Challenger Limited
Analyst Pack

FY13
30 June 2013

challenger

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Important Note

Information presented in the FY13 Analyst Pack is presented on an operational basis (rather than statutory) to reflect a management view of the business. Challenger also provides statutory reporting as prescribed under the Corporations Act 2001. The audited full year financial report is available from Challenger's website at www.challenger.com.au.

The analyst pack is not audited. The statutory net profit after tax as disclosed in the consolidated profit and loss (see page 2) has been prepared in accordance with Australian Accounting Standards and the Corporations Act 2001. Challenger's external auditors, Ernst & Young, have audited the statutory net profit after tax as disclosed in the consolidated profit and loss. Normalised net profit after tax, as disclosed in the consolidated profit and loss (see page 2) has been prepared in accordance with a normalised profit framework. The normalised profit framework has been disclosed in the Directors' Report and Note 2 – segment information, in the Challenger Limited 30 June 2013 financial report. The normalised profit after tax has been subject to a review performed by Ernst & Young.

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 are based.

While Challenger has sought to ensure that information is accurate by undertaking a review process, it makes no representation or warranty as to the accuracy or completeness of any information or statement in this document. In particular, information and statements in this document do not constitute investment advice or a recommendation on any matter, and should not be relied upon.

Key Performance Indicators

	FY13	FY12	FY11	2H 13	1H 13	2H 12	1H 12	2H 11	1H 11
Earnings									
Normalised NPAT ($m)	308.5	296.8	248.0	159.8	148.7	170.1	126.7	127.7	120.3
Statutory NPAT ($m)	416.8	148.5	261.4	194.8	222.0	128.5	20.0	143.5	117.9
Normalised EBIT ($m)	364.8	338.3	313.8	187.0	177.8	178.4	159.9	161.6	152.2
Underlying operating cashflow ($m)	321.5	282.3	276.4	170.4	151.1	142.6	139.7	149.8	126.6
Normalised cost to income ratio	34.4%	35.9%	36.5%	33.9%	35.0%	34.5%	37.3%	36.5%	36.5%
Normalised effective tax rate	14.4%	11.4%	20.3%	13.6%	15.1%	3.4%	20.3%	19.8%	20.8%
Earnings per share (cents)									
– Basic – normalised	58.6	57.5	51.7	30.7	28.0	32.0	25.3	26.5	25.2
– Basic – statutory	79.2	28.8	54.5	37.4	41.8	24.1	4.0	29.8	24.7
– Diluted – normalised	58.0	55.7	48.1	30.2	27.8	31.5	24.1	24.5	23.6
– Diluted – statutory	78.3	27.8	50.7	36.8	41.5	23.8	3.8	27.5	23.1
Normalised Return on Equity (RoE) – pre-tax	19.6%	21.2%	22.3%	19.7%	19.6%	21.4%	21.0%	22.5%	22.1%
Normalised Return on Equity (RoE) – post-tax	16.8%	18.8%	17.7%	17.0%	16.6%	20.6%	16.8%	18.0%	17.5%
Statutory Return on Equity (RoE) – post-tax	22.7%	9.4%	18.7%	20.7%	24.9%	15.5%	2.6%	20.2%	17.1%
Capital management									
Net assets – average[1] ($m)	1,836	1,577	1,398	1,899	1,772	1,658	1,502	1,431	1,367
Net assets – closing ($m)	1,947	1,692	1,488	1,947	1,827	1,692	1,618	1,488	1,415
Net assets per basic share ($)	3.78	3.20	3.12	3.78	3.47	3.20	3.02	3.12	2.92
Net tangible assets ($m)	1,426	1,173	969	1,426	1,308	1,173	1,099	969	893
Net tangible assets per basic share ($)	2.77	2.22	2.03	2.77	2.48	2.22	2.05	2.03	1.84
Dividend (cps)	20.0	18.0	16.5	10.5	9.5	10.5	7.5	9.5	7.0
Normalised dividend payout ratio	34.1%	31.3%	31.9%	34.2%	33.9%	32.9%	29.6%	35.8%	27.8%
Sales, net flows and AUM									
Life sales ($m)									
– Retail	2,179.2	1,954.3	1,903.4	1,123.9	1,055.3	971.0	983.3	1,190.3	713.1
– Institutional	951.8	703.5	59.3	30.6	921.2	415.1	288.4	40.6	18.7
Total Life sales	3,131.0	2,657.8	1,962.7	1,154.5	1,976.5	1,386.1	1,271.7	1,230.9	731.8
Life retail net flows[2] ($m)	598.1	582.9	468.1	385.3	212.8	329.7	253.2	259.2	208.9
Life retail annuity book ($m)	7,123.3	6,553.0	5,629.0	7,123.3	6,819.6	6,553.0	6,065.0	5,629.0	4,877.9
Life retail net book growth[2]	9.1%	10.4%	9.9%	5.6%	3.2%	5.4%	4.5%	5.3%	4.4%
Funds Management – net flows ($m)	6,978.6	4,226.0	2,397.0	4,754.4	2,224.2	2,505.0	1,721.0	1,324.0	1,073.0
Assets under management ($m)									
– Life	10,787	9,773	8,387	10,787	10,170	9,773	8,709	8,387	7,630
– Funds Management	41,103	31,017	23,608	41,103	35,335	31,017	27,721	23,608	21,864
– Cross holding elimination	(7,120)	(7,361)	(4,086)	(7,120)	(7,221)	(7,361)	(6,863)	(4,086)	(3,723)
Total assets under management	**44,770**	**33,429**	**27,909**	**44,770**	**38,284**	**33,429**	**29,567**	**27,909**	**25,771**
Other									
Headcount – closing FTEs	487	479	455	487	482	479	480	455	458
Weighted average number of basic shares on issue (m)	526.1	516.4	479.4	520.8	531.4	532.5	500.5	481.1	477.7
Number of basic shares on issue (m)	515.6	529.0	476.9	515.6	526.4	529.0	536.0	476.9	484.5
Share price closing ($)	4.01	3.25	4.89	4.01	3.54	3.25	4.13	4.89	4.70

1 Average net assets calculated on a monthly basis.
2 Retail annuity net flows and net book growth exclude the High Yield Fund conversion in 2H11 ($444m).

Consolidated profit and loss

$m	FY13	FY12	FY11	2H 13	1H 13	2H 12	1H 12	2H 11	1H 11
Cash earnings	416.2	392.0	355.3	209.7	206.5	203.3	188.7	187.4	167.9
Normalised capital growth	36.0	43.7	45.5	17.4	18.6	21.6	22.1	21.3	24.2
Normalised Cash Operating Earnings (COE)	**452.2**	**435.7**	**400.8**	**227.1**	**225.1**	**224.9**	**210.8**	**208.7**	**192.1**
Net fee income	99.4	83.0	88.4	54.2	45.2	43.3	39.7	43.9	44.5
Other income	4.9	8.8	4.8	1.7	3.2	4.3	4.5	1.7	3.1
Total net income	**556.5**	**527.5**	**494.0**	**283.0**	**273.5**	**272.5**	**255.0**	**254.3**	**239.7**
Personnel expenses	(130.3)	(128.9)	(123.9)	(64.9)	(65.4)	(65.8)	(63.1)	(61.5)	(62.4)
Other expenses	(61.4)	(60.3)	(56.3)	(31.1)	(30.3)	(28.3)	(32.0)	(31.2)	(25.1)
Total expenses	**(191.7)**	**(189.2)**	**(180.2)**	**(96.0)**	**(95.7)**	**(94.1)**	**(95.1)**	**(92.7)**	**(87.5)**
Normalised EBIT	**364.8**	**338.3**	**313.8**	**187.0**	**177.8**	**178.4**	**159.9**	**161.6**	**152.2**
Interest and borrowing costs	(4.6)	(3.3)	(2.7)	(1.9)	(2.7)	(2.3)	(1.0)	(2.3)	(0.4)
Normalised profit before tax	**360.2**	**335.0**	**311.1**	**185.1**	**175.1**	**176.1**	**158.9**	**159.3**	**151.8**
Normalised tax	(51.7)	(38.2)	(63.1)	(25.3)	(26.4)	(6.0)	(32.2)	(31.6)	(31.5)
Normalised profit after tax	**308.5**	**296.8**	**248.0**	**159.8**	**148.7**	**170.1**	**126.7**	**127.7**	**120.3**
Investment experience after tax	99.8	(148.3)	(28.7)	26.5	73.3	(41.6)	(106.7)	(26.3)	(2.4)
Significant items after tax[1]	8.5	–	42.1	8.5	–	–	–	42.1	–
Statutory net profit after tax	**416.8**	**148.5**	**261.4**	**194.8**	**222.0**	**128.5**	**20.0**	**143.5**	**117.9**
Performance analysis									
Normalised earnings per share – basic (cents)	58.6	57.5	51.7	30.7	28.0	32.0	25.3	26.5	25.2
Shares for basic EPS calculation	526.1	516.4	479.4	520.8	531.4	532.5	500.5	481.1	477.7
Normalised cost to income ratio	34.4%	35.9%	36.5%	33.9%	35.0%	34.5%	37.3%	36.5%	36.5%
Normalised effective tax rate	14.4%	11.4%	20.3%	13.6%	15.1%	3.4%	20.3%	19.8%	20.8%
Total net income analysis									
Cash earnings (Life)	74.7%	74.3%	71.9%	74.1%	75.5%	74.6%	74.0%	73.7%	70.0%
Normalised capital growth (Life)	6.5%	8.3%	9.2%	6.1%	6.8%	7.9%	8.7%	8.4%	10.1%
Net fee income (Funds Management)	17.9%	15.7%	17.9%	19.2%	16.5%	15.9%	15.6%	17.3%	18.6%
Other income (Corporate)	0.9%	1.7%	1.0%	0.6%	1.2%	1.6%	1.8%	0.7%	1.3%
Normalised EBIT by division									
Life	381.9	367.7	348.8	191.8	190.1	191.1	176.6	178.0	170.8
Funds Management	34.1	21.0	20.1	21.2	12.9	11.5	9.5	10.8	9.3
Corporate	(51.2)	(50.4)	(55.1)	(26.0)	(25.2)	(24.2)	(26.2)	(27.2)	(27.9)
Normalised EBIT	**364.8**	**338.3**	**313.8**	**187.0**	**177.8**	**178.4**	**159.9**	**161.6**	**152.2**

1 2H13 significant items primarily represent the gain on sale of Challenger's equity investment in Homeloans Limited. 2H11 significant items represent a tax provision release following confirmation from the Australian Tax Office on Challenger's tax treatment of prior year matters.

Consolidated profit and loss

Normalised profit after tax

Normalised profit after tax was $309m in FY13, up $12m (4%) on FY12. Normalised EBIT was $365m, up $27m (8%) on FY12. Normalised profit after tax increased as a result of higher net income (up $29m), partly offset by higher expenses (up $2m), higher interest and borrowing costs (up $1m) and higher normalised tax (up $14m).

FY13 normalised EPS increased by 2% from 57.5 cps to 58.6 cps. The increase in normalised EPS reflects higher normalised profit after tax (up 4%), partly offset by a higher weighted average number of shares on issue. The number of shares on issue increased in October 2011 following the exercise of 60m CPH Investments Management Pty Limited options, partly offset by shares cancelled under Challenger's on-market buy back program.

Total net income

Total net income increased by $29m (5%) due to:

- higher Life Cash Operating Earnings (up $17m) as a result of growth in Life's annuity business;
- higher Funds Management net fee income (up $16m) due to higher Funds Under Management (FUM); partly offset by
- lower Corporate other income (down $4m) due to lower interest income.

Expenses

FY13 total expenses were $192m, up $2m (1%) on FY12. Life expenses and Funds Management expenses increased by $2m and $3m respectively, and were partly offset by a $3m reduction in Corporate costs.

Challenger's business is highly scalable, resulting in Challenger being one of Australia's most efficient financial services companies. Over the past five years, total expenses have increased by 3%, while revenue has increased by 50%.

The scale and operating leverage in Challenger's business has resulted in the normalised cost to income ratio falling by 16 percentage points over the last five years to 34.4% in FY13.

Reflecting the scale and leverage, Challenger has lowered its medium term normalised cost to income ratio target to a range of 32% to 36% (down from 34% to 38%).

Normalised EBIT

FY13 normalised EBIT was $365m, increasing by $27m (8%) from $338m in FY12.

Life normalised EBIT increased by $14m and Funds Management by $13m. The increase in both Life and Funds Management normalised EBIT reflects growth and higher assets and funds under management. Corporate normalised EBIT fell by $1m, due to lower interest income.

Normalised tax

The FY13 effective normalised tax rate was 14.4%, which is up from 11.4% in FY12. The increase is due to higher normalised profit taxed at the 30% corporate tax rate.

Normalised tax in FY12 and FY13 includes the effect of a private binding tax ruling received from the Australian Taxation Office in February 2012 in relation to the application of Taxation of Financial Arrangements (TOFA). The TOFA private ruling is expected to reduce normalised tax by approximately $30m for each of the three financial years FY12 to FY14.

Excluding the TOFA tax benefit, the FY13 effective normalised tax rate was 22.7%.

Investment experience

Challenger Life is required by Life accounting standards to value all assets and liabilities supporting the Life business at fair value. This gives rise to fluctuating valuation movements on assets and liabilities being recognised in the profit and loss. Challenger is generally a long-term holder of assets, due to them being held to match the term of life contract liabilities. As a result, Challenger takes a long-term view of the expected capital growth of the portfolio rather than focusing on short-term movements.

Investment experience represents the difference between actual investment gains/losses (both realised and unrealised) and expected gains/losses based on Challenger's long-term expected returns. Investment experience also includes any economic and actuarial assumption changes, including the impact of changes in economic variables (refer to page 29 for more detail).

Investment experience relates to the Life business and pre-tax investment experience is disclosed as part of the Life's financial results (refer to page 12).

FY13 investment experience after tax was a profit of $100m, compared to a loss of $148m in FY12. FY13 investment experience was primarily from gains on the fixed income portfolio, which were supported by a contraction in credit spreads following an improvement in global market sentiment.

Significant items

FY13 significant items after tax was $9m and primarily relates to a gain on the sale of Challenger's investment in Homeloans Limited.

Following the sale of Challenger's Mortgage Management business in 2009, Challenger retained a residual investment in Homeloans Limited, an Australian non-bank provider of home loans. In 2H13, Challenger sold the majority of its stake in Homeloans Limited.

Statutory net profit after tax

Statutory net profit after tax includes investment experience and significant items after tax.

FY13 statutory net profit after tax was $417m, up from $149m in FY12. The increase in statutory net profit after tax reflects higher normalised profit after tax (up $12m), a significant improvement in investment experience after tax (up $248m) and FY13 significant items ($9m).

FY14 guidance

- FY14 retail net book growth is targeted to grow by 8% (~$570m), excluding maturity of the High Yield Fund annuity. In February 2011, the Challenger High Yield Fund was converted to a 3 year annuity, with approximately $300m maturing in March 2014. FY14 retail net book growth guidance excludes the High Yield Fund maturity, as reinvestment rates are difficult to determine.
- Life institutional outflows of ~$790m are expected in the September 2013 quarter. This maturity will reduce the size of the Guaranteed Index Return (GIR) AUM, and has been considered in determining FY14 Life Cash Operating Earnings (COE) guidance.
- FY14 Life COE guidance of between $465m and $475m. Based on the mid-point of Life COE and retail net book growth guidance, and expected institutional outflows, the implied Life COE margin for FY14 is ~4.5%, which is unchanged on FY13.

Management balance sheet

$m	FY13	1H 13	FY12	1H 12	FY11	1H 11
Group balance sheet[1]						
Assets						
Life investment assets						
Fixed income and cash (net)	8,219.2	7,974.2	7,388.1	6,369.3	6,114.2	5,431.2
Property (net)	1,761.1	1,540.9	1,539.3	1,552.1	1,535.1	1,497.0
Infrastructure (net)	488.4	426.9	617.5	568.4	478.6	464.6
Equity and other investments	318.5	227.7	228.4	219.3	258.9	237.0
Life investment assets	**10,787.2**	**10,169.7**	**9,773.3**	**8,709.1**	**8,386.8**	**7,629.8**
Cash and cash equivalents	177.1	135.5	93.8	208.7	93.0	66.2
Receivables	446.3	381.6	332.5	355.3	310.5	271.9
Derivative assets	336.9	438.9	512.9	430.5	355.7	363.6
Fixed assets	14.5	16.0	18.2	18.5	19.4	21.0
Tax assets	–	–	–	–	–	1.8
Other investment assets	5.4	7.5	7.4	38.0	43.9	48.4
Investment in associates	40.0	49.8	51.2	40.9	40.9	25.6
Other assets	35.2	42.1	39.2	38.9	34.4	43.2
Goodwill and intangibles	521.1	519.6	519.4	519.1	518.8	521.6
Less Group/Life eliminations[2]	(223.1)	(254.9)	(290.0)	(302.0)	(363.0)	(403.5)
Total assets	**12,140.6**	**11,505.8**	**11,057.9**	**10,057.0**	**9,440.4**	**8,589.6**
Liabilities						
Payables	165.4	275.1	239.3	235.2	276.6	240.4
Tax liabilities	133.9	100.5	22.8	14.9	41.9	70.5
Derivative liabilities	393.9	123.9	144.6	114.3	113.0	116.1
Subordinated debt	510.1	472.3	450.1	460.9	481.9	474.9
Other interest bearing liabilities	88.2	79.9	77.3	69.0	62.7	59.8
Provisions	27.0	30.2	27.4	33.3	30.3	27.5
Life retail annuity book	7,123.3	6,819.6	6,553.0	6,065.0	5,629.0	4,877.9
Guaranteed index return liabilities	1,751.4	1,777.0	1,851.2	1,446.8	1,316.7	1,307.5
Total liabilities	**10,193.2**	**9,678.5**	**9,365.7**	**8,439.4**	**7,952.1**	**7,174.6**
Group net assets	**1,947.4**	**1,827.3**	**1,692.2**	**1,617.6**	**1,488.3**	**1,415.0**
Equity						
Contributed equity	1,271.9	1,313.5	1,313.1	1,339.3	1,101.1	1,147.4
Reserves	49.8	33.0	109.0	96.8	179.8	169.6
Retained earnings	625.7	480.8	270.1	181.6	207.4	98.0
Total equity	**1,947.4**	**1,827.3**	**1,692.2**	**1,617.7**	**1,488.3**	**1,415.0**

1 Excludes consolidation of Special Purpose Vehicles (SPV's) and non-controlling interests.
2 Group/Life eliminations represent the fair value of SPV residual income notes held by Challenger Life Company.

Management balance sheet

$m	FY13	1H 13	FY12	1H 12	FY11	1H 11
Life balance sheet						
Assets						
Life investment assets						
Cash and equivalents	1,292.7	441.3	556.9	625.5	640.9	551.0
Asset backed securities	3,397.3	3,593.4	3,160.8	2,652.9	2,451.8	2,378.6
Corporate credit	3,366.8	3,692.1	3,363.0	2,664.0	2,488.0	1,884.4
Other	162.4	247.4	307.4	426.9	533.5	617.2
Fixed income and cash (net)	**8,219.2**	**7,974.2**	**7,388.1**	**6,369.3**	**6,114.2**	**5,431.2**
Australian – Office	656.8	643.9	781.8	771.6	779.1	755.0
Australian – Retail	260.0	131.4	122.1	114.0	111.2	111.6
Australian – Industrial	130.6	123.7	125.6	149.8	142.8	141.5
Japanese	241.4	235.3	247.4	257.5	234.4	247.6
REITs and other	472.3	406.6	262.4	259.2	267.6	241.3
Property (net)	**1,761.1**	**1,540.9**	**1,539.3**	**1,552.1**	**1,535.1**	**1,497.0**
Infrastructure (net)	488.4	426.9	617.5	568.4	478.6	464.6
Equity and other investments	318.5	227.7	228.4	219.3	258.9	237.0
Life investment assets	**10,787.2**	**10,169.7**	**9,773.3**	**8,709.1**	**8,386.8**	**7,629.8**
Other assets (including intangibles)	612.4	847.9	874.4	898.1	790.9	694.8
Total assets	**11,399.6**	**11,017.6**	**10,647.7**	**9,607.2**	**9,177.7**	**8,324.6**
Life retail annuity book	7,123.3	6,819.6	6,553.0	6,065.0	5,629.0	4,877.9
Guaranteed index return liabilities	1,751.4	1,777.0	1,851.2	1,446.8	1,316.7	1,307.5
Subordinated debt	510.1	472.3	450.1	460.9	481.9	474.9
Other liabilities	149.5	183.7	132.7	155.6	200.2	212.8
Total liabilities	**9,534.3**	**9,252.6**	**8,987.0**	**8,128.3**	**7,627.8**	**6,873.1**
Net assets	**1,865.3**	**1,765.0**	**1,660.7**	**1,478.9**	**1,549.8**	**1,451.5**

Life investment assets

Life investment assets support retail and institutional products and includes shareholder capital.

FY13 Life investment assets were $10.8bn, an increase of 10% from FY12. The increase in Life investment assets was due to retail annuity net book growth, Life cash earnings (net of dividends to Group) and a positive impact from marking Life's investment assets to market.

Life manages a cash flow matched portfolio, with liability cash flows (i.e. payments to customers) matched with cash flows from investment assets. Life has a policy to mitigate interest rate and foreign exchange risk through the use of derivatives.

Life's investment assets at 30 June 2013 comprised:

- Fixed income and cash 76%
- Property 16%
- Infrastructure 5%
- Equities and other investments 3%.

Fixed income and cash

Fixed income and cash of $8.2bn represents 76% of Life's total investment assets, which is unchanged from FY12 and down from 79% in 1H13.

Challenger manages credit risk by maintaining a high quality investment portfolio and applying a rigorous investment process. The fixed income portfolio is diversified across different industries, rating bands, asset classes and geographies.

A total of 84% of the fixed income and cash portfolio is investment grade (BBB- or higher), with 79% of the portfolio externally rated (Standard & Poor's, Fitch or Moody's) and 21% based on internal ratings calibrated to Standard & Poor's ratings framework.

The fixed income and cash portfolio is Australian focused, with domestic cash, corporate credit and asset backed securities accounting for over 70% of the portfolio. The portfolio has no exposure to offshore sovereign debt.

Details of Challenger Life's fixed income and cash portfolio is disclosed in the table below.

Fixed income portfolio by rating

Security rating	Total $m	Investment grade	Non-investment grade	Duration
Cash and equivalents	1,293	16%		n/a
AAA	1,212	15%		3 years
AA	1,325	16%		4 years
A	1,571	19%		5 years
BBB	1,479	18%		4 years
BB	640		8%	7 years
B	355		4%	4 years
Unrated[1]	344		4%	5 years
Total	8,219	84%	16%	4 years

1 Approximately one third of unrated relates to the NIM mortgage asset.

Cash and equivalents represent 16% of the total fixed income portfolio, up from 8% at 30 June 2012. The increase in cash and equivalents at 30 June 2013 is in preparation for institutional maturities of ~$790m expected in the first quarter of FY14.

Property

Property of $1.8bn (net of debt) represents 16% of Life's investment assets.

Life's property portfolio principally comprises directly held properties and jointly held properties with the listed Challenger Diversified Property Group (ASX: CDI). Property also includes investments in Australian REITs.

The property portfolio is predominantly invested in high grade Australian office buildings. Over 70% of the Australian direct portfolio is leased to AAA tenants (government) and the weighted average lease expiry is 6.6 years. A total of 90% of the Australian direct portfolio has either fixed or CPI-linked rental increases, giving rise to sustainable and increasing cash flows over time.

Property includes $241m (14% of the property portfolio) net exposure to Japanese property, which consists of suburban shopping centres, focused on non-discretionary retailing. The weighted average lease expiry of the Japanese portfolio is 11.2 years.

Challenger Life has a policy that all properties are independently valued each year with approximately 50% valued in June and 50% valued in December. Internal valuations are also undertaken for properties not independently valued each June and December. An independent valuation is subsequently undertaken if the internal valuation shows a significant variance to the most recent independent valuation.

All properties were independently valued during the year. As a result, the value of the property portfolio increased marginally. The weighted average capitalisation rate of the Australian portfolio was 8.1% at 30 June 2013, compared to 7.7% at 30 June 2012.

In 2H13, Life's property investments increased following the acquisition of interests in five retail shopping centres at an average capitalisation rate of 7.8%. The increase in property investment assets reflect longer tenor annuity sales in FY13.

Infrastructure

Challenger Life seeks infrastructure assets that generate reliable and consistent cash flows, which are preferably inflation linked, giving rise to sustainable income growth.

Infrastructure represents 5% of Life's investment assets and includes directly held infrastructure assets and indirectly held listed and unlisted investments. The infrastructure portfolio is diversified across a number of geographic regions and sectors. Approximately two thirds of the portfolio is invested in logistics, utility and patronage assets, predominately in Australia and Europe.

Infrastructure assets of $0.5bn are down from $0.6bn in FY12 following the wind up of the Challenger Infrastructure Fund (ASX: CIF) and return of capital to unit holders.

Equity and other investments

Equity and other investments of $0.3bn comprise only 3% of Life's total investment assets and include domestic and international listed and unlisted equity investments.

Capital management

Challenger Life Company (CLC) regulatory capital[1]

$m	FY13	1H 13	FY12
CLC regulatory capital base			
Common Equity Tier 1 (CET1) regulatory capital	1,563.5	1,465.8	1,358.0
Tier 2 regulatory capital – subordinated debt[2]	488.8	477.3	450.1
CLC total regulatory capital base	**2,052.3**	**1,943.1**	**1,808.1**
CLC prescribed capital amount (PCA)			
Prescribed capital amount – excluding transition balance	1,477.7	1,347.2	1,088.7
Transition balance	(322.8)	(322.8)	–
CLC prescribed capital amount	**1,154.9**	**1,024.4**	**1,088.7**
CLC excess capital above prescribed capital amount	**897.4**	**918.7**	**719.4**
PCA ratio (times)	**1.78**	**1.90**	**1.66**
CET1 ratio (times)	**1.35**	**1.43**	**1.25**

Tier 2 regulatory capital – subordinated debt[2]

First call date after 1 Jan 2013	Maturity date	FY13	1H13	FY12
7 Jun 2013	7 Dec 2016	103.2	109.4	105.0
7 Dec 2016	7 Dec 2026	28.0	24.2	23.2
7 Nov 2017	7 Nov 2037	357.6	343.7	321.9
		488.8	**477.3**	**450.1**

Group cash, CLC debt facilities and Group net assets

$m	FY13	1H 13	FY12	1H 12	FY 11	1H 11
Group cash	**177.1**	**135.5**	**93.8**	**208.7**	**93.0**	**66.2**
CLC debt facilities						
Controlled property debt	591.3	611.1	663.0	705.0	659.6	683.6
Subordinated debt	510.1	472.3	450.1	460.9	481.8	474.9
CDI controlled property debt[3]	254.3	246.8	243.7	235.8	226.6	136.9
Repurchase agreements	448.9	235.7	–	–	–	–
Infrastructure debt	206.1	206.1	206.3	207.4	206.1	–
Loan note finance	88.2	79.9	74.0	69.0	62.7	59.8
Total CLC debt facilities	**2,098.9**	**1,851.9**	**1,637.1**	**1,678.1**	**1,636.8**	**1,355.2**

Change in Group net assets

$m	2H 13	1H 13	2H 12	1H 12	2H 11	1H 11
Opening net assets	**1,827.3**	**1,692.2**	**1,617.6**	**1,488.3**	**1,415.0**	**1,339.6**
Statutory net profit after tax	194.8	222.0	128.5	20.0	143.5	117.9
Dividends paid	(49.9)	(55.7)	(40.0)	(45.8)	(32.6)	(43.1)
Share buy-back	(29.6)	(20.4)	(28.3)	(24.7)	(40.9)	(3.7)
Reserve movements	16.8	(31.7)	12.3	(22.7)	8.8	(40.2)
CPP Trust movements	(12.0)	20.9	2.1	15.5	(5.5)	44.5
Option exercise – new shares issued	–	–	–	187.0	–	–
Closing net assets	**1,947.4**	**1,827.3**	**1,692.2**	**1,617.6**	**1,488.3**	**1,415.0**

1 1H13 and FY13 CLC regulatory capital disclosures have been calculated based on LAGIC standards, which are effective from 1 January 2013. FY12 has been calculated based on the capital standards that applied on 30 June 2012.
2 FY13 subordinated debt ($489m) differs to the management balance sheet ($510m) due to inadmissable sub-debt ($26m) less accrued interest and amortised costs ($5m).
3 Represents 100% of Challenger Diversified Property Group.

Capital management

Challenger Life Company (CLC) regulatory capital base

CLC holds capital in order to ensure that under a range of adverse scenarios it can continue to meet its regulatory and contractual obligations to its customers. CLC is regulated by the Australian Prudential Regulation Authority (APRA) and is required to hold a minimum level of regulatory capital.

Life and General Insurance Capital (LAGIC) standards were issued by APRA in October 2012, with the new standards effective from 1 January 2013.

CLC's 30 June 2013 (FY13) and 31 December 2012 (1H13) regulatory capital base and prescribed capital amounts have been calculated based on the new LAGIC standards. All capital disclosures prior to 1H13 have been prepared based on the capital standards in place at that time and have not been restated to reflect LAGIC standards.

CLC's excess capital above the prescribed capital amount as at 30 June 2013 was $897m. CLC's excess capital includes an allowance of $323m in respect of LAGIC transition arrangements.

LAGIC transition arrangements

Prescribed capital amount

The introduction of new LAGIC standards on 1 January 2013 increased CLC's regulatory capital requirement by $323m. APRA has confirmed that transition arrangements will apply, resulting in the increase in capital requirements occurring over a three year period.

The initial LAGIC transition balance ($323m) will amortise over a three year period, so that the increase in prescribed capital will be phased in by $108m each year with the first increase being on 1 January 2014. The entire transition balance will be amortised by 1 January 2016.

Subordinated debt

CLC's total regulatory capital base includes $489m of admissible subordinated debt. APRA has advised that existing subordinated debt tranches will continue to be fully eligible as Tier 2 regulatory capital until each tranche's first call date after 1 January 2013, and will then amortise over four years.

CLC's subordinated debt includes $129m which had a call date on 7 June 2013. As a result, under APRA's transition arrangements, only $103m (i.e. 80% of the total amount) is included in Tier 2 regulatory capital on 30 June 2013.

The largest tranche of CLC's existing subordinated debt is a $358m tranche with a call date in November 2017. As such, this tranche will continue to be fully eligible as Tier 2 regulatory capital until its call date in November 2017 and will continue to be partially eligible until November 2021.

Tier 1 and Tier 2 regulatory capital

Under APRA's transition arrangements, CLC's statutory funds have three years to transition to the minimum requirement of Tier 1 capital representing 80% of the prescribed capital amount. At CLC consolidated level, APRA has provided an eighteen month transition period to meet the minimum 80% Tier 1 capital requirement. CLC is currently meeting these requirements at both a statutory fund level and a consolidated level.

CLC target surplus

CLC maintains a target level of capital representing APRA's prescribed capital amount plus a target surplus. The target surplus is a management guide to the level of excess capital that CLC seeks to carry over and above APRA's minimum requirements.

CLC's target surplus is set to ensure that it provides a buffer against adverse market conditions and having regard to CLC's credit rating. CLC uses internal capital models to determine its target surplus, which are risk-based and are responsive to changes in CLC's asset allocation and market conditions.

While CLC does not target a specific PCA ratio, CLC's internal capital models result in a PCA ratio under current circumstances in the range of 1.4 times to 1.6 times. This range can change over time and is dependent on numerous factors.

CLC's PCA ratio at 30 June 2013 (based on LAGIC capital standards) was 1.8 times, higher than the 1.4 to 1.6 times target range, reflecting strong earnings of CLC during the period and contemplates amortisation of the LAGIC transition balance over the next two and a half years. Excluding the full LAGIC transition balance ($323m), CLC's PCA ratio at 30 June 2013 was 1.4 times, which is within CLC's targeted PCA range.

Group cash

Group cash at 30 June 2013 was $177m up from $94m at 30 June 2012.

Challenger has an undrawn Group banking facility of $250m and is maintained to provide additional financial flexibility. The banking facility was partially drawn during FY13, however was fully repaid by 30 June 2013.

CLC debt facilities

CLC debt facilities represents debt which is non-recourse as it is secured against assets of CLC including direct properties, the Challenger Diversified Property Group, repurchase agreements, infrastructure investments or subordinated to policyholders, in the case of subordinated debt.

Change in Group net assets

FY13 Group net assets were $1,947m, up $255m from FY12. The movement in group net assets is predominantly due to net profit after tax (including investment experience), partially offset by dividends to shareholders, funding of the share buy back and reserve movements.

CLC excess regulatory capital and Group cash

In addition to CLC's excess regulatory capital, Challenger also maintains cash at a Group level which is available to meet regulatory requirements if required. Group cash at 30 June 2013 was $177m, up $83m for the year.

Total CLC excess regulatory capital plus Group cash was $1,074m, up from $813m at 30 June 2012. The increase reflects FY13 statutory net profit after tax (including investment experience) net of dividends to Group, increase in capital intensity due to book growth, and initial subordinated debt amortisation.

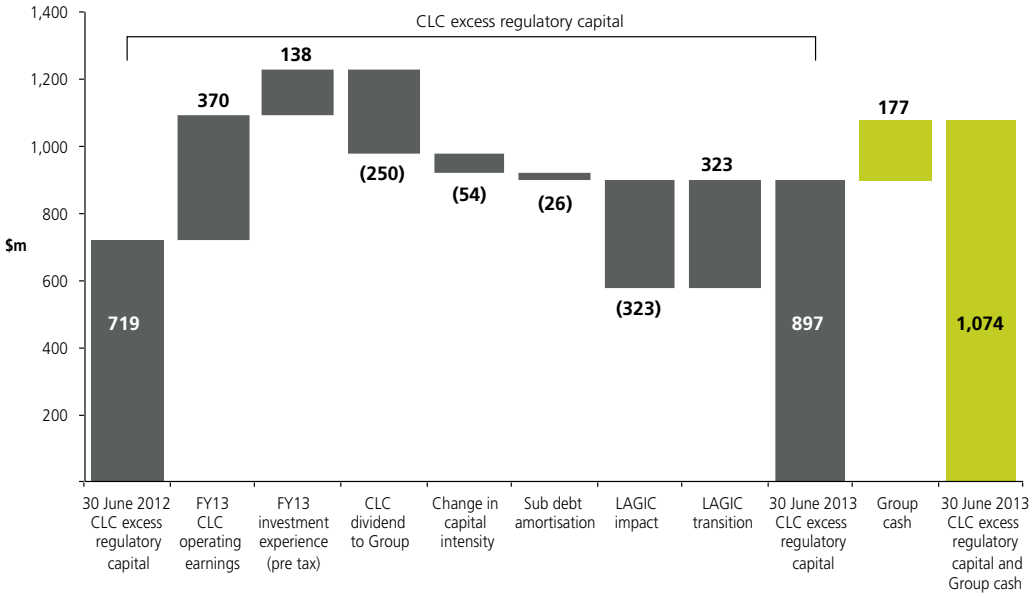
APRA's Level 3 (conglomerate) proposals

APRA is currently developing a supervisory framework for Level 3 (conglomerate) groups, which is expected to be effective from 1 January 2015. Level 3 are groups of companies that perform material activities across more than one APRA-regulated industry and/or in one or more non-APRA-regulated industry.

Draft Level 3 standards were issued by APRA in May 2013. APRA is still consulting with industry on the draft standards before finalising. Based on the draft standards, Challenger expects to be fully compliant on 1 January 2015.

Following APRA's finalisation of the Level 3 capital standards, Challenger will determine an appropriate target PCA ratio range, based on both LAGIC and Level 3 capital standards, which will apply to the Challenger Group.

Movement in CLC excess regulatory capital and Group cash



Challenger dividends and share buy back

Dividend

A final 2013 dividend of 10.5 cents per share, unfranked, has been declared. Total 2013 dividends were 20.0 cents per share (unfranked), representing an 11% increase on 2012. The increase reflects a higher normalised profit after tax (up 4%) and a higher dividend payout ratio.

The dividend payout ratio was 34.1% and is in line with the Group's dividend policy (refer below).

Final 2013 dividend dates are as follows:

- Ex-date: 2 September 2013;
- Record date: 6 September 2013; and
- Payment date: 27 September 2013.

There is no dividend reinvestment plan in operation for this dividend.

Dividend and share buy back policy

The Challenger Board reviews the dividend policy on a regular basis as part of the Group's capital management plan. Challenger targeted a dividend payout ratio for FY13 of 30% to 35% of normalised net profit after tax.

Challenger intends to frank dividends to the maximum extent possible. However, Challenger is unable to frank dividends at present due to carried forward tax losses which need to be utilised before franking credits are generated. Challenger expects to commence partial dividend franking in FY14, subject to future earnings and market conditions.

In FY14 Challenger is increasing its targeted dividend payout ratio to a range of 35% to 40% of normalised net profit after tax.

Given the current inability to frank dividends, Challenger operates an on-market share buy back program to enhance shareholder returns. Challenger's on-market buy back program operates under s257B of the Corporations Act, which allows up to 10% of the smallest number of shares on issue in the previous 12 months to be bought back. Challenger initiated its buy back program in 2008 and has bought back 150m shares ($500m) since initiating the program.

As announced on 26 November 2012, Challenger committed $50m to the buy back program over the remainder of FY13, acquiring 13.8m shares by 30 June 2013.

Challenger is committed to maintaining its on-market share buy back program over the medium term to enhance shareholder returns and expects to commit between $35m and $45m to the on-market buy back program in FY14, subject to prevailing market conditions, capital allocation priorities, the FY14 normalised dividend payout ratio and FY14 normalised profit after tax.

Challenger targets a combined dividend and buy back payout ratio of approximately 50% of normalised profit after tax over the medium term.

Credit ratings

In May 2013, Standard & Poor's (S&P) affirmed both Challenger Life Company Limited's (CLC) and Challenger Limited's ratings under S&P's new revised global insurance ratings criteria.

Ratings were confirmed as:

- CLC: 'A' with a stable outlook; and
- Challenger Limited: 'BBB+' with a stable outlook.

The S&P ratings reflect the financial strength of Challenger Limited and CLC. In particular, they demonstrate Challenger's strong business profile, earnings and capital position.

Life financial results

$m	FY13	FY12	FY11	2H 13	1H 13	2H 12	1H 12	2H 11	1H 11
Investment yield – policyholders' funds	761.3	758.5	670.4	375.2	386.1	381.2	377.3	354.9	315.5
Interest expense	(398.9)	(409.1)	(371.1)	(195.9)	(203.0)	(202.0)	(207.1)	(196.1)	(175.0)
Fees and commissions	(25.0)	(23.2)	(25.7)	(12.2)	(12.8)	(10.7)	(12.5)	(11.8)	(13.9)
Product margin	**337.4**	**326.2**	**273.6**	**167.1**	**170.3**	**168.5**	**157.7**	**147.0**	**126.6**
Investment yield – shareholders' funds	78.8	65.8	81.7	42.6	36.2	34.8	31.0	40.4	41.3
Cash earnings	**416.2**	**392.0**	**355.3**	**209.7**	**206.5**	**203.3**	**188.7**	**187.4**	**167.9**
Normalised capital growth	36.0	43.7	45.5	17.4	18.6	21.6	22.1	21.3	24.2
Normalised Cash Operating Earnings (COE)	**452.2**	**435.7**	**400.8**	**227.1**	**225.1**	**224.9**	**210.8**	**208.7**	**192.1**
Personnel expenses	(39.1)	(37.4)	(28.4)	(19.6)	(19.5)	(18.6)	(18.8)	(14.9)	(13.5)
Other expenses	(31.2)	(30.6)	(23.6)	(15.7)	(15.5)	(15.2)	(15.4)	(15.8)	(7.8)
Total expenses	**(70.3)**	**(68.0)**	**(52.0)**	**(35.3)**	**(35.0)**	**(33.8)**	**(34.2)**	**(30.7)**	**(21.3)**
Normalised EBIT	**381.9**	**367.7**	**348.8**	**191.8**	**190.1**	**191.1**	**176.6**	**178.0**	**170.8**
Investment experience	138.1	(195.1)	(41.0)	37.8	100.3	(50.4)	(144.7)	(37.6)	(3.4)
Net profit after investment experience before tax	**520.0**	**172.6**	**307.8**	**229.6**	**290.4**	**140.7**	**31.9**	**140.4**	**167.4**
Reconciliation of investment experience to capital growth									
Investment experience	138.1	(195.1)	(41.0)	37.8	100.3	(50.4)	(144.7)	(37.6)	(3.4)
Normalised capital growth	36.0	43.7	45.5	17.4	18.6	21.6	22.1	21.3	24.2
Capital growth	**174.1**	**(151.4)**	**4.5**	**55.2**	**118.9**	**(28.8)**	**(122.6)**	**(16.3)**	**20.8**
Performance analysis									
Cost to income ratio[1]	15.5%	15.6%	13.0%	15.5%	15.5%	15.0%	16.2%	14.7%	11.1%
Net assets – average[2]	1,763	1,540	1,491	1,815	1,707	1,625	1,463	1,587	1,383
Normalised RoE (pre-tax)	21.7%	23.9%	23.4%	21.4%	22.1%	23.7%	24.0%	22.6%	24.5%

1 Cost to income calculated as total expenses / Normalised Cash Operating Earnings.
2 Average investment assets and average liabilities are calculated on a monthly basis.

$m	FY 13	FY 12	FY 11	2H 13	1H 13	2H 12	1H 12	2H 11	1H 11
Sales									
Retail sales	2,179.2	1,954.3	1,903.4	1,123.9	1,055.3	971.0	983.3	1,190.3	713.1
Maturities and repayments	(1,581.1)	(1,371.4)	(1,050.7)	(738.6)	(842.5)	(641.3)	(730.1)	(527.8)	(522.9)
Life net retail flows	**598.1**	**582.9**	**852.7**	**385.3**	**212.8**	**329.7**	**253.2**	**662.5**	**190.2**
Life retail annuity book	7,123.3	6,553.0	5,629.0	7,123.3	6,819.6	6,553.0	6,065.0	5,629.0	4,877.9
Retail annuity net book growth[1]	**9.1%**	**10.4%**	**9.9%**	**5.6%**	**3.2%**	**5.4%**	**4.5%**	**5.3%**	**4.4%**
Institutional sales	951.8	703.5	59.3	30.6	921.2	415.1	288.4	40.6	18.7
Maturities and repayments	(993.1)	(239.8)	–	(39.4)	(953.7)	–	(239.8)	–	–
Life net institutional flows	**(41.3)**	**463.7**	**59.3**	**(8.8)**	**(32.5)**	**415.1**	**48.6**	**40.6**	**18.7**
Assets									
Spot investment assets	**10,787**	**9,773**	**8,387**	**10,787**	**10,170**	**9,773**	**8,709**	**8,387**	**7,630**
Fixed income and cash[2]	7,890	6,640	5,598	8,102	7,690	6,967	6,274	5,886	5,287
Property	1,563	1,541	1,528	1,606	1,517	1,543	1,541	1,519	1,532
Infrastructure	489	551	492	438	531	585	519	484	487
Equity and other investments	219	232	245	246	194	226	236	242	246
Average investment assets[3]	**10,161**	**8,963**	**7,863**	**10,392**	**9,932**	**9,321**	**8,569**	**8,132**	**7,552**
Liabilities									
Spot liabilities – annuities, GIR and sub debt	**9,385**	**8,858**	**7,428**	**9,385**	**9,069**	**8,858**	**7,973**	**7,428**	**6,660**
Average liabilities – annuities and GIR	8,563	7,652	6,374	8,667	8,463	7,981	7,302	6,603	6,119
Average liabilities – sub debt	478	465	475	491	465	459	470	479	471
Average liabilities[4]	**9,041**	**8,116**	**6,8490**	**9,158**	**8,928**	**8,440**	**7,773**	**7,081**	**6,590**
Margins[4]									
Investment yield – policyholders' funds	7.5%	8.5%	8.5%	7.3%	7.7%	8.2%	8.7%	8.8%	8.3%
Interest expenses	(3.9%)	(4.6%)	(4.7%)	(3.8%)	(4.1%)	(4.4%)	(4.8%)	(4.9%)	(4.6%)
Fees and commissions paid	(0.2%)	(0.2%)	(0.3%)	(0.2%)	(0.2%)	(0.2%)	(0.3%)	(0.3%)	(0.4%)
Product margin	**3.3%**	**3.6%**	**3.5%**	**3.2%**	**3.4%**	**3.6%**	**3.6%**	**3.6%**	**3.3%**
Investment yield – shareholders' funds	0.8%	0.7%	1.0%	0.8%	0.7%	0.8%	0.7%	1.0%	1.1%
Cash earnings	**4.1%**	**4.4%**	**4.5%**	**4.1%**	**4.1%**	**4.4%**	**4.4%**	**4.6%**	**4.4%**
Normalised capital growth	0.4%	0.5%	0.6%	0.3%	0.4%	0.5%	0.5%	0.5%	0.7%
Normalised Cash Operating Earnings (COE)	**4.5%**	**4.9%**	**5.1%**	**4.4%**	**4.5%**	**4.9%**	**4.9%**	**5.1%**	**5.1%**

1 Retail annuity net book growth excludes the High Yield Fund conversion in 2H11 ($444m).
2 Includes NIM (FY13:$258m, FY12: $316m).
3 Ratio of Normalised Cash Operating Earnings components to average investment assets.
4 Average investment assets and average liabilities are calculated on a monthly basis.

Life financial results

Challenger Life Company Limited (CLC) is the leading provider of annuities and guaranteed retirement income solutions in Australia. Products appeal to investors seeking the security and certainty of guaranteed cash flows with protection against market, inflation and longevity risks. Products are distributed via financial advisers, both independent and part of major dealer groups. Being an independent provider, CLC has representation on all major hubs and platforms.

CLC has won the Association of Financial Advisers/Plan for Life annuity provider of the year for the past five years and has won the income stream innovation award for the past three years, including the 2012 award for the Care Annuity. The Care Annuity also won Canstar's 2012 innovation excellence award.

Normalised EBIT

FY13 normalised EBIT increased by $14m (4%) to $382m due to higher normalised cash operating earnings (up $16m), partly offset by higher expenses (up $2m).

Normalised Cash Operating Earnings (COE) and COE margin

FY13 normalised COE increased by 4% to $452m, predominantly due to growth in AUM, partially offset by a reduction in COE margin. FY13 average AUM was 13% higher than FY12.

COE margin (normalised COE to average AUM) decreased from 4.9% in FY12 to 4.5% in FY13. The 0.4% reduction in COE margin reflects lower cash earnings (down 0.3%) and a lower contribution from normalised growth (down 0.1%).

FY13 cash earnings fell by 0.3%, reflecting:

- Lower product margin (down 0.3%) reflecting lower returns on assets backing annuities, partly offset by lower annuity funding costs. Returns on assets backing annuities were lower (down 0.9%) due to lower returns on fixed income, including the NIM asset (down 0.1%), property, and infrastructure (down 0.1%). The lower asset yields were offset by lower funding cost (down 0.6%).

  Infrastructure distributions were lower due to the Challenger Infrastructure Fund (CIF) (down 0.1%). CIF returned capital to unit holders and there were no distributions paid during FY13. The return of capital has been accounted for as part of investment experience during the period.

- The return on shareholder funds was unchanged, with the benefit from higher shareholder capital offset by lower interest rates. Shareholder capital is not hedged for movements in interest rates.

FY13 normalised capital growth was 0.4%, down from 0.5% in FY12. The reduction in normalised capital growth reflects a higher weighting to fixed income, where the normalised capital growth assumption is an allowance for credit default (-35 bps). Fixed income as a portion of total average investment assets was 78% in FY13, up from 74% in FY12.

Life's COE guidance for FY14 is between $465m to $475m. Based on the mid-point of Life COE and retail net book growth guidance, and expected institutional outflows, the implied Life COE margin for FY14 is ~4.5%, which is unchanged from FY13.

Expenses

FY13 total expenses were $70m, up $2m from FY12 as a result of higher personnel expenses. Personnel expenses of $39m increased by $2m reflecting higher average Life employee numbers. Other expenses of $31m were unchanged from FY12.

Investment experience

FY13 investment experience before tax was positive $138m. The key contributors were positive movements from fixed income (positive $182m), partially offset by property (negative $11m) and economic and actuarial assumptions (negative $33m).

Fixed income benefited from a tightening of credit spreads following an improvement in global market sentiment. For example, the Australian Itraxx credit default index narrowed from 184 bps at 30 June 2012 to 138 bps at 30 June 2013. Fixed income generated positive investment experience of $182m.

Consistent with the broader Australian commercial property market, there was no material uplift in property valuations despite the falling interest rate environment. CLC did not achieve its full normalised growth assumption of 2% ($31m) in FY13.

Economic and actuarial assumption changes (loss of $33m) represent the impact of mark-to-market on new business and changes in macro-economic variables, including interest rates, expense assumptions and other factors applied to the valuation of life contract liabilities.

	Actual capital growth	Normalised capital growth	Investment expereience
Fixed income	154m	(28m)	182m
Property	20m	31m	(11m)
Infrastructure	17m	20m	(3m)
Equity	16m	13m	3m
Actuarial assumptions	(33m)	–	(33m)
Total	174m	36m	138m

Sales and AUM

FY13 Life retail annuity sales were $2.2bn, representing a 12% increase on FY12 and is a record for retail annuity sales.

Lifetime annuity (Liquid Lifetime and Care Annuity) sales were $257m, up from $46m in FY12. Lifetime annuity sales represented 12% of total retail annuity sales in FY13, up from 2% in FY12.

Retail annuity sales continue to benefit from high reinvestment rates, with around 80% of FY13 maturities (with a residual capital value of 50% or more) reinvested in a Challenger annuity.

FY13 institutional sales were $952m, mainly representing the reinvestment of maturities in Challenger's Guaranteed Index Return (GIR) product.

FY13 Life AUM was $10.8bn, up 10% on FY12.

For additional Life sales and AUM commentary, refer to the Assets Under Management and sales disclosures on page 21.

Capital management

Refer to page 8 for details on CLC's regulatory capital.

Outlook

The Australian retirement incomes market is expected to grow strongly over the next twenty years as Australia's baby boomers (born 1943–1960) move from retirement savings to retirement spending. Baby boomers control approximately two thirds of Australia's $1.6 trillion of superannuation assets. As a result of these demographic trends, approximately $66bn[1] will move from the savings phase to the retirement and spending phase in 2013.

In addition to these demographic trends, Life is well positioned to benefit from changes in consumer risk preferences. Many retirees are risk averse[2] and are focused on longevity risk and the need for regular and dependable income in retirement, which is linked to inflation. Annuities address these concerns, and is resulting in increased demand for Life's products, particularly longer dated lifetime annuities.

Life is well placed to drive business growth through:

- strong retirement incomes brand recognition;
- leading product innovation and development;
- thought leadership in retirement incomes research and strategies; and
- a highly regarded distribution team.

1 Rice Warner Actuaries.
2 Senior Sentiment Index – retiree risk aversion report February 2013.

Funds Management financial results

$m	FY13	FY12	FY11	2H 13	1H 13	2H 12	1H 12	2H 11	1H 11
Fidante Partners									
Fidante Partners income[1]	31.8	23.2	22.0	17.9	13.9	11.8	11.4	11.9	10.1
Equity accounted profits[2]	16.1	9.2	7.5	11.2	4.9	5.8	3.4	5.2	2.3
Net income	**47.9**	**32.4**	**29.5**	**29.1**	**18.8**	**17.6**	**14.8**	**17.1**	**12.4**
Aligned Investments									
Net management fees	41.0	42.9	48.9	19.4	21.6	21.6	21.3	19.3	29.6
Performance and transaction fees	10.5	7.7	10.0	5.7	4.8	4.1	3.6	7.5	2.5
Net income	**51.5**	**50.6**	**58.9**	**25.1**	**26.4**	**25.7**	**24.9**	**26.8**	**32.1**
Total net fee income	**99.4**	**83.0**	**88.4**	**54.2**	**45.2**	**43.3**	**39.7**	**43.9**	**44.5**
Personnel expenses	(45.8)	(43.1)	(46.1)	(23.0)	(22.8)	(22.3)	(20.8)	(22.5)	(23.6)
Other expenses	(19.5)	(18.9)	(22.2)	(10.0)	(9.5)	(9.5)	(9.4)	(10.6)	(11.6)
Total expenses	**(65.3)**	**(62.0)**	**(68.3)**	**(33.0)**	**(32.3)**	**(31.8)**	**(30.2)**	**(33.1)**	**(35.2)**
Normalised EBIT	**34.1**	**21.0**	**20.1**	**21.2**	**12.9**	**11.5**	**9.5**	**10.8**	**9.3**
Performance analysis									
Fidante Partners – income margin (bps)[3]	20	20	24	21	18	20	19	25	23
Aligned Investments – income margin (bps)[3]	45	45	61	44	45	45	45	61	62
Cost to income ratio	65.7%	74.7%	77.3%	60.9%	71.5%	73.4%	76.1%	75.4%	79.2%
Net assets – average[4]	129.2	123.2	115.9	127.4	130.5	125.9	120.4	116.2	115.7
Normalised RoE (pre-tax)	26.4%	17.0%	17.3%	33.6%	19.6%	18.3%	15.7%	18.7%	15.9%
Fidante Partners	29,757.0	19,251.3	14,848.1	29,757.0	23,984.3	19,251.3	16,244.0	14,848.1	12,697.8
Aligned Investments	11,346.4	11,765.8	8,759.5	11,346.4	11,351.0	11,765.8	11,476.7	8,759.5	9,166.3
Spot FUM – total	**41,103.4**	**31,017.1**	**23,607.6**	**41,103.4**	**35,335.3**	**31,017.1**	**27,720.7**	**23,607.6**	**21,864.1**
Fidante Partners	24,330.1	16,435.9	12,271.4	27,359.9	21,250.9	17,719.9	15,107.4	13,795.5	10,808.2
Aligned Investments	11,556.6	11,294.7	9,611.4	11,456.2	11,627.7	11,594.3	11,021.0	8,841.8	10,317.4
Average FUM – total[5]	**35,886.7**	**27,730.6**	**21,882.8**	**38,816.1**	**32,878.6**	**29,314.2**	**26,128.4**	**22,637.3**	**21,125.6**
FUM and net flows analysis									
Fidante Partners	7,544.7	4,458.0	3,749.0	4,801.9	2,742.8	2,472.1	1,985.9	1,893.8	1,846.1
Aligned Investments	(566.1)	(232.0)	(1,352.0)	(47.5)	(518.6)	32.9	(264.9)	(569.8)	(772.9)
Net flows	6,978.6	4,226.0	2,397.0	4,754.4	2,224.2	2,505.0	1,721.0	1,324.0	1,073.0
Distributions	(315.4)	(197.4)	(267.5)	(245.4)	(70.0)	(77.0)	(120.4)	(164.3)	(103.2)
Market linked movement	3,423.1	658.9	1,241.0	1,259.1	2,164.0	868.4	(209.5)	372.5	868.5
Total FUM movement	**10,086.3**	**4,687.5**	**3,370.5**	**5,768.1**	**4,318.2**	**3,296.4**	**1,391.1**	**1,532.2**	**1,838.3**

1 Fidante Partners income includes distribution and administration fees.
2 Equity accounted profits represent Challenger's share of boutiques' pre-tax earnings.
3 Income margin represents net income divided by average FUM.
4 Net assets – average calculated on a monthly basis.
5 Average FUM calculated on a monthly basis.

Funds Management financial results

Challenger's Funds Management business comprises Fidante Partners and Aligned Investments and is one of the fastest growing investment managers in Australia and now the 9th[1] largest, up from 19th largest two years ago.

Funds Management has been growing strongly, with FUM increasing by 33% to $41.1bn in FY13. The strong growth has been driven by a clear business strategy focused on investor alignment, which has helped deliver strong investment performance in both Fidante Partners and Aligned Investments.

Fidante Partners multi boutique platform comprises co-owned, separately branded, active boutique investment managers. Fidante Partners provides administration and distribution services to the boutique investment managers and shares in the profits of these businesses through its equity ownership and distribution contracts. Fidante Partners FUM was $29.8bn at 30 June 2013, up 55% for the year.

Aligned Investments develops and manages assets under Challenger's brand for the Life business and third party institutional investors. Aligned Investments FUM was $11.4bn at 30 June 2013, down 4% for the year, reflecting the wind up of legacy products, including the Challenger Infrastructure Fund (CIF) and Howard Mortgage Fund.

Normalised EBIT

Funds Management normalised EBIT increased by $13m (62%) to $34m in FY13. The increase in EBIT reflects higher total net fee income (up $16m), partially offset by higher expenses (up $3m).

Total net fee income

FY13 total net fee income increased by $16m (20%) due to higher fee income for both Fidante Partners (up $15m) and Aligned Investments (up $1m).

FY13 Fidante Partners net income increased by 48% as a result of strong growth in average FUM and higher performance fees. Fidante Partners average FUM was 48% higher than in FY12.

Fidante Partners income includes distribution and administration fees.

Fidante Partners participates in performance fees earned by the boutiques through distribution fees and equity accounted profits. FY13 Fidante net income includes $12m of performance fees, up from $4m in FY12.

FY13 equity accounted profits increased significantly, reflecting increased boutique profits from higher FUM and performance fees.

Fidante Partners income margin (net income to average FUM) was unchanged from FY12 at 20 bps. Fidante Partners income margin benefited from higher performance fees, offset by lower base fees on large boutique mandates.

FY13 Aligned Investments net income increased by $1m (2%) due to higher performance and transaction fees (up $3m), partly offset by lower net management fees (down $2m).

Aligned Investments performance and transaction fees increased by $3m, with $1m of the increase due to the sale of the Challenger Infrastructure Fund (CIF) assets.

Aligned Investments net management fees reduced as a result of the Howard Mortgage Fund run-off. FY13 Aligned Investments net management fees includes $5m in relation to a supplementary management fee following the sale of CIF's assets and wind up of the fund.

FY13 Aligned Investments income margin (net income to average FUM) was 45 bps, which is unchanged from FY12. The FY13 Aligned Investments margin reflects higher performance fees offset by lower management fees.

Expenses

FY13 total expenses were $65m, which increased by $3m (5%) on FY12.

The increase in total expenses was due to higher personnel expenses (up $3m) including redundancy costs associated with the wind up of CIF and the Howard Mortgage Fund.

The FY13 cost to income ratio was 65.7%, down 9 percentage points for the year. The cost to income ratio continues to benefit from the scale and operational leverage in the Funds Management business.

FUM

Total Funds Under Management (FUM) at 30 June 2013 was $41.1bn, up 33% for the year.

Fidante Partners FUM was $29.8bn at 30 June 2013, an increase of $10.5bn (55%) for the year. The growth in Fidante Partners FUM was due to strong net inflows across Fidante Partners boutiques ($7.5bn) and a positive impact from market movements ($3.4bn), partly offset by distributions ($0.3bn).

Aligned Investments FUM was $11.3bn at 30 June 2013 which was down $0.4bn for the year. New institutional mandates in fixed income, property and infrastructure were offset by a reduction in FUM from the Howard Mortgage Fund and windup of CIF. The only legacy product remaining in Aligned Investments is the Howard Mortgage Fund, with $0.4bn of FUM at 30 June 2013.

1 Consolidated FUM Australian Fund Managers – Rainmaker Roundup – March 2013.

For additional Funds Management FUM and net flows commentary, refer to the Funds Under Management and net flows disclosures on page 21.

Outlook

The Australian funds management market is an attractive market underpinned by compulsory superannuation contributions, which are gradually increasing from 9.25% (from 1 July 2013) to 12% of gross employee salaries (by 1 July 2019). As a result, the Australian superannuation market is forecasted to grow from $1.6 trillion today to over $6 trillion by 2030[1].

Challenger's Fidante Partners business model has widespread support from investors and asset consultants due to its alignment of interests between the investor, investment manager and Fidante Partners.

Fidante Partners has a track record of achieving strong net flows, which are a result of the quality of the investment managers, strong investment performance, the institutional platform and Fidante Partner's distribution reach and capability.

Opportunities exist to expand the number of Fidante Partners boutiques and its offering. Since 30 June 2013, Fidante Partners acquired an interest in WyeTree Asset Management and formed an Australian partnership with River & Mercantile Asset Management. These new boutique partners provide further opportunities for business growth.

Aligned Investments will continue to build out its client base, offering products across fixed income, property and infrastructure. Aligned Investments has a strong pipeline with approximately $1bn of mandates, which were unfunded at 30 June 2013.

1 Deloitte – Dynamics of the Australian superannuation system: the next 20 years 2011 – 2030 – November 2011.

Corporate financial results

$m	FY13	FY12	FY11	2H 13	1H 13	2H 12	1H 12	2H 11	1H 11
Net income	**4.9**	**8.8**	**4.8**	**1.7**	**3.2**	**4.3**	**4.5**	**1.7**	**3.1**
Personnel expenses	(34.6)	(32.5)	(30.3)	(17.0)	(17.6)	(16.4)	(16.1)	(16.6)	(13.7)
Other expenses	(10.7)	(10.8)	(10.5)	(5.4)	(5.3)	(3.6)	(7.2)	(4.8)	(5.7)
Total expenses (excluding LTI)	**(45.3)**	**(43.3)**	**(40.8)**	**(22.4)**	**(22.9)**	**(20.0)**	**(23.3)**	**(21.4)**	**(19.4)**
Long term incentive plans[1]	(10.8)	(15.9)	(19.1)	(5.3)	(5.5)	(8.5)	(7.4)	(7.5)	(11.6)
Total expenses	**(56.1)**	**(59.2)**	**(59.9)**	**(27.7)**	**(28.4)**	**(28.5)**	**(30.7)**	**(28.9)**	**(31.0)**
Normalised EBIT	**(51.2)**	**(50.4)**	**(55.1)**	**(26.0)**	**(25.2)**	**(24.2)**	**(26.2)**	**(27.2)**	**(27.9)**
Interest and borrowing costs	(4.6)	(3.3)	(2.7)	(1.9)	(2.7)	(2.3)	(1.0)	(2.3)	(0.4)
Normalised profit/(loss) before tax	**(55.8)**	**(53.7)**	**(57.8)**	**(27.9)**	**(27.9)**	**(26.5)**	**(27.2)**	**(29.5)**	**(28.3)**

Corporate financial results

The Corporate division comprises central functions such as group executives, finance, treasury, legal, human resources, risk management and strategy.

Corporate also includes interest received on Group cash balances and any interest and borrowing costs associated with Group debt facilities.

Normalised profit/(loss) before tax

FY13 Corporate normalised loss was $56m, up $2m from FY12. This was as a result of lower net income (down $4m), higher interest and borrowing costs (up $1m), partly offset by lower expenses, which fell by $3m.

Net income

Net income includes interest received on Group cash balances.

FY13 net income decreased by $4m as a result of lower average Group cash and a reduction in interest rates. FY12 Group cash included approximately $190m following the early exercise of CPH Investments Management Pty Ltd options in October 2011.

Total expenses

FY13 total expenses were $56m, down $3m on FY12. Personnel expenses increased by $2m and were more than offset by a $5m reduction in costs associated with the Group's long term incentive plan.

FY13 long term incentive plan expenses fell as a result of lower amortisation costs of prior period grants and a lower value of long term incentive grants made in FY13.

Interest and borrowing costs

FY13 interest and borrowing costs were $5m, up $1m on FY12. The increase reflects higher debt facility fees and the partial drawdown of the facility in FY13.

The Group maintains a banking facility to provide additional financial flexibility. The banking facility was partially drawn during FY13, however was fully repaid from operating cash flows.

1 Corporate financial results include all of the Group's long term incentives provided under the Challenger Performance Plan and Long Term Incentive Plan. Short term incentives under the Employee Incentive Plan are accounted for within each operating division's personnel expenses.

Consolidated operating cash flows

$m	FY13	FY12	FY11	2H 13	1H 13	2H 12	1H 12	2H 11	1H 11
Receipts from customers	456.8	454.8	492.3	224.9	231.9	231.8	223.0	243.1	249.2
Dividends received	44.2	39.5	35.7	22.5	21.7	20.5	19.0	18.3	17.4
Interest received	542.7	486.7	403.9	272.8	269.9	250.9	235.8	231.8	172.1
Interest paid	(373.3)	(361.3)	(327.6)	(187.5)	(185.8)	(189.9)	(171.4)	(174.0)	(153.6)
Payments to suppliers and employees	(344.2)	(335.7)	(329.9)	(159.0)	(185.2)	(169.8)	(165.9)	(168.2)	(161.7)
Income tax (paid)/refund	(4.7)	(1.7)	2.0	(3.3)	(1.4)	(0.9)	(0.8)	(1.2)	3.2
Underlying operating cashflow	**321.5**	**282.3**	**276.4**	**170.4**	**151.1**	**142.6**	**139.7**	**149.8**	**126.6**
Adjust for:									
Net retail annuity policy capital receipts	598.1	582.9	912.0	385.3	212.8	329.7	253.2	703.1	208.9
Net institutional capital (payments)/ receipts	(150.0)	340.0	10.0	(40.0)	(110.0)	340.0	–	10.0	–
CDI non controlling interest	22.0	17.7	23.0	13.7	8.3	7.4	10.3	11.3	11.7
Net SPV operating cashflow	(2.4)	(8.4)	(1.5)	(1.2)	(1.2)	(5.8)	(2.6)	3.5	(5.0)
Operating cashflow per financial report	**789.2**	**1,214.5**	**1,219.9**	**528.2**	**261.0**	**813.9**	**400.6**	**877.7**	**342.2**

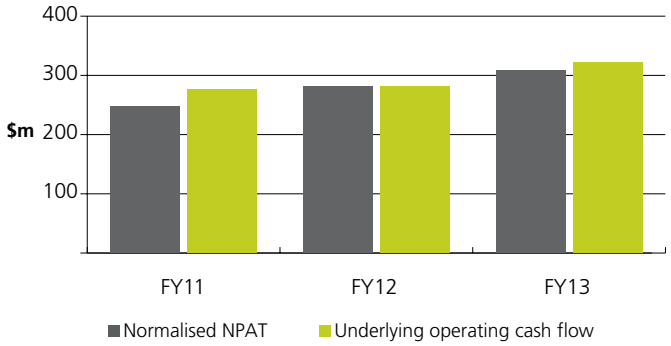
Consolidated operating cash flows

Underlying operating cash flow excludes cash flows that are capital in nature such as annuity sales and annuity capital payments.

FY13 underlying operating cash flow was $322m, up 14% on FY12.

Normalised profit after tax is Challenger's preferred profit and loss measure. Normalised profit after tax excludes Life investment experience (as Life is generally a hold to maturity investor) and is a good proxy for the Group's underlying cash earnings. Challenger's dividend payout ratio is based on normalised net profit after tax.

Normalised profit after tax and underlying operating cash flow



Net retail annuity policy capital receipts

Net retail annuity policy capital receipts of $598m in FY13 comprise:

- retail annuity sales of $2,179m; less
- retail annuity capital payments of $1,581m.

Retail annuity capital payments are capital payments to annuitants and exclude interest payments.

Retail annuity net book growth can be calculated as net retail annuity policy capital receipts divided by opening period Life retail annuity book (refer to page 6).

FY13 retail net book growth was $598m (9.1% of opening retail annuity book), up from $583m (10.4% of opening retail annuity book) in FY12.

FY14 retail annuity net book is targeted to grow by 8% (~$570m), excluding the High Yield Fund annuity, which is due to mature in March 2014. Refer to FY14 guidance on page 4 for more detail.

Net institutional capital payments

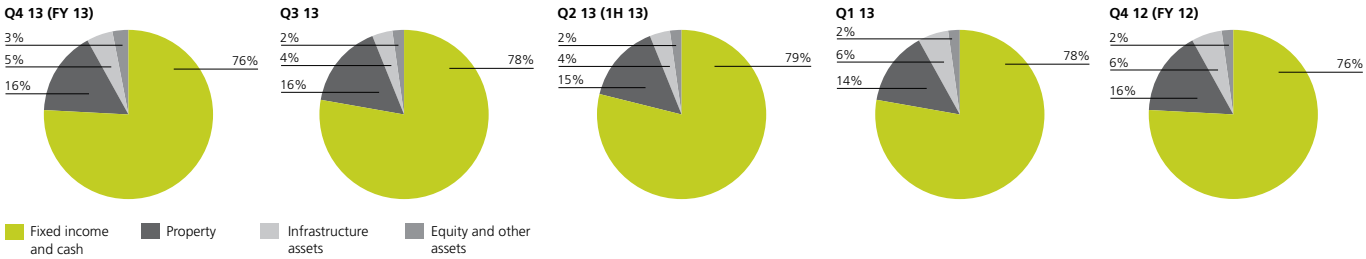
Net institutional capital payments in FY13 of $150m comprise:

- Institutional capital payments $1,102m; less
- Institutional sales of $952m.

Assets and Funds Under Management, net flows and sales

$m	Q4 13	Q3 13	Q2 13	Q1 13	Q4 12
Total Assets and Funds Under Management	**44,770**	**40,873**	**38,284**	**35,227**	**33,429**
Represented by:					
Funds Management					
Fidante Partners[1]					
Equities	15,132	13,409	12,021	9,695	8,879
Fixed income	14,625	13,005	11,963	11,226	10,372
Total Fidante Partners	29,757	26,414	23,984	20,921	19,251
Aligned Investments[2]					
Fixed income[3]	6,699	7,621	7,815	7,637	7,516
Property					
Institutional mandates	2,921	2,199	1,910	1,845	1,835
Challenger Diversified Property Group (ASX:CDI) (gross assets)	888	883	881	888	869
Infrastructure					
Institutional Mandates	838	677	690	885	1,136
Challenger Infrastructure Fund (ASX:CIF) (adjusted equity value)	–	4	55	430	410
Total Aligned Investments	11,346	11,384	11,351	11,685	11,766
Total funds under management	**41,103**	**37,798**	**35,335**	**32,606**	**31,017**
Average Fidante Partners	29,023	25,460	22,372	20,364	18,426
Average Aligned Investments	11,417	11,478	11,449	11,838	11,708
Average total funds under management[4]	**40,440**	**36,938**	**33,821**	**32,202**	**30,134**
Life					
Fixed income and cash[5]	8,219	8,002	7,974	7,891	7,388
Property[6]	1,761	1,575	1,541	1,484	1,539
Infrastructure[7]	488	414	427	623	618
Equity and other	319	241	228	170	228
Total Life investment assets	**10,787**	**10,232**	**10,170**	**10,168**	**9,773**
Average Life investment assets[4]	**10,503**	**10,239**	**10,032**	**9,908**	**9,637**

Life asset allocation



1 Fidante Partners comprise a number of co-owned, separately branded active multi-boutique investment managers from which Fidante receives distribution and administration fees. Fidante Partners also shares in the profits from these businesses through its equity ownership.
2 Aligned Investments develops and manages products under Challenger's brand for the Life business and third party institutional investors.
3 Fixed income (including asset backed securities).
4 Average total funds under management and Life investments calculated on a monthly basis.
5 Fixed Income is reported at Q4 13 net of debt of $449m (Q3 13 $195m).
6 Property is reported at Q4 13 net of senior debt of $591m (Q3 13 $574m). Property includes unlisted direct and indirect holdings and listed property securities.
7 Infrastructure is reported at Q4 13 net of debt of $206m (Q3 13 $206m).

Assets and Funds Under Management, net flows and sales (continued)

Analysis of flows	Q4 13	Q3 13	Q2 13	Q1 13	Q4 12
Funds Management net flows					
Fidante Partners	3,626	1,176	2,110	633	1,858
Aligned Investments	(104)	56	(323)	(195)	2
Net flows	**3,522**	**1,232**	**1,787**	**438**	**1,860**
Life sales					
Fixed Term	678	290	506	449	590
Lifetime	92	64	69	32	17
Total Retail	**770**	**354**	**574**	**481**	**607**
Institutional	–	31	844	77	–
Sales	**770**	**385**	**1,418**	**558**	**607**
Reconciliation of Total Group Assets and Funds Under Management					
Funds Management (FUM)	41,103	37,798	35,335	32,606	31,017
Life investment assets	10,787	10,232	10,170	10,168	9,773
Adjustments to remove double counting of cross holdings:					
Life Company investment in CDI and CIF	(338)	(327)	(329)	(496)	(488)
Life Company investment in fixed income, property and infrastructure	(6,782)	(6,830)	(6,892)	(7,051)	(6,873)
Total Assets and Funds Under Management	**44,770**	**40,873**	**38,284**	**35,227**	**33,429**

Funds Management FUM and net flows

FY13 Funds Management FUM was $41.1bn, up 33% on FY12.

Funds Management FY13 net flows were $7.0bn, representing an increase of 65% on FY12. Fidante Partners net inflows were $7.5bn and Aligned Investments net outflows were $0.6bn.

Fidante Partners

At 30 June 2013, approximately 50% of FUM was invested in fixed income products and 50% in equity products. Approximately 55% of FY13 net flows were to equity managers and 45% were to fixed income managers.

Fidante Partners net flows are supported by strong investment performance across its boutiques. On a five year basis, 100% of boutique flagship funds have outperformed their benchmark and since inception 98% have outperformed.

Aligned Investments

Aligned Investments net outflows of $0.6bn in FY13 reflects the run-off of the Howard Mortgage Fund (net outflow of $0.4bn) and wind up of CIF (net outflow of $0.4bn) partly offset by new institutional mandates.

During FY13, Howard Mortgage Fund FUM reduced by $0.4bn. In November 2012, it was announced that following a detailed review, the Fund would commence a process of returning capital to all investors on a monthly basis. Commencing in January 2013, the Fund initially returned 10% of FUM and then moved to returning 5% of FUM to unitholders each month.

The Howard Mortgage Fund is Aligned Investments only legacy product with year end FUM of $0.4bn. It is expected that all of this FUM will be returned to unitholders by mid-2015.

Life AUM and sales

FY13 Life AUM was $10.8bn, up 10% on FY12.

FY13 Life retail annuity sales were $2.2bn, representing a 12% increase on FY12 and is a record for retail annuity sales.

Lifetime annuity (Liquid Lifetime and Care Annuity) sales were $257m up from $46m in FY12. Lifetime annuity sales represented 12% of total retail annuity sales in FY13, up from 2% in FY12.

Annuity sales continue to benefit from Challenger's distribution product and marketing initiatives which are leveraging the commencement of the baby boomer retirement phase.

Retail annuity sales continue to benefit from high reinvestment rates, with around 80% of FY13 maturities (with a residual capital value of 50% or more) reinvested in a Challenger annuity.

FY13 average tenor for new business sales was 6.2 years, up from 5.4 years in FY12. Tenor is lengthening due to an increase in demand for longer dated products. The launch of new products such as the Care Annuity and increased volumes in Liquid Lifetime are assisting to lengthen the tenor of new business. A lengthening of tenor assists the future rate of net book growth, enables investment in longer-dated assets, which earn higher illiquidity premiums and is more efficient in terms of distribution and administration.

FY13 institutional sales were $952m, mainly representing the reinvestment of maturities in Challenger's Guaranteed Index Return (GIR) product.

Challenger Life is well positioned for the implementation of Future of Financial Advice (FoFA) reforms, which introduces a 'best interest' duty for advisers and bans adviser conflicted remuneration structures, including commissions, from 1 July 2013.

Profit and equity sensitivities

$m	Change in variable	Profit/(loss) after tax FY13	Change in equity FY13	Profit/(loss) after tax FY12	Change in equity FY12	Profit/(loss) after tax FY11	Change in equity FY11
Interest rate							
Non-SPV[1]	+100bps	5.5	5.5	6.0	6.0	2.7	2.7
	–100bps	(5.5)	(5.5)	(6.0)	(6.0)	(2.6)	(2.6)
SPV	+100bps	(3.6)	(3.6)	(4.8)	(4.8)	(6.1)	(6.1)
	–100bps	3.6	3.6	4.8	4.8	6.1	6.1
Total	+100bps	1.9	1.9	1.2	1.2	(3.4)	(3.4)
	–100bps	(1.9)	(1.9)	(1.2)	(1.2)	3.5	3.5
Equity							
Property securities	+10%	31.4	31.4	12.0	12.0	11.8	11.8
	–10%	(31.4)	(31.4)	(12.0)	(12.0)	(11.8)	(11.8)
Infrastructure investment	+10%	21.2	21.2	31.2	31.2	24.8	24.8
	–10%	(21.2)	(21.2)	(31.2)	(31.2)	(24.8)	(24.8)
Other assets	+10%	16.1	16.1	16.0	16.0	20.4	20.4
	–10%	(16.1)	(16.1)	(16.0)	(16.0)	(20.4)	(20.4)
Total	+10%	68.7	68.7	59.2	59.2	57.0	57.0
	–10%	(68.7)	(68.7)	(59.2)	(59.2)	(57.0)	(57.0)
Direct Property							
Direct Property[1]	+1%	13.3	13.3	13.6	13.6	14.3	14.3
	–1%	(13.3)	(13.3)	(13.6)	(13.6)	(14.3)	(14.3)
Credit							
Fixed Income assets	+50bps	(91.9)	(91.9)	(75.1)	(75.1)	(62.5)	(62.5)
	–50bps	91.9	91.9	75.1	75.1	62.5	62.5
Currency							
British Pound	+10%	(1.0)	(1.0)	0.4	0.4	1.4	1.4
	–10%	1.0	1.0	(0.4)	(0.4)	(1.4)	(1.4)
US Dollar	+10%	(0.2)	(0.2)	1.1	1.1	–	–
	–10%	0.2	0.2	(1.1)	(1.1)	–	–
Euro[1]	+10%	(2.0)	(2.0)	(2.0)	(2.0)	(1.2)	(1.2)
	–10%	2.0	2.0	2.0	2.0	1.2	1.2
Japanese Yen	+10%	–	–	–	0.4	–	(0.4)
	–10%	–	–	–	(0.4)	–	0.4
Other	+10%	–	–	(0.1)	(0.1)	0.3	0.3
	–10%	–	–	0.1	0.1	(0.3)	(0.3)

[1] Sensitivity includes Challenger's proportional share of the Challenger Diversified Property Group (CDI).

Profit and equity sensitivities

Profit and equity sensitivities set out the expected impact from changes in a range of economic and investment market variables on Challenger's earnings. These sensitivities represent the post-tax impact, assuming a tax rate of 30%. The sensitivities are not forward looking and make no allowance for events occurring after 30 June 2013.

If using these sensitivities as forward looking, an allowance for changes post 30 June 2013, such as sales, purchases and asset growth, should be made.

These sensitivities assess the risk of changes in economic and investment markets on the valuation of assets, which in turn impact earnings. The earnings impact is included in investment experience and does not take into consideration the impact of any under or over performance of normalised growth assumptions for each asset category. Refer to pages 28 and 29 for details.

These sensitivities do not include the indirect impact on fees from the Group's Funds Management business.

Interest rate sensitivities

Interest rate risk is the risk to earnings from movements in interest rates, including changes in absolute levels, shape of the yield curve, margin between the different yield curves, and volatility of interest rates.

It is assumed that the change in variable occurs on 30 June 2013, and is based on assets and liabilities held at that date. It is the Group's policy to minimise the impact of movements in interest rates via the use of interest rate swaps.

Interest rate sensitivities are disclosed as either SPV (special purpose vehicle) or non-SPV.

SPV interest rate sensitivities relate to securitisation trusts that hold residual income stream notes (NIM) acquired by Challenger Life Company in 2009. For the SPV, an increase/decrease in the BBSW benchmark over the RBA's target cash rate, results in an increase/decrease in the cost of funding and impacts earnings. SPV interest rate risk is mitigated by actively adjusting the interest rate charged to borrowers and the use of cash flow hedges.

In determining the interest rate sensitivities, it is assumed that changes in interest rates occur at balance date and there are concurrent movements in interest rates and parallel moves in the yield curve. All material underlying exposures and related interest rate hedges are included in the interest rate sensitivity analysis.

Equity sensitivities

The equity sensitivities apply to Challenger's financial assets, as disclosed in note 11 of the 30 June 2013 full year financial report.

Equity risk sensitivities represent the impact of changes in investment markets on earnings. It is assumed that the change in variable occurs on 30 June 2013 and is based on the assets held at that date.

Direct property sensitivities

Direct property sensitivities relate to Challenger's direct property portfolio, including properties jointly held with the listed Challenger Diversified Property Group.

The direct property sensitivities represent the impact from a change in property valuations on balance date. They do not include the impact on management fees in Funds Management.

Credit sensitivities

Credit risk sensitivities set out the expected impact from movements in credit spreads. Challenger is exposed to movements in credit spreads above the interbank swap curve on its fixed income portfolio. The sensitivities apply to fixed income investments held at 30 June 2013.

Currency sensitivities

Currency sensitivities set out the expected impact from changes in currency. It is the Group's policy to hedge the exposure of all balance sheet items to movements in foreign exchange rates. Currency exposure arises primarily as a result of offshore investments. In order to mitigate foreign currency risk, the Group has entered into foreign currency derivatives.

Issued share capital

Number of shares (m)	FY13	FY12	FY11	2H 13	1H 13	2H 12	1H 12	2H 11	1H 11
Basic share count	515.6	529.0	476.9	515.6	526.4	529.0	536.0	476.9	484.5
CPP "treasury" shares	15.3	15.7	20.7	15.3	12.3	15.7	16.2	20.7	21.8
Total issued shares	530.9	544.7	497.6	530.9	538.7	544.7	552.2	497.6	506.3
Less unquoted LTIP shares	–	–	(0.9)	–	–	–	–	(0.9)	(4.3)
Total ASX listed shares	**530.9**	**544.7**	**496.7**	**530.9**	**538.7**	**544.7**	**552.2**	**496.7**	**502.0**
Movement in basic share count									
Opening	529.0	476.9	471.7	526.4	529.0	536.0	476.9	484.5	471.7
On market buyback during the period	(13.8)	(12.9)	(9.5)	(7.8)	(6.0)	(7.5)	(5.4)	(8.7)	(0.8)
CPP deferred share purchase	(6.6)	–	–	(3.0)	(3.6)	–	–	–	–
Net treasury shares released	7.0	5.0	14.7	–	7.0	0.5	4.5	1.1	13.6
Option exercise	–	60.0	–	–	–	–	60.0	–	–
Closing	515.6	529.0	476.9	515.6	526.4	529.0	536.0	476.9	484.5
Movement in CPP 'treasury' shares									
Opening	15.7	20.7	35.4	12.3	15.7	16.2	20.7	21.8	35.4
Shares vested to participants	(7.0)	(17.9)	(32.9)	–	(7.0)	(0.5)	(17.4)	(9.8)	(23.1)
CPP deferred share purchase	6.6	–	–	3.0	3.6	–	–	–	–
Shares bought into CPP Trust	–	12.9	18.2	–	–	–	12.9	8.7	9.5
Closing	15.3	15.7	20.7	15.3	12.3	15.7	16.2	20.7	21.8

Share capital for EPS calculations **Weighted average number of shares (m)**	FY13	FY12	FY11	2H 13	1H 13	2H 12	1H 12	2H 11	1H 11
Basic EPS shares									
Total issued shares	538.8	533.9	500.5	533.5	544.0	548.4	519.6	499.9	506.8
Less CPP 'treasury' shares	(12.7)	(17.5)	(21.1)	(12.7)	(12.6)	(15.9)	(19.1)	(18.8)	(29.1)
Shares for basic EPS calculation	526.1	516.4	479.4	520.8	531.4	532.5	500.5	481.1	477.7
Diluted EPS shares									
Shares for basic EPS calculation	526.1	516.4	479.4	520.8	531.4	532.5	500.5	481.1	477.7
Add dilutive impact of LTI schemes	6.1	11.7	20.3	8.6	3.6	7.1	15.9	21.1	19.0
Add dilutive impact of external options	–	5.2	16.1	–	–	–	10.4	19.4	12.9
Shares for dilutive EPS calculation	532.2	533.3	515.8	529.4	535.0	539.6	526.8	521.6	509.6

Issued share capital

Summary of Share Rights, Options and LTIP

Number of shares/options (m)	FY13	FY12	FY11	2H 13	1H 13	2H 12	1H 12	2H 11	1H 11
Hurdled Performance Share Rights									
Opening	14.4	5.6	–	22.2	14.4	13.1	5.6	6.0	–
New grants	8.4	8.9	6.0	0.2	8.2	1.3	7.6	–	6.0
Vesting/forfeiture	(1.0)	(0.1)	(0.4)	(0.6)	(0.4)	–	(0.1)	(0.4)	–
Closing	21.8	14.4	5.6	21.8	22.2	14.4	13.1	5.6	6.0
Performance Share Rights									
Opening	3.2	3.5	9.7	3.3	3.2	3.2	3.5	3.7	9.7
New grants	2.7	2.0	2.6	0.1	2.6	–	2.0	0.1	2.5
Vesting/forfeiture	(2.6)	(2.3)	(8.8)	(0.1)	(2.5)	–	(2.3)	(0.3)	(8.5)
Closing	3.3	3.2	3.5	3.3	3.3	3.2	3.2	3.5	3.7
Executive Options									
Opening	4.4	23.1	41.7	–	4.4	4.9	23.1	30.3	41.7
New grants	–	–	–	–	–	–	–	–	–
Vesting/forfeiture	(4.4)	(18.7)	(18.6)	–	(4.4)	(0.5)	(18.2)	(7.2)	(11.4)
Closing	–	4.4	23.1	–	–	4.4	4.9	23.1	30.3
Long Term Incentive Plan									
Opening	–	1.4	10.0	–	–	–	1.4	5.0	10.0
Vesting/forfeiture	–	(1.4)	(8.6)	–	–	–	(1.4)	(3.6)	(5.0)
Closing	–	–	1.4	–	–	–	–	1.4	5.0

CPP Treasury shares

The Challenger Performance Plan (CPP) Trust is a trust established to satisfy Challenger's employee equity obligations arising from Hurdled Performance Share Rights (HPSRs) and Deferred Performance Share Rights (DPSRs) issued under employee remuneration structures. Shares are acquired by the CPP Trust to mitigate shareholder dilution and to provide a mechanism to hedge the cash cost of acquiring shares in the future to satisfy vested equity awards.

The CPP Trust acquires physical shares on market or via forward share purchase agreements entered into by Challenger. The use of forward share purchase agreements was implemented in FY13 to support increased capital efficiency.

Hurdled Performance Share Rights (HPSRs)

Challenger's approach to executive remuneration includes providing Long Term Incentives (LTI's) to ensure alignment between key employees and shareholders. LTI awards are delivered as Hurdled Performance Share Rights (HPSRs) and are subject to meeting performance hurdles before they vest.

Deferred Performance Share Rights (DPSRs)

A portion of Short Term Incentives (STI) awards are deferred and vest in equal tranches over two years. The deferred STI is delivered as Deferred Performance Share Rights (DPSRs) and is subject to continuing employment before vesting.

External options

There were no external options outstanding over Challenger Limited shares at 30 June 2013.

In 2007, Colony Marlin Holdings (Colony) paid $63m for an option to purchase 57.1 million Challenger Limited ordinary shares, exercisable up to November 2012 at $7.00 per share. These options expired in November 2012.

Normalised profit framework

Life normalised cash operating earnings

Normalised cash operating earnings is Challenger's preferred profitability measure for the Life business, as it aims to reflect the underlying performance trends of the Life business.

The Life normalised cash operating earnings framework was introduced in June 2008 and has been applied consistently since. The framework removes the impact of market and economic variables, which are generally non-cash and are a result of external market factors. The normalised profit framework is subject to a review performed by Ernst & Young each half year.

Life normalised cash operating earnings includes cash earnings plus normalised capital growth, but excludes investment experience (see below).

Cash earnings	Cash earnings represents investment yield, less interest expenses and fees and commissions paid. **Investment yield** Represents the investment return on assets held to match annuities and the return on shareholder investment assets. Investment yield includes net rental income, dividends received, infrastructure distributions, accrued interest on fixed income and cash, and discounts/premiums on fixed income assets amortised on a straight line basis. **Interest expense** Represents interest accrued at contracted rates to annuitants and Life subordinated debt holders. **Fees and commissions** Represents payments made for the acquisition and management of Life products, including annuities and commissions to third party mortgage brokers on term funded residential mortgage assets (NIM).
Normalised capital growth	Normalised capital growth represents the expected capital growth for each asset class through the investment cycle and is based on Challenger's long term expected investment returns for each asset class. Normalised capital growth can be determined by multiplying the normalised capital growth assumption (see below) by each asset class average investment assets (net of debt). Normalised capital growth assumptions: • Fixed income and cash – negative 0.35% representing an allowance for credit defaults; • Property – 2.00%; • Infrastructure – 4.00%; and • Equity and alternative asset classes – 6.00%. Normalised capital growth assumptions have been set with reference to long term market growth rates and are reviewed regularly to ensure consistency with prevailing medium to long term market conditions. Since the normalised profit framework was introduced in 2008, the only change to the normalised capital growth assumptions has been a reduction in property from 2.50% to 2.00% in January 2010. The reduction in the property assumption reflects the purchase of a portfolio of Japanese property assets, which have a lower expected long term capital growth return.

Normalised profit framework

Investment experience	**Impact from market variables** Challenger Life is required by accounting standards to value all assets and liabilities supporting the Life business at fair value. This gives rise to fluctuating valuation movements on assets and liabilities being recognised in the profit and loss, particularly during periods of market volatility. As Challenger is generally a long-term holder of assets, due to them being held to match the term of life liabilities, Challenger takes a long-term view of the expected capital growth of the portfolio rather than focusing on short-term movements. Investment experience is a mechanism employed to remove the volatility arising from asset and liability valuation movements from Life business earnings so as to more accurately reflect the underlying performance of the Life business. The asset and liability valuation movements are reported as investment experience. These movements are generally non-cash, and by separating them from the Life business result, Life's reported earnings more closely represent the cash earnings of the business. **Impact from economic variables** Investment experience also includes the impact of changes in macro-economic variables on the valuation of Life's assets and liabilities. Economic and actuarial assumption changes include changes to bond yields and inflation factors, expense assumptions, losses on new business and other factors applied in the valuation of life contract liabilities. Investment experience is calculated as the difference between actual investment gains/losses (both realised and unrealised) and the normalised capital growth plus any economic and actuarial assumption changes for the period.

Glossary of terms

Terms	Definitions
Additional Tier 1 regulatory capital	High quality capital that provides a permanent and unrestricted commitment and is freely available to absorb losses.
Cash earnings (Life)	Investment yield less interest expenses and fees and commissions paid.
CET1 ratio	Common Equity Tier 1 regulatory capital divided by prescribed capital amount.
Common equity tier 1 regulatory capital	The highest quality capital comprising items such as paid-up ordinary shares and retained earnings. Common equity tier 1 capital is subject to certain regulatory adjustments including in respect of intangibles and adjusting policy liabilities.
Earnings per share	Net profit after tax divided by weighted average number of shares in the period.
Equity accounted profits (FM)	Challenger's share of Fidante Partners boutique investment manager pre-tax profits.
Fees and commissions paid (Life)	Payments made for the acquisition and management of annuities and other Life products.
Fidante Partners income (FM)	Distribution and administration fees from boutique investment managers.
Funds under management (FUM)	Total value of listed and unlisted funds/mandates managed by the Funds Management business.
Group cash	Cash available to Group excluding cash held by Challenger Life Company.
Interest and borrowing costs (Corporate)	Interest and borrowing costs associated with group debt and group debt facilities.
Interest expenses (Life)	Interest accrued and paid to annuitants, subordinated debt note holders and other debt providers.
Investment experience (Life)	The difference between actual investment gains/losses (both unrealised and realised) and the normalised capital growth plus any economic and actuarial assumption changes for the period.
Investment yield (Life)	Net rental income, dividends received and accrued interest and discounts/premiums on fixed income securities amortised on a straight line basis.
Investment yield – shareholder funds (Life)	Represents the return on shareholder capital held by the Life business.
Life investment assets	Total value of investment assets that are managed by the Life business.
Life net book growth	Life net retail annuity policy capital receipts over the period divided by the opening Life retail annuity book.
Life net retail annuity policy receipts	Life retail annuity sales less retail annuity capital payments.
Net assets – average (Group)	Average net assets over the period (excluding non-controlling interest) calculated on a monthly basis.
Net fee income (FM)	Fidante Partners income, equity accounted profits (FM) and Aligned Investments net management fees and performance and transaction fees.
Net management fees (FM)	Management fees for managing investments.
Net tangible assets	Consolidated net Assets less goodwill and intangibles.
Net Interest Margin (NIM)	Net interest margin on term funded prime mortgages and included as part of Life's investment assets.
Normalised capital growth	Long term expected capital growth based on long term return assumptions calculated as long term capital growth assumption multiplied by average investment assets.
Normalised Cash Operating Earnings (NCOE) (Life)	Cash earnings plus normalised capital growth.

Glossary of terms

Terms	Definitions
Normalised cost to income ratio	Total expenses divided by total net income.
Normalised dividend payout ratio	Dividend per share divided by normalised earnings per share (basic).
Normalised EBIT (Life)	Normalised cash operating earnings less total Life expenses.
Normalised EBIT (FM)	Net income less total FM expenses.
Normalised effective tax rate	Normalised tax divided by normalised profit before tax.
Normalised Return on Equity (RoE) – pre-tax	Normalised EBIT (Life/FM) or Normalised NPBT (Group) divided by average net assets.
Normalised Return on Equity (RoE) – post-tax	Group's normalised NPAT divided by average net assets.
Other expenses	Non-employee expenses, including external professional services, occupancy costs, marketing and advertising, travel, technology and communications costs.
Other income (Corporate)	Includes equity accounted profits of associates and interest received on Group cash balances.
Performance and transaction fees (FM)	Fees earned for outperforming benchmarks and fees earned for the origination, disposal and restructuring of assets.
Personnel expenses	Includes fixed and short term variable incentive components of remuneration structures. The amortisation of long term incentive plans is reported separately within the Corporate results.
PCA ratio	The ratio of the total capital base divided by the prescribed capital amount.
Prescribed capital amount (PCA)	Amount of capital that a life company must hold which is intended to be sufficient to withstand a 1 in 200 year shock and still meet adjusted policy liabilities and other liabilities. For further details refer to APRA's LPS110 Capital Adequacy.
Product margin (Life)	Represents the return on assets backing annuities, less interest expenses and fees and commissions paid.
Significant items	Non-recurring or abnormal income or expense items.
Tier 1 regulatory capital	Tier 1 regulatory capital comprises Common equity tier 1 regulatory capital and additional tier 1 regulatory capital.
Tier 2 regulatory capital	Tier 2 Capital is capital that contributes to the overall strength of a life company and its capacity to absorb losses but does not satisfy all the criteria to be included as Tier 1 regulatory capital.
Total expenses	Personnel expenses plus other expenses.
Total net income	Normalised Cash Operating Earnings (Life) plus net fee income (FM) plus other income (Corporate).

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