

Half-year Report to Shareholders

Six months to 31 December 2003



Directory

Challenger Financial Services Group Limited

ABN 85 106 842 371

Principal registered office in Australia

Level 41, Aurora Place
88 Phillip Street
Sydney NSW 2000 Australia

Board of Directors

James Packer – Chairman
Chris Cuffe – Chief Executive Officer
Graham Cubbin
Russell Hooper
Ashok Jacob
Peter Polson
James Service
Brenda Shanahan
Michael Tilley – Deputy Chairman

Company Secretary

Stuart Nelson – Acting
Anne Gardiner – Commencing April 2004

Share register

Computershare Investor Services Pty Limited
Level 3, 60 Carrington Street
Sydney NSW 2000
Tel 02 8234 5000
Fax 02 8234 5050
www.computershare.com.au

Auditor

Ernst & Young
321 Kent Street
Sydney NSW 2000

Internet address

www.challenger.com.au

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Company overview

Summary of earnings – six months to 31 December 2003

	Consolidated using Margin on Services statutory basis \$m	Consolidated using annuities modified accounting basis \$m
Profit pre-tax and corporate charges	66.6	28.7
Corporate charges	(16.6)	(16.6)
Profit before tax	50.0	12.1
Income tax expense	(16.7)	(3.5)
Profit after tax	33.3	8.6

Breakdown of earnings – six months to 31 December 2003

	Statutory NPAT \$m
CFSG Trust 1 July to 21 December	32.6
CFSGL (Company) 22 December to 31 December – Appendix 4D	0.7
Total	33.3

The above summary of earnings aggregates the trust and company results for the period. 'Corporatisation' occurred on 22 December and hence there are two statutory results periods for two separate head entities.

No dividend has been declared, consistent with previous indications from the Board.

Breakdown of earnings – by segment

	Consolidated using Margin on Services statutory basis \$m	Consolidated using annuities modified accounting basis \$m
Annuities	60.2	22.3
Mortgage finance	13.5	13.5
Funds management, administration and financial planning	(9.9)	(9.9)
Non-core business/assets	2.8	2.8
Profit pre-tax and corporate charges	66.6	28.7
Corporate charges	(16.6)	(16.6)
Profit pre-tax	50.0	12.1

On 23 February 2004, Challenger announced a net profit after tax of \$33 million for the half-year ending 31 December 2003.

Overall pre-tax profit on Challenger's annuity business was \$60 million on a statutory basis, generating solid operating margins and benefiting from a rise in both interest rates and the A\$ over the period.

Challenger also introduced its annuity results on a modified accounting methodology which applies accrual accounting principles to illustrate the underlying spread earned on the annuity business.

Challenger has introduced the modified accounting methodology to assist the market in understanding the underlying profitability of Challenger's annuity business. The modified accounting methodology aims to provide a more comparable basis with funds management and mortgage finance products. This policy is outlined in further detail on page 61.

The pre-tax profit for the annuities division using the modified accounting methodology was \$22 million for the half-year ending 31 December 2003 but ignores property revaluations, marked to market of fixed interest investments, and changes to policyholder liability discount rates.

Challenger's mortgage finance division, including Howard Mortgage Trust and Interstar Securities (acquired on 29 September 2003), contributed a pre-tax profit of \$13.5 million for the half-year ending 31 December 2003.

Challenger's fast growing but immature funds management, administration and financial planning division reported a pre-tax loss of \$9.9 million for the half-year ending 31 December 2003. During the same period, Challenger's Australian equities under management more than doubled to \$1.15 billion.

In December 2003, the Challenger Board indicated no dividends would be paid in the near to medium term as capital would be retained by the company while Challenger continues to build its structure and develop new business streams. Therefore, an interim dividend was not paid for the half-year to 31 December 2003.

Challenger has prepared this Report as an overview of its operations and financial position as at 31 December 2003. This Report is not intended to be, and should not be relied on, as investment advice or a recommendation about Challenger or any financial products issued by Challenger.

Corporate profile

Our passion at Challenger is to find better ways to develop and deliver financial services products. We want to make a difference. We believe that the work we are doing to develop quality financial products that connect with quality financial advice is in the best interests of all of our stakeholders: investors, intermediaries, shareholders, employees and other business partners.

Since the merger with CPH Investment Corp in July 2003, Challenger is beginning to emerge as a mainstream player in Australian financial services. We have both broadened and sharpened our focus: making important acquisitions, forging strategic alliances and exiting non-core businesses.

Our strategy is focused on three core businesses areas:

- Annuities;
- Mortgage finance;
- Funds management, administration and financial planning.

Challenger has genuine competitive advantages in each of these businesses, and each is experiencing strong and sustainable growth. However, the real beauty of this strategy is the opportunity to leverage expertise and infrastructure in one area to create or capitalise on a competitive advantage in another. We believe that each of these businesses represents an opportunity to deliver real benefits to our clients. If we can do that, we will also be delivering real value and sustainable growth to our shareholders.

Annuities

Challenger is a market leader

Challenger has long been a benchmark in the annuities business. We have consistently provided some of the market's most competitive rates to retirees who are attracted to the tax and social security advantages of complying annuities. These are retirees who are prepared to forgo the potential upside of investment volatility in exchange for the certainty of known returns and a guaranteed retirement income.

Challenger's competitive advantage – growth assets

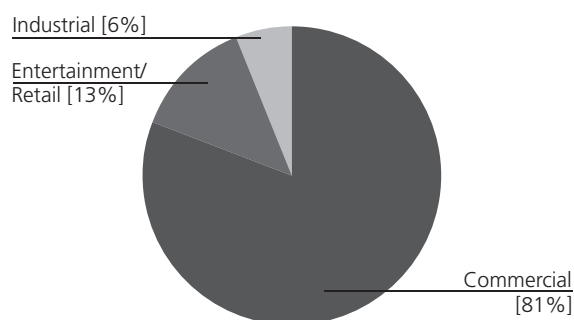
The thing that sets the Challenger annuity model apart is the portfolio of quality growth assets that backs the annuities and funds the promises to investors. The benefits flow both directions, with the same growth assets allowing us to deliver attractive returns to investors and also deliver real growth prospects to shareholders.

A quality property portfolio complemented by other assets

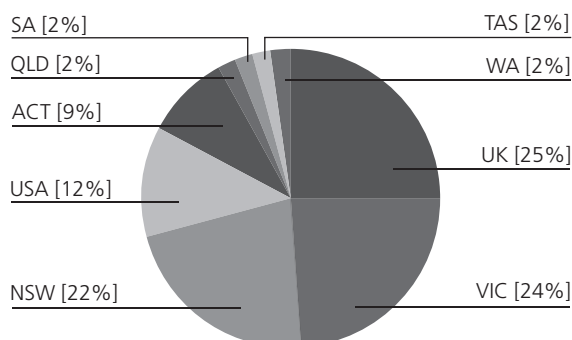
The backbone of the portfolio is commercial property, located in both Australia and overseas, complemented by retail and industrial property and a growing portfolio of fixed income and hybrid debt/equity assets. However, we are also exploring opportunities in infrastructure investment.

Property allocation of current portfolio as at 31 December 2003

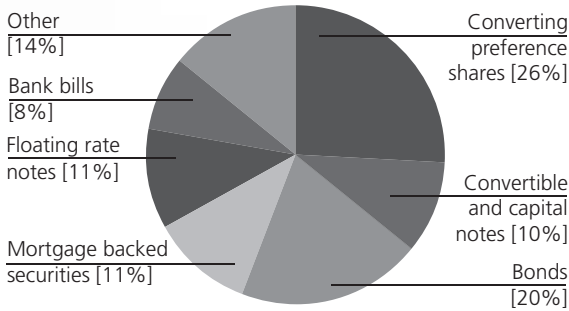
Value by sector



Value by location



Fixed income portfolio



Enhanced risk management to protect investors and shareholders

Challenger is an astute and patient investor, with a history of finding and prudently leveraging assets that have delivered stable income to annuitants and an economic return to shareholders. The recent addition of considerable investment banking expertise to the Challenger senior management team has seen the introduction of even more robust risk controls.

Mortgage finance

The shift in the residential mortgage market

The Australian home loan market has grown, on average, by more than 10% each year for the past 25 years. But the long Australian love affair with property has never extended to a love affair with the traditional lenders. In recent years, there has been a pronounced shift away from the banks towards non-bank mortgage brokers and funding sources.

Non-bank brokers now originate approximately 30% of all new home loans, and this is expected to grow to between 40% and 50% over the next three years. Although this business flows both to bank and non-bank funding sources, non-bank finance now accounts for nearly 20% of residential loans, up from 4% just a decade ago.

A market that is so obviously looking for a better way to do business and build wealth is fertile ground for Challenger. Residential mortgages are a huge component of many Australians' financial plans, which means this is an area where we can make a real difference to people's experience of financial services. And because we want to help advisers to

Mortgage finance

Mortgage finance business

Third party distribution via mortgage originators, brokers and financial planners

Commercial Howard Mortgage Trust	Prime residential Interstar	Non-conforming residential
<ul style="list-style-type: none"> • 100% financed through managed investment schemes • Largest commercial mortgage trust in Australia with \$3 billion FUM • Market size approx. \$14 billion 	<ul style="list-style-type: none"> • 100% financed by continuous global securitisation program • Managed mortgage portfolio of \$12.5 billion • All mortgages insured • Market size approx. \$570 billion 	<ul style="list-style-type: none"> • 100% financed by whole loan sales • Impending launch of residential non-conforming (i.e. sub-prime) wholesale loan product • Market size \$10 billion

Challenger's market-leading mortgage finance businesses cover the residential (prime and non-conforming) and commercial mortgage markets, with significant growth opportunities in each.

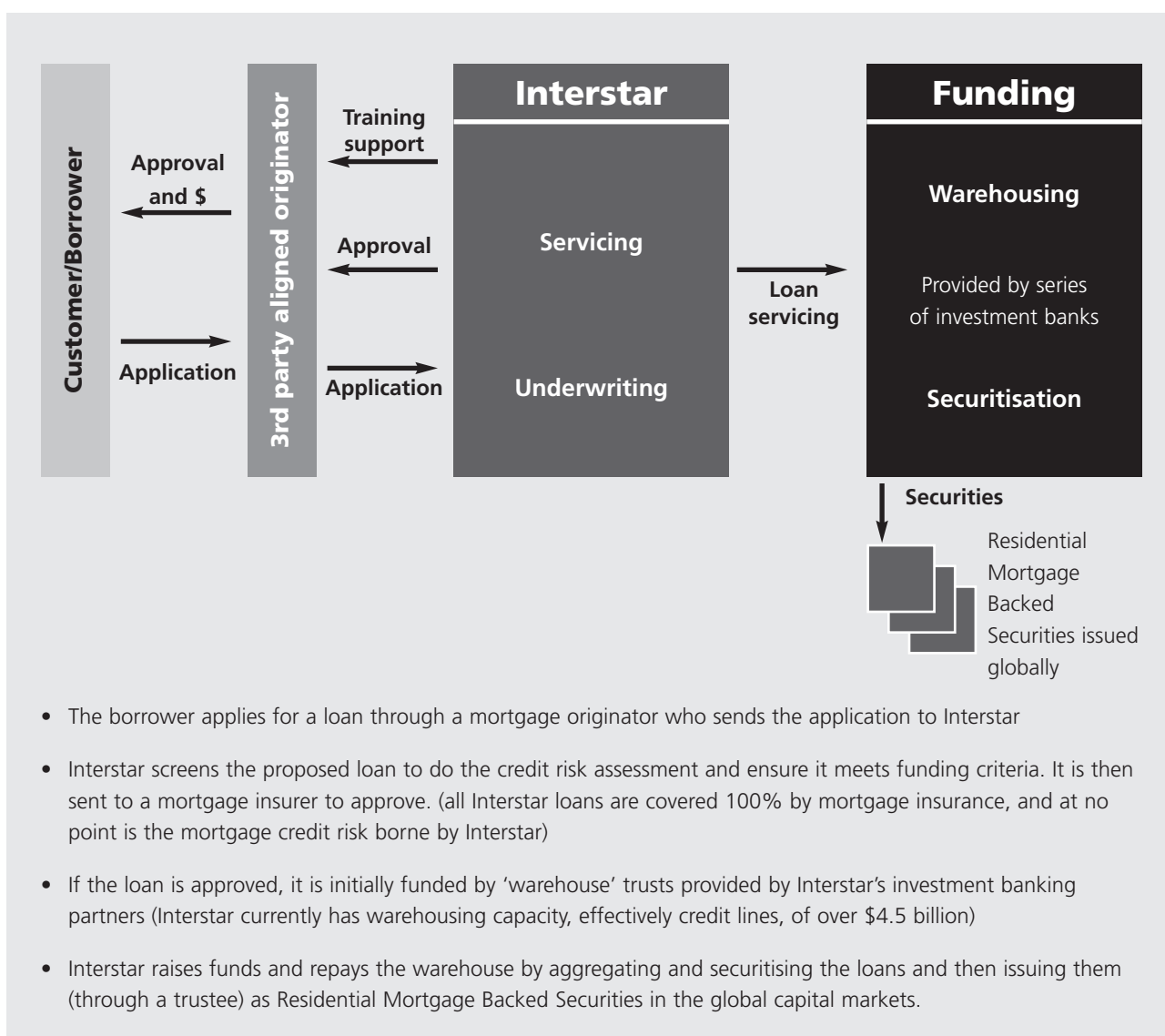
provide holistic financial planning advice to their clients, managing their debt as well as managing their investments, we see ourselves playing a key role in this market.

Interstar prime residential loans – a key beneficiary of the shift in the market

In September last year, Challenger acquired Interstar Securities, one of Australia’s leading independent mortgage financiers. Interstar offers a range of unbranded home loan products, including standard owner-occupied loans, investment loans, construction loans and interest-only loans, at fixed and variable rates.

Interstar’s business is prime residential mortgages offering both standard verified loans and low doc loans for self-employed borrowers with a clean credit history. These loans are subject to additional risk controls and higher interest rates.

At present, Interstar loans are chiefly distributed through a network of over 500 independent mortgage originators. Going forward, we expect this distribution network to grow to include financial planners, accountants, solicitors and other financial advisers.



- The borrower applies for a loan through a mortgage originator who sends the application to Interstar
- Interstar screens the proposed loan to do the credit risk assessment and ensure it meets funding criteria. It is then sent to a mortgage insurer to approve. (all Interstar loans are covered 100% by mortgage insurance, and at no point is the mortgage credit risk borne by Interstar)
- If the loan is approved, it is initially funded by ‘warehouse’ trusts provided by Interstar’s investment banking partners (Interstar currently has warehousing capacity, effectively credit lines, of over \$4.5 billion)
- Interstar raises funds and repays the warehouse by aggregating and securitising the loans and then issuing them (through a trustee) as Residential Mortgage Backed Securities in the global capital markets.

The Mortgage Alternative – non-conforming residential loans

In February 2004, Challenger launched The Mortgage Alternative (TMA), a mortgage financing business established to service the market for non-conforming mortgages, a market estimated by Standard & Poor's to be worth approximately 2.5% of the total residential market or approximately \$10 billion.

Non-conforming mortgage products suit borrowers who are not serviced by traditional lenders, including self-employed and recently employed borrowers, older borrowers, new migrants, and other borrowers deemed to have insufficient employment history or an impaired credit history.

TMA's competitive advantages

TMA's position in the market is unique, as it allows mortgage originators and other distributors to 'badge' unbranded non-conforming mortgage products. TMA leverages the existing Interstar operating platform and originator relationships. TMA will also be able to achieve economies of scale by using the established Interstar core lending systems. However, TMA will use its own specialist underwriting and credit collection facilities, and the funding of non-conforming mortgages will be completely separate from Interstar securitisations.

Howard Mortgage Trust – commercial mortgages

Challenger's Howard Mortgage Trust is Australia's largest commercial mortgage trust, managing over \$3 billion. The Trust raises funds from both retail and wholesale investors, and the funds are applied to lending for commercial purposes.

The popularity of the Trust is the result of sustained performance; the Trust has consistently ranked in the top quartile of Australian mortgage trusts over the past five years.

Funds management, administration and financial planning

Funds management – the market is growing and maturing

The Australian retail managed fund market continues to experience solid growth, increasing more than 13% in value from \$236 billion to \$267 billion in 2003 alone. This growth was largely fuelled by Australia's mandated superannuation system together with increased intergenerational transfer of wealth.

While this growth is showing no signs of slowing, the market is maturing in a number of significant ways.

The trend to style specialisation and boutique managers

The growing sophistication of investors and advisers has been the catalyst of a number of continuing influences and trends, including the now widely-accepted notion that different investment processes and equity management 'styles' outperform at different points in the market cycle. Additionally, boutique managers with distinct investment styles, small funds under management and a focus on asset management, have become increasingly popular.

This disaffection with many established, mainstream players in funds management, and the trend towards alternative providers is not dissimilar to the dynamic in the mortgage market that saw the emergence of the non-bank originators and financiers. And like that market, funds management is another area where Challenger is providing a better way. Our offer is being designed, distributed and promoted in direct response to the movement away from the seemingly stale big names and the related trend toward greater specialisation and boutique managers.

Challenger's level of funds under management, when combined with our team of skilled individuals, provides an alternative investment choice that offers 'boutique-style' qualities with the stability of a diverse financial services company.

Challenger's emerging recognition as an investment manager*

In recent years, Challenger's recognised strength as an annuities provider and the strong growth of the Howard Mortgage Trust have tended to overshadow our ability as an investment manager. Until now.

The performance of the flagship Challenger Australian Share Fund, which has delivered returns of more than 13% per annum for nearly a decade, outperforming the S&P/ASX 300 Accumulation Index by an average of more than 4% each year over that time, has been recognised recently with an 'A' rating by van Eyk Research.

This recognition comes on top of the 'AA' rating given to the Challenger Smaller Companies Fund by van Eyk Research. The fund, which has returned more than 34% per annum in the three years since inception in July 2000, has outperformed the smaller companies benchmark, the S&P/ASX Small Ordinaries Accumulation Fund by a 29% average each year.

Challenger's in-house investment management team was further strengthened in December last year by the appointment of Peter Greentree as our new Head of Equities.

The new multi-manager capability

In other telling developments, Challenger has also developed a significant manager research capability led by Caroline Saunders, Challenger's Head of Manager Research & Alliances and the former CEO of ASSIRT Research. The expertise and skill of this team resulted in the launch late last year of the Challenger Boutique Australian Share Portfolio – a multi-manager portfolio of five quality boutique Australian shares managers including Orion Asset Management, 452 Capital, GMO Australia, Alpha Investment Management and Investors Mutual. The Fund provides ease of access to the growing boutique manager sector.

An important strategic alliance

In November 2003, Challenger also launched the Challenger Orion Australian Share Fund, a growth-style fund managed by Challenger's strategic alliance partner Orion Asset Management, using the proven investment ability of Tim Ryan and his team at Orion. This fund is already highly rated by research houses and recently received an 'A' rating from van Eyk Research.

In-house expertise and a gateway to expertise

As a whole, the Challenger Australian Share Suite, which includes the Challenger Australian Share Fund, Challenger Smaller Companies Fund, Challenger Orion Australian Share Fund, Challenger Financials Sector Fund and Challenger Boutique Australian Share Portfolio, showcases Challenger's various roles and strengths in domestic equities, asset management, external manager research and portfolio construction.

* Performance returns are calculated as at 31 December 2003. The returns figures are the total returns based on exit prices for the relevant funds with distributions reinvested and no allowance made for tax. The returns figures have been rounded up to the nearest number. Past performance is not a guide to future performance – returns may change over time. Neither Challenger nor any related company guarantees repayment or the performance of any investment in its funds.

Units in the Howard Mortgage Trust, Challenger Australian Shares Fund and Challenger Smaller Companies Fund are issued by their responsible entity, Challenger Managed Investments Limited. A product disclosure statement is available for each fund and should be considered before deciding whether to acquire or retain units in the funds. You can obtain a copy of the product disclosure statements by contacting your financial planner, Challenger Investor Services team on 13 35 66 or by visiting Challenger's website at www.challenger.com.au.

In addition to our domestic equities expertise, Challenger has a proven capability in the management of Australian fixed interest. Challenger's High Yield Fund invests in a blend of high yielding fixed interest and hybrid debt equity securities and has performed strongly since inception in August 2002.

Our willingness to build a managed funds business that meets the market's demand for a better way is already paying off. Challenger was ranked ninth in net retail inflows for the December 2003 quarter, up from 17th in the previous quarter, and our funds under management (excluding the Howard Mortgage Trust and our annuities business) has grown by 60% in the six months to 31 December 2003.

Financial planning

Garrisons Financial Planning is a wholly owned subsidiary of Challenger, with 165 planners operating out of more than 90 offices located throughout Australia. Garrisons' planners provide financial planning advice to thousands of Australian investors. With funds under advice increasing from approximately \$2.5 billion to \$3 billion in the six months to 31 December 2003, Garrisons is one of Australia's fastest growing dealer groups. And the Garrisons business and the planners within it are perfectly placed to leverage and adopt the infrastructure and opportunities being created across the Group as a whole.

Margin lending

Challenger's margin lending business continues to grow with the introduction of new registry systems and expanded product features, in preparation for a relaunch of our margin lending offer in the second quarter of this year.

Platform administration

Challenger's platform administration business provides administration services for financial planners through our wholly owned subsidiary, Synergy Capital Management. Our focus over the last six months has been simplifying the Synergy platform and exploring further leverage of our systems capabilities going forward. Total funds under administration grew to \$1.6 billion over the half year to 31 December 2003.

Challenger Financial Services Group Limited

and its controlled entities

ACN 106 842 371

Pro-forma Financial Report

For the half-year ended 31 December 2003

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Overview

Challenger Financial Services Group Limited (Challenger) commenced operations on 22 December 2003 when it acquired 100% of the issued units in Challenger Financial Services Group (CFSG Trust) and its controlled entities. The Pro-forma Statement of Financial Performance, Pro-forma Statement of Financial Position and Pro-forma Statement of Cash Flows present the results of the operations of the combined group for the half-year ended 31 December 2003. Comparative information has not been provided as the nature of the operations of CFSG Trust fundamentally changed on 27 June 2003 upon the merger of CPH Investment Corp and Challenger International Limited. The Pro-forma reported net profit after tax of Challenger for the half-year ended 31 December 2003 was \$33,304,000.

The Pro-forma Financial Report has been prepared to report the financial performance and financial position of Challenger Financial Services Group Limited and its controlled entities for the half-year ended 31 December 2003. Notes to the Pro-forma Financial Report have been provided to enable a reconciliation between the Pro-forma Financial Report and the statutory reported results of CFSG Trust for the period ended 21 December 2003 and Challenger for the period ended 31 December 2003, both of which have been subject to audit review.

The Pro-forma Financial Report provides an aggregation of the results and cash flow statements for the two discrete statutory reporting periods noting that prior to 22 December 2003 Challenger did not trade, and accordingly its individual contribution to the Pro-forma net profit after tax is for the period from 22 December 2003 to 31 December 2003. The Pro-forma Statement of Financial Position as at 31 December 2003 is a direct extract from the statutory (audit reviewed) Statement of Financial Position of Challenger.

Pro-forma statement of financial performance

For the half-year ended 31 December 2003

		Consolidated
	Notes	2003 \$000's
Revenue from ordinary activities		384,530
Expenses from ordinary activities		(262,655)
Borrowing costs		(74,336)
Share of net profits of associates accounted for using the equity method		2,529
Profit from ordinary activities before income tax expense	1	50,068
Income tax expense		(16,764)
Net profit attributable to shareholders after tax from ordinary activities	1	33,304
Total valuation adjustments attributable to shareholders		–
Total changes in shareholders' funds from non-shareholder transactions		33,304
Basic earnings per share (cents)		1.4
Diluted earnings per share (cents)		1.4

The above pro-forma statement of financial performance should be read in conjunction with the notes to the pro-forma financial report.

Pro-forma statement of financial position

As at 31 December 2003

	Consolidated
	2003 \$000's
Assets	
Cash assets	350,715
Receivables	260,828
Debt securities	1,157,467
Other financial assets	25,080
Equity securities	208,679
Investment properties	2,558,902
Fixed assets	11,164
Land and plantation timber	54,000
Deferred tax assets	49,130
Investment in associates	20,344
Intangible assets	401,953
Other assets	133,211
Excess of net market value of the interests of Challenger Life Limited in its subsidiaries over their net assets	375,453
Total assets	5,606,926
Liabilities	
Payables	213,750
Current tax liabilities	7,510
Interest bearing liabilities	2,111,577
Provisions	44,437
Deferred tax liabilities	100,512
Life insurance policy liabilities	1,926,222
Total liabilities	4,404,008
Net assets	1,202,918
Shareholders Equity	
Shares on issue	1,140,521
Reserves	61,700
Retained Profits	697
Total Shareholders Equity	1,202,918

The above pro-forma statement of financial position should be read in conjunction with the notes to the pro-forma financial report.

Pro-forma statement of cash flows

For the half-year ended 31 December 2003

	Notes	Consolidated 2003 \$000's
Cash flows from operating activities		
Receipts from customers (inclusive of GST)		589,458
Payments to suppliers and employees (inclusive of GST)		(489,591)
Dividends received		11,609
Interest received		44,289
Borrowing costs		(75,265)
Income taxes paid		(6,982)
Net cash inflow from operating activities		73,518
Cash flows from investing activities		
Purchase of investments		(319,809)
Payment for purchases of controlled entities, net of cash acquired		(122,960)
Purchase of fixed assets		(1,899)
Capitalised acquisition costs paid		(11,551)
Proceeds from sale of investments		55,781
Net cash outflow from investing activities		(400,438)
Cash flows from financing activities		
Proceeds from borrowings		46,318
Repayment of borrowings		(47,776)
Net cash outflow from financing activities		(1,458)
Net decrease in cash held	2	(328,378)
Cash at the beginning of the period		660,421
Prior year reclassification of cash held by controlled property trusts		19,344
Effects of exchange rate changes on cash		(672)
Cash at the end of the financial period		350,715

The above pro-forma statement of cash flows should be read in conjunction with the notes to the pro-forma financial report.

Notes to the pro-forma half-year financial report

Note 1. Reconciliation to statutory net profit

	1/7/2003 to 21/12/2003*	22/12/2003 to 31/12/2003**	Half-year ended 31/12/2003
	\$000's	\$000's	\$000's
Revenue from ordinary activities			
Rental income earned by property trusts controlled by Life Company subsidiaries	116,240	5,978	122,218
Management fee income	81,728	4,203	85,931
Interest income	44,590	2,293	46,883
Dividend income	14,862	–	14,862
Change in net market value of investments held by Life Company subsidiaries			
– Properties (net of exchange fluctuations)	(587)	–	(587)
– Property valuation and foreign currency debt movements attributable to exchange fluctuations	(16,550)	–	(16,550)
– Interest rate swaps and forward foreign exchange contracts	102,330	–	102,330
– Trading securities	1,528	(690)	838
Net realised gains on sale of investments and subsidiaries	8,642	(18)	8,624
Other income	19,003	978	19,981
Revenue from ordinary activities	371,786	12,744	384,530
Expenses from ordinary activities			
(Increase)/decrease in net policy liabilities	(96,689)	–	(96,689)
Responsible entity fee	(3,366)	–	(3,366)
Property management expenses incurred by property trusts controlled by Life Company subsidiaries	(13,362)	(687)	(14,049)
Amortisation and depreciation	(17,774)	(913)	(18,687)
Employee expenses	(45,479)	(2,339)	(47,818)
Commission expense	(48,509)	(2,495)	(51,004)
Occupancy expense	(5,535)	(285)	(5,820)
Other expenses	(23,757)	(1,465)	(25,222)
Expenses from ordinary activities (excluding borrowing costs)	(254,471)	(8,184)	(262,655)
Borrowing costs			
– incurred by property trusts controlled by Life Company subsidiaries	(58,424)	(3,005)	(61,429)
– incurred by other entities	(12,276)	(631)	(12,907)
	(70,700)	(3,636)	(74,336)
Total expenses from ordinary activities	(325,171)	(11,820)	(336,991)
Share of net profits of associates accounted for using the equity method	2,405	124	2,529
Profit from ordinary activities before income tax expense	49,020	1,048	50,068
Income tax expense	(16,413)	(351)	(16,764)
Net profit attributable to shareholders after tax from ordinary activities	32,607	697	33,304

* Source: Challenger Financial Services Group Statutory Interim Financial Report for the period ended 21 December 2003.

** Source: Challenger Financial Services Group Limited Statutory Interim Financial Report for the period ended 31 December 2003. Note that the Statutory Interim Financial Report was prepared for the period beginning 6 November 2003 (date of incorporation) to 31 December 2003. However, no transactions were entered into by Challenger until the acquisition of CFSG on 22 December 2003.

Notes to the pro-forma half-year financial report (continued)

Note 2. Reconciliation of Pro-forma Statement of Cash Flows

	1/7/2003 to 21/12/2003*	22/12/2003 to 31/12/2003**	Half-year ended 31/12/2003
	\$000's	\$000's	\$000's
Cash flows from operating activities			
Receipts from customers (inclusive of GST)	585,160	4,298	589,458
Payments to suppliers and employees (inclusive of GST)	(483,251)	(6,340)	(489,591)
Dividends received	11,609	–	11,609
Interest received	44,289	–	44,289
Borrowing costs	(75,265)	–	(75,265)
Income taxes paid	(6,712)	(270)	(6,982)
Net cash inflow/(outflow) from operating activities	75,830	(2,312)	73,518
Cash flows from investing activities			
Purchase of investments	(319,809)	–	(319,809)
Payment for purchases of controlled entities, net of cash acquired	(122,960)	–	(122,960)
Purchase of fixed assets	(1,547)	(352)	(1,899)
Capitalised acquisition costs paid	(11,551)	–	(11,551)
Proceeds from sale of investments	50,281	5,500	55,781
Net cash inflow/(outflow) from investing activities	(405,586)	5,148	(400,438)
Cash flows from financing activities			
Proceeds from borrowings	46,318	–	46,318
Repayment of borrowings	(47,776)	–	(47,776)
Net cash inflow outflow from financing activities	(1,458)	–	(1,458)
Net increase/(decrease) in cash held	(331,214)	2,836	(328,378)
Cash at the beginning of the period	660,421	–	660,421
Prior year reclassification of cash held by controlled property trusts	19,344	–	19,344
Effects of exchange rate changes on cash	(672)	–	(672)
Cash acquired upon corporatisation of CFSG	–	347,879	–
Cash at the end of the financial period	347,879	350,715	350,715

* Source: Challenger Financial Services Group Statutory Interim Financial Report for the period ended 21 December 2003.

** Source: Challenger Financial Services Group Limited Statutory Interim Financial Report for the period ended 31 December 2003. Note that the Statutory Interim Financial Report was prepared for the period beginning 6 November 2003 (date of incorporation) to 31 December 2003. However, no transactions were entered into by Challenger until the acquisition of CFSG (the Trust) on 22 December 2003.

Note 3. Segment information

The primary business segments of the Group have been identified as follows:

Half-year ended 31 December 2003

	Annuities	Funds Management	Mortgage Finance	Corporate*	Total consolidated
	\$000's	\$000's	\$000's	\$000's	\$000's
Segment revenue	248,986	54,337	62,713	18,494	384,530
Segment result	60,208	(9,910)	13,547	(13,777)	50,068

* Corporate segment relates to non-core activities of the Group, including businesses to be restructured or sold as previously announced to the Australian Stock Exchange (ASX).

Challenger Financial Services Group Limited

and its controlled entities

ACN 106 842 371

Interim Financial Report

For the period from 6 November 2003 to 31 December 2003

(Incorporating the trading result for the period from 22 December to 31 December 2003)

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Directors' report

The Directors present their report, together with the financial statements of Challenger Financial Services Group Limited (Challenger) and its controlled entities (the Group) for the period ended 31 December 2003. The names of the Directors of the company holding office during the period beginning 6 November 2003 until the date of this report are:

James Douglas Packer (Chairman) (appointed 6/11/2003)
Christopher Edgar Cuffe (Chief Executive Officer) (appointed 6/11/2003)
Graham Allan Cubbin (appointed 6/1/2004)
Russell Richard Roberts Hooper (appointed 6/11/2003)
Ashok Peter Jacob (appointed 6/11/2003)
Peter Leith Polson (appointed 6/11/2003)
James Glen Service (appointed 6/11/2003)
Brenda Mary Shanahan (appointed 6/11/2003)
Michael Tilley (Deputy Chairman) (appointed 6/11/2003)

Principal activities

The principal activities of the Group are the provision of financial services, in particular:

- Annuities;
- Mortgage finance; and
- Funds management, administration and financial planning.

State of affairs

Challenger was incorporated on 6 November 2003. On 22 December 2003, the unitholders of Challenger Financial Services Group (CFSG) approved a restructure of CFSG involving the corporatisation of CFSG.

Under the restructure, CFSG unitholders exchanged their units for Challenger shares (on a one for one basis) and Challenger became the sole holder of CFSG units. Challenger was admitted to the official list of the ASX on 23 December 2003.

As a result of the restructure of CFSG:

- the Chief Executive Officer entered into an employment contract with Challenger, the material terms of which were disclosed as part of the restructure information;
- Challenger issued to Consolidated Press Holdings Limited 300 million non-transferable call options over unissued shares with an exercise price of \$0.65 and a 10-year term;
- a long-term equity-based incentive plan for senior executives of Challenger was approved; and
- the issue of 40 million Challenger shares to the Chief Executive Officer was approved which were disclosed as part of the restructure information.

Directors' report (continued)

Review and results of operations

Net profit after tax for the nine-day period from 22 December 2003 to 31 December 2003 was \$697,000. The net profit reported in the Statement of Financial Performance represents the net profit for the nine day period from 22 December to 31 December 2003, which represents the period from the date Challenger commenced trading and 31 December 2003.

The Directors of Challenger propose that no dividend be declared for the period ended 31 December 2003.

Subsequent events

On 22 January 2004, 40,000,000 shares in Challenger were issued to the Chief Executive Officer at a price of \$0.53 per share pursuant to the terms of the corporatisation restructure as noted above in the section of this report titled 'State of affairs'.

Rounding

The amounts contained in this report and in the financial statements have been rounded off under the option available to the Group under Australian Securities and Investments Commission (ASIC) Class Order 98/0100. The Consolidated Entity is an entity to which the class order applies.

Signed in accordance with a resolution of the Directors of Challenger Financial Services Group Limited.



GA Cubbin
Director



CE Cuffe
Director

Signed 20 February 2004

Statement of financial performance

For the period from 6 November 2003 to 31 December 2003

		Consolidated
	Notes	2003 \$000's
Revenue from ordinary activities	2	12,744
Expenses from ordinary activities	3	(8,184)
Borrowing costs	3	(3,636)
Share of net profits of associates accounted for using the equity method		124
Profit from ordinary activities before income tax expense		1,048
Income tax expense		(351)
Net profit attributable to shareholders after tax from ordinary activities		697
Total valuation adjustments attributable to shareholders		–
Total changes in shareholders funds from non-shareholder transactions		697
Basic earnings per share (cents)	17	0.03
Diluted earnings per share (cents)	17	0.03

The Group traded for the nine-day period from 22 December 2003 to 31 December 2003.

The above statement of financial performance should be read in conjunction with the accompanying notes.

Statement of financial position

As at 31 December 2003

		Consolidated
	Notes	2003 \$000's
Assets		
Cash assets		350,715
Receivables		260,828
Debt securities		1,157,467
Other financial assets		25,080
Equity securities	4	208,679
Investment properties	5	2,558,902
Fixed assets		11,164
Land and plantation timber		54,000
Deferred tax assets		49,130
Investment in associates		20,344
Intangible assets	6	401,953
Other assets	7	133,211
Excess of net market value of the interests of Challenger Life Limited in its subsidiaries over their net assets		375,453
Total assets		5,606,926
Liabilities		
Payables	8	213,750
Current tax liabilities		7,510
Interest bearing liabilities	9	2,111,577
Provisions		44,437
Deferred tax liabilities		100,512
Life insurance policy liabilities	10	1,926,222
Total liabilities		4,404,008
Net assets		1,202,918
Shareholders' Equity		
Shares on issue	11	1,140,521
Reserves	12	61,700
Retained Profits	13	697
Total Shareholders' Equity		1,202,918

The above statement of financial position should be read in conjunction with the accompanying notes.

Statement of cash flows

For the period from 6 November 2003 to 31 December 2003

	Consolidated
	2003 \$000's
Cash flows from operating activities	
Receipts from customers (inclusive of GST)	4,298
Payments to suppliers and employees (inclusive of GST)	(6,340)
Dividends received	–
Interest received	–
Borrowing costs	–
Income taxes paid	(270)
Net cash outflows from operating activities	(2,312)
Cash flows from investing activities	
Purchase of investments	–
Purchase of fixed assets	(352)
Capitalised acquisition costs paid	–
Proceeds from sale of investments	5,500
Net cash inflows from investing activities	5,148
Cash flows from financing activities	
Proceeds from borrowings	–
Repayment of borrowings	–
Net cash inflow/(outflow) from financing activities	–
Net increase in cash held	2,836
Cash at the beginning of the period	–
Cash acquired upon corporatisation of CFSG	347,879
Cash at the end of the financial period	350,715

The above statement of cash flows should be read in conjunction with the accompanying notes.

Notes to the interim financial report

Note 1. Summary of significant accounting policies

Challenger was incorporated on 6 November 2003, and the period ended 31 December 2003 is the first reporting period that a financial report has been prepared for Challenger. Accordingly comparative information is not available for Challenger.

This interim financial report is a general purpose financial report that has been prepared in accordance with the requirements of Accounting Standard AASB 1029 'Interim Financial Reporting', the recognition and measurement requirements of applicable AASB standards, Urgent Issues Group Consensus Views and other authoritative pronouncements of the Australian Accounting Standards Board and the Corporations Act 2001.

The financial report is prepared in accordance with the historical cost convention except for all life insurance assets and liabilities and certain other assets and liabilities which are stated at valuation as described in the summary of significant accounting policies.

The statement of financial position is presented in order of liquidity.

(a) Principles of consolidation

The consolidated financial statements incorporate the assets and liabilities of all entities controlled by Challenger as at 31 December 2003 and the results of all controlled entities for the period then ended. Challenger and its controlled entities together are referred to in this financial report as the 'Consolidated Entity'. The effects of all transactions between entities in the 'Consolidated Entity' are eliminated in full.

Where control of an entity is obtained during a financial year, its results are included in the consolidated statement of financial performance from the date on which control commences. Where control of an entity ceases during a financial year its results are included for that part of the year during which control existed.

Life insurance controlled entities

Both the shareholders' and policy owners' interests in the life insurance funds of the controlled entities are consolidated.

Some aspects of generally accepted Australian accounting practices applicable to life insurers, in particular net market value accounting, differ from generally accepted practices for non-life insurers. Where a life insurer consolidates a subsidiary, any differences between the values consolidated line by line and the market value of the controlled entity recorded in the life insurer's financial statements is shown as 'Excess of the net market values of its interests in its subsidiaries over their net assets'.

Non-life insurance controlled entities

Where controlled entities of non-life insurance companies are consolidated the excess of the purchase price over the fair value of net assets of controlled entities is goodwill and is amortised as described in note 1(m).

Investments in associates

Investments in associates are carried at the lower of equity accounted amount or recoverable amount in the consolidated financial report.

Notes to the interim financial report (continued)

(b) Life insurance financial reporting

Assets, liabilities, revenues and expenses are measured on the following basis.

- (i) Premiums (claims) are separated into their revenue (expense) and liability components. Premium (expense) amount received (paid) which are akin to deposits (withdrawals), are recognised as an increase (decrease) in policy liabilities.
- (ii) Investment assets relating to Challenger Life Limited and its life subsidiary Challenger Life No. 2 Limited (together 'Challenger Life') have been recorded at net market value. Where no quoted market values exist, various methods determined by the Directors have been adopted. They include the following:
 - Investments in unit trusts that are not controlled entities are recorded at their latest available market value.
 - Investments in controlled property trusts consist of income units (entitlements to rental income less financing and hedging costs) and capital units (entitlements to residual net assets upon the maturity of the income units).

The values of investments in income and capital units are derived from net market valuations on the underlying properties, undertaken by independent accredited valuers, less the costs of related debt and hedging contracts.

Revaluation gains and losses on property investments arise where the net market value differs to cost. Net market value (fair value) is the most probable price reasonably obtainable in the market from a willing and knowledgeable buyer. The cost of acquired properties includes its purchase price, and any directly attributable expenditure including professional fees for legal services, property transfer taxes and other related transaction costs.

- Investments in controlled entities that do not have a market price are recorded at fair value as determined by the Directors.
- Interest-bearing securities listed on exchanges are shown at quoted prices at balance date.
- Loans are recorded at market value based on discounting the estimated recoverable amount using prevailing interest rates.

Gains and losses arising from the revaluation of investments are included as part of investment income in the statement of financial performance.

(iii) Overview of Margin on Services (MoS) methodology

MoS is the financial reporting methodology for Australian life insurance companies as prescribed in the Life Insurance Act 1995 (the Act). MoS is designed to recognise profits on life insurance as services are provided to policyholders and income is received. Services used to determine profit recognition include the cost of the expected claims, maintaining policies, and investment management. Policy liabilities are valued by the Life Insurance Actuarial Standard 1.02 (Valuation of Policy Liabilities) issued by the Life Insurance Actuarial Standards Board under the Life Insurance Act.

Policy liabilities are amounts which, when taken together with future premiums and investment earnings:

- are required to meet the payment of future benefits and expenses; and
- incorporate profit margins on existing business to be released when earned in future periods.

Note 1. Summary of significant accounting policies (continued)

(b) Life insurance financial reporting (continued)

Life insurance policy liabilities are not categorised as current or non-current which is consistent with the presentation of investment assets backing those liabilities.

On the basis of an actuarial assessment under the MoS methodology the excess of net assets over policy liabilities accrues to the benefit of Challenger Life.

MoS profit can be analysed in the following categories:

- Planned margins of revenues and expenses.

At the time of writing a policy and at each balance date, best estimate assumptions are used to determine all expected future payments and premiums. Where actual experience replicates best estimate assumptions, the expected profit margins will be released to profit over the life of the policy.

- The difference between actual and assumed experience.

Experience profits/losses are realised where actual experience differs from best estimate assumptions. Instances giving rise to experience profits/losses include variations in claims, expenses, mortality, discontinuance and investment returns. For example, an experience profit will emerge when the expenses of maintaining all in-force business in a year are lower than the best estimate assumption in respect of those expenses.

- Changes to underlying assumptions.

Assumptions used for measuring policy liabilities are reviewed each period by the Appointed Actuary. Where the review leads to a change in assumptions, the change is deemed to have occurred from the end of the financial year.

The financial effect of changes to the assumptions underlying the measurement of policy liabilities made during the reporting period are recognised in the statement of financial performance over the future reporting periods during which services are provided to policyholders. However, if based on best estimate assumptions, written business for a group of related products is expected to be unprofitable, the whole expected loss for that related product group is recognised in the statement of financial performance immediately. When loss making business becomes profitable, it is necessary to reverse previously recognised losses.

(iv) Basis of expense apportionments

Direct expenses are allocated on the basis of statutory fund, class and category of business. Other expenses have been apportioned between statutory funds, classes and categories of business in accordance with Division 2 of Part 6 of the Life Insurance Act 1995, with general management expenses being apportioned on a similar basis.

Apportionment between policy acquisition, policy maintenance and investment management has been made in line with principles set out in the Life Insurance Actuarial Standards Board (LIASB) Valuation Standard (Actuarial Standard AS 1.02).

- (v) Policy acquisition costs are the fixed and variable costs of acquiring new business and include the related commission, policy issuing and underwriting costs, agency expenses and other sales costs. The actual acquisition costs incurred in life business are recorded in the statement of financial performance.

In determining life insurance policy liabilities, the Appointed Actuary takes account of the deferral and the future recovery of acquisition costs. The acquisition costs deferred are determined as the greater of actual costs incurred and any explicit policy charges for the recovery of those costs, subject to an overall limit that the value of future profits at inception cannot be negative. Acquisition losses are recognised at inception to the extent the latter situation arises.

- (vi) Consolidated payables include all of Challenger Life's creditors, other liabilities and some of its borrowings. Borrowings and 'other liabilities' relating to life insurance operations are measured at net present values, and changes to those net present values, as well as borrowing costs, are recognised as expenses (and, in some cases, revenues) of the period. The borrowings and other liabilities relating to the retail operations are measured at their face values with only borrowing costs recognised as expenses of the period.

(c) Income tax

Tax effect accounting is applied using the balance sheet liability method, which focuses on the tax effect of transactions and other events that affect amounts recognised in either the statement of financial position or a tax-based balance sheet.

As a result of the changes from the Income Tax Amendment Bill, the income tax expense of Challenger Life is determined at the corporate tax rate, except for complying superannuation policies and segregated exempt assets (including immediate annuities).

The income tax expense or revenue for the period is the tax payable on the current period's taxable income adjusted by changes in deferred tax assets and liabilities attributable to amounts recognised as assets or liabilities, and to unused tax losses.

Deferred tax assets and liabilities are recognised for temporary differences between the carrying amount of assets and liabilities for accounting purposes and the tax bases of those assets and liabilities, and for unused tax losses. The tax rates expected to apply when the assets are recovered or liabilities are settled, based on those tax rates which are enacted or substantively enacted for each jurisdiction, are applied to the cumulative amounts of deductible and assessable temporary differences to measure the deferred tax asset or liability.

Deferred tax assets are recognised for deductible temporary differences and unused tax losses only if it is probable that future taxable amounts will be available to utilise those temporary differences and losses.

(d) Foreign currency translation

(i) Transactions

Foreign currency transactions are initially translated into Australian currency at the rate of exchange at the date of the transaction. At balance date amounts payable and receivable in foreign currencies are translated to Australian currency at rates of exchange current at that date. Resulting exchange differences are brought to account in determining the profit or loss for the year.

(ii) Foreign controlled entities

As the foreign controlled entities are integrated, their assets and liabilities are translated into Australian currency at rates of exchange current at balance date, while their revenues and expenses are translated at the average of rates ruling during the year. Exchange differences arising on translation are taken to the Statement of Financial Performance.

Note 1. Summary of significant accounting policies (continued)

(e) Acquisitions of assets

The purchase method of accounting is used for all acquisitions of assets, except for those assets held by Challenger Life, regardless of whether shares or other assets are acquired. Cost is determined as the fair value of the assets given up, shares issued or liabilities undertaken at the date of acquisition plus costs incidental to the acquisition. Where shares are issued in an acquisition, the value of the shares is determined having reference to the assessed fair value of the assets or net assets acquired, including goodwill or discount on acquisition where applicable.

Goodwill is brought to account on the basis described in note 1(m).

The fair value of acquired tax losses is determined via their recoverability in the hands of the acquirer and probability of recognition in future periods.

(f) Revenue and expense recognition

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the entity and the revenue can be reliably measured. Revenue and expenses are generally recognised on an accruals basis.

The following specific recognition criteria must also be met before revenue is recognised:

Dividend income

Dividends are recognised as income on the date the share is quoted ex-dividend. Dividends from unlisted companies are recognised when the dividend is received.

(g) Receivables

All trade debtors are recognised at the amounts receivable. Trade debtors are due for settlement no more than 120 days from the date of recognition, and other debtors no more than 30 days from the date of recognition.

The recoverability of trade debtors is reviewed on an ongoing basis. Debtors which are known to be uncollectible are written off. A provision for doubtful debts is raised where it is probable the debt will not be fully recoverable.

Bills of exchange have been purchased in the market at a discount to face value. The bills are carried at an amount representing cost and a portion of the discount recognised as income on an effective yield basis. The discount brought to account each period is accounted for as interest received.

(h) Recoverable amount of non-current assets

The recoverable amount of an asset is the net amount expected to be recovered through the net cash inflows arising from its continued use and subsequent disposal.

Where the carrying amount of a non-current asset is greater than its recoverable amount, the asset is written down to its recoverable amount. Where net cash inflows are derived from a group of assets working together, recoverable amount is determined on the basis of the relevant group of assets.

(i) Investments

Investments held outside Challenger Life in listed and unlisted securities and strategic non-current investments, other than investments in controlled entities and associates, are brought to account at the lower of cost or net realisable value. Controlled entities and associates are accounted for in the consolidated financial statements as set out in note 1(a).

(j) Depreciation of fixed assets

Depreciation is calculated on a straight line basis to write off the net cost or revalued amount of each item of property, plant and equipment (excluding land) over its expected useful life to the consolidated entity. Estimates of remaining useful lives are made on a regular basis for all assets, with annual reassessments for major items. The expected useful lives are as follows:

Plant and equipment	– 4 years
Computer equipment and software	– 3 years

(k) Leasehold improvements

The cost of improvements to or on leasehold properties is amortised over the unexpired period of the lease or the estimated useful life of the improvement to the consolidated entity, whichever is the shorter. Leasehold improvements held at the reporting date are being amortised over five years.

(l) Leased assets

A distinction is made between finance leases which effectively transfer from the lessor to the lessee substantially all of the risks and benefits incident to ownership of leased non-current assets, and operating leases under which the lessor effectively retains substantially all such risks and benefits.

Finance leases are capitalised. A lease asset and liability are established at the present value of minimum lease payments. Lease payments are allocated between the principal component of the lease liability and the interest expense.

The lease asset is amortised on a straight line basis over the term of the lease, or where it is likely that the consolidated entity will obtain ownership of the asset, the life of the asset. Lease assets held at the reporting date are being amortised over periods ranging from three to five years.

Incentives received on entering into operating leases are recognised as liabilities and amortised over the life of the lease.

Surplus lease space

The present value of future payments for surplus leased space under non-cancellable operating leases is recognised as a liability, net of sub-leasing revenue, in the period in which it is determined that the leased space will be of no future benefit to the consolidated entity. Each lease payment is allocated between the liability and finance charge.

Other operating lease payments are charged to the statement of financial performance in the periods in which they are incurred, as this represents the pattern of benefits derived from the leased assets.

(m) Intangible assets and expenditure carried forward

On acquisition of some, or all, of the assets of another entity or, in the case of an investment in a controlled entity, on acquisition of some, or all, of the equity of that controlled entity, the identifiable net assets acquired are measured at fair value. The excess of the fair value of the cost of acquisition over the fair value of the identifiable net assets acquired, including any liability for restructuring costs, is brought to account as goodwill and amortised on a straight line basis over the period during which the benefits are expected to arise, being no more than 20 years.

Note 1. Summary of significant accounting policies (continued)

(n) Deferred portfolio and origination costs

Portfolio costs represent expenses incurred in establishing mortgage backed pooled funds. Origination costs represent expenses incurred in originating mortgages for inclusion in the pooled funds.

Portfolio and Origination costs incurred are recognised as an asset and subsequently amortised over the life of the future economic benefits expected to be received. Total deferred portfolio and origination costs are not carried at an amount above their recoverable amount.

(o) Land and plantation timber

Land and plantation timber represents the right to acquire specified forestry assets acquired as part of the acquisition of the assets of Zurich Capital Markets Australia Principal Finance business. The right to acquire these assets are brought to account at the lower of cost and their recoverable amount.

(p) Payables

These amounts represent liabilities for goods and services provided to the consolidated entity prior to the end of the financial year and which are unpaid and liabilities in respect of issuance of endowment warrants.

(q) Interest bearing liabilities

Loans and debentures are carried at their principal amounts which represent the present value of future cash flows associated with servicing the debt. Interest is accrued over the period it becomes due and is recorded as part of other creditors.

(r) Derivative financial instruments

The consolidated entity is exposed to changes in interest rates and foreign exchange rates and may use interest rate swaps and forward foreign exchange contracts to hedge these risks. Derivative financial instruments are held for risk management purposes and not for the purpose of speculation. The Group does not hold a derivative trading portfolio.

For other than life insurance companies, costs arising at the time of entering into hedge transactions are brought to account in the statement of financial performance over the lives of the hedge contracts. For life insurance companies or controlled entities of the life insurance companies, costs arising at the time of entering into hedge transactions are recognised in the statement of financial performance in the period in which the costs are incurred.

Derivative financial instruments designated as hedges are accounted for on the same basis as the underlying exposure. Derivatives not meeting the definition of a hedge, or held within the life insurance group, are accounted for on a mark to market basis and changes in value are recorded in the statement of financial performance in the period in which they arise.

(s) Goods and services tax

Revenues, expenses and assets are recognised net of the amount of goods and services tax (GST), except where the amount of the GST incurred is not recoverable from the taxation authority. In these circumstances, the GST is recognised as part of the cost of the acquisition of the asset or as part of the expense.

Receivables and payables are stated with the amount of GST included.

The net amount of GST recoverable from, or payable to, the Australian Taxation Office (ATO) is included as an asset or liability in the statement of financial position.

Cash flows are included in the statement of cash flows on a gross basis. The GST components of cash flows arising from investing and financing activities which are recoverable from, or payable to, the ATO are classified as operating cash flows.

(t) Employee entitlements

(i) Wages and salaries, and annual leave

Liabilities for wages and salaries and annual leave expecting to be settled within 12 months of the reporting date are recognised in provisions in respect of employees' services up to the reporting date and are measured at the amounts expected to be paid when the liabilities are settled.

(ii) Long service leave

A liability for long service leave is recognised, and is measured as the present value of expected future payments to be made in respect of services provided by employees up to the reporting date. Consideration is given to expected future wage and salary levels, experience of employee departures and periods of service. Expected future payments are discounted using interest rates on national government guaranteed securities with terms to maturity that match, as closely as possible, the estimated future cash outflows.

(iii) Termination benefits

Liabilities for termination benefits relating to an acquired entity or operation that arise as a consequence of acquisition are recognised as at the date of acquisition if, at or before the acquisition date, the main features of the termination were planned and a valid expectation had been raised in those employees affected that the terminations would be carried out and this is supported by a detailed plan developed within three months of the acquisition or prior to the completion of the financial report, if earlier. These liabilities are disclosed in aggregate with other restructuring costs as a consequence of the acquisition.

Liabilities for termination benefits expected to be settled within 12 months are measured at the amounts expected to be paid when they are settled.

(u) Restructuring costs

Liabilities for the cost of restructuring entities or operations acquired are recognised as at the date of acquisition of an entity, or part thereof, if the main features of the restructuring were planned and there was a demonstrable commitment to the restructuring at the acquisition date and this is supported by a detailed plan developed within three months of the acquisition or prior to the completion of the financial report, if earlier.

The cost of restructurings provided for, other than related employee termination benefits, is the estimated cash flows, having regard to the risks of the restructuring activities.

Liabilities for employee termination benefits associated with restructurings are brought to account on the basis described in the accounting policy note for employee entitlements (note 1(s)). Liabilities for costs of restructurings and related employee termination benefits are disclosed in aggregate where the restructuring occurs as a consequence of an acquisition.

Reversals of part or all of a provision for restructuring relating to an acquisition because costs are no longer expected to be incurred as planned are adjusted against goodwill on acquisition. The adjusted carrying amounts of the goodwill are amortised from the date of the reversal.

(v) Borrowing costs

Borrowing costs are recognised as expenses in the period in which they are incurred.

Borrowing costs include:

- interest on bank overdrafts and short-term and long-term borrowings;
- amortisation of ancillary costs incurred in connection with the arrangement of borrowings; and
- finance lease charges.

Note 1. Summary of significant accounting policies (continued)

(w) Cash

For purposes of the statement of cash flows, cash includes deposits at call which are readily convertible to cash on hand and are subject to an insignificant risk of changes in value, net of outstanding bank overdrafts.

(x) Earnings per share

(i) Basic earnings per share

Basic earnings per share is determined by dividing net profit after income tax attributable to members of the company by the weighted average number of shares outstanding during the financial year.

(ii) Diluted earnings per share

Diluted earnings per share adjusts the figures used in the determination of basic earnings per share by taking into account amounts unpaid on shares and any reduction to earnings per share that will probably arise from the exercise of options outstanding during the financial year.

(y) Funds under management

Within the consolidated entity certain controlled entities act as the single responsible entity/manager for a number of investment funds and trusts.

These funds and trusts have not been consolidated in the financial statements, as individual entities within the economic entity do not have control of the funds and trusts as defined by AASB 1024 'Consolidated Accounts'.

(z) Restrictions on assets

Investments held in Challenger Life can only be used within the restrictions imposed under the Life Insurance Act 1995. The main restrictions are that the assets in a Fund can only be used to meet the liabilities and expenses of that Fund, to acquire investments to further the business of the Fund or as distributions when solvency and capital adequacy requirements are met.

(aa) Dividends

Provision is made for the amount of any dividend declared, determined or publicly recommended by the Directors of Challenger on or before the end of the financial year but not distributed at balance date.

(bb) Tax consolidation

Challenger and its wholly owned Australian subsidiaries intend to form a tax consolidation group in terms of the tax consolidation legislation. Whilst the Minister for Revenue and Assistant Treasurer of the Commonwealth Government, Senator Helen Coonan, announced in March 2003 that legislation allowing a corporate unit trust to be the head entity of a tax consolidated group was to be introduced as soon as is practical, this legislation has not been substantively enacted. Given this, the financial effect of the forming of a tax consolidation group has not been recognised in these financial statements. The Group intends to enter into a tax-sharing agreement but the details of this agreement are not yet finalised.

(cc) Rounding of amounts

The consolidated entity is of a kind referred to in Class Order 98/0100, issued by the Australian Securities and Investments Commission, relating to the rounding of amounts in the financial report. Amounts in the financial report have been rounded off in accordance with the class order to the nearest thousand dollars, or in certain cases, to the nearest dollar.

Note 2. Revenue from ordinary activities

	Consolidated
	Period from
	6 November to
	31 December
	2003
	\$000's
Rental income	5,978
Management fee income	4,203
Interest income	2,293
Change in net market value of investments held by Challenger Life	
– Trading securities	(690)
Net realised gains on sale of investments and subsidiaries	(18)
Other income	978
Revenue from ordinary activities	12,744

Note 3. Expenses from ordinary activities

Borrowing costs

Interest expense:

– incurred by property trusts controlled by Life Company subsidiaries	3,005
– incurred by other entities	631
	3,636

Expenses from ordinary activities, excluding borrowing costs

Property management expenses incurred by property trusts controlled by Life Company subsidiaries	687
Amortisation and depreciation	913
Employee expenses	2,339
Commission expense	2,495
Occupancy expense	285
Other expenses	1,465
	8,184
Total expenses from ordinary activities	11,820

Note 4. Equity securities

	Consolidated
	31 December
	2003
	\$000's
Shares in listed corporations	62,412
Unit trusts and managed funds	47,618
Shares in listed corporations held in relation to endowment warrants	72,359
Strategic equity investments	26,290
	208,679

Notes to the interim financial report (continued)

Note 5. Investment properties

	Acquisition date	Acquisition price	Total cost including additions	Carrying value*	Valuer	Date of latest valuation
		\$m	\$m	\$m		
Australia						
Commercial						
ABS Building, ACT	1-Jan-00	35.2	78.1	118.8	Colliers	Dec-03
Bird Cameron Building, WA	23-Nov-98	10.1	10.8	10.8	FPD Savills	Jun-03
County Court, VIC	30-Jun-00	153.7	186.4	239.6	CBRE	Jun-03
CSIRO, NSW	27-Jun-01	137.0	151.7	145.0	FPD Savills	Dec-03
Discovery House, ACT	28-Apr-98	30.6	32.9	35.0	Colliers	Dec-03
Elders House, SA	21-Jun-02	40.2	42.7	41.6	JLL	Jun-03
Executive Building, Hobart, TAS	30-Mar-01	20.7	21.5	23.2	M3	Jun-03
Globe, Port Melbourne, VIC	13-Nov-02	17.3	18.5	17.7	CKC	Jun-03
Goodman Fielder, North Ryde, NSW	23-Feb-01	35.2	35.3	42.6	DTZ	Dec-03
Heidelberg, Bowen Hills, NSW & QLD	7-Jan-00	14.8	15.7	16.8	DTZ	Dec-03
Kraft, Port Melbourne, VIC	28-Jun-02	24.1	25.7	24.8	CKC	Jun-03
Makerston, QLD	14-Dec-00	38.0	39.7	42.5	CBRE	Jun-03
Mobil House, VIC	27-Jun-02	73.0	73.9	74.4	CKC	Jun-03
Rexel, North Ryde, NSW	18-Dec-99	15.1	16.0	18.4	FPD Savills	Dec-03
Taylor's Institute, Waterloo, NSW	16-May-01	35.0	37.1	38.5	M3	Jun-03
The Forum, Cisco, NSW	5-Jan-01	96.0	101.4	102.7	FPD Savills	Dec-03
The Forum, UUNet, NSW	5-Jan-01	61.0	65.8	65.0	FPD Savills	Dec-03
Vodafone, Kingston, TAS	19-Mar-99	11.9	12.8	13.8	M3	Jun-03
Sub-sector Commercial Total		848.9	966.0	1,071.2		
Entertainment						
Albury Cinema Complex	4-Jul-00	5.1	5.0	5.8	M3	Jun-03
Century City Walk, VIC	4-Jul-00	24.1	22.4	23.8	M3	Dec-03
Innaloo Cinema Centre, WA	17-Dec-01	20.3	22.9	23.8	FPD Savills	Jun-03
Jam Factory, VIC	4-Jul-00	74.9	88.9	105.5	M3	Dec-03
Rivoli, VIC	4-Jul-00	12.7	13.7	20.0	M3	Dec-03
Village City Centre, VIC	4-Jul-00	21.2	23.3	24.9	M3	Jun-03
Village Geelong, VIC	4-Jul-00	7.7	7.7	8.2	M3	Jun-03
Village Hobart, TAS	4-Jul-00	10.0	11.1	12.0	M3	Jun-03
Village Hoyts Cinema Centre, NSW	4-Jul-00	68.5	69.9	79.0	M3	Jun-03
Village Launceston, TAS	4-Jul-00	2.0	2.2	2.6	M3	Jun-03
Sub-sector Entertainment Total		246.5	267.1	305.6		

	Acquisition date	Acquisition price \$m	Total cost including additions \$m	Carrying value* \$m	Valuer	Date of latest valuation
Industrial						
Toll Drive, Altona North, VIC	31-Jan-01	18.9	20.0	20.0	CKC	Jun-03
API, Richlands, QLD	29-Dec-99	10.5	11.0	10.9	CBRE	Jun-03
Auto Group, Enfield, NSW	17-Feb-99	15.6	16.6	20.6	FPD Savills	Dec-03
Elders Woolstore, Gillman, SA	25-Jun-99	8.1	8.1	10.4	JLL	Jun-03
Spicers, Cannington, WA	29-Dec-99	7.3	7.8	8.0	FPD Savills	Jun-03
Spotlight, Laverton North, VIC	11-May-00	12.1	12.9	13.3	CKC	Jun-03
Tetra Pak, Fairfield, NSW	15-May-02	17.4	18.5	18.7	FPD Savills	Dec-03
Tyco, QLD	1-Dec-00	6.5	6.8	6.5	Landmark White	Jun-03
Wesfarmers Woolstore, Brooklyn, VIC	28-May-99	26.3	28.0	29.0	CKC	Jun-03
CPI Braeside, VIC (JV)	29-Dec-99	6.4	6.4	5.8	M3	Jun-03
CPI Wetherill Park, NSW (JV)	29-Dec-99	4.5	4.5	3.9	Chesterton	Jun-03
Sub-sector Industrial Total		133.6	140.6	147.1		
Retail						
Chapel Street Air Rights, VIC	15-May-01	6.0	6.0	12.9	M3	Jun-03
Kings Langley, NSW	29-Jul-01	14.1	14.6	14.9	M3	Jun-03
Sub-sector Retail Total		20.1	20.6	27.8		
Development						
DIMIA Building, ACT		43.4	76.4	70.8	Colliers	Jun-03
Sub-sector Development Total		43.4	76.4	70.8		
Total Australia		1,292.5	1,470.7	1,622.5		
United Kingdom						
3 World Business Centre, Heathrow	22-Mar-02	58.0	59.5	61.7	Knight Frank	Dec-03
Hayes Park	8-Oct-01	175.4	178.4	166.1	Knight Frank	Dec-03
Minster Court (50%)	7-Jul-01	204.0	206.8	205.8	CB Hillierparker	Jun-03
Senator House	3-May-01	198.4	202.8	195.3	CB Hillierparker	Jun-03
Sub-sector UK Total		635.8	647.5	628.9		
United States						
Las Cimas II & III, USA	15-Jul-02	80.1	85.0	85.1	C&W	Jun-03
50 Milk Street, Boston, USA	15-Oct-02	145.3	148.8	144.5	CBRE	Dec-03
Invesco, Denver, USA	31-Dec-02	76.8	77.8	77.9	CBRE	Dec-03
Sub-sector USA Total		302.2	311.6	307.5		
Grand Total		2,230.5	2,429.8	2,558.9		

Notes to the interim financial report (continued)

Note 5. Investment properties (continued)

* The carrying value of all properties reflects their latest independent valuation with the exception of the following properties:

	Independent valuation	Capitalised costs subsequent to valuation	Carrying value 31/12/03
	\$m	\$m	\$m
DIMIA Building, ACT	65.1	5.7	70.8
Village City Centre, VIC	24.8	0.1	24.9
	89.9	5.8	95.7

Qualifications of valuers

The Valuer or Valuation Practice are authorised to practice as a Valuer under the law of the relevant jurisdiction where the valuation takes place. The Valuer performing the valuation has at least five years of continuous experience in the valuation of property of a similar type to the property being valued. Neither the Valuer nor Valuation Practice has a pecuniary interest that could conflict with the valuation of the property. The Valuer and Valuation Practice comply with the Australian Property Institute (API) Code of Ethics and Rules of Conduct.

Methodology

Valuations are prepared on the basis of Market Value as defined by The International Assets Valuation Standards Committee (TIAVSC) and endorsed by the API, being:

Market value is the estimated amount for which an asset could exchange on the date of valuation between a willing buyer and willing seller in an arm's length transaction after property marketing costs wherein the parties had each acted knowledgeably, prudently and without compulsion.

In determining Market value, Valuers have examined available market evidence and applied this analysis to both the traditional capitalisation approach and discounted cash flow approach.

Note 6. Intangible assets

	Consolidated 31 December 2003
	\$000's
Goodwill	401,953
	401,953
Note 7. Other assets	
Deferred portfolio and origination costs	115,765
Prepayments	8,819
Other	8,627
	133,211

Note 8. Payables

	Consolidated 31 December 2003
	\$000's
Trade creditors and accruals	161,778
Warrant liability	30,362
Other creditors	21,610
	213,750

Note 9. Interest bearing liabilities

31 December 2003

	Outstanding	Facility	Unused
	\$000's	\$000's	\$000's
Bank loans			
– Corporate	85,000	100,000	15,000
– Interstar	125,785	150,000	24,215
– Controlled property trusts	1,181,960	1,195,286	13,326
Total bank loans	1,392,745	1,445,286	52,541
Non-bank loans			
– Controlled property trusts	502,000	502,000	–
– Share finance	148,500	250,000	101,500
– Corporate	65,000	65,000	–
Total non-bank loans	715,500	817,000	101,500
Lease liabilities	3,332	3,332	–
Total secured liabilities	2,111,577	2,265,618	154,041

Security for borrowings

The corporate banking and Interstar facility amounting to \$100,000,000 and \$150,000,000 respectively are secured by fixed and floating charges granted by Challenger and Iroka Pty Limited and an Equitable Mortgage of Shares over the shares in Howard Mortgage Management Limited granted in favour of ANZ Banking Group Limited. In addition, there are cross guarantees in place between certain Group companies.

Further bank loans and non-bank loans in the controlled entities are secured solely by first mortgages over properties. The remaining non-bank loans, \$148,500,000, in relation to the margin lending business are secured over shares.

Lease liabilities are effectively secured as the rights to the leased asset revert to the lessor in the event of default.

Interest on loan facilities accrues at a floating interest rate based on market rates plus a margin of between 0.5% and 1.65% per annum.

Notes to the interim financial report (continued)

Note 10. Life insurance business

(a) Actuarial policies and methods

The amount of policy liabilities has been determined in accordance with methods and assumptions disclosed in this financial report and with the standards of the Life Insurance Actuarial Standards Board (LIASB) under section 114 of the Life Act.

Policy liabilities

These amounts, together with future premiums and investment earnings, are required to:

- (i) meet the payment of future benefits and expenses; and
- (ii) provide for future profits.

The policy liabilities have been calculated using the Margin on Services (MoS) method in accordance with the requirements of Actuarial Standard 1.03 'Valuation of Policy Liabilities' under section 114 of the Life Insurance Act 1995. The Actuarial Standard requires the policy liabilities to be calculated in a manner that allows for the systematic release of planned margins as services are provided to policyholders and premiums are received.

The methods and profit carriers for particular policy types are as follows:

Business type	Method (projection or other)	Profit carrier
Individual		
Investment linked	Accumulation	–
Investment account	Projection and accumulation	Account balance
Annuity	Projection	Interest on annuity account balance
Allocated pension	Projection	Account balance

Investment earnings/discount rate

The expected future earnings rate is used as the discount rate. The assumption is based on the proportion of the fund that each asset sector represents. Expected earnings rates for each sector are then applied to these proportions with an appropriate allowance for tax dependent on the class of the business being valued. The expected earnings rates are reviewed annually for changes in the market environment. Where the products being valued are matched by a fixed interest portfolio, the earnings rate is determined with reference to the actual yield to maturity of those assets.

Maintenance expenses

The assumption is based on budgeted maintenance expenses for the year ending 30 June 2004. These expenses are converted to a per policy unit cost based on an expense analysis for each fund.

Inflation

The assumption is based on long-term expectations of inflation and is reviewed annually for changes in the market environment. The current assumption is 2.5% p.a.

Voluntary discontinuances

The assumption is based on an investigation of recent experience. The current assumption range is 0.5% to 5.0%.

Surrender values

Current and future surrender values have been calculated using the surrender bases under the products. Where appropriate, surrender values have taken into account the requirements of AS 4.02 'Minimum Surrender Values and Paid Up Values' standard issued by the LIASB.

Mortality – annuity products

The mortality assumption is based on IM/IF90 (mortality tables developed by the Institute of Actuaries and the Faculty of Actuaries based on United Kingdom annuitant lives experience from 1990 to 1992) and adjusted for future mortality improvements.

Shareholder tax

Tax has been projected in a manner consistent with the new tax environment applying from 30 June 2000.

The corporate tax rates of 30% have been used.

Solvency position of the life insurers

These are amounts required to meet the prudential standards specified by the Life Insurance Act 1995 to provide protection against the impact of fluctuations and unexpected adverse circumstances on the Company.

The methodology and bases for determining Solvency Requirements are in accordance with the requirements of Actuarial Standard 2.03 Solvency Standard and 6.02 Management Capital Standard under section 65 of the Life Insurance Act 1995.

As at 31 December 2003, the statutory funds of Challenger Life Limited and Challenger Life No. 2 Limited satisfied the requirements of the solvency standard.

(b) Policyholder liabilities

	Consolidated 31 December 2003
	\$000's
Policy liabilities	1,926,222
Made up of:	
Value of future policy benefits	1,803,559
Value of future expenses	100,856
Planned margins of revenues over expenses	21,807
	1,926,222

Notes to the interim financial report (continued)

Note 11. Shares on Issue

(a) Shares on issue

	Consolidated and parent entity	Consolidated and parent entity
	2003 Shares	2003 \$000's
Fully paid shares	2,439,035,735	1,140,521
(b) Movement in shares on issue		
Fully paid shares		
Opening balance	–	–
Issue of shares on incorporation	1	–
Issue of shares as part of corporatisation equity restructure	2,439,035,734	1,140,521
Closing balance	2,439,035,735	1,140,521

Terms and conditions of shares

A holder of a share is entitled to certain rights, including rights:

- (a) to benefit from dividends;
- (b) to be provided with copies of annual reports and other information in respect of the company;
- (c) to receive notice of, and vote at, meetings of holders of shares;
- (d) after liquidation of the company, to receive the distribution of the net proceeds of company assets according to the number of shares registered at liquidation;
- (e) to transfer shares and, on death, to pass the shares to a surviving joint holder, or by will or otherwise to the holder's estate.

A holder of a share is entitled to one vote on a show of hands and on a poll, each shareholder will have one vote for each dollar of the total value of shares, determined from the sale of such shares on the ASX on the trading day immediately before the day on which the poll is taken.

Note 12. Reserves

	Consolidated 31 December 2003
	\$000's
Equity option premium reserve	61,700
	61,700
Movements in reserves	
Equity option premium reserve	
Opening balance	–
Issue of options to previous option holders of Challenger Financial Services Group	1,700
Issue of options to related party as part of corporatisation equity restructure*	60,000
Closing balance	61,700
* Represents non-transferable call options over ordinary shares of Challenger that have been issued to Consolidated Press Holdings Limited.	
Nature and purpose of reserves	
Equity option premium reserve	
Represents the valuation assigned to options that were issued as a result of the restructure of the Parent Entity.	
Note 13. Retained profits	
Opening balance	–
Net profit	697
Balance at the end of the period	697
Note 14. Non-cash financing and investing activities	
Acquisition of Challenger Financial Services Group:	
– Acquisition of units in Challenger Financial Services Group	(1,146,347)
– Issuance of Challenger shares to unitholders of Challenger Financial Services Group	1,140,521
– Issuance of non-transferable call options over ordinary shares	60,000
– Issuance of options to previous option holders in Challenger Financial Services Group	1,700
	55,874

Notes to the interim financial report (continued)

Note 15. Acquisition of controlled entities

31 December 2003

Name	Date acquired	Consolidated entity's interest %	Consideration \$'000
Challenger Financial Services Group and its controlled entities	22-Dec-03	100	1,146,347

Challenger was incorporated on 6 November 2003. On 22 December 2003, the unitholders of Challenger Financial Services Group (CFSG) approved a restructure of CFSG involving the corporatisation of CFSG.

Under the restructure, CFSG unitholders exchanged their units for Challenger shares (on a one for one basis) and Challenger became the sole holder of CFSG units. Challenger was admitted to the official list of the ASX on 23 December 2003.

As a result of the restructure of CFSG:

- the Chief Executive Officer entered into an employment contract with Challenger, the material terms of which were disclosed as part of the restructure information;
- Challenger issued to Consolidated Press Holdings Limited 300 million non-transferable call options over unissued shares with an exercise price of \$0.65 and a 10-year term;
- a long term equity-based incentive plan for senior executives of Challenger was approved; and
- the issue of 40 million Challenger shares to the Chief Executive Officer was approved which were disclosed as part of the restructure information.

Note 16. Segment information

The primary business segments of the Group have been identified as follows:

Period ended 31 December 2003

	Annuities \$000's	Mortgage finance \$000's	Funds management** \$000's	Corporate* \$000's	Total consolidated \$000's
Segment revenue	8,252	2,078	1,801	613	12,744
Segment result	598	151	131	168	1,048

* Corporate segment relates to non-core activities of the Group, including businesses to be restructured or sold as previously announced to the ASX.

** Represents Funds management, administration and financial planning.

Note 17. Earnings per share

	Consolidated 31 December 2003
	Cents
Basic earnings per share	0.03
Diluted earnings per share	0.03

	Consolidated 31 December 2003
	Number
Weighted average number of shares used as the denominator	
Used as the denominator in calculating basic earnings per share	2,439,035,735

	Consolidated 31 December 2003
	\$000's
Reconciliations of earnings used in calculating earnings per share	
Earnings used in calculating diluted earnings per share	697
Earnings used in calculating basic earnings per share	697

Note 18. Events occurring after reporting date

On 22 January 2004, 40,000,000 shares in Challenger were issued to the Chief Executive Officer at a price of \$0.53 per share pursuant to the terms of the corporatisation restructure.

Note 19. Contingent liabilities

A controlled entity, Challenger Property Nominees Pty Limited, has received an amended assessment of stamp duty in connection with the acquisition of an interest in a property at 417 St Kilda Road, Melbourne of \$5,362,002. Based on legal advice received, the Directors do not consider that any stamp duty is payable on the transaction and are in the process of commencing litigation in respect of the assessment.

A controlled entity, Challenger Property Nominees Pty Limited, has received an assessment of stamp duty in connection with the acquisition of an interest in a property at ABS House, Belconnen of \$4,233,649. Based on legal advice received, the Directors do not consider that any stamp duty is payable on the transaction and are in the process of lodging an objection to the assessment.

Directors' declaration

In the opinion of the Directors of Challenger Financial Services Group Limited:

- (a) the financial statements and notes of the consolidated entity:
 - (i) give a true and fair view of the financial position as at 31 December 2003 and the performance for the period ended on that date of the consolidated entity; and
 - (ii) comply with Accounting Standard AASB 1029 'Interim Financial Reporting' and the Corporations Regulations 2001.
- (b) there are reasonable grounds to believe that the company will be able to pay its debts as and when they become due and payable.

This declaration is made in accordance with a resolution of the Directors of Challenger Financial Services Group Limited.



GA Cubbin
Director



CE Cuffe
Director

Sydney 20 February 2004

Independent review report to members of Challenger Financial Services Group Limited

Scope

The financial report and directors' responsibility

The financial report comprises the statement of financial position, statement of financial performance, statement of cash flows and accompanying notes to the financial statements for the consolidated entity comprising both Challenger Financial Services Group Limited (the company) and the entities it controlled during the period, and the directors' declaration for the company, for the period ended 31 December 2003.

The directors of the company are responsible for preparing a financial report that gives a true and fair view of the financial position and performance of the consolidated entity, and that complies with Accounting Standard AASB 1029 "Interim Financial Reporting", in accordance with the Corporations Act 2001. This includes responsibility for the maintenance of adequate accounting records and internal controls that are designed to prevent and detect fraud and error, and for the accounting policies and accounting estimates inherent in the financial report.

Review approach

We conducted an independent review of the financial report in order to make a statement about it to the members of the company, and in order for the company to lodge the financial report with the Australian Stock Exchange and the Australian Securities and Investments Commission.

Our review was conducted in accordance with Australian Auditing Standards applicable to review engagements, in order to state whether, on the basis of the procedures described, anything has come to our attention that would indicate that the financial report is not presented fairly in accordance with the Corporations Act 2001, Accounting Standard AASB 1029 "Interim Financial Reporting" and other mandatory financial reporting requirements in Australia, so as to present a view which is consistent with our understanding of the consolidated entity's financial position, and of its performance as represented by the results of its operations and cash flows.

A review is limited primarily to inquiries of company personnel and analytical procedures applied to the financial data. These procedures do not provide all the evidence that would be required in an audit, thus the level of assurance is less than given in an audit. We have not performed an audit and, accordingly, we do not express an audit opinion.

Independence

We are independent of the company, and have met the independence requirements of Australian professional ethical pronouncements and the Corporations Act 2001. In addition to our review of the financial report, we were engaged to undertake other non-audit services. The provision of these services has not impaired our independence.

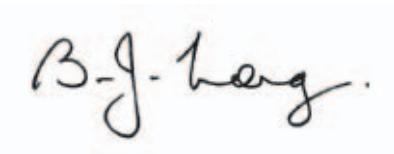
Statement

Based on our review, which is not an audit, we have not become aware of any matter that makes us believe that the financial report of the consolidated entity, comprising Challenger Financial Services Group Limited and the entities it controlled during the period is not in accordance with:

- (a) the Corporations Act 2001, including:
 - (i) giving a true and fair view of the financial position of the consolidated entity at 31 December 2003 and of its performance for the period ended on that date; and
 - (ii) complying with Accounting Standard AASB 1029 “Interim Financial Reporting” and the Corporations Regulations 2001; and
- (b) other mandatory financial reporting requirements in Australia.



Ernst & Young



B J Long
Partner
Sydney
20 February 2004

Challenger Financial Services Group

and its controlled entities

ARSN 091 545 185

Interim Financial Report

For the period ended 21 December 2003

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Directors' report

Challenger Managed Investments Limited (CMIL), the Responsible Entity of Challenger Financial Services Group (CFSG), presents its report together with the financial statements of CFSG and its controlled entities (the Group) for the period ended 21 December 2003. The names of the Directors of the Responsible Entity holding office during the period beginning 1 July 2003 until the date of this report are:

Robert William Adams	(appointed 09/7/2003)
Martin Alan Ashe	(resigned 03/7/2003)
Blair Wellington Beaton	(resigned 03/7/2003)
Brian Roland Benari	(appointed 03/7/2003)
Christopher Edgar Cuffe	(appointed 03/7/2003)
Timothy Harrison Foster	(appointed 03/7/2003)
Stephen John Gilsenan	(resigned 03/7/2003)

Principal activities

Prior to the June 2003 acquisition of Challenger Group Holdings Limited (CIL), (formerly Challenger International Limited), by CPH Management Limited, as Responsible Entity of CFSG, the principal activity of CFSG was pursuing investment opportunities which the Responsible Entity considered to be undervalued.

As a result of the acquisition, the principal activities of CFSG have expanded to include the provision of financial services, in particular:

- Annuities;
- Mortgage finance; and
- Funds management, administration and financial planning.

Review and results of operations

Net profit after tax for the period ended 21 December 2003 was \$32,607,000 (half-year ended 31 December 2002: \$14,150,000).

State of affairs

On 27 June 2003, CFSG assumed control of CIL by way of merger. Per the schemes of arrangement approved by CFSG unitholders and shareholders of CIL, the shareholders of CIL received 4.5 units per CIL share. Following the acquisition of CIL, \$235 million was injected into CIL's life insurance entities.

On 1 September 2003, an agreement was reached with Zurich Capital Markets to acquire the assets of their Australian Principal Finance Business. On 29 September 2003, this acquisition was completed which resulted in the acquisition of 100% of the issued capital of Interstar Securities (Australia) Pty Limited (Interstar), one of Australia's largest independent and privately held mortgage financiers, for \$87.5 million, together with a high yield fixed interest portfolio for \$46.3 million. An agreement was also entered into to acquire 84,500 hectares of forestry assets, for \$54 million, on a 12 month deferred settlement basis. The details of this acquisition have been disclosed in note 6 to the financial statements.

On 16 December 2003, the securities of CFSG were suspended from quotation on the ASX. This suspension was at the request of CFSG to facilitate a restructure of CFSG involving the corporatisation of CFSG. Accordingly, on 16 December 2003, CFSG ceased to be a disclosing entity as defined by the Corporations Act 2001. On 22 December 2003, the unitholders of CFSG approved the restructure.

Further detail in relation to the restructure of CFSG is disclosed in the section of this report titled 'Subsequent events' and note 10 to the financial statements.

Apart from the matters noted above, there have been no other significant changes to the state of affairs of CFSG, other than those changes identified in the financial statements for the period ended 21 December 2003.

Subsequent events

On 22 December 2003, the unitholders of CFSG approved a restructure of CFSG involving the corporatisation of CFSG.

In accordance with the approval, the following transactions occurred subsequent to balance date:

- the issue of five units in CFSG to Challenger Financial Services Group Limited (Challenger), the new ultimate holding company under the corporatisation proposal;
- redemption of all units in CFSG other than the five units issued to Challenger in consideration for the issue to CFSG unitholders of the same number of shares in Challenger;
- the payment by CFSG to CPH Management Limited (CPHML) of \$96 million for CPHML agreeing to retire as Responsible Entity and terminating the Investment Management Agreement;
- the payment by Consolidated Press Holdings Limited (CPH) to CFSG of \$36 million to acquire CFSG's interest in Jurlique, a CFSG private equity investment;
- the payment by CPH to Challenger of \$60 million to acquire 300 million non-transferable call options over shares in Challenger with an exercise price of \$0.65 and a 10-year term; and
- the retirement of CPHML as the Responsible Entity of CFSG; and
- the appointment of CMIL, a wholly owned subsidiary of Challenger, as the Responsible Entity of CFSG.

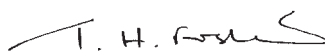
Rounding

The amounts contained in this report and in the financial statements have been rounded off under the option available to CFSG under ASIC class order 98/0100. CFSG is an entity to which the class order applies.

Signed in accordance with a resolution of the Directors of the Responsible Entity:



CE Cuffe
Director



TH Foster
Director

Sydney 20 February 2004

Statement of financial performance

For the period from 1 July 2003 to 21 December 2003

		Consolidated	
		Period ended 21 December 2003 \$000's	Half-year ended 31 December 2002 \$000's
	Notes		
Revenue from ordinary activities	2	371,786	20,222
Expenses from ordinary activities	3	(254,471)	(4,033)
Borrowing costs	3	(70,700)	(423)
Share of net profits of associates accounted for using the equity method		2,405	2,525
Profit from ordinary activities before income tax expense		49,020	18,291
Income tax expense		(16,413)	(4,141)
Net profit attributable to unitholders after tax from ordinary activities		32,607	14,150
Net increase/(decrease) in asset revaluation reserve		–	(4,108)
Total revenues, expenses and valuation adjustments attributable to unitholders		–	(4,108)
Total changes in unitholder funds from non-unitholder transactions		32,607	10,042
Basic and diluted earnings cents per unit	8	1.3	1.5

The above statement of financial performance should be read in conjunction with the accompanying notes.

Statement of financial position

As at 21 December 2003

	Notes	Consolidated	
		21 December 2003 \$000's	30 June 2003 \$000's
Assets			
Cash assets		347,879	660,421
Receivables		251,674	243,591
Debt securities		1,158,398	846,237
Other financial assets		25,080	19,645
Equity securities		213,956	229,452
Investment properties		2,558,902	2,613,851
Fixed assets		10,812	10,820
Land and plantation timber		54,000	–
Deferred tax assets		26,090	29,279
Investment in associates		49,923	47,416
Intangible assets	4	427,289	278,461
Other assets		136,498	11,282
Excess of net market value of the interests of Challenger Life Limited in its subsidiaries over their net assets		375,453	375,371
Total assets		5,635,954	5,365,826
Liabilities			
Payables		205,733	223,099
Current tax liabilities		4,458	4,601
Interest bearing liabilities		2,111,577	2,023,361
Provisions		44,437	34,095
Deferred tax liabilities		106,272	69,867
Life insurance policy liabilities		1,926,222	1,806,155
Total liabilities		4,398,699	4,161,178
Net assets		1,237,255	1,204,648
Unitholders' funds			
Units on issue		1,140,502	1,140,502
Reserves		25,012	25,012
Undistributed income	5	71,741	39,134
Total unitholders' funds		1,237,255	1,204,648

The above statement of financial position should be read in conjunction with the accompanying notes.

Statement of cash flows

For the period from 1 July 2003 to 21 December 2003

	Consolidated	
	Period ended 21 December 2003 \$000's	Half-year ended 31 December 2002 \$000's
Cash flows from operating activities		
Receipts from customers (inclusive of GST)	585,160	18
Payments to suppliers and employees (inclusive of GST)	(483,251)	(4,665)
Dividends received	11,609	327
Interest received	44,289	10,102
Borrowing costs	(75,265)	–
Income taxes paid	(6,712)	(10,647)
Other	–	116
Net cash inflow/(outflow) from operating activities	75,830	(4,749)
Cash flows from investing activities		
Purchase of investments	(319,809)	(190,354)
Payment for purchases of controlled entities, net of cash acquired	(122,960)	–
Purchase of fixed assets	(1,547)	–
Capitalised acquisition costs paid	(11,551)	–
Proceeds from sale of investments	50,281	158,049
Net cash outflow from investing activities	(405,586)	(32,305)
Cash flows from financing activities		
Proceeds from borrowings	46,318	–
Repayment of borrowings	(47,776)	(30,003)
Net cash outflow from financing activities	(1,458)	(30,003)
Net decrease in cash held	(331,214)	(67,057)
Cash at the beginning of the financial period	660,421	390,641
Prior year reclassification of cash held by controlled property trusts	19,344	–
Effects of exchange rate changes on cash	(672)	–
Cash at the end of the financial period	347,879	323,584

The above statement of cash flows should be read in conjunction with the accompanying notes.

Notes to the interim financial report

Note 1. Summary of significant accounting policies

This interim financial report is a general purpose financial report that has been prepared in accordance with the requirements of the CFSG Constitution (as amended), Accounting Standard AASB 1029 'Interim Financial Reporting', the recognition and measurement requirements of applicable AASB standards, Urgent Issues Group Consensus Views and other authoritative pronouncements of the Australian Accounting Standards Board and the Corporations Act 2001.

The interim financial report does not include full note disclosures of the type normally included in the annual financial report, and therefore cannot be expected to provide as full an understanding of the financial performance, financial position and financing and investing activities of the consolidated entity as the full financial report.

The interim financial report should be read in conjunction with the Annual Financial Report of CFSG as at 30 June 2003. It is also recommended that the interim financial report be considered together with any public announcements made by CFSG and its controlled entities during the period ended 21 December 2003 in accordance with the continuous disclosure obligations arising under the Corporations Act 2001.

The financial report is prepared in accordance with the historical cost convention except for all life insurance assets and liabilities and certain other assets and liabilities which are stated at valuation.

Unless otherwise stated, the accounting policies adopted are consistent with those applied in the 30 June 2003 Annual Report.

On 16 December 2003, the securities of CFSG were suspended from quotation on the ASX. This suspension was at the request of CFSG to facilitate a restructure of CFSG involving the corporatisation of CFSG. Accordingly, on 16 December 2003, CFSG ceased to be a disclosing entity as defined by the Corporations Act 2001. On 22 December 2003, the unitholders of CFSG approved the restructure.

As a result of the above noted corporatisation, the current period reported in the financial report is for the period ended 21 December 2003. Comparative information has been provided for the half-year ended 31 December 2002. This period is not consistent with the current period for which information has been reported, however, has been selected as it has previously been subject to audit review.

Certain comparative information has also been reclassified to conform with the disclosures reported in the current period.

The statement of financial position is presented in order of liquidity.

(a) Accounting policy of acquired entities

The following new accounting policy has been adopted subsequent to the acquisition of controlled entities during the financial period.

Deferred portfolio and origination costs

Portfolio costs represent expenses incurred in establishing mortgage backed pooled funds. Origination costs represent expenses incurred in originating mortgages for inclusion in the pooled funds.

Portfolio and origination costs incurred are recognised as an asset and subsequently amortised over the life of the future economic benefits expected to be received. Total deferred portfolio and origination costs are not carried at an amount above their recoverable amount.

Notes to the interim financial report (continued)

Note 2. Revenue from ordinary activities

	Period from 1 July to 21 December 2003	Half-year ended 31 December 2002
	\$000's	\$000's
Rental income	116,240	–
Management fee income	81,728	–
Interest income	44,590	10,171
Dividend income	14,862	–
Change in net market value of investments held by Life Company subsidiaries:		
– Properties (net of exchange fluctuations)	(587)	–
– Property valuation movement attributable to exchange fluctuations	(16,550)	–
– Interest rate swaps and forward foreign exchange contracts	102,330	–
– Trading securities	1,528	–
Net realised gains on sale of investments and subsidiaries	8,642	9,707
Other income	19,003	344
Revenue from ordinary activities	371,786	20,222

Note 3. Expenses from ordinary activities

Borrowing costs

Interest expense:

– Controlled property trusts	58,424	–
– Other entities	12,276	423
	70,700	423

Expenses from ordinary activities, excluding borrowing costs

Increase in net policy liabilities	96,689	–
Unrealised losses on investments	–	1,232
Responsible entity fee	3,366	1,838
Property management expenses incurred by property trusts controlled by Life Company subsidiaries	13,362	–
Amortisation and depreciation	17,774	–
Employee expenses	45,479	–
Commission expense	48,509	–
Occupancy expense	5,535	–
Other expenses	23,757	963
Total expenses from ordinary activities	325,171	4,456

Note 4. Intangible assets

The following provides a reconciliation of the movement in intangible assets from 30 June 2003 to 21 December 2003.

	21 December 2003
	\$000's
Balance as at 1 July 2003	278,461
Acquisition of controlled entities (refer note 6)	158,048
Amortisation during the period	(9,220)
Balance as at 21 December 2003	427,289

Note 5. Undistributed income

	21 December 2003	30 June 2003
	\$000's	\$000's
Opening balance	39,134	26,986
Net profit/(loss) from operating activities	32,607	21,323
Interim distribution	–	(9,175)
Balance at the end of the period	71,741	39,134

Note 6. Acquisition and disposal of controlled entities

The following controlled entities were acquired or disposed of during the period.

Acquisitions

Name	Date acquired	Consolidated entity's interest	Consideration
		%	\$'000
Zed Capital Markets Australia Structured Finance Pty Limited and its controlled entities*	29-Sep-03	100	133,815

* The controlled entities of Zed Capital Markets Australia Structured Finance Pty Limited included Interstar Securities (Australia) Pty Limited.

As part of the acquisition of Zed Capital Markets Australia Structured Finance Pty Limited and its controlled entities, the Group acquired a high yield fixed interest portfolio for \$46.3 million and entered into an agreement to acquire 84,500 hectares of forestry assets, for \$54 million, on a 12 month deferred settlement basis.

Disposals

Name	Date of disposal	Consolidated entity's interest	Consideration
		%	\$'000
Howard Finance Ltd and its controlled entity*	16-Dec-03	100	2,634

* The controlled entity of Howard Finance Ltd was Howard Leasing Limited.

Notes to the interim financial report (cont.)

Note 7. Segment Reporting

Period from 1 July to 21 December 2003

	Annuities	Mortgage finance	Funds management**	Corporate*	Total consolidated
	\$000's	\$000's	\$000's	\$000's	\$000's
Segment revenue	240,734	60,635	52,536	17,881	371,786
Segment result	59,610	13,396	(10,041)	(13,945)	49,020

* Corporate segment relates to non-core activities of the Group, including businesses to be restructured or sold as previously announced to the ASX.

** Represents Funds management, administration and financial planning.

The Group operated in one industry segment prior to the acquisition of Challenger Group Holdings Limited (CIL), (formerly Challenger International Limited), (which occurred on 27 June 2003), being the dealing with and the making of investments in securities. As a result, comparative information has not been provided.

Note 8. Earnings per unit

	Period ended 21 December 2003	Half-year ended 31 December 2002
	Cents	Cents
Basic earnings per unit	1.3	1.5
Diluted earnings per unit	1.3	1.5
	Number	Number
Weighted average number of units used as the denominator in calculating basic earnings per unit	2,439,035,735	917,522,392
	\$000's	\$000's
Earnings used in calculating basic earnings per unit	32,607	14,150

Note 9. Contingent liabilities

A controlled entity, Challenger Property Nominees Pty Limited, has received an amended assessment of stamp duty in connection with the acquisition of an interest in a property at ABS House, Belconnen of \$4,233,649. Based on legal advice received, the Directors do not consider that any stamp duty is payable on the transaction and intend to lodge an objection to the assessment.

There are no other changes to contingent liabilities to those disclosed in the 30 June 2003 Annual Report.

Note 10. Events occurring after reporting date

On 22 December 2003, the unitholders of CFSG approved a restructure of CFSG involving the corporatisation of CFSG.

In accordance with the approval, the following transactions occurred subsequent to balance date:

- the issue of five units in CFSG to Challenger Financial Services Group Limited (Challenger), the new ultimate holding company under the corporatisation proposal;
- redemption of all units in CFSG other than the five units issued to Challenger in consideration for the issue to CFSG unitholders of the same number of shares in Challenger;
- the payment by CFSG to CPH Management Limited (CPHML) of \$96 million for CPHML agreeing to retire as Responsible Entity and terminating the Investment Management Agreement;
- the payment by Consolidated Press Holdings Limited (CPH) to CFSG of \$36 million to acquire CFSG's interest in Jurlique, a CFSG private equity investment;
- the payment by CPH to Challenger of \$60 million to acquire 300 million non-transferable call options over shares in Challenger with an exercise price of \$0.65 and a 10 year term;
- the retirement of CPHML as the Responsible Entity of CFSG; and
- the appointment of CMIL, a wholly-owned subsidiary of Challenger, as the Responsible Entity of CFSG.

Directors' declaration

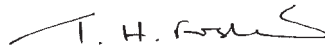
In the opinion of the Directors of the Responsible Entity of Challenger Financial Services Group:

- (a) the financial statements and notes of the consolidated entity:
 - (i) give a true and fair view of the financial position as at 21 December 2003 and the performance for the period ended on that date of the consolidated entity; and
 - (ii) comply with Accounting Standard AASB 1029 'Interim Financial Reporting' and the Corporations Regulations 2001; and
 - (iii) comply with the provisions of the Trust Constitution.
- (b) there are reasonable grounds to believe that Challenger Financial Services Group will be able to pay its debts as and when they become due and payable.

This declaration is made in accordance with a resolution of the Directors of Challenger Managed Investments Limited.



CE Cuffe
Director



TH Foster
Director

Sydney 20 February 2004

Independent review report to unitholders of Challenger Financial Services Group

Scope

The financial report and directors' responsibility

The financial report comprises the statement of financial position, statement of financial performance, statement of cash flows and accompanying notes to the financial statements for the consolidated entity comprising both Challenger Financial Services Group (the trust) and the entities it controlled during the period, and the directors' declaration for the trust, for the period ended 21 December 2003.

The directors of the Responsible Entity of the trust are responsible for preparing a financial report that gives a true and fair view of the financial position and performance of the consolidated entity, and that complies with Accounting Standard AASB 1029 "Interim Financial Reporting", in accordance with the Corporations Act 2001 and the trust's constitution. This includes responsibility for the maintenance of adequate accounting records and internal controls that are designed to prevent and detect fraud and error, and for the accounting policies and accounting estimates inherent in the financial report.

Review approach

We conducted an independent review of the financial report in order to make a statement about it to the unitholders of the trust.

Our review was conducted in accordance with Australian Auditing Standards applicable to review engagements, in order to state whether, on the basis of the procedures described, anything has come to our attention that would indicate that the financial report is not presented fairly in accordance with the Corporations Act 2001, Accounting Standard AASB 1029 "Interim Financial Reporting" other mandatory financial reporting requirements in Australia and the trust's constitution, so as to present a view which is consistent with our understanding of the consolidated entity's financial position, and of its performance as represented by the results of its operations and cash flows.

A review is limited primarily to inquiries of trust personnel and analytical procedures applied to the financial data. These procedures do not provide all the evidence that would be required in an audit, thus the level of assurance is less than given in an audit. We have not performed an audit and, accordingly, we do not express an audit opinion.

Independence

We are independent of the trust, and have met the independence requirements of Australian professional ethical pronouncements and the Corporations Act 2001. In addition to our review of the financial report, we were engaged to undertake other non-audit services. The provision of these services has not impaired our independence.

Statement

Based on our review, which is not an audit, we have not become aware of any matter that makes us believe that the financial report of the consolidated entity, comprising Challenger Financial Services Group and the entities it controlled during the period is not in accordance with:

- (a) the Corporations Act 2001, including:
 - (i) giving a true and fair view of the financial position of the consolidated entity at 21 December 2003 and of its performance for the period ended on that date; and
 - (ii) complying with Accounting Standard AASB 1029 “Interim Financial Reporting” and the Corporations Regulations 2001;
- (b) other mandatory financial reporting requirements in Australia; and
- (c) the trust’s constitution



Ernst & Young



B J Long
Partner
Sydney
20 February 2004

Challenger Financial Services Group Limited
and its controlled entities

Modified accounting for annuities

Modified accounting for annuities

Background paper on Modified Accounting

What is 'Modified Accounting'?

The 'Modified Accounting' methodology is an alternative, non-statutory method of accounting for Challenger Financial Services Group Limited's annuity business. The methodology applies accrual accounting principles to report the underlying 'spread' earned from the annuities business over the reported period. This 'spread' represents the difference between the yield on the investment assets and the interest and expenses incurred.

Why present the annuities result on a Modified Accounting basis?

Modified Accounting is presented to assist the market in understanding the business model and the underlying profitability of the annuity business. The statutory profits of the annuity business continues to be reported on the required 'Margin on Services' (MoS) basis.

Transparent/simple method of presentation

Challenger Financial Services Group Limited believes that Modified Accounting provides a transparent and simple method of presenting the annuities business that better reflects its business fundamentals:

- Term annuities are fundamentally a 'spread' business;
- Rent and interest income earned on assets is used to pay:
 - annuitant interest
 - senior debt interest (on leveraged property)
 - commissions
 - expenses;
- Resultant margin used to repay annuitant principal (akin to a compulsory 'dividend reinvestment plan').

Similarities to accounting for funds management and mortgage finance products

In addition, Modified Accounting provides a more comparable methodology with funds management and mortgage finance products which essentially are similar 'spread' products but which are accounted for in the historical cost environment where the underlying spread emerges in the profit and loss account.

Modified Accounting methodology

The methodology that Challenger has applied is consistent for income and expenses and may be summarised as follows:

Income

- Property net rentals (gross less outgoings) calculated under standard accrual accounting principles;
- Fixed interest income calculated as the 'running yield' at either:
 - last balance date; or
 - purchase date, if purchased in the period;
- Reported earnings include both earnings on assets directly backing liabilities plus earnings on excess assets held.

Interest expense

- Interest on senior debt at the effective interest rate on total debt (including swaps) at either:
 - last balance date, or
 - issue date, if debt is issued during the period;
- Interest on annuities at the market rates set at either:
 - last balance date, or
 - issue date, for annuities issued during the period.

Expenses

- Upfront commissions are amortised over the policy term on a straight line basis;
- Trailing commissions are expensed as incurred;
- Overhead expenses under normal accrual accounting principles. There is therefore no deferral of acquisition overhead expenses as is the case under MoS.

MoS limitations for Challenger's annuities business

- It appears to be more aligned to regular premium business;
- Challenger term annuities have a single premium and policy payments that (bar indexation) are fixed;
- Underlying spreads earned are potentially clouded under MoS by:
 - market value and discount rate fluctuations, and
 - spreading profit margin releases evenly.

International Accounting Standards

Challenger has a project in place to consider the impact of International Accounting Standards on the annuity business. While the introduction of International Accounting Standards is still evolving and further clarity is expected, Challenger believes that its Modified Accounting methodology has considered the direction that appears to be emerging under International Accounting Standards for term certain annuities.

In particular, it is expected that the majority of Challenger's annuities will be treated as 'investment' rather than 'insurance' contracts, which under current proposals would result in liabilities being accounted for at fair value. As such, under International Accounting Standards, it is likely that MoS accounting will cease to be the methodology for reserving and bringing profit margins to account.

Conclusion

Challenger's Modified Accounting methodology aims to provide the market with a more transparent basis to measure the performance of Challenger's annuities business. In addition to the operating margins emerging under Modified Accounting, Challenger provides shareholders with the opportunity to share in capital growth in property portfolios.

Modified accounting for annuities (continued)

Reconciliation of Modified Accounting to statutory Margin on Services (MoS) result

The key principles of MoS are:

- profit is determined through the valuation of policy liabilities;
- profit is recognised over the life of the policy in line with the services provided (annuity interest);
- policy liabilities represent best estimates of expected future net cash inflows or outflows plus the planned profit margin; discounted to present value;
- investments are valued at net market value with resultant change in value going through profit and loss account.

Reconciliation of Modified Accounting result for annuities to statutory result

	Notes	\$m	\$m
Modified result			22.3
• Acquisition expenses	1	5.1	
– Capitalised under MoS			
– Expensed in determining the modified result			
• Experience items not captured within the modified annuity result	2	0.8	
• Difference in annuity principal amortisation	3	(8.6)	
Subtotal of 'margins differences'			(2.7)
Statutory margins emerging			19.6
Market related movements (effect of changes in interest rates, forex rates and policyholder liability discount rates)	4		40.6
Total statutory result			60.2

Modified result/statutory result reconciliation

1. Under MoS both acquisition commissions and acquisition expenses are effectively deferred and amortised. Under Modified Accounting only acquisition commissions are deferred and amortised.
2. Experience items arise under MoS:
 - MoS reserves for planned future profit margins and as actual experience differs from, 'experience' items arise; while
 - Modified Accounting does not reserve for future profits and hence no deviations from 'expected' arise.
3. Very different treatment of amounts available to paydown annuity principal:
 - under Modified Accounting, accrual-based earnings are used to paydown principal; while
 - under MoS principal paydown is reported using the assumed asset earning rate.
4. Marked-to-market of investment assets not included under Modified Accounting but included under statutory basis. In this period it represents exchange and interest rates changes, policyholder discount changes and reconciles to the statutory result analysis presented to the market on 23 February 2003.

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