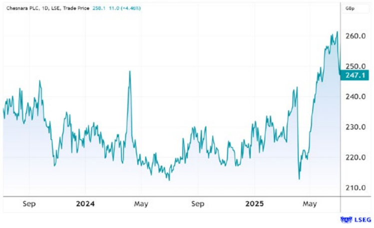
8 July 2025

HARDMAN & CO.

Life assurance



Source: LSEG, 2025

Market data

EPIC/TKR	**CSN**
Price (p)	**285.0**
12m high (p)	304.5
12m low (p)	238.0
Shares (m)	151.0
Mkt cap (£m)	430.3
Economic Value (£m)	531.0
Country of listing	UK
Market	London

Description

Chesnara manages and acquires closed life assurance books in the UK, Sweden and the Netherlands.

Company information

CEO	Steve Murray
CFO	Tom Howard
Chairman	Luke Savage

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www.chesnara.co.uk

Key shareholders

Columbia Threadneedle	11.7%
Hargreaves Lansdown	9.1%
Aberdeen	8.5%
Interactive Investor	8.4%
M&G	5.8%
Canaccord Genuity	3.8%
Royal London	3.7%
Janus Henderson	3.5%

Diary

7 Jul	Record date for rights
22 Jul	Close of rights issue
28 Aug	Interim results

Analyst

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CHESNARA PLC

Landing the big one

After a longer wait than planned, Chesnara has announced a large acquisition, HSBC Life (UK). At a cost of £260m, it is almost 60% of Chesnara's pre-announcement market capitalisation and will be funded by a mixture of equity, existing cash resources (primarily from the earlier Tier 2 bond issue) and drawing down from a newly increased revolving credit facility. The rights issue should complete by 23 July 2025, with deal completion in early 2026. There is a one-off additional uplift to the dividend per share (adjusted for the rights issue) of 6%, which will apply to the 2025 final and 2026 interim dividends.

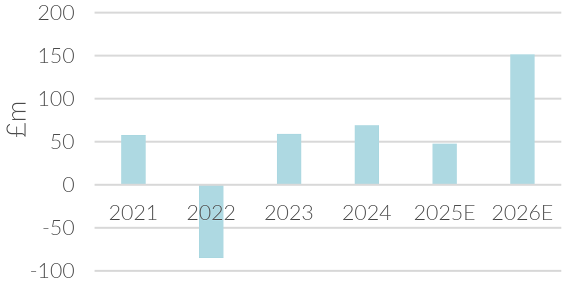
- **Rights issue:** The rights issue is 10 shares for every 19 existing shares with an execution price of 176p. This is a 40% discount to Chesnara's pre-announcement share price and a 30% discount to the theoretical ex-rights price. The 79.6m new shares increase total shares by 53%.
- **Estimates:** With the rights issue taking place immediately but the deal not completing until early 2026, the 2025 per-share figures do not reflect the economics. 2026 EPS will more than double, boosted by the acquisition gain. We still estimate the deal should be accretive on an underlying basis in 2026.
- **Valuation:** With a price at ca.70% of its forecast Economic Value, Chesnara seems undervalued. A prospective dividend yield of above 8%, with good prospects of continued growth, also suggests an undervalued stock, in our view.
- **Risks:** Ultimately, the company remains tied to movements in financial markets and adverse developments in operational areas. Making a large acquisition also brings some execution risk, but Chesnara has good experience in managing smaller deals successfully.
- **Investment summary:** Chesnara has three pillars for delivering value under responsible risk-based management. A close analysis reveals that there is substance underlying these aims. In our opinion, the discount to Economic Value looks wider than it should, and the yield appears high for a dividend that is both secure and growing.

Financial summary and valuation

Year-end Dec (£m)	2021	2022	2023	2024	2025E	2026E
Operating earnings	-58.8	-26.8	-7.7	10.4	16.0	16.5
Economic earnings	109.6	-109.1	42.9	50.3	51.8	53.4
Economic Value earnings	57.8	-85.1	59.1	69.1	60.7	169.6
Economic Value/share (p) *	416	340	348	352	293	351
Base cash generation	20	83	33	52	57	82
EPS (p) *	33.2	-48.8	33.8	39.5	25.0	65.7
Dividend (p) *	19.48	20.07	20.66	21.28	22.34	23.24
Price/Economic Value (x) *	0.69	0.84	0.82	0.81	0.84	0.70
Yield *	7.9%	8.2%	8.4%	8.7%	9.1%	9.5%

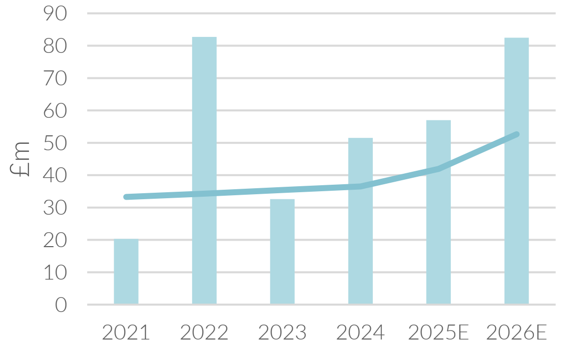
** Restated to adjust for the rights issue. Source: Hardman & Co Research*

Economic Value earnings



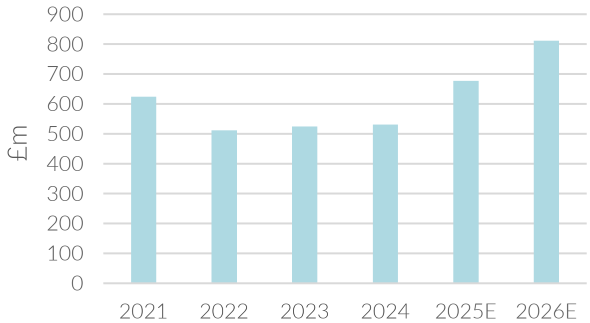
- Volatility for investment assets in 2022
- Also affected by operational challenges
- Forecasts are based on normalised assumptions
- Gains from acquisitions of £28.4m in 2023 and £10.5m in 2024 as well as a large gain expected in 2026

Base cash generation and dividends paid (line)



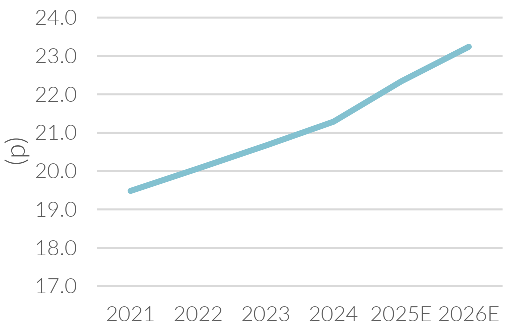
- 2021 and 2023 affected by a challenging Swedish market
- Symmetric adjustment smooths effect of markets on cash
- 2023 cash boosted by Risk Margin reduction in UK
- More normal conditions keeping cash generation at comfortable levels

Economic Value



- Volatility for investment assets has reduced in the past couple of years
- Also affected by operational challenges
- Forecasts are based on normalised assumptions
- Gain from acquisitions of £28.4m in 2023 and £10.5m in 2024 as well as a large gain expected in 2026

Dividend per share (restated)



- Chesnara has been a consistent dividend payer for two decades
- Change in trajectory 2025 and 2026 reflects one-off 6% uplift
- We forecast continued steady growth of 3% p.a. thereafter

Source: Company data, Hardman & Co Research

Summary

After several attempts falling through, Chesnara has finally announced a deal of the scale that management have been hoping for. The intended acquisition of HSBC Life (UK) will enhance Chesnara's scale significantly, with Own Funds (+37% pro forma), assets under administration (AuA) (+29%) and the number of shares (+53%) all increasing significantly.

Just as important, the financial details seem to stack up too. The total cost is at a 17% discount to the Own Funds of HSBC Life. Although the usual measure of Economic Value is unavailable, it will be greater than Own Funds, giving a larger discount.

Future cashflows will be enhanced meaningfully, with over £800m expected over the life of the book, of which £140m in the next five years. This improved cashflow is reflected in a one-off uplifted dividend increase to 6%, from the usual 3%. This will be applied to the 2025 final and 2026 interim dividends.

Financing will consist of a mixture of existing cash resources, drawing down the revolving credit facility (RCF) and a £140m rights issue. The size of the RCF has been increased from £100m to £150m, leaving resources in the bank for future acquisitions.

HSBC Life (UK)

HSBC Life UK was founded in 1906. As part of Midland Bank, it became HSBC Life (UK) in 1999. Its main areas are in protection and onshore bonds, which constitute the majority of its business. Perhaps unexpectedly, it has successfully penetrated the IFA market, from which most of its new business derives. The onshore business is the second largest in the UK.

From Chesnara's perspective, these are product areas it already has meaningful exposure to. For example, both featured in the recent acquisitions from Sanlam and Canada Life. As well as ease of management, this should assist in generating expense and capital synergies.

Of the 454,000 policies, around 5% are onshore bonds, with the balance protection. For AuA, the position is almost exactly reversed, with 94% of the assets unit linked.

Deal terms

The deal will cost Chesnara £260m in total, assuming completion on schedule. Funding is coming from three sources:

- Existing cash resources of £55m. In essence, this is the bulk of the residual proceeds from the Tier 2 bond issue in 2022.
- There will be £65m drawn down from the RCF.
- A rights issue will raise £140m gross, with net proceeds of £130m.

The details of the rights issue are as follows:

- A 10 for 19 share issue with a record date of 7 July.
- Issue price of 176p, representing a 40% discount to the share price on 2 July (293.5p).

- The theoretical equivalent share price is 253p, with a bonus factor of 1.16p based on the share price before the announcement (we have used these throughout – the actual price depends on the price at the time of the rights issue)..
- Nil paid shares will trade from 8 July to 22 July, with the new fully paid shares trading from 23 July.
- There will be 79,539,337 new shares issued compared with an existing number of 151m, growing the total by 52.6%.

The composition of the funding, in particular the equity proportion, is clearly intended to retain some future flexibility. Two key statistics suggest that Chesnara has not pushed the financing. The pro forma Solvency II ratio will be 169%, compared with a target range of 140%-160%. We would expect the actual ratio to be a little better: while initial capital synergies are limited, there will be some improved diversification.

The leverage ratio will also decrease slightly, from 31% to 29%. Chesnara intend to pay down the RCF (its term is three years), so this ratio, if all else remains unchanged, should continue to improve. We'll discuss what this means for the future below, but here we note that the balance sheet is not stressed by this deal and should improve.

The increased market capitalisation will have a couple of benefits. There will be a greater free float. Many Chesnara investors are long-term holders, which has adversely affected liquidity. In addition, it should be eligible for the FTSE250, which should broaden interest.

We note that Fitch has had Chesnara's rating on a negative outlook. This deal directly addresses two of the rating agency's main concerns: the pace of M&A and finances/expenses. With separate progress on their third concern (the UK transition), there are good prospects for Fitch taking another look.

The deal timetable expects completion in early 2026. The Part VII transfer (which requires court approval) is more uncertain, but early 2027 seems the most probable.

Dividends

Chesnara has had a remarkable dividend record, increasing it continually for 20 years. Recent increases have been steady at 3% p.a. Management are proposing a step-up for the next year, with a one-off 6% increase. This will be based on the dividend after the bonus factor has been applied. The figures that are expected to apply are as set out in the table.

Expected dividends and increases

Year-end Dec (£m)	2024 (actual)	2024 (restated)	2025 (post deal)	2026
Interim dividend	8.6	7.4	7.6 (+3%)	8.1 (+6%
Final dividend	16.1	13.9	14.7 (+6%)	15.1 (+3%)
Total dividend	24.7	21.3	22.3 (+4.7%)	23.2 (+4%)

Source: Hardman & Co Research

The rights issue should be finished in time for the new shares to receive the 2025 interim dividend.

Beyond that, we expect the dividend to return to a steady 3% p.a. increase. We expect that it will take further deals for that to change.

Finances

The HSBC Life (UK) business has a solid balance sheet and decent profitability. Its Solvency II ratio was 149% at year end, with £314m of Own Funds and £277m of shareholder equity. In 2024, IFRS profit after tax was £26m. Economic Value figures are not available.

The lack of big deals since the Tier 2 bond issue in 2022 has meant Chesnara has been somewhat overcapitalised for the past few years. This deal returns some of the metrics to a more normal range. On a pro forma basis, the combined entity will have £881m of Own Funds, of which £244m is Tier 2/3. With a combined SCR of £520m, the Solvency II ratio drops from 203% to 169%. While this is still above Chesnara's target range, it feels like a more acceptable figure going forward.

No details on returns on the deal have been supplied, other than a comment from management that they are expected to meet or exceed the required metrics. We have previously noted Chesnara's reluctance to do deals at the wrong price and commended its discipline (especially with cash to spend on the balance sheet). This gives some confidence that this is a deal worth raising equity for,

Synergies

As yet, there have been few comments on synergies. As a business that wrote meaningful new business and was profitable, HSBC Life (UK) should already be reasonably efficient. Chesnara has based most of its pro forma figures on existing operations and costs. As yet, it has not identified cost synergies but expects to do so after completion. We would expect more on this in 2026.

While some capital synergies can be achieved quickly, Chesnara is limited in what it can do before the Part VII transfer is complete. There will be some diversification benefits, but as Chesnara already has exposure to HSBC Life (UK)'s business lines in the UK, these are likely to be limited.

Once the full merger takes place, there may be opportunities for some management action to generate capital synergies. For example, there is reinsurance in place against a mass lapse in the UK business and this could be extended to the new operations.

Cash generation

Chesnara expect the acquisition to add ca.£800m to future cashflows over its lifespan, of which £140m in the first five years. These figures include estimates of cost savings and management actions. The duration of the new book is longer than Chesnara's existing business. A few years ago, there was some concern in the market about the sustainability of cashflows. A couple of Chesnara's smaller recent deals provided meaningful near-term improvements and reassured those with concerns.

In more recent conversations with management, there has been a definite change in perspective to look at acquisitions that bring longer-term benefits. This acquisition definitely fits the bill. Management also note that the composition of the new book means that they have greater certainty about future cashflows from it compared with the current business. Less volatile cashflow will be welcome.

The increased RCF will supply £65m of the funding. The aim is to pay this down over its three-year term. We can see that the increased cash flow should do that in about 2.5 years, which, allowing for the six months until completion, is about right. Of course this depends on what else the RCF is used for in this period.

New business

As indicated above, HSBC Life (UK) is a meaningful writer of new business, writing £116m of premiums in 2024. This is an area in which it has had success and grown meaningfully over the past few years. The primary source of business is IFAs, although it has had a relationship with the parent bank too.

While Chesnara clearly intends to continue to write new business, it is not clear whether or how it will change the products or strategy. It has strict profitability criteria, and price changes in protection in particular can meaningfully affect market share. Nevertheless, Chesnara's experience with Scildon shows it is willing to compete too. This could be a meaningful addition to Chesnara's new business flow.

Future prospects

As noted above, the funding structure deliberately left some headroom in available funding. Management have clearly signalled they remain open to new deals: when asked when they would be ready for the next one, the answer was now.

Realistically, doing another UK deal immediately might be a challenge. The expectation is for the integration to take about six months, which would be around the middle of 2026. While the SS&C link should provide greater capacity, the migration of Chesnara's existing UK business is still ongoing. A further UK deal this year might raise some concerns.

However, the overseas businesses are much better placed. They will be unaffected by this deal and so would be able to transact immediately if required.

Clearly financial headroom is more limited than before the transaction. While there is £85m of capacity in the RCF, using all of that could push leverage to or beyond investment-grade limits. Obviously, as the RCF gets paid down, headroom will grow. Chesnara estimate it has ca.£100m of firepower available now and this should rise to ca.£150m in reasonably short order. This compares to an estimated £200m (without equity) that was available prior to the transaction.

Chesnara has indicated that it is considering issuing a restricted Tier 1 instrument and obtained shareholder permission to do so at the AGM in May. This would help with the leverage ratio, although we understand that the likely cost is higher than the RCF.

Forecasts

Updating our forecasts has proved more challenging than usual, as our forecasts are based on Economic Value, whereas only IFRS data is available for HSBC Life (UK). For 2025, the effects of the transaction are limited to the increased number of shares. This will dilute EPS for the year and increase the dividend cost.

For 2026, there will be two significant additions. The gain on the transaction is easier to assess. We know that the cost is 83% of Own Funds, resulting in a minimum gain of £53m. Comparing with Chesnara's existing UK business, we increase this to £85m.

We note that the relative scale of the acquisition depends on which measure is used. Own Funds will be 37% larger, while the SCR increases by 65%. However, with completion in early 2026, Chesnara will not get a full year of earnings. Rather than trying to give some false precision on a line-by-line basis, we have increased 2026 profits by 35%. This adds another £21.9m to Economic Value earnings for 2026.

Dividends are as set out above, although we have added a row of restated EPS and dividends adjusted for the bonus factor. As usual, we make no assumption about future acquisitions.

Our forecasts are on a normalised basis economically. The effect of the increased number of shares is to decrease our 2025E EPS by 8% to 25.0p from 27.0p (restated). The 2026E EPS more than doubles to 65.7p, although this large gain means this figure is not indicative of future earnings. Excluding the gain we arrive at 28.9p, although there is much lower confidence in this figure than usual.

Economic Value earnings

Year-end Dec (£m)	2021	2022	2023	2024	2025E	2026E
Expected movement	-1.7	-1.3	14.9	15.0	15.5	15.9
New business	2.4	8.0	4.40	5.2	5.5	5.7
Operating experience variances	-19.2	-20.7	0.8	-9.1	-9.4	-9.7
Operating assumption changes	-13.9	-14.5	-27.8	9.0	9.3	9.5
Other operating variances	-0.2	1.7				-5.0
Total u/l operating earnings	-32.6	-26.8	-7.7	10.4	16.0	16.5
Material other operating items	-26.2	0.0				
Total operating earnings	-58.8	-26.8	-7.7	10.4	16.0	16.5
Economic experience variances	79.5	0.0	43.0			
Economic assumption changes	30.1	0.0	2.3			
Total economic earnings	109.6	-109.1	42.9	50.3	51.8	53.4
Other non-operating variances	4.5	-2.6	-11.9	-11.3	-11.6	-12.0
Central costs				-11.8	-12.2	-12.5
Risk margin movement	10.8	20.4	1.1	22.8	9.1	9.4
Tax	-8.2	12.0	6.3	-1.8	-5.3	-5.5
Gain on acquisition	0.0	21.0	28.4	10.5	0.0	85.0
Economic Value earnings	**57.8**	**-85.1**	**59.1**	**69.1**	**47.8**	**151.6**
EPS (p) (actual)	38.5	-56.6	39.3	45.8	25.0	65.7
EPS (p) (restated)	33.2	-48.8	33.8	39.5	25.0	65.7
DPS (p) (actual)	22.60	23.28	23.97	24.69	22.34	23.24
DPS (p) (restated)	19.48	20.07	20.66	21.28	22.34	23.24

Source: Hardman & Co Research

The year-end Economic Values per share are again distorted by the extra shares. For 2025, we have added in the value of the rights issue; 2026 reflects a real post-deal value.

We have increased UK cashflow in 2026 by 90% of the average annual rate of the expected £140m in the first five years post acquisition. While the 2025 dividend cover drops sharply with the extra shares but no extra cash flow, the 2026 cover is noticeably improved.

Key balance sheet and cash generation

Year-end Dec (£m)	2021	2022	2023	2024	2025E	2026E
Borrowings	47.2	212.0	207.9	207.9	269.8	249.8
Economic Value	624.2	511.7	524.7	531.0	677.0	811.4
Economic Value/share (p)	416	340	349	352	293	351
Economc Value/share (p) (restated)	358	293	300	303	293	351
Base cash generation						
UK	27.4	40.8	45.0	35.3	33.5	57.1
Movestic	-14.4	16.1	-7.0	8.2	7.8	8.2
Waard	2.9	8.4	15.3	1.4	4.2	4.4
Scildon	15.2	-3.4	-3.1	14.1	11.3	11.6
Group	-10.8	20.8	-17.6	-7.5	0.2	1.2
Total	20.3	82.7	32.6	51.5	57.0	82.5
Dividends paid	-33.3	-34.3	-35.4	-36.5	-41.9	-52.6
Dividend cash cover (x)	0.6x	2.4x	0.9x	1.4x	1.4x	1.6x

Source: Hardman & Co Research

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