



# Challenger Infrastructure Fund

Half-yearly Update 31 December 2008

## Challenger Infrastructure Fund

Comprising:

CIF Investment Trust 1 ARSN 114 139 703

CIF Investment Trust 2 ARSN 114 139 632

## Responsible Entity

Challenger Listed Investments Limited

(ABN 94 055 293 644)

(AFSL 236887)



## Important notice

Challenger Listed Investments Limited (ABN 94 055 293 644) (AFSL 236887) (CLIL) is the Responsible Entity of CIF Investment Trust 1 (ARSN 114 139 703) and CIF Investment Trust 2 (ARSN 114 139 632), which together form Challenger Infrastructure Fund (CIF).

CLIL, as the Responsible Entity of CIF, has prepared this Half-year Update (Update) based on information available to it. The information in this Update should be regarded as general information only. Nothing contained in this Update constitutes investment, legal, tax or other advice. It has been prepared without taking account of any person's objectives, financial situation or needs. Recipients should, before acting on any such information, consider its appropriateness, having regard to their objectives, financial situation and needs, and seek the assistance of their financial or other licensed professional adviser before making any investment decision.

Any investment in CIF is subject to investment risk and other risks, including possible loss of income and principal invested. None of CLIL, Challenger Management Services Limited (ABN 29 092 382 842) (AFSL 234678) (CMSL), Challenger Financial Services Group Limited (ABN 85 106 842 371) (Challenger) or any other related body corporate of Challenger (together, Challenger Group) gives any guarantee or assurance as to the performance of CIF or the repayment of capital.

Nothing in this Update should be considered a solicitation, offer or invitation to buy, subscribe for or sell, or a recommendation of, any financial products.

While all reasonable care has been taken to ensure that the facts stated and opinions given in this Update are fair and accurate at the date of this Update, no representation or warranty (express or implied) is made as to, and no member of the Challenger Group accepts any responsibility for, the accuracy or completeness of any recommendation, information in this Update.

Any forward looking statements included in this Update may involve subjective judgement and analysis and be subject to significant uncertainties, risks and contingencies, many of which are outside the control of, and are unknown to, CLIL. In particular, they speak only as of the date of these materials, they assume the success of CIF's business strategies, and they are subject to significant regulatory, business, competitive economic and other uncertainties and risks. Actual future events may vary materially from forward looking statements and assumptions on which those statements are based. Given these uncertainties, recipients are cautioned not to place undue reliance on such forward looking statements.

Any past performance information provided in this Update is not a reliable indication of future performance. CLIL does not receive any specific remuneration for any general advice which may be provided to you in this Update. However, CLIL and CMSL receive trustee and management fees as Responsible Entity and Manager of CIF, respectively. For more details on fees, please refer to the CIF 2008 Annual Report and additional information on the Australian Securities Exchange (ASX) website [www.asx.com.au](http://www.asx.com.au). Financial advisers (including some Challenger Group companies) may receive fees or commissions if they provide advice to you or arrange for you to invest in a Challenger product (including CIF). CLIL and its associates may have an interest in the financial products referred to in this Update and may earn fees or other benefits as a result of transactions in any such financial products.

Members of the Challenger Group and their officers and directors may hold securities in CIF from time to time.

# Investment strategy

To provide investors with a combination of long-term, predictable income streams via investment in a diversified portfolio of global infrastructure and utility assets.

Key investment criteria:

- regulated industry or monopolistic characteristics;
- high barriers to entry;
- strong cash generation and attractive cash returns;
- long-term predictable cash flows;
- growth potential;
- first-class management teams; and
- controlling or strategic stakes which provide an opportunity to influence strategic direction and monitor and manage risks.

# Chief Executive's report

Dear securityholder

On behalf of Challenger Infrastructure Fund's (CIF or the Fund) Responsible Entity, Challenger Listed Investments Limited (CLIL) and the Fund's manager, Challenger Management Services Limited (CMSL or the Manager), I am pleased to provide this report to securityholders on the operations and performance of the Fund for the six months ended 31 December 2008.

The result for the half year ended 31 December 2008 highlights the resilient nature of CIF's high quality portfolio. Despite current global uncertainty, revenues have increased 28% on the prior corresponding period and underlying proportionate EBITDA<sup>1</sup> increased by 19% over the same period, reflecting the resilience of our three assets: Inexus, LBC and Southern Water.

Highlights for the period include:

- The sale of 1/3 of Southern Water for £100 million at net asset value (NAV), providing significant financial flexibility;
- \$102 million of cash held at Fund level for capital management initiatives, including the on-market buy-back announced 22 December 2008;
- A reduction in proportionate net debt by \$560 million since June 2008<sup>2</sup>;
- Repayment of 50% of redeemable preference securities (RPS);
- Refinancing of the remaining RPS to \$118.5 million and extended term to April 2011;
- Repayment and cancellation of Fund level acquisition facility in December 2008, reducing Fund level gearing to nil<sup>3</sup>;
- A Net Asset Value (NAV) of \$3.35 cents per security, a decrease of 10% on 30 June 2008 NAV, predominately due to changes in long term capital management assumptions; and
- The payment of the interim distribution on 27 February of 12 cents per security, funded 100% from operating cashflow, consistent with previous market guidance.

<sup>1</sup> Underlying Proportionate EBITDA has been normalised to exclude disposed assets and include the full period impact of Southern Water and removes asset specific one off items as defined in each of the asset sections.

<sup>2</sup> As a result of the sale of one third of Southern Water.

<sup>3</sup> Excludes CIF RPS of £50.7 million at 31 December 2008.

## Asset Update

CIF's portfolio of assets performed well in their respective operating environments during the first half of the 2009 financial year.

### Inexus

(80.4% ownership level)

Despite operating in a market that has experienced the lowest level of housing starts since 1950, Inexus' performance was solid for the six months ended 31 December 2008, producing an underlying EBITDA of £14.5 million, a 28% increase on the prior corresponding period, and revenue of £24.6 million, an increase of 24% on the prior corresponding period. Inexus' strategy of pursuing a multi-utility approach has seen it achieve sales of 59,981 for the period, an increase of 25% on the prior corresponding period with 29,558 new connections being made. During the half year, Inexus has been actively refining its operating model in response to changing market conditions; this has resulted in protecting underlying EBITDA margin of ~59%.

### LBC

(66.2% ownership level)

LBC's storage capacity utilisation rate remained strong averaging 95% during the period. LBC's revenues increased by 20% over the period, reflecting completed growth projects. Over the period operating cash flow has also increased 52%, highlighting the cash generative nature of the business. LBC's underlying EBITDA increased 28% over the same period, despite underlying costs slightly increasing over the period.

### Southern Water

(15.6% ownership level)

Southern Water continues to progress in its core strategy of delivering its capital program in the current regulatory period 2006-2010. Southern Water has delivered £335 million revenue over the period, and £152 million of its regulated capital program for the six months ended 31 December 2008. Southern Water remains on track to deliver the largest capex program by percentage of regulated capital value of all the Water and Sewerage Companies in the UK during the current regulatory period.

## Capital Management

In December 2008, CIF sold £100 million of Southern Water (representing one-third of CIF's stake) at NAV, which is the fourth asset the Fund has sold at NAV or better over the last 12 months. As a result of the sale of Southern Water, the Fund was able to:

- Repay £50.7 million of RPS;
- Refinance the remaining RPS to \$118.5 million and extend the term to April 2011;
- Reduce CIF's proportional net debt by \$560 million;
- Initiate an on market buy-back; and
- Retain \$102 million of cash for capital management initiatives (including the buy-back).

During the six months ended 31 December 2008, CIF repaid and cancelled its Senior Debt Acquisition Facility. The cancellation will provide CIF with some cash savings from the avoidance of commitment fees.

In the past 12 months, CIF has reduced its total proportional net debt by \$1.7 billion via asset sales.

Given recent market volatility, CIF prudently extended its hedging policy in October 2008 to include capital hedging of up to 50% of its net foreign currency assets.<sup>4</sup> This hedging is in addition to the Board's policy of rolling 5-year distribution hedges. Due to the revision of CIF's NAV, CIF will be targeting total (capital and distribution) hedging of ~60% of CIF's NAV against currency movements. The benefit for securityholders is a closer alignment between the performance of underlying assets, regardless of their base currency, and the Fund's NAV.

## Net Asset Value

The Net Asset Value per CIF stapled security as at 31 December 2008 was \$3.35 compared with \$3.74 as at 30 June 2008. Whilst the assets have performed strongly over the period, increased expected cost of debt and increased risk premia required by equity investors, have accordingly resulted in a lower valuation.

<sup>4</sup> Net foreign currency assets net of market value of current foreign currency distribution hedges.

## Board Changes

The Board of CLIL comprises a majority of independent directors.

In November the CLIL Board announced the appointment of Mr Michael Cole, as an independent director. Mr Cole has extensive experience in the financial services and funds management sectors, having worked as a consultant to the industry since retiring from Bankers Trust Australia in 1997 where he held senior management roles over an 18 year period. Mr Cole is currently Chair of Platinum Asset Management Ltd, Ironbark Capital Limited, and IMB Ltd (Illawarra Mutual Building Society). As well, Mr Cole is a director of NSW Treasury-Corp and a director of State Super Financial Services Australia Ltd. In 2007 Mr Cole retired as Chair of SAS Trustee Corporation, a position he held from 2000.

Mr Russell Hooper resigned from the CLIL Board in October 2008 after nearly four years as an independent non-executive director of CLIL. Mr Hooper made significant contribution to the establishment and management of Challenger's listed funds.

## Performance Fee

CIF's relative performance over the last six months has been solid, culminating in CIF outperforming its benchmark, the S&P/ASX 200 Industrial Accumulation Index for the second consecutive period.

As a result of the outperformance of CIF relative to its benchmark, the deferred performance fee for the six month period ended 30 June 2008, announced on 21 August 2008, has become payable. Additionally a performance fee of \$0.4 million is payable for the 6-month period to 31 December 2008. The performance fee is payable to CMSL and CLIL.

The performance fee (excluding the deferred component) applicable to the 6-month period to 31 December 2008 will be settled in cash and the deferred component will be settled in CIF securities.<sup>5</sup> 606,503 securities will be issued at an implied value of \$2.74 per unit, which is equivalent to the market value<sup>6</sup> of CIF securities at the time the deferred component was originally due for payment.

<sup>5</sup> Under the CIF constitutions and the Management Agreement, base and performance fees to the period 30 June 2008 were payable in CIF securities. Fees thereafter are payable in securities or cash at the discretion of the Responsible Entity.

<sup>6</sup> As defined in the CIF constitutions.

## Distribution Guidance

Consistent with previous market guidance, CIF's interim distribution will be 12.0 cents per stapled security for the six months ended 31 December 2008. The distribution is 100% funded from operating cashflow. The effect of this distribution strategy is a clear alignment of securityholder returns with underlying performance of CIF's assets. As previously announced, given the volatility in global equity and financial markets, the CLIL Board has prudently decided that it will not confirm distribution guidance for the full year ending 30 June 2009.

## Outlook

Despite the challenging times confronting the global economy, CIF's high quality assets have performed well and CIF's proactive capital management initiatives have derisked the Fund and strengthened its balance sheet.

As economic and financial markets remain unpredictable, CIF will continue to adapt and look for opportunities to improve operating efficiency of our underlying assets and further mitigate potential impacts from the slowing global economy. We will continue to proactively manage our capital in a prudent and conservative manner, as evidenced by our actions over the last six months. However, it is important to not under emphasise CIF's primary focus, which will continue to be on the longer term strategic imperatives of seeking further opportunities to strengthen the Fund, its balance sheet and underlying asset performance with a view to maximising securityholder value.

Thank you for your continued support of the Fund over the six months to 31 December 2008.

Yours sincerely,

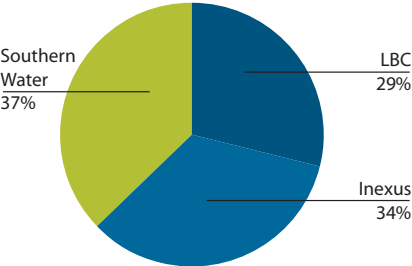
A handwritten signature in black ink that reads "Steve Bickerton". The signature is written in a cursive, flowing style with a long horizontal stroke at the beginning.

**Steve Bickerton**

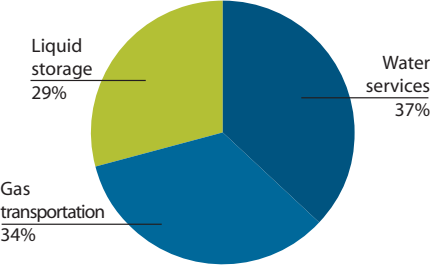
Chief Executive

# Portfolio Diversification

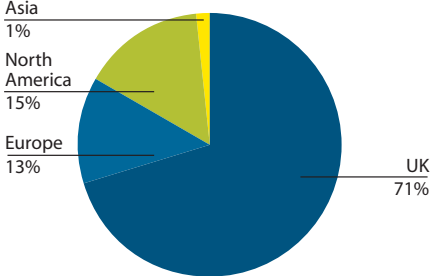
## Asset diversification<sup>7</sup>



## Industry diversification<sup>7</sup>



## Geographic diversification<sup>8</sup>



<sup>7</sup> Based on Directors' value as at 31 December 2008.

<sup>8</sup> Based on 31 December 2008 EBITDA contribution.

# Securityholder information

## ASX listing

Challenger Infrastructure Fund (CIF) is listed on the Australian Securities Exchange (ASX). The Fund's securities trade under the code 'CIF'. Security prices are published daily in major Australian metropolitan newspapers, and are also accessible from the CIF website.

## The CIF website

The CIF website [www.challenger.com.au/cif](http://www.challenger.com.au/cif) contains important information about the Fund, including security prices, announcements, annual reports and an overview of each asset in the CIF portfolio.

## Securityholder enquiries

If you have queries relating to your securityholding or wish to provide a change of address, Tax File Number, instructions for payment of distributions or annual report elections, please contact the Registry, Link Market Services Limited, using the contact details located on the opposite page.

Alternatively, visit the Link Investor Service Centre at [www.linkmarketservices.com.au](http://www.linkmarketservices.com.au), where you can access information about your securityholding and update your holding details online.

If you have any questions relating to the management of CIF, please contact Challenger on +61 2 9994 7000, or send an email to [cif@challenger.com.au](mailto:cif@challenger.com.au).

## Distributions

CIF pays distributions six monthly for the periods ending 30 June and 31 December.

Distribution payments can be paid by:

- direct credit to a nominated Australian financial institution account; or
- a cheque mailed to your registered securityholding address.

An Annual Taxation Statement is sent to securityholders in August each year. This statement includes important taxation information and should be retained by securityholders to assist in the completion of their taxation return. In addition a breakdown of the interim distribution is available on CIF's website [www.challenger.com.au/cif](http://www.challenger.com.au/cif).

# Directory

## Challenger Infrastructure Fund

Comprising:

CIF Investment Trust 1

ARSN 114 139 703

CIF Investment Trust 2

ARSN 114 139 632

## Australian Securities Exchange (ASX) code

CIF

## Responsible Entity

Challenger Listed Investments Limited

ABN 94 055 293 644

AFSL 236887

## Directors of Responsible Entity

B Shanahan (Chair)

M Cole

I Martens

G McWilliam

I Moore

B O'Connor

R Woods

## Company Secretary

C Robson

S Koeppenkastrop

## Manager

Challenger Management Services Limited

ABN 29 092 382 842

## Address

Level 15

255 Pitt Street

Sydney NSW 2000

Telephone: +61 2 9994 7000

Facsimile: +61 2 9994 7777

Email: [cif@challenger.com.au](mailto:cif@challenger.com.au)

Website: [www.challenger.com.au/cif](http://www.challenger.com.au/cif)

## Registry

Link Market Services Limited

Locked Bag A14

Sydney South NSW 1235

Telephone (within Australia): 1800 114 027

Telephone (outside Australia): +61 2 8280 7111

Facsimile: +61 2 9287 0303

Level 15  
255 Pitt Street  
Sydney NSW 2000  
telephone 02 9994 7000  
facsimile 02 9994 7777

[www.challenger.com.au](http://www.challenger.com.au)

