Chesnara plc – Preliminary Results for the year ended 31 December 2006

Strong emerging surplus supports 6.6% final dividend increase

29 March 2007

Chesnara today reported final results for the twelve months to 31 December 2006. The Group is committed to offering shareholders an attractive long-term income stream arising from the profits of its substantially closed life assurance business.

- Profit (on IFRS basis) before tax increased by 22% to £25.0m, 18.41p earnings per share (2005 profit before tax: £20.5m, 19.26p earnings per share)
- Transfer of City of Westminster Assurance (CWA) business to Countrywide Assured delivers positive solvency effects, tax benefits and operational efficiencies
- Disposal of Premium Life International and charge obtained on Guardian Assurance-held assets improve solvency position
- Contract concluded with Capita to outsource former CWA business provides greater certainty of future policy-related expenses
- Mortgage endowment misselling provision assumptions prove adequate
- Favourable persistency experience
- Shareholder equity on EEV basis, pre proposed final dividend payment, now £189.1m (31 December 2005: £176.2m)
- Life Company solvency ratio improves to 205%, post dividend, (31 December 2005: 178%). Group solvency ratio, post dividend, increased to 225% (31 December 2005: 158%)
- 8.05p final dividend per share proposed (7.55p): increased by 6.6%
- Total dividend for year of 13.1p (12.45p): increased by 5.2%
- Board remains committed to progressive dividend policy
- Search for value adding acquisition opportunities broadens and continues

Graham Kettleborough, Chief Executive said:

'At the half year we saw a strong emergence of surplus and this has continued, in line with our expectations, through the full year. The completion of the transfer of the acquired CWA business into CA in the first half has enabled us to begin to realise the financial and operational synergies we planned. This has been complemented by three significant further transactions in the year – the sale of PLI, the charge on Guardian assets and the Capita outsourcing deal – which all bring greater financial certainty to the Group. This enables the Board to deliver, once again, on its promise to shareholders of a reliable and progressive dividend stream by proposing an increase to the final dividend of 6.6% to 8.05p'

The Board approved this preliminary statement on 28 March 2007.

Enquiries

Graham Kettleborough Chief Executive, Chesnara plc	07799 407519
Michael Henman/John Beresford-Peirse Cubitt Consulting	0207 367 5106

Notes to editors:

Chesnara plc, which listed on the London Stock Exchange in May 2004, is the owner of Countrywide Assured plc ("CA"). CA is a life assurance company that is substantially closed to new business. In June 2005, Chesnara confirmed its strategic intentions when it acquired a further closed life insurance company – City of Westminster Assurance ("CWA") – for £47.8m. With effect from 30 June 2006, CWA's policies and assets were transferred into CA plc. Chesnara's operating model is to maintain a relatively small corporate governance team and outsource the majority of its back office functions.

Financial Highlights

	Year ended 31 December	
	2006	**2005**
IFRS basis		
Operating profit	26.5	21.3
Financing costs	(1.2)	(0.8)
Loss on sale of subsidiary company	(0.3)	–
Profit before income taxes	**£25.0m**	**£20.5m**
Basic earnings per share	18.41p	19.26p
Dividend per share	13.1p	12.45p
Shareholders' net equity	**£114.3m**	**£108.3m**
European Embedded Value basis (EEV)		
Operating profit	15.0	10.7
Exceptional item		
Profit on acquisition of subsidiary company	–	30.3
Investment variances and economic assumption changes	15.6	10.9
Profit before tax	**£30.6m**	**£51.9m**
Covered Business		
Shareholder net worth	84.5	84.5
Value of in-force business	109.9	110.0
Embedded value	194.4	194.5
Acquired embedded value financed by debt	(16.8)	(21.0)
Shareholders' equity in other Group companies	11.5	2.7
Shareholders' equity on EEV basis	**£189.1m**	**£176.2m**
Life annual premium income (AP)	£113.4m	£118.0m
Life single premium income (SP)	£54.8m	£60.1m
Life annualised premium income (AP + 1/10 SP)	£118.9m	£124.0m

In contrast with the IFRS basis of reporting, the EEV basis recognises the discounted value of the expected future cash flows, arising from the long-term business contracts in force at the year end, as a component of shareholder equity. Accordingly, the EEV result recognises, within profit, the movement in this component.

The Group presents supplementary financial information, prepared in accordance with the EEV basis, with effect from 1 January 2006. This first-time adoption of EEV principles and associated disclosures represents a change from the Achieved Profit ("AP") basis of reporting, which was previously adopted by the Group as the basis for presenting supplementary financial information. Restatement of information for the comparative period from the AP basis to the EEV basis, together with explanatory notes, was set out in the 2006 Interim Financial Statements which are available on www.chesnara.co.uk

Under the EEV basis of reporting, the exceptional profit arising during the year ended 31 December 2005 relates to the acquisition of CWA Life Holdings plc and represents the excess of the embedded value of that company, at the acquisition date, over the total purchase price. Investment variances and economic assumption changes for the year ended 31 December 2006 are stated net of a £0.3m loss arising on the sale of a subsidiary company.

Chairman's Statement

I am pleased to present the third annual financial statements of Chesnara plc ("Chesnara").

Background

Chesnara, owner of Countrywide Assured plc ("CA") since its listing in May 2004, seeks to participate actively in the consolidation of the closed life business sector in the UK. In 2005 it acquired City of Westminster Assurance Company Limited ("CWA"), another closed life assurance company, from Irish Life and Permanent plc.

CA now manages a portfolio of some 228,000 life assurance and pension policies and is substantially closed to new business. It writes Guaranteed Bonds, a small amount of protection business and accepts top-ups to existing contracts. As a substantially closed book it is expected that the embedded value of the business will decline over time as the number of policies in force reduces and as the surpluses emerging in the business are distributed by way of dividends. As the portfolio runs off, the regulatory capital supporting it may also be reduced and returned to shareholders.

In order to prolong the yield delivery, Chesnara seeks to acquire similar businesses. We believe, however, that such potential acquisitions should not detract from our key objective of delivering a steady and attractive dividend yield.

Review

New acquisition opportunities in the closed life sector in the UK slowed considerably in 2006, particularly within our £50m to £200m target value range. Our main focus has, therefore, been on enhancing shareholder value in the existing business and I am pleased to report a number of significant developments, which prolong and secure the dividend yield from those businesses.

- At the end of June 2006 the long-term business of CWA was transferred to CA under the provisions of Part VII of the Financial Services and Markets Act 2000 (the "Part VII Transfer"). Besides realising significant financial savings and synergies in resources required to manage the combined businesses, the transfer has given rise to more efficient use of capital required for regulatory purposes. In the second half of the year, following a successful application to the High Court, £3m of CWA share capital was released;
- In January 2007 we entered into a contract with Capita Life and Pensions Regulated Services Limited for the provision of administration services to the CWA business for an initial term of 15 years. This followed discussions with the incumbent administration services provider, whose contract was due to expire in February 2009, which indicated that terms for renewal beyond this date were unlikely to be attractive to us. Although the terms of the new contract have given rise to a reduction of some £5m in the value of the in-force portfolio to reflect increased administration costs over the life of the contract, they provide certainty of the administration expense base for some time to come;
- During 2006 we have begun to witness a fall in the number of mortgage endowment misselling complaints received. This follows less intense media attention and a lower pitch of advertising by complaints handling firms as more policyholders have become time-barred from making successful complaints. Approximately 70% of our in-force endowment policies are now time-barred, this proportion being expected to increase to a maximum of 80% over the course of 2007. These circumstances, together with the strength of investment markets during 2006, have contributed to a position where assumptions previously adopted to fix the level of associated provisions have proved to be adequate. In addition, the 2006 results have benefited from a Professional Indemnity ("PI") insurance recovery of £1.1m in respect of administration costs incurred in the handling of misselling claims; and
- Policy lapse experience and, accordingly, the rate of policy retention within the in-force portfolio were favourable over 2006, particularly with respect to protection policies. While this experience to some extent follows naturally as the closed books proceed along their run-off cycle, the underlying persistency was reinforced by investment market experience over 2006. The strength of the markets has both enhanced the short-term surplus and improved the longer-term outlook, as it has the effect of increasing deductions made from unit funds.

The positive effects of these developments have more than compensated for the negative impact of revised expense assumptions in relation to third-party administration contracts and have translated into a strong earnings performance for 2006 on both of our principal bases of financial reporting.

On the IFRS basis, we have posted a pre-tax profit of £25.0m for the year ended 31 December 2006, compared with £20.4m for the corresponding period in 2005. This improvement is underpinned by the continuing strong emergence of surpluses in the life business, together with the absence of additional charges required to strengthen misselling provisions.

This result allows the Board to recommend a final dividend of 8.05p per share (2005: 7.55p per share), in respect of the year ended 31st December 2006, representing an increase of 6.6% over the final dividend for 2005. The resulting total dividend for the year of 13.1p (2005: 12.45p) represents a 5.2% increase.

On the EEV basis of reporting, the Group recognises a pre-tax profit of £30.6m for the year ended 31 December 2006, compared with £21.6m, before an exceptional item, for the corresponding period in 2005, and compared with an underlying return of £10.4m expected to arise from the unwind of the risk discount rate within the embedded value. This significant improvement reflects:

- The positive impact of economic assumption changes, which have been driven principally by strength in the investment markets and by a reduction of £4.3m in projected policyholder tax arising as a result of the Part VII Transfer;
- A positive variance of £6.3m in the longer-term investment return; to which investment market strength also contributed;
- The release of a reinsurer default reserve, measured for EEV purposes at £3.5m;
- Favourable lapse experience, across both the CA and CWA businesses, amounting to some £2.9m; and
- The adequacy of the additional provisions in respect of misselling redress exposure, together with the related PI insurance recovery of £1.1m.

offset by:

- A reduction of some £7.7m in respect of revised expense assumptions relating to third-party administration contracts.

In addition to the reduction in projected policyholder tax of £4.3m, arising as a result of the Part VII Transfer, there is also a reduction in projected shareholder tax of £5.7m. These amounts, together with an associated release of a deferred tax provision of £0.6m, give rise to total projected tax synergies over the whole life of the in-force portfolio arising as a result of the Part VII Transfer of £10.6m in EEV terms.

Total shareholder equity, as stated on the EEV basis, pre final dividend appropriations has increased from £176.2m at 31 December 2005 to £189.1m at 31 December 2006 which reflects the strong net EEV earnings performance in the period.

CA's capital solvency ratio at 205% post dividend is at a healthy premium to the target set by the Board of 150%, having increased from the combined CA and CWA post-dividend level of 178% at 31 December 2005. The Group's solvency ratio has strengthened to 225% from the 31 December 2005 level of 158%, stated after allowing for the respective final dividends.

Outlook

Experience during the year in the two key areas of mortgage endowment complaints and persistency has proved favourable. This leads the Board to continue to look to the future with optimism. We remain aware of the importance of these issues and, in the light of some continuing uncertainty with regard to the application and interpretation of regulatory rules, will continue to manage them closely. The key outsourcing contracts for the CA and CWA businesses now provide greater certainty regarding the overall expense base for some time to come. During 2006 investment market performance has provided a positive underpin and, although returns in the medium term have been encouraging, the equity market performance during the first quarter of 2007 serves to remind us of the potential for future volatility. Following its acquisition, CWA is providing a strong surplus flow and, following the Part VII Transfer, the expected financial and operational synergies are being realised. We believe we are well placed to fulfil our stated objective of continuing to deliver a reliable and progressive dividend flow.

The flow of closed life book consolidation opportunities remains slow. Whilst continuing to pursue our activity in this marketplace we will also consider other opportunities which could leverage value from our existing capabilities. If there is no clearly superior investment alternative the possibility of a return of surplus capital remains.

The Board wishes to extend its thanks to all employees for their continued contribution to the Group.

Christopher Sporborg
Chairman

28 March 2007

Operating and Financial Review

Basis of Accounting

The Group reports primarily in accordance with International Financial Reporting Standards ("IFRS"). As IFRS essentially permits the "grandfathering" of the principles and bases used to measure profit arising on long-term insurance contracts under previously-adopted UK GAAP and, as the business of the Group predominantly relates to life contracts in run off, so the earnings profile of the Group will continue to be dominated by the underlying emergence of surplus in these businesses as measured for UK regulatory reporting purposes.

The Group continues to provide financial information supplementary to the IFRS basis. With effect from reporting periods commencing on 1 January 2006, the Group has adopted European Embedded Value ("EEV") principles as the basis for providing this supplementary information in lieu of the Achieved Profit ("AP") basis of reporting. AP and EEV methodologies are similar, insofar as both aim to measure the underlying embedded value of the Group's life assurance, pensions and annuity businesses. However, EEV principles provide a framework which is intended to improve the comparability and transparency of embedded value reporting across Europe.

IFRS Result

(a) Analysis of results

The following summarises pre-tax earnings information reflected in the IFRS Income Statement, showing, for the year ended 31 December 2006, the contribution from the constituent businesses of the Group.

	CA business £000	CWA business £000	Parent company £000	Amortisation of AVIF £000	Total £000
Year ended 31 December 2006					
Operating profit	17,184	12,506	313	(3,502)	26,501
Finance costs	–	–	(1,206)	–	(1,206)
Loss on sale of subsidiary company	(248)	–	–	–	(248)
Profit before income taxes	**16,936**	**12,506**	**(893)**	**(3,502)**	**25,047**
Year ended 31 December 2005					
Operating profit	8,591	14,607	105	(2,042)	21,261
Finance costs	–	–	(805)	–	(805)
Profit before income taxes	**8,591**	**14,607**	**(700)**	**(2,042)**	**20,456**

Notes

(1) The CWA component of the 2005 pre-tax result is for the 7-month post-acquisition period, whereas the component for 2006 is for a 12-month period.

(2) Financing costs arise in respect of a bank loan raised to part finance the acquisition of CWA.

(3) Amortisation of Acquired Value In-Force (AVIF) represents a post acquisition charge to profits of the write down of the acquired value of CWA in-force business, as measured at the acquisition date. The pattern of amortisation is broadly intended to match the pattern of surplus arising from the run off of the underlying CWA insurance and investment contract portfolios.

(b) Commentary on overall result

Overall, the result for the year ended 31 December 2006 reflects the continuing strong emergence of surplus in both the CA and CWA life businesses, as the underlying in-force insurance and investment contracts run off. The CA results for the year ended 31 December 2005 were materially adversely affected by increases in provisions for redress and administration costs in connection with mortgage endowment misselling claims. We do not consider it necessary to make further increases to these provisions as at 31 December 2006 and this, together with a £1.1m recovery from PI insurers for misselling claims administration costs, underpins the significant improvement in the results compared with the preceding year.

Other significant factors which have impacted the result attributable to CA for the year ended 31 December 2006 are:

(1) The recognition of £0.4m of costs incurred in connection with the Part VII Transfer. While, under the IFRS basis of reporting, the synergistic benefits arising from the transfer arise principally in future periods, the results for the current year benefit from the release of some £0.6m of deferred tax provisions, thus reducing income tax expense for the year ended 31 December 2006;

(2) The recognition of a pre-tax book loss of £0.3m arising on the disposal of Premium Life International Limited ("PLI"). The related benefit arises from a reduction in the cost of maintaining regulatory capital, as the disposal has given rise to a reduction of £2.0m in the Long Term Insurance Requirement (see "Solvency and Regulatory Capital" section below); and

(3) A charge of £1.1m in respect of the amortisation of deferred acquisition costs relating to insurance contracts (compared with £4.0m for the year ended 31 December 2005). As these costs are now fully amortised there will, in future, be a greater degree of correlation between distributable surplus arising from the run off of the life businesses and the reported IFRS profits attributable to them.

The CWA result continues to make a significant contribution to Group earnings. Net of related parent company debt financing costs and of amortisation of acquired in-force value, both of which are identified in the table above, the pre-tax contribution was £7.8m for the year ended 31 December 2006 (£11.8m for the 7-month post-acquisition period ended 31 December 2005). While the prior-period post-acquisition result benefited from a change in statutory valuation assumptions, resulting in part from favourable mortality experience which we indicated would not necessarily replicate in future periods, the 2006 result has been impacted by:

(1) A reduction of £1.4m in respect of the recapture of certain reinsurance arrangements. This recapture, which became effective from 31 December 2006, gives rise to future offsetting surpluses as the underlying policy contracts run off; and
(2) A net reduction of £2m in respect of statutory expense assumptions which have been revised to reflect fully the anticipated impact of changed outsourcer administration arrangements for the in-force policy portfolio. This is explained more fully in the following section.

(c) Management of the policy portfolio expense base

A key aspect of the ongoing profitability of the Group's life businesses is the extent to which they are able to secure appropriate third-party administration arrangements. These arrangements seek to avoid fixed and semi-fixed expense issues that would otherwise arise from a diminishing income stream as the in-force policy base runs off. Accordingly, the expense assumptions underlying the result give recognition to a projected expense stream which is more certain and which effectively reflects a higher proportion of expenses which are variable with policy volume.

Following from these arrangements:

(1) For the CA business, a 15% decline in policy-based surplus, driven principally by the reduced size of the policy portfolio, comparing 2006 with the previous year, has been sheltered by a reduction in the expense base, which was largely anticipated by the expense assumptions established at the end of 2005; and

(2) For the CWA business, the expense assumptions adopted at the end of 2006 reflect the anticipated impact of the replacement of CSC by Capita as the third-party administration partner with effect from 1 April 2007, leading to a net reduction of some £2.0m in the CWA pre-tax result. Significantly, as the CSC contract was due to expire in 2009, while the Capita contract expires in 2022, there is now a greater degree of certainty regarding the expense base over a longer contractual term.

The expense assumptions relating to both the CA and CWA businesses also reflect a revised view of anticipated costs, over the life of the contracts, relating to core systems developments, which may be necessary for business and operational purposes, but which are not otherwise provided for in the contracts.

EEV Result

Supplementary information prepared in accordance with EEV principles and set out on pages 20 to 24 is presented to provide alternative information to that presented under IFRS. EEV principles recognise profits as they are earned over the life of insurance and investment contracts and assist in identifying the value being generated by the life businesses. The result determined under this method represents principally the movement in the life businesses' embedded value, before transfers made to the Parent Company and ignoring any capital movements. As the Group's life assurance operations are now substantially closed to new business, the principal underlying components of the EEV result are the expected return from the business in force (being the yield at the risk discount rate on the related policy cash flows as they fall into surplus) together with (1) variances of actual experience from that assumed for each component of the policy in force cash flows and (2) the impact of resetting assumptions for each component of the prospective cash flows.

The following is a summarised statement of the EEV pre-tax result:

	Year ended 31 December	
	2006	**2005**
	£000	**£000**
Operating profit of covered business	15,684	11,353
Other operational loss	(699)	(700)
Exceptional item		
Profit on acquisition of subsidiary company	-	30,324
Operating profit before tax	14,985	40,977
Variation from longer term investment return	6,307	14,525
Economic assumption changes	9,284	(3,598)
Profit before tax	**30,576**	**51,904**

Operating profit of covered business before tax at £15.7m is significantly greater than the underlying return of £10.4m expected to arise from the unwind of the risk discount rate within the embedded value. The principal factors which have contributed to the net excess are:

(1) Favourable lapse experience within both the CA and CWA businesses amounting to some £2.9m;

(2) £3.5m arising on the release of the Guardian default reserve; this is explained more fully on page 11; and

(3) £1.1m recovery from PI insurers for misselling claims administration costs, as also referred to in the commentary under "IFRS Result" above.

The net excess has also been adversely affected by operating assumption changes of £7.7m, which relates principally to the strengthening of expense assumptions in connection with third-party administration arrangements. These arrangements were changed significantly during the year.

The absence of the need for additional provisions in respect of redress for mortgage endowment misselling claims has contributed to the improvement in the operating profit of the covered business compared with 2005.

Profit before tax of £30.6m has also benefited from the impact in both the CA and CWA businesses of a strong performance in investment markets during the last quarter of 2006. Besides giving rise to a favourable effect on current-year investment returns, this has also given rise to a resetting of assumptions regarding future investment returns within the cashflows underlying the in-force value. This is reflected in "Economic assumption changes" in the table above, which also include the favourable impact of a £4.3m reduction in notional policyholder tax as a consequence of the Part VII Transfer. Together with concomitant projected future tax savings of £5.7m in shareholder tax and a release of a deferred tax provision of £0.6m, this gives rise to a projected total saving in future tax of £10.7m arising as a result of the Part VII Transfer and the net of tax result for the year has benefited by this amount

The results for the year ended 31 December 2005 reflect an exceptional credit of £30.3m (£20.3m net of tax) relating to the acquisition of CWA. This amount represents the difference between the total purchase price and the embedded value of CWA on acquisition, which has now been re-stated in accordance with EEV principles. Under the AP basis the exceptional credit was reported as £18.3m (£13.1m net of tax) for the year ended 31 December 2005. The upward revaluation at the acquisition date arises principally from the application of a lower risk discount rate to the projected cashflows from the acquired in-force business.

Shareholders' Equity and Embedded Value of Covered Business – EEV Basis

The consolidated balance sheet prepared in accordance with EEV principles may be summarised as:

	31 December	
	2006	**2005**
	£000	**£000**
Value of in-force business	109,941	109,961
Other net assets	79,167	66,212
	189,108	**176,173**
Represented by:		
Embedded value ("EV") of covered business	194,405	194,437
Less: amount financed by borrowings	(16,800)	(21,000)
EV of covered business attributable to shareholders	177,605	173,437
Net equity of other Group companies	11,503	2,736
Shareholders' equity	**189,108**	**176,173**

The tables below set out the components of the value of in-force business by major product line at each period end:

	31 December	
	2006	**2005**
Number of policies	**000**	**000**
Endowment	75	85
Protection	86	102
Annuities	4	4
Pensions	53	55
Other	10	10
Total	**228**	**256**

	31 December	
	2006	**2005**
Value in-force	**£m**	**£m**
Endowment	70.3	76.7
Protection	73.1	80.7
Annuities	2.8	3.4
Pensions	41.7	39.6
Other	0.8	4.7
Total at product level	**188.7**	**205.1**
Valuation adjustments		
Holding company expenses	(21.7)	(25.5)
Other	(16.9)	(28.9)
Cost of capital	(3.4)	(3.1)
Value in-force pre-tax	**146.7**	**147.6**
Taxation	(36.8)	(37.6)
Value in-force post-tax	**109.9**	**110.0**

The value in force represents the discounted value of the future surpluses arising from the insurance and investment contracts in force at each respective period end. The future surpluses are calculated by using realistic assumptions for each component of the cash flow.

The amount in respect of "other valuation adjustments" has reduced significantly over the year following a refinement of the projection processes, whereby certain elements previously contained within this category are now identifiable at product level and have accordingly been allocated to the product lines shown. The 2005 amounts have not been re-stated to reflect this.

Policyholder Funds Investment Return

The CA Managed Fund, which is managed by Schroder Investment Management Limited and which represents a significant proportion of CA policyholder funds under management, returned 9.82% over the year ended 31 December 2006. The CWA Global Managed Fund, which is managed by Irish Life Investment Managers Limited and which represents a significant proportion of CWA policyholder funds under management, returned 9.34% over the same period. Both funds outperformed the average of 9% achieved by the ABI Life Balanced Managed Fund sector.

The absolute level of growth has had a positive effect on policyholder values, reduced the level of mortgage endowment misselling redress and led to an increase in the value in-force, as projected future charges, based on fund values, have increased.

Returns to Shareholders

Returns to shareholders are underpinned by the emergence of surplus in, and transfer of surplus from, the life business' long-term insurance fund to shareholder funds and by the return on shareholder net assets representing shareholder net equity. These realisations are utilised in the first instance for the repayment and servicing of the bank loan on the basis set out in Note 5. The surplus arises from the realisation of value in-force, which effectively unwinds at the risk discount rate used to discount the underlying cash flows: at 31 December 2006 this rate was reset to 6.1% (31 December 2005: 5.6%). The return on shareholder net assets is determined by the Group's investment policy. Shareholder funds bear central corporate governance costs which cannot be fairly attributed to the long-term insurance funds and which arise largely in connection with the status of Chesnara as a listed company.

Dividend distributions are currently set in the context of the Board's target for a minimum level of regulatory capital resources. This target, together with the excess over it at 31 December 2006 is set below.

The Board's continuing primary aim is to provide a reliable and progressive dividend flow to shareholders within the context of the emergence of surplus in the life business. The Company's share price strengthened progressively through the second and third quarters of 2005, stabilising at a range between 155p and 170p per share. This growth was driven in part by (i) the well publicised consolidation of that part of the life industry which focuses on the run off of closed life and pensions policy portfolios and by a positive reaction to Chesnara's participation in this marketplace through the acquisition of CWA in 2005 and by (ii) the recognition that, in accordance with its current strategy, Chesnara is essentially a yield stock, which, in the absence of the acquisition of further closed-book propositions, holds out the prospect of a return of capital to shareholders. After some volatility in the early months of 2006 the shares have generally traded within a range of 170p to 185p. With total proposed dividends in respect of the year ended 31 December 2006 at 13.1p per share, this implies a yield of between 7.1% and 7.7%. At a market price of 170p per share, the shares may be characterised as trading at a discount of 6% to the embedded value of the Group as now reported on the EEV basis as at 31 December 2006. Similarly, at a market price of 185p per share, they may be characterised as trading at a premium of just over 2% to Group embedded value.

Solvency and Regulatory Capital

Regulatory Capital Resources and Requirements

The regulatory capital of life insurance companies in the UK is calculated by reference to FSA prudential regulations. The rules are designed to ensure that companies have sufficient assets to meet their liabilities in specified adverse circumstances. As such, there is a restriction on the full transfer of surplus from the long-term business fund to shareholder funds of the life company and on the full distribution of reserves from the life company to Chesnara.

The following summarises the capital resources and requirements of the life company for regulatory purposes, before and after making provision for dividend payments from the life company to Chesnara, which were approved after the respective period ends.

Subsequent to the Part VII Transfer on 30 June 2006, the capital requirements and, accordingly, the regulatory solvency position of the life businesses, subsist entirely within one regulated entity, Countrywide Assured plc ("CA"). Prior to that date the capital requirements and regulatory position were determined separately for the two regulated life companies, being CA and City of Westminster Assurance Company Limited ("CWA"). The prior period information presented below shows the information in a pro-forma aggregated format, for the sake of comparison with the current period. The Directors do not consider that it is misleading to present the prior period information, which was previously reported on a separate-entity basis, in this way.

	31 December	
	2006	**2005**
	£m	**£m**
Pre-dividend		
Available capital resources ("CR")	84.4	84.5
Long-term insurance capital requirement ("LTICR")	28.8	34.1
Resilience capital requirement ("RCR")	2.6	2.8
Total capital resources requirement ("CRR")	31.4	36.9
Target capital requirement cover	45.8	54.7
Excess of CR over target requirement	38.6	29.8
Ratio of available CR to CRR	269%	229%
Post dividend		
Available capital resources ("CR")	64.4	65.7
Long-term insurance capital requirement ("LTICR")	28.8	34.1
Resilience capital requirement ("RCR")	2.6	2.8
Total capital resources requirement ("CRR")	31.4	36.9
Target capital requirement cover	45.8	54.7
Excess of CR over target requirement	18.6	11.0
Ratio of available CR to CRR	205%	178%

The CA Board, as a matter of policy, continues to target CR cover for total CRR at a minimum level of 150% of the LTICR and 100% of the RCR. Up until 30 June 2006, the CWA target capital requirement cover was expressed as a £5m excess over the regulatory CRR, as a consequence of a long-standing agreement with the FSA. With effect from 30 June 2006 the CRR of the transferred business is determined on the same basis as the existing CA business, so that, overall, the Group benefits to the extent that the total CRR is lower than if the £5m excess had continued to be applied to the transferred business.

£5.8m of the target capital requirement cover set out above (2005: £11.7m) is represented by shareholder retained earnings: to the extent that the target cover is maintained, this amount is not currently distributable from the life business.

Available capital resources at 31 December 2006 and, therefore, the overall solvency position have benefited from the full release of the £6m reserve held against the possible default of Guardian Assurance plc ("Guardian"), a major reinsurer (see below).

Further, CA's solvency position has benefited from the disposal of PLI, referred to under IFRS Result in the Operating Review above, which has reduced the LTICR by £2.0m, while capital resources reduced by £0.3m.
It can be seen from this information that Chesnara, which relies on dividend distributions from its life company, is currently in a favourable position to service its loan commitments and to continue to pursue a progressive dividend policy.

Insurance Group Directive

In accordance with the EU Insurance Group Directive, the Group calculates the excess of the aggregate of regulatory capital employed over the aggregate minimum solvency requirement imposed by local regulators. The following sets out these calculations pre and post the recognition of interim and final dividends for the financial year, but approved by the Board and paid to Group shareholders after the respective dates:

	31 December	
	2006	**2005**
	£m	**£m**
Pre-dividend		
Available group capital resources	79.2	66.2
Group regulatory capital requirement	(31.4)	(36.9)
Excess	47.8	29.3
Cover	252%	179%
Post-dividend		
Available group capital resources	70.8	58.3
Group regulatory capital requirements	(31.4)	(36.9)
Excess	39.4	21.4
Cover	225%	158%

The regulatory requirement is that available group capital resources should be at least 100% of capital requirements.

Individual Capital Assessments

The FSA Prudential Sourcebooks require an insurance company to make its own assessment of its capital needs to a required standard (a 99.5% probability of being able to meet its liabilities to policyholders after one year). In the light of scrutiny of this assessment, the FSA may impose its own additional individual capital guidance. The Individual Capital Assessment is based on a realistic liability assessment, rather than the statutory mathematical reserves, and involves stress testing the resultant realistic balance sheet for the impact of adverse events.

Following the Part VII Transfer as at 30 June 2006, an Individual Capital Assessment for the life businesses was established on a combined basis during the second half of 2006. As a result, it has been concluded that the effective current- and medium-term capital requirement constraints on distributions to Chesnara will continue to be on the basis set out under "Regulatory capital resources and requirements" above.

Guardian Default Reserve

Following the implementation of the Insurers (Reorganisation and Winding Up) Regulations 2004, CA maintained a reserve of £6m at 31 December 2005 relating to possible default by Guardian, with whom it had aggregate reinsured liabilities at that time of £221.3m. During 2006 Guardian granted a legal charge to CA over the related investment assets, as a result of which the CA Board determined that the reserve is no longer required.

The reserve was established in determining the regulatory capital resource position and, therefore, served to restrict the amount which may be transferred from CA's long-term business fund to shareholder funds. It was also recognised at £3.5m in establishing the Embedded Value of the covered business in accordance with EEV principles, which employ a market-consistent embedded value methodology (see below). Accordingly, the release of the reserve during 2006 has increased available capital resources, as determined for regulatory solvency purposes by £6m and has also increased the profit of the covered business, as reported in the EEV supplementary information on page 24, by £3.5m.

Neither the establishment nor the release of the reserve have been recognised for IFRS reporting purposes, as the likelihood of default by Guardian under the reinsurance arrangements was considered by the CA Board to be remote.

EEV Reporting

As explained in the Notes to the Supplementary Information on pages 23 to 24, the Group has adopted European Embedded Value ("EEV") principles as the basis for reporting supplementary financial information in lieu of the Achieved Profit ("AP") basis. This first-time adoption of EEV principles involves the restatement of supplementary financial information previously reported under the AP basis. The impact of the adoption of EEV on shareholder net equity and profit after tax as previously reported on the AP basis is set out and explained in the 2006 Interim Financial Statements, which are available on our website www.chesnara.co.uk.

Consolidated Income Statement for the year ended 31 December 2006

	Note	Year ended 31 December 2006 £000	2005 £000
Insurance premium revenue		112,800	115,673
Insurance premium ceded to reinsurers		(22,194)	(26,691)
Net insurance premium revenue		**90,606**	**88,982**
Fee and commission income			
Insurance contracts		43,519	49,405
Investment contracts		9,085	5,971
Investment income		151,470	214,691
Total revenue (net of reinsurance payable)		**294,680**	**359,049**
Other operating income		1,195	1,226
Net income		**295,875**	**360,275**
Policyholder claims and benefits incurred		(218,541)	(291,921)
Reinsurers' share of claims and benefits incurred		32,761	61,300
Net policyholder claims and benefits incurred		(185,780)	(230,621)
Change in investment contract liabilities		(58,905)	(85,130)
Reinsurers' share of investment contract liabilities		1,304	3,742
Net change in investment contract liabilities		(57,601)	(81,388)
Fees, commission and other acquisition costs		(2,881)	(5,699)
Administrative expenses		(17,184)	(18,675)
Other operating expenses			
Charge for amortisation of intangible assets		(3,773)	(2,364)
Reinsurance recapture premium		(1,374)	–
Other		(781)	(267)
Total expenses		**(269,374)**	**(339,014)**
Operating profit		**26,501**	**21,261**
Financing costs		(1,206)	(805)
Loss on sale of subsidiary company	3	(248)	–
Profit before income taxes		**25,047**	**20,456**
Income tax expense	4	(5,791)	(1,841)
Profit for the year		**19,256**	**18,615**
Basic earnings per share	8	18.41p	19.26p
Diluted earnings per share	8	18.41p	19.26p

Consolidated Balance Sheet at 31 December 2006

	Note	31 December 2006 £000	2005 £000
Assets			
Intangible assets			
Deferred acquisition costs		10,687	13,000
Acquired value of in-force business			
Insurance contracts		22,144	24,900
Investment contracts		13,644	14,661
Property and equipment		–	–
Reinsurers' share of insurance contract provisions		207,279	199,563
Amounts deposited with reinsurers		63,721	62,697
Investment properties		27,750	25,422
Financial assets			
Equity securities at fair value through income		738,487	688,478
Holdings in collective investment schemes at fair value through income		342,352	340,379
Debt securities at fair value through income		350,524	383,817
Loans and receivables including insurance receivables		17,130	19,810
Derivative financial instruments		30,642	16,108
Total financial assets		1,479,315	1,448,592
Reinsurers share of accrued policyholder claims		4,191	4,810
Income taxes		260	199
Cash and cash equivalents		301,218	282,452
Total assets		**2,130,209**	**2,076,296**
Liabilities			
Insurance contract provisions		1,115,197	1,072,064
Financial liabilities			
Investment contracts at fair value through income		812,979	803,146
Borrowings	5	16,574	20,638
Derivative financial instruments		1,421	416
Total financial liabilities		830,974	824,200
Provisions		597	1,433
Deferred tax liabilities		13,946	13,327
Reinsurance payables		3,059	2,049
Payables related to direct insurance and investment contracts		24,927	23,866
Deferred income		18,231	20,195
Income taxes		2,023	3,345
Other payables		7,000	7,550
Total liabilities		**2,015,954**	**1,968,029**
Net assets		**114,255**	**108,267**
Shareholders' equity			
Share capital	6	41,501	41,501
Share premium	6	20,458	20,458
Other reserves		50	50
Retained earnings	7	52,246	46,258
Total shareholders' equity		**114,255**	**108,267**

Consolidated Statement of Cash Flows for the year ended 31 December 2006

	Year ended 31 December	
	2006 **£000**	**2005** **£000**
Profit for the year	19,256	18,615
Adjustments for:		
Depreciation	–	105
Amortisation of deferred acquisition costs.	2,312	4,998
Amortisation of acquired in-force value	3,772	2,363
Tax expense	5,791	1,841
Interest receivable	(26,331)	(7,929)
Dividends receivable	(30,266)	(17,901)
Interest expense	1,206	805
Change in fair value of investment properties	(2,328)	(1,344)
Fair value gains on financial assets	(54,154)	(75,786)
Loss on sale of property and equipment	–	300
Loss on sale of subsidiary company	248	–
Interest received	28,981	9,545
Dividends received	27,099	18,473
Interest expense	1,206	805
Changes in operating assets and liabilities (excluding the effect of acquisitions)		
Increase in intangible assets related to investment and insurance contracts	–	(8,936)
Decrease/(increase) in financial assets	20,039	(3,537)
Increase in reinsurers share of insurance contract provisions	(7,097)	(37,818)
Increase in amounts deposited with reinsurers	(1,024)	(4,021)
Decrease in other loans and receivables	2,932	9,706
Increase in insurance contract provisions	44,056	122,572
Increase in investment contract liabilities	9,833	52,510
(Decrease)/Increase in provisions	(836)	507
Increase/(decrease) in reinsurance payables	1,010	(1,284)
Increase in payables related to direct insurance and investment contracts	1,061	9,515
Decrease in other payables	(1,650)	(5,199)
Cash generated from operations	**43,910**	**88,100**
Income tax paid	(6,470)	(4,217)
Net cash generated from operating activities	**37,440**	**83,883**
Cash flows from investing activities		
Acquisition of subsidiary, net of cash acquired	–	124,497
Disposal of subsidiary, net of cash disposed of	(295)	–
Purchases of property and equipment	–	(2)
Net cash (utilised by)/generated from investing activities	**(295)**	**124,495**
Cash flows from financing activities		
Proceeds from the issue of share capital	–	23,533
(Repayment of)/proceeds from borrowings	(4,200)	21,000
Payment of transaction costs	–	(2,539)
Dividends paid	(13,268)	(11,249)
Interest paid	(911)	(604)
Net cash (utilised by)/generated from financing activities	**(18,379)**	**30,141**
Net increase in cash and cash equivalents	**18,766**	**238,519**
Cash and cash equivalents at beginning of period	**282,452**	**43,933**
Cash and cash equivalents at end of period	**301,218**	**282,452**
In the cash flow statement proceeds from the sale of property and equipment comprise:		
Net book amount	–	300
Loss on sale	–	(300)
Proceeds from sale	–	–

Consolidated Statement of Changes in Equity for the year ended 31 December 2006

	Year ended 31 December 2006				
	Share capital	Share premium	Capital redemption reserve	Retained earnings	Total
	£000	£000	£000	£000	£000
Equity shareholders' funds at 1 January 2006	**41,501**	**20,458**	**50**	**46,258**	**108,267**
Profit for the period representing total recognised income and expenses	–	–	–	19,256	19,256
Dividends paid	–	–	–	(13,268)	(13,268)
Equity shareholders' funds at 31 December 2006	**41,501**	**20,458**	**50**	**52,246**	**114,255**

	Year ended 31 December 2005				
	Share capital	Share premium	Capital redemption reserve	Retained earnings	Total
	£000	£000	£000	£000	£000
Equity shareholders' funds at 1 January 2005	**40,500**	**–**	**50**	**38,892**	**79,442**
Profit for the period representing total recognised income and expenses	–	–	–	18,615	18,615
Dividends paid	–	–	–	(11,249)	(11,249)
Issue of ordinary shares pursuant to exercise of option	84	1,449	–	–	1,533
Issue of ordinary shares pursuant to placing and open offer	917	21,083	–	–	22,000
Expenses incurred in connection with issue of ordinary shares pursuant to placing and open offer	–	(2,074)	–	–	(2,074)
Equity shareholders' funds at 31 December 2005	**41,501**	**20,458**	**50**	**46,258**	**108,267**

1. Basis of Preparation

These financial statements have been prepared in accordance with International Financial Reporting Standards including International Accounting Standards and Interpretations (collectively "IFRS") issued by the International Accounting Standards Board ("IASB") and endorsed for use by companies in the EU, and with those parts of the UK Companies Act 1985 applicable to companies reporting under IFRS.

Full details of IFRS policies applied, which are unchanged from those applied for the year ended 31 December 2005 are set out in the financial statements for the year then ended, a copy of which is available from our website www.chesnara.co.uk.

2. Status of financial information

The financial information contained in this preliminary announcement does not constitute the Company's consolidated statutory financial statements for the years ended 31 December 2006 or 2005, but is derived from those financial statements. The financial statements for the year ended 31 December 2005, have been delivered to the Registrar of Companies. The financial statements for the year ended 31 December 2006 will be delivered following the Company's Annual General Meeting. The auditors have reported on those financial statements; their reports were unqualified and did not contain statements under section 237 (2) or (3) of the Companies Act 1985.

The financial statements will be posted to shareholders on 12 April 2007, copies of which will also be available from the Company Secretary, Chesnara plc, Harbour House, Portway, Preston, PR2 2PR.

3. Disposal of subsidiary

On 15 January 2006 the Group disposed of its interest in Premium Life International Limited to LCL International Life Assurance Company Limited for a consideration receivable in cash of £1, which, net of cash balances of £ 295,067 in the subsidiary at that date, gave rise to a net cash outflow of £295,066. This amount is reflected as a cash outflow from investing activities in the Consolidated Statement of Cash Flows.

The contribution of the subsidiary to the net profit for the year ended 31 December 2006 is not material and a loss of £248,000 arising on the disposal has been recognised in the Consolidated Income Statement for that period.

Following the disposal there was a reduction of £2,030,000 in the regulatory capital resource requirements of Countrywide Assured plc and there was a reduction in available capital resources of £248,000.

4. Income tax expense

	Year ended 31 December	
	2006	**2005**
	£000	**£000**
Current tax expense		
Current year	4,212	5,021
Adjustment to prior years	626	–
Overseas tax	334	253
	5,172	5,274
Deferred tax expense		
Origination and reversal of temporary differences	619	(3,433)
Total income tax expense/(credit)	**5,791**	**1,841**

Reconciliation of effective tax rate on profit before tax	Year ended 31 December	
	2006	**2005**
	£000	**£000**
Profit before tax	25,047	20,456
Income tax using the domestic corporation tax rate of 30% (2004: 30%)	7,514	6,137
Effect of tax rates in offshore jurisdictions	–	4
Permanent differences	163	–
Effect of UK taxing bases on insurance profits		
Offset of franked investment income	(3,463)	(3,790)
Other	951	(510)
Under provided in prior years	626	–
Total income tax expense	**5,791**	**1,841**

5. Borrowings

Group and Company

	31 December 2006 £000	31 December 2005 £000
Bank loan	16,574	20,638

The bank loan which was drawn down on 2 June 2005 under a facility made available in 4 May 2005 is unsecured and is repayable in five equal annual instalments on the anniversary of the draw down date. Accordingly the current portion as at 31 December 2006, being that payable within one year, is £4,102,176 and the non-current portion is £12,471,943. The outstanding principal on the loan bears interest at a rate based on the London Inter-bank Offer Rate and is payable in arrears over a period which varies between one and six months at the option of the borrower.

6. Share capital and share premium

Group	**31 December 2006**		**31 December 2005**	
	Number of shares	**Share capital £000**	**Number of shares**	**Share capital £000**
Share capital	104,588,785	41,501	104,588,785	41,501

There have been no changes in Group share capital and share premium during the year ended 31 December 2006.

Under the reverse acquisition basis of accounting, at the date of acquisition of Chesnara plc (the legal parent) the amount of issued share capital in the consolidated balance sheet represents the amount of issued share capital of Countrywide Assured Life Holdings Limited (the legal subsidiary) immediately before the acquisition and the deemed cost of acquisition, is taken as £nil. The number of shares, representing the equity structure, reflects the equity structure of Chesnara plc as set out below.

Company

The share capital of Chesnara plc comprises:

		31 December 2006	**31 December 2005**
Authorised		**£**	**£**
201,000,000 Ordinary shares of 5p each		10,050,000	10,050,000
	Number of Shares	**Share Capital**	**Share Capital**
Issued		**£**	**£**
Ordinary shares of 5p each	104,588,785	5,229,439	5,229,439

There have been no changes in Company share capital and share premium during the year ended 31 December 2006.

7. Retained earnings

	Year ended 31 December 2006 £000	**Year ended 31 December 2005 £000**
Retained earnings attributable to equity holders of the parent company comprise:		
Balance at 1 January	**46,258**	**38,892**
Profit for the year	19,256	18,615
Dividends		
Final approved and paid for 2004	–	(6,124)
Interim approved and paid for 2005	–	(5,125)
Final approved and paid for 2005	(7,986)	–
Interim approved and paid for 2006	(5,282)	–
Balance at 31 December	**52,246**	**46,258**

The retained earnings balance represents the amount available for dividend distribution to the equity shareholders of the parent company except for £2,504,000 (31 December 2005: £12,959,000) which is not distributable and which must be retained in the regulated life subsidiary company in accordance with the solvency capital requirements pertaining to that subsidiary.

The interim dividend in respect of 2005, approved and paid in 2005, was paid at the rate of 4.9p per share. The final dividend in respect of 2005, approved and paid in 2006, was paid at the rate of 7.55p per share so that the total dividend paid to the equity shareholders of the Parent Company in respect of the year ended 31 December 2005 was made at the rate of 12.45p per share.

The interim dividend in respect of 2006, approved and paid in 2006, was paid at the rate of 5.05p per share to equity shareholders of the Parent Company registered at the close of business on 15 September 2006, the dividend record date.

A final dividend of 8.05p per share in respect of the year ended 31 December 2006 payable on 14 May 2007 to equity shareholders of the parent company registered at the date of business 10 April 2007, the dividend record date, was approved by the Directors after the balance sheet date. The resulting total dividend of £8.4m has not been provided for in these financial statements and there are no income tax consequences.

The following summarises dividends per share in respect of the year ended 31 December 2005 and 31 December 2006:

	2006	2005
	p	p
Interim – approved and paid	5.05	4.90
Final – proposed	8.05	7.55
Total	13.10	12.45

8. Earnings per share

Earnings per share is based on the following:

	Year ended 31 December	
	2006	2005
Profit for the year (£000)	19,256	18,615
Weighted average number of ordinary shares	104,588,785	96,637,227
Basic earnings per share	18.41p	19.26p
Diluted earnings per share	18.41p	19.26p

The weighted average number of shares in respect of the year ended 31 December 2005 is based on

(i) 84,564,168 shares in issue at the beginning of the period

(ii) 1,691,284 shares issued on 10 February 2005 pursuant to exercise of a share option

(iii) 18,333,333 shares issued on 2 June 2005 pursuant to a placing and open offer

The weighted average number of ordinary shares in respect of the year ended 31 December 2006 is based on 104,588,785 shares in issue at the beginning and end of the period.

The diluted weighted average number of shares in respect of the year ended 31 December 2005 was 96,673,130. The dilution reflects an adjustment for the equivalent number of shares that would have been issued for no consideration had the exercise of the share option, granted to Numis Securities limited for broking services, provided in connection with the admission of the company to the Official List of the UK Listing Authority, been exercised prior to its actual exercise date of 10 February 2005.

There were no further share options outstanding during the year ended 31 December 2005 or during the year ended 31 December 2006.

9. Additional information

Additional information relating to the Company can be found on its website www.chesnara.co.uk.

10 Forward looking statements

This document may contain forward-looking statements with respect to certain of the plans and current expectations relating to future financial condition, business performance and results of Chesnara plc. By their nature, all forward-looking statements involve risk and uncertainty because they relate to future events and circumstances that are beyond the control of Chesnara plc including, amongst other things, UK domestic and global economic and business conditions, market-related risks such as fluctuations in interest rates, inflation, deflation, the impact of competition, changes in customer preferences, delays in implementing proposals, the timing, impact and other uncertainties of future acquisitions or other combinations within relevant industries, the policies and actions of regulatory authorities, the impact of tax or other legislation and other regulations in the jurisdiction in which Chesnara plc and its subsidiaries operate. As a result, Chesnara plc's actual future condition, business performance and results may differ materially from the plans, goals and expectations expressed or implied in these forward looking statements

Supplementary Information – European Embedded Value Basis

Summarised consolidated income statement

		Year ended 31 December	
		2006	**2005**
	Note	**£000**	**£000**
Operating profit of covered business	3	15,684	11,353
Other operational result		(699)	(700)
Operating profit		**14,985**	**10,653**
Exceptional Item			
Profit on acquisition of subsidiary company		-	30,324
Variation from longer-term investment return		6,307	14525
Effect of economic assumption changes		9,284	(3,589)
Profit before tax		**30,576**	**51,904**
Tax		(4,373)	(11,970)
Profit for the period		**26,203**	**39,934**
Earnings per share			
Based on profit for the period before exceptional item, net of attributable tax		25.05p	20.34p
Based on profit for the period		25.05p	41.32p
Diluted earnings per share			
Based on profit for the period before exceptional item, net of attributable tax		25.05p	8.42p
Based on profit for the period		25.05p	33.20p

Supplementary Information – European Embedded Value Basis

Summarised consolidated balance sheet

	Note	31 December 2006 £000	31 December 2005 £000
Assets			
Value of in force business	2,4	109,941	109,961
Reinsurers' share of insurance contract provisions		183,033	174,154
Amounts deposited with reinsurers		62,794	60,979
Investment properties		27,750	25,422
Deferred tax assets		121	120
Financial assets			
Equity securities at fair value through income		738,487	688,478
Holdings in collective investment schemes at fair value through income		342,352	340,379
Debt securities at fair value through income		350,524	383,817
Loans and receivables including insurance receivables		17,310	19,810
Derivative financial instruments		30,642	16,108
Total financial assets		1,479,315	1,448,592
Reinsurers' share of accrued policy claims		4,191	4,810
Income taxes		260	199
Cash and cash equivalents		301,218	282,452
Total assets		**2,168,623**	**2,106,689**
Liabilities			
Insurance contract provisions		1,091,889	1,051,913
Financial liabilities			
Investment contracts at fair value through income		832,025	819,306
Borrowings		16,574	20,638
Derivative financial instruments		1,421	416
Total financial liabilities		850,020	840,360
Provisions		597	1,433
Reinsurance payables		3,059	2,049
Payables related to direct insurance and investment contracts		24,927	23,866
Income taxes		2,023	3,345
Other payables		7,000	7,550
Total liabilities		**1,079,515**	**1,930,516**
Net assets		**189,108**	**176,173**
Shareholders' equity			
Share capital		41,501	41,501
Share premium		20,458	20,458
Other reserves		50	50
Retained earnings		127,099	114,164
Total shareholders' equity	2,4	**189,108**	**176,173**

Supplementary Information – European Embedded Value Basis

Summarised consolidated statement of changes in equity

	Year ended 31 December	
	2006	2005
	£000	£000
Shareholders' equity at 1 January	**176,173**	**126,029**
Profit for the period representing total recognised income and expense	26,203	39,934
Dividends paid	(13,268)	(11,249)
Issue of ordinary shares pursuant to exercise of option	-	1,533
Issue of ordinary shares pursuant to placing and open offer	-	22,000
Expenses incurred in connection with issue of ordinary shares pursuant to placing and open offer	-	(2,074)
Shareholders' equity at 31 December	**189,108**	**176,173**

Supplementary Information – European Embedded Value Basis

Notes to the Supplementary Information

1. Basis of preparation

The Group presents financial statements which are supplementary to the Group's primary financial statements which have been prepared in accordance with International Financial Reporting Standards ("IFRS"). This supplementary information has been prepared in accordance with the European Embedded Value ("EEV") principles issued in May 2004 by the European CFO Forum and supplemented by Additional Guidance on EEV Disclosures issued by the same body in October 2005. The principles provide a framework intended to improve comparability and transparency in embedded value reporting across Europe.

This first time adoption of EEV principles and associated disclosures represents a change from the Achieved Profit (AP) basis of reporting, which has previously been adopted by the Group as the basis for presenting supplementary financial information. The adoption of EEV principles does not affect the basis of reporting the statutory results, the regulatory capital position or the dividend paying capacity of Chesnara plc.

The Directors consider that the EEV methodology is a refinement of the AP basis previously adopted by the Group and represents a more meaningful basis of reporting the underlying value of the business and the underlying drivers of performance.

Information relating to the restatement of supplementary financial information, from reporting in accordance with the AP basis to reporting in accordance with EEV principles, is set out in 2006 Interim Financial statements, which are available on our website www.chesnara.co.uk.

The description of covered business and the methodology and assumptions used in applying EEV principles are also set out in the Interim Financial Statements.

2. Analysis of shareholders' equity

	31 December 2006 £000	31 December 2005 £000
Covered business		
Required capital	44,192	54,749
Free surplus	40,268	29,727
Shareholder net worth	84,460	84,476
Value of in-force business	109,941	109,961
Embedded value of covered business	**194,401**	**194,437**
Less: amount financed by borrowings	(16,800)	(21,000)
Embedded value of covered business attributable to shareholders	177,601	173,437
Net equity of other Group companies	11,507	2,736
Total shareholders' equity	**189,108**	**176,173**

The movement in the value of in-force business comprises:

	2006 £000	2005 £000
Value at beginning of period	**109,961**	**61,437**
Acquired in-force value arising on the acquisition of CWA Life Holdings plc	-	53,804
Amount charged to operating profit	(20)	(5,280)
Value at end of period	**109,941**	**109,961**

On 2 June 2005, the Group drew down £21m on a bank loan facility, in order to part fund the acquisition of CWA Life Holdings plc. This effectively represented a purchase of part of the underlying value in force of CWA by way of debt finance and it follows that the embedded value of the covered business is not attributable to equity shareholders of the Group to the extent of the outstanding balance on the loan account at each balance sheet date. The loan is repayable in five equal annual instalments on the anniversary of the draw down date, the funds for the repayment effectively being provided by way of the realisation of the underlying value of in-force business of the covered business. In accordance with this, £4.2m of the loan was repaid on 2 June 2006, leaving principal outstanding at that date of £16.8m.

3. Analysis of profit of covered business

	Year Ended 31 December	
	2006	**2005**
	£000	**£000**
New business contribution	1,599	1,147
Return from in-force business		
Expected return	10,386	9,087
Experience variances	7,459	(563)
Operating assumption changes	(5,072)	542
Return on shareholder net worth	1,312	1,140
Operating profit	**15,684**	**11,353**
Variation from longer-term investment return	6,307	14,525
Effect of economic assumption changes	9,284	(3,598)
Profit before tax	**31,275**	**22,280**
Tax	(4,496)	(2,068)
Profit after tax	**26,779**	**20,212**

The profit of covered business varies from amounts presented in the summarised consolidated income statement in respect of the pre-tax result of the holding company presented as “other operational result”, any tax pertaining thereto, which is included in “other tax”, and profit on acquisition of subsidiary company and related tax, which are exceptional items. The variation from longer-term investment return for the year ended 31 December 2006 is stated net of a loss of £248,000 arising on the sale of a subsidiary company.

4. Reconciliation of shareholders’ equity on the IFRS basis to shareholder equity on the EEV basis

	31 December	
	2006	**2005**
	£000	**£000**
Shareholders’ equity on the IFRS basis	**114,255**	**108,267**
Adjustments		
Deferred acquisition costs		
Insurance contracts	-	(1,114)
Investment contracts	(10,074)	(11,239)
Deferred income	17,239	19,145
Adjustment to provisions on investment contracts, net of amounts deposited with reinsurers	(19,596)	(16,700)
Adjustments to provisions on insurance contracts, net of reinsurers’ share	(936)	(34)
Acquired in-force value	(25,933)	(28,703)
Deferred tax	4,212	2,590
Reinsurer default reserve	-	(6,000)
Group shareholder net worth	**79,167**	**66,212**
Value of inforce business	109,941	109,961
Shareholders’ equity on the EEV basis	**189,108**	**176,173**
Group shareholder net worth comprises:		
Shareholder net worth in covered business	84,460	84,476
Shareholder’s equity in other Group companies	11,507	2,736
Debt finance	(16,800)	(21,000)
Total	**79,167**	**66,212**

The reinsurer default reserve adjustment at 31 December 2005 related to a reserve which was established for FSA prudential reporting and which was recognised for reporting on the EEV basis, but not for reporting on the IFRS basis. The reserve was not recognised for reporting in accordance with IFRS as the events to which it relates were, in the opinion of the Directors, considered to be remote or uncertain. However, the reserve was charged to the shareholder net worth component of the embedded value of the covered business, as this was held to be consistent with the market-consistent valuation approach adopted in accordance with EEV principles. The reserve was maintained against the effect of possible default by a major reinsurer, Guardian Assurance plc, which is a subsidiary of Aegon NV. As a result of mitigating action that was taken during 2006 the reserve is no longer required at 31 December 2006.