

# Challenger Financial Services Group Limited

Full Year results to 30 June 2008

Mike Tilley – Chief Executive Officer

25 August 2008



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Challenger Group

Year Ended 30 June 2008

## Resilient financial performance

- Continuing to deliver despite challenging market conditions
  - Normalised EBIT of \$321m – up 21%
  - Normalised NPAT of \$218m – up 20%
  - Reported NPAT of (\$44m) impacted by negative investment experience and significant items
  - Final dividend of 7.5 cps bringing full year dividend to 12.5 cps
- Significant financial flexibility
  - \$672m equity and regulatory capital raised in Nov 07
  - Sale of Financial Planning division for \$150m cash in Jun 08
  - Available cash of \$241m and un-drawn facilities of \$350m
  - CL2 surplus capital to regulatory requirements ~\$750m

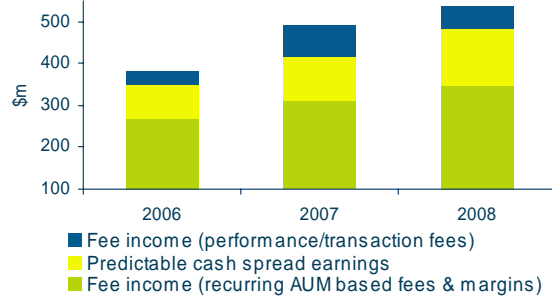


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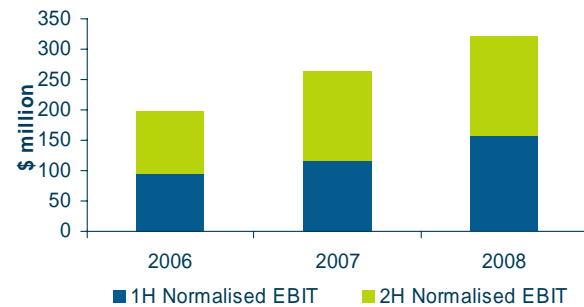
# Resilient financial performance

- Strong revenue quality
  - fee income 65% of revenue
  - recurring AUM fees 86% of total fee income
- Normalised EBIT up 21% on pcp underpinned by
  - strong cash spread earnings from Asset Management
  - 11% increase in Mortgage Management EBIT
  - Cost to income ratio continuing to improve
- All business exceeding their RONA target of 18%

Quality of earnings

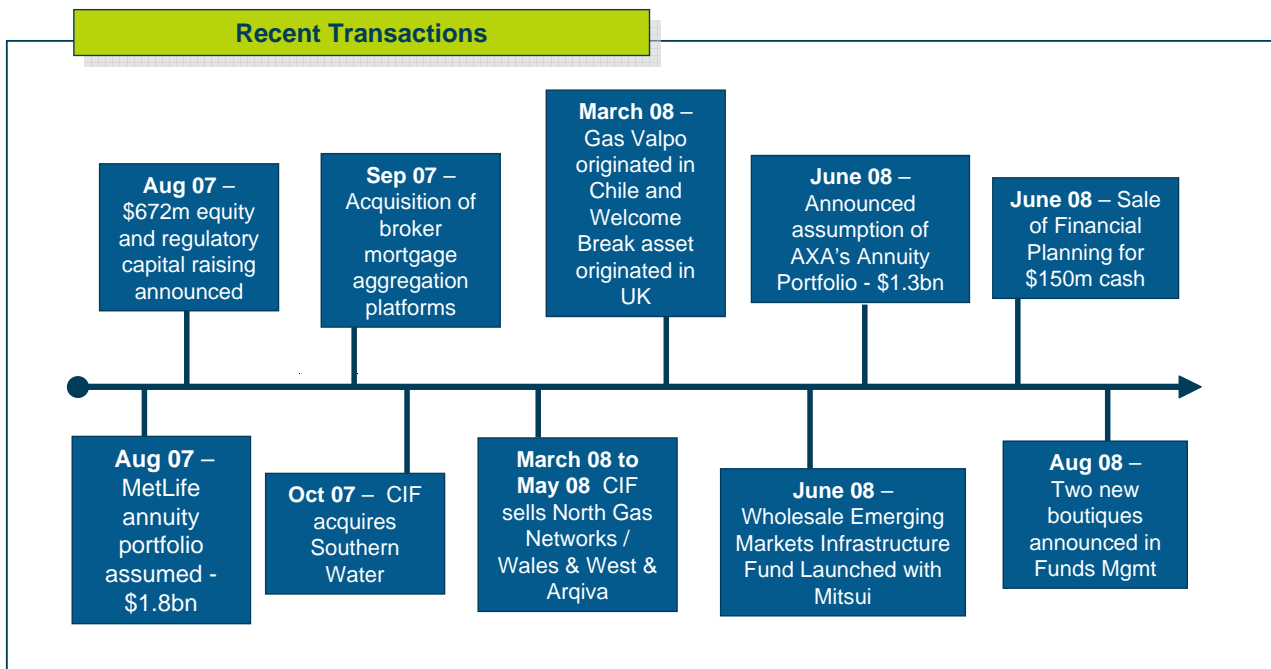


Group EBIT



# Operating through the cycle

## Recent Transactions



# Challenger Financial Services Group Limited

Full year results to 30 June 2008

Paul Rogan – Chief Financial Officer

25 August 2008



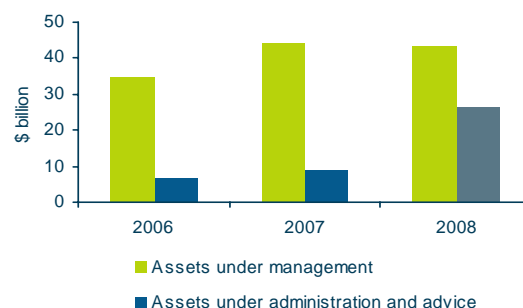
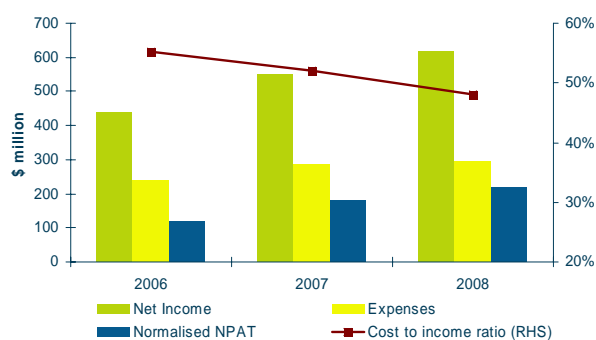
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## Financial highlights

Challenger Group

Year Ended 30 June 2008

Financial Performance	FY08	FY07	% Mvt FY07-FY08	Trend
Assets Under Management	\$43.5bn	\$44.0bn	(1)%	↓
Assets Under Administration and Advice	\$26.2bn	\$8.8bn <sup>1</sup>	large	↑
Net Income	\$617m	\$551m	12%	↑
Expenses	\$296m	\$287m	3%	↑
Normalised EBIT <sup>2</sup>	\$321m	\$264m	21%	↑
Normalised NPAT <sup>2</sup>	\$218m	\$182m	20%	↑
Statutory Reported NPAT	(\$44m)	\$255m	large	↓
EPS (Normalised Basic) - cps	37.1	33.0	12%	↑
EPS (Statutory Reported Basic) - cps	(7.5)	46.3	large	↓



Note: In 2006/2007 AUA related to Financial Planning; in 2008 AUA relates to mortgages under administration



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<sup>1</sup> Relates to Financial Planning which was sold on 30 June 2008  
<sup>2</sup> Excluding investment experience and significant items

## Divisional performance



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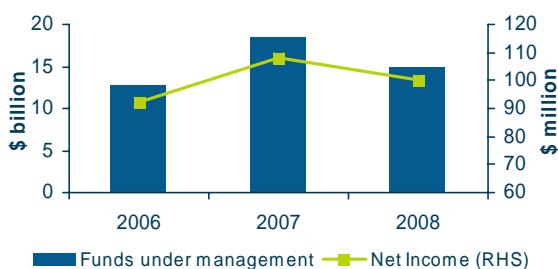
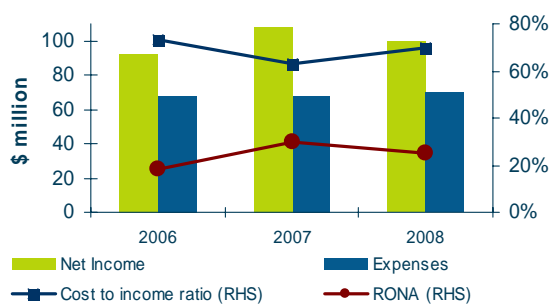
## Funds Management financial highlights

Funds Mgmt Mortgage Mgmt Asset Mgmt  
Year Ended 30 June 2008

Financial Performance	FY08	FY07	% Mvt FY07-FY08	Trend
Funds Under Management <sup>1</sup>	\$14.9bn	\$18.4bn	(19)%	↓
Net Income	\$100m	\$108m	(7)%	↓
Expenses	\$70m	\$68m	2%	↑
EBIT	\$30m	\$40m	(23)%	↓
RONA <sup>2</sup>	25%	30%	-	↓
Net Assets	\$124m	\$135m	-	↓

<sup>1</sup> – FY08 includes \$857m of segregated boutique partnerships mandates (FY07: \$710m)

<sup>2</sup> – Calculated on opening Net Assets. Net Assets at 30 June 2008 were \$108m



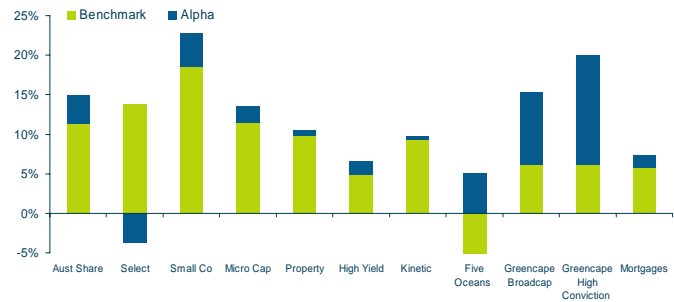
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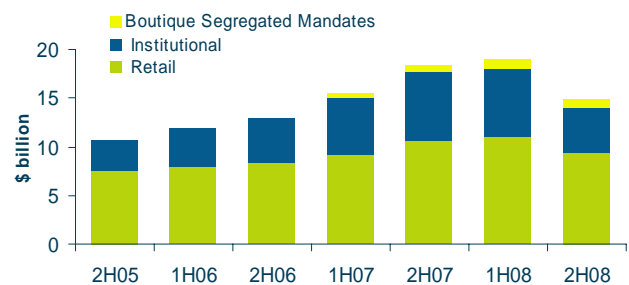
# Key value drivers of the result

- Reduced FUM, particularly in 2H08 post equity market falls led to lower fee contribution
- Net income as a proportion of average FUM down across the year - primarily driven by minimal performance fees versus 2007
- 2H08 investment performance mixed across asset classes but remains strong over the longer term

Performance since inception

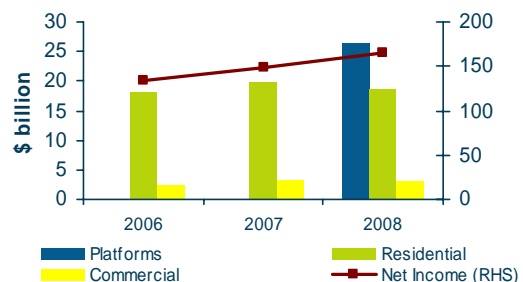
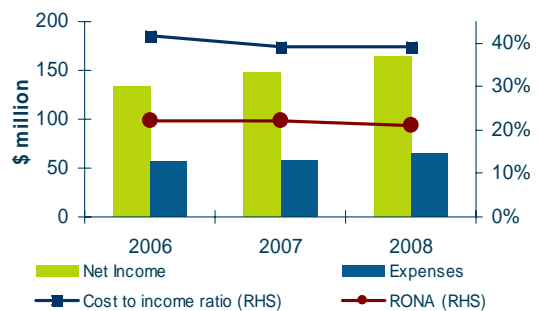


FUM by channel



# Mortgage Management financial highlights

Financial Performance	FY08	FY07	% Mvt FY07-FY08	Trend
Mortgages Under Management	\$21.8bn	\$23.0bn	(5)%	↓
Mortgages Under Administration	\$26.3bn	-	large	↑
Net Income	\$165m	\$148m	11%	↑
Expenses	\$65m	\$58m	12%	↑
EBIT	\$100m	\$90m	11%	↑
RONA	21%	22%	-	↓
Net Assets	\$469m	\$412m	-	-



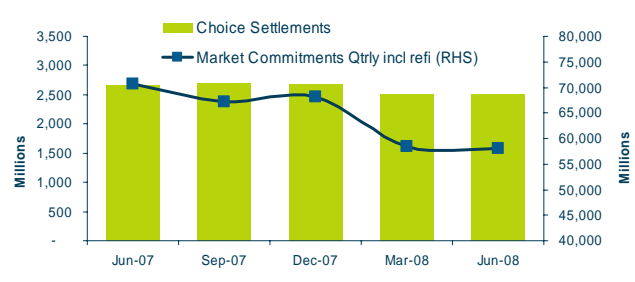
<sup>1</sup> - Calculated on opening Net Assets. Net Assets at 30 June 2008 were \$571m



# Key value drivers of the result

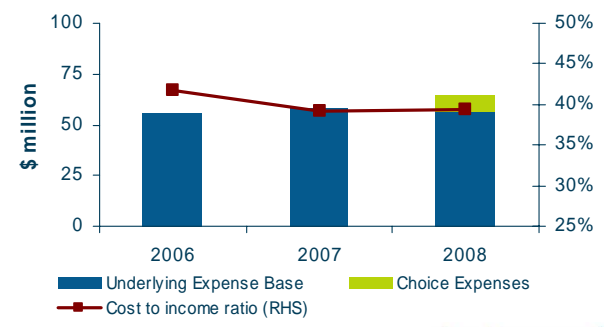
- Contribution from lending operations reduced modestly – residential lending book contracted 5% on pcp
- Offset by growing contribution from newly acquired distribution platforms – now 13% of net income
- Aggregation income driven by settlement volumes
- Underlying operating expenses excluding Choice, fell 3% on pcp, reflecting flexible cost base

Choice Settlements / Market Commitments



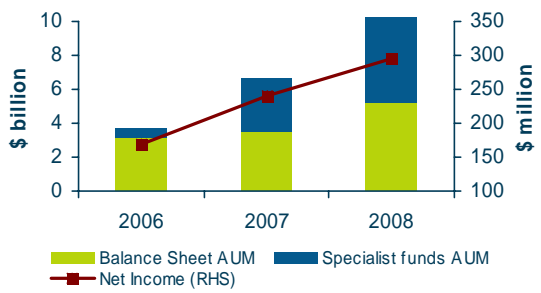
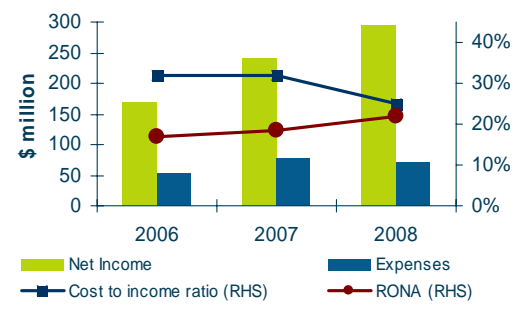
Source – ABS, Challenger, Choice

Flexible cost base



# Asset Management financial highlights

Financial Performance	FY08	FY07	% Mvt FY07-FY08	Trend
AUM – Balance Sheet	\$5.3bn	\$3.5bn	49%	↑
AUM – Specialised Funds	\$5.2bn	\$3.2bn	65%	↑
Normalised Net Income	\$295m	\$240m	23%	↑
Expenses	\$72m	\$78m	(7)%	↓
Normalised EBIT <sup>1</sup>	\$223m	\$162m	37%	↑
RONA	22%	18%	-	↑
Net Assets <sup>2</sup>	\$1,014m	\$883m	-	-



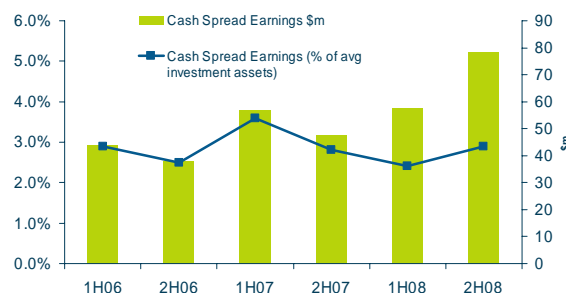
<sup>1</sup> – Before significant items and investment experience  
<sup>2</sup> – Based on opening Net Assets. Net Assets at 30 June 2008 were \$919m



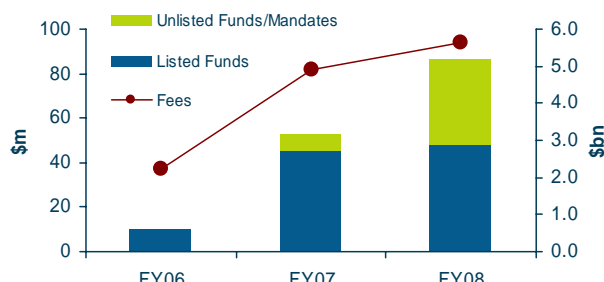
## Key value drivers of the result

- Normalised cash spread earnings re-expanding as MetLife cash invested and margins widening
- Up 50bps on prior period driven by opportunities in fixed income
- Annuity cost of funds stable relative to bank bill swap rate
- Fees up 15% on pcp
- Transaction fees flat – increase in fees driven by higher contribution from recurring base management fees

Steady Growth in Cash Spread Earnings



Growing Specialised Funds business



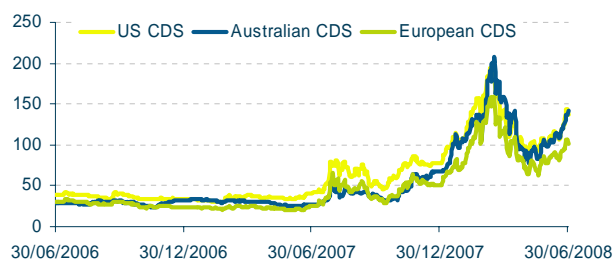
## Investment Experience

- Primary drivers of investment experience in Life Company:
  - Non-cash mark to market of investments in listed funds
  - Widening credit spreads in fixed income investments
- Committed long term investor with ample excess capital and liquidity
- No need to realise adverse movements

Mark to market of investments in listed vehicles

Listed vehicle	% Holding	Current NAV/NTA/ NIV per unit	30/06/07	30/06/08
CIF	33%	\$3.74	\$4.06	\$2.71
CDI	39%	\$1.01	\$1.03	\$0.65
CWT	26%	\$0.94	\$0.83	\$0.58

Widening credit spreads – Investment Grade (unfunded positions)

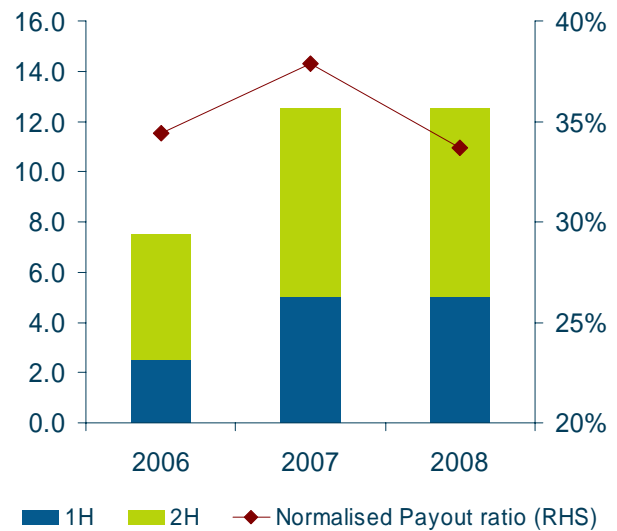


# Dividends

- 2008 final dividend declared
- 7.5 cents per share
- 60% franked

Key Dates	
Ex-dividend date	19 September 2008
Record date	24 September 2008
Payment date	17 October 2008

Dividends – cents per share (cps)



## Opportunities, Challenges and Outlook

Dominic Stevens – Incoming Chief Executive Officer

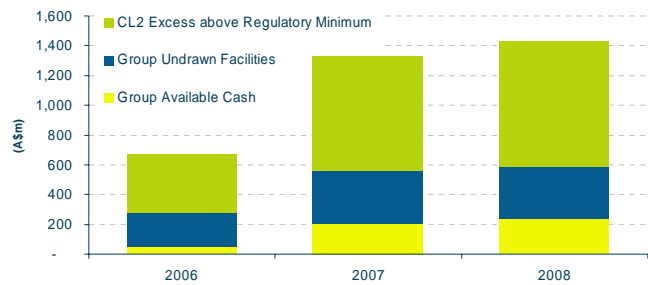
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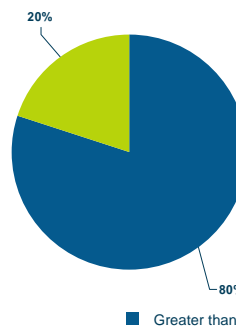
# Business opportunities and challenges

- Last 12 months has been about liquidity and capital – who has it and who doesn't
  - Challenger built capital & liquidity significantly over last two years and increased regulatory capital base over 40% in Nov 07
  - CL2 holding ~\$750m excess capital to minimum regulatory requirement
- Challenger's most valuable financial asset – its annuities
  - 100% retail / 100% fixed rate
  - Long duration
  - 07/08 organic sales of more than \$750m
- Balance sheet scale to increase further with AXA portfolio ~\$1.3bn in 2H09 (more than 90% long term)

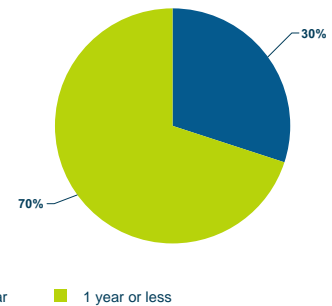
Life Company Capital and Group Liquidity



Challenger annuity duration



Major Bank liability duration

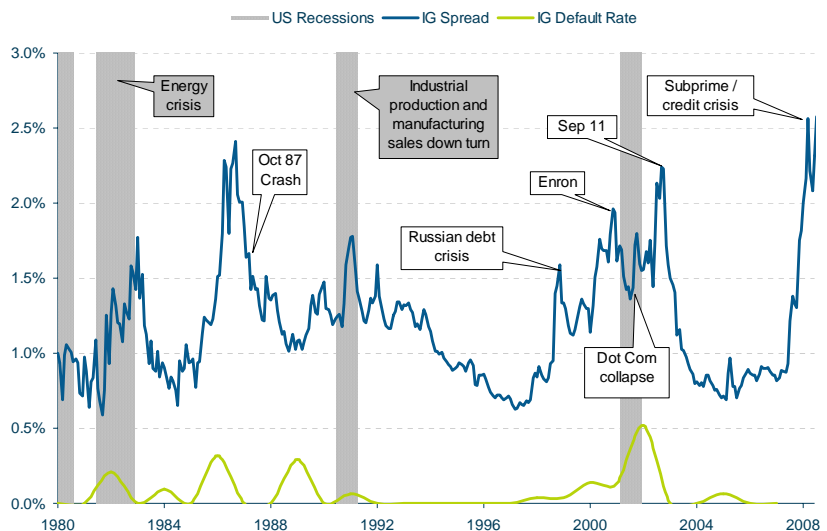


Source: Challenger, Major Bank Annual Reports

# Business opportunities and challenges

- High risk adjusted return available in fixed income, particularly at AAA, AA and A grades
- Expect these high returns to remain given market liquidity constraints
- Positive for reinvestment of assets backing AXA portfolio

Fixed income - historic global investment grade spreads/defaults



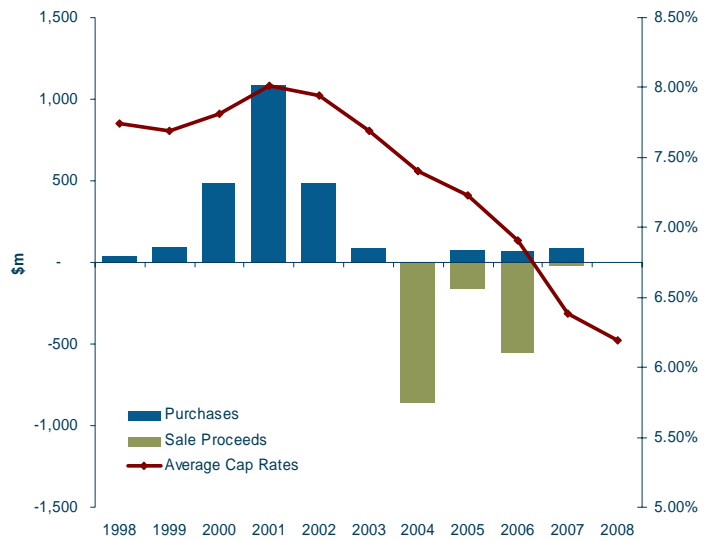
(Source: Moody's IG Default Rate, JPM JULI IG Spread, NBER Recessions)



# Business opportunities and challenges

- Direct property portfolio valuations robust – reflecting quality and low risk nature of the portfolio
  - Properties purchased at high cap rates and will perform as expected
- Infrastructure assets
  - demand remains strong from global pension funds for assets with long term regulated or contracted income streams
  - Investor support for managers with proven infrastructure capabilities

Challenger property purchases/sales



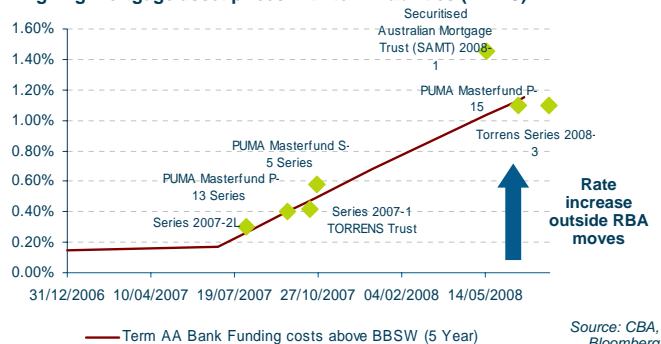
Source: Challenger, IPD Australian Composite Weighted Average Cap Rates



# Business opportunities and challenges

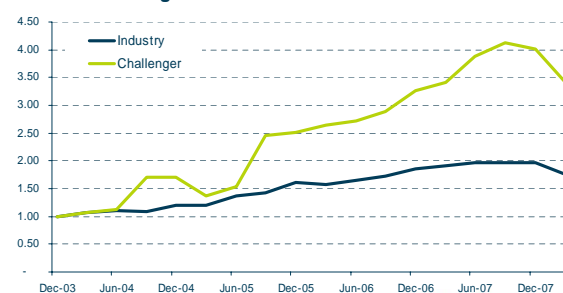
- Mortgage book – value increasing as asset spreads widen; approx two thirds of book is term funded (~20bps over BBSW)
- Gap between mortgage rates and term securitisation rates narrowing
- Strong distribution footprint via aggregation platforms
- Funds Management - after 3 years of strong growth and out performance – cyclical pull-back
- Well diversified FUM but last 12 months saw increased correlation between asset classes
- Two new boutiques announced recently – existing four all performing well

Aligning mortgage asset prices with term liabilities (RMBS)



Source: CBA, Bloomberg

Cumulative FUM growth



source: Morningstar / Challenger



## Outlook

- Macro environment remains challenging – expecting tough but moderating conditions for some time to come
- Strong risk management focus means we are well positioned to manage through this cycle
- All businesses remain on solid footings
  - Investing at contemporary wider asset spreads for our balance sheet, full impact becoming evident
  - Continue to win mandates and launch funds despite weak markets in Funds Management and Specialised Funds
  - Wider margins but slower mortgage origination pending certainty on term funding markets
- Remain committed to deliver double digit EPS growth in the long term

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