

MARKET RELEASE

CHALLENGER FINANCIAL SERVICES GROUP LIMITED HALF YEAR RESULTS TO 31 DECEMBER 2005

27 February 2006, Sydney – Challenger Financial Services Group Limited (CGF) today announced a statutory net profit after tax before significant items and minority interests of \$72 million for the interim period ending 31 December 2005, an increase of 29 per cent over the previous corresponding period. Statutory profit before interest, tax and significant items was up 26 per cent in the half to \$115 million.

On a historic cost basis, net profit after tax was \$57 million, an increase of 33 per cent over the previous corresponding period. Profits from asset realisations accounted for 18 per cent of Earnings Before Interest and Tax (EBIT) this half, compared with 51 per cent in the previous corresponding half.

Statutory net profit after tax, significant items and minority interests was \$60 million. Half year earnings per share increased to 13.4 cents before significant items and minorities on a statutory basis, 11.2 cents after significant items and minorities (10.7 cents previously) and 10.6 cents per share on a historic cost basis (8.3 cents previously). Challenger will pay an interim dividend of 2.5 cents for the half-year ended 31 December 2005.

Challenger Chief Executive Officer Mike Tilley said: “Challenger has maintained steady growth across its three core businesses over the last six months and the company’s decision to pay an interim dividend reaffirms the Board’s confidence in the sustainability of this growth. In December 2004, we had reached completion of the clean up process. In June 2005, we began to invest for future growth. The December 2005 result shows the continuation of investment in future growth through investment in new people, reorganisation of our management structure and leveraging the business model, investment in fully integrated technology, and improved efficiency in our capital structure.

Highlights during the period included:

- Strong residential mortgage growth - 14.3 per cent annualised and 26 per cent above the market
- Strong growth in funds under management - 26 per cent annualised
- The formation of the Challenger Infrastructure Fund and new infrastructure investments
- Strategic relationship with Bank of Queensland for financial planning and mortgages



- Investment in and strategic relationship with mortgage aggregator PLAN Australia
- Formation of Five Oceans Asset Management and Kinetic – boutique funds management businesses
- Acquisition of Inexus by Challenger Infrastructure Fund for \$1.2 billion

Underlying business performance was in line with plan for the six months to 31 December 2005, reinforced by continued EBIT margin improvements (up from 20 per cent to 23 per cent on a comparable basis) due to continuing strong cost management.

Historic cost highlights include:

- **Revenue** up 18 per cent
- **Costs** controllable costs grew at 12 per cent half on half due to tight cost control, despite significant investments in new senior executives in the Life Group and Associated Planners being included for only for part of the prior period
- **Historic cost EBIT** was up 36 per cent to \$95 million

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A key measure of financial discipline within the Group is the performance of the three core businesses against a return on net assets target of 18 per cent. On an annualised basis, Challenger Wholesale Finance and Challenger Life achieved a 20 per cent RONA for the period. As previously stated, Challenger Wealth Management is on track to meet its target and the result for the December half shows the business is half way to the attainment of that target.

Challenger Life

Challenger Life had an active six months to December, with the launch of the Challenger Infrastructure Fund in August and subsequent acquisition of Inexus, the UK's largest independent gas transporter, in September. The business reported a statutory profit before tax and significant items of \$81 million, \$60 million on a historic cost basis.

Challenger Life also received recognition for the work put in over the last two years to de-risk and improve the underlying strength of the business when its Fitch Insurer Financial Strength Rating was upgraded from "BBB" to "A-".

Annuity sales for the December half were \$154 million and remain comfortably on target for levels of at least \$300 million for the year.

A number of important senior management appointments were made during the period, deepening Challenger Life's capabilities across property and infrastructure. These investments



have been made as part of its strategy to leverage investment returns from the Life balance sheet as it looks to continue to develop additional specialist investment vehicles.

Challenger Wholesale Finance

Challenger Wholesale Finance profit grew 33 per cent to \$36 million before tax. The loan book grew to \$19.7 billion at the end of December and the residential lending book grew by an annualised 14.3 per cent - 26 per cent above the market. Margins were maintained in a very competitive operating environment where major competitors are aggressively sacrificing margins and credit quality.

A core component of the success of the business is its ability to expand its offer of products, features and service.

Challenger entered into an alliance with the Bank of Queensland to provide residential mortgage products with features not offered by Bank of Queensland's traditional mortgage products.

Leading technology remains a significant competitive advantage for Wholesale Finance and the business completed development of its automated loan processing system *Litework* during the period. *Litework* allows lenders to conduct credit checks, receive valuer instructions and loan approvals online, with no transaction fees. The system significantly reduces the time taken to process loan applications and will in time allow for fully automated, real time loan approvals.

A number of structural and process changes were made to the business during the period to improve timeliness and efficiency. This included the creation of a more functionally aligned management structure and the consolidation of residential lending operations in Melbourne to improve the timeliness and the consistency of service delivery. The benefits of this process engineering project are likely to become apparent over the next 12-18 months.

Challenger took a 15 per cent stake in mortgage aggregator PLAN Australia during the period. PLAN's business model is strategically aligned with Challenger; it is a white label service provider that provides technology and support services for mortgage brokers.

Challenger Wealth Management

Challenger Wealth Management performed ahead of expectations reporting a profit before tax of \$12 million, compared with a loss of \$3 million for the corresponding period in 2004. Wealth Management achieved material improvement in its cost-to-income ratio, which improved to 80 per cent during the half.



Despite exiting property syndicates and the sale of the HSBC Asset Management private clients business in the period, funds under management rose by 26 per cent annualised from \$10.6 billion to \$11.9 billion. This was supported by continuing diversification of revenue streams; outstanding performance by our investment funds; and significant upgrades in research house ratings across the breadth of Challenger Wealth Management products. Diversification of revenue from product channels included the launch of the QIC managed Custom Choice funds, the half-year impact of ex-HSBC Asset Management funds, and the entry into international markets through Five Oceans Asset Management.

Genesys Wealth Advisers reached an agreement with the Bank of Queensland for Genesys to provide financial planning advice throughout the Bank's branch network. This alliance offers quality financial advice to Bank of Queensland's customer base.

New Sydney premises

Challenger has previously announced its intention to relocate its head office to new premises in Sydney that will bring staff together from three locations to one - meeting the Challenger principle of working together – as well as reduce occupancy costs and accommodate future growth.

After an extensive search, Challenger has entered into a lease to occupy almost 8000 square metres at the Hilton office development on Pitt Street, Sydney.

Challenger staff currently located at three Sydney CBD locations will be relocated to these new premises by the end of March 2007. Challenger will incur approximately \$5 million in relocation costs, which will be expensed over the next 12 months, but anticipates the relocation will deliver significant productivity improvements during the years ahead.

Outlook

Challenger has continued to focus on investment in people and systems during the December half. This investment phase will continue in the second half as the focus on building new investment funds and vehicles and distribution initiatives continues. The additional cost of building this team ahead of new revenue generation and continuing to meet extreme pressure on remuneration has and will continue to be absorbed by scale economies and tight cost control in other areas.

ENDS



Note to editors:

Statutory and Historic cost accounting: Life companies are required to be accounted for on a Statutory basis consistent with Life company accounting. Challenger has chosen to also present its results on a historic cost basis to help the market better understand the underlying profit and cashflow generated by the Life company.

SUMMMARY FINANCIALS

	31 Dec 2005	(restated) 31 Dec 2004	Increase
	\$m	\$m	%
Profit before interest and tax:			
▪ Statutory ¹ (before significant items ²)	115	91	26
▪ Historic cost	95	70	36
Profit after tax:			
▪ Statutory ¹ pre-significant items ² and minority interests	72	56	29
▪ Historic cost	57	43	33
Basic EPS:			
▪ Statutory ¹			
▪ Pre significant items ² and minority interests	13.4	10.7	26
▪ Post significant items ² and minority interests	11.2	10.7	5
▪ Historic cost	10.6	8.3	28

¹ Certain IFRS standards only commenced from 1 July 2005 and statutory comparatives have not been changed accordingly. In particular, the change in valuation of policy liabilities.

² An unrealized loss of \$19 million was incurred by the Challenger Infrastructure Fund under the new IFRS hedge accounting requirements.