

17 June 2003

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Dear Investor

**Proposed merger with CPH Investment Corp**

On 16 June 2003 the requisite majorities of Challenger security holders approved the three schemes of arrangement under which Challenger proposes to merge with CPH Investment Corp, as outlined in the scheme booklet sent to security holders in May 2003.

Earlier today, CPH Investment Corp's unitholders also gave their approval for the proposed merger.

The next step in the merger process is to obtain the approval of the Federal Court to each of the three schemes of arrangement. The second court hearing for this purpose will take place on Friday, 27 June 2003 at the Federal Court, Queens Square in Sydney.

Attached for those security holders who were unable to attend yesterday's meetings is a copy of the Chairman's Address. I would like to draw your attention to one point of clarification made by the Chairman at the meetings in relation to the description of the Performance Fees in section 10.7 of the scheme booklet, which is set out on page 2 of the attached copy of the address.

If you have any further questions in relation to the proposed merger, please call the information line on 1300 302 106 or for overseas callers on 612 9240 7460 between the hours of 9.00 am and 5.00 pm Australian eastern standard time Monday to Friday.

Yours faithfully

A handwritten signature in black ink, appearing to read "David H Slatyer".

**David H Slatyer**  
Company Secretary

Att

## **Chairman's Address to Security Holders ~ Monday 16 June 2003**

### **Meeting 1. Chairman's remarks Share Scheme of Arrangement**

The scheme booklet which was sent to all Challenger security holders sets out a considerable amount of information about the proposed merger including reasons why shareholders may consider voting in favour of or against the share scheme. Further matters relevant to the vote of option holders on the option scheme and note holders on the notes scheme are set out in explanatory statement booklets sent to them. Also, in the scheme booklet we encouraged shareholders with questions to take advantage of the enquiry service information line and it is pleasing to note that many security holders did call with questions.

Let me focus on outcomes. If the share scheme is approved Challenger shareholders will substitute their Challenger shares for units in CPH Investment Corp, a listed managed investment scheme. They will become part of a larger operation which is expected to be a top 100 ASX listed entity with a market Cap of over \$1bn. Challenger Shareholders will in total own greater than 50% of the new enterprise and they will have the opportunity to benefit from the greater scale of the new operation.

You will have read in the scheme booklet that CPH Management believes the merged entity has the ability to become a significant diversified financial services group. This can only be achieved if the capital base of the company is strong both in quality and quantity. The combined operation will have solid capital assets. The cash assets of CPHIC will materially improve the quality of capital of the group and the injection of \$235m into the life companies will ensure they are in the best position to meet all regulatory requirements going forward and to finance future growth. It is worthwhile noting that APRA is focusing on increasing financial strength and quality of capital. It is likely that even though Challenger currently meets all regulatory requirements it would be constrained in its future growth if it were unable to raise additional capital. This is in spite of the fact that Challenger raised capital late last year. Challenger could continue to go it alone but the risks are great and the outcome is less certain. This merger, represents the marriage of a business and capital, and will produce a strong group well equipped to grow into the future with capital reserves and access to capital

Prior to the merger proposal Challenger shares were trading at a level, which would make capital raising expensive and difficult and which in my view would have undervalued the company.

It was the view of the Board that a broader based solution was more appropriate. The market certainly appears to be comfortable with the proposed merger. Challenger's share price has stabilized at prices about 30% above pre-announcement levels.

Before recommending the merger the Board took appropriate advice. It engaged the services of Rothschild's to advise it on the terms of the merger and to handle details of the negotiation. Mallesons completed legal due diligence on CPHIC and provided legal advice on the merger. Price Waterhouse Coopers was commissioned to complete financial due diligence on CPHIC. Grant Samuel was commissioned to provide an independent expert opinion

The process has been extensive and professional and produced no roadblocks.

Issues have emerged and it is appropriate that I comment on some of these.

### **Management Fees**

CPHIC is a trust and trusts are different from companies. While the effects of proposed changes in legislation seek to treat trusts as companies, differences do persist. Trusts are typically set up with management companies along side them. This is the case here. The Listed Trust, CPHIC, will be

managed by CPH Management Limited. CPH Management is also the responsible entity for CPHIC.

Under the constitution of CPHIC, CPH Management is entitled to both management fees and performance fees.

Management fees relate to assets under management and are set at 1.5% of the asset value per annum. The basis for Challenger assets is to be as follows:

Until the CPHIC unit price reaches 60 cents per unit there will be no management fee payable on Challenger assets. This is equivalent to the Challenger share price reaching \$2.70, about 60% above the price prevailing before Christmas last year and implies an increase in market capitalization from that time of about \$300 million.

The fee, if payable, will be based on a CPHIC unit price of 40.5 cents, which equates to about \$1.82 in Challenger terms. The fee will be fixed until 30 June 2005.

The Board takes the view that an equivalent share price for Challenger of \$2.70 would be something we would all be happy about. Should the Challenger equivalent share price move above these levels we would all be pleased but the level of management fee would not change.

CPH Management would also be entitled to performance fees. These in their simplest terms are 20% of gains over and above a hurdle rate of 10% per annum compounded. The Board takes the view that the achievement of a 10% per annum compound return is challenging and if achieved would add real value to Challenger shareholders. For example, over a five year period value would need to lift by 61% before any performance fee was payable.

For the period to 30 June 2005 performance will be based on the benchmark acquisition value of Challenger, which would imply that future performance fees would be based on a hurdle equivalent price of about \$2.20. However, there are carried forward performance losses of \$137 million, which would mitigate any performance fees payable in 2005.

I would like to clarify one matter in the scheme booklet on this point. Section 10.7 describes the calculation of the Performance Fees. That section notes that the current carried forward deficit (or performance losses) is approximately \$137 million. This is correct. However, Section 10.7 also inadvertently describes this amount as being the Cumulative Aggregate Shortfall which is a definition used in the formula for calculating these performance fees. The Cumulative Aggregate Shortfall is 20% of the carried forward deficit, not the gross amount of that deficit as suggested in the booklet.

I also note that the Independent Expert correctly assumed the effect of the carried forward deficit in assessing the impact of the performance fees in concluding that the Merger is in the best interests of shareholders in the absence of a superior offer. This is clearly indicated on page 222 of the booklet and has also been confirmed in writing by the Independent Expert to the Board.

Your Directors confirm their unanimous support for the merger.

### **Tax position and Rollover relief.**

When the merger was announced the tax position was uncertain. Trusts like CPHIC were unable under current legislation to benefit from the rollover relief available to company-to-company acquisitions. However, on 27 March 2003 the Assistant Treasurer announced that those Trusts that elect to head a consolidated group when the proposed legislation takes effect on 1 July 2002, would be taxed as companies in all respects wherever possible. A consequence, which was confirmed in writing to Challenger's solicitors, was that they would be eligible to utilize specific tax provisions applicable to companies including scrip for scrip rollover relief.

This statement was not qualified in any way.

CPHIC has undertaken to Challenger to satisfy the conditions referred to in that Press Release provided that Challenger also elects to head a consolidated group. Challenger intends to do this by 1 July 2003.

This should mean that, if the proposed changes become law, rollover relief would apply. In addition, to provide a wider window for all this to happen, the effective date of the merger is after 30 June ensuring that these matters are for the next tax year rather than this one. This does not of course establish certainty but it does provide significant comfort that Challenger security holders should not miss out on any rollover relief that may be available.

There are many other matters I could comment on but I believe they are well set out in the scheme booklets.

### **Summary**

The Board believes the merger is in the best interests of Challenger shareholders and the independent expert's conclusions set out in the scheme booklet also supports this view. This merger if approved represents a new era for Challenger, which will go forward as a bigger better-capitalized entity.

I will not be associated with its future other than as a shareholder but I wish it all the best.

### **Meeting 2. Chairman's remarks Option Scheme of Arrangement**

The booklet relating to the Options Scheme sets out details of what is proposed for option holders. Put in its simplest form any option holder who elects to convert Challenger options on any exercise date will receive, in lieu of a Challenger share 4.5 unit of CPHIC.

The Option Scheme is conditional on the Share Scheme being approved by the requisite majority of Challenger Shareholders and the Court. I believe that the poll results will be in favour of the merger meaning final approval will wait for Court approval later this month.

It should be noted that the Share Scheme is not conditional on the Option Scheme being approved but, if the Share Scheme is approved and the Option Scheme is not approved today, option holders who exercise their options at a later date would still receive Challenger shares but these would not be listed because Challenger will cease to be listed should the Share Scheme becomes effective.

The Independent Expert has concluded that the Options Scheme is in the best interests of Challenger option holders and your Directors recommend it. Your Directors who hold Challenger options intend to vote in favour of the Options Scheme.

### **Meeting 3. Chairman's remarks Notes Scheme of Arrangement**

The booklet relating to the Notes Scheme sets out details of what is proposed for note holders. Should note holders vote in favour of the scheme they will have two choices:

Either to transfer their Notes on the date the scheme becomes effective to CPH Management in return for 5.5CPHIC Units for each Note transferred

Or

Maintain the current interest arrangements but on conversion receive 4.5 Units in CPHIC rather than one Challenger share.

The difference in the two offers is designed to take account of the value of interest lost if the note holders choose to convert immediately and for foregoing the equity option inherent in the Notes.

It should be noted that the Share Scheme is not conditional on the Notes Scheme proceeding, however, if the Share Scheme is implemented but the Notes Scheme is not implemented, the Notes will be over unlisted securities. The market value of unlisted securities is usually uncertain.

No Challenger Director holds Notes but all Directors recommend you vote in favour of the scheme. Explanations and reasons are contained in Section 2 of the Explanatory Statement.

#### **Meeting 4. Chairman's Remarks Notes Amendment**

Note holders are being asked to approve amendments to the Notes Scheme. The outline of these amendments is shown at item 1.7 on page 10 of the Explanatory Statement.

These amendments are designed to take account of the effect of the Notes Scheme. They will only become effective if the Notes Scheme becomes effective and if you approve the changes at this meeting.

The amendments are designed to ensure that, if a Note is transferred, or converted, after the Effective Date, the holder of the Note at that time will be bound by the terms of the Notes Scheme so that any share issued on conversion will be transferred to CPH Management in return for the issue of 4.5 CPHIC Units. At present the Trust Deed only refers to a conversion to Challenger Shares.

The amendments will also relieve Challenger from its obligation to apply to the ASX for quotation of the Notes and for quotation of any Challenger shares issued on conversion of a Note after the Effective Date.

CPH Management has, under the implementation agreement, obligations to apply to the ASX for quotation of CPHIC Units which are issued under the Notes Scheme.

No Challenger Director holds Notes but all Directors recommend you vote in favour of the amendments. Explanations and reasons are contained in Section 2 of the Explanatory Statement.