

ASX RELEASE

TRANSFER OF AXA'S \$1.3BN ANNUITIES PORTFOLIO SALE OF FINANCIAL PLANNING TO REALISE \$150 MILLION EARNINGS AND DIVIDEND GUIDANCE FOR FY08 STRONG CAPITAL AND LIQUIDITY POSITION CONFIRMED

Sydney, 4 June, 2008: Challenger Financial Services Group Limited (ASX:CGF) today announced it had reached agreement with AXA to transfer to Challenger its \$1.3 billion Australian annuity portfolio. This annuity portfolio, which will be backed by approximately \$1.25 billion of assets, will bring Challenger's annuity, allocated pension and personal superannuation portfolio to \$5.1 billion and will add some 17,000 new customers to Challenger's base. In a parallel transaction, Challenger will sell its Financial Planning business (comprising Genesys Wealth Advisers and Synergy Capital Management) to AXA for \$150 million in cash.

Challenger is providing guidance for its 2H08 dividend of 7.5 cents per share and expects FY08 Group Net Profit Before Tax ('NPBT') of \$270 million, based on normalised cash operating earnings ('COE'). The Company anticipates reporting a statutory profit after tax of \$20 million for FY08, subject to various earnings sensitivities (see attached presentation). Normalised COE represents spread income on a cash and accruals basis, plus normalised capital growth from Challenger's balance sheet operations, but excludes investment experience and individually significant items.

Giving an update on the course of business, the Company said strong earnings growth on a normalised COE basis continued in the Asset Management business. The returns generated from the investments held on balance sheet are expected to once again contribute to strong cash earnings, notwithstanding the mark-to-market investment experience during the period. This is reflected in a normalised COE from the balance sheet operations in the order of \$198 million for FY08.

In the other parts of the business, the contribution made by its mortgage aggregation interests to Mortgage Management is increasing, supported by growth in volumes.

Consistent with broader market trends, Challenger's Funds Management operations have experienced contraction in funds under management, although its boutique partnership strategy is reaping rewards as support for these boutique firms grows.

To further increase transparency levels, Challenger will supplement its existing disclosure and financial reporting for the Asset Management balance sheet operations from 2H08 to provide a breakdown of normalised COE. As part of this process, the Company has also released guidance for Asset Management balance sheet operations for FY09 excluding the transfer of the AXA annuity portfolio, expecting normalised COE for this business of approximately \$210 million.

The Company has also reaffirmed the strength of its capital position. Operating within a prudentially regulated environment, Challenger maintains a conservative approach to financial measures and as at 30 April 2008, held more than \$700 million above its minimum regulatory capital requirements in Challenger Life No. 2 Limited.



Transfer of \$1.3 billion AXA annuity portfolio

Challenger Chief Executive Officer, Mike Tilley said: "The transfer of this \$1.3 billion annuity portfolio reaffirms our position as a committed participant in the Australian annuities market and is consistent with our strategic aim to maintain leadership in the sector. The portfolio will be backed by approximately \$1.25 billion of assets, comprising circa \$625 million cash and \$625 million investment grade fixed income assets. The transfer of the portfolio will bring some 17,000 new customers to Challenger."

Mr Tilley added the transaction was a 'win-win' benefiting Challenger and AXA as it would provide scale and efficiency benefits for both parties.

"With some \$5.1 billion in retirement income policies, the business will be highly efficient and competitive in a market where there is continuing demand for quality guaranteed retirement income streams. We are also pleased with the value to be realised for the financial planning business which reflects its restructuring and improved financial performance under Greg Kirk," said Mr Tilley.

For AXA, Andrew Penn, Chief Executive Officer of AXA APH said: "This transaction is a great result for both AXA and Challenger. AXA further grows its distribution business at the same time as simplifying the business, whilst Challenger gains further scale in its strong annuity business."

The transfer of the annuity portfolio will occur via a Part 9 Scheme of Arrangement and is subject to regulatory and court approval. The cash sale of the Financial Planning business to AXA is expected to close on 30 June 2008 and remains subject to Foreign Investment Review Board approval.

Mr Tilley said following completion of the sale of the Financial Planning business, a number of options would be considered for deploying the proceeds of \$150 million, including possible capital management initiatives.

Market Update

Challenger also announced a number of important updates with respect to its performance for the current financial year.

1. FY08 guidance, capital and liquidity, business updates and FY08 significant items

FY08 guidance

Challenger's dividend payment for 2H08 is expected to be 7.5 cents per share, reflecting the Board's confidence in underlying profit.

Challenger said also that while net profits after tax would be affected by the unrealised investment experience, operating NPBT on a normalised COE basis remains strong.

The pre-tax normalised COE result for the full year ended 30 June 2008 is expected to be \$270 million before significant items. The FY08 statutory profit after tax is expected to be \$20 million after mark-to-market investment experience and significant items principally comprising impairments of strategic investments in two third party businesses.

Capital & liquidity

While the unrealised mark to market impacts during the period in the Asset Management balance sheet operations have been significant, even after these impacts Challenger Life No. 2 Limited held more than \$700 million of capital above its minimum regulatory requirements as at 30 April 2008.

Mr Tilley said: "Importantly, as a consequence of its high levels of liquidity and strong capital position, Challenger is well placed to absorb the impact of volatile markets."



Challenger Life No. 2 Limited is rated 'A' by Standard and Poor's (re-affirmed December 2007) and Challenger Financial Services Group is rated 'BBB+' (re-affirmed January 2008).

In addition, at 30 April 2008 at the Group level Challenger had cash and undrawn facilities that exceeded \$400 million (cash \$150m; undrawn facilities \$250m). This position will be further enhanced by the \$150 million proceeds from the sale of the Financial Planning business when received in late June 2008. Gearing at 30 April 2008 remained conservative at less than 10 per cent. For further details, including key sensitivities, see the attached presentation.

Business update

Commenting on the course of business, Mr Tilley said: "Mortgage market conditions continue to remain challenging. We have maintained lower levels of new business origination until clearer sight on the reopening of term funding markets occurs. The business has more than 12 months of origination capacity. Mortgage Management continues to earn a comparable operating margin on its existing book.

"In the mortgage aggregation business volumes are growing well above system growth as customers continue to look to intermediaries to assist them in achieving the best price and service outcome for loans.

"Asset Management earnings on a normalised COE basis continue to show solid growth. Over the year Challenger's in force annuities have grown, via the transfer of the MetLife Portfolio on 31 August 2007, as well as organic growth. It is the stability of this annuity book that provides the business with the opportunity to focus on investing in assets that deliver strong operating spread for shareholders.

"Fees for specialised funds also remain strong despite more challenging market conditions.

"Consistent with broader market trends, in Funds Management we have experienced a contraction in FUM during 2H08 which has reduced our base management fees. We are not forecasting any significant performance fees in 2H08, although FUM and revenue from our boutique partnership strategy continue to grow".

In line with Challenger's subsequent event disclosure of 22 February 2008 (Note 20 in 31 December 2007 Interim Financial Accounts), the investment experience in the Asset Management's balance sheet operations has resulted in a negative accounting impact, primarily due to:

- The listed equity market discounting the earnings of property and infrastructure funds at significantly higher rates than those being applied in the direct market for these assets, impacting the holdings in CIF, CDI and CWT; and
- The unprecedented liquidity premium being demanded by credit markets, particularly in the higher grade credit markets where the book is heavily focused which is impacting the mark-to-market of the fixed income portfolio.

Challenger expects these unrealised mark-to-market positions to recover over time, and as at the date of this update there are no fixed income investments in default.

Significant items for FY08

Significant items are expected within the FY08 result totalling \$69 million after tax, following the announcement of the sale of its Financial Planning business, transfer of AXA's annuity portfolio and accounting for impairments of the Group's investment in Homeloans Limited (ASX: HOM) and in US-based investment bank FBR Capital Markets Inc (NASDAQ: FBCM). Further details: see presentation attached.



2. Supplementary disclosure – normalised COE for Asset Management

Additional disclosure for the Asset Management division has been introduced to improve the transparency of the operating spread performance within the Challenger Life No. 2 Limited balance sheet operations.

Challenger will supplement the existing statutory disclosure framework and reporting format from 2H08, along with prior year comparatives providing greater transparency on:

- A. **Cash spread earnings** of the portfolio – comprising investment yield net of interest, fees and commissions. Accounting for the cash spread will be on a cash and accruals basis.
- B. **Normalised capital growth** of the portfolio – being the expected medium term growth given the asset allocation of the portfolio and the disclosed growth rates per asset class.
- C. **Investment experience** of the portfolio – this item will reflect all realised and unrealised gains and losses on the portfolio net of the normalised capital growth.

3. Guidance on normalised COE for Asset Management for FY09

Following the introduction of this additional disclosure regarding the normalised COE (excluding fee income) for Asset Management, Challenger is also releasing guidance regarding this component for FY09. The company expects FY09 cash spread earnings and normalised capital growth of \$210 million for this business – based on consistent levels of spread and normalised growth and an expected level of \$5.0 billion of average assets (excludes AXA portfolio transfer).

ENDS

Attachment: Market presentation 4 June 2008, lodged with the ASX.

Any forward looking statements included in this document are by nature subject to significant uncertainties, risks and contingencies, many of which are outside the control of, and are unknown to Challenger, so that actual results or events may vary from those forward looking statements, and the assumptions on which they based.