



Challenger
Financial Services

Challenger Financial Services Group

Market Briefing

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Contents

Overview	4
Potential restructure and corporatisation	9
Product review	13
Annuities model update	20
Property update	26
Financial matters	28
Summary	37

Overview

- Highlights
- Business changes since 10 April
- Acquisition announced
- Our strategy

Highlights

- 23 January Merger announced
- 10 April Change of CEO
- 27 June Merger complete
- 1 July Name change to Challenger Financial Services Group (CFG)
- 23 July New Board confirmed
- 26 August Inclusion into the S&P/ASX100
- 1 September Acquisition - Interstar
- 9 September Potential restructure & corporatisation announcement
- 9 September Strategic alliance announcement - Orion

Business changes since 10 April

- Changed management structure
- Significant staff changes
 - Redundancies, new staff
- Activities reorganization
 - Sydney, Melbourne, Hobart
- Exiting of non core businesses
 - Garrisons Accounting
 - UK; New Zealand
 - Corporate Finance
 - Howard Finance (no relation to Howard Mortgage Trust)
 - Endowment warrants
- New IT systems
- Group entities rationalisation
- Products review complete & implementation commenced

Acquisition announced

- 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
 - 84,500 hectares of forestry assets
- Acquisition cost
 - Interstar \$85m
 - High yield fixed interest & loan portfolio \$48m
 - Forestry assets \$54m – 12 month deferred settlement
- Interstar will refinance its current working capital facility
- Interstar employs 160 people based in Melbourne
- Interstar brings strong earnings growth prospects; significant synergies
- Considerable “on-sell” and “packaging” interest in forestry assets

} settlement
29 September 2003

Our strategy

- Broad focus on financial services (multi-faceted)
- Seeking growth opportunities via:
 - Government policy (superannuation)
 - Scarce products (mortgage funds, property syndicates)
 - Use of balance sheet (annuities promises)
 - Secular change (home lending)
 - Attractive risk/return arbitrage (margin lending)
- Key attributes to leverage
 - Balance sheet strength
 - Distribution pipelines
 - Brand
 - IT / Administration capabilities
 - Skilled people (in-house & alliances)

Potential restructure and corporatisation

- Corporatisation
- Potential costs to Challenger
- Potential benefits for Challenger

Corporatisation

- Challenger is giving consideration to the feasibility of corporatising
- UBS and Gilbert & Tobin have been appointed to advise Challenger
- Corporatisation would result in the Responsible Entity function being internalised
- This proposal would require concurrence with CPH Management
 - Compensation for foregoing Management and Performance Fees
 - Compensation would be subject to Unitholder approval excluding CPH related parties
 - Challenger Unitholders would have the benefit of an Independent Expert report
- Challenger will make an announcement if a decision to corporatise is made and will provide all relevant details at that time

Potential costs to Challenger

- Compensation to CPH Management for foregoing Management and Performance Fees
- Challenger would assume liability for all Challenger operating costs including CEO compensation and directors' fees
- New long term employee incentive plan would form part of restructure

Potential benefits for Challenger

- No ongoing Management Fees
 - Current cost approximately \$17 million pa*
- No sharing in upside through Performance Fee obligations
 - Currently CPH Management entitled to 20% of outperformance in excess of 10% pa
- Simpler corporate structure – enhances investment appeal
- Corporate Governance
 - Election of directors
 - AGMs

* \$7.5 million for pre merger assets of CPHIC plus \$9.24m in respect of Challenger investment (payable when \$0.60 threshold reached). Excludes fees that will generate from additional assets acquired post recent acquisition.

Product review

- All existing products thoroughly reviewed
- Revised product set now finalised
- Progressive launch/relaunch over coming 12 months
 - Investment, superannuation & retirement products
- Expansion into International Equities and Property Securities
- Orion Alliance
- PH Sydney Hotel Group
- Growth of Howard Mortgage Trust
- Growth of Annuities
- Momentum in institutional market - funds management
- FUM analysis at 30 June 2003

Orion Alliance

- Boutique tie-up with Orion Asset Management
- Led by Tim Ryan & ex Credit Suisse AM Australian Equities portfolio managers
- 4 year retail market exclusivity with renewal rights
- *Challenger Orion Australian Share Fund* to be launched in November 2003

PH Sydney Hotel Group

- Single asset trust offers investment in Australian '5 star' hotel
- Acquired in June for \$137m for property syndicate
- PH Sydney Hotel Group launched 8 August 2003
 - Offer size \$69.3m
 - Offer fully underwritten
 - Offer closes 14 November 2003
- Forecast yield of 9% p.a. in year 1 rising to 12% p.a. in year 5
- The Park Hyatt Sydney has consistently outperformed its peers
 - Highest room yield & profit performance of any hotel in the country
 - Occupancy levels have averaged 80% since 1993
 - Considered best performing hotel in Australia
 - Voted Sydney's favorite hotel by business travelers - Euromoney

Growth of Howard Mortgage Trust

- Australia's largest Commercial Mortgage Trust
 - \$2.8 billion at 31 August 2003
 - 47% growth over 12 months to 31 August 2003
- Invests in commercial mortgage loans and short-term securities
 - Majority of borrowers are individuals and small to medium sized companies
 - 2,990 mortgages at 31 August 2003
- Highest rate of return over the past 5 years amongst peer group*
- Money Management – ASSIRT 2003 Fund Manager of the Year – Mortgage Trusts (3 of last 4 yrs)
- Rated 5 Stars by ASSIRT

* As compared with other funds rated 4 stars or higher by ASSIRT

Growth of Annuities

- Challenger annuity sales have totalled \$810m during year ended 30 June 2003
 - Increased by approx \$200m from 2002
 - Short term annuities sales totalled \$393m
 - Long term annuities sales totalled \$417m
- Ranked '1' in inflows in the Annuity Market over year ended 30 June 2003 (Plan for Life)
- Market Share 19.4% of sales over year ended 30 June 2003
- Annuity Provider of the year – 1st Qtr Results to March 2003 – Challenger ranked 1st (Plan for Life)

Momentum in institutional markets - funds management

- 9 new institutional mandates in funds management since start of July 2003 totalling approx \$300m
- Key wins
 - Mainstream Australian equities
 - Smaller companies

FUM/FUA analysis at 30 June 2003

Funds under management (internal)	\$m
Direct property	2,614
Fixed interest and cash	1,347
Australian equities (listed and unlisted)	204
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	4,165
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Funds under management (external clients)	
Fixed interest and cash	805
Australian equities	625
Property securities	26
Direct property (syndicates)	251
Mortgages (net of cash)	2,061
Alternative	458
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	4,226
	<hr/>
Funds under administration (Synergy/Galaxy master trust and external manager allocations in Custom Choice)	1,420

Annuities model update

- Pricing annuities
- Investments and constraints
- Property appetite
- Life company balance sheet at 30 June 2003

Pricing annuities

Benchmark rate for corresponding term		x.x%
Less commissions		x.x%
Less cost of operations		
Acquisition	x.x%	
Maintenance	<u>x.x%</u>	x.x%
Less profit margin (akin to MER)		<u>x.x%</u>
Indicative rate to be paid to investor		<u>x.x%</u>

The above pricing model is based on the proposition that the “default” investment is high-credit fixed interest securities

Possible investments

- Cash
- Fixed interest
- Equities
- Property securities
- Direct property
- Infrastructure
- Other structured investments

Investment constraints

- Cash flows
- Regulatory capital requirements
- Investment risk
- Investment supply

Property appetite

- Acquisitions over last 12 months
 - Milk Street, Boston (\$161m 15/10/02)
 - Globe, Melbourne (\$18m 13/11/02)
 - Invesco, Denver (\$87m 2/1/03)
- Not pressed to purchase property
 - Upfront profits on purchase no longer recognised, hence no time pressure to purchase
 - Less aggressive pricing reduces need for high returns
- Greater use of fixed interest or other assets?
 - Need to be confident of generating an acceptable profit margin
 - Depends on administration efficiencies and commission structures

Life company balance sheet at 30 June 2003

(annuities portion only)

Assets	\$b
Property	2.61
Fixed interest/cash	1.32
	<hr/>
	3.93
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Liabilities	
Policyholder liabilities*	1.72
Borrowings	1.80
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	3.52
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Excess	0.41
	<hr/>

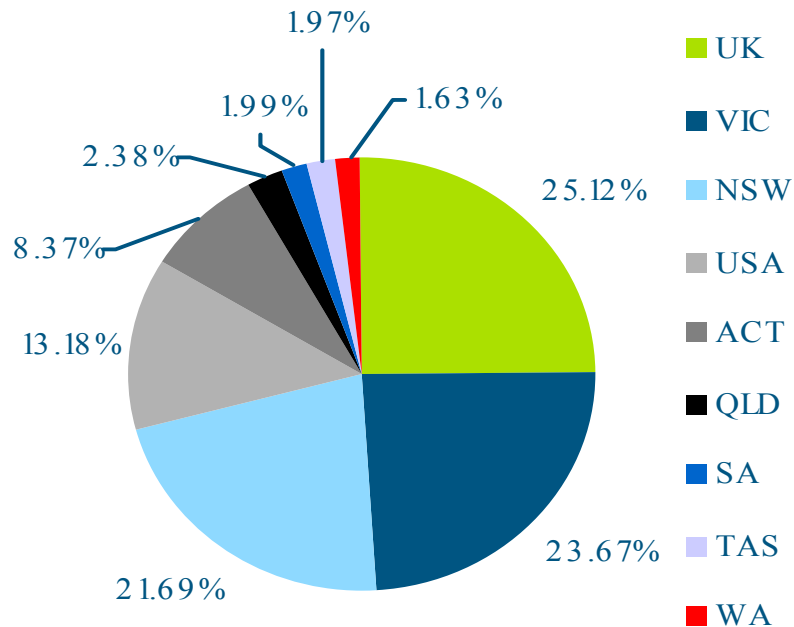
* calculated on Margin on Services basis which requires discount rates based on expected earnings of underlying assets

Property update

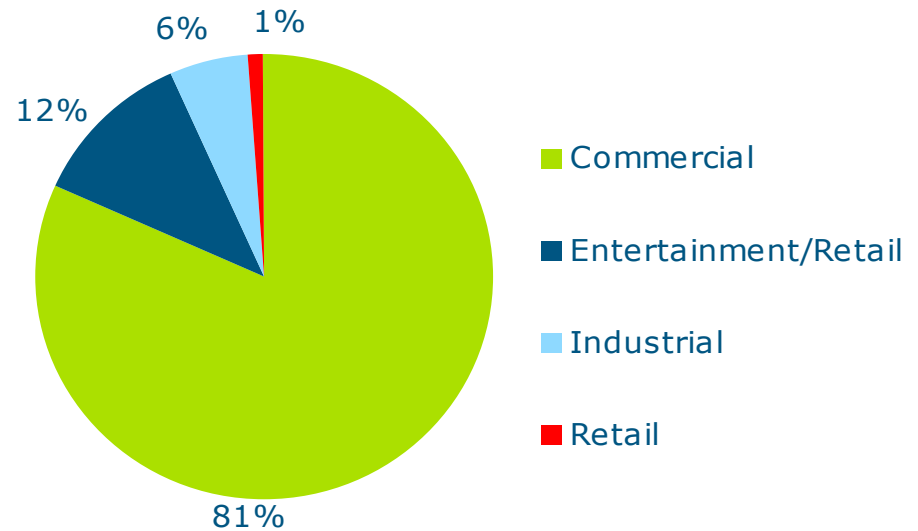
- Life company property portfolio value at 30 June 2003 is \$2.6b
- 52 properties (average property value \$50m)
- Average lease expiry 11.3 years
- Average yield 7.92% on current valuations and 8.35% on cost base
- Occupancy rate 99.2% by income and 99.6% by area

Property update

Property portfolio by region



Property portfolio by sector



Financial matters

- Challenger Group results to 30 June 2003
- Challenger International results – pre acquisition
- Consolidated Group Balance Sheet
- Analysis of goodwill
- Improvements to financial reporting
- Business segments and drivers
- Distribution policy and tax update

Challenger Group results 30 June 2003

- Profit of former CPH Investment Corp trust

	2003 \$m	2002 \$m
Profit before tax	28	8
Profit after tax	21	9

- Main drivers:
 - Disposal of investment in Zurich Capital Markets
 - Net interest benefit
- Following 1 cent interim distribution; no final distribution is proposed

Challenger International results - pre acquisition

Year ended 30 June 2003

	\$m	\$m
Loss excluding valuation changes and one-off items		(14)
Overall impact of changes in Income/Capital units valuation methodology		(244)
One-off items:		
- revaluation of Life company subsidiaries and management rights	(32)	
- professional fees	(14)	
- closed and sold operations	(38)	
- restructuring costs and provisions	(36)	
- asset write-downs and other provisions	(50)	
		<u>(170)</u>
Pre-tax loss for the year		<u>(428)</u>

Consolidated Group Balance Sheet

	30/6/03 \$m		
Cash	660	}	Life companies 501 (includes \$235m merger injection)
Receivables and non Life investments	421		Non-Life companies 159
Other assets	52		
Property Investments	2,614		
Other Life investments	965		
EMVONA	376	}	Life 2 136 Management Rights 240
Goodwill on acquisition of CIL	278		
Total Assets	5,366		
Payables and provisions	179		
Other Liabilities	78		
Taxation	75	}	Property related 1,725 Core group debt 85 Margin Lending 159 Other 54
Interest bearing Liabilities	2,023		
Policy Liabilities	1,806		
Total Liabilities	4,161		
Net Assets	1,205		

Analysis of goodwill

	\$m
Goodwill per Scheme pro forma accounts (12 May 2003)	201
Additional write-down in management rights	29
Year end valuation of property, swaps and policyholder liabilities	(22)
Additional provisions	25
Deferred tax adjustments	31
Other	14
Goodwill per accounts	<u>278</u>

Improvements to financial reporting

- Enhancements incorporated in 30 June 2003 accounts
- Valuation of interests in properties
- Fair value approach rigorously applied
- Balance Sheet disclosures
 - Liquidity presentation
 - Details of investment properties
 - Analysis of EMVONA components

Improvements to financial reporting cont.

Further planned changes

- Annual independent property valuations
- Proposed actions to remove revaluations of Challenger Life subsidiaries
 - Non-Life (management rights)
 - Challenger Life No.2
- Analysis of component parts of investment income

Business segments and drivers

Life (annuities)

- Promises off our balance sheet
- Tax & social security favoured
- Ongoing profit margin (equivalent to an MER)
- Investment returns in excess of bond rate
- Returns on excess assets held for regulatory purposes

Funds Management & Administration

- Risk borne by investors
- Management fees (higher in growth assets)
- Performance fees
- FUM and fees leveraged to investment returns

Mortgage Financing

- Secular change
- Net interest margin
- Default risk low and risk insured

Margin Lending

- Net interest margin on loans
- Low default history

Distribution policy and tax update

- Present expectation is no distributions over coming 12 months due to restructure, acquisition & further development of the business streams
- CGT rollover relief legislation pending

Summary

- Building multi-faceted financial services group
- Changes establish foundations for growth
 - Skilled people
 - Exited non core business
 - Growth through organic development, acquisition & alliances
- Major business streams
 - Ongoing margin from writing annuities business
 - Principal investing to support annuities promises
 - Funds Management / Administration and Financial Planning
 - Wholesale mortgage financing
 - Margin Lending (early stage)
- Considering feasibility to corporatise structure