



# Challenger Financial Services Group

Interstar Acquisition - Analyst Briefing



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## Acquisition Overview

- Challenger acquires assets of Zurich Capital Markets Australian Principal Finance business:
  - Interstar Securities – one of Australia’s largest independent wholesale mortgage financiers
  - High-yield fixed interest and loan portfolio – to be incorporated into existing fixed interest portfolios
  - Challenger to acquire 84,500 hectares of forestry assets on a 12 month deferred settlement basis
- Acquisition cost
  - Interstar \$85m
  - High yield fixed interest portfolio \$48m
  - Forestry assets \$54m
- Challenger assists Interstar with refinancing of working capital facility
- Interstar employs 160 people based in Melbourne
  - Existing management will report through to Chris Cuffe in Sydney
- Interstar brings strong earnings growth prospects
- Settlement date by 29 September 2003 (forests 29 September 2004)

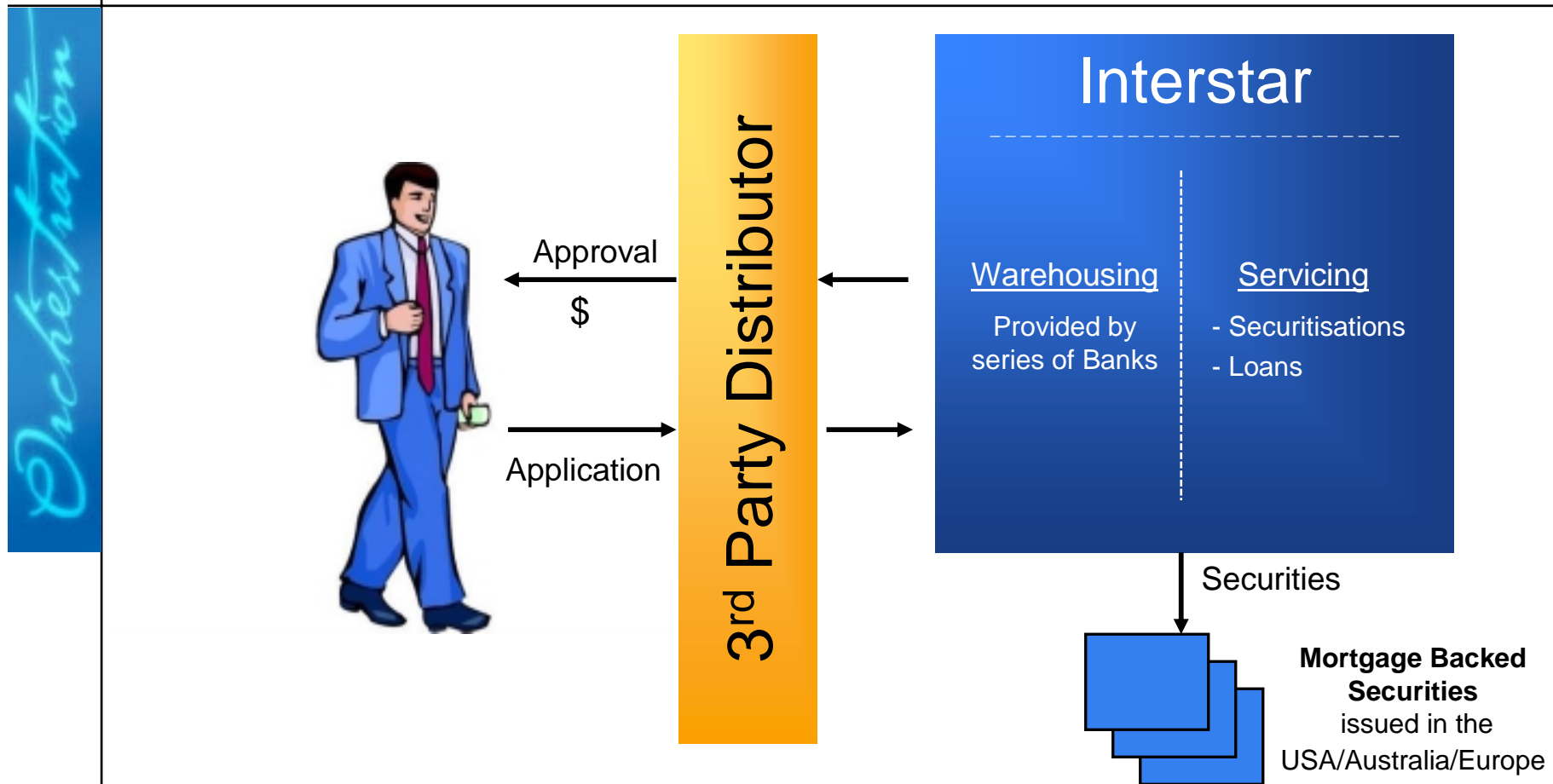
## Challenger's Strategy

- To build a multi-faceted financial services group
- Primary focus on Funds Management/Administration, Annuities, Margin Lending, Financial Planning and Mortgage Management
- Sources of growth for Challenger:
  - Organic growth
  - Focused acquisitions – eg Interstar
  - Alliances
  - Leverage different distribution bases
- Divestments
  - UK & New Zealand
  - Mergers & Acquisitions Group
  - Howard Finance

## Assets - Interstar

- Established in 1992
- One of Australia's largest independent wholesale mortgage financiers
  - \$11b mortgage portfolio
  - Portfolio has grown an average 53% pa for the past 3 years
  - Increased from \$1.7b to \$11b in 4 years
- Currently services residential loans and associated securitisations
- Australia wide distribution network – over 450 retail originators
- Interstar earns a net interest margin, after trustee servicing & financing costs
- Profitability not materially impacted by movements in interest rates

## Interstar – The Business Model



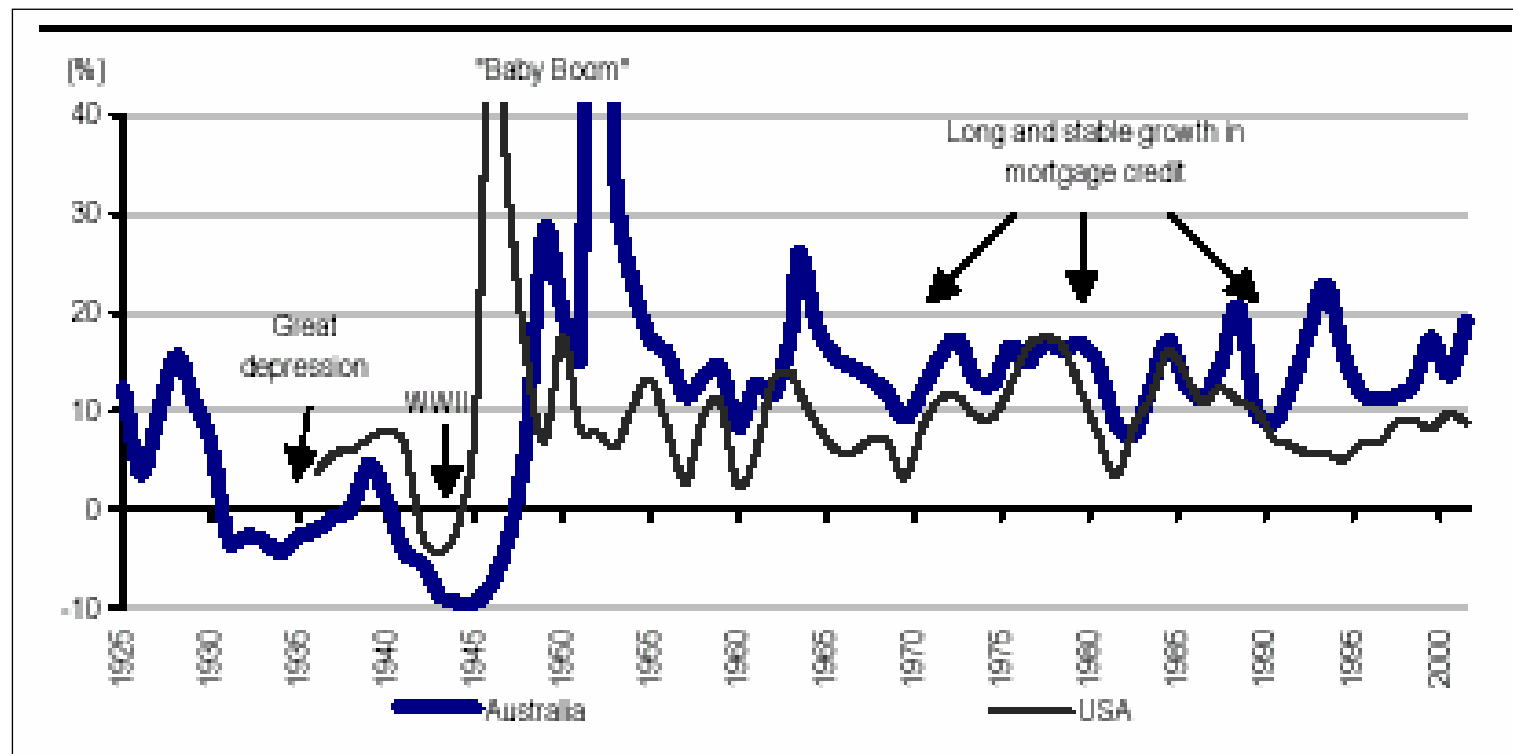
## Interstar – Australian Mortgage Market

- Growth in Australian housing credit
  - Rising from A\$100b-A\$355b in the last 10 years with compound growth of 13.5% pa
  - Averaged double digit growth each year for past 25 years
  - Since WWII never slowed below 8% pa
- Strong expansion of non- bank mortgage originators
  - Brokers now originate approx 30% of all new home loans
  - Expect proportion to grow 40-50% over next 3 years
- High growth in wholesale funding of mortgages via securitisation
  - Now accounts for more than 23% of all mortgages

# Interstar – Australian Mortgage Market

Long term mortgage growth - cyclical

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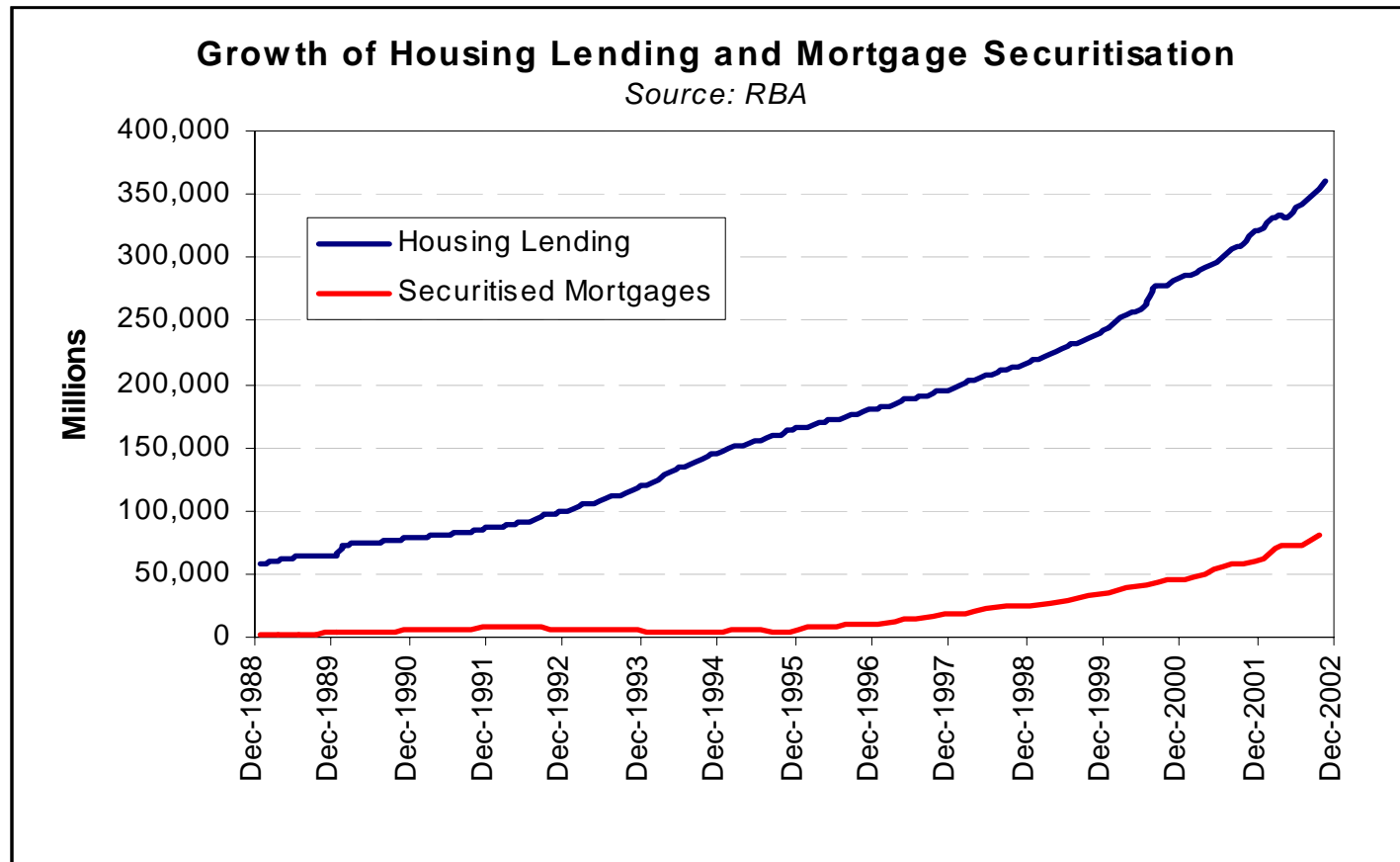


Source: Central Banks, UBS estimates

# Interstar – Australian Mortgage Market

## Long term mortgage growth - secular

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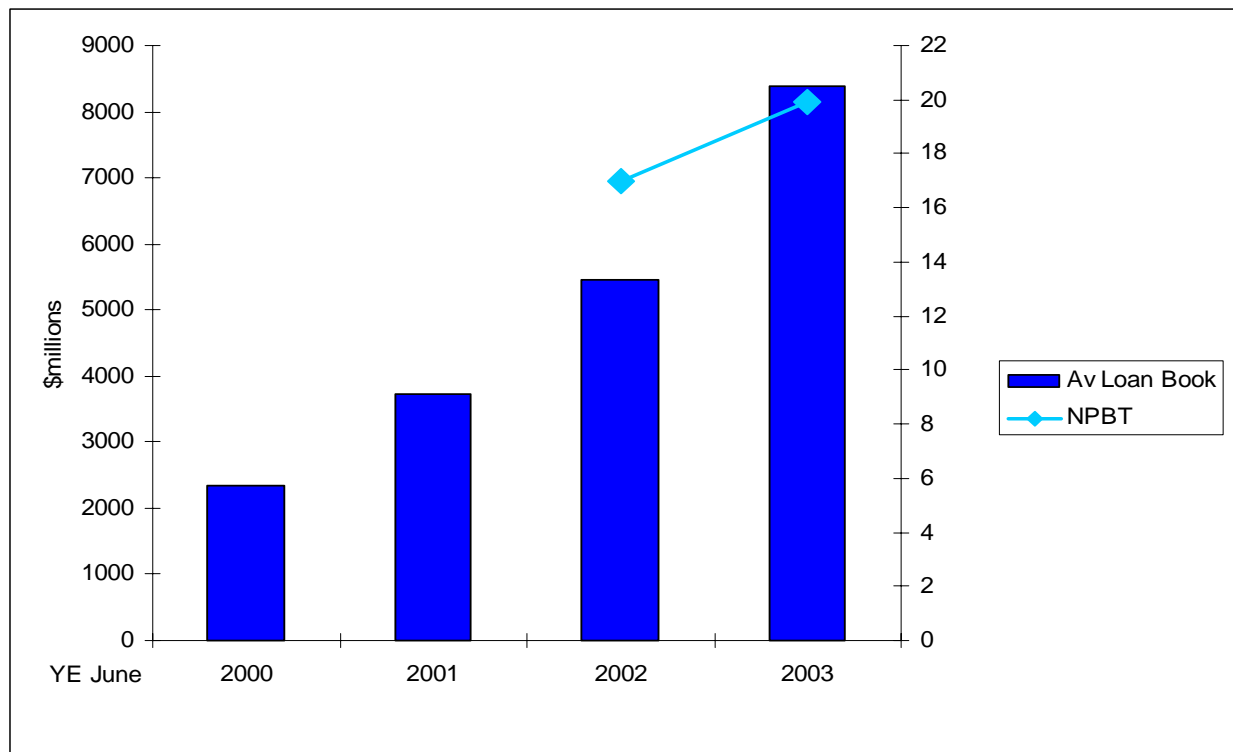
## Interstar – Mortgage Profile

- 88% of loans secured against property in Australian capital cities and major regional hubs
- High quality assets – low delinquency, minimal default
- In June 2003 financing approximately 4% of all new residential loan originations in Australia
- Mortgage portfolios are fully insured and securitised
- S&P rated STRONG - for service and technology capability
- Mortgage-backed securities issued in Australia, USA and Europe

# Interstar - Earnings

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## Pre-tax earnings 2002-2003



- 2003 pre tax profit includes a change in accounting policy which if adopted in a prior period would have resulted in an additional \$850,000 expense accrual in 2002.
- NPBT 2000 & 2001 not available due to reconstruction of Interstar corporate structure when ZCM acquired option in 2001.

## Interstar – Strategic & Operational Fit

- Signals build of Challenger as multi faceted financial services company
- Operating model consistent with Challenger business
- Distribution synergies of product & services
- Technology platform synergies
- Leverage Interstar's capital markets capability
- Leverage Interstar's platform to provide other debt style products

## Assets - High Yield Portfolio

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- Acquisition consideration \$48 million
- Underlying asset – personal loan portfolios secured against interests in agricultural investment schemes
- Loans to medium to high net worth individuals with full recourse
- Average duration 2.03 years
- Average yield 10.26% pa

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## Assets - Forestry Assets

- Asset valued at \$54m
- Challenger to acquire forestry assets on a 12 month deferred settlement basis
- 84,500 ha freehold title (ex Australian Plantation Timber Ltd)
- Asset located in SW Western Australia, and “green triangle” in Victoria & South Australia
- Expected compound return in excess of 11% pa pre tax over a duration of 8 years
- 3 possible strategies
  - On sell
  - Package into forestry fund
  - Hold on balance sheet

## Sources & Application of Funds

Applications		Sources	
Equity in Interstar	85	Internal Capital Resources	85
High Yield Fixed Interest Portfolios	48	Existing Fixed Interest Portfolios	48
	<u>133</u>		<u>133</u>

-Deferred acquisition 84,500 hectare forestry assets by 29 September 2004 at a value of \$54m

-Assist Interstar to refinance its working capital

## Other

- The final determination and treatment of goodwill on acquisition will be disclosed on completion of settlement
- Challenger will assist Interstar in refinancing its working capital facility of \$115m, the primary source being a major Australian bank

## Summary

- Acquisition aligns strategy to build multi faceted financial services group
- Significant growth in the mortgage industry over the past 10 years
- Mortgage industry going through significant secular change
- Interstar offers access to significant distribution platform
- Interstar offers technology and funding capabilities
- Credit losses mitigated and profitability not materially impacted by interest rates
- High yield fixed interest & loan portfolio additive to Challenger's existing capabilities
- Strong earnings growth

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Offers of interests in the [fund] are contained in the Prospectus dated [date]. Investors must complete the Application Form that is attached to the Prospectus.