolia) UK regulated water business (now renamed Affi nity Water). Affi nity Water is the largest regulated water-only company in the UK by turnover. The acquisition is the fi rst investment for Infracapital Partners II LP, which has current commitments of Ł358 million.

Financial performance

M&G continues to execute against its strategy and deliver strong performance for both clients and its shareholder, the Prudential Group. M&G s 2012 fi nancial performance continues the momentum from the strong full year results recorded in both 2011 and 2010, with further growth in profi ts and improvement in operating margins.

Total revenues, including other income, were Ł734 million, an increase of 10 per cent on the 2011 position. The increased scale of the business following the strong growth in FUM over recent periods has generated operational effi ciencies. Combined with a focus on cost discipline across the business, this has resulted in the cost/income ratio1 improving from 61 per cent in 2011 to 59 per cent for 2012. Underlying profi t for the full year rose by 14 per cent to a new record level of Ł298 million. Following the addition of performance-related fees and profi t from our associate investment in South Africa, total operating profi t for 2012 was at a record level of Ł320 million. Although affected by

For the Twelve Months Ended December 31,

the reduction in our holding in our South African business, this is an increase of 6 per cent on the 2011 position of Ł301 million, which had been the previous record year.

Note

1 Excluding performance-related fees, carried interest on private equity investment and profit from the PPM South Africa entity.

The profi t from the South Africa entity represents our proportionate share of its operating profi t which, following the divestment transaction in the fi rst quarter of 2012, reduced our ownership to 49.99 per cent. For 2011 and prior periods, the results of the South Africa entity were fully consolidated within our operating profi t.

Given the ongoing strength of its fi nancial performance, M&G continues to provide capital-effi cient profi ts and cash generation for the Prudential Group. This is in addition to the strong investment returns generated on the internally managed funds. M&G remits a substantial proportion of its post-tax profi ts to the shareholder. During 2012 cash totalling Ł206 million (2011: Ł213 million) was remitted to Group.

Prudential Capital

Prudential Capital manages the Group s balance sheet for profi t by leveraging Prudential s market position. This business has three strategic objectives: (i) to provide professional treasury services to the Prudential Group; (ii) to operate a fi rst-class wholesale and capital markets interface; and (iii) to realise profi table opportunities within a tightly controlled risk framework. Prudential Capital generates revenue by providing bridging fi nance, managing

For the Twelve Months Ended December 31,

investments and operating a securities lending and cash management business for the Prudential Group and its clients.

Markets have remained diffi cult and volatile in 2012, and as a result the business remains focused on liquidity across the Prudential Group, management of the existing asset portfolio and conservative levels of new investment. Prudential Capital has continued to invest in developing its capabilities, by seeking to maintain the dynamism and fl exibility necessary to ensure that the treasury and wholesale services remain robust in a period of increased regulatory change, and to identify and realise opportunities for profi t within acceptable risk parameters. Prudential Capital is committed to working closely with other business units across the Prudential Group to exploit opportunities and increase value creation for Prudential as a whole.

Prudential Capital has a diversifi ed earnings base derived from its portfolio of secured loans, debt investments and the provision of wholesale markets services. IFRS operating profi t was

51 million in 2012 (2011: Ł56 million). In 2012 a total of

91 million (2011: Ł67 million) cash was remitted to Group.

[Graphic Appears Here]

For the Twelve Months Ended December 31,

Asset management: M&G/ Eastspring Investments Prudential plc Annual Report 2012 43

Asset management continued

Asset management: optimise

Eastspring Investments

Eastspring Investments AER CER Business

2012 Łm 2011 Łm Change % 2011 Łm Change % unit

Gross investment inflowsnote 9,036 7,824 15 7,707 17

Net investment flowsnote 1,626 633 157 599 171 review

Total IFRS operating profit 75 80(6) 79(5)

Funds under management Ł58.1bn Ł50.3bn 16 Ł49.8bn 17

Market overview During 2012 Eastspring Investments delivered excellent Business

Prudential s asset management business in Asia investment performance with 65 per cent of funds exceeding

manages investments for Asia s third-party retail their benchmarks or were peer-ranked within the top two review

and institutional clients in addition to investments quartiles over a three year period.

of Prudential s Asia, UK and US life companies. It has

operations in 11 markets, including Indonesia which Business performance

For the Twelve Months Ended December 31,

fully opened during 2012, increasing our Net third-party inflows (excluding Money Market Funds) of

asset management footprint in the region. Ł1,626 million were driven by net inflows in India, Taiwan and

China. Specifically, strong fund-raising was seen in India for our

Markets remained challenging in 2012. Equity funds struggled to

fixed maturity plan range and open-ended bond funds, while the

gain traction, due to poor investor sentiment in the face of weak

Taiwan business saw a successful launch of the Emerging Asian

macroeconomic signals. Fixed income and regular yield products

Local Fixed Income Fund in the first half of the year and the

remained in favour.

Global Aggregate Strategy High Yield Bond Fund in the second

In November 2011, Prudential announced that its Asia Asset half. In addition, Taiwan s existing range of onshore and offshore

Management operations would be rebranded Eastspring bond funds also generated significant net inflows in 2012. In

Investments. The new brand, which was officially launched in China, both the CSI 500 Index Fund and the Tianjin Split Bond

For the Twelve Months Ended December 31,

February 2012, is enabling the business to establish a cohesive Fund launched in the second half of the year attracted positive

regional presence, thereby penetrating the offshore segment flows. The positive net flows were partially offset by redemptions

more effectively. It also supports distribution to new markets from an institutional client in Singapore and another in Korea.

outside Asia and we have recently opened a distribution office

Total funds under management (FUM) reached a record

in the US.

Ł58.1 billion and represent a 16 per cent increase from a year ago

Eastspring Investment s leading presence in Asia was on the back of strong net inflows and positive market movements.

acknowledged when it was ranked the largest retail asset

manager in Asia (based on assets sourced from Asia ex-Japan), Financial performance

as at 30 June 2012, in a survey conducted by Asia Asset Fee income rose by a more modest 3 per cent, reflecting a change

Management magazine. Eastspring Investments also received in FUM mix, with a higher proportion of internal, institutional and

multiple accolades for its investment capabilities, including four retail bond funds, all of which attract lower average annual

For the Twelve Months Ended December 31,

fund managers from Singapore, Malaysia and Indonesia being charges. At the same time costs have increased as we continue to

named 2012 Most Astute Investors in Asian currency bonds by invest in the development of the Eastspring Investments platform

The Asset Benchmark Research and the joint venture business in and expand into new markets. IFRS operating profit was,

India being recognised as the Best Debt Fund House of the year therefore, 6 per cent lower than the prior year at Ł75 million.

in the Morningstar Awards 2012.

Note

Gross and net investment fl ows exclude Eastspring Money Market Funds, that had net outfl ows of Ł226 million in 2012 (2011: net outfl ows Ł512 million).

For the Twelve Months Ended December 31,

44 Business review Prudential plc Annual Report 2012

Asset management continued

Asset management: optimise United States

PPM America AER CER

2012 Łm 2011 Łm Change % 2011 Łm Change %

Total IFRS operating profit 6 4 50 4 50

Market overview Financial performance

PPM America (PPMA) manages assets for Prudential s US, IFRS operating profit in 2012 was Ł6 million, compared

UK and Asia affiliates. PPMA also provides other affiliated to Ł4 million in 2011, principally reflecting the increase in

and unaffiliated institutional clients with investment services funds under management over the period.

including collateralised debt obligations (CDOs), private equity

At 31 December 2012, funds under management of Ł64 billion

funds, institutional accounts, and mutual funds. PPMA s strategy

were as follows:

is focused on managing existing assets effectively, maximising

the benefits derived from synergies with our international asset

For the Twelve Months Ended December 31,

management affiliates, and leveraging investment management

capabilities across the Prudential Group. PPMA also pursues

third-party mandates on an opportunistic basis.

AER

2012 Łbn 2011 Łbn

US UK Asia Total US UK Asia Total

Insurance 38 15 1 54 32 15 47

Unitised 2 1 6 9 1 1 5 7

CDOs 1 1 1 1

Total funds under management 41 16 7 64 34 16 5 55

Curian AER CER

2012 Łm 2011 Łm Change % 2011 Łm Change %

Gross investment inflows 1,550 1,684(8) 1,704(9)

Revenue 69 51 35 52 33

Costs(54)(45)(20)(46)(17)

Total IFRS operating profit 15 6 150 6 150

Total funds under management Ł7.1bn Ł4.7bn 51 Ł4.5bn 58

Market overview

Curian Capital, Jackson s registered investment adviser, provides innovative fee-based managed accounts and investment products to advisers through a sophisticated technology platform. Curian expands Jackson s access to advisers while also complementing Jackson s core annuity product lines with Curian s retail asset

For the Twelve Months Ended December 31,

management products.

Business performance

At 31 December 2012, Curian had total assets under management of Ł7.1 billion, compared to Ł4.7 billion at the end of 2011. Curian generated deposits of Ł1,550 million in 2012, down 8 per cent from 2011. Curian s asset growth continues to benefi t from its prior investment platform expansions and its significant expansion in 2012 of the firm s wholesaling team and new distribution territories.

Financial performance

Curian reported an IFRS basis operating profit of Ł15 million in

2012 compared to Ł6 million in 2011. This increase was primarily due to higher net revenue from a larger book of assets under management.

Asset management: United States Prudential plc Annual Report 2012 45

For the Twelve Months Ended December 31,

US Broker-dealer AER CER Business

National Planning Holdings, Inc. 2012 Łm 2011 Łm Change % 2011 Łm Change %

Revenue 528 491 8 497 6 unit

Costs(510)(477)(7)(483)(6)

Total IFRS operating profit 18 14 29 14 29 review

Market overview Financial performance

National Planning Holdings, Inc. (NPH) is Jackson s affiliated NPH generated revenues of Ł528 million in 2012, up from Business

independent broker-dealer network. The business is comprised Ł491 million in 2011, on gross product sales of Ł10.5 billion

of four broker-dealer firms, including INVEST Financial(2011: Ł8.6 billion). The network continues to achieve

Corporation, Investment Centers of America, National Planning profitable results, with 2012 IFRS operating profit of Ł18 million, review

Corporation, and SII Investments. a 29 per cent increase from Ł14 million in 2011. At 31 December

2012, the NPH network had 3,540 registered advisers

NPH continues to grow the average business and revenue

(2011: 3,636 registered advisers).

per representative. By utilising high-quality, state-of-the-art

For the Twelve Months Ended December 31,

technology. Jackson provides NPH s advisers with the tools they

need to operate their practices more efficiently. At the same time,

through its relationship with NPH, Jackson continues to benefit

from an important retail distribution outlet, as well as receive

valuable insights into the needs of financial advisers and

their clients.

For the Twelve Months Ended December 31,

46 Business review Prudential plc Annual Report 2012

Financial review

Results summary

International Financial Reporting Standards (IFRS) basis results*

Statutory IFRS basis results

2012 2011

note (i)

Profit after tax attributable to equity holders of the Company Ł2,197m Ł1,415m

Basic earnings per share 86.5p 55.8p

Shareholders equity, excluding non-controlling interests Ł10.4bn Ł8.6bn

Supplementary IFRS basis information

2012 Łm 2011 Łm

note (i)

Operating profit based on longer-term investment returns* 2,533 2,027

Short-term fluctuations in investment returns on shareholder-backed business 204(220)

Shareholders share of actuarial and other gains and losses on defined benefit pension schemes 50 21

Gain on dilution of Group holdings 42

Amortisation of acquisition accounting adjustments arising on the purchase of REALIC(19)

For the Twelve Months Ended December 31,

Profit before tax attributable to shareholders 2,810 1,828

Operating earnings per share*(refiecting operating profit based on longer-term investment returns after

related tax and non-controlling interests) 76.8p 62.8p

European Embedded Value (EEV) basis results*

2012 Łm 2011 Łm

Operating profit based on longer-term investment returns* 4,321 3,978

Short-term fiuctuations in investment returns 538(907)

Mark to market value movements on core borrowings(380)(14)

Shareholders share of actuarial and other gains and losses on defined benefit pension schemes 62 23

Effect of changes in economic assumptions(16)(158)

Gain on dilution of Group holdings 42

Gain on acquisition of REALIC 453

Profit before tax (including actual investment returns) 5,020 2,922

Operating earnings per share* (refiecting operating profit based on longer-term investment returns after

related tax and non-controlling interests) 125.0p 115.7p

Shareholders equity, excluding non-controlling interests Ł22.4bn Ł19.6bn

2012 2011

For the Twelve Months Ended December 31,

Dividends per share declared and paid in reporting period 25.64p 25.19p

Dividends per share relating to reporting period 29.19p 25.19p

Funds under management Ł405bn Ł351bn

Insurance Groups Directive capital surplus (as adjusted)notes (ii) and (iii) Ł5.1bn Ł4.0bn

Notes

(i) Comparatives adjusted for retrospective application of the accounting policy change for deferred acquisition costs as discussed in note A5 of the IFRS financial statements.

(ii) The surpluses shown for 2012, which is estimated, and 2011 are before allowing for the final dividends for 2012 and 2011 respectively.

(iii) From March 2013, the basis of calculating Jackson s contribution to the Group s IGD surplus will change, further detail can be found in the Capital position, financing and liquidity section of the Chief Financial Officer s overview.

For the Twelve Months Ended December 31,

Financial review Prudential plc Annual Report 2012 47

* Basis of preparation

Results bases

The IFRS basis results have been prepared in accordance

with the accounting policies discussed in notes A2 to A4

of the IFRS financial statements.

Life insurance products are, by their nature, long-term and the

profit on this business is generated over a significant number

of years. Accounting under IFRS alone does not, in Prudential s Financial

opinion, fully reflect the value of future profit streams. Prudential

considers that embedded value reporting provides investors review

with a measure of the future profit streams of the Group s in-force

long-term businesses and is a valuable supplement to statutory

accounts. The EEV basis results have been prepared in

accordance with the EEV principles discussed in note 1

of EEV basis supplementary information. Business

Operating profit based on longer-term investment returns

For the Twelve Months Ended December 31,

The Group provides supplementary analysis of profit before tax review attributable to shareholders so as to distinguish operating profit based on longer-term investment returns from the other elements of total profit shown. Operating profit per share is calculated using operating profits based on longer-term investment returns, after related tax and non-controlling interests.

Exchange translation Actual Exchange Rate (AER) and Constant Exchange Rate (CER)