

DRIVING GROWTH BY EXPANDING PRODUCT AND DISTRIBUTION

Strong financial performance

- Assets under management **\$64.7** billion, up **12%**
- Normalised net profit after tax¹ **\$197** million, up **8%**
- Statutory net profit after tax **\$202** million
- Normalised pre-tax return on equity **18.7%** (1H16 18.1%)
- Record low cost to income ratio of **32.9%** (1H16 33.8%)
- Interim dividend **17** cents per share, up **6%**
- Record annuity sales **\$2.2** billion, up **34%**
- Funds Management net flows **\$3.2** billion

Good progress implementing growth strategy

- Strong start to MS Primary (Japan) relationship
- MS Primary sales of **\$125** million for first two months
- Announcing new annuities relationship with BT
- Launching new product partnership with Standard Life Investments
- Fidante Partners adds Avenir Capital as new global equities boutique

14 February 2017, Sydney – Challenger Limited (ASX:CGF) today announced record operating results boosted by continued strong growth in annuity sales.

Challenger Chief Executive Officer Brian Benari said: “Our interim results demonstrate strong momentum in both our Life and Funds Management businesses and our key underlying performance metrics are growing well.

“During the first half we achieved record annuity sales, strong growth in funds under management and a record low cost to income ratio.

“Importantly, we also paved the way for future growth by expanding our distribution relationships and our product offering. This is enabling us to make the most of the opportunities arising from the rapid growth in the retirement income market.

“In addition to eight new distribution and product initiatives commenced during the half, today we are announcing a new relationship with BT Financial Group which will see us work towards offering Challenger annuities through the innovative platform BT Panorama, in Q118. We are also announcing a new product relationship with Standard Life Investments to launch a new retirement product in Australia.

“Challenger’s vision is to provide our customers with financial security for retirement. As the superannuation industry pivots towards generating sustainable retirement incomes, supported by the Government’s reform agenda, we are excellently positioned to meet the needs of the rising wave of retirees.”

Group financial performance

Total Group assets under management (AUM) were \$64.7 billion, as at 31 December 2016, up 12% on the prior corresponding period (pcp). This AUM growth delivered an 8% increase in normalised net profit after tax (NPAT) to \$197 million.

Statutory NPAT was \$202 million (1H16 \$234 million), down on the pcp, largely due to a significant one-off item in 1H16 being profit from the sale of Kapstream Capital.

One of the key features of the 1H17 result is increased efficiency with the cost to income ratio improving 90 basis points (bps) to a record low of 32.9%.

Normalised pre-tax return on equity (ROE) increased by 60 bps to 18.7%, while normalised earnings per share rose 7% to 35.0 cents per share (cps).

Challenger's sustained track record of growth enabled the Board to declare a higher interim dividend of 17 cps, up 6%.

Capital

Challenger Life holds a strong capital position to support future growth and, as at 31 December 2016, held \$0.9 billion of excess regulatory capital and Group cash. This represents 1.4 times its Prescribed Capital Amount set by the Australian Prudential Regulatory Authority (APRA), within its target range of 1.3 times to 1.6 times.

It is anticipated that this will increase to 1.5 times, on a 31 December 2016 pro-forma basis, as Challenger intends to issue new additional tier 1 capital notes in Q317 and has targeted raising \$350 million, subject to prevailing market conditions.

Life (Annuities) performance

Total Life Product sales were \$2.8 billion. This comprised record annuity sales of \$2.2 billion, up 34% with sales in both the first and second quarters exceeding \$1 billion, and other Life sales of \$0.6 billion. Other Life sales included Guaranteed Index Return client mandates and reinvestments of \$0.4 billion, and \$0.2 billion from the newly launched Challenger Index Plus Fund.

Life's total net book growth was \$843 million, or 7.8%, compared to 3.6% in 1H16. This included annuity net book growth of \$449 million, or 4.7% for the half.

Challenger not only achieved record annuity sales but the quality of sales improved due to a reweighting to longer term business. Average new business tenor rose to 8.7 years, up from 5.6 for 1H16. For 1H17, longer dated annuity sales, that is lifetime annuities and 20-year fixed-term annuities with MS Primary, represented 31% of sales.

The Life division's normalised Cash Operating Earnings (COE) rose 8% to \$316 million, driven by a 10% increase in average AUM. COE margin was down slightly at 4.4% (1H16 4.5%). Earnings before interest and tax (EBIT) increased 7% to \$267 million.

Funds Management performance

Strong net flows of \$3.2 billion for the half led to FUM of \$62.1 billion, as at 31 December 2016. Net flows accelerated through the half with \$2.3 billion in the second quarter. Average FUM rose to \$59.1 billion, up 8% on the pcp.

Net income was \$65 million (1H16 \$67 million) while Funds Management EBIT was \$21 million (1H16 \$22 million) reflecting increased revenue from Fidante Partners in the UK, offset by lower performance fees.

Distribution and product initiatives

Australian annuity relationships

Challenger has continued to expand its customer reach, launching a number of new Australian annuity relationships during 1H17.

- ClearView WealthSolutions platform began to sell Challenger annuities;
- The CarePlus aged care product has been added to the CFS platform;
- Challenger annuities have been made available to three profit-for-members funds – Local Government Super, CareSuper and legalsuper;
- Suncorp began to sell Challenger-backed annuities through its bank branch network.

In addition, it was announced in October 2016 that AMP would make Challenger annuities and its CarePlus product available to AMP customers via their retail and corporate superannuation platforms.

Through the BT relationship announced today, Challenger and BT Financial Group will work towards offering Challenger term annuities, Lifetime annuities and CarePlus through BT Panorama in the first quarter of FY18.

This aligns with the expected AMP commencement date. Once both of these distribution relationships have come on line, Challenger annuities will be represented on investment and administration platforms used by two-thirds of financial advisers in Australia.

Access to annuities on platforms makes it easier and more efficient for advisers to recommend the use of annuities to their clients and is a key driver of sales.

MS Primary (Japan)

Challenger recently formed an annuities distribution relationship with MS Primary, part of the MS&AD Insurance Group and a leading provider of Australian dollar annuities and life insurance products in Japan. The country's ageing population, combined with low domestic interest rates, is driving a large market for foreign currency annuities. The market in Japan for Australian dollar annuities is estimated to be seven times the size of the Australian market.

MS Primary recently launched a new Australian dollar annuity product in Japan. To support a reinsurance agreement with MS Primary, Challenger is issuing 20-year fixed rate annuities as part of this product.

This relationship has delivered sales for Challenger of \$125 million for the initial two month period to 31 December 2016.

The relationship diversifies Challenger's product and distribution footprint and is operationally efficient with no fixed direct distribution costs. The premiums are invested in the key asset classes Challenger currently invests in for its existing book. The long tenor of the product is consistent with Challenger's reweighting to long-term business.

Funds Management

Funds Management is continuing to build out its range of products to meet retirement needs and is partnering with Standard Life Investments to distribute the Absolute Return Global Bond Strategies Fund in Australia. This will be launched in April under the Challenger brand. It aims to provide retirees with capital stability and a steady income stream.

Challenger's multi-boutique funds management business, Fidante Partners, is expanding its stable of boutique fund managers. It has recently added a new boutique, Avenir Capital, a global equities manager, and plans to establish a new small caps boutique.

Regulatory reform

The growth of Australia's retirement income market is supported by the Government's regulatory agenda. Over the past six months there has been substantial progress in the creation of a policy framework that shifts the focus of superannuation from wealth

accumulation to providing sustainable income in retirement. There are three key pieces of policy reform aimed at enhancing the retirement phase of superannuation.

First, the Government has proposed that the objective of superannuation should be to provide income in retirement to substitute or supplement the Age Pension. The Superannuation (Objective) Bill 2016 was passed by the House of Representatives in November 2016 and is currently being considered by the Senate.

Second, the Government adopted a package of proposals to clear the way for new and innovative pooled longevity products, including deferred lifetime annuities. Key enabling legislation was passed in November 2016 and it is anticipated that new products will be able to be offered from July 2017.

Third, consultation is underway on Comprehensive Income Products for Retirement or CIPRs, which the Government proposes calling MyRetirement. Under the proposed CIPR structure, superannuation fund trustees will be enabled to offer retirees the choice of a product that combines an account-based pension with a longevity solution, such as an annuity. Consultation is underway and the Government is targeting an implementation date post mid-2018.

Outlook

Challenger has reaffirmed its FY17 Life cash operating earnings guidance within a range of \$620 million to \$640 million.

Challenger continues to target an overall normalised pre-tax ROE of 18% and expects to maintain a fully franked dividend payout ratio of 45 to 50% of normalised profit, subject to prevailing market conditions.

Key metrics	1H17	1H16	Movement
Total AUM (\$bn)	64.7	57.6	12%
Annuity sales (\$bn)	2.2	1.6	34%
Normalised EBIT (\$m)	256	239	7%
Normalised NPAT (\$m)	197	182	8%
Statutory NPAT (\$m)	202	234	(14%)
Normalised EPS (cps)	35.0	32.6	7%
Statutory EPS (cps)	35.8	41.9	(15%)
Normalised ROE pre-tax (%)	18.7	18.1	60 bps
Statutory ROE post-tax (%)	14.8	18.0	(320 bps)
Cost to income ratio (%)	32.9	33.8	90 bps
Interim dividend (cps)	17.0	16.0	6%

Investor presentation webcast

Challenger Chief Executive Officer, Brian Benari, and Chief Financial Officer, Andrew Tobin, will give an investor presentation on the results at 10:30 am (Sydney time) on 14 February 2017. The presentation will be streamed live via webcast which can be accessed at www.challenger.com.au

About Challenger

Challenger Limited (Challenger) is an investment management firm managing \$64.7* billion in assets. It is focused on providing customers with financial security for retirement.

Challenger operates two core investment businesses, a fiduciary Funds Management division and an APRA-regulated Life division. Challenger Life Company Limited (Challenger Life) is Australia's largest provider of annuities.

*31 December 2016

ENDS

¹ The normalised profit figures are non-statutory amounts and in Challenger's view better reflect the underlying operating performance of the business. The normalised profit figures exclude investment experience and significant items. Investment experience is the difference between actual investment gains and losses (both realised and unrealised) and the normalised gains and losses (being based on Challenger's long term assumed returns), as well as any impact of changes in economic variables and assumptions used to value liabilities. The normalised profit also excludes any significant items which represent one-off or abnormal gains or losses for the period. The normalised profit framework and reconciliation to statutory profit have been discussed in Section 2.2 of the Directors' Report of the Challenger Limited Interim Financial Report 2017. The normalised profit is not audited but is subject to a review performed by Ernst & Young.

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