

24 November 2005

**CHALLENGER FINANCIAL SERVICES GROUP LIMITED
ANNUAL GENERAL MEETING**

**CHAIRMAN AND CEO'S ADDRESSES
24 NOVEMBER 2005**

**10.30 AM
VERBRUGGHEN HALL
SYDNEY CONSERVATORIUM OF MUSIC
MACQUARIE STREET
SYDNEY**

(Check against delivery)

Chairman's address

I am pleased to report that the 2005 year resulted in a strong improvement in the operating performance of your company as the strategy adopted by your Board following the merger of Challenger International Limited and CPH Investment Corp in June 2003 began to take effect.

Our deliberate focus on three core businesses - Challenger Life, Challenger Wholesale Finance and Challenger Wealth Management delivered solid returns marking a strong turn around and making the year to 30 June 2005 an important year for your company.

We reported a 159 per cent increase in our historic cost profit after tax this year, after adjusting for the substantial once only write down of goodwill in 2004. We refer to our historic cost results because this provides a better comparison of operating performance across Challenger's three core businesses.

I am also pleased to report that your company paid its first dividend on the 21st of October. The initial distribution was a five cent per share fully franked dividend paid from the 2005 financial year profits.

Your company is committed to active capital management. While your company continues to grow, there are a number of opportunities in which to invest capital. With this in mind, your Board is committed to growing dividends in line with profit growth while also investing in the future growth of Challenger.

Your Board has a strong commitment to financial disciplines and focus across each of the businesses. Challenger Life, Challenger Wholesale Finance and Challenger Wealth Management operate and make decisions based on an



ability to deliver 18 per cent return on net assets within three years. This criterion applies to all investment decisions including direct assets, acquisitions and employment of our people.

Challenger's CEO Mike Tilley has made a significant commitment of time and effort to communicate your company's strategy and comparative advantage to shareholders and the broader investment community.

As a consequence of improving financial performance and a better understanding of Challenger's objectives, the price of Challenger shares has risen substantially since July last year.

Your Board is optimistic about the outlook for your company in the coming year. We have seen solid growth across each of our businesses highlighted in the growth of our assets and loans under management in the September quarter. We anticipate this growth to continue in the December quarter further building on the earnings capacity of your company.

I'd now like to comment briefly on each of our three core businesses.

Chris Cuffe has remained with Challenger as Chief Executive of the rapidly expanding Wealth Management business. Under Chris's expert guidance this business has had an outstanding year achieving profitability 12 months ahead of plan.

During the year, Challenger Wealth Management acquired and integrated two new businesses. In August, we purchased the Associated Planners financial planning business and then merged it with Garrisons Financial Planning to form Genesys Wealth Advisors. In March this year, we acquired HSBC Asset Management (Australia) Limited. Both businesses made solid contributions to Wealth Management.

Revenue in Challenger Wealth Management grew by 48 per cent over the year while funds under management grew by 73 per cent from \$6.1 billion at June 2004 to \$10.6 billion at June 2005.

Challenger Wholesale Finance is a leading participant in the Australian residential mortgage lending industry. Under the guidance of Brian Benari, Chief Executive of the Wholesale Finance division, revenue for the 2005 year rose by more than 60 per cent. Profits before tax increased by 76 per cent, from \$37 million in 2004, to \$65 million in 2005.

Challenger's residential mortgage loan book grew by 16 per cent in the 2005 financial year. In the quarter to September 2005, the loan book grew at an annualised rate of 14 per cent per annum. This was 36 per cent above the market growth rate which was nearly 10.5 per cent. Your company's share of



the residential loan market has grown strongly and continues to run above system growth.

Importantly, tight cost control and improvements in administration processes and IT systems also led to 43 per cent growth in our residential lending margin.

Your Board remains confident that Challenger's Wholesale Finance business can continue to outperform its competitors and grow ahead of the market in the coming year.

Your company's third and largest business is Challenger Life. Challenger Life sells annuities, a capital guaranteed investment product. Annuitant funds are invested into a range of high quality assets, generating a return for both annuitants and shareholders. In addition, Challenger Life is also developing a growing range of publicly listed managed funds.

Your Board and the management of Challenger believe the annuity market will increasingly benefit from the ageing of Australia's population. While long-term annuity sales have reduced since the Government changed its asset testing limits last year, we continue to see satisfactory demand for annuities and expect this to continue in the coming year.

Robert Woods was appointed Chief Executive, Challenger Life in August 2004. Since his appointment, Robert has overseen a remarkable expansion of Challenger Life's business including the diversification in the mix of assets used to back annuities.

Your company has moved to diversify risk in the Challenger Life asset portfolio by reducing its historical dependency on property assets. This has been achieved by increasing its investments in fixed income and infrastructure to realise optimal long-term returns for policy holders and shareholders.

Challenger Life has more than \$3 billion of Challenger policy holder and shareholder assets under management. These include quality investments in Australian commercial and government property as well as broadcast and gas infrastructure assets based in the United Kingdom.

Challenger Life is targeting an asset mix of 30 per cent each in property, fixed interest, and infrastructure with an additional 10 per cent invested in a combination of cash and equities. Management anticipates it will achieve this mix by the end of calendar year 2006.

As part of the diversification strategy, Challenger Life began to acquire infrastructure assets identifying long-life, low-risk businesses, and often



essential service providers, with monopoly like business models that operate in proven, secure, regulated pricing regimes.

Since July last year, your company has acquired minority interests in two United Kingdom based gas distribution networks supplying more than 13 million customers and a broadcast transmission business which utilises more than 1300 transmission towers providing coverage to 98 per cent of the United Kingdom's population.

These assets were then sold into a listed vehicle, the Challenger Infrastructure Fund, which is managed by Challenger Life. Challenger Life is also a 50 per cent unitholder in the fund.

The management of listed specialist investment vehicles is likely to constitute a growing and important part of Challenger's future.

As I mentioned earlier, your Board and management have a strong focus on financial discipline, business strategy, and execution. It is the combination of these disciplines as well as the successful implementation of your company's strategy that have delivered a material improvement in results for the 2005 year which CEO, Mike Tilley will discuss in further detail.

Turning to the issue of Governance ... Corporate Governance is very important to the Challenger Board both culturally and operationally. In the last two years, your company has introduced a comprehensive range of governance and compliance policies.

Management has worked extensively with Challenger's employees to develop a culture which recognises a commitment to good governance.

The Challenger Principles, which you will have seen as you passed through registration this morning, illustrate the attitude of all Challenger employees towards our policy holders, shareholders, investors, and stakeholders.

Your Board and management believe Corporate Governance is an important obligation of all listed company boards today.

Increasingly however, the balance between good Governance and prescriptive, costly regulation has become skewed.

In the last year, your company has spent a disproportionate amount of resources fulfilling a number of regulatory obligations which have not contributed to your company's growth or value.

Your Board and management believe business leaders and regulators need to work together to ensure risks are appropriately managed. However, we believe



regulators should not attempt to eliminate appropriate risk taking in business. Sensible and well-managed risk decisions create wealth for policyholders and shareholders.

A desire by regulators to eliminate all risk results in excessive regulation which stifles competition and limits product choice for consumers. The cost of licence fees and servicing regulator obligations is inevitably passed onto consumers through increased cost for products and services.

Your Board and management also believe that in the rush to establish new regulatory regimes, Australia has created a system that lacks cooperation and coordination between regulatory bodies resulting in many costly overlaps and conflicting objectives.

Challenger's Board and management welcome the Australian Government's recent decision to establish a task force to review the cost and effectiveness of regulation in Australia. We believe sensible and competent regulation is recognised as a benefit to the community.

Chief Executive Officer's Address

I'd like to emphasise the importance of Challenger's principles to our culture. They provide the basis on which we have been able to deliver our results over the last year.

Revenue for the year grew by 36 per cent. However, if we eliminate discontinued activities from 2004 comparable revenue, this figure is closer to 45 per cent.

Costs grew by 23 per cent, which means revenue grew by about \$100 million more than costs. Most importantly controllable costs, that are those costs that the management can control such as wages, rent and travel and communications costs only rose by \$19 million while revenue grew by almost \$200 million.

As a consequence our EBIT margin, the margin of earnings before interest and tax to revenue, grew by 55 per cent from 11 per cent in 2004 to more than 17 per cent in 2005.

90 per cent of the 6 per cent improvement in operating margin achieved during the 2005 year was directly attributable to improved operating efficiencies – in other words very tight cost control.

This combination of growing revenues and growing margins drove historic cost profit after tax up by almost 160 per cent.



As Peter mentioned, each of our three businesses is required to generate returns on net assets of no less than 18 per cent per year.

In the 2005 year, Challenger Life and Challenger Wholesale Finance exceeded the criteria. Challenger Wealth Management, which is essentially a start-up business has made great strides in the year and is expected to reach its return on net assets in the 2007-2008 years.

As your CEO, I'd like you to understand how proud I am of what the Challenger team has achieved in a relatively short amount of time. These results would not have been possible without the effort of a talented and committed group of people.

This is a great opportunity for me to talk with you about what it is that we, your Board and management, believe will make Challenger succeed in the years ahead.

Our strategy is well founded and delivering – evidenced by the substantial increase of pre-tax profit in 2005 and growing support from the financial community reflected in the growth of assets and loans under management.

Our strategy puts us fairly and squarely in competition with companies which are bigger and offer far greater financial and human resources; they have well established and heavily promoted brands, most have been in operation for decades; some for as long as 150 years.

Your company's market capitalisation is just over \$2 billion, but our visibility in the financial markets and with our shareholders is higher than many companies of our size. Our increased recognition is to the credit of our highly-skilled, quality people and their dedication to providing outstanding service and value for money.

As your Chairman said, the Board and management have a strong focus on attracting, retaining and developing our people. At a Board and management level, we aim to attract the highest quality individuals available and are committed to their development.

Your management believes Challenger offers skilled individuals a high level of opportunity. We aim to attract highly-skilled employees who are interested in working in a company where they can be actively involved in decision making, encouraged to demonstrate leadership and ultimately make a difference.

I'd now like to explain:

- The basis on which we compete
- How we will continue to compete



- And the steps taken to build one of the best teams of people in Australian financial services

The priority of your management is to build a lean and focused financial services business.

- We offer the market modern, highly innovative and differentiated products. We will continue to identify sustainable comparative advantages in our business model and implement them efficiently.
- We build quality third party distribution relationships. We want our distributors to want to do more business with us, to rate us better than our competitors, to appreciate our commitment to low cost efficiency. We need to provide them with the tools that enable them to make more profit from selling our products over those of our competitors.
- We provide friendly and outstanding service and are committed to meeting our customers' needs and exceeding their expectations.
- We run a lean, low-cost, efficient business platform and work to drive synergy benefits across our business model.
- We actively manage risk and compliance with all of our operating licenses, systems and procedures.

Challenger is not entrenched in the past but focussed on our ability to achieve. We are recognised amongst peers for our flexibility and the speed at which we can execute business strategy.

Your management believes however, that in order to continue to achieve these outcomes over the long term we will need to continue to attract and retain exceptional individuals. People who are committed to the success of Challenger and whose interests are aligned with those of Challenger's shareholders.

Hopefully you will have passed by the Challenger Principles this morning which have been developed and adopted by Challenger's employees over the past 15 months. Our principles are our credo by which we operate, the values we bring to everything we do within Challenger.

The Challenger Principles focus on five broad areas:

- our compliance culture,
- each employee's right and obligation to act and take responsibility for their actions as if they were an owner of the business,
- each employee's obligation to participate in creating customer solutions and better service,



- the role of teamwork in everything we do, and
- the integrity we bring to all of our relationships, the process of saying what we mean and meaning what we say.

During the past year I have met with our 900 employees in small groups to talk about how they individually could cause us to succeed or fail in our endeavours.

We determined that Challenger could only succeed by having the best products and services available and being relentless in the way we manage costs. We discussed how we intend to achieve this.

These sessions were supported by a training program that was developed and conducted by Challenger staff from all parts of our business. The program was attended by all of our employees and members of our Board. The photos you have seen this morning were taken at these sessions.

We also presented awards during the year to people who exhibited what we call a "can do" attitude and we gave staff who have worked at Challenger for two years or longer \$1000 worth of Challenger shares - a critical element to developing a shared sense of ownership and responsibility amongst our team.

It is our collective desire – your management and employees of Challenger - to deliver superior differentiated products and outstanding service which will enable us to win in the competitive environment we have chosen against our larger, well resourced but often bureaucratic competitors.

It is the sense of ownership, the sense of being able to make a real difference and the sense of belonging that will attract people who wish to be part of an outstanding organisation. We are seeing the benefits of these initiatives with an increasing number of highly skilled individuals wanting to join the Challenger team.

We have seen senior executives from a number of our competitors approach us about opportunities to join Challenger over the past six months which benefits Challenger significantly - it makes our team stronger and that of our competitors weaker.

With your support, the Long Term Incentive Plan has been and will be the bond that aligns employees with shareholders. The incentive plan requires a compound 15 per cent per annum growth in total shareholder returns for employees to qualify for shares. It is a significant incentive to grow shareholder returns at rates above the normal growth rate in the market.

This is one of the reasons we strongly believe that employee rewards should be tied to shareholder rewards.



Challenger's greatest asset is its employees. Just as a mining company might invest capital in a new mine, or a manufacturer in a new factory, our ability to invest in our people is pivotal to Challenger's growth. It is through the Long Term Incentive Plan that we invest in our people.

With your support - I believe we can continue to build significant shareholder value at Challenger.