Challenger Wholesale Finance

An overview

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Key messages

- Challenger Wholesale Finance is analogous to a funds management business:
  - Investors, via residential mortgage backed securities, invest
  - In portfolios of mortgages (securitised pools)
  - Which are originated and managed by Challenger for a fee
  - With the benefit of excess spread earnings accruing to Challenger
- The business generates predictable annuity style income conservatively accounted for on an accruals basis
- There are continuing significant growth opportunities with sustained historical growth in residential lending - since WWII never below 8%
- A scaleable flexible platform makes the business a low capital intensity proposition
- Challenger holds leading market positions in prime residential, non conforming residential and commercial lending

Agenda

2004 highlights

- Net profit before goodwill, interest and tax - $33m[1]
- Acquired Australia's No. 1 prime residential white-label wholesale lender, Interstar, in September 2003
- Established Australia's fastest growing non-conforming residential wholesale lender, 'The Mortgage Alternative' (TMA) in April 2004
- Achieved continuing strong commercial lending growth off the back of Australia's largest commercial mortgage trust – Howard Mortgage Trust
- Grew total mortgage book up from $2.1b to $16.2b (30 June 2003), which includes Interstar on acquisition of $11.2b
- Completed Australia's largest non-bank residential mortgage backed securities issue to meet growth in asset origination

1. Includes results for Interstar Securities Australia for the 9 months ended 30 June 2004

Business model

Sourcing investors / funding	Portfolio management	Mortgage origination

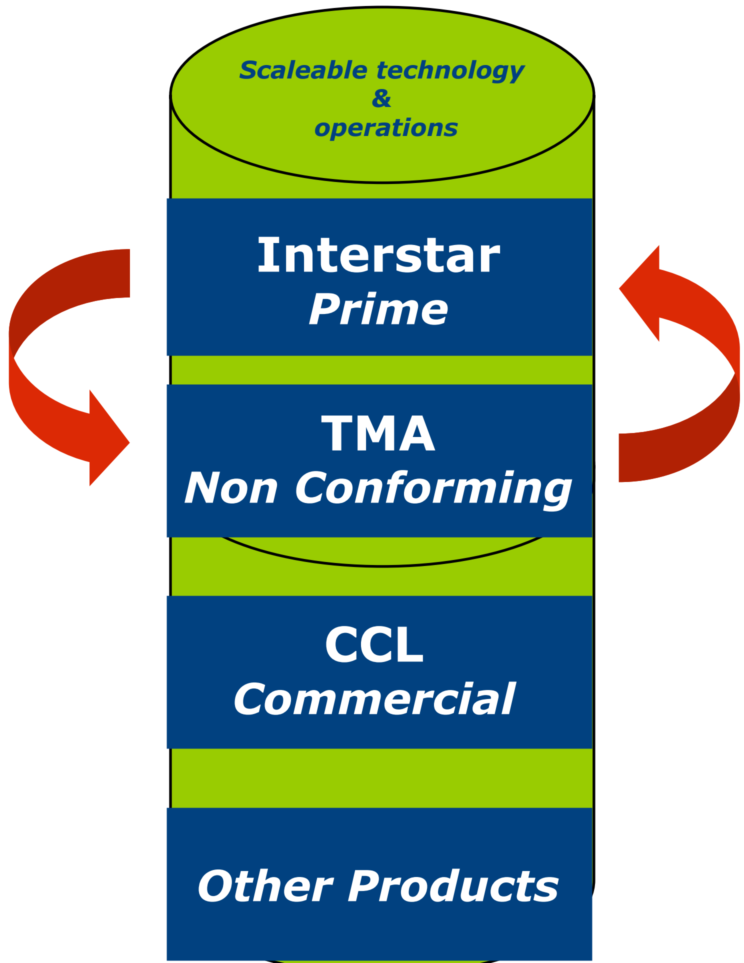
Residential

Warehousing
- **Banks**
- **Life Company**
- **Wealth management**

Global & domestic securitisation programs
- **External investors**
- **Life company**
- **Wealth management**

Commercial

Retail & wholesale investors
- **Howard Mortgage Trust**



540+ white-label originators

Financial planners

Broker referral

Predictable earnings stream

- Revenue
  - Management fees
  - Excess spread
    - Difference between portfolio return and investor required return
    - Weighted average mortgage life 4.2 years
- Operating expenses
  - Trailing commissions paid to originators
- Overhead expenses
  - Cost of running the portfolio management platform
- Amortisation expenses
  - Upfront commissions paid to originators
  - Upfront securitisation costs
- Interstar generates annuity style earnings on managing mortgages with a weighted average life of 4.2 years. As the mortgages under management grows so do earnings

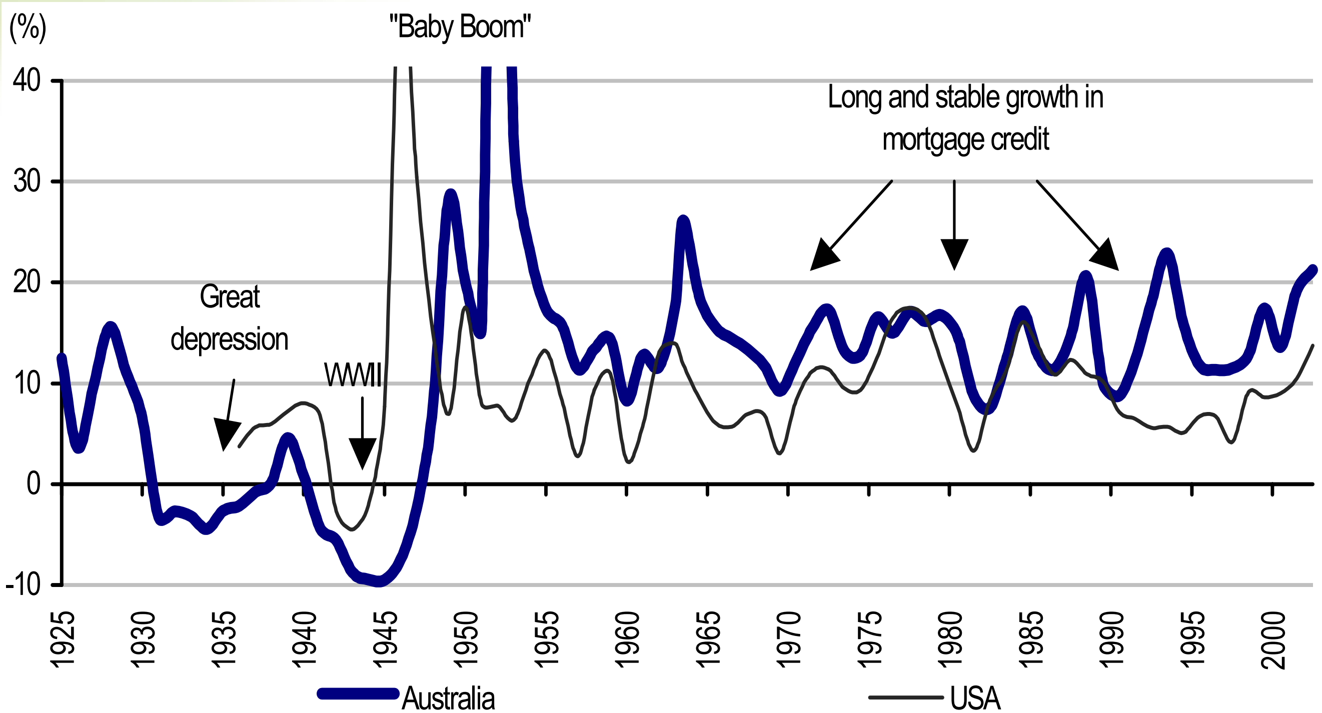
Predictable earnings stream

- Credit losses
  - There is no recourse to Challenger for any credit losses
  - Credit losses on mortgage portfolios are absorbed by the insurers of the mortgages or the investors in the residential mortgage backed securitisations

- Interest rates
  - Official interest rate changes do not impact the business, as both investors and borrowers receive or pay floating rates of interests
  - Compression spread may have a short term positive or negative impact on earnings

Significant growth opportunities

Macroeconomic environment



Source : UBS

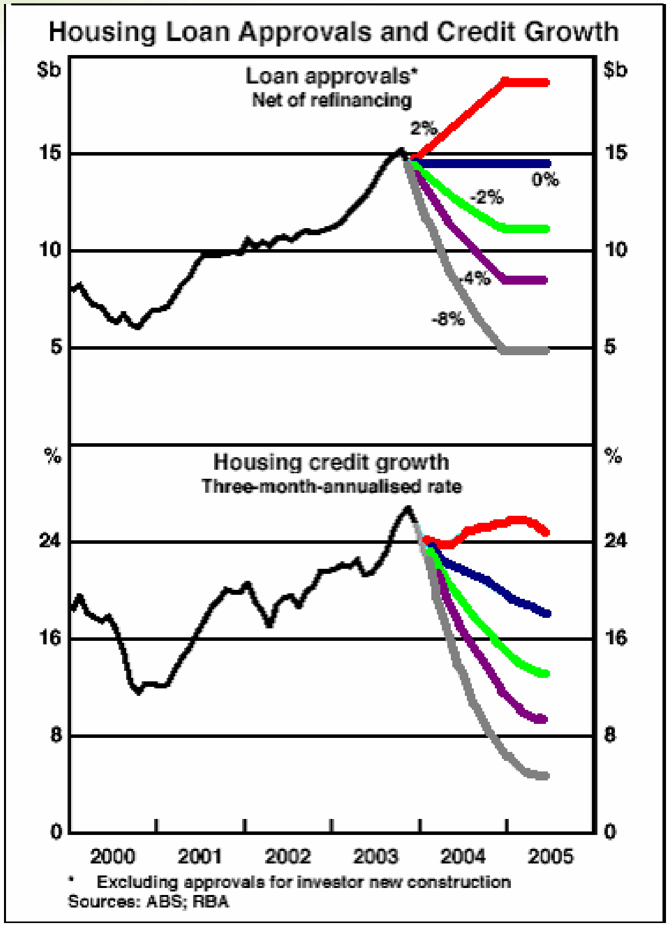
"According to a recently published RBA rule of thumb…mortgage credit growth will be tracking along at around a 16% annualised pace. This is … still above the 10% pace that the RBA would view as sustainable in the longer term."

Goldman Sachs JB Were 13 April 2004

"Mortgage lending has grown by ~15% per year and rarely dips below 10% growth per year."

Macquarie Equities 14 July 2003

Significant growth opportunities
Macroeconomic environment



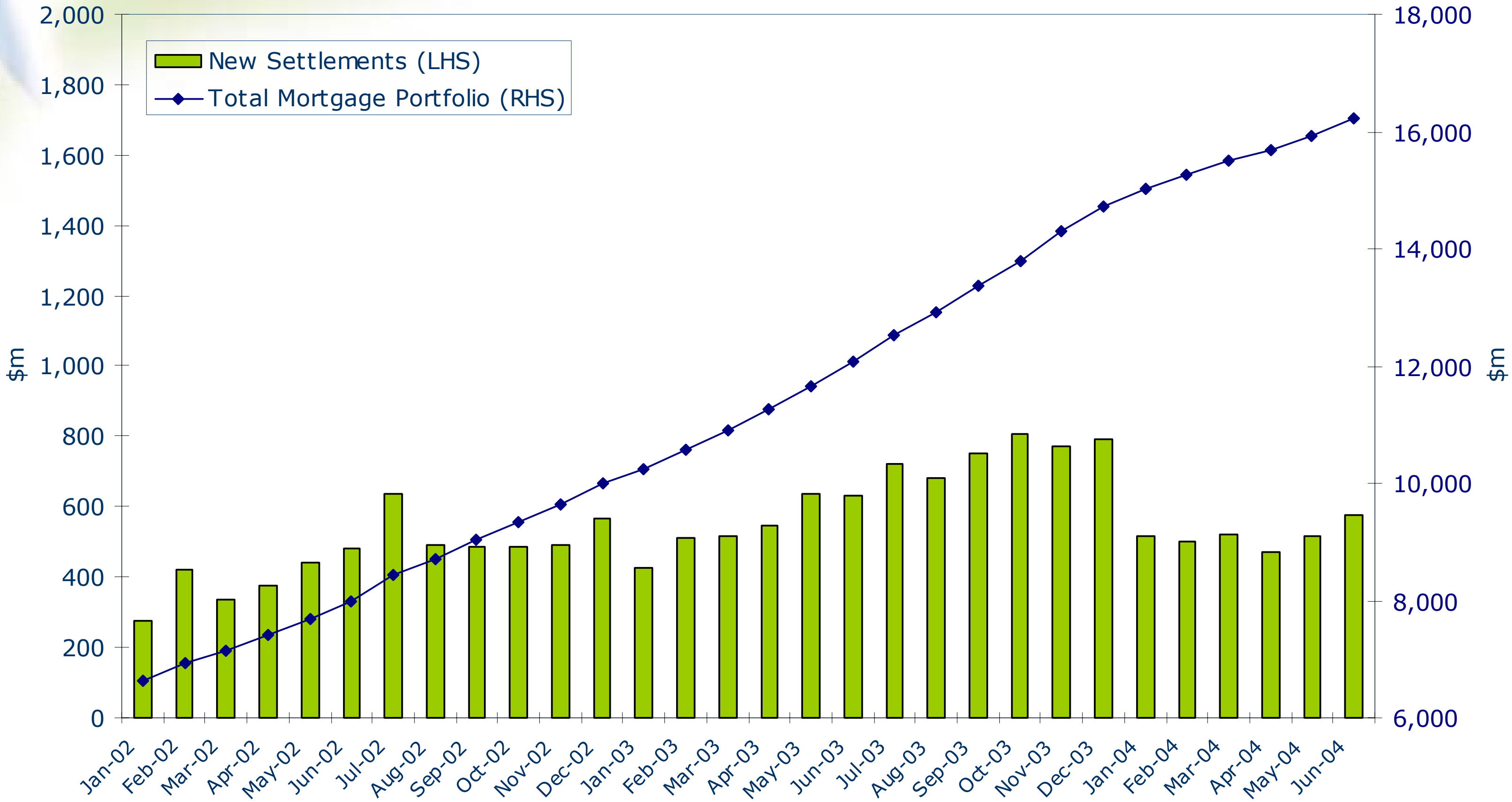
- The RBA does not believe this rate of growth is sustainable and is targeting a compound annual growth rate of 10-15%
- Signs are that settlements have been contracting to more sustainable growth levels
- This sets the scene for long term sustainable growth

Significant growth opportunities
Industry trends

- Brokers now originate more than 30% of mortgages, a level substantially lower than the US and UK (>50%) and are here to stay
- Traditional lenders efforts to shift away from brokers will propel non-bank lenders like Challenger
- Financial planners moving into lending will provide further growth upside augmented by Challenger Wealth Management
- We see and have the capability to access additional asset classes that have previously been dominated by banks

Mortgage book growth

Total book – Interstar, Commercial & TMA



- Originations would need to fall in excess of 40% for the loan book to cease growing

Low capital intensity business

- Challenger's product and servicing infrastructure will support:
  - Material increases in volumes
  - Increased product breadth
  - New asset classes
- Australia wide asset origination support teams can facilitate new products and asset classes with minimal cost increases
  - TMA, which will be P&L and cashflow positive in 2005, has required only $2.3m cash to date, yet is already a major player in the non conforming sector
- Challenger is well placed to further leverage its platform and monetise its investment in Interstar with minimal additional capital requirements

Challenger Wholesale Finance

Financials

Drew Hall, Chief Financial Officer, Challenger Wholesale Finance

Financials

	Interstar 9 mths to 30 Jun 04 $m	TMA 9 mths to 30 Jun 04 $m	Commercial 12 mths to 30 Jun 04 $m	Total 12 mths to 30 Jun 04 $m
Revenue	125.7	1.0	21.8	148.5
Operating expenses before amortisation & interest	41.8	1.1	-	42.9
Overhead	24.3	2.2	7.8	34.3
EBITA	59.6	(2.3)	14.0	71.3
Amortisation	38.2	-	-	38.2
EBIT	21.4	(2.3)	14.0	33.1
Average mortgage portfolio	12,749	n/a	2,208	
Closing mortgage portfolio	13,787	35	2,407	16,229

Interstar earnings analysis

challenger
Financial Services Group

Securitisation trusts

Average borrower rate 7.23%

Management fees and excess spread

1.30%

Trustees fees

RMBS investor return

5.89%

1.30%

Interstar earnings

Profit	0.24%
Portfolio mgt costs	0.24%
Amortisation	0.39%
Trail	0.43%

Interstar annuity revenue

	6 months to 31 Dec 03 $m	6 months to 30 Jun 04 $m	12 months to 30 Jun 04 $m
Revenue	39.8	85.9	125.7
% of average mortgage portfolio	1.34%	1.30%	1.31%

- Revenue is annuity style from management fees and excess spread
  - Excess spread is the margin earned between mortgages and that paid to residential mortgage backed security investors
- In the short-term excess spread is impacted by:
  - Compression spread – official cash rate versus 30 & 90 day BBSW
  - Mortgage discharges – deferred establishment fees
  - Penalty interest on mortgages in arrears
- Over the medium to longer term revenue is driven by:
  - Size of mortgage portfolio
  - Product mix
  - Residential mortgage backed security margins above BBSW set at the time of sourcing investors

Interstar expenses

	6 months to 31 Dec 03 $m	6 months to 30 Jun 04 $m	12 months to 30 Jun 04 $m
Operating expenses before amortisation	13.2	28.6	41.8
% of average mortgage portfolio	0.44%	0.43%	0.44%
Overhead expenses	8.4	15.9	24.3
% of average mortgage portfolio	0.28%	0.24%	0.25%

- Operating expenses are trailing commissions paid to originators
  - Accounted for on an accruals basis with cashflow closely following accounting
- Overhead expenses represent cost of running the operating platform
  - Key drivers are origination levels and ongoing servicing of the mortgage portfolio
  - Economies of scale for servicing platform
  - Flexible work force
- Costs expensed when incurred

Interstar amortisation

	6 months to 31 Dec 03 $m	6 months to 30 Jun 04 $m	12 months to 30 Jun 04 $m
Amortisation expense	12.2	26.0	38.2
% of average mortgage portfolio	0.41%	0.39%	0.40%

- Interstar capitalises:
  - Upfront third party origination costs (deferred origination costs)
  - Upfront capitalised bond issuance and securitisation costs (deferred portfolio costs)
  - This creates P&L / cashflow timing differences
- Amortisation policy conservative
  - Match amortisation with the mortgage repayment profile – consistent effective yield, ie. high $ expensed in earlier years of mortgage than latter
  - Deferred origination costs - expensed immediately for early mortgage discharges
  - Deferred establishment fee income compensates for expenses from early discharge

Commercial Lending
Revenue & overhead expenses

	6 months to 31 Dec 03 $m	6 months to 30 Jun 04 $m	12 months to 30 Jun 04 $m
Revenue	10.9	10.9	21.8
% of average mortgage portfolio	1.03%	0.96%	0.99%
Overhead expenses	4.1	3.7	7.8
% of average mortgage portfolio	0.39%	0.33%	0.35%

- Revenue reflects approximately 2/3 of earnings of Howard Mortgage Trust structure and includes:
  - Mortgage establishment fees
  - A manager / administrator fee based on mortgages outstanding
  - Penalty interest on arrears
- Revenue is annuity style with the majority based on ongoing mortgage FUM
- Accruals accounting with the exception of penalties (cash)
- Overhead Expenses is scaleable at current growth trends

Operating cashflow

	6 months to 31 Dec 03(1) $m	6 months to 30 Jun 04 $m	12 months to 30 Jun 04* $m
EBIT	12.5	20.6	33.1
Add back:			
Depreciation & amortisation	12.4	26.3	38.7
Deferred origination & portfolio costs	(28.9)	(38.3)	(67.2)
Timing differences accrued income and payables	(7.6)	3.5	(4.1)
Operating cashflow before interest & tax	(11.6)	12.1	0.5

- Deferred origination and portfolio costs are primarily a function of new settlements
- In times of high growth cashflows will decline due to upfront payment of deferred origination and portfolio costs
- Timing differences are short term by nature with managed trusts distributing either monthly or quarterly

1 Represents results of Interstar for 3 months only. TMA did not commence writing mortgages until April 2004
* Represents results of Interstar for 9 months only. TMA did not commence writing mortgages until April 2004

Balance sheet
Before allocation of corporate debt

	$m
Interstar(1)	211
TMA acquisition and seed capital over 3 years	6
Share of CMV of HMT management rights	107
Net assets before allocation of corporate debt	324

(1) Note: A contingent liability exists for deferred acquisition consideration payable of $15m as at 30 June 2004, calculated as:

- A one off performance payment calculated by reference to the excess of the loan portfolio over $4.9b, the EBIT margin being achieved by the business and the average duration of the loan book as at 30 June 2006; and
- Trailer based payments of 3.5bps per annum of the outstanding value of all new loans settled, between 30 June 2006 and 31 December 2011

Summary

- ➔ Challenger Wholesale Finance is a high growth, low capital intensity business generating annuity style revenues from funding, servicing and managing prime residential, non conforming residential and commercial mortgages
- ➔ The business will:
  - — Achieve 18% RONA on historic cost net assets in 2005
  - — Work with originators and Challenger Life to develop new mortgage and other wholesale finance opportunities that meet the Life Company's investment criteria
  - — Work with Challenger Wealth Management in offering lending capability to financial planners and asset opportunities for its investment trusts (HMT, HI Yield, etc.)
- ➔ Accordingly Challenger Wholesale Finance is an natural fit with both Challenger Life and Challenger Wealth Management and will be a material contributor to the group

Discussion / Questions