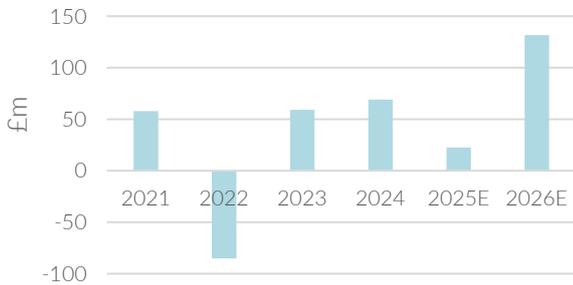
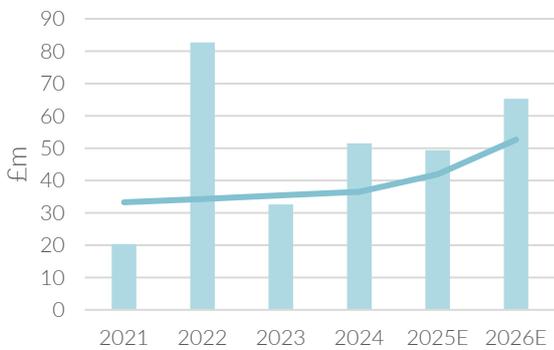


Economic Value earnings



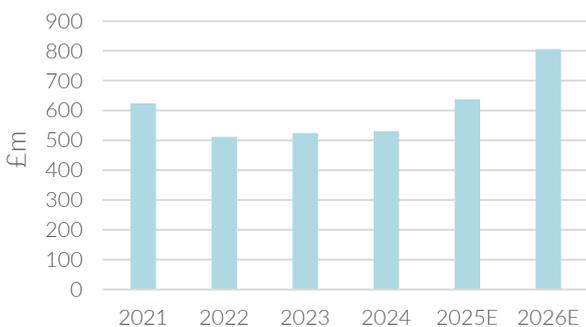
- ▶ Volatility for investment assets in 2022
- ▶ Also affected by operational challenges
- ▶ Forecasts are based on normalised assumptions
- ▶ Gains from acquisitions of £28.4m in 2023 and £10.5m in 2024 as well as a large gain expected in 2026

Base cash generation and dividends paid (line)



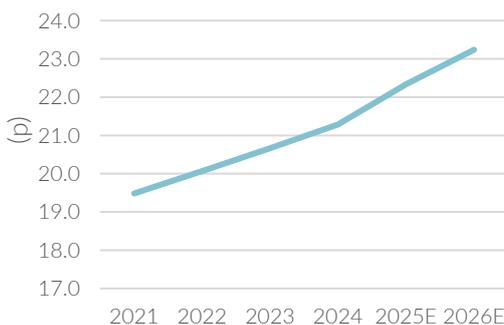
- ▶ 2021 and 2023 affected by a challenging Swedish market
- ▶ Symmetric adjustment smooths effect of markets on cash
- ▶ 2023 cash boosted by Risk Margin reduction in UK
- ▶ More normal conditions and acquisitions keeping cash generation at comfortable levels

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
- ▶ Gains from acquisitions of £28.4m in 2023 and £10.5m in 2024 as well as further large gains expected in 2026

Dividend per share



- ▶ Chesnara has been a consistent dividend payer for over 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

Scottish Widows Europe

For almost 20 years from 1995, Scottish Widows sold UK products into Europe via its branches. The vast majority – 88% by assets under administration (AuA) – were sold into Germany, with Austria and Italy also seeing some sales. Although it stopped writing this business before Brexit, a new company was required post Brexit. In 2019, Scottish Widows Europe was created to satisfy this requirement; existing policies were moved across but reinsured back to the parent company.

The majority of business (79% of policies) is made up of endowments, mostly with-profits with some unit-linked options. These policies have guaranteed annuity options on maturity, so appear to have been sold as an alternative to pensions. There are also a smaller number of pension policies as well as annuities (1% of total) from each of these policy classes that have converted. Overall, unit-linked AuA make up only 16% of the total.

As of December 2024 (latest available figures), Scottish Widows Europe had total assets of €3.805bn and liabilities of €3.709bn, a difference of €95m. It made a loss of €39m that year.

The total AuA brought across will be €1.7bn across 46,000 policies, representing ca.9% and ca.3%, respectively, of Chesnara's most recently announced totals.

Scottish Widows is now owned by Lloyds Banking Group.

Acquisition finances

Chesnara has agreed to pay €110m (£96m) for Scottish Widows Europe. While the underlying economics need a little explaining (see below), the figure paid is 0.64x Scottish Widows Europe's end-2024 Own Funds of €173m (£151). The SCR of the acquired entity is €97m (£85m). From an income perspective, the main feature is the cash generation, with €250m (£218m) expected over the lifetime of the portfolio, €100m (£87m) of which in the first year.

Completion of the deal is expected to take place in late 2026, so there will be little or no effect on Chesnara's 2026 results, but it will fully benefit from 2027 onwards.

Funding will be met from existing resources, in particular deploying part of the proceeds from the £150m raised from issue of the Tier 1 instrument in summer 2025. On a *pro forma* basis, as of December 2024, Chesnara's Solvency II ratio would have been 173% post-transaction. This is still comfortably above the target range of 140%-160%. We note that FY'25 results are due in March and updated figures will be available then.

Chesnara also notes that its leverage ratio will remain below the key 30% level and should allow it to retain its current investment grade rating.

Operational considerations

Luxembourg is a new country for Chesnara, so Scottish Widows Europe will be operating as a standalone entity within the group, at least initially. There will be no direct operational synergies, although Chesnara notes that there may be some opportunities for replacing some of the central services that Lloyds provided. From a Chesnara perspective, the low price reflects a lack of synergies.

In 2023, Scottish Widows, as a whole, started to move all of its business onto the Lifeware platform. This is a modern operating system, which should be good for managing the business going forward. Chesnara has no plans to change this.

While operational synergies are limited, there may be some opportunities for capital synergies. In particular, Chesnara may be able to take some of the management actions that it has used elsewhere in the business, such as forex hedging and mass lapse reinsurance, and apply them to Scottish Widows Europe. With Luxembourg operating under the same Solvency II regime as the rest of Europe, Chesnara is already familiar with most regulatory requirements.

Strategic options

The entry into Luxembourg provides Chesnara with increased strategic options going forward. With an attractive taxation regime, several companies have used it as a base in Europe where the passporting rules allow selling across the EU. Like Scottish Widows Europe, not all of these have been successful.

Chesnara estimates there are ca.30 providers of life insurance in Luxembourg, with ca.€235bn of life insurance liabilities. Most of these are sub-scale businesses, many writing little or no new business. There are also few incumbent consolidators, especially at Chesnara's scale.

In short, there is good potential for Chesnara to do further deals in this market. While there may be no operating synergies from this transaction, it could provide opportunities for synergies from future deals. The Lifeware platform is certainly scalable. As we have noted previously, an established relationship with the regulator and a reputation for delivering on deals can make Chesnara an attractive buyer.

As always, the timing and size of any future deals is uncertain. The average solvency coverage ratio is 195%, so business sales may be more about strategy and releasing capital than financial weakness. Nevertheless, the increase in future options is a positive.

Post the transaction, Chesnara will retain ca.£100m of resources for further transactions. With this deal being more of an add-on at group level, there is no barrier now to the Netherlands or Swedish operations taking something on. In the UK, the HSBC Life deal (now renamed Chesnara Life) has just completed. While this still needs to be integrated, a deal that completes late this year may be feasible.

Reinsurance and indemnities

The structure of this transaction is somewhat more complicated than has been usual for Chesnara's recent deals. While this complexity does bring some additional risk, in practice it is very limited and should not worry shareholders. We note that three of these agreements are continuations of existing arrangements with the parent company, with only the final indemnity relating to this transaction.

Reinsurance arrangements

There are two reinsurance arrangements:

- ▶ **Investment reinsurance:** As indicated above, the majority of assets are in with-profits funds. They are reinsured into the Clerical Medical With-Profits Fund. In particular, this means the cost of meeting any with-profits guarantees will be met by Scottish Widows/Lloyds, removing that risk from Scottish Widows Europe.

- ▶ **Annuity reinsurance:** Many of the policies have a guaranteed annuity option attached to them. The payments on these are also reinsured, this time to Scottish Widows. Given the challenges guaranteed annuity options have sometimes presented in the past, the removal of the risk on these is welcome.

Both of these arrangements can only be cancelled if Scottish Widows runs into severe financial problems, effectively meaning that they should remain in place for the lifetime of the liabilities. While the effective transfer of guarantees reduces risk, it does mean that some of the economics also continues to reside with Scottish Widows. Chesnara will continue to receive the usual fees on unit-linked funds (including unitised with-profits), offset by external fund management costs (similar to many of its existing arrangements) and expenses.

Other indemnities

As well as the reinsurance arrangements, Chesnara has received indemnities from Scottish Widows for two other items.

When Scottish Widows Europe was created in 2019, it received an indemnity from Scottish Widows for issues arising from previous sales of policies. Essentially, these are historical mis-selling issues. In summary, 90% of these costs were retained by Scottish Widows. Scottish Widows Europe was liable for the other 10%, up to a total cost of €60m. Any claims in excess of that would be paid by the (former) parent.

This indemnity is being transferred with Scottish Widows Europe to Chesnara. Claims paid by Scottish Widows Europe to date are €7.75m, and there is also a €60.4m gross provision, as of 31 December 2024. The expectation is that this provision is unlikely to be used: the relevant policies are already running off and, as time passes, possible claims will diminish.

The second indemnity has been created for the transaction. In 2023, Scottish Widows Europe, alongside its parent, started to transfer its administration onto Lifeware. In the course of doing this, it was discovered that there were some errors in the old system, with policies not being logged correctly.

Rectifying these faults has incurred costs, with additional benefits being required for some policyholders. While they should have been largely rectified now (we understand the pace of discovery has declined over the past year), some errors will remain. Scottish Widows has provided an indemnity for additional costs of up to 20% of the base consideration (€20m) over the two years following completion of the acquisition.

We understand that Chesnara has become comfortable with this indemnity over the course of its diligence process. Given that the indemnity period effectively covers almost three years from today, we would expect there to be little residual risk here.

In summary

Overall, this looks like another good deal for Chesnara. The price is attractive, which offsets the lack of synergies. The complications in the structuring should not bring material additional risks compared with other transactions.

Forecasts

With the completion not expected until “around the end of 2026” and our current forecasts only applying to the end of the year, there are only limited, but positive, adjustments to our forecasts. We have made no adjustments to earnings or cashflow, assuming completion does not take place until the year-end. Completion a month before the year-end would add ca.€1.4m to cashflow, or 2% of our forecast for this year.

There is a more noticeable effect on Economic Value if we assume completion at the year-end. The purchase price of £96m is 64% of Scottish Widows Europe’s Solvency II Own Funds, as at 31 December 2024. If there are no changes (which is very unlikely), that implies an uplift of ca.£54m, or 7% of our pre-existing forecast of £752.3m. That suggests our 2026E Economic Value per share increases from 326p to 349.2p.

Looking forward to 2027, Scottish Widows Europe should bring ca.£17m of extra annual cashflow each year (although management notes this is not a level amount each year). This equates to just over 20% of our 2026 forecast.

Our forecasts are based on normalised estimates, so we are not adjusting our 2025E; although we note that there was a generally positive economic background in 2H’25. The FTSE All-Share Index increased by 12%, while the Swedish OMX Index was up 16%: both will be very positive in results. Ten-year bond yields rose ca.4bps in the UK but by more in the Netherlands (from 2.81% to 2.97%), which will reduce bond values. Overall, we expect next month’s full-year results (due 24 March) to come in ahead of our estimates.

There are no comments on the dividends, but the prospect of improved cashflow further underpins it.

| Economic Value earnings | | | | | | |
|---------------------------------|--------------|---------------|-------------|-------------|-------------|--------------|
| Year-end Dec (£m) | 2021 | 2022 | 2023 | 2024 | 2025E | 2026E |
| Expected movement | -1.7 | -1.3 | 14.9 | 15.0 | 15.8 | 16.2 |
| New business | 2.4 | 8.0 | 4.40 | 5.2 | 5.7 | 5.7 |
| Operating experience variances | -19.2 | -20.7 | 0.8 | -9.1 | -4.4 | -9.7 |
| Operating assumption changes | -13.9 | -14.5 | -27.8 | 9.0 | 12.3 | 9.5 |
| Other operating variances | -0.2 | 1.7 | | | -4.9 | -5.0 |
| Total u/l operating earnings | -32.6 | -26.8 | -7.7 | 10.4 | 24.5 | 16.8 |
| Material other operating items | -26.2 | 0.0 | | | | |
| Total operating earnings | -58.8 | -26.8 | -7.7 | 10.4 | 24.5 | 16.8 |
| 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 | 26.8 | 53.4 |
| Other non-operating variances | 4.5 | -2.6 | -11.9 | -11.3 | -11.6 | -12.0 |
| Central costs | | | | -11.8 | -19.2 | -24.5 |
| Risk margin movement | 10.8 | 20.4 | 1.1 | 22.8 | 4.6 | 4.7 |
| Tax | -8.2 | 12.0 | 6.3 | -1.8 | -2.5 | -3.8 |
| 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 | 22.6 | 131.6 |
| EPS (p) (actual) | 38.5 | -56.6 | 39.3 | 45.8 | 11.8 | 57.0 |
| EPS (p) (restated) | 33.2 | -48.8 | 33.8 | 39.5 | 11.8 | 57.0 |
| 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

While the normalised basis is our core expectation, in practice, results will rarely match the average. To give some idea of sensitivity, the following table gives estimates with two adjustments:

- ▶ annual equity returns of 3.5% instead of 7%; and
- ▶ no returns from credit spreads, i.e. credit losses match the gain from the spread.

Investors can easily imply the effect of different assumptions from these adjustments.

Sensitivity to economic assumptions

| £m | 2023 | 2024 | 2025E | 2026E |
|------------------------------------|------|------|-------|-------|
| Normalised Economic Value earnings | 59.1 | 69.1 | 22.6 | 131.6 |
| Half equity returns | | | 0.0 | 86.6 |
| Reduction | | | -100% | -34% |
| No credit spreads | | | 5.5 | 92.2 |
| Reduction | | | -76% | -30% |

Source: Hardman & Co Research

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 | 354.8 | 334.8 |
| Economic Value | 624.2 | 511.7 | 524.7 | 531.0 | 637.7 | 806.3 |
| Economic Value/share (p) | 416 | 340 | 349 | 352 | 276 | 349 |
| Base cash generation | | | | | | |
| UK | 27.4 | 40.8 | 45.0 | 35.3 | 44.2 | 60.6 |
| Movestic | -14.4 | 16.1 | -7.0 | 8.2 | 4.0 | 8.2 |
| Waard | 2.9 | 8.4 | 15.3 | 1.4 | 6.1 | 6.4 |
| Scildon | 15.2 | -3.4 | -3.1 | 14.1 | 21.1 | 16.9 |
| Group | -10.8 | 20.8 | -17.6 | -7.5 | -26.0 | -26.8 |
| Total | 20.3 | 82.7 | 32.6 | 51.5 | 49.4 | 65.3 |
| Dividends paid | -33.3 | -34.3 | -35.4 | -36.5 | -41.9 | -52.6 |
| Dividend cash cover (x) | 0.6 | 2.4 | 0.9 | 1.4 | 1.2 | 1.2 |

Source: Hardman & Co Research

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research@hardmanandco.com

9 Bonhill Street
London
EC2A 4DJ

www.hardmanandco.com