

# Challenger Financial Services Group Limited

Full Year Results to 30 June 2009

Dominic Stevens – Chief Executive Officer

24 August 2009



# Agenda

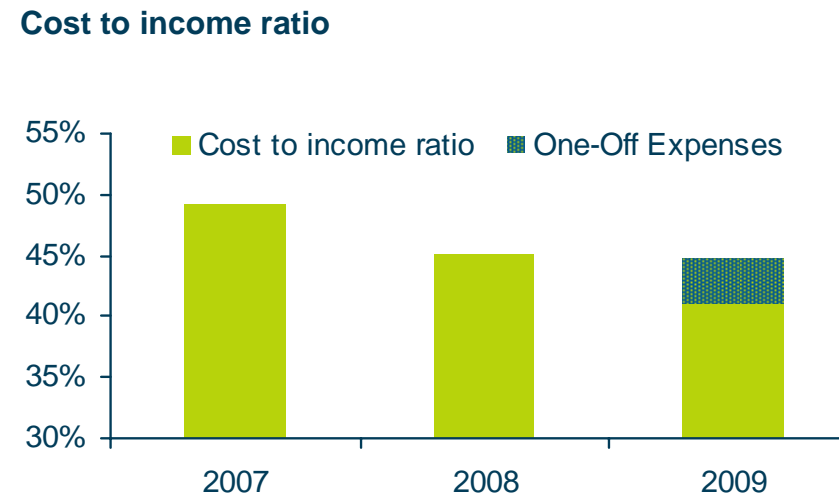
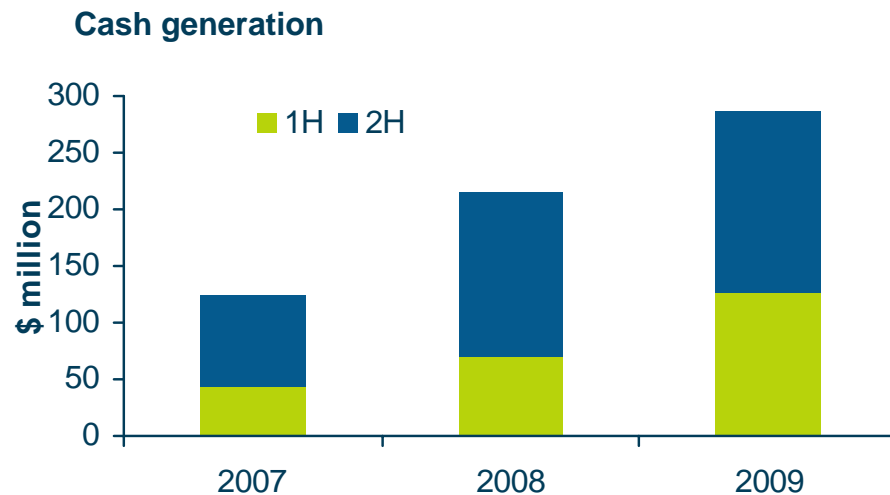
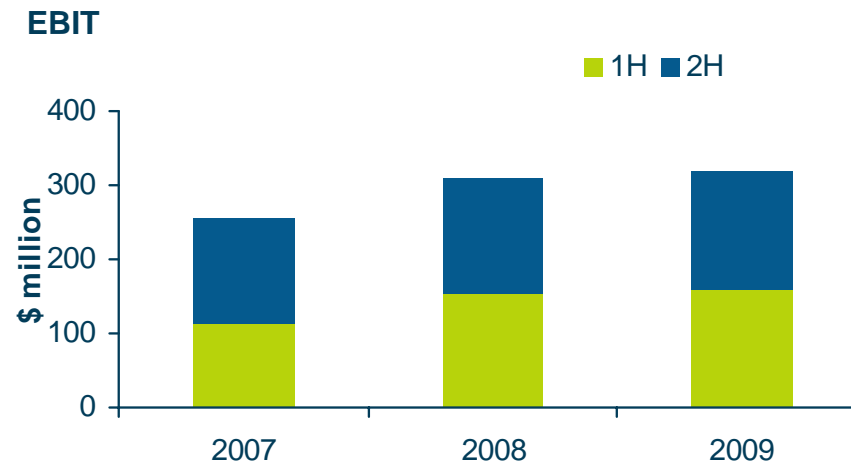
- Full Year 2009 results summary
- Impact of sales to NAB and Challenger Life
- Increased financial flexibility and capital
- Life and Funds opportunities
- Financial results including earnings/balance sheet impact of recent transactions
- Strategic outlook

# Robust full year financial performance

- Financial performance
  - Normalised EBIT of \$320m – up 3%
  - Normalised NPAT of \$219m – up 1%
  - Strong operating cash flow of \$287m – up 33%
  - FY09 Statutory NPAT of \$(91m) impacted by negative investment experience
  - Final dividend declared of 7.5 cps – unfranked
  - On-market buy-back continuing, 60% complete
- Capital excess to minimum regulatory requirements ~\$530m as at 30 June 2009
- Strategic decision to re-deploy capital supports future accretive growth
- Significant surplus cash position of ~\$350m and no net debt\*

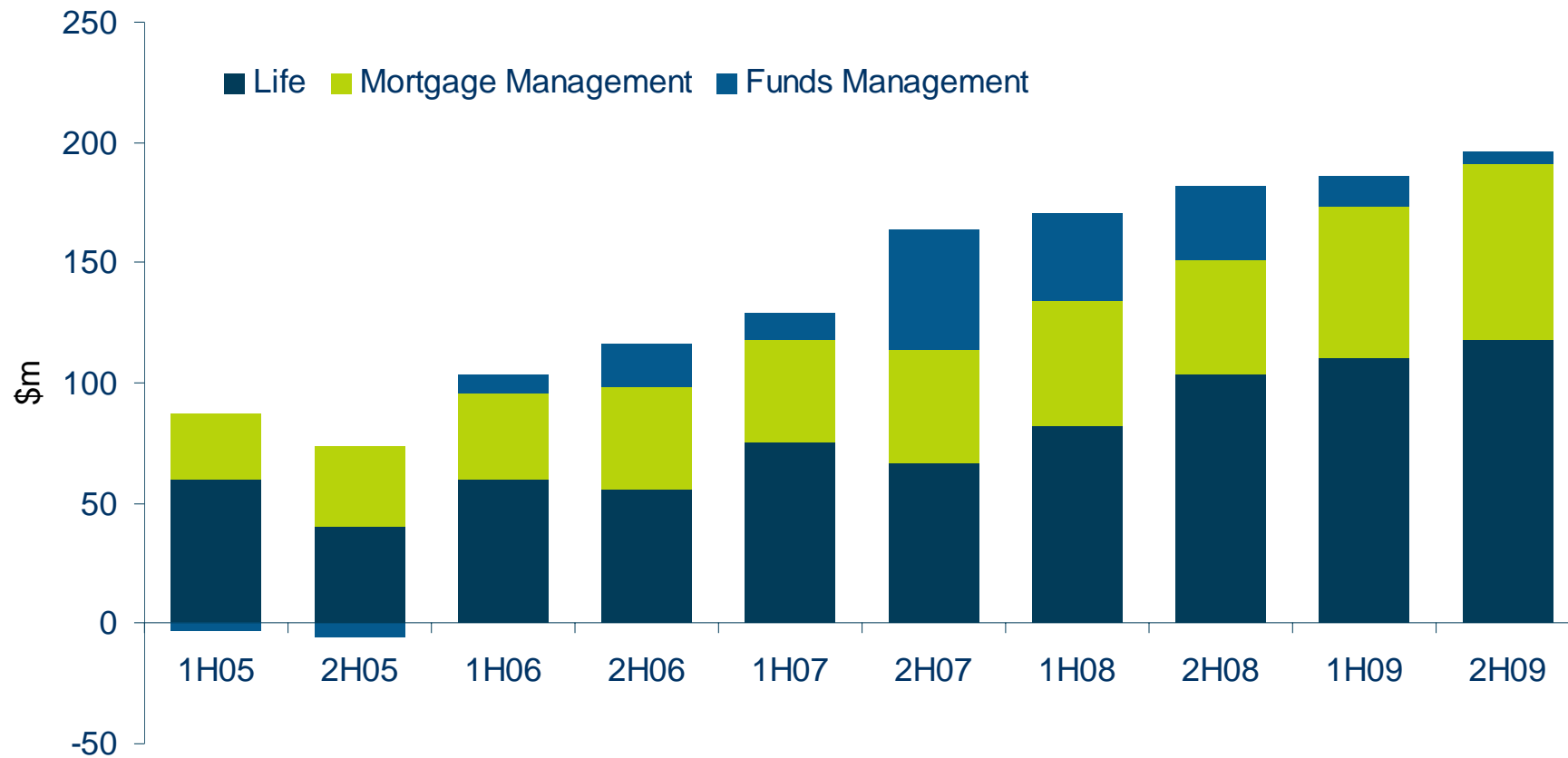
# 2009 financial performance

- Normalised EBIT up 3% over the prior year
- Driven by a strong focus on expense control – full run-rate of expense savings will continue to flow through in 2010
- Cash generation significantly increased



# 5 year long term financial performance

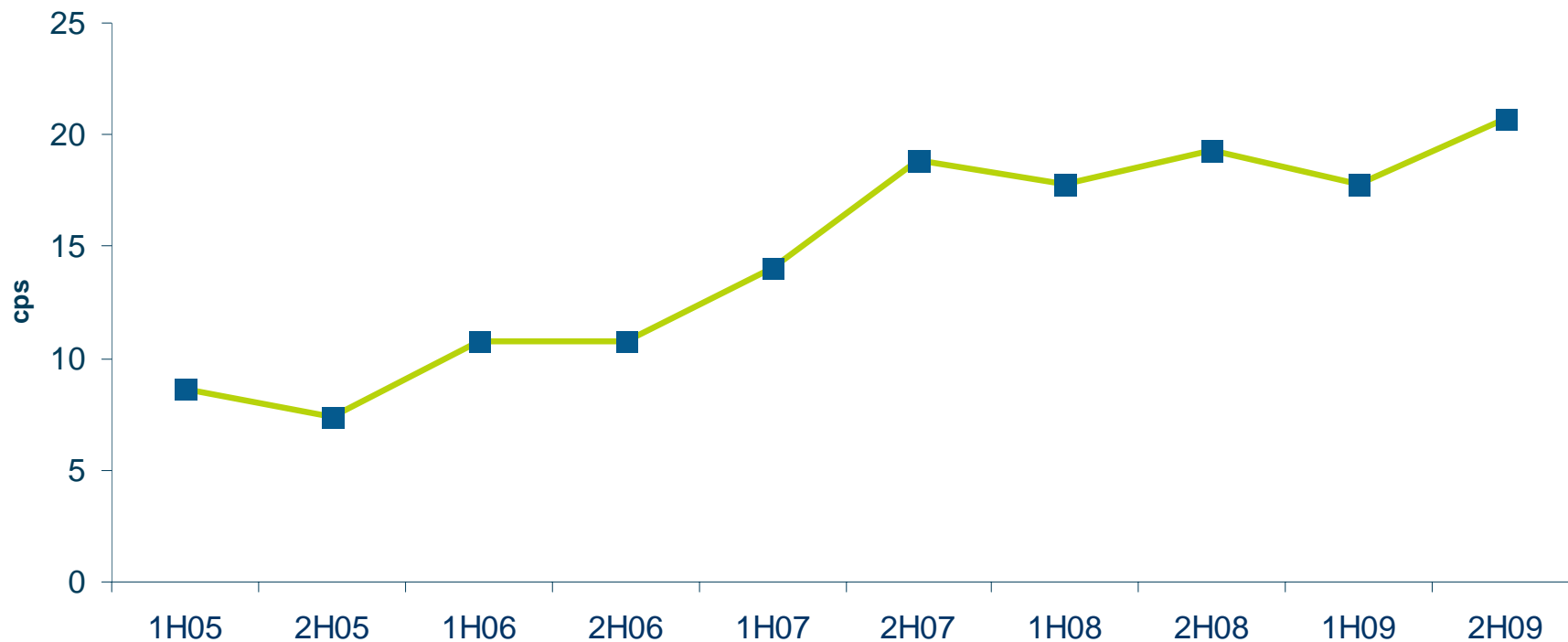
*Normalised EBIT continuing to grow*



# 5 year long term financial performance

*Normalised EPS continuing to grow*

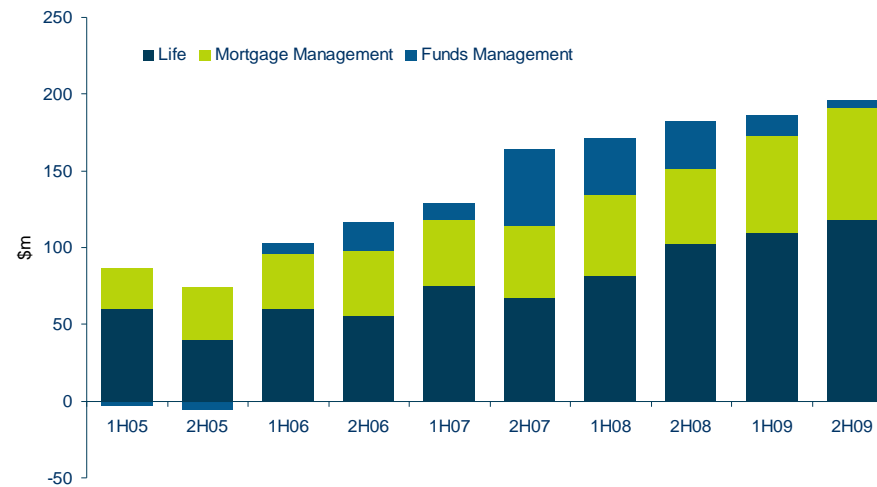
Normalised EPS



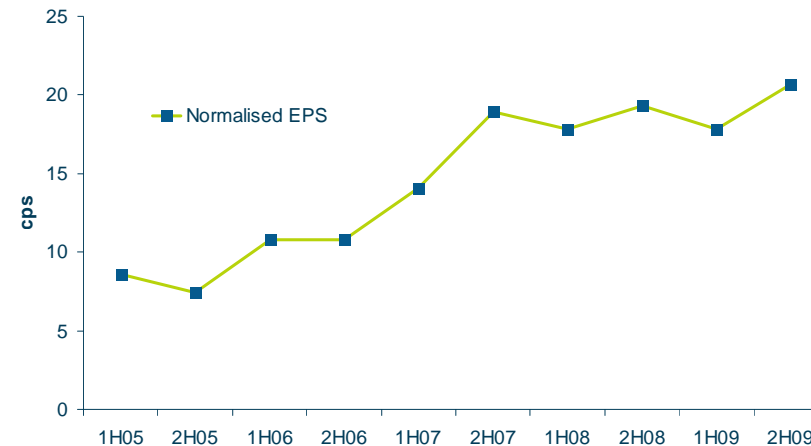
# Our people

- Core executive team in place since mid-2003
- Experienced leadership team, each with ~20 year industry experience
- Deep risk management skills
- Proven track record on acquisitions and integration
- Markets have created challenges but we have reacted and pro-actively managed through difficult times
- Our people have delivered sustainable earnings growth

Normalised EBIT



Normalised EPS

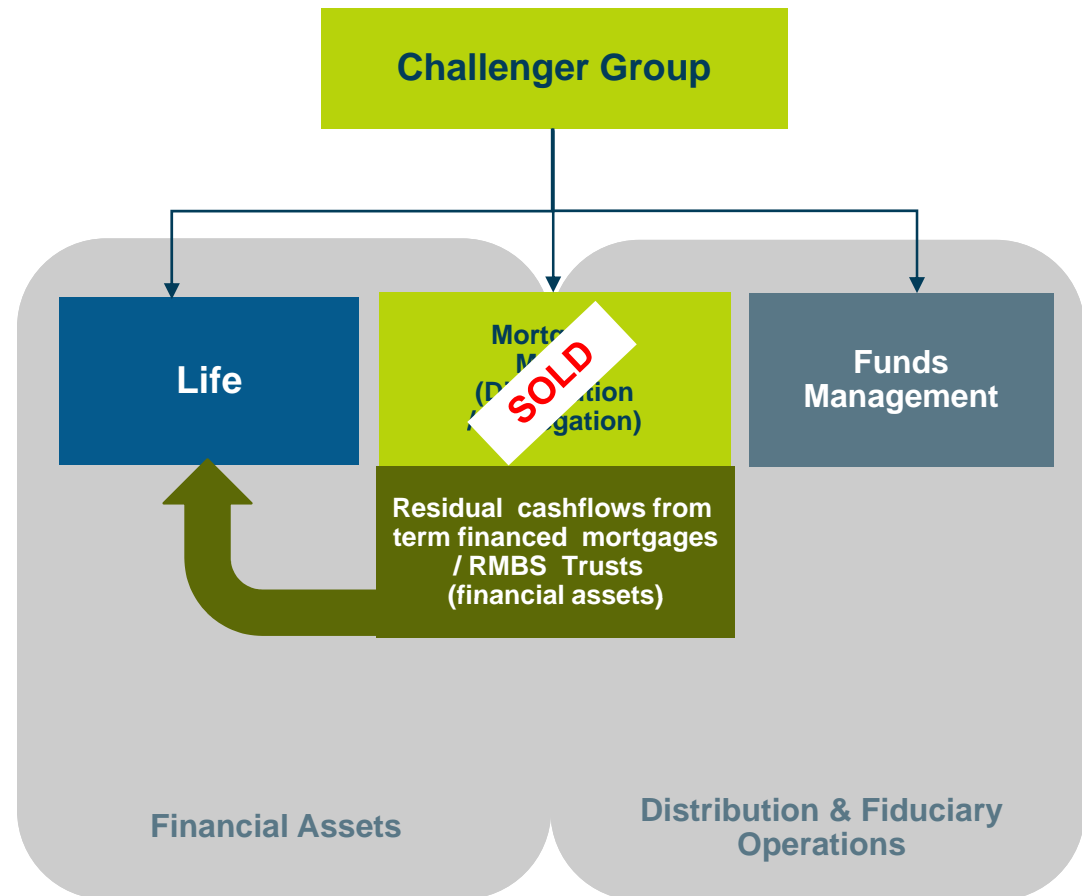


# Redeploy capital – exit mortgage business

- Board and Management regularly reviewed strategic alternatives
  1. Wait for recovery of securitisation markets
  2. Obtain funding partner
  3. Redeploy capital
- During the year repeated approaches for the business
- Benefits of sale
  - Simplify and focus our business model
  - Reduce risk
  - Act on significant opportunities in Life and Funds Management
- Proceeds
  - Minimal profit and loss impact expected on completion
  - ~\$350m available for new opportunities

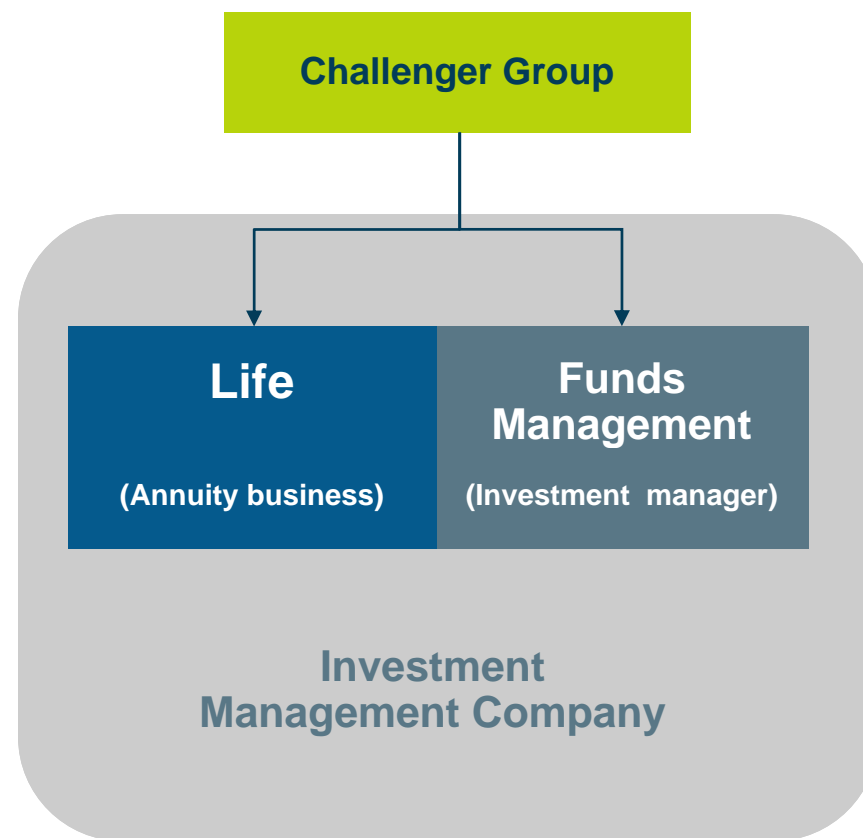
# Simplified business model

- Residual cashflows from term financed mortgages / RMBS trusts sold to CLC for \$575m
- Mortgage distribution and aggregation business sold to NAB for \$385m



# Simplified business model

- Residual income from term financed mortgages / RMBS trusts sold to CLC for \$575m
- Mortgage distribution and aggregation business sold to NAB for \$385m
- Complementary businesses



# Capital and financial flexibility

- ~\$530m excess capital at balance date
- Post balance date cash injection into the CLC to:
  - Support the \$575m asset
  - Provide for future growth opportunities
  - Significant excess capital via organic re-generation in CLC
- Future Group cash position ~\$350m and no debt
- Access to funding lines

# Use of capital

Surplus cash, capital, organic earnings and available lines



Life

Liability growth

- Organic
- Platforms
- Capture upside from any regulatory changes
- M&A

Allocated to high ROE and asset opportunities

- E.g: increased holding in CDI from recent entitlement offer
- Fixed income investments



FM

Re-investment in Funds operations

- Expansion of boutique partnership strategy
- Accretive bolt on opportunities



Group

Capital Management

- On-market share buy-back underway

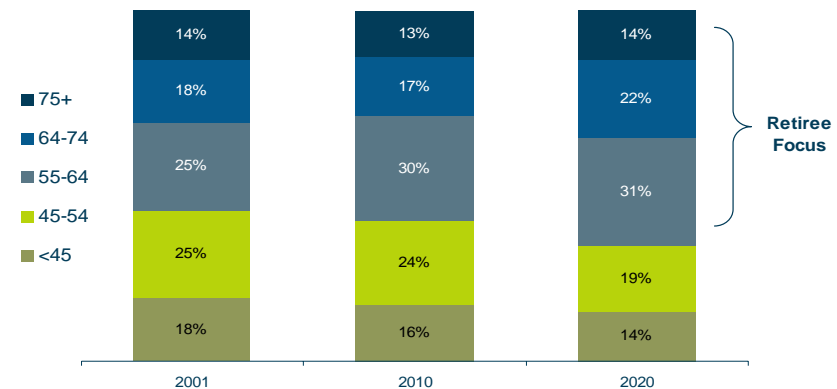
# Business opportunities



# Life – the retirement income opportunity

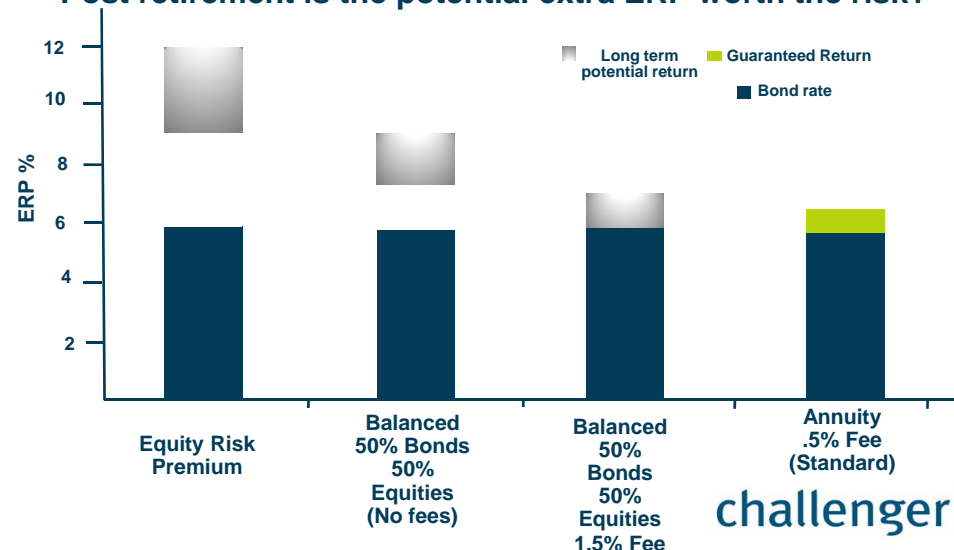
- Global shift in the next ten years. It's estimated that two-thirds of investable assets will be in income protection / preservation
- Post retirement sector to grow to 36% from 24% over the next 10 years<sup>1</sup>
- Not a question of equities versus guaranteed income streams
- We question whether in the decumulation stage the risk of an equity centric strategy is worth the marginal extra return
- Annuities not 'expensive'
- Once in drawdown phase hits to retiree's capital are impossible to earn back so risk return is not appropriate

Investable Assets by Age Group



Investable assets include financial assets held in pension accounts such as 401(k) and IRAs; Source: Survey of Consumer Finances 1989, 1995, 2001; US Census Bureau; McKinsey Analysis

Post retirement is the potential extra ERP worth the risk?



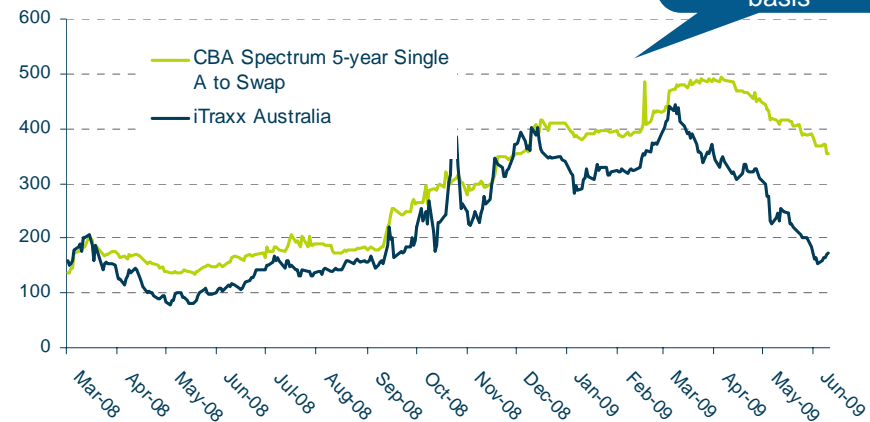
# Raising the profile of annuities

Date	Government	Industry
Oct 2008	<ul style="list-style-type: none"> <li>Initial submission to Henry Review raising longevity and mandatory annuitisation as a possible response</li> </ul>	
Mar 2009	<ul style="list-style-type: none"> <li>Main submission to Henry Review on Retirement Incomes Policy               <ul style="list-style-type: none"> <li>Challenger on international pension arrangements and problem of excessive market risk</li> <li>Towers Perrin on retirement income modelling, longevity risk and impact of compulsion</li> <li>Access Economics on impact on fiscal position</li> <li>Challenger on targeting</li> </ul> </li> <li>Most comprehensive submission, which now leads public debate</li> </ul>	<ul style="list-style-type: none"> <li>Appeared before Henry Panel as part of IFSA delegation</li> <li>Member of IFSA Henry Working Group</li> </ul>
Jun 2009	<ul style="list-style-type: none"> <li>Member of Henry Review Industry Reference Group on Longevity</li> </ul>	<ul style="list-style-type: none"> <li>Challenger addressed Investment and Financial Services Association (IFSA) conference</li> <li>Challenger addresses NSW Uni Colloquium on Superannuation</li> </ul>
Aug 2009	<ul style="list-style-type: none"> <li>Third submission on key issues raised:               <ul style="list-style-type: none"> <li>Voluntary or mandatory</li> <li>Guaranteed or non-guaranteed</li> <li>Private or public provision</li> <li>Watson Wyatt on the UK experience</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>Challenger addresses conferences:               <ul style="list-style-type: none"> <li>Australian Super Investment (ASI)</li> <li>Association of Financial Advisors (AFA)</li> <li>Association of Super Funds of Australia (ASFA)</li> </ul> </li> </ul>

# Life – assets opportunities

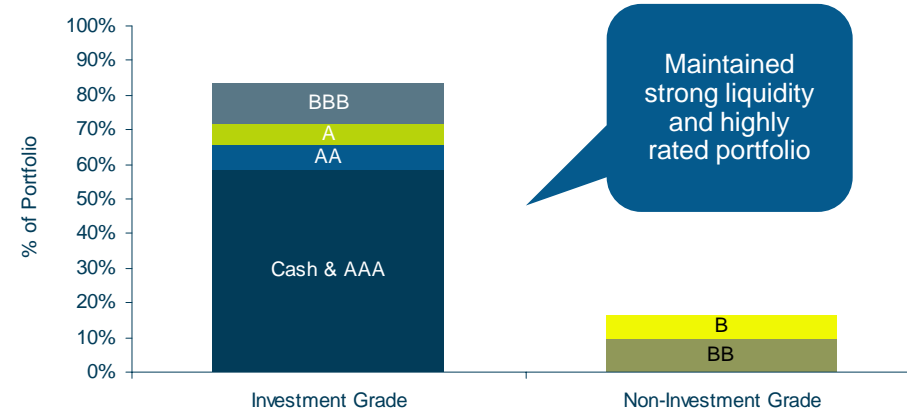
- Fixed income continues to offer the most attractive return on capital invested
- Cash bond spreads are starting to contract but a significant liquidity premium can still be earned
- Continued focus and overweight asset allocation to fixed income

Cash bond spreads beginning to contract



Source: CBA, Bloomberg

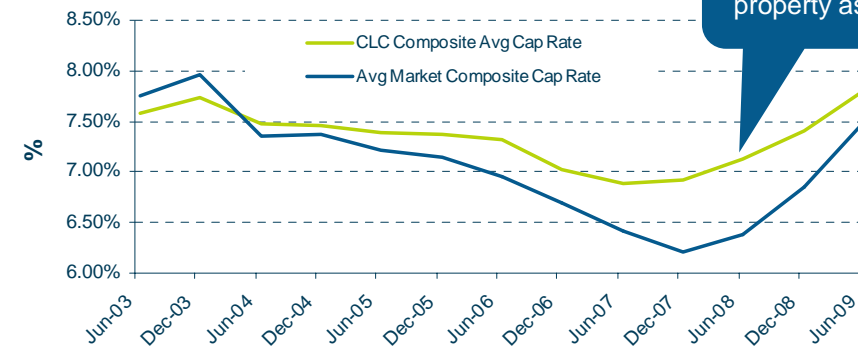
Life fixed income portfolio by S&P equivalent rating



# Life – assets opportunities

- Significant opportunities in the real estate sector
- Large CMBS expiries
- REITs recapitalising at a significant discount to NAV
- Dividend yields significantly higher than the swap rate

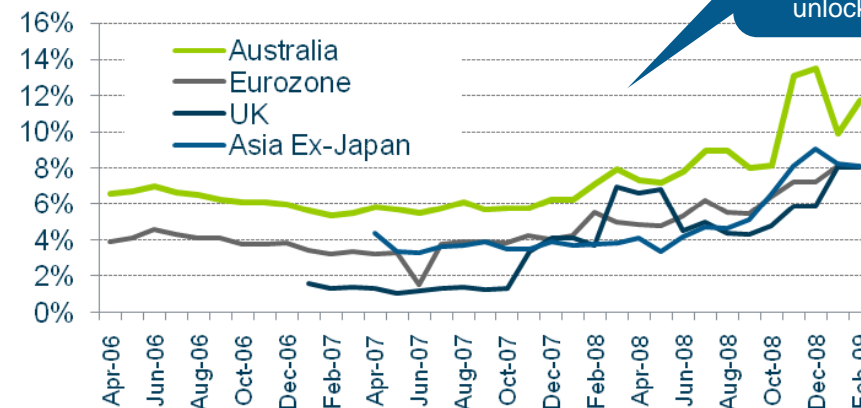
Challenger composite Cap Rate versus Market



Long history of low volatility property assets

Source: Challenger, IPD/ PCA Australian Composite Weighted Average Cap Rates

Global REIT's - Dividend Yield

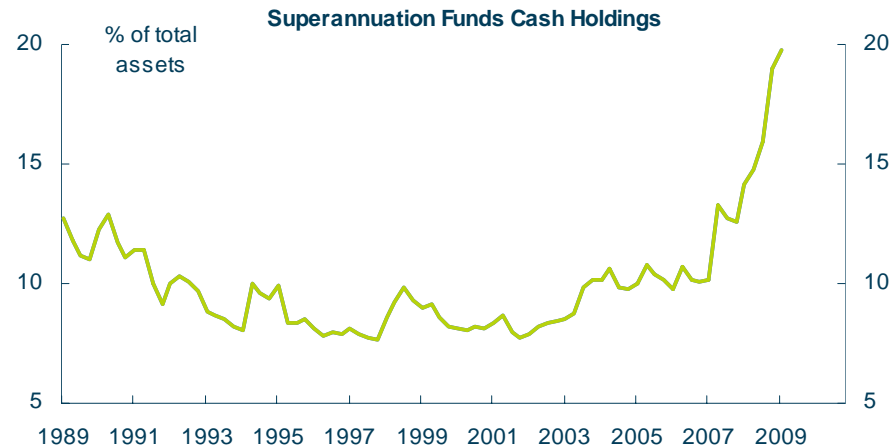


REIT opportunity still to be unlocked

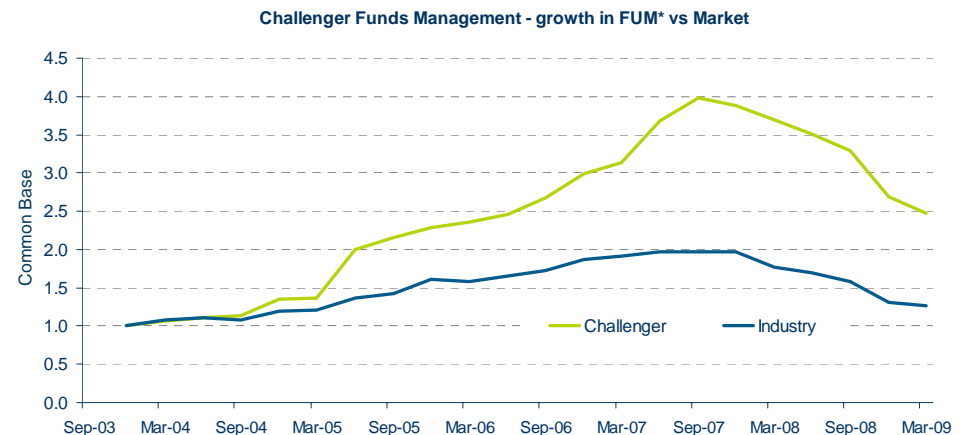


# Funds Management opportunities

- Australian market an attractive long term opportunity
  - 4<sup>th</sup> largest asset management market in the world
  - Compulsory superannuation
  - Re-allocation of cash starting
- ~\$20bn of FUM managed by Challenger Group
- Growth via acquisition
  - Reviewing accretive opportunities that deliver significant synergy benefits
- Growth organically
  - Boutique partnerships FUM doubled, now circa \$2bn and pipeline strengthening



Source: ABS, Deutsche Bank estimates

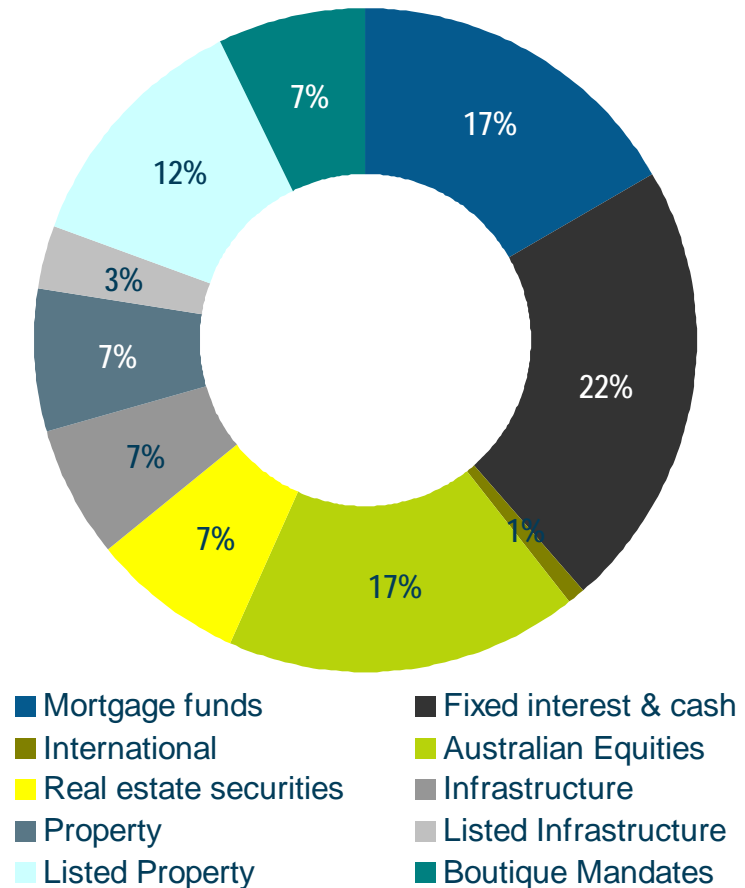


\* Challenger Funds Management and Specialised Funds business merged in Nov 2008. FUM figures above reflect the combined assets of both businesses prior to Nov 2008. Source: Morningstar Market Share Report, Challenger

# Core platform for growth

- 75% of our funds have outperformed their 12 month benchmarks
- Continued focus on developing core products (~70% of FUM) that are:
  - Capital secure
  - Income certain
  - Yield focused
- Boutique model
  - Portfolio approach diversifies risk
  - Boutiques need sponsors with key distribution, strong compliance and capital

FUM by asset class – June 2009



# Challenger Financial Services Group Limited

Full Year Results to 30 June 2009

Brian Benari – Group Chief Financial Officer & Group Chief Operating Officer

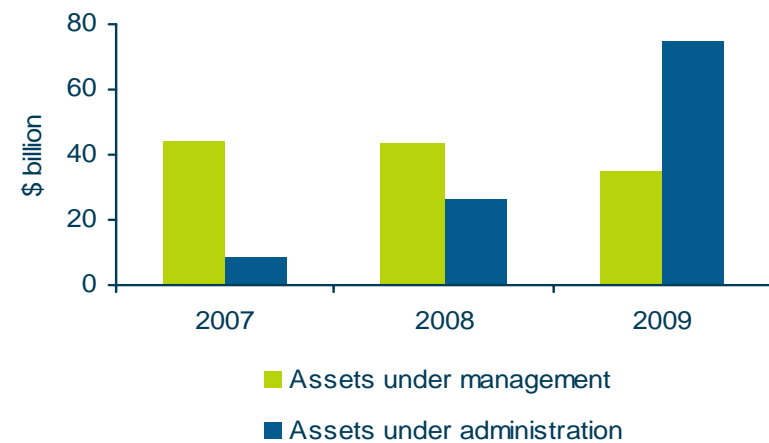
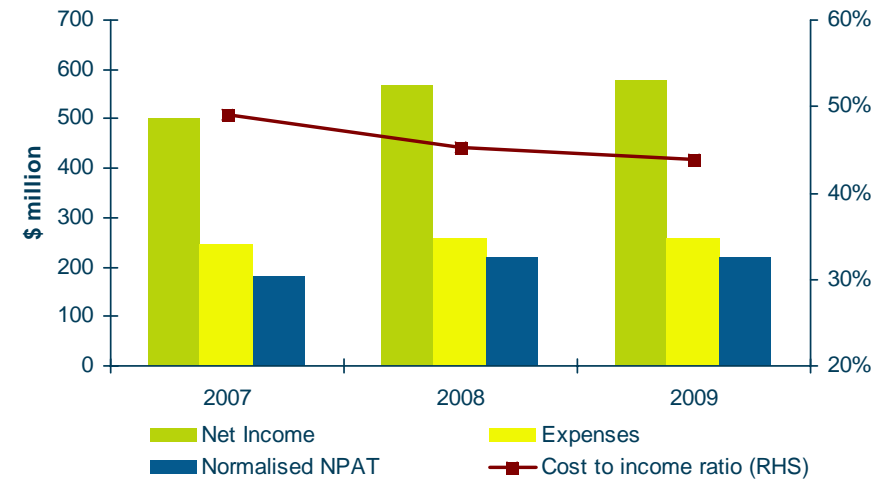
24 August 2009



# Financial highlights

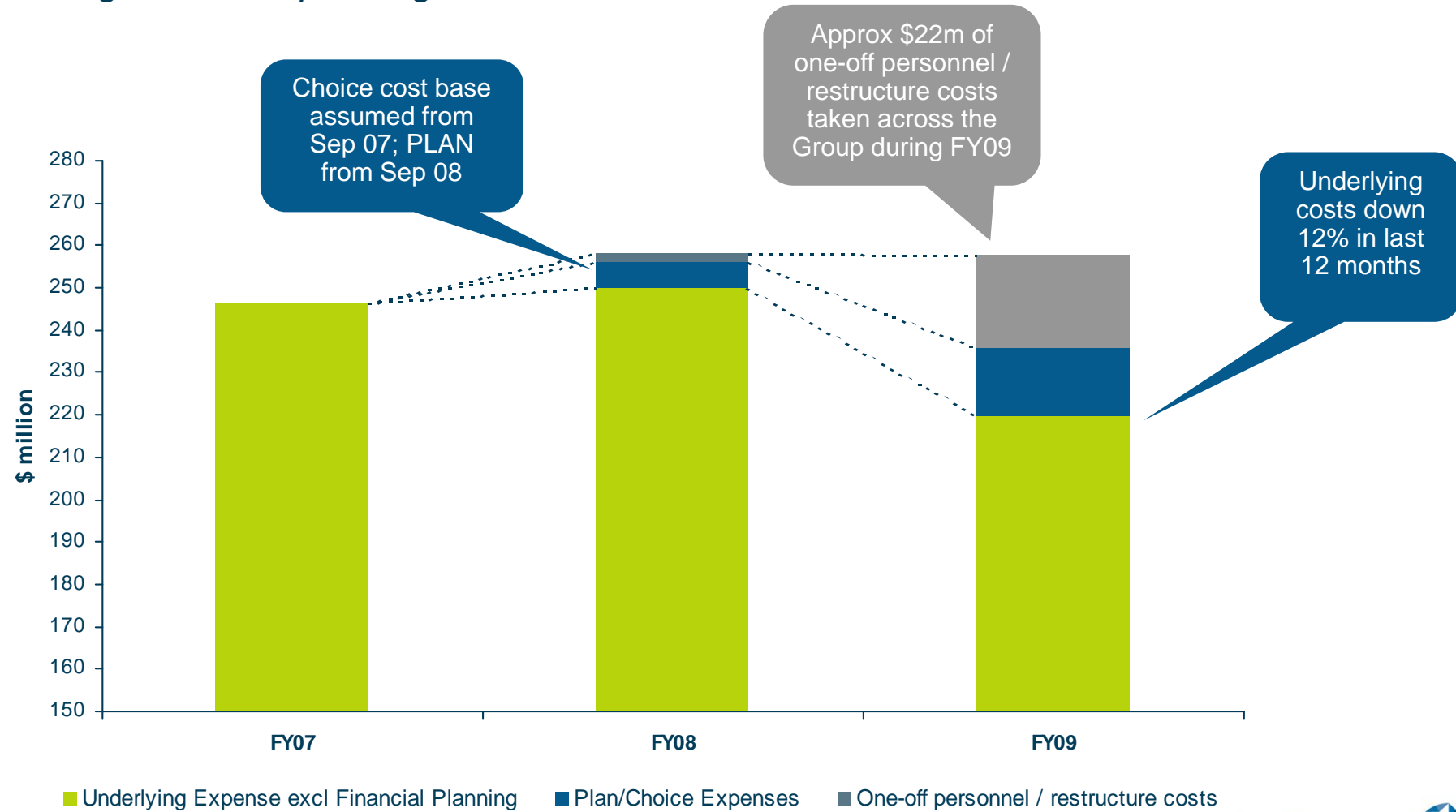
Financial Performance	2009	2008	% Mvt 2008 - 2009	Trend
Assets Under Management	\$35.3bn	\$43.5bn	(19)%	↓
Assets Under Administration	\$75.0bn	\$26.2bn	large	↑
Net Income	\$579m	\$567m	2%	↑
Expenses	\$259m	\$256m	1%	↑
Normalised EBIT <sup>1</sup>	\$320m	\$311m	3%	↑
Normalised NPAT <sup>1</sup>	\$219m	\$218m	Flat	↑
Statutory NPAT	\$(91m)	\$(44m)	large	↓
EPS (Normalised Basic) - cps	39.2	37.1	6%	↑
EPS (Statutory Basic) - cps	(16.2)	(7.5)	large	↓

<sup>1</sup> Excluding investment experience and significant items



# Delivering on cost control across the Group

*Strong focus on operating costs*

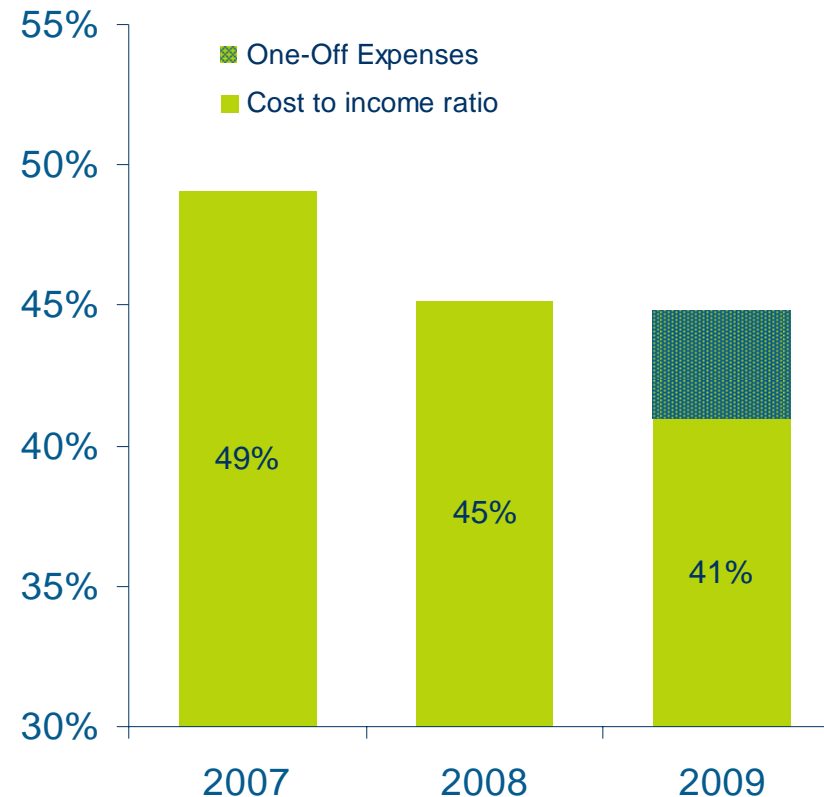


# Delivering on cost control across the Group

*Strong focus on operating costs*

- Expense base centralised under single CFO/COO role
  - Strong focus on expense control – full run-rate of expense savings only partially evident
- Corporate costs
  - Increase in FY09 reflects one-offs items taken above the line including \$18m of operational restructure expenses and personnel charges
  - \$3m increase of non-cash LTI expense

Group cost to income ratio



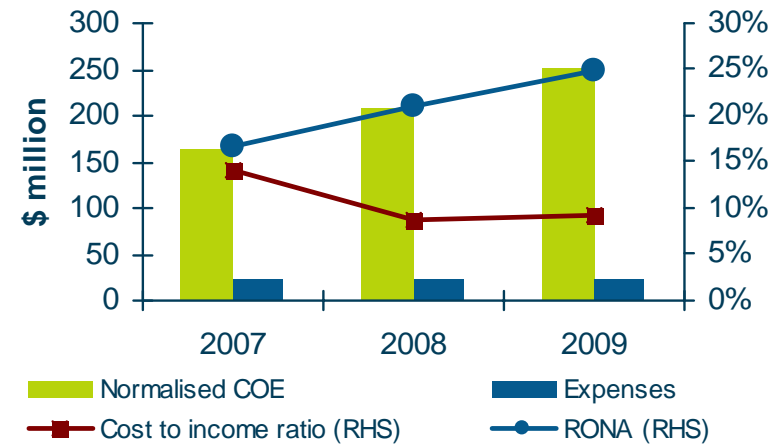
# Life financial highlights

Financial Performance	2009	2008	% Mvt 2008 - 2009	Trend
AUM – Life	\$5.8bn	\$5.4bn	7%	↑
Normalised Cash Operating Earnings	\$251m	\$208m	21%	↑
Expenses	\$23m	\$23m	flat	↔
Normalised EBIT <sup>1</sup>	\$228m	\$185m	23%	↑
Investment Experience post tax	(\$310m)	(\$192m)	large	↑
Normalised RONA <sup>2</sup>	25%	21%	-	↑
Opening Net Assets	\$909m	\$981m		↓

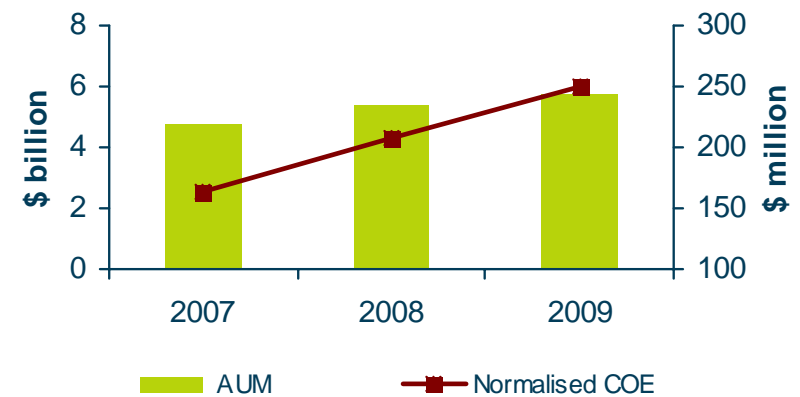
<sup>1</sup> – Excludes the impact of investment experience

<sup>2</sup> - Calculated on opening Net Assets.

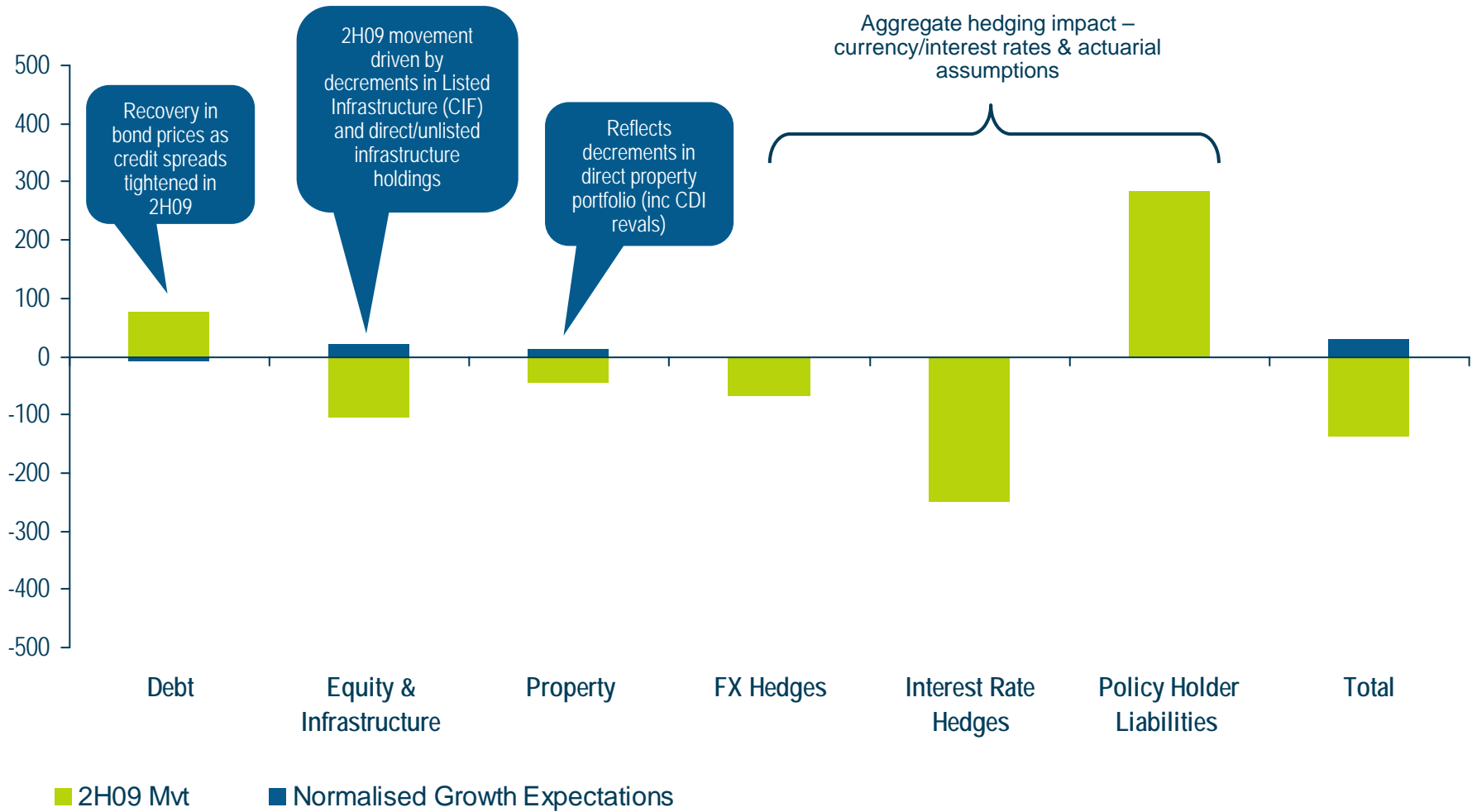
## Financial Performance



## Assets Under Management



# Investment Experience – 2H09

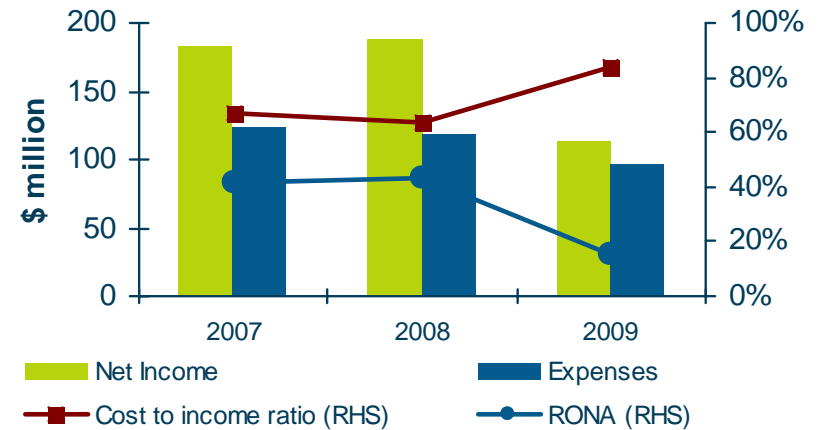


# Funds Management financial highlights

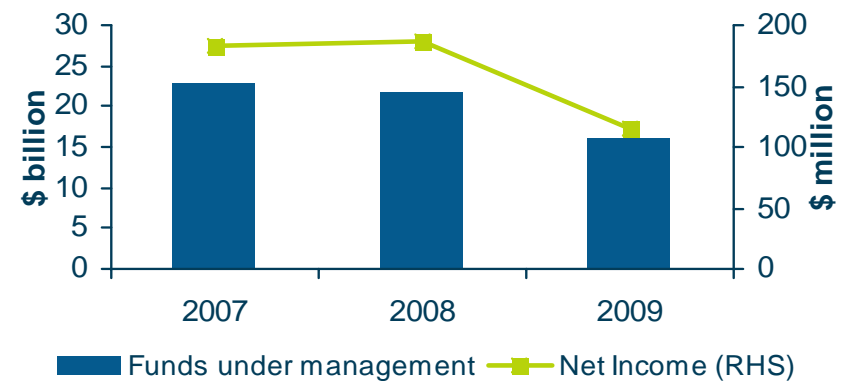
Financial Performance	2009	2008	% Mvt 2008 - 2009	Trend
Funds Under Management	\$16.0bn	\$21.9bn	(27%)	↓
Net Income	\$114m	\$187m	(39%)	↓
Expenses	\$96m	\$119m	(19%)	↓
EBIT	\$18m	\$68m	large	↓
RONA <sup>1</sup>	15%	44%	-	↓
Opening Net Assets	\$117m	\$157m	-	↓

<sup>1</sup> – Calculated on opening Net Assets.

Financial Performance



Assets Under Management



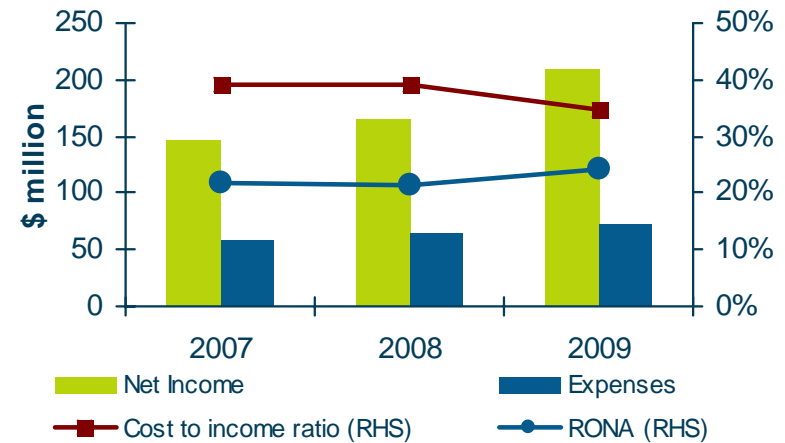
# Mortgage Management financial highlights

Financial Performance	2009	2008	% Mvt 2008 - 2009	Trend
Mortgages Under Management	\$17.9bn	\$21.8bn	(18%)	↓
Mortgages Under Administration <sup>1</sup>	\$75.3bn	\$26.3bn	Large	↑
Net Income	\$209m	\$165m	27%	↑
Expenses	\$73m	\$65m	12%	↑
EBIT	\$136m	\$100m	36%	↑
RONA <sup>2</sup>	24%	21%	-	↔
Opening Net Assets	\$571m	\$469m	-	-

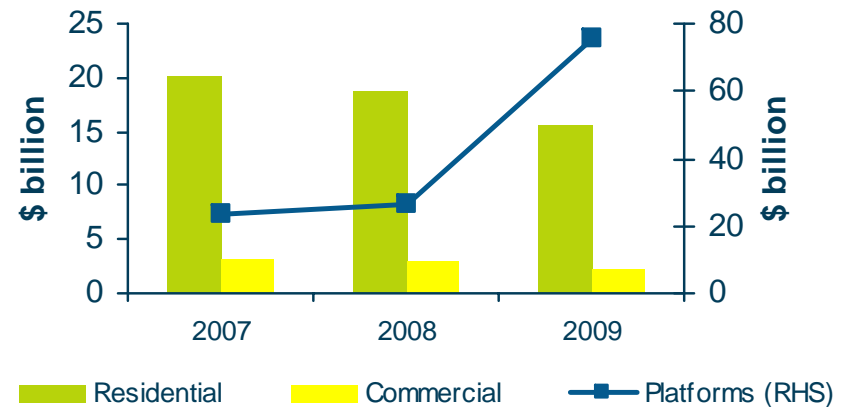
<sup>1</sup> - 2009 includes PLAN which became a 100% subsidiary on 30 September 08

<sup>2</sup> - Calculated on opening Net Assets.

## Financial Performance



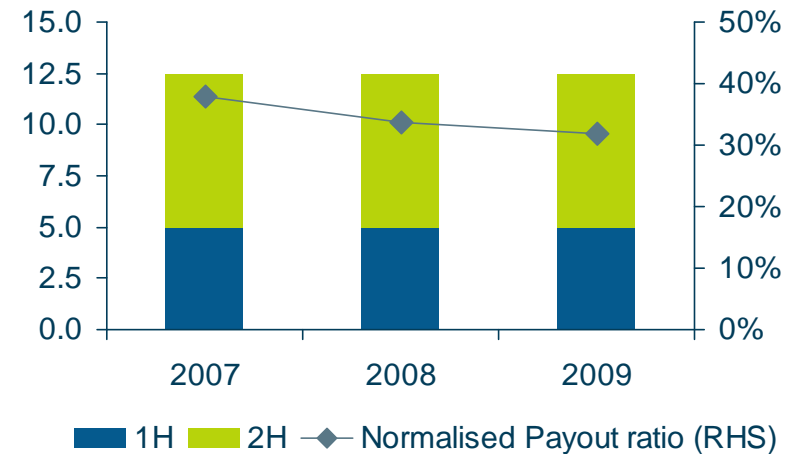
## Assets Under Management



# Capital Management

- 2009 final dividend declared
- 7.5 cents per share, unfranked
- Sustainable payout ratio and dividend path maintained
- Active capital management delivering accretion for shareholders
  - on-market buy-back 60% complete and extended for another 12 months
  - average price bought back \$1.34

Dividends – cents per share (cps)

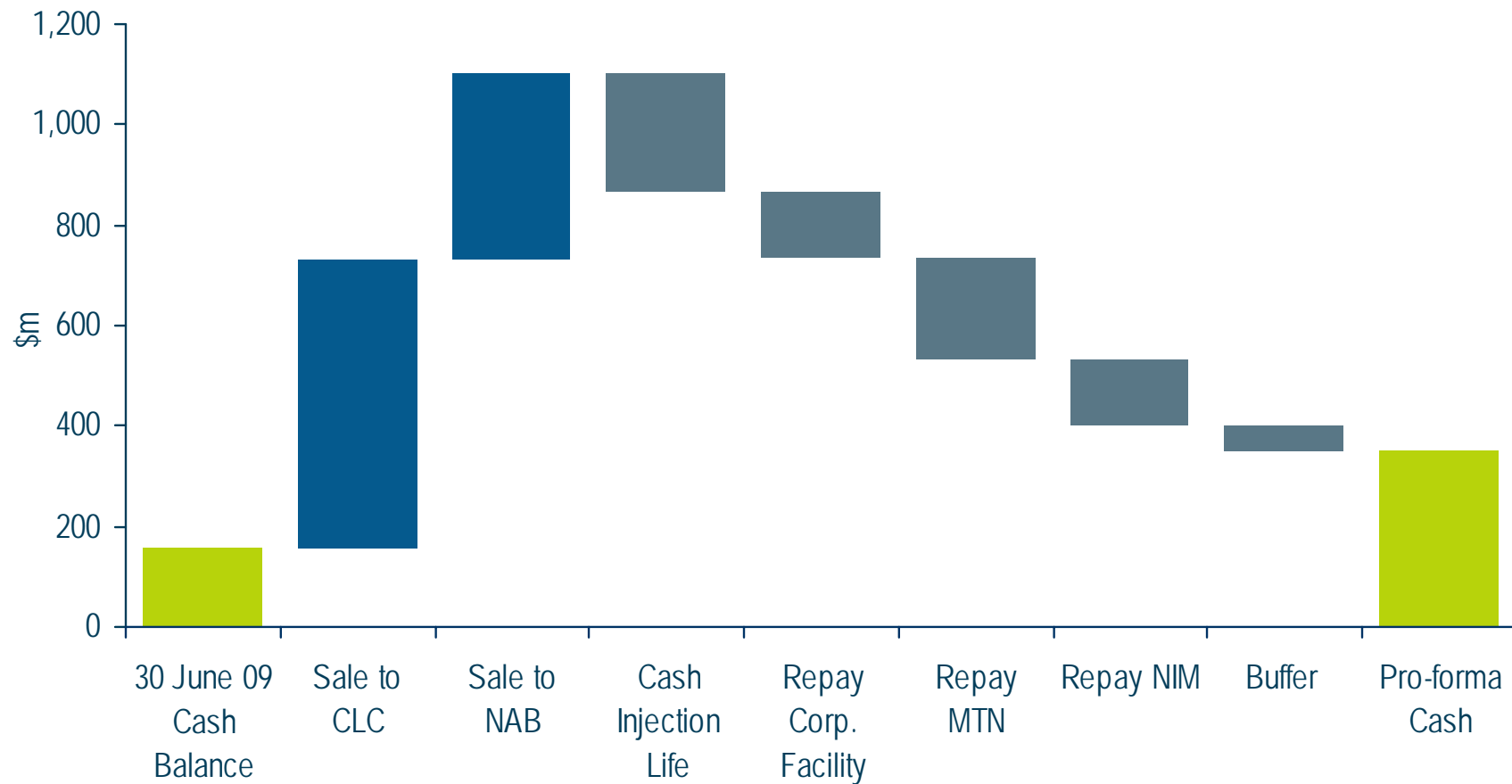


Key Dates	
Ex-dividend date	17 September 2009
Record date	23 September 2009
Payment date	16 October 2009

# Impact of recent transactions

- Sale of distribution business to NAB
  - \$385m proceeds realising book value
  - Achieved 20x post tax multiple
  - Warehouse loans transferred had minimal earnings contribution
- Sale of residual cashflows from term financed mortgages to Life
  - \$575m proceeds
  - Eliminates on consolidation therefore no profit on sale
  - Valuation excludes trail obligations and amortisation
  - Earnings will emerge in Life consistent with prior periods in Mortgage Management (inclusive of trail and amortisation)
  - COE guidance Life for FY10 - \$300m (assumes 8 months of back book earnings)
- Mortgage Management to generate earnings of circa \$40m<sup>1</sup> in FY10 by expected completion date

# Cash - Impact of recent transactions



# Outlook

Dominic Stevens – Chief Executive Officer

24 August 2009



# Strategic positioning

- Streamlined simplified business model
  - Focus on investment management
  - Clear synergies between Life and Funds operations
- Growth opportunities
  - Life
    - Organic growth – change in investor risk preference and expanded distribution
    - Potential for further upside from regulatory change
    - Onshore and offshore liability acquisition opportunities
  - Funds Management
    - Long term growth fundamentals driven by compulsory superannuation
    - Re-allocation of cash beginning
    - Solid position for consolidation
- Execution capabilities
  - Proven integration capabilities and price discipline
  - Scalable operations

# Outlook

- Challenger has come through the toughest phase of the global financial crisis
- Financial system healing however elevated risk premium on assets will continue for some time
- Challenger well-positioned to take advantage of this with significant excess cash and capital
- Organic growth supported by demographic and regulatory trends
- Looking for accretive opportunities to grow in our complementary businesses
- New cash operating earnings guidance for Life FY10 - \$300m

Disclaimer: The material in this presentation is general background information about Challenger Financial Services Group activities and is current at the date of the presentation. It is information given in summary form and does not purport to be complete. It is not intended to be relied upon as advice to investors or potential investors and does not take into account the investment objectives, financial situation or needs of any particular investor. These should be considered with or without professional advice when deciding if an investment is appropriate.

