Chesnara plc Interim Management Statement

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Interim Management Statement for the three months ended 30 September 2012

16 November 2012

Steady progress in continuing uncertain markets

- Increase in EEV to £305.8m at 30 September 2012 from £294.5m at 31 December 2011, net of the impact of the distribution of a £12.5m dividend in May. The increase is predominantly due to £18.4m of pre-tax profit emerging as a direct result of investment market performance.

- EEV pre-tax profit for the nine months ended 30 September 2012 of £29.6m (nine months ended 30 September 2011: loss of £(59.8)m).

- Profit on an IFRS basis before tax for the nine months ended 30 September 2012 of £20.1m, excluding exceptional item (nine months ended 30 September 2011: loss of £(8.9)m) is underpinned by UK product-based surpluses which remain strong at £16.9m.

- Net cash generation of £30.1m for the nine months ended 30 September 2012 (full year 2011: £25.4m). The 2012 cash generation includes £7.0m resulting from the de-authorisation of the S&P companies following the Part VII transfer.

- Solvency ratios remain strong with Group (IGD) at 216% (31 December 2012: 198%), CA at 256% (31 December 2012: 183%) and Movestic 280% (31 December 2012: 245%).

- Movestic generated £7.9m of Embedded Value in the nine months ended 30 September 2012 (nine months ended 30 September 2011: loss of £(20.5)m), with the recovery in Swedish equity markets more than compensating for continuing challenging operating conditions.

- Shareholder equity on EEV basis (pre interim dividend payment of £7.0m on 15 October 2012) at 30 September 2012 of £2.66p per share (31 December 2011: £2.56p per share).

- Acquisition opportunities continue to be examined.

This statement relates primarily to the financial position of Chesnara plc (the ‘Group’) as at 30 September 2012 and to its financial performance during the first nine months of the year. Where events and transactions have occurred since the end of the third quarter, which are estimated to have a material impact on management’s core expectation of the financial position and/or financial performance of the Group, then these are identified, together with a broad indication of their impact.

Background

Investment Markets

During the third quarter global investment market performance has continued to have a significant influence on the Group's results. The effects of these influences were generally positive, reflecting improving equity markets, with the leading UK and Swedish indices increasing by 3.1% and 5.2% respectively, while bond yields deteriorated marginally over the whole range of the UK yield curve. The impact of these market movements is explained more fully in the EEV and IFRS sections below.

Insofar as equity and bond capital growth performance has had a favourable impact on Group earnings during the third quarter, a note of caution is necessary as markets are expected to continue to be volatile.

EEV

Detail of the movement in Group European Embedded Value ('EEV'), is set out in the following table:

	Quarter ended 30 September 2012 £m	9 months ended 30 September 2012 £m	Quarter ended 30 September 2011 £m	9 months ended 30 September 2011 £m	Year ended 31 December 2011 £m
EEV at beginning of period	**296.3**	**294.5**	**340.1**	**354.6**	**354.6**
Modelling adjustments	-	-	-	(5.3)	(10.3)
Earnings for the period:					
UK Businesses					
Countrywide Assured ('CA'), pre-tax	3.1	9.9	(12.0)	(9.1)	2.7
Save & Prosper ('S&P'), pre-tax	5.8	13.9	(32.7)	(29.1)	(22.0)
Tax	(2.1)	(6.4)	8.8	7.7	5.6
Swedish Business, net of tax					
Movestic	2.1	7.9	(9.2)	(15.5)	(14.2)
Other Group Activities	(1.7)	(2.2)	(0.5)	(1.1)	(1.9)
Foreign exchange reserve movement	2.3	0.7	(5.8)	(1.3)	(1.0)
Dividends paid	-	(12.5)	-	(12.2)	(19.0)
EEV at end of period	**305.8**	**305.8**	**288.7**	**288.7**	**294.5**

EEV of £305.8m as at 30 September 2012 is stated before appropriation of a dividend of £7.0m, paid on 15 October 2012.

Overall, the net of tax EEV result for the third quarter of 2012 was ahead of expectations due in the main to the impact of the increase in UK and Swedish equity markets over the quarter. By comparison, investment markets over the third quarter of 2011 fell sharply.

The EEV pre-tax profit for the nine months ended 30 September of £29.6m has improved significantly compared to the profit of £20.2m reported for the first half of the year.

The half year EEV result benefited from £6.2m of economic profits and further economic profits of £5.6m were generated during Q3. Investment return on shareholder net worth has also improved by £3.0m during the quarter with a year to date total of £6.0m. Therefore a significant proportion of the total pre-tax profit directly relates to economic conditions.

The S&P result is sensitive to movements in the risk-free yield curve because the cost of guarantees on with-profit contracts increases when rates decline. During the nine months ended 30 September 2011 there was a sharp decline in the rates which contributed to the significant loss in the prior year. During 2012 bond yields have also fallen but the level of decline is significantly less marked, resulting in an adverse EEV impact of £2.0m which is more than offset by a £11.0m positive impact of bond and equity asset growth.

Investment market performance in Sweden has resulted in £4.0m of EEV profit during the year.

Other significant pre-tax influences on the EEV result are:

UK Businesses

CA

(i) Mortality surplus continues to emerge at a level greater than assumed, generating £2.3m of surplus for the year to date.

(ii) Despite a general weakening of lapse assumptions at the 2011 year end, actual experience continues to be better than the levels assumed resulting in a positive lapse experience variance of £3.3m.

S&P

(i) Favourable experience variances in the form of tax deductions and expense underruns have contributed £3.4m to the year to date result.

The total EEV movement is net of a UK tax charge of £6.4m which relates to a £4.9m current tax charge and a £1.5m increase in deferred tax liabilities.

Swedish Business

Movestic
(all amounts stated are pre-tax, tax effects for the period being immaterial)

(i) Movestic has posted a new business loss in the quarter which results in a cumulative new business loss of £0.8m for the nine months ended 30 September 2012.

(ii) Persistency assumptions were strengthened at the half year with a £5.5m adverse impact. No further adjustments have been posted during the third quarter.

(iii) In general, lapse experience continues to be worse than expected although the adverse variance of £1.0m during the third quarter indicates a general improvement compared to the level of adverse variance of £4.3m during the first half of the year.

(iv) Revenue relating to changes in fund rebates has increased by £1.3m during the third quarter resulting in a cumulative favourable rebate assumption variance of £6.1m.

The foreign exchange gain of £0.7m, set out in the EEV table above, arises from the effect of translating the SEK-denominated EEV of the Swedish Business into Sterling, which depreciated slightly against the Swedish Krona during the nine months ended 30 September 2012. Subsequent to the quarter end, Sterling has strengthened against the Swedish Krona with an estimated adverse EEV impact of £1.0m.

The Group year-to-date EEV result is significantly higher than for the comparative nine month period for 2011. The majority of the year on year movement relates directly to changes in the investment market performance in the respective periods. In addition the 2011 loss includes a £5.3m adverse modelling adjustment and the £8.2m one-off adverse impact from recognising the expected expense increase from the revised HCL outsource contract.

IFRS

The IFRS result for the quarter ended 30 September 2012 is set out in the following table:

	Quarter ended 30 September 2012 £m	9 months ended 30 September 2012 £m	Quarter ended 30 September 2011 £m	9 months ended 30 September 2011 £m	Year ended 31 December 2011 £m
Pre-tax earnings					
UK Businesses					
Countrywide Assured ('CA')	4.9	10.7	0.4	8.4	22.2
Save & Prosper ('S&P')	7.5	12.2	(13.9)	(15.2)	6.5
Swedish Business					
Movestic	0.2	-	2.0	0.7	(0.7)
Other Group Activities	(1.8)	(2.8)	(1.1)	(2.8)	(5.6)
Exceptional item *	-	(4.8)			
Total pre-tax earnings	**10.8**	**15.3**	**(12.6)**	**(8.9)**	**22.4**
Tax	(1.4)	1.2	6.5	5.9	3.3
Post-tax earnings	**9.4**	**16.5**	**(6.1)**	**(3.0)**	**25.7**

* An exceptional item of £4.8m, relating to the reclassification of policy-holder tax liabilities in the balance sheet has been charged to IFRS pre-tax profits. There is a corresponding deferred tax release to income tax of £4.8m, so that the net-of-tax impact is £nil.

The underlying UK product-based surpluses from which the core earnings arise have remained strong during the third quarter, continuing the experience of the first half of 2012.

During the third quarter S&P has generated a significant profit of £7.5m arising principally from a strong performance in product-based surpluses and from asset growth.

The Movestic result has benefited from the continued recovery in Swedish equity markets. The positive impact on profits derives from both direct investment income items and from the impact of an increased investment asset base on asset-based fees within the core Pensions and Savings business.

The year-to-date profit, before tax and exceptional item, of £20.1m is significantly higher than the £(8.9)m loss in the equivalent nine month period for 2011. This improvement arises principally from:

- A £14.3m lower with-profits strain comparing equivalent nine month periods. During the third quarter of 2011 sharp drops in equity markets and bond yields combined to create a significant with-profits strain. The opposite was true during 2012. Despite quarterly fluctuations, equity markets have generally improved with only relatively modest reductions in bond yields. As a result there has been a significantly lower with-profits strain during the year.
- £4.0m increase in investment gains on shareholder assets, mainly due to an increase in S&P with-profits investment income.
- £3.0m increase in product-based surpluses predominantly due to the increase in product-based tax deductions exceeding the run-off in management charges.
- £5.1m improvement in the impact of expense reserve movements. During 2011 the S&P sterling reserve was increased as investment markets fell, whereas the opposite is the case during 2012.

- A one-off £7.4m governance reserve created in 2011 to cover the estimated future impact of the revised HCL outsource contract.
- £0.5m reduction in the Movestic result. The year on year deterioration is primarily due to an increase in the cost of financial reinsurance arrangements. Underlying operating IFRS results have therefore improved compared to 2011.

The following key performance indicators relate to Movestic:

	Quarter ended September 2012 £m	Quarter ended June 2012 £m	Quarter ended March 2012 £m	9 months ended September 2012 £m	Quarter ended September 2011 £m	9 months ended September 2011 £m	Year ended December 2011 £m
Total premium income*							
Pension and savings	45.6	47.5	46.9	140.0	53.0	170.5	222.7
Risk insurance	8.1	9.9	9.3	27.3	9.1	28.2	37.7
Total	**53.7**	**57.4**	**56.2**	**167.3**	**62.1**	**198.7**	**260.4**
New business premium income*							
Pension and savings	6.9	10.5	9.6	27.0	9.3	34.9	45.4
Risk insurance	0.3	0.3	0.4	1.0	0.3	1.3	1.8
Total	**7.2**	**10.8**	**10.0**	**28.0**	**9.6**	**36.2**	**47.2**

*Translated into £ at constant rate of SEK10.7506 = £ (2012 average rate)

The decline in new business premium income, compared with the third quarter of 2011, partially reflects the general decline in total market size. This decline in new business premiums, together with policy attrition, results in the reduction in total premium income reported above.

Market share of unit-linked pensions business

	Q3 11 %	Q4 11 %	Q1 12 %	Q2 12 %
Total business	6.5	7.2	4.6	5.5
Company-paid contribution business	9.1	10.7	7.6	7.9

Market share data for Q3 2012 are not available at the date of the IMS release.

Policy attrition

	Quarter Ended September 2012 %	Quarter Ended June 2012 %	Quarter Ended March 2012 %	Quarter ended September 2011 %	Year Ended December 2011 %
Surrenders	13.9	19.8	17.2	13.4	14.7
Transfers	6.9	5.2	5.2	5.7	5.3
Lapses	11.8	20.4	24.2	16.3	16.2

It can be seen from the new business figures above that market conditions in Sweden continue to be challenging. Our market share and retention (despite the recently introduced retention measures), have been negatively affected by the impact on administration performance of a significant system migration completed in 2011. We previously stated that recent system fixes and further training will lead to improved performance and support renewed sales initiatives. The third quarter policy attrition figures do provide some early indication that such changes are beginning to have a positive impact. Management is also seeing positive signs in terms of IFA support for new business but as yet the impact has not translated into the level of completed new business. Management remain cautiously optimistic that the lead indicators suggest the operational improvements are having a positive impact in the IFA market.

On a further positive note, assets under management, the main driver of profitability, continue to grow. Furthermore, fund performance has begun to show some improvement since the end of the year. During the third quarter 52% of the funds out-performed against the relevant benchmark as compared to 39% for the quarter ended 30 September 2011.

	September 2012	June 2012	March 2012	September 2011	December 2011
Assets under management*	£1,312.2m	£1,263.1m	£1,317.1m	£1,161.7m	£1,227.9m

*Translated at a constant rate of SEK10.5881 = £ (30 September 2012 closing rate).

Fund performance	Quarter Ended			Quarter ended	Year Ended
	September 2012	June 2012	March 2012	September 2011	December 2011
Outperformed against relevant index	29	19	26	16	17
Underperformed against relevant index	27	31	25	25	30
No relevant index	5	9	2	7	9

Cash Generation

Net cash generation, representing the net change in funds to service debt and equity, for the nine months ended 30 September 2012 was £30.1m compared to £25.4m for the 2011 full year. This includes the favourable impact of the release of £7.0m of regulatory solvency capital requirement, following the de-authorisation of the rump S&P companies and reflects strong underlying trading conditions during the year.

Solvency

The underlying emergence of surplus in the UK businesses remains strong. This is reflected in the ratio of regulatory capital resources to regulatory capital requirements in CA, which have improved from 183% at 31 December 2011 to 256% at the end of the third quarter. The Swedish life business solvency ratio as at 30 September 2012 is estimated to be 280%, compared with 245% as at 31 December 2011. As at 30 September 2012, the corresponding Group (IGD) position remains strong at an estimated 216% compared with 198% as at 31 December 2011.

Market Opportunity

We continue to see a number of potential acquisition opportunities and we will readily progress these if we see value and a clear strategic fit. While we remain open-minded as to location in the UK and Western Europe, we will continue to apply strict financial and risk criteria in assessing them.

Enquiries

Graham Kettleborough
Chief Executive, Chesnara plc - 07799 407519

Michael Henman, Cubitt Consulting - 0207 367 5100

Notes to Editors

Chesnara plc, which listed on the London Stock Exchange in May 2004, is the owner of Countrywide Assured plc ("CA"), Save & Prosper Insurance Ltd and its subsidiary Save & Prosper Pensions Ltd (together ‘S&P') and Movestic Livförsäkringar AB ('Movestic').

CA is a UK life assurance subsidiary that is substantially closed to new business. In June 2005 Chesnara acquired a further closed life insurance company - City of Westminster Assurance (‘CWA’)and with effect from 30 June 2006, CWA's policies and assets were transferred into CA. S&P was acquired on 20 December 2010. S&P was closed to new business prior to acquisition and it operated an outsourced business model which is complementary to Chesnara's existing UK operations. With effect from 31 December 2011, the business of S&P was transferred into CA.

Movestic, a Swedish life assurance company which originally focused on pensions and savings, was acquired on 23 July 2009. The company is open to new business and seeks to grow its position in the Swedish unit-linked market. Its proposition was strengthened in February 2010 with the acquisition of the operations of Aspis Försäkringar Liv AB which has a risk and health product bias.